

**CFM QUARTERLY
OF FINANCE
OCTOBER, 2012**

A: ARTICLES AND CASES

1. HUMAN ASPECTS OF PROJECT MANAGEMENT

A satisfactory human relations system is essential for the successful execution of a project. Without such a system, the other systems of project management, however sound they may be by themselves, are not likely to work well. While technical problems can often be solved with additional investment of resources, people's problems may not be amenable to a satisfactory solution in the short span of the project life.

To achieve satisfactory human relations in the project setting, the project manager must successfully handle problems and challenges relating to:

- Authority
- Orientation
- Motivation
- Group functioning

Authority Except in the divisional organisation, the project manager, whose activities cut across functional lines of command, lacks the desired formal authority over project-related personnel. Without the conventional leverage of hierarchical authority, the project manager has to coordinate the efforts of various functional groups (within the organisation) and outside agencies. While he often has formal control emanating from contracts and agreements, as far as outside agencies involved in the project work are concerned, in his own organisation he has to contend with split authority and dual subordination.

Since the project manager works largely with professionals and supervisory personnel, the basis of the authority would be different from that found in simple superior-subordinate relationships. For exercising leadership and influence over professional people, he has to explain the logic and rationale for the project activities; show receptivity to the suggestions made by others; avoid unilateral imposition of decisions; eschew dogmatic postures; and search for areas of agreement which can be the basis of acceptable solutions.

His effective authority would stem from his ability to develop a rapport with the project personnel, his skill in resolving conflicts among various people working on the project, his professional reputation and stature, his skills in communication and persuasion, and his ability to act as a buffer between the technical, engineering, financial, and commercial people involved in the project.

Orientation Most of the managers working for a project are usually engineers (or

technologists). Typically, an engineer:

- Works with physical laws, characterised by mathematical precision, as his tools.
- adopts a structured, mechanical approach to his problems.
- seeks an enduring solution to his problem.
- attaches a high value on technical perfection.

When an engineer assumes managerial responsibilities, he faces a very different world in which he is supposed to:

- Perform the tasks of planning, organising, directing, and controlling the resources of the firm in a world of uncertainty.
- Adopt a more creative approach to solve non-programmed and unstructured problems.
- Attach greater importance to efficient utilisation of resources and resolution of human relation problems.

Thus the project manager has to strengthen the managerial orientation of project personnel so that the project goals and objectives can be efficiently achieved within the constraints of time and budget. Clearly for achieving this task he must himself be an accomplished engineer–manager.

Motivation The project manager functions within the boundaries of a socio-technical system. Most of the factors of this system—organisational structure, technical requirements, competencies of project personnel—are more or less ‘given’ for him. The principal behavioural factor which he can influence is the motivation of the project personnel. In this context, he should bear in mind the following:

- Human beings are motivated by a variety of needs: physiological needs, social needs, recognition needs, and self-actualization needs. Individuals differ greatly in the importance they attach to various need satisfactions. Further, their attitudes tend to change with time and circumstances, and are significantly influenced by their peers and superiors.
- The traditional approach to management was based on the assumption that human beings regard work as unpleasant, shirk responsibility, and ordinarily employ inefficient and wasteful methods. Such a conception of human behaviour suggests that a great deal of pressure has to be applied. Behavioural research, however, has shown that while some pressure is beneficial, an excess of it is undesirable. Beyond a certain point, pressure is dysfunctional.
- Motivation tends to be strong when the goal set is challenging, yet attainable. If the goal is too demanding, it results in frustration and conflict; if too lax, it induces complacency.
- Expectation of reward, rather than fear of punishment, has a greater bearing on individual behaviour. Further, the effectiveness of reward or punishment depends

on how quickly it is administered.

- In a project setting where hygiene factors (like pay, physical working conditions, etc.) are reasonably taken care of, the principal motivators would be a sense of accomplishment and professional growth. In this setting, the project manager should rely more on participative methods of management.

In order to succeed in motivating project personnel, the project manager must be a perceptive observer of human beings, must have the ability to appreciate the variable needs of human beings, must have skill in several styles of management suitable to different situations, and must be sensitive to the reactions of people so that he can act supportively rather than threateningly.

