

Project Cost Overrun

Causes, Consequences, and Investment Decisions

Cost overrun is common in public- and private-sector projects. Costs tend to grow, plans fail, and financial problems follow, but how can we approve the right projects if we cannot estimate their true cost? This book, for academics in project management, management accounting, and corporate finance, as well as for managers in the public and private sectors, offers a new way of thinking about the causes and consequences of cost overrun for firms and society. It demonstrates that there is a logic behind cost growth and overrun, identifies projects and situations that are more vulnerable, and examines the effects of increased costs. It further identifies the negative and positive consequences of cost overrun, analyses how and why preconditions for cost overrun differ when the logic governing private firms dominates versus the logic of the political sector, and explains why cost can sometimes be of lesser importance to decision makers.

Esbjörn Segelod is Professor in Business Administration at Mälardalen University, and was previously at Gothenburg and Uppsala Universities. Most of his research has focused on the appraisals, assessments, and processes associated with investments in major firms, entrepreneurship, the economic aspects of software development, and accounting history. He has previously published nine books, three as editor.

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Acknowledgements

My interest in cost overrun, and its causes and consequences, derived from an interest in corporate finance and cost–benefit analysis, as well as the observation that textbooks and articles on these subjects disregarded the problem of estimating the costs and revenues needed to make the calculations proven theoretically correct. The figures and the probabilities, when such were used, put into our calculations were assumed to be correct, although they were seldom based on reviews of implemented investments. We did not seem to learn from experience, which made the link between theory and practice weak.

An opportunity to research the area opened up in 1982 when I, as part of a larger research programme designed by Göran Bergendahl and Lennart Hjalmarsson, received the assignment of finding out the true cost, in real monetary value, of two nuclear power reactors at Barsebäck, which the owner, and funder of the research programme, the South Swedish Power Company, had constructed. It turned out to be time-consuming work due to all the calculations that had to be made, but it offered the opportunity for very informative discussions with former project managers, and the power company later asked me to review two more of their major investments in new power plants.

These experiences led me to apply for funding to study investment planning and deviations in major construction projects in both the private and public sectors, which were reported in my doctoral dissertation and book published in 1986. Having defended my dissertation, I left the cost overrun area and devoted my research time to other issues. Most important to the present book are three other empirical studies of investments in industry. The first was a study of the way some major ventures in new areas had been initiated and implemented, the second a study of investments and investment processes in major industrial groups, and the third a similar study of intangible investments and investment processes in major service groups.

In 1979–80 Göran Bergendahl and I had had an assignment for a government committee on the organization and finance of nuclear

x Acknowledgements

waste to propose a system for its financing. The committee resulted in the creation of the Swedish Nuclear Waste Fund, an organization for which I would undertake a few assignments in the years to come. It was probably these earlier experiences that, in 2003, led Per-Anders Bergendahl and Peter Rosén to ask me to review the cost development for the nuclear waste programme on behalf of a new government committee on the financing of nuclear waste. This gave me a reason to review the literature on cost overrun published since I left the area in 1986. To my disappointment, I observed that there had been a great number of new publications and studies in the area, but many of them were just replications, often without reference to similar earlier studies. Surprisingly few radically new ideas had been advanced, and it was still a fragmented area of research. This made me think: It seems time to summarize what we know about cost overrun, its causes, and its consequences, before embarking on any major new study of the subject matter.

Later, when time permitted, this allowed me to sketch out a book summarizing what research has taught us about cost overrun, its causes, and the consequences to firms and society. It led to an application for funding to Ragnar Söderberg's Foundation, without whose generous financial support the book would never have been written.

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