

# Pinky, The Brain, and Strategic Investment Management:

by Marek Gmerski and Borys Stokalski

*Before each night is done, their plan will be unfurled;  
By the dawning of the sun, they'll take over the world.*

— Theme song from *Steven Spielberg Presents Pinky and The Brain*.  
Lyrics by Tom Ruegger.

Last year the “gold rush” era of e-business ended. The dot-comicide, or massive fall of Internet companies, had been expected by industry analysts since 1999. Still, many people who placed their bets on the Internet maintain a sense of disappointment and suspicion about the “new economy.” Yet despite the scale of the breakdown, one can hardly agree

that the Web-based economy is fake. The economy of information [1] and of business webs [4] has created a different business environment. It seems worthwhile to scrutinize the dot-com initiatives in order to identify best practices to be followed and worst practices to avoid.<sup>1</sup> Our article focuses on one particular practice, strategic investment management.

## STRATEGIC INVESTMENT FOR ANIMANIACS

Companies need to learn from the practices of those looking for e-business funding. Many companies have had an immature approach to strategic investment management that closely parallels that of “Pinky” and “The Brain” — lab mice from the *Animaniacs* cartoon series created by Steven Spielberg. Pinky is innocent, not so clever, and irritatingly enthusiastic. He is the

sidekick of The Brain, whose single purpose in life is World Domination. Though he is brilliant, Brain lacks the subtlety and skills to turn his brilliant plans of taking over the world into reality. So, every night, Pinky and Brain set out to conquer the world. Every night they end up in the very same place where their conquest started — the cage. Sound familiar?

Studying the tombstones at the dot-com graveyard (<http://www.upside.com/graveyard>), as well as dusty Powerpoint presentations abandoned by venture capitalists, we can see how the Pinky and Brain mentality led the e-adventurers into traps. Most start with bold assertions of future achievements with enthusiasm, support, and commitment from the founders and initial investors. These plans include little support for their world-beating vision in the form of sound number crunching and disciplined business planning, other than the infamous hockey stick diagram shown in Figure 1.

The hockey stick refers to the company’s plans that revenue will grow slow at first as the company becomes established, then accelerate quickly once the business reaches critical mass. That acceleration “kinks” the curve similar to a hockey stick — hence the name. The diagram also shows the early “investment opportunity” that enables investors to buy in ahead of the company’s breakeven point, when the company is undervalued against its future potential. In other words, the investment hockey stick is a tool to convince investors that if one has a unique (read: untested) idea and works really hard, then somehow cool site features and a cool advertising campaign will turn into explosive growth and positive cash flow. All this miracle requires is a couple million dollars of initial investment.

<sup>1</sup>Tom Bragg does an excellent job of analyzing the traps of e-business projects in his article, “Worst Practices for E-Business Projects,” *Cutter IT Journal*, Vol. 13, No. 4 (April 2000), pp. 35-39.

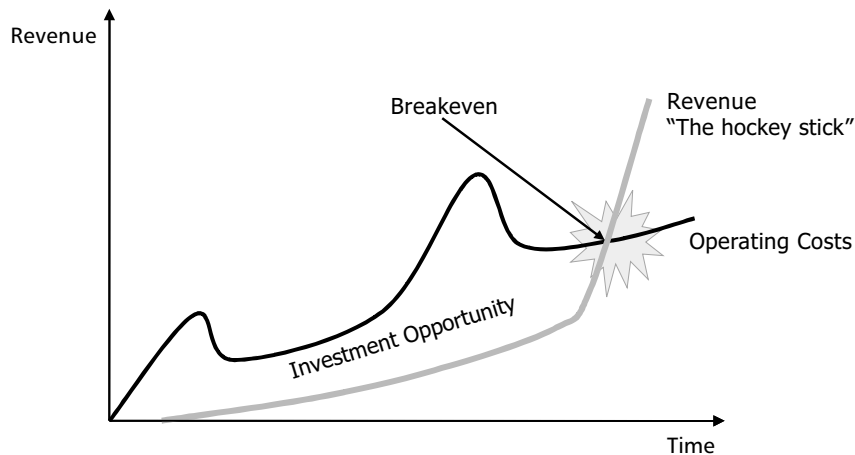


Figure 1 — The investment hockey stick

It would be nice if the world were as simple as a cartoon. However, this approach to strategic investment management reveals the need for a more sophisticated approach to investment management that reflects the realities of the business and the true nature of an e-business:

