

Fortune 1000 IT investments are riskier than capital investments, says management insights

A study of Fortune 1000 companies shows that investments in information technology carry higher risk than other capital investments, according to the Management Insights feature in the current issue of *Management Science*, the flagship journal of the Institute for Operations Research and the Management Sciences.

Management Insights, a regular feature of the journal, is a digest of important research in business, management, operations research, and management science. It appears in every issue of the monthly journal.

“Investigating the Risk–Return Relationship of Information Technology Investment: Firm-Level Empirical Analysis” is by Sanjeev Dewan, Charles Shi, and Vijay Gurbaxani of the University of California at Irvine.

Investment decisions are guided by both expected returns and incremental risks, the authors note. Yet, outside of anecdotal evidence, very little is known about the riskiness of information technology (IT) investments, which make up an increasingly dominant component of firms’ capital asset portfolios. This paper attempts to fill this gap by analyzing a large-scale data set of IT capital spending by Fortune 1000 companies.

The authors find that IT investments are substantially riskier than ordinary capital investments, and that IT risk is associated with a substantial risk premium. This risk premium is driven in part by the lost option value of making irreversible capital investment decisions.

A key implication of the findings is that managers should apply a substantially higher discount rate when evaluating IT investments relative to other types of less risky capital investments. Furthermore, the results suggest that the timing of IT capital investment is a critical factor in managing both the risks and returns of IT investments.

Source: Institute for Operations Research and the Management Sciences

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