

Project Governance

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PMG 424

Lecture 01



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Definition of Governance

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Chapter
01

Learning Outcomes

- Defining a project and describing its four main phases.
- Understanding the definition of governance.
- Discussing project governance as a part of organizational governance.
- Clarifying the implications of various governance theories on project management.

What Is a Project?

A Project Is a Temporary Endeavour Undertaken To Create a Unique Product, Service, or Result

- Projects are complex, one-time processes.
- Projects are limited by budget, schedule, and resources.
- Projects are developed to resolve a clear goal or set of goals.
- Projects are customer-focused.

General Project Characteristics

- Projects are ad hoc endeavors with a clear life cycle.
- Projects are building blocks in the design and execution of organizational strategies.
- Projects are responsible for the newest and most improved products, services, and organizational processes.
- Projects provide a philosophy and strategy for the management of change.
- Project management entails crossing functional and organizational boundaries.

General Project Characteristics

- Traditional management functions of planning, organizing, motivation, directing, and controlling apply to project management.
- Principal outcomes of a project are the satisfaction of customer requirements within the constraints of technical, cost, and schedule objectives.
- Projects are terminated upon successful completion of performance objectives.

Project Life Cycle

- A project life cycle refers to the stages in a project's development and are divided into four distinct phases:
- Conceptualization: development of the initial goal and technical specifications of the project; key stakeholders are identified and signed on at this phase.
- Planning: all detailed specifications, schedules, schematics, and plans are developed.
- Execution: the actual “work” of the project is performed.
- Termination: project is transferred to the customer, resources reassigned, project is closed out.

Projects are endeavors through which multiple decisions must be made and various amounts of resources must be carefully allocated; this requires having clear frameworks to govern the relationship between all project stakeholders

The Evolution of Governance

- Interest in governance is growing rapidly.
- Well known scandals made inadequate governance and investor protection a subject of public interest.
- The need to refine existing governance policies and laws, as well as new developments.
- Early disclosure of possible financial risk, including those related to projects.

The Evolution of Governance

- The term is derived from the Latin word *gubernare* meaning 'to steer'.
- While originally describing the government of countries, it is nowadays synonymous with the good and transparent management of firms and institutions.
- Governance is recently denoting 'the conduct of conduct', shaped by self-regulating relationships among the forces within a society.
- This leads to the development of laws and contextual frameworks which shape, but do not necessarily determine every action of the members of a society.

The Evolution of Governance

- The related governance theory was originally found in policy research in political science.
- It has outgrown its initial context and is nowadays applied in different sectors of industry, for example, within construction and IT.
- Governance Theory refers to two main components:
- Actors, with their individual perspectives and meanings, who act within the system, but collectively can regulate or counter-regulate the system.
- Organizations (often in the form of rules), which shape the context within which actors' behaviour occurs.

Organizational Governance

- Governance within organizations is a form of self-regulation where the regulator is part of the system under regulation.
- Organizational governance is ultimately concerned with creating the conditions for ordered rule and collective action.
- Governance, applied at the corporate level, affects projects through its impact on the behavior of people.
- Governance needs to be implemented through a framework that guides managers in their daily work of decision-making and action taking.

Project Governance

- Projects governance implementation is often defined in terms of policies, processes, roles and responsibilities.
- Project governance allows for a smooth integration between organization-wide, general processes and the specific sub-processes related to projects.



What is Governance?

- From the widespread use of the term governance and its application in politics, industry and education, etc., a number of definitions have emerged. However, within the scope of project, program, and portfolio management, the following definition can be adopted:

Governance denotes the values, responsibilities, processes and policies that
allow
projects to achieve organizational objectives and foster implementation that
is in the best interests of all the stakeholders, internal and external, and the
corporation itself

Why Governance?

- Governance provides a framework for ethical decision-making and managerial action within an organization that is based on transparency, accountability and defined roles.
- Governance provides a clear distinction between ownership and control of tasks.
- Governance sets the boundaries for management action, by defining the goals of the organization and how they should be attained.
- Governance determines the processes that managers should use to run their areas of responsibility.

Without a governance structure, an organization runs the risk of conflicts and inconsistencies between the various means of achieving organizational goals, processes and resources, thereby causing costly inefficiencies that impact negatively on both smooth running and bottom-line profitability

Governance Theories

- Shareholder Theory
- Stakeholder Theory
- Transaction Costs Economics (TCE)
- Agency Theory

Shareholder Theory

- Shareholder Theory of governance assumes that the main purpose of an organization is to maximize shareholder return on investment (ROI).
- Develops structures (such as contracts, processes and policies) to assure managerial actions are always in the best interests of shareholders.
- Shareholder Theory sees an organization as the property of its shareholders.
- Managers (including board of directors) are seen as agents of the shareholders.

Principles of Shareholder Theory

- Shareholder Theory, within its pure understanding and conceptualizations, implies that:
- An organizational value system should prioritize the interests of shareholders over those of other stakeholders.
- Narrow focus on quantitative financial results and measures such as return on investment and revenue streams.