- E-business investments are complex, involving investments in individual projects as well as the core e-business platform. These two investment tiers require an approach that recognizes the strategic components as well as how to make investments in each component.
- The “hockey stick” metaphor oversimplifies the company’s revenue stream, treating the business as a monolithic set of revenues and costs. This is not the true nature of revenues and costs, as most companies experience multiple revenue and cost streams.

An effective approach to strategic investment is one that recognizes and understands the business’s key value drivers and how that value is aligned with the essential characteristics of the business infrastructure. This involves aligning the investment model, organization, and revenue model into a strategic investment management approach

for e-business. Let us try to present an example of how the strategic investment management might be improved.

### INVESTMENT COMPONENTS OF AN E-BUSINESS

E-business investments involve addressing a number of individual components, ranging from the quality of the information architecture to the brand strength. The value of a business stems from profitable relationships with the users of an e-business platform. Figure 2 provides an example of these elements and their relationships — in this case, a horizontal portal targeting a growing community of Internet users in Poland.

There are two types of investment in the portal’s strategic investment approach: vertical investments and platform investments. These investments are unique from the perspective that they involve different decisions, projects, and payback windows. Breaking the investment program into these categories increases the organization’s investment flexibility.

#### Platform Investments

The e-business platform is the infrastructure supporting basic user attractions (e.g.,

