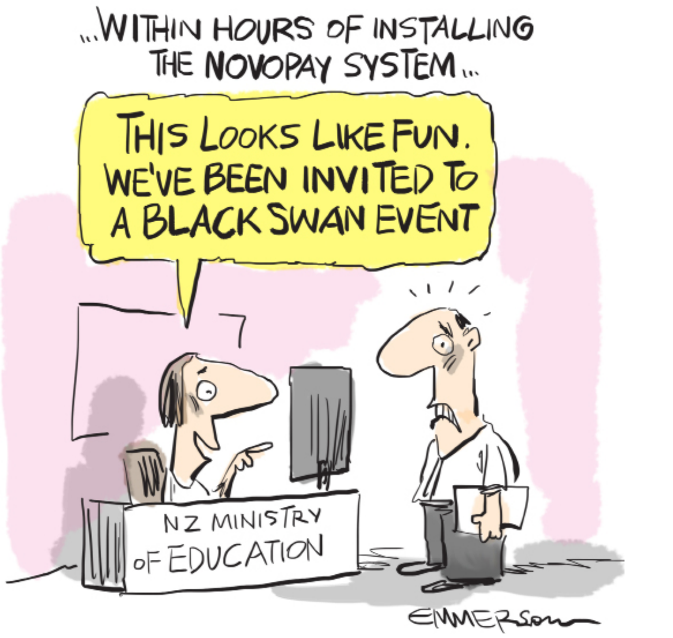
Optimising and attacking ICT and online contract terms: Part 1

Speed read

In this series of articles over May and June, we overview some of the issues that we addressed at the New Zealand Law Society's May 2015 IT and Online Law Conference.

Part 1 focuses on why getting B2B ICT contracts right is important. We discuss how McKinsey's use of Nassim Nicholas Taleb's 'Black Swan' idea applies to ICT contracts and projects.



May 2015

The Detail

Why does this matter?

As contract risk goes, the odds of parties having to rely on ICT contracts are significantly higher than in other businesses, upping the need to get them right. These really are contracts that emerge from the bottom drawer. For example, McKinseys has said that:[1]

> *On average, large IT projects run 45 percent over budget and 7 percent over time, while delivering 56 percent less value than predicted... Staggering as these findings are, most companies survive the pain and cost of schedule overruns. However, 17 percent of IT projects go so bad that they can threaten the very existence of the company. These unpredictable high-impact events – "black swans" in popular risk parlance – occur significantly more often than would be expected under a normal distribution.*

McKinsey's use of Nassim Nicholas Taleb's Black Swan applies well to ICT contracts and projects, as outlined in an HBR article "Why your IT project may be riskier than you think" . The authors noted that, following a review of 1,400 IT projects:

> *A $5 million project that leads to an almost $200 million loss is a classic "black swan." The term was coined by our colleague Nassim Nicholas Taleb to describe high-impact events that are rare and unpredictable but in retrospect seem not so improbable. Indeed, what happened at Levi Strauss [a major IT project failure] occurs all too often, and on a much larger scale. IT projects are now so big, and they touch so many aspects of an organization, that they pose a singular new risk....*
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> *When we broke down the [1400] projects' cost overruns, what we found surprised us. The average overrun was 27%—but that figure masks a far more*

alarming one. Graphing the projects' budget overruns reveals a "fat tail"—a large number of gigantic overages. Fully one in six of the projects we studied was a black swan, with a cost overrun of 200%, on average, and a schedule overrun of almost 70%. This highlights the true pitfall of IT change initiatives: It's not that they're particularly prone to high cost overruns on average, as management consultants and academic studies have previously suggested. It's that an unusually large proportion of them incur massive overages—that is, there are a disproportionate number of black swans. By focusing on averages instead of the more damaging outliers, most managers and consultants have been missing the real problem.

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1. Michael Bloch "Delivering large-scale IT projects on time, on budget, and on value" (October 2012) McKinsey & Company.

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