Disadvantages of Shareholder Theory

- Difficult to manage a diverse set of stakeholders in alternative governance structures.
- Managers only focus their attention on a single bottom-line result, represented by financial profits.
- Less consideration of qualitative objectives, such as employee well-being, ethical standards and good relationships with the society.
- Lacks focus on customer needs and thus cause organizations to lack direction of their performance goals.

Implications of Shareholder Theory on PM

- Within the lens of this theory, projects are undertaken to add value to the sponsoring organisation, which means increasing the value of shares to the holders of equity in the company.
- Portfolio managers often act in the best interest of shareholders, thus take a shareholder perspective when deciding on whether to select projects.
- Projects can be directed by their commercial feasibility without proper linkage to the real value they create for other stakeholders (customers, team members, societal communities, etc.).

Stakeholder Theory

- Stakeholder Theory takes the wider social responsibility of organizations into account.
- A firm here is seen as a system of stakeholders, which operates within the wider host society, which, in turn, provides the legal and market infrastructure for the firm's activities.
- The purpose of the firm is to create wealth and value for all stakeholders.
- This theory include considering the quality of relationships between internal and external stakeholders.
- It contrasts with companies run under Shareholder Theory which usually focus on short term financial results.

Principles of Stakeholder Theory

- Stakeholder Theory suggests that an organization's objectives should be developed by balancing the conflicting interests and claims of the different stakeholders, such as managers, employees, suppliers and the wider society.
- Stakeholder Theory include traditional financial objectives over an extended period of time, such as five years.
- It insists on corporate social performance measures such as the organization's reputation, the organization's attractiveness as an employer and generation of good-will from the society in which it operates.

Disadvantages of Stakeholder Theory

- The interests of the group are just too broad to realistically manage; you can't please everyone, as the saying goes.
- The needs of some stakeholders will naturally place higher than the interests of others.
- Requires highly sophisticated stakeholder analysis to carefully balance project objectives.

Implications of Stakeholder Theory on PM

- Organizations are at a position that allows defining and selecting their projects for greater balance between shareholders and stakeholders.
- Projects and programs within this spectrum of shareholder to stakeholder perspective, depending on the corporation's governance philosophy.
- Projects are more value oriented through balancing between the objectives of the sponsor and the needs and requirements of other stakeholders.

Transaction Costs Economics

- Transaction Costs Economics (TCE) applies to the early (pre-contract) phases of a project, where the contract type and governance structure of the project are developed.
- TCE originated in economics and can be loosely characterized by the classic *make or buy* decision.
- It is used to justify a decision to make a product internally or to buy it from the open marketplace.

Make or Buy Decision Example

	Make	Buy
Pros	Better control of fit for purpose Maladaptation costs are minimized	Lower prices through economies of scale and price competition in the marketplace
Cons	Higher cost	Adaptation costs higher

Pros and Cons of a Make or Buy Decision

Principles of Transaction Costs Economics

- TCE focuses on the individual transaction which converts input to desired output.
- The make or buy decision is based on a combination of:
- The degree of asset specificity; the extent to which the object of the transaction is specific (or unique) to the individual transaction and can not be redeployed in future transactions.
- The degree of uncertainty which arises from a lack of communication or conscious supply of misleading signals; the uncertainty in human behaviour; and the risk of the undertaking.
- The frequency of the transaction as it was originally developed for routine organizational transactions because they do not require specific governance structure.
- TCE regards a firm as a governance structure, rather than a production function.

Implications of TCE on Organizations

- TCE implies that organizations adapt their governance structures to achieve the lowest possible transaction costs.
- Transaction costs are the economic equivalent to friction in physical systems, stemming from the complexity of the relationship between buyer and seller and the impossibility of developing and agreeing contracts that cover all eventualities in the transaction.
- To economize on transaction costs, TCE proposes that high levels of asset specificity, uncertainty and contract incompleteness lead to make decisions, whereas low levels lead to buy decisions.

Disadvantages of TCE

- TCE is criticized for the crudeness of its primitive models, underdeveloped tradeoffs, severe measurement problems and too many degrees of freedom.
- As a theory developed in marketing, it is frequently used to explain marketing phenomena, such as joint projects between independent firms in a buyer-seller relationship.
- TCE does not properly consider the long term financial and commercial benefits when deciding whether to make or buy.

Implications of TCE on PM

- In projects, TCE explains the need for different governance structures for different projects along the need for different contracts when either buying a product in the market or making it within the organization.
- A fix-price, fix-date delivery contract for a project or components thereof requires different governance and control structures than a time and material or cost reimbursement contract.

