This book is a joint publication by SITDRAC (Singapore IT Dispute Resolution Advisory Committee) and Butterworths Asia. This publication is the first of its kind and it aims to assist professionals involved in the IT industry to manage and resolve disputes arising from technology transactions. It is also useful reading for anyone who wants to obtain a better understanding of IT disputes and the methods available for resolving them.
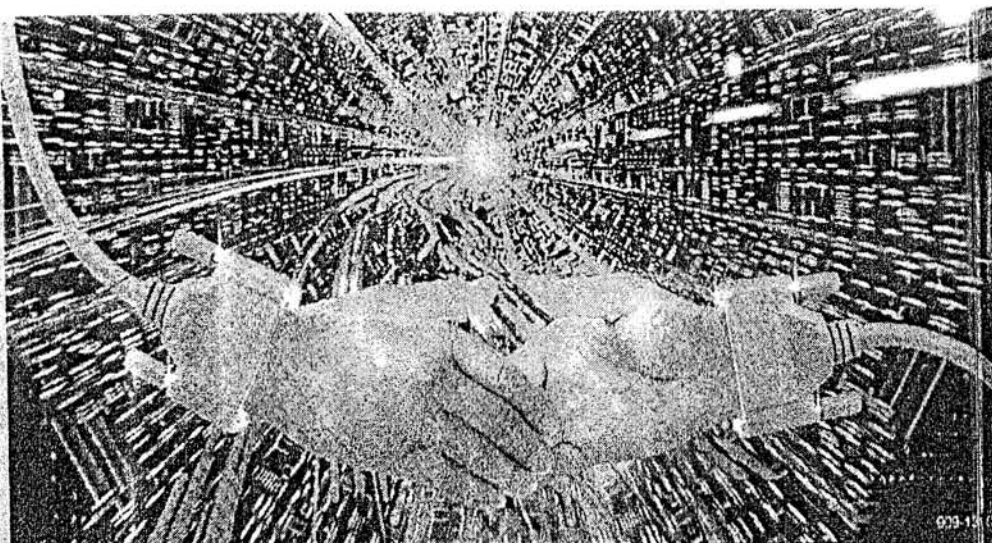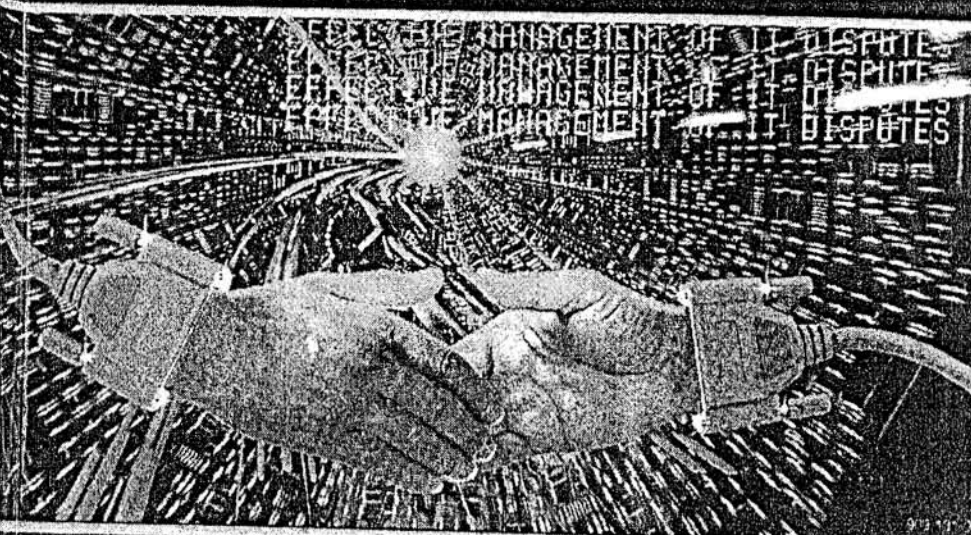
Written by leaders in the IT and legal communities in Singapore, it covers:

* an overview of why and how IT disputes arise and provides a dispute resolution model;
* psychological contracting and how IT disputes can be avoided;
* legal aspects of IT contracts from both private and public sector perspectives;
* effective resolution through mediation and arbitration; and
* a historical summary of the Y2K issue.

