

Initiating and Creating the Project Charter

The following exercises are presented here:

- Exercise 2.1: Justifying a Project—Project Selection Matrix
- Exercise 2.2: Project Selection Methods—Financial Returns
- Exercise 2.3: Project Initiation and the Project Charter

Exercise 2.1: Justifying a Project—Project Selection Matrix

The objectives for Exercise 2.1 are as follows:

- Describe various project selection criteria.
- Select and justify a project based on a project selection matrix exercise.

Background

Organizations need to be selective about the projects they undertake. Otherwise, they would work on all proposed projects, which most organizations cannot afford. Projects need to align with the organization's strategy and provide some kind of return on investment, whether it is financial or based on some other criteria the organization finds important.

A well-defined method, such as using a project selection matrix (which could be based on a weighted scoring model), and predefined project selection criteria help an organization select projects. A project selection committee, a project management office, or some other organization authorized by an enterprise might use this matrix to make decisions. First, the organization sets up the criteria for selecting projects, and then, for each criterion, it decides what methods to use to measure the project's potential. (For instance, see Exercise 2.2 for an example of financial return methods.)

The matrix allows a project selection committee to make objective decisions (at least, as objective as possible) in deciding which projects to undertake. It also helps the organization prioritize the selected projects—allowing the organization to cut lower-ranked projects if budgets or resources become tight. An organization might have several criteria for selecting projects and might use several project selection methods. Sometimes, even though a project might look financially risky, it might be worth undertaking because it will provide a public perception boost the organization needs to regain or improve its market penetration. So, even after using the project selection matrix, a selection committee might choose to proceed with a project based on some other criteria that might not have been part of the initial selection process.

Using a Project Selection Matrix

When creating a project selection matrix, you must first decide on the project selection criteria and weight the criteria according to the organization's strategic goals and other objectives. This list includes some possible criteria:

- Financial return
- Alignment with/advancement of corporate strategy
- Market value/share
- Public perception
- Technical advancement or innovation
- Effect on employees/alignment with corporate culture

For each criterion in your matrix, complete each project's objective or subjective measurements. Table 2.1 provides some possible benefit measurements for sample criteria.

TABLE 2.1 Project Selection Criteria

Criteria	Possible Benefit Measurements
Financial return	Net present value (NPV). Cost/benefit analysis. Internal rate of return (IRR).
Cost avoidance	Cost/benefit analysis (calculate savings and all costs).
Technical advancement or innovation	Will the innovation apply only to the project, will it apply to the entire organization, or will what is developed during the project be marketable outside the organization? Will it appear as innovative to others in the industry, thus creating prestige for the organization?
Market value/share	Increase value/share according to set formula, research, or surveys.
Public perception	Measure perceived increase/decrease in perception based on focus groups, surveys, or interviews. Estimate the awareness/perception that will be created. Calculate the number of people affected/made aware.
Alignment with organization expertise	Does the project team have the expertise to do the project? Can the organization acquire the expertise, and does it want to acquire it? Will the project efforts help develop some expertise or skill the organization wants developed?
Needed infrastructure improvement	Improved productivity—show cost savings if possible. Describe old system/processes that might collapse or decline and include impact. Compare with other infrastructure projects.

Project Justification Criteria

When justifying a project, follow these steps:

1. Select five to seven main criteria to justify your organization's projects. If you select more, this exercise will become difficult to manage. Assign a weighting factor to each criterion according to what is most important to the organization.
2. For each criterion, select the benefit measurement or measurements you will use.
3. Create the list of all proposed projects. Note that most should have a written business case to provide more information for the project selection committee.
4. Put the projects in a matrix, and rate each project according to the method selected. Then, multiply the weighting factor to each rating received.
5. Eliminate any projects based on any minimum standards or thresholds you have established prior to the ranking exercise (for instance, if the project would lose money and all other rankings are below a 5 average, it automatically is eliminated).
6. Rank the remaining projects.
7. Select the projects you want to proceed with from this ranking.
8. Make sure you document justifications for each project selected based on this process. You can use the justification in your project charter, scope statement, business case, or any other document supporting the project.

In this exercise, you'll practice using a project selection matrix to justify a project. Then, you'll put on your consultant shoes and put those practices to use.

Scenario

You have been asked to help an established investment company, Best Investments Company (BIC), create a project selection process. The company tends to take on all projects that are proposed, and it has become increasingly difficult to manage the company's project portfolio. You will help the company establish a semiannual review process using a project selection matrix based on the company's major project criteria.

