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Risk is a Four-letter Word, But Denial is our Biggest Enemy: Risk Management is an Essential Part of Project Portfolio Management

As a practitioner and proselytizer of project management for over 38 years, one thing has puzzled me above all others. That is; why is **risk management** virtually ignored as an integral part of the project management process? We all recognize that risk is an important part of all projects. If we thought about it, we would all acknowledge that the management of risk can be the most critical factor in project success. Yet as I look at the practices that have been put in place in most firms, and at the tools that are being used to support these practices, risk analysis and management are most often missing.

It's not that the processes and tools are not available, but more of a major lack of interest in the process. I can provide two stories that might help to explain the perilous avoidance of this essential practice.

The Downside Won't Happen

A company decided to enter into a new business segment. As was standard practice for this well managed conglomerate, a business analysis plan was prepared to evaluate the potential profitability of the new venture. As a normal part of the business plan procedure, three business cases were analyzed: the most probable case, a potential upside case, and a potential downside case. All well and good up to here. But then, the general manager, when presenting the business plan to the board, said this: "Here is the most likely scenario, a potential upside and a potential downside. However, we can ignore the downside case because it will never happen".

The company went ahead with the new venture (assuming that it couldn't lose), as the most likely and upside scenarios predicted a reasonable profit in a reasonable amount of time. Needless to say, the downside did materialize and the venture failed within two years.

Denial is our Biggest Enemy

This true incident can be explained, in part, by the message that was presented by James Taylor, Senior Vice President of Gateway 2000, in his keynote address to the Project Management Institute, in Long Beach (10/12/98). His theme was: "**Denial is our biggest enemy**". Digging deeper, we will find that there are several dimensions to this denial. Perhaps, in the company illustration above, the GM deliberately devalued the weight of the potential downside because "he couldn't sell the venture if he admitted the risk". Another dimension is our eternal optimism - preferring to look at the bright side. Unfortunately, wishing that bad things won't happen is almost a sure way of establishing an atmosphere that will breed unwanted events.

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Furthermore, an atmosphere of fear (fear of the truth) brings on such denial. The success-minded manager must remove the emotional elements from the business evaluation and promote methods that require objective analyses of the entire business case. To do otherwise, puts the liar, the bully, (and the myopic) at an unfair advantage. The result, understandably, is the improper selection of business opportunities and a deleterious effect on the corporate bottom line. To put it even more strongly, the failure to select the best business opportunities may eventually cause the business to lose its market position, and eventually cause a fatal collapse.

So why, knowing all of this, do we fail to require the objective analysis and management of risk? It can't be because the process is difficult. Actually there are many approaches and processes for risk evaluation. All are simple and valid (except for the pain of admitting that something can go wrong (that denial thing, again). The key thing to realize is that all of the available approaches are simple, down-to-earth methods, certainly not in the realm of rocket science. We will discuss these methods in a sequel to this article.

The solution must consist of a total risk management system. Such a system, as part of a project management system, must contain all of the necessary elements that we would have in our PM system. This includes a risk management process, tools to support the risk management process, training in the process and use of the tools, and clear support for the process at all levels of management. An enlightened, risk management-aware senior management must demand to see the entire picture (rather than just the good stuff) and must play the role of the devil's advocate until the entire picture is presented. Yet, in my experience, executives have done just the opposite. They often give the impression that they don't want to know the potential downside, or that if they do learn the true risks that they will squash the proposal (which in many cases would be the proper action). We must discourage the common environment where we tend to "kill the messenger" of "bad" news. Under this deleterious environment, we reward those that ignore or hide the truth and penalize those that are diligent about risk analysis and honest about potential project risk exposure.

Project Portfolio Management

One of the emerging themes as we approach the end of this decade is "Project Portfolio Management". Senior management is paying closer attention to the strategic management of a portfolio of projects, merging project and operations management and all of the tools and practices associated with both disciplines. Risk management is one of these practices. Yet, there is one aspect of risk assessment that I have not seen, either in the literature or in practice. This is the effect of risk on "payback time".

Can we assume that our typical business analysis case will contain a cash flow analysis? This CFA will show the outflow of money as the project is executed, and the inflow of money (or the projected cost savings) once the benefits of the project start to be realized. At some point in time, the cumulative curve will cross from negative territory (having recouped the investment plus the time-value cost of that money) to where the expected

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payback starts to accumulate. Usually, this payback analysis is a key component of the decision to proceed with the project.

Now, consider this. Let's say that a project was to cost ten thousand dollars per month, with expected completion in two years. Let's also say that the cost of money is 8% per year and that the project will generate an income of \$10,000 per month, starting immediately upon completion. The projected payback time would be about 50 months (from project initiation).

What do you think would happen to the payback time if the project ran just 4 months over, at a cost overrun of 15 percent per month? The payback time is extended by a whopping 18 months. If a truthful risk analysis indicated that there was a high probability of this extension to the payback time, might this be enough to sour the executives on the value of this project?

Let's further consider that this project was the average IT/IS project that was surveyed by the Standish Group, several years ago. That survey noted that the average IT/IS project ran 50% longer than planned at a cost overrun of 186%. If we apply this to our subject project, it would make it a three year job, at a cost of \$686,000 (not including the time value of the investment). In this case, the payback time would be 99 months. I wonder how many executives would approve the project, if the risk assessment showed a good probability that the payback time would be 99 months, rather than 50 months?

The "Effect on payback time" concept is so simple that it can be done on the proverbial "back of the envelop". I created a simple example in an Excel spreadsheet, in less than an hour. I am amazed that I rarely see anyone evaluating the effect of delays and cost overruns on "return on investment". Yet, if we use the Standish data, such an evaluation would show that the typical project would, based on such performance, extend the payback time to more than twice the original plan. Of course, this is another example of "downside" potential. And in today's business environment, such bad news is more likely to be swept under the rug, rather than to have the project rejected because of the risk. Unfortunately, hiding the risk does not prevent it from happening.

Organizing for Managing Project Risk

Projects, executives have come to realize, are the basis for future profitability of the firm. Hence, there is a rising interest on the part of executives in how projects are selected and managed. They are precipitating a growing demand for more standardization and automation of project management. But I do not see the stipulation of a structured approach toward risk management. There has been some success in getting organizations to recognize the importance of having some kind of Project Office (among pockets of resistance). There has been a flood of articles promoting the importance of the project office (also called: project support office, central project office, project management competency center, program office, etc.) I, for one, have not only preached this gospel at every opportunity, but have gone as far as to suggest that the firm have a position of Chief Project Officer. With CEO's, COO's, CFO's, etc., why not a CPO?

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Furthermore, in an environment of Project Portfolio Management, why not a **Chief Risk Officer**? The CRO would be responsible for establishing standards for risk analysis and management, and for implementing a system of risk practices and tools. The input of the CRO would be required before a proposed project is accepted into the portfolio.

A Series of Closing Doors

As a youth group adviser, a few decades ago, I listened to a colleague tell a group of high school kids that life was a series of closing doors. That they had all kinds of opportunities under their control. That the decisions that they made and the actions that they took (or didn't take) could allow some of those doors to become closed to them.

In a similar vein, Dr. Taylor suggested that a project is a series of closing doors. By the decisions that we make and the actions that we take (or postpone), we tend to shut some of these doors. As we move through a project there are fewer alternatives available to address problems. This is a natural condition, that cannot be overcome by even the best management practices. But what we can do is to minimize the problems and further, to minimize the deleterious effect of the eventual problems, by organizing properly for projects (with a CPO and a CRO), by implementing a solid risk management program, and by fostering proactive management for early recognition and rectification of such problems.

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