EFFECTIVE MANAGEMENT OF I.T. DISPUTES

Foreword by the Honourable Chief Justice Yong Pung How

Willie Cheng
Lim Kien Thye
Jeffrey Chan
Ang Soon & Christine Koh
Phang Hsiao Chung
Ang Yong Tong
Edna Reid
Lo Yoong Khong

SITDRAC
SINGAPORE IT DISPUTE RESOLUTION ADVISORY COMMITTEE

Butterworths

Effective Management of IT Disputes

Willie Cheng
Lim Kien Thye
Jeffrey Chan
Ang Soon & Christine Koh
Phang Hsiao Chung
Ang Yong Tong
Edna Reid
Lo Yoong Khong

Chapter 4

Psychological Contracting in IT Contracts

Ang Soon and Christine Koh

Singapore is increasingly moving towards an information society. Organisations are becoming more IT intensive, and IT pervades almost every function of an organisation. Given the wide array of IT products and services, one can hardly avoid getting into contracts with IT vendors and service providers.

However, as in any form of contracting relationship, disputes between clients and vendors can and will arise. The unique characteristics of the IT industry (see Chapter 1 for a discussion of these characteristics: differing orientation, hype, bugs, project overruns, and changing requirements) make disputes even more likely to occur. Whether you are a client or an IT vendor, it is important that you pay special attention to managing your IT contracts. In this chapter, we will introduce the idea of psychological contracting and discuss some of the areas that we must focus on and manage effectively.

PSYCHOLOGICAL CONTRACT v LEGAL CONTRACT

Like it or not, the written legal contract is the main document that will stand up in a court of law. Drafting a carefully designed legal contract is very important because you have to rely on it to protect your legal rights. Chapter 2 discusses some of the issues that you should consider and incorporate into your legal contract.

However, we must also realise that in common business practice, we can never predict and spell out everything in a legal contract. Businesses and technologies change too rapidly for contracts to provide for every possible contingency. It is not unusual to be faced with a situation where, after a contract has been signed, circumstances change so drastically that everything one has

39

carefully planned for is no longer applicable. If we rely too much on the detailed terms and conditions in a legal contract, there is a great likelihood of the working relationship with our contractual partner becoming very strained. We would then end up following the letter, but violating the underlying spirit, of the contract.

To get into the spirit of the contract, it is very important that we look beyond the legal contract to what we term the 'psychological contract'. According to Professor Denise Rousseau from Carnegie Mellon University, a psychological contract refers to one's *mental beliefs and expectations about the mutual obligations in a contractual relationship.* Unlike a legal contract, where expectations are explicitly laid out, a psychological contract refers to those expectations each contracting party has implicitly in their minds about what the other party should do to fulfill the contract. When such 'mental' expectations are not met, a psychological breach occurs, leading to contractual disputes. In order to reduce the potential for subsequent conflicts, it is important that we negotiate and make explicit these expectations in the contract. Only then can we effectively manage the contract to ensure that these expectations are met.

Therefore, before entering into any IT contract with your client or vendor, you must understand what they expect of you and what you want from them. Unless we know what our mutual obligations are, misunderstandings are bound to arise and disagreements will inevitably surface.

Mutual Expectations

In 1998, in a study commissioned by the Singapore IT Dispute Resolution Advisory Committee (SITDRAC), major IT vendors and clients in Singapore were interviewed and the elements of the psychological contract, or kinds of 'implicit' expectations that clients and vendors have of each other in an IT contract, were identified. Tables 1 and 2 below show these expectations. It would be beneficial to examine each of these expectations and assess how well these obligations have been met in each contractual relationship.

