What’s wrong with Project Governance?*

We like risk

Think inside the box

Who's in charge today?

It's not me, it's you

The games people play

Spend, spend, spend

Budget variances are good

Project owners have made significant strides in recent years in improving governance structures for capital projects and programmes.

Comprehensive methodologies and procedures have been developed and implemented.

But, despite what might appear to be good governance, too many projects still fail to deliver. Why?

In the current tight credit environment, cash-hungry complex capital projects are likely to come under even greater scrutiny and demands for transparency will escalate. Project owners need to know that their projects will deliver.

Poorly run projects can be hidden behind soft budgets and schedules. Conflicts between functions can drive self-serving decisions to meet budget or schedule at the expense of the long term viability of the assets being built. And well run projects may be unfairly criticised for spending early or over-running when such actions may actually secure long term value.

So what really happens on projects? And how can governance be improved?

We believe more attention is needed between the major review points and below the programme and project boards in order to link governance with the reality of projects and facilitate timely, well informed decisions.

Governance in this environment requires real understanding of the motivations and pressures of all the significant stakeholders. In reality, personal objectives and priorities can override corporate objectives, and this impacts a project outcome.

Governance requires an active, independent and sceptical mindset that anticipates the consequences of conflicts and behavioural dilemmas throughout the lifecycle of project delivery - it is not just about compliance.

The purpose of this document is to initiate debate - it is intentionally provocative and we hope that it will stimulate thought and lead to improvements in our clients' projects.

Please contact anyone from the team listed at the back of this document to talk about the issues that you face on your capital projects.

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Spend, spend, spend

There is often a temptation to get on with projects, before they have been fully defined – particularly when the owner has a good execution track record.

But experience shows that eventual success (or failure) depends more on the robustness of project definition than the quality of execution. A well-defined requirement and a well-surveyed site will provide a sound basis for successful execution. The post-contract changes that are likely to flow from a poorly defined requirement or a cursory site survey can at best only be mitigated by good execution.

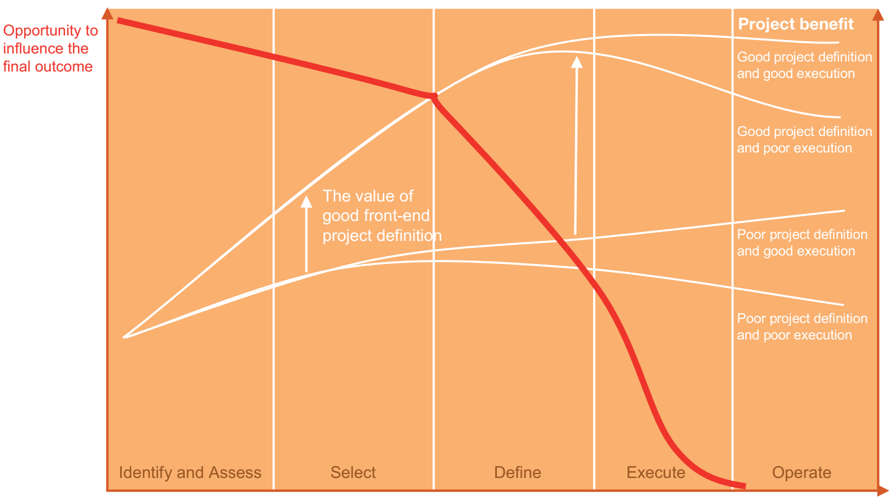
Poorly defined projects will always deliver a sub-optimal result regardless of how well the project is executed. Well defined projects can deliver successful outcomes even when project execution is poor.

Upfront investment in the definition stage is the key to success. If the project manager (who may naturally be time-driven) is seeking approval to move on to execution, governance should be questioning whether enough time and money has been spent on definition, rather than challenging the need for further investigation.

Case Study

A project manager decided to forego a £100,000 soil survey to save costs at the definition stage and to rely on survey data from a neighbouring site (on the surface, the two sites appeared very similar). The construction contract was awarded with a fixed price and with substantial liquidated damages to be paid for late completion. The contractor placed advanced orders for the long-lead time project-specific structural frame at the start of the project and commenced excavation for the foundations. Before long it became clear that the ground conditions were very different to the neighbouring land. The structural design had to be substantially revised with little re-use being possible of the components that had been ordered. The re-design also delayed the project and the foundation sub-contractor incurred substantial down-time. Not only did the total cost of the contract increase substantially but the completion date was delayed and the project owner missed the market opportunity that had been the basis for the business case.

