

## PM WORLD TODAY – VIEWPOINT – DECEMBER 2009

### Financial Aspects of Project Launch:

#### Clarifying Project Value

*By Helen Cooke, PMP, PMI Fellow*

An aspect of professional project management that was part of the PMP exam and Global Standard in 1986, but fell out of active use during the IS/IT boom years, is overt attention to assessing the value of a project as part of its initiation process.

Perhaps assessing a project's 'business value' fell out of favor because of the 'IS/IT bubble.' When every expenditure on both systems and software generated money, the comparison of projects across-the-board to compare their value contribution fell into disfavor. But it is back 'with a vengeance,' according to HSBC's SVP-PMO Michael Chachula, speaking at a mid 2009 dinner of the Chicagoland chapter of PMI.

Return on investment, internal rate of return, and net present value are back in the project assessment process. As to project managers, their superiors and senior management all pay attention to project value calculation. "They all know they need it, they just don't know why they do it," he says. There is nothing like an economic downturn to clear the air. As Chachula quips, often "management does not have two nickels to rub together." They need the leverage of a good financial return to get a project through the approval process.

Ignoring project value is no longer an option: the projects that promise big return get funded first, or the ones that "avoid big losses." It has always been the author's contention that organizations embrace project management either when they stand to gain a profit by doing it, or lose a lot of money or opportunity by not doing it.

For most of the senior professionals in project management, pinning down the real value of the project at its earliest phase has always been an accepted part of the project manager's responsibility. Clarifying the project's goal and objectives--for not only the customer but also the sponsor and stakeholders--is a critical foundation for managing project decisions. There are many difficult tradeoffs made during project execution, the most common being the tradeoffs made among staying on schedule, keeping costs within projections, and delivering a quality product while staying within the originally defined scope of the project. Those midnight emergencies, left to chance without a crystal-clear understanding of what the customer or sponsor consider 'value,' can compromise the ultimate success of the project.

There has been a rash of 'undervaluing' project managers and business analysts in recent years. These are the professionals who have traditionally been responsible for

making those hard project decisions and making adjustments or refinements during product development. Some organizations have devalued their contribution to the extent of removing decision-making from their job roles, effectively relegating them to the role of communications coordinator or schedule expeditor rather than project professionals.

We all know it to be true: the definition of project success belongs in the initial project documentation. Those organizations that have developed or adapted a project management methodology will have a designated section of initial documentation that requires that the project's success criteria be documented.

Some organizations require formal spreadsheets and formulas for calculating the project's revenue contribution. There may indeed be two or more views of project success to cite in those documents. The sponsoring organization – such as a corporate executive board or professional services firm --- may have one definition (entering a new market, with or without significant profit from the project, for instance). The customer or 'user' may have a different definition of success, often having to do with the end product's fitness for use, effectiveness or efficiency, or ability to be integrated into the receiver's operating environment or business culture. Other stakeholders may be more interested in containing the impact of the project on their business operations or tapping resulting benefits.

The project management professional must fill out that section of the project documentation before getting 'sign-off' from management to proceed with detailed planning and cost estimating.

A common way to introduce the topic to management is, "Tell me how it aligns with the business strategy; I will need to do some analysis, and need to look at potential trade-offs."

If there is push-back from management, it can signal a hidden risk. Perhaps the business objective is still "in contention." There may be a political aspect to the mission or goal being publicly displayed (such as protecting market position or business intelligence). But it is also possible that the differing views of project value have not yet been reconciled among affected executive stakeholders, signaling a need to get management's heads together on corporate strategy.

Regardless of the reason for pushback, the project manager should dig it out, put it in the plan (and the risk plan), or if confidentiality is truly necessary, she should keep the value statement in less visible files for future reference when project tradeoffs are needed.

Since so much of project decision-making is dependent on a clear view of the project's anticipated value proposition, not having a clear statement is a primary risk that will need to be aggressively managed in the project's risk plan. Turf battles, managerial

'silos,' fuzzy objectives and fragile communication among sponsor and customer are all risks that will ultimately need to be managed by the project team.

### **What to Consider When Assessing Project Value**

The key value assessments when a project is first being initiated are the project's ability to deliver financial benefits and program objectives upon completion.

Of course, the revenue generating aspects of a project are only one part of the value proposition. Some viable reasons for undertaking a project are:

- Preparing the organization for some major change (a global event, or a merger or acquisition)
- Avoiding non-compliance with a regulation or law that could jeopardize business continuity
- Building a presence in a new market, one that promises repeat earnings over several years
- Repositioning the organization in an emerging technology (either mandated or inevitable).

In each of these cases, the project is linked to another goal, laying a foundation, avoiding damage to a necessary operating condition, or 'buying' visibility and public awareness in an unfamiliar arena.

**Common Measures:** Some of the more common measures of a project's ability to deliver financial benefits are the project's potential return on investment (ROI), the project's resource internal rate of return (IRR), and the net present value of the money that will be tied up in carrying out the project (NPV). Why not look at each in turn during the project initiation process, and document it in the plan?

**Return on Investment:** ROI is used to measure the benefit of the investment in the project as compared with other potential investments for the same resource (other projects, or other non-project investment vehicles). If an organization invests \$1,000,000 in a single project, and 'nets' a benefit of \$200,000 from the project, it has delivered a 20% rate of return (much higher than what financial investments typically deliver, and more on a par with private equity capital might deliver). If two projects are being considered, management will compare a project promising a 20% ROI with a competing project promising a 6% return. The priorities often sort themselves out relatively quickly.

**Internal Rate of Return (IRR):** The costs associated with maintaining necessary cash flow for operations is a key concern of management, and a project that promises a higher internal rate of return than can be had from other sources is, of course, more

desirable than a project that consumes needed cash, making it less available for doing business. Quickly adding a new product to an already profitable product line will generate an internal rate of return that is greater than other sources of cash flow, making needed cash available to other projects and the business as a whole.

**Net Present Value (NPV):** A project is expected to have a net present value of at least zero, in that it either delivers current value to the organization, or remains neutral. Projects that are considered to be worth 'less than zero' in net present value do not get funded. The question asked to determine that value is, "Will this project be profitable now?" A project with high net present value will increase stakeholder wealth. Stakeholders investing in the project stand to reap immediate benefits, a key motive in contributing money to the project. Purchase of an already profitable smaller business pays off quickly, even considering the expense necessary to complete the purchase. Stakeholders benefit.

**Long Term Gain:** An example of the potential for long term gain that is poignant--although not common--is the opportunity for individuals to invest in deep sea recovery projects (a ship of gold recovered by deep water technology in the 1980s, or the Titanic in the 1990's). If successful, the investors were promised a portion of the gold or earnings that would be generated by lifting a lost ship from the depths of the sea, generating an immediate source of wealth to all active investors. In both cases, the recent improvements in undersea exploration equipment paid off, and the investors captured immense value, albeit at the risk of not finding anything at all.

Strategy implementation is of course important to all types of organizations. Once strategy is defined, executives have an urgent need to see it through. The short tenure of senior executives in their positions (average 2.5 years) means strategy needs to be seen quickly to generate positive results.

Most technology projects are strategy execution projects. Executives want to see what they can accomplish by leveraging strategic technological improvements, and look for technology to position them in the market, reduce head count and salary costs, distinguish them from their competitors, respond to emerging opportunities, and ultimately get things done more quickly than in the past. In short, technology enables productivity.

Since project value is so critical to project initiation, continuity and overall success, the project manager should put 'defining project value' high on the chart of initial things to do.

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