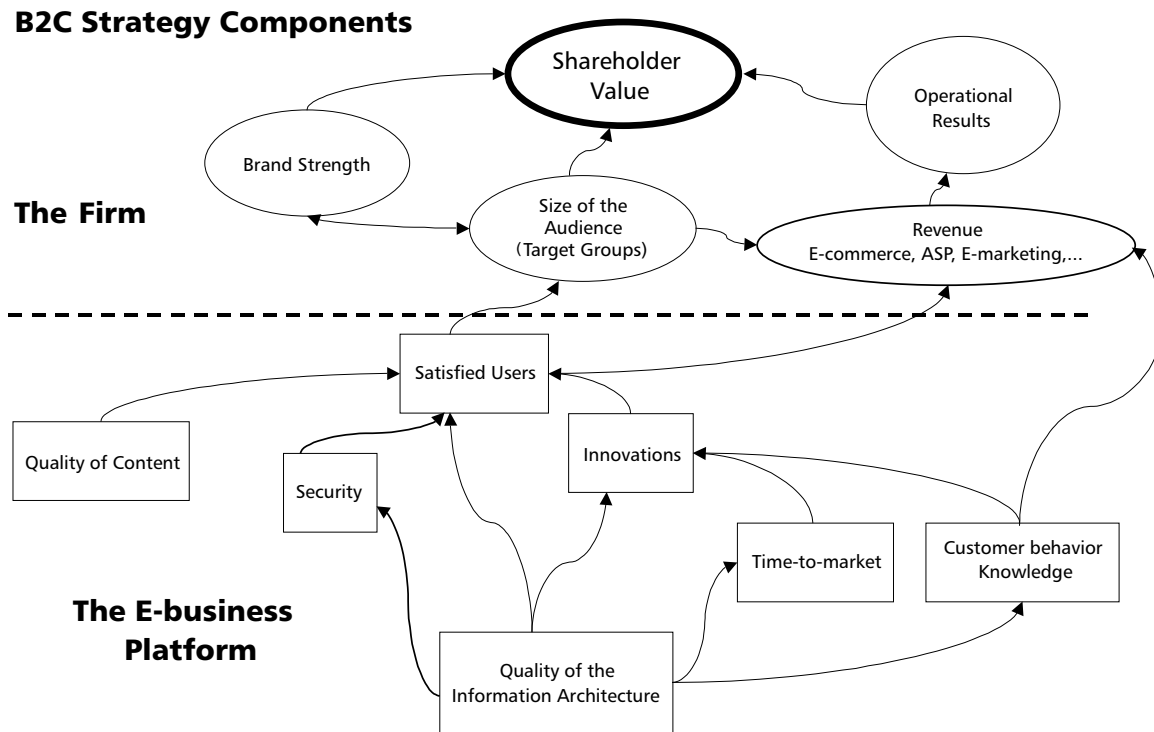


Figure 2 — Investment components.

general content, basic services such as e-mail, newsletters, personal home pages, discussion groups, and chat). The agility of the business platform involves its ability to effectively share knowledge about users among vertical components, as well as the ability to quickly add new vertical components and communication channels.

Investing in the platform should create value for all investments across the company. This means that it should contribute to the individual projects by providing shared services and reusable components. This enables the individual vertical investments to concentrate more fully on their goals and objectives.

#### Vertical Investments

Vertical initiatives are investments in individual projects that involve specific business partners and a value proposition targeted to specific customer segments. A vertical

initiative represents a specific investment that should have a focused investment plan.

Consider the opportunities presented by the sudden, immense popularity of Adam Malysz, the Polish ski jumping champion. Malysz became almost a national hero during the last three months, winning most of the World Cup events, as well as the gold medal at the World Championship in Lahti.

The portal may wish to invest in a vertical initiative devoted to Adam's achievements. Such a component could offer services for Malysz fans, including:

- Trips to sporting events
- Referrals to e-shops with winter sports equipment and gadgets
- Advertising targeted at Malysz supporters

Such an initiative is largely ad hoc and has a fairly short lifecycle. In a matter of weeks,

the ski jumping season is over, and this component of the portal will be deserted by users. Obviously, other vertical components may be less ad hoc and can therefore be planned. The key point here is that the revenue of the portal is built through distinctive components.

### Analyzing Investment Projects

We therefore suggest that the viability of an e-business proposal should be analyzed in the following way:

1. Determine which investments constitute the basic platform. For this platform, it is necessary to use a total costs of ownership approach for assessing the quality of the proposed architecture in financial terms. Against that, basic revenues (if any — the basic services are often free) should be projected.
2. Each “vertical investment” should be analyzed as a separate investment component, with its own revenue projections, risks, and initial costs.

3. Plotting the results of 1 and 2 gives us a basic “cash flow envelope,” or the projected returns from a particular set of investments. This forms the basis for one set of investments and enables us to calculate the net present value (NPV) of the returns on these investments.

The resulting analysis produces a more sophisticated and realistic picture of the company’s strategic investments. Figure 3 provides a representation of those investments, breaking the company’s decisions into platform and vertical investments, along with the overall cash flow envelope. The graphic illustrates two points: first, that the overall cash flow envelope is the sum of the individual investments; and second, that each individual vertical investment has income and costs of its own.

Investment decisions are driven by analyzing the cash flow envelope of the platform and vertical investments. The total value of the investment is the aggregated NPV of the cash flow envelope and the values of all option components. The components of