Spend early for maximum influence on the final outcome



- To what extent are the requirements defined at the outset and communicated and agreed with the key project stakeholders?
- How have you tested the business case for the project?
- To what extent has the appropriate range of alternatives been considered?
- How did you make sure that those involved in the project are clear on their roles and responsibilities?
- What are the key risks and how could they be mitigated early?
- Have you performed detailed due diligence?
- What might cause changes to be required during execution? Could these be avoided by front-end work?

Who's in charge today?

- What processes are in place to ensure that the project business case is adequately scrutinised?
- How rigorous, independent and sceptical is the scrutiny of the business case?
- Have the users and other key stakeholders been involved in defining the requirement and developing and agreeing the business case?
- Has the project manager who will be responsible for delivery been involved in assembling the delivery plans that underpin the business case?
- Is a project that is an apparent "no-brainer" really such a good idea?
- How does governance offset management bias at each stage?
- What mechanisms do you have to manage the transition between the managers of each stage?

Major projects can take several years to shape and deliver. Realising the investment requires them to pass through many stages (business case, design, build, operate) that require quite different skill sets. Changes in project leadership are inevitable.

But the characteristics of the leaders needed at each stage are often quite different from each other – and these differences can pull projects off track:

- Business Case Managers are responsible for examining options and assembling the case for the project. They tend to focus on the financials. They may be motivated by achieving approval for "their" projects and so prone to optimism bias, missing the practical issues of project delivery or operation.
- Project Managers are responsible for designing and then building the facility defined in the business case. They tend to focus on delivery, perhaps priding themselves on "always delivering on time". But they have to cope with reality and often find that the budget and plan set in the business case need to be re-written. They can also be prone to cutting corners in order to deliver.
- Operations Managers run the completed facility. They are interested only in how well it works in practice. What they are given is rarely what they would have built! They may operate the facility contrary to the way that the designer intended – or even commission local changes to put it right.

The damage to the eventual value achieved through change of project leadership can be substantial. Governance must ensure that the project is defined well up front and focus on good transition between stages and managers so that the value is retained and the objectives are met.

Case Study

An international chemicals company became tired of dominating the league table for value destruction in capital project execution.

Closer examination revealed that the projects were consistently delivering well below the IRR expected in their business cases. Risk assessments at the business case stage were very high level. And single point assessments of cost, programme and revenue meant that approvers did not have the means to distinguish between, for example, high return projects with substantial uncertainty (and possibly an unacceptable worst case outcome) and lower return projects with more acceptable risk profiles.

Fuller consideration of risk and presentation in business cases of outcomes as ranges allowed the company to make better choices as to which projects to take forward. The plans that were then handed on to delivery managers were also much more robust.

Think inside the box

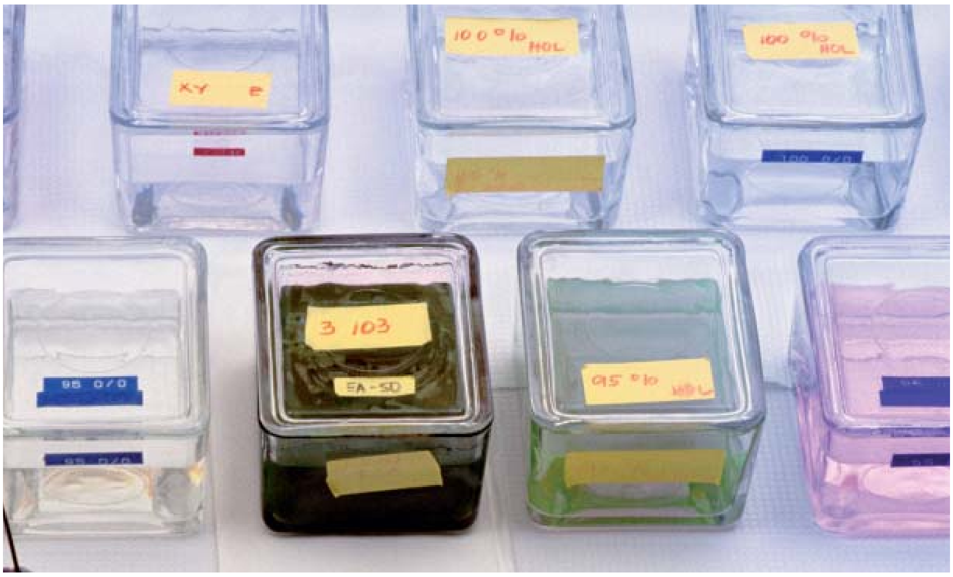
Capital project owners typically appoint contractors to deliver their projects and they often then become remote from delivery activity. Syndicates of lenders are likely to be even more remote. It is all too easily assumed that, once the contract is in place, the project will run itself and no active control is needed. As a result, the project turns into a "black box" where there is little visibility over what is going on until the very end. Project sponsors then find that they face significant time and cost overruns, and possibly even litigation. Towards the end of the project, options reduce and there is an increased tendency to spend more money to resolve the problem.