Understandably, the project manager has a difficult task. In this endeavour, he can, however, count on one blessing: the stimulating and satisfying nature of project work. In established organisations many professional and supervisory personnel find it difficult to see how their efforts redound to the realisation of organisational goals. Separated from top management by several layers of organisational hierarchy, they may not be able to relate their work meaningfully to the missions of the firm (which themselves often may be blurred to them). In addition, the jobs in established organisations are somewhat dull and routine. All this creates a sense of alienation and frustration which dampens motivation. Fortunately, in a project setting, where the superordinate goals are clearly defined and visible to all involved, where there is usually a great emphasis on participative style of management, where the layers in the organisational hierarchy are few, and where the jobs are more challenging, project personnel tend to have greater commitment. Being able to relate their work easily to the goals of the project, their motivation is usually high.

Group Functioning In a large complex project, many persons drawn from different functions, departments, and organisations are involved. This leads to formation of groups, formal and informal. According to Rensis Likert, organisations may be considered as systems of interlocking groups. Thus, in a typical project organisation, many interlocking and interdependent groups are formed.

The groups formed in a project setting may be of three types: vertical groups, horizontal groups, and mixed groups. A vertical group consists of people drawn from different levels in the same department, or function, or company. A horizontal group consists of people drawn from different functions, departments, and companies, but occupying similar hierarchical positions. A mixed group consists of people drawn from different levels from various functions, departments, and companies.

A vertical group tends to form most naturally because of departmental/functional/organisational affinities. However, the existence of such groups may lead to a pronounced “we/they” attitude and accentuate conflicts. A horizontal group is a useful instrument in linking the overall project organisation. The members of the horizontal group, occupying key positions in their respective fields, serve as channels of communication. By their influence, they can strengthen the

commitment to the project. The mixed group tends to promote greater cohesion of the total project organisation. It is very conducive to creating a 'project' attitude and developing an overriding commitment for the project. Hence the project manager should strive to establish a mixed group as the principal group of the project. However, it is difficult to establish such a group because of the temporary nature of a project—when members of a group know that the group would be dissolved sooner or later, they retain strong links with their parent company or department.

Building Effective Groups An effective group consists of members who are satisfied and committed and who strive for the attainment of project objectives, without dissipating their energies in inter-personal and inter-group conflicts. The manifest signs of an effective group are: esprit de corps, pride in the project, supportive behaviour, coordinated endeavour, mutual respect, and resilience during trying periods. An ineffective group, on the other hand, consists of disgruntled members who are more involved in inter-personal and inter-group rivalries and less concerned about project goals. Such a group is characterised by apathy, animosity, mutual bickering, disjointed efforts, cynical attitudes, and low morale.

How can effective groups be established? Studies in group dynamics suggest several stages, which are partially overlapping, in the formation of an effective group:

- Development of mutual trust
- Diminution of defensive behaviour
- Openness and candour in communication
- Cooperation and supportive behaviour
- Resolution of differences by mutual negotiation

For building an effective group, the firm must pursue a genuinely participative style of management. With this managerial philosophy, the project manager can facilitate the development of mutual trust and acceptance, open communication, cooperation, and project attitude. In this task, he needs leadership capabilities, sensitivity to human nature, perceptiveness, concern for welfare of others, maturity, and impartial approach. Clearly this is a difficult and challenging task.

2. PORTRAIT OF THE INDIVIDUAL INVESTOR

It is part of Wall Street folklore that small individual investors are 'dumb.' Behavioural research too paints a 'sorry picture.' It suggests four classes of weaknesses characterising individual investor behaviour.

Perception of Price Movements People tend to:

- Spot trends and see patterns where none exist.
- Naively extrapolate recent behaviour on the future
- Perceive likely variation in equity returns to be too narrow.
- Be overconfident of their prediction because they anchor too much on their most likely forecast.

Perception Of Value Most individuals

- Do not have an adequate understanding of or ability to use the valuation techniques recommended in finance texts.
- Perceive value on the basis of popular models or mental frames that are socially shared through stories in the news media
- Cannot distinguish good stocks from good companies.

The basic problem is that too many people have a short-term orientation and judge a book by its cover

Managing Risk and Return People do not manage their risk and return optimally. This is manifested in the following

Many households are under-diversified, ignoring the important lesson of modern portfolio that 'diversification pays.'

- The idea that risk is defined at the portfolio level - and not at the level of individual assets - and that risk depends on covariation between returns is alien to many investors.
- Many people believe that after committing their funds they can manage risk through knowledge and trading skills.
- Most households over - invest in riskless assets, foregoing the attractive long -term returns offered by stocks. When confronted with price volatility, they act myopically Prospect theory explains this puzzle.