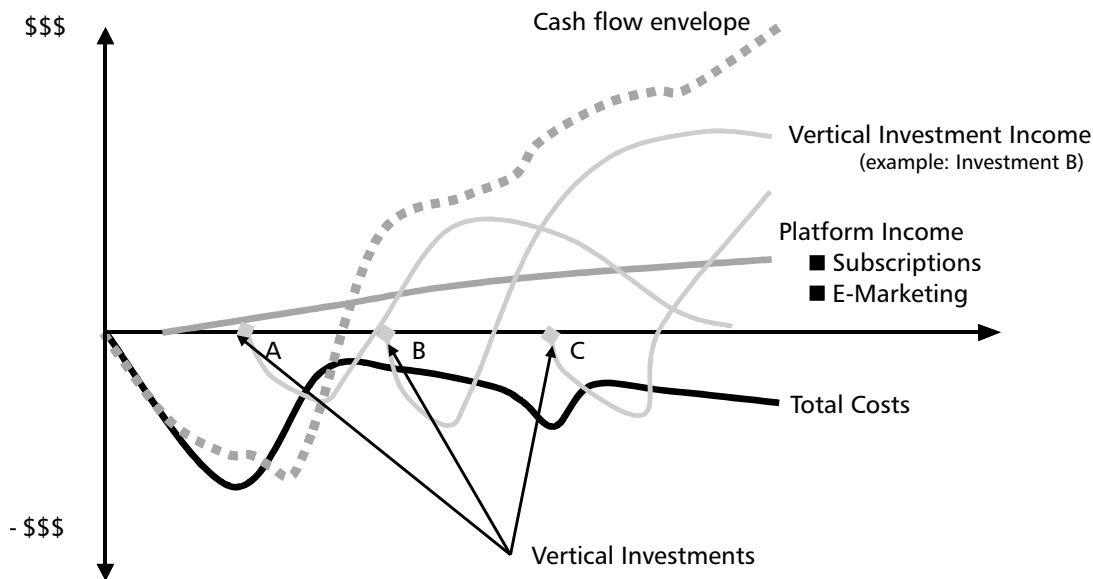


Figure 3 — Cash flow breakdown: platform and vertical investments.

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total value can be analyzed, providing us with some insights concerning the nature of the proposed investment. The envelope approach enables us to consider the investments in terms of expenditures, returns, and options.

Each key potential strategic move should be analyzed as a growth option. The application of option valuation techniques to non-financial assets (such as an Internet portal) is becoming increasingly popular. It is presented by the business press, textbooks (both practical and academic), and by real options enthusiasts such as John Favaro (see <http://www.favaro.net>). The option component of the analysis enables an assessment of the future flexibility of the investment decisions. The rate of change makes incorporating this consideration critical to making good e-business decisions.

### THE TOTALLY INVESTING ENTERPRISE

In the hyper-competitive world of e-business, the only sustainable advantage lies in the ability to innovate effectively while at the same time maintaining operational excellence. Each innovation is effectively a vertical investment with its own risks and revenues. Thus, we believe that the essence

of successful e-businesses can be extracted into a model, which we call the Totally Investing Enterprise (TIE). The investment evaluation and management process presented in the previous section is the core competency of such an organization.

The TIE has two types of organizational components: *business tribes* — agile, empowered business units focused on developing, conquering, and harvesting various markets, and a *resource broker* — a strategic management unit that serves as a coordinating hub enabling effective sharing of key resources, an “investment engine,” and the headquarters of the organization.

### Resource Broker

The resource broker provides a platform for interaction among TIE components and for the accumulation of essential knowledge (the information capital of the organization). It is responsible for investments that maintain the e-business platform. The resource broker maintains the organization’s cultural integrity and defines the basic business rules, a strategic foundation for adaptive behavior of the whole organization. The resource broker is also an incubator where new tribes are formed, and it takes care of the tribes that can no longer survive or

Table 1 — Investment Considerations

	<b>Weak option component of the total value</b>	<b>Strong option component of the total value</b>
<b>Positive NPV of the cash flow envelope</b>	The viability of the core strategy is a critical risk factor. Consider mitigating the risk by defining additional options that will provide a contingency plan for your investment.	Yes, you have a chance to take over the world!
<b>Negative NPV of the cash flow envelope</b>	Dead dog. You can consider focusing the investment on the most valuable option, as a core strategy, and redefining the whole business plan.	Risky investment, with no core strategy. All value is located in the options, which may mean that the proposed business model is too generic.

generate profits, by recycling their core resources and competencies.