After much discussion with the project selection committee, you've helped the committee members agree on the most important objectives for the company. You've also helped the committee create a weighting factor for each (presented in Table 2.2). These weighting factors will be multiplied by the benefit measurement ratings each of the projects received for the criteria. The BIC project managers have scheduled a series of meetings to determine the rating system to be used by the company for this and future project selection processes. You will help them develop ratings for each of the criteria. This will help rank projects so that those with good rating scores for higher-weighted projects will be selected over those with high ratings for less-important criteria.

TABLE 2.2 Best Investments Company Criteria and Weighting

Criteria	Weight Factor
Increase market share as the investment company of choice	5
Good financial return	4
Provide possible innovation in investment tools and techniques	3
Support the corporate culture of employee supporting employee	2
Increase public awareness	1

Currently, BIC is considering the following three projects:

- The kiosk project: Build investment kiosks and put them in major malls across the United States.
- The financial advisor project: Create a program to recruit community financial advisors who provide services to investors within a particular territory based on per-capita income of various communities.
- The franchise project: Build franchises that work like fast-food restaurants in strip malls.

BIC could choose all, one, or two of these projects to improve its portfolio performance. After BIC's business analysts researched each proposed project, they applied project measurement ratings for each of the criteria supplied in Table 2.2. The projects were given scores, as shown in Tables 2.3 through 2.5 (with 10 being the highest possible mark).

TABLE 2.3 Kiosk Project Criteria Ratings

Criteria	Rating
Increase market share	5
Good financial return	6
Innovation	9
Support culture	1
Increase public awareness	8

TABLE 2.4 Financial Advisor Project Criteria Ratings

Criteria	Rating
Increase market share	7
Good financial return	3
Innovation	5
Support culture	5
Increase public awareness	5

TABLE 2.5 Franchise Project Criteria Ratings

Criteria	Rating
Increase market share	7
Good financial return	7
Innovation	4
Support culture	3
Increase public awareness	6

Testing Your Knowledge of Justifying a Project— Project Selection Matrix

Use the new project ranking system, your knowledge of sound project selection practices, and information about the three projects BIC is considering to complete the project selection matrix. Then answer the questions that follow. Remember that the actual score for a criterion is the rating times the criteria weight factor.

1. Fill in the Best Investment Company project selection matrix shown in Table 2.6 based on the preceding information.
2. If you could choose only one project after this process, which one would it be, and why?
3. Does the project ranking determine which project will be selected over the other?

TABLE 2.6 BIC Project Selection Matrix Template

Criteria	Kiosk	Financial Advisor	Franchise
Increase market share			
Good financial return			
Innovation			
Support culture			
Increase public awareness			
Total score			
Project rank			

4. Is this a good method for selecting projects? Why or why not?
5. What other criteria might a company use for deciding on projects?
6. What are some potential problems using this method of selecting projects?

Exercise 2.2: Project Selection Methods— Financial Returns

The objectives for Exercise 2.2 are as follows:

- Describe the importance of having a measurement methodology for selecting projects for a particular criterion.
- Describe various cash flow analysis techniques.
- Use financial return methods to select a project.

Background

Project selection methods help an organization objectively decide which proposed projects to pursue. Project selection methods also help the organization prioritize projects based on the outcome of applying the method selected to approved projects. The method used is based on the selection criteria an organization uses (as explored in the previous exercise). The more objective methods an organization uses, the better it can justify the selection and sustain the project over time. If your organization does not use selection criteria and project selection methods, projects might be selected according to the person who lobbies the loudest for their project, or the organization might overload itself with projects. One of the best methods for

selecting projects analyzes cash flow to estimate financial return for the project. Some of the most common cash flow analysis techniques are payback period, net present value (NPV), return on investment (ROI), and internal rate of return (IRR).

In the following scenario, you'll explore financial return methods for project selection. Then you'll provide additional project advice for one of your clients.

Before you begin the project selection process, you will have to make a few decisions regarding your approach.

First, decide on the project selection criteria that you want to measure. Exercise 2.1 lists several of those criteria. Next, decide on a consistent and standardized approach for measuring benefits for the criteria. For instance, for financial return you could use one or more of the following:

- Payback period
- NPV
- IRR
- Other forms of cost/benefit analysis

Finally, apply the same methodology to each project using objective measurements.



Subjective measurements, based on expert judgment or some kind of methodology created by the organization or team, can work as well as objective measurements. For instance, how do you measure an increase in public perception? Using previous similar projects as a basis, you could use a focus survey or market research to measure success. These methods offer a way to measure criteria using a consistent and standard approach and provide information based on analysis to help you better justify your project selection decision.

Scenario

Just as BIC helps its customers achieve the best return on their investments, it would like to ensure that its projects have the best financial return possible. The selection team decided to use financial return as the major project selection method. To select a financial return analysis method, you have been asked to take the executives at BIC through several exercises to help them decide which one best fits their needs. They already have decided that they want their project managers to be able to calculate these financial return methodologies; they do not want to make the work too complex, but they want the most accurate method possible.

