Project Portfolio Selection with Strategic Buckets - The Role of Naïve Diversification

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Problem definition: The management of a company's project portfolio is a crucial success factor. Due to information asymmetries, top managers typically specify general project portfolio guidelines but delegate actual project selection to lower level managers. We analyze the effect of naïve diversification on project selection behavior if projects are classified into so-called strategic buckets. ***Academic / Practical Relevance:*** Strategic buckets that divide an overall budget into budgets for different project types are a powerful approach to steer project selection, for instance to balance the risk-return profile of the portfolio. ***Methodology:*** We develop a behavioral decision model and use laboratory experiments to analyze how strategic buckets and their degree of implementation influence project selection. ***Results:*** When strategic buckets are used to steer project selection, decision makers seem to be prone to a naïve diversification effect, which can result in biased project portfolios. They have the tendency to allocate budgets evenly among buckets and among project types within buckets. In our laboratory experiments, the effect is strongest when bucket budgets are binding once they are set, but remains significant when they are not binding, or even when projects are only classified. ***Managerial Implications:*** Understanding the effect of strategic buckets on actual project selection behavior allows managers to steer project selection decisions that are aligned with their objectives without having to limit project management's discretion. Awareness of naïve diversification is crucial in project portfolio management, and its effect has to be considered in order to implement efficient bucket-based project selection guidelines.

Key words: Project Selection, Strategic Buckets, Naïve Diversification, Information Asymmetry