These anomalies led Shefrin and Statman to propose a new behavioural theory of portfolio. According to this theory, the portfolio is built in a 'pyramidal mode,' with multiple layers of investment that are segmented. The bottom layers of the pyramid (cash, fixed deposits, provident fund) are meant to guarantee financial survival and the upper layers (stocks, options, and so on) offer upside potential with attendant volatility. Risk is managed by matching different assets to different investment objectives. The covariation of returns between different asset categories and individual securities is largely ignored.

Trading Practices Seasoned traders use a variety of rules and precommitment techniques, such as stop-loss order, to control emotion and discipline themselves.

Most individuals, however, lack such discipline. They trade shares on impulse or on random tips from acquaintances, without prior planning. Their trading sentiment trails the market: they tend to buy when the market rises and sell when the market falls. Such trading mistakes suggest that people are in justifiably optimistic about almost everything that concerns their personal lives.

3. EVALUATING A STRATEGY FOR ITS VALUE CREATION POTENTIAL

Every strategy must be assessed in terms of its contribution to shareholder value. A symbiotic relationship exists between strategy formulation and strategy valuation. Strategies have a bearing on shareholder value and shareholder value as a corporate objective guides the search for and selection of strategies. Strategies typically require substantial investments that can be justified, in the final analysis, only in terms of their contribution to shareholder value. Put differently, the strategy formulation process searches for strategies that may create value, while shareholder value is the yardstick by which the optimal strategies should be selected.

There seems to be no shortage of books that promise substantial improvement in performance to those who implement the strategy advocated by the author. Almost every author argues that the strategies recommended by him would result in favourable competitive outcomes, but hardly any one demonstrates why they should significantly enhance shareholder value. Perhaps some authors would argue that their prescriptions are so worthwhile that doing shareholder value analysis is redundant. However, this cannot be taken for granted and it is necessary to quantify the impact on shareholder value. As Al Rappaport says: "Unfortunately as I can attest even after three decades of experience, the value creation consequences of strategies are sometime not so obvious: as one may initially believe. The lesson is clear; it's best to run the numbers."

Here are some conspicuous examples:

- In their bestselling work *Reengineering the Corporation: A Manifesto for Business Revolution*, Michael Hammer and James Champy advocate business process reengineering. Business Process Reengineering is a technique to help organisations rethink how they do their work to improve customer service, cut

operational costs, and gain competitive edge. It involves redesigning the way work is done to better support organisation's mission and pare costs.

- In their immensely popular book *Competing for the Future*, Gary Hamel and C. K. Prahalad make a spirited case for investing aggressively in building competencies. As the authors say: "What is needed for a strategic architecture that provides the blueprint for building competencies needed to dominate future markets".
- In a yet another best seller, *The Discipline of Market Leaders* Michael Treacy and Fred Wiersema emphasise customer value.

There are encouraging signs of books that integrate strategy formulation and strategy valuation. For example, Adrian J. Slyworksy's book *Value Migration* (HBIS Press, 1996) links superior business designs to shifts in stock market values among companies in a industry. Another example is Alan s. Cleland and Albert V Bruna's book *The Market Value Process* (San Francisco: Jossey Bass, 1996) which discusses explicitly the linkage between strategies aimed at increasing customer value and shareholder value contributions.

B. SNIPPETS

1. Some Observations on the Stock Market

On the basis of my observation of the stock market for about four decades it appears to me that:

1. More often than not reports rationalise what has happened by saying that the economic event-GDP growth rate, interest rate change, and so on-was more or less in line with market expectation.
2. It is unrealistic to assume that there is a stable cause-effect relationship between economic events and stock price movement.
3. It is pointless to look for 'news' behind every stock market move.
4. Expectations influence stock price changes as much as changes in stock prices influence expectations (This is George Soros' famous reflexivity principle)

2. Financial Inclusion

I have come across many people who consider investing in equity as akin to speculation and write off the contribution that equity investing can make to economic development. This myth has to be dispelled. Financial inclusion is a much- talked about concept these days. But many people have not understood its scope properly. For them financial inclusion means extending banking facility for everyone. Some go beyond banking to include insurance. But meaningful financial inclusion must involve mass participation in equities as well.

As an asset class, equities have provided attractive returns compared to bank deposits. Unfortunately, equities have been shunned by the average small investor. As a result, the bulk of the prosperity and wealth created by massive increase in market capitalisation has been enjoyed by promoters, foreign institutional investors, and equity-savvy high net worth individuals (HNIs). It is a pity that hardly 4 percent of the savings of Indian households gets invested in equities.