You will acquaint them with the following financial return methods:

Payback period Payback period determines the amount of time it takes a company to recoup its initial investment, which is the cost of producing a product, service, or result. It is a fairly simple method to use but is not as accurate as other methods. It does not consider how the value of money is affected by interest accrued over time. The rating is based solely on the length of the payback period. No consideration is given to how much the organization would make after the payback point.

Discounted cash flow/net present value (NPV) NPV brings the value of future monies received into today's dollars minus the initial investment. It is a fairly accurate method because it takes interest (also known as the *time value* of money) into account. This method uses more complicated formulas. Your highest rating would be assigned to projects with the highest NPV.

Internal rate of return (IRR) IRR is the discount rate when the present value of the cash inflows equals the original investment. This is a complex but accurate calculation. Using this method, you would give projects with the highest IRR value the highest rating.

Now, use the projects they are currently considering and the following financial projections to help the committee see how the methods work:

The kiosk project The initial cost is \$5 million to install in targeted locations. The return is expected to be \$750,000 the first year; \$500,000 per quarter over the next two years; and \$750,000 semiannually thereafter.

The financial advisor project The initial cost is \$8 million to recruit and train the advisors. The return is expected to be \$1.5 million the first year; \$400,000 per quarter over the next three years; and \$750,000 semiannually thereafter.

The franchise project The initial cost is \$11 million to build or convert existing buildings in targeted locations and to hire employees. The return is expected to be \$1 million the first six months; \$2.5 million the second six months; \$500,000 per quarter the second year; \$600,000 per quarter the third year; and \$3 million annually thereafter.

Testing Your Knowledge of Project Selection Methods— Financial Returns

Use your knowledge of financial returns project selection methods and the information you've gathered about the projects to determine the financial return for the three BIC projects. You will use this information to present the three financial return methods to the project selection committee. You might want to create tables for each project. You begin with the simplest method, the payback period method. Calculate the payback period for each project, and use that information to answer questions 1–3:

1. Based on the three projects, which one has the best payback? Rank them.
2. Will the project manager be able to calculate this information? Why?
3. For Best Investments Company, what are some of the advantages/disadvantages of the payback period method?

You then prepare to present the NPV method to the committee. You decide to use the same investment and expected financial projection information you gathered earlier, but for this case, the time value of money (interest rate) is 5 percent and you calculate NPV over five years for each project. This way, the committee has comparable information to evaluate.

To prepare for this presentation, you will need to lay out the actual inflows for each year, apply the present value formula for each year, and then subtract the initial investment.

Also, round to the nearest dollar. To make this easier for the committee to understand, you use the following interest rate table:

$$\text{Year 1: } (1 + .05)^1 = 1.0500$$

$$\text{Year 2: } (1 + .05)^2 = 1.1025$$

$$\text{Year 3: } (1 + .05)^3 = 1.1576$$

$$\text{Year 4: } (1 + .05)^4 = 1.2155$$

$$\text{Year 5: } (1 + .05)^5 = 1.2763$$

Use this information to answer questions 4–6.

4. Which of the three projects provides the best NPV? Rank them.
5. In your judgment, will the project manager be able to calculate this information?
6. For Best Investment Company, what are some of the advantages/disadvantages of this method?

Finally, you present the IRR method without actually showing the complex calculations you used to derive the values. You suspect that the complexity of the calculations will cause confusion and hinder the committee's ability to evaluate the method. For the three projects, you use the following IRR values during the presentation:

- Build an investment kiosk. IRR = 5.5 percent.
- Create a program to recruit community financial advisors. IRR = 3 percent.
- Build franchises in strip malls that work like a fast-food restaurant. IRR = 5 percent.

Use this information to answer questions 7–9:

7. Based on the kiosk, financial advisor, and franchise projects, which one will provide the best IRR? Rank them.
8. Will the project manager be able to calculate this information?
9. For BIC, what are some of the advantages/disadvantages of this method?
10. Which financial return method would you recommend for BIC, and why?

Exercise 2.3: Project Initiation and the Project Charter

The objectives for Exercise 2.3 are as follows:

- Describe the need for a project charter.
- Describe the essential elements of a project charter.
- Create parts of a project charter.