Agency Theory

- Agency Theory applies more to the later (post-contract) phases of projects, where information imbalance between Project Owner and Project Manager can create the principal-agent problem.
- These problems are summarized in the two Agency problems, these are:
- Information imbalances between principal and agent during the precontractual phase, when the principal selects and offers a contract to a possible agent.
- Information asymmetries during the post-contractual stage, caused by incomplete information on the side of the principal about the agent's actions while carrying out the assigned task.

Implications of Agency Theory on PM

- The principal-agent problems are equally applicable at the project level, with the project sponsor as principal and the project manager as agent.
- These problems are addressed in projects by:
- Attempting to realign the interests of the project sponsor (principal) and project manager (agent) through effective use of contracts.
- Defining either actual behaviour of project managers (agents) or the outcomes of their tasks.
- Developing contracts to ensure that actions regarded as most appropriate by the project sponsor (principal) yield the highest payoff for the project manager (agent).

Disadvantages of Agency Theory

- Agency Theory takes an inherent investor view only, and assumes that humans are primarily motivated by financial gain.
- The delegation of authority from principal to agent can cause problems because:
- The interests of principal and agent will typically diverge if both are trying to maximize their individual gains or utility in the relationship.
- The principal cannot perfectly and without cost monitor the actions of the agent.
- The principal cannot perfectly and without cost monitor and acquire the information available to or possessed by the agent.

Governance theories must aim to provide a framework through which all project stakeholder priorities are taken into consideration and that their voices are heard in decision-making over the allocation of project development resources

Conclusion

- A project is a temporary endeavor (organization) undertaken to create a unique product, service, or result.
- Projects have four main phases (conceptualization, planning, execution, closing) that require decision-making and resource allocation.
- Projects require having clear frameworks to govern the relationship between all project stakeholders.

Conclusion

- Well known scandals made inadequate governance and investor protection a subject of public interest.
- The term 'governance' is derived from the Latin word gubernare meaning 'to steer'.
- While originally describing the government of countries, it is nowadays synonymous with the good and transparent management of firms and institutions.
- Governance Theory refers to two main components:
 - actors who act within the system, but collectively can regulate or counter-regulate the system;
 - and organizations that shape the context within which actors' behaviour occurs.

Conclusion

- Within the scope of an organization, governance is a form of self-regulation where the regulator is part of the system under regulation.
- Within the scope of project, program, and portfolio management, governance is the values, responsibilities, processes and policies that allow projects to achieve organizational objectives and foster implementation that is in the best interests of all the stakeholders, internal and external, and the corporation itself.

Our Focus Is More on Governance Within the Scope of Project, Program,
and Portfolio Management

Conclusion

- Shareholder Theory is a governance theory implying that an organizational value system should prioritize the interests of shareholders over those of other stakeholders.
- Shareholder Theory also implies that narrow focus on quantitative financial results and measures such as return on investment and revenue streams.
- Stakeholder Theory takes the wider social responsibility of organizations into account.
- Stakeholder Theory suggests that an organization's objectives should be developed by balancing the conflicting interests and claims of the different stakeholders, such as managers, employees, suppliers and the wider society.

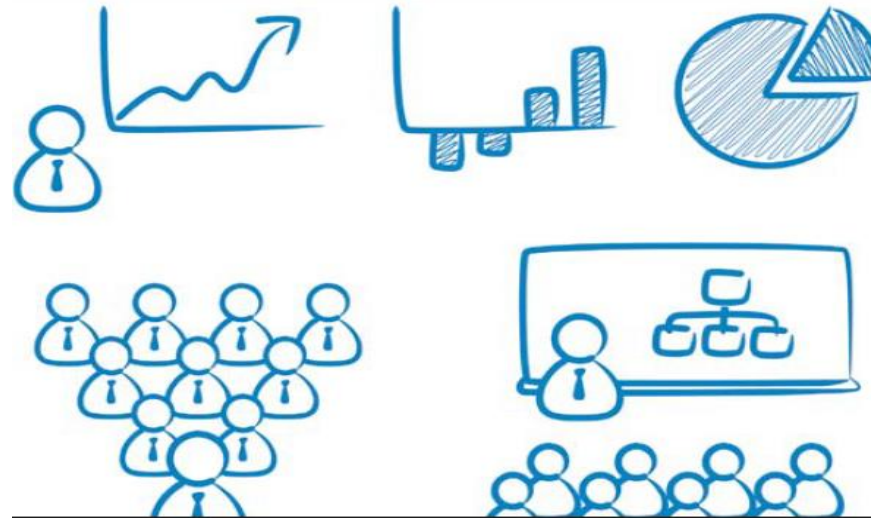
Conclusion

- Transaction Costs Economics (TCE) applies to the early (pre-contract) phases of a project, where the contract type and governance structure of the project are developed.
- TCE is used to justify a decision to make a product internally or to buy it from the open marketplace.
- Agency Theory applies to the later (post-contract) phases of project, where the imbalance of information between the project owner and manager can create a principal-agent problem.
- The principal-agent problems are equally applicable at the project level, with the project sponsor as principal and the project manager as agent.

Reference

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Thank You