3. Major Developments in Investment Management

The classical approach to investment management is a top-down approach that starts with strategic asset allocation (SAA), in which strategic long-term decisions are made about how to allocate assets based on estimates of future returns, risks, and correlations.

1. **Global Tactical Asset Allocation (GTAA)** This involves over-or under-weighting of various asset classes in response to perceived short-to- medium- term opportunities.
2. **Global Dynamic Asset Allocation (GDAA)** This involves over-or-under-weighting of various asset classes to take advantage of long-term opportunities. GDAA works with long-term forecasts exploiting such process as mean reversion. It is typically performed with such techniques as stochastic programming .Both GTAA and GDAA are dynamic insofar as asset allocation decisions are revised in response to changes in market conditions; the fundamental distinction is the time horizon.
3. **Expansion of the Universe of Investable Asset Classes** The traditional asset classes are stocks, bonds, cash, and real estate. To this mix, other asset classes are added, such as currencies, natural resources, precious metals, private equity, infrastructure, and even such intangibles as IPRs. All asset classes except stocks, bonds , and cash are commonly called alternatives.

4. Premortem

People prefer harmony over conflict. This leads to social biases like groupthink and sunflower management. Group think involves striving for consensus at the expense of a realistic evaluation of alternatives. Sunflower management is the tendency for groups to align with the opinions of their leaders.

Thanks to these social biases, people do not express their reservations candidly and forcefully. They do not want to disrupt harmony by trying to surface potential problems. As a result, an objective and balanced appraisal of decision alternatives is compromised.

How can people be encouraged to express contrary views freely? Psychologist Gary Kleen suggests the use of the premortem technique. It is a sneaky way to get to motivate people to serve as a devil's advocate without encountering resistance. If a project turns sour, some lessons will be learned about why the project failed and what went wrong as in the case of a medical postmortem. Why don't we invert the process? Before the project starts, someone should say, "We have a crystal ball that can predict the future. Our crystal ball says that the project has failed. It has been a fiasco. Now everyone should take few minutes and write down all the reasons why he thinks the project failed." This will encourage people to think of insightful reasons why this project might fail. There will be an interesting competition among people to come up with potential problems that others many have overlooked. The entire dynamics would change. Instead of avoiding things that might disrupt harmony, people will try to surface potential problems.

Daniel Kahneman regards premortem as a great idea. He says "My guess is that, in general, doing a premortem on a plan that is about to be adopted won't cause it to be abandoned. But it will probably be tweaked in ways that everybody will recognize as beneficial. So the premortem is a low-cost, high-pay off kind of thing."

Part C: WIT AND WISDOM

1. Humour

- A senior businessman was educating his son. He said, "Integrity and Wisdom are the keys to business success." He continued, "By integrity I mean that when you promise the delivery of merchandise on a certain day you must do so even if it bankrupts you." The son asked, "Well, what is wisdom?" The father replied, "Don't make such promises"
- A mechanical engineering course had a text book on various machining process. Each chapter described a machining operation. So chapter titles were "Milling," "Drilling," and so on. According to the seniors, however, the entire course was summed up by Chapter 21 which was titled "Boring."

2. Wise Saws

Pascal: "The mind of man at one and the same time is both the glory and the shame of the universe." *Einstein* "Not everything that counts can be counted and not everything that can be counted counts."

3. Perspective

Most ethical philosophies have sought to isolate and standardize the goods of life and to make one or another set of purposes supreme. They have looked upon pleasure or

social efficiency or duty or imperturbability or rationality or self-annihilation as the chief crown of a disciplined and cultivated spirit. This effort to whittle down valuable conduct to a single set of principles and ideal end does not do justice to the nature of life, with its paradoxes, its complicated processes, its internal conflicts, its sometimes irresolvable dilemmas. In order to reduce life to a single clear intellectually consistent pattern, a system tends to neglect the varied factors that belong to life by reason of its complex organic needs and its ever-developing purposes. This accounts for a general failure in every rigorously formulated system to meet all of life's diverse and contradictory occasions. Modernman, committed to the ideology of machine has succeeded in creating a lop-sided world which favours certain aspects of personality that were long suppressed but which equally suppress whatever does not fit into its predominantly mechanical mold. *Lewis Mumford*.