There is often little ongoing assurance of the project for the owner or lenders. Contractors may even be asked to assess their own performance, which may not provide as much comfort to the owner or lenders as to the actual health of the project as independent review and assurance would.

Whatever the size of the company, if projects matter, project governance matters. If the responsibilities are delegated to a third party, management should not relinquish control over the work. Project sponsors and managers should periodically open the "black box" with the objective of understanding the real progress and health of the project.

Case Study

Post-completion review of a project revealed that 40% of actual spend fell outside the original authorised budget for the contract. Examples of inappropriate expenditure identified included £2m of private jet trips to conferences and corporate events and £0.5m of unplanned sponsorships and donations. This indicated poor project governance and significant weaknesses in spend authorisation and control procedures. Now the syndicate of lenders, which hadn't looked inside the project "box", is having to initiate a lengthy dispute proceeding with the contractors.



- Do you have visibility of what is going on within the projects and what the real issues are?
- Do you have strong procedures defining what funds can and cannot be spent on?
- Do you periodically audit progress reports?
- To what extent are you confident that variations are within contractual limits?
- How effective is your supplier relationship management?
- Is there someone in the organisation who understands and knows all about your contracts?

The games people play

- What are the contractor reward and incentivisation structures? How do they align with the owner's corporate objectives?
- How many contractors do you have? How confident are you that each of them is properly monitored?
- Are the contract reward mechanisms being triggered?
- How do you know that you do not have supplier pricing arrangements that inadvertently reward delay or inefficiency?
- How visible to the project are sub-contractor risks?
- Could some suppliers have a significant impact on your business (disproportionate to the cost of service) if they fail to deliver and/or to maintain standards?
- To what extent are you absorbing the cost of supplier inefficiencies and mistakes?

We often see project owners include complex incentivisation schemes in their contracts to motivate contractors to perform in a desired fashion. Despite best intentions, such schemes are often counter-productive.

Complexity in such schemes may lead to ambiguity and provide scope for gaming and manipulation of incentives and rewards. This drives behaviour that was not envisaged and which actually works against the owner's objectives. Inconsistent interpretation of reward conditions results in time being wasted in discussions between owner and contractor management – time that should have been spent pursuing a successful outcome to the project.

These issues often multiply where there are multiple staff from each of the owner and the contractor engaged on the management of the contract. Clarity of responsibilities and authority and clear communication paths, preferably with single point responsibility in each party, are important in reducing the risk of significant value erosion.

Complexity can also result in a disconnection between the project and the overall objectives of the owner. Good governance should ensure that incentive schemes connect directly to valid corporate objectives and drive out any elements that do not.

Case Study 1

We reviewed a Maintenance and Service contract for an oil and gas company and discovered that the contractor was not pursuing the incentives offered by the contract - they did not appear to be motivated to work for the additional remuneration. The contractor had found that they were able to extract more value from the contract by charging the day rate for tools and equipment for extended periods, than by completing their work faster to qualify for the incentives.

Case Study 2

An equipment maintenance team was rewarded based on timely completion of individual repair requests. On a call to fix a broken machine, they replaced the broken part with the working part from a neighbouring machine, and closed the repair request. When the call came to fix the second machine, they returned the working part to that machine and closed that request. This cycle could be repeated for as long as was necessary to obtain a replacement part, whilst building an enviable response time record (and earning the associated reward) but with one machine always being out of service.

Budget variances are good

Projects are rarely delivered smoothly to plan. No matter how much experience the project team has, it is unlikely that costs can be estimated and risks provided for accurately from the outset. You should expect to see ups and downs in status reports. If your projects are always reported as on time and to budget, the real issues will almost certainly be hidden.