Background

A *project charter* is the official written acknowledgment and recognition that a project exists. An appropriate senior manager with commensurate authority issues it to the funding level of the project. The charter gives the project manager authority to assign organizational resources

to the work of the project. The project charter is usually the result of applying project selection methods and signals the organization's choice to proceed working on a project. Previous feasibility analysis or justification should be included in the charter to ensure that it's linked to the organization's strategic initiatives. It's best if the project manager is selected for the project and assigned to help develop the project charter, although that doesn't always happen in reality. When writing a charter, you will capture and document information such as the following:

- In an introduction, a description of the stakeholder requirements for the project's product, service, or result, and an overview of the project. This might include a list of the project deliverables.
- Project purpose and goals/objectives.
- Stakeholders, including any participating functional organizations, and their needs and influences.
- The business case, justification, and business need for the project. This could include any feasibility study or business justification already developed.
- Preliminary high-level resource and cost estimates (budget).
- Preliminary high-level schedule, including milestones.
- Authorization for and responsibilities of the project manager.
- Initial assumptions and constraints.

You will use this charter to continue to ensure that the decisions you make during planning and executing are valid. You also might use it to confirm that you have completed one phase and can move to the next phase of the project.

In this exercise, you will learn the steps required for writing a project charter and lead your client, BIC, through the process as well.

A project charter describes the basic elements of the project and authorizes the project to continue. To write a project charter, follow these steps:

1. Interview the sponsor of the project, any product managers, and any other organizational leaders involved in the project to ensure that you understand the product, service, or result expected and the purpose of the project. For each succeeding interview, as you listen to the information and take notes, confirm that all of the interviewees concur with the major points you progressively discover. After analysis, if you have too much disagreement, you might need to invite the interviewees to a facilitated session and work with them to come to an agreement.
2. Ask your sponsor and other stakeholders about the main goals and objectives of the project. Ask questions such as this: When you get to the end of this project, what does the product, service, or result need to look like? What will it have to do? Have them attempt to define what their concept of success looks like for the project. Ask them what constraints and assumptions they have about the project.
3. Ask your sponsor and other stakeholders what tangible deliverables they expect as part of the project. Give them some examples based on the typical life cycle of your product, service, or result. Ask what skills and functional organization input they think might be needed for the project.

4. Collect the business case for your project, and attach it to the charter. If the business case has not been completed, then complete it yourself. Note that you might want to share the major points of the business case with your sponsor and other interviewees. Confirm that all the product justifications have been included and that your stakeholders agree with the business case.
5. Start an estimate of resource needs, costs, and schedules with milestones. Use previous projects as comparisons; ask your stakeholders for estimates, and use industry-estimated figures if you can find them.
6. Create a description of the authority the project manager will need (can you hire/fire people, control the budget, reward/punish performance?).
7. Write the project charter with all the information you have gathered.
8. Check to be sure that all the elements described in the introduction of this exercise are documented.
9. Ask your sponsor or a senior leader to review and revise the charter as needed.
10. Incorporate the revisions into the final document, and then ask your sponsor (or the senior leader who reviewed the charter) to sign and distribute the charter to leadership and management affected by the project.
11. Hold a meeting to ensure concurrence with the charter. Invite all executives and identified team members.

Scenario

The Best Investments Company (BIC) has selected a project and wants to understand how a project charter can help further define and authorize the project. The company has decided to go forward with the kiosk project and build electronic investor kiosks in major malls throughout the United States. You are mentoring Jim Thoroughgood, project manager, through the process of creating the project charter.

BIC expects the project to deliver most of the standard items for a new investment program, but this project has a twist: BIC is an investment company, not a construction company, and the project involves the construction of kiosk structures. The project also involves electronic innovation—specifically, easy computerized menus for kiosk users. So, you will need a software application with an easy-to-use graphical user interface (GUI), a finished kiosk structure, the investment program you will try to sell, advertisements for the program, and other items for a successful new product. Martha Pena, your sponsor, has asked that the first kiosk be in place within nine months, and the budget for initial implementation of 25 kiosks should be no more than \$5 million. She says the company doesn't expect anything glitzy—just something efficient and attractive to the average investor.

Testing Your Knowledge of Project Initiation and the Project Charter

Jim Thoroughgood has been assigned as project manager, and you will be mentoring him on the project. Your first task: help Jim write a project charter. Use your knowledge of sound

project initiation practices and the information about the kiosk project to help Jim answer the following questions:

1. Describe the product and services of the project. Do this in your own words, and don't hesitate to add some of your own thoughts to this description.
2. What are the main goals and objectives of this project? Again, don't hesitate to add some things you know need to be included that might not be included in the exercise setup description. Include some assumptions and constraints that the project might have.
3. What are the main, high-level project deliverables?
4. List the responsibility and authority Jim Thoroughgood would require to succeed on this project.
5. Is it a good idea to have the project manager's responsibility and authority written in this project charter? Why?
6. What are the resource and cost estimates? Can you list some major milestones and when they might occur?
7. Who needs to sign the charter and to whom should the charter given?