

Case Study

Project Selection at Nova Western, Inc.

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Phyllis Henry, vice president of new product development, sat at her desk, trying to make sense of the latest new project proposals she had just received from her staff. Nova Western, Inc., a large developer of business software and application programs, had been experiencing a downturn in operating revenues over the past three quarters. The senior management team was feeling pressure from the board of directors to take steps to correct this downward drift in revenues and profitability. Their consensus opinion was that Nova Western needed some new product ideas, and fast.

The report Phyllis was reading contained the results of a project screening conducted by two independent groups within the new product development department. After several weeks of analysis, it appeared that two top contenders had emerged as the optimal new project opportunities. One project, code-named Janus, was championed by the head of software development. The other project idea, Gemini, had the support of the business applications organization. Phyllis's original charge to her staff was to prepare an evaluation of both projects in order to decide which one Nova Western should support. Because of budget restrictions, there was no way that both projects could be funded.

The first evaluation team used a scoring model, based on the key strategic categories at Nova Western, to evaluate the two projects. The categories they employed were: (1) strategic fit, (2) probability of technical success, (3) financial risk, (4) potential profit, and (5) strategic leverage (ability of the project to employ and enhance company resources and technical capabilities). Using these categories, the team evaluated the two projects as shown here. Scores were based on: 1 = low, 2 = medium, and 3 = high.

Project Janus

Category	Importance	Score	Weighted Score
1. Strategic Fit	3	2	6
2. Probability of technical success	2	2	4
3. Financial risk	2	1	2
4. Potential profit	3	3	9
5. Strategic leverage	1	1	1
			Score = 22

Project Gemini

Category	Importance	Score	Weighted Score
1. Strategic Fit	3	3	9
2. Probability of technical success	2	2	4
3. Financial risk	2	2	4
4. Potential profit	3	3	9
5. Strategic leverage	1	2	2
			Score = 28

The above results seem to suggest that Project Gemini is the choice for the next new project. However, Phyllis was also presented with an NPV analysis of the two projects by her second team of evaluators. Assuming a required rate of return of 15% and anticipated inflation

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rate of 3% over the lives of the two projects, their findings are shown as follows:

Project Janus

Initial investment = \$250,000

Life of the project = 5 years

Anticipated stream of future cash flows:

Year 1 = \$50,000

Year 2 = 100,000

Year 3 = 100,000

Year 4 = 200,000

Year 5 = 75,000

Calculated NPV = \$60,995

Project Gemini

Initial investment = \$400,000

Life of the project = 3 years

Anticipated stream of future cash flows:

Year 1 = 75,000

Year 2 = 250,000

Year 3 = 300,000

Calculated NPV = \$25,695

The analyses of the two projects by different means had yielded different findings. The scoring model indicated that Project Gemini was the best alternative, and the financial screening favored the higher project NPV of Project Janus. Phyllis was due to present her recommendations to the full top management team this afternoon, seemingly armed with more questions than answers.

Questions for Discussion

1. Phyllis has called you into her office to help her make sense of the contradictions in project evaluation. How would you explain the reasons for this divergence of opinion from one technique to the next? What are the strengths and weaknesses of each screening method?
2. Choose the project that you feel, based on the above analysis, Nova Western should select. Defend your choice.
3. What does the above case suggest to you about the use of project selection methods in organizations? How would you resolve the contradictions found in this example?