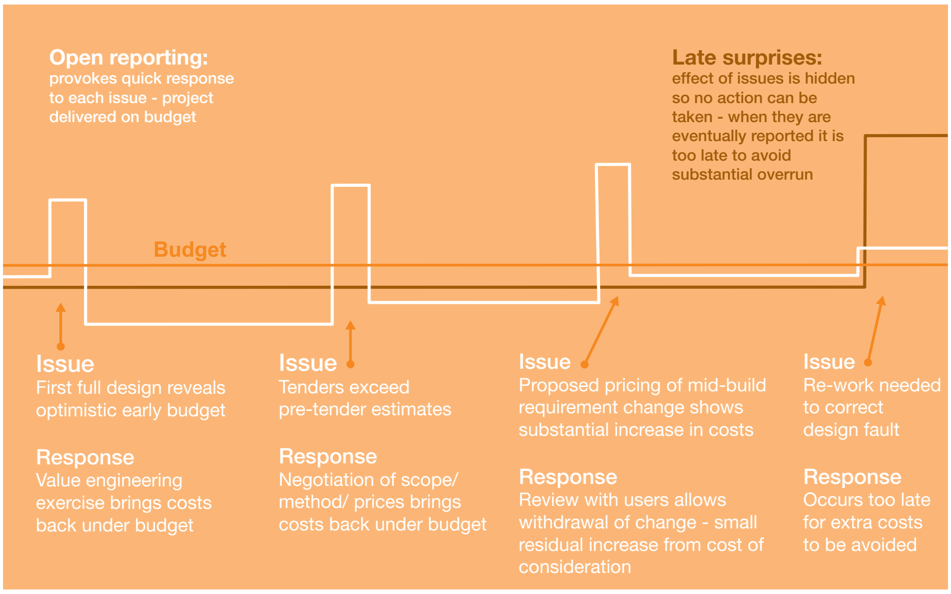
Good governance only operates with open honest reporting of project status, coupled with clarity on what is being done to fix problems, and openness when an adverse outcome is expected or when help is needed. Two aspects of what is often regarded as “good” project management culture are actually unhelpful:

“I always deliver on time and to budget”. Certainty would of course be great, and we all want to be associated with success. But this must also mean that project budgets include contingency for a high proportion of risk – perhaps to 90% confidence (a P90 budget). This can both provide a screen to the real status and increase the likelihood that the P90 contingency will actually be spent on each project, whereas (on average) only P50 should be spent.

“If there are problems, I’ll sort them out quietly.” You might sleep well for now but without open and timely reporting of the real status and issues, how can governance support and engage when needed? If issues emerge late they are likely to be harder to solve and more costly than if they had they been dealt with earlier on.

So, are you over funding your projects and allowing a delivery culture to increase the likelihood of late surprises? If your projects are always on budget, you may be way off the mark - it might be better to have some budget variances.

Projected total cost at completion – over time through the project



- What is the budgeting culture in your organisation?
- How are you encouraging communication of things that go wrong?
- What visibility do you have over the use of contingency?
- How do you ensure consistency of information to support management decisions?
- Can management see the actual project costs at any particular point in time?
- How much value erosion occurs due to poor budgeting?
- How do you monitor the actual costs of the project?
- How much of the budget do you allocate to project management and how much to hold at programme level?
- Is project management incentivised to report the likely outcome early (or to hide problems for as long as possible)?

Case Study

The design for a power plant was subject to owner and regulator review. The design and build contract was based on a single review cycle with a defined timescale for comment. In practice, thousands of comments were made in several cycles over an extended timescale, ultimately delaying design completion and subsequent procurement. Design and project management did not report the delays and the contractor’s project director and the owner did not see the developing problem – they are now in dispute over the substantial delays and extra costs.

It's not me, it's you

- To what extent do you have clear definition of roles, interfaces and responsibilities?
- How well do the project stakeholders communicate with each other?
- What is the process for planning and managing interdependencies?

Projects are complex and the processes required for their delivery typically cut across business functions, different organisations, business units and sometimes geographies. In such a multi-stakeholder environment, functions are not always clear on what the others do, and each function may assume that another is responsible for a particular step or piece of work. Such lack of transparency of the respective responsibilities of each team leads to loss of accountability and control.

In multidisciplinary projects, where there is a degree of internal interdependency, functions may be keen to report their own positive performance and to hold someone else responsible for failures.