The resource broker bears many similarities to an investment fund. Its key goal is to maximize enterprise value. The value provided by the resource broker to the business tribes has the following key components:

- Integrated corporate communication infrastructure, including platforms necessary for establishing B2C and B2B relationships
- Enterprise risk management, monitoring the exposure that various activities performed by the tribes create for other tribes or for the organization as a whole
- Strategic brand management
- Access to accumulated intellectual capital of the entire organization
- Access to other resources (capital, sales channels, shared services, real estate, external service providers) as required by the tribes
- Resource recycling mechanisms (asset management, retraining, reassignment)
- Bargaining power for the tribes

The resource broker defines high-level goals for the tribes in the form of a brief, agreed business plan, leaving tactical and operational management to the tribe community, as long as the business plan is executed and financial results are OK. The business tribes reward the resource broker with a negotiated proportion of the economic value they generate (as if the resource broker had an equity stock).

### Business Tribes

Business tribes are the organizational element responsible for the vertical investments. The term “tribe” is intentional, as we believe that maintaining a “tribal” mentality

is essential for the overall model to succeed. A tribe has a sense of common values, a common purpose, and a motivation to support the group in both bad and good times. The key features of the tribe are:

- Independent management accounting and cash flow management
- The right to execute the agreed business plan and to take risks within the limits of agreed exposure
- The right to use knowledge about customers and corporate know-how from other tribes based on the corporate rules
- The right to apply for resources provided by the resource broker

Tribes can look for external capital and external distribution channels within the confines of corporate rules, but they must always make information about their business available to the company. The market competition between tribes is minimized; instead, tribes have to compete for resources (especially human capital). This rule is targeted at protecting the value propositions of the organization while stimulating the most effective utilization of the best assets of the company.

Tribes compete for skills internally (within the company) as well as externally (on the open labor market). The value of the entire TIE organization relies very much on the quality of human and intellectual capital. The internal culture amplifies the need to maintain low employee turnover, creating an employee-friendly and compelling work environment.

### Tribes Contribute to Flexibility

Business tribes are adaptive units running fairly independent, profit-oriented operations. Most of the time tribes operate in disruptive markets, and their evolution is

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shaped by the market dynamics described by Geoffrey Moore in his insightful books *Crossing the Chasm* [2] and *Inside the Tornado* [3].

Disruptive markets are hostile environments, and there are numerous reasons why the business plan of a tribe may fail. A tribe that fails to deliver the value assumed in the business plan must be dissolved. Assets of the dissolved tribe must be absorbed and recycled by the broker. This is a critical factor for flexibility, and effective tribe dissolution requires a high level of employee safety. Indeed, this internal “key employee security system” is the major glue of the whole organization. It is also, admittedly, an important cost driver, yet the costs of employee security can be seen as an investment in low turnover, which results in more efficient use of intellectual capital.

We believe the keys to success are excellence in investment management and a proper balance of value exchanged between the tribes and the resource broker, assuring mutual attraction of these units. To protect the value of the entire organization, all such relationships should be built on solid economic principles, such as activity-based costing, cash flow management, and other key disciplines of strategic management accounting.

## CONCLUSION

Strategic investment management is important for making the right e-business decisions. It involves more than an endless drive to conquer the world. It requires matching investment decisions with options and understanding the difference between platform and project investments. This matching increases consistency between the organization's investments and cash flow models.

Achieving a Totally Investing Enterprise involves more than a strong investment management approach. It requires organizational changes that match your structure to your investment approach. The need to make the connections between how the company realizes revenue, how it invests, and how it is organized is one lesson learned from the e-Gold Rush.

Confidence in the promises of the brave new e-world has been shaken by the spectacular fall of Internet stars. But life goes on. We guess that the best (and briefest) conclusion will be as follows:

Pinky: “What are we going to do now, Brain?”

Brain: “The same thing we always do... try to take over the universe!”

Pinky: “Yeah! But this time we'd better get our investment strategy right.”

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