The objectives of each function may not coincide with the overall project objectives and the resulting tension often results in wasted time and effort and even re-work and delays to the project.

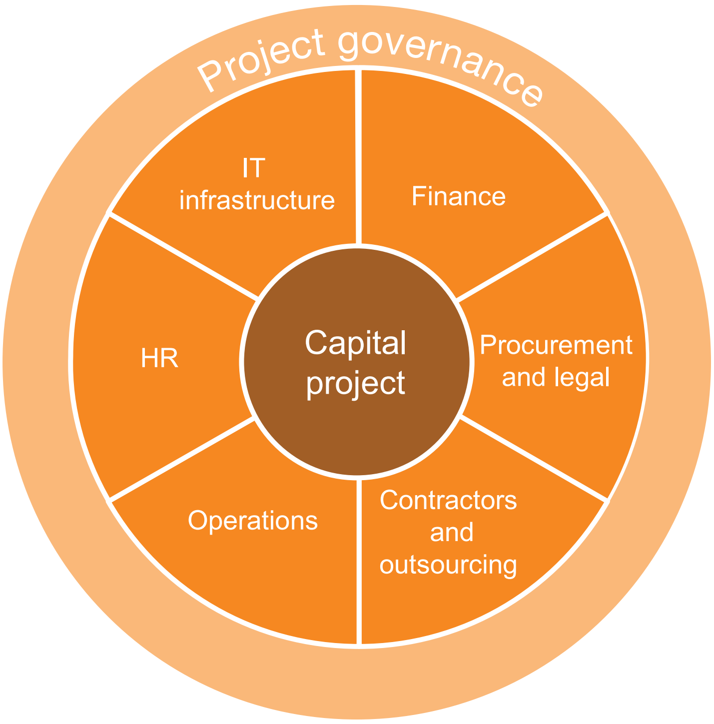
Recognising these realities and working hard to define and agree interfaces and responsibilities is vital to the successful delivery of major projects.

Case Study

An oil company operated two projects on different sites. The Contracts department negotiated one contract with the supplier for servicing both sites, and hence invoices received did not split the costs between the sites.

The projects were financed by separate banks, which required that the costs were split for each site to ensure funding. When this request was put to the supplier, they refused to split the costs between sites in invoices.

The Finance team had to spend weeks splitting the costs, since the invoice narratives were ambiguous as to which site the costs related to, and the supplier insisted on sending invoices in bulk once a quarter. This led to extended times for processing the invoices, delays in payments by the banks and disputes with the supplier.



We like risk

Risk management processes and systems have improved and extensive risk registers and risk matrices are now common place. But the effort required to develop and maintain these registers detracts from the effort actually applied to managing risk. And the focus tends to be just on the downside. Is this the best approach to risk management?

There is a risk (pun intended) that all the effort that goes into creating detailed risk registers means that less attention is paid to the practicalities of mitigating and managing risks, and to implementing sound contingency measures to minimise the impact of risk, should it occur. Only action (not risk registers) will improve the outcome of the project.

Conventionally, risk is regarded as something that, should it occur, would have a negative effect on the project. But what about the upside of uncertainty? In fact, in its Arabic origins, the word "risk" means "to seek prosperity".

Things go wrong but new opportunities can also occur. Personal agendas and a compliance culture often means that the upside of uncertainty are seldom identified and rarely pursued.

It is down to the approach – risk management should be about actively pursuing the upside, as well as mitigating the downside.

Case Study

A Project Manager mitigated the risk of the non-availability of equipment by forward purchasing for a fixed number of days that allowed for bad weather.

Good weather meant that the risk did not transpire, however the opportunity to sell surplus capacity into the open market was missed.

Pursuing the upside of risk

- Does Board/Management have visibility of key upside opportunities?
- What are the critical uncertainties and risks and what are the probabilities of success? How are these managed?
- To what extent have the risk and opportunity matrices for all the functions involved in the project, including action/mitigation plans, been developed and implemented?

How does governance of your capital projects and programmes connect with your corporate governance?

Do you know where and how value is lost?

How do you provide direction to the definition and delivery of the portfolio, programmes and projects?

What happens between major review points?

How could you provide better continuity between review points and sustain the value that your projects should deliver?

Do projects maintain the business value from one review point to the next?

Capital project governance team

The issues raised in this paper represent the views of our Capital Projects team. Please contact anyone from the team to find out more.

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