Table 1 — Vendor Psychological Contract:
What your vendor expects of you as a client

Client obligations	As a client, your vendor expects you to:
1 Project specifications	• define the requirements and specifications clearly
2 Fair compensation	• pay competitive prices instead of accepting the lowest bid, and be flexible to accept price changes
3 Prompt payment	• make payment promptly at predefined milestones
4 Client staffing	• assign high quality staff with experience, the requisite skills and good work attitude to the project
5 Client staff turnover	• maintain minimal staff turnover during the project
6 Client leadership	• own the project and provide strong leadership, support and commitment
7 Client responsiveness	• respond promptly and beyond the call of duty to vendor's requests
8 Project monitoring	• attend project meetings and discussions regularly
9 Relationship building	• work as a team and build good working relationship with vendor
10 Knowledge transfer	• provide the necessary information to vendor and transfer business know-how to vendor

Table 2 — Client Psychological Contract:
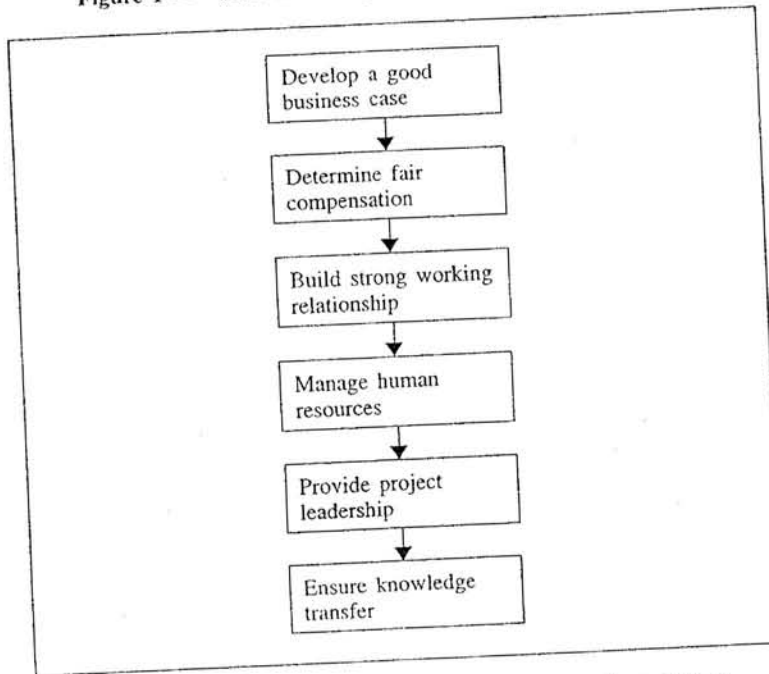### What your client expects of you as a vendor

Vendor obligations	As a vendor, your client expects you to:
1 Project scoping	• estimate project scope accurately and accept changes in scope
2 Soft deliverables	• deliver a 'total solution' including training, documentation, communication and implementation plans
3 Project pricing	• charge a fair and competitive price for the product or service
4 Vendor staffing	• assign high quality vendor staff with experience, the requisite skills and good work attitude
5 Vendor staff turnover	• maintain minimal staff turnover during the project
6 Vendor initiative	• complete the job and solve problems independently, with minimal client involvement
7 Vendor responsiveness	• respond promptly and beyond the call of duty to client's requests
8 Project feedback	• conduct regular project meetings to provide feedback to client
9 Role clarity	• define the roles and responsibilities of each party clearly
10 Relationship building	• work well and build good working relationship with client
11 Knowledge transfer	• transfer best industry practices and know-how to client

Generally, both clients and vendors are not very good at meeting most of these expectations. If success is to be achieved in projects, more attention has to be focused on the areas where expectations are not being met. As an aid, some practical ways to better meet these obligations have been identified. These will be discussed below.

THE PSYCHOLOGICAL CONTRACT

In the above study, six major areas which need to be focused on were identified. Figure 1 below shows what needs to be done to improve one's project success:

Figure 1 — How to Manage Your IT Contract Effectively


```
┌─────────────────────────┐
│  Develop a good         │
│  business case          │
└─────────────────────────┘
            │
            ▼
┌─────────────────────────┐
│  Determine fair         │
│  compensation           │
└─────────────────────────┘
            │
            ▼
┌─────────────────────────┐
│  Build strong working   │
│  relationship           │
└─────────────────────────┘
            │
            ▼
┌─────────────────────────┐
│  Manage human           │
│  resources              │
└─────────────────────────┘
            │
            ▼
┌─────────────────────────┐
│  Provide project        │
│  leadership             │
└─────────────────────────┘
            │
            ▼
┌─────────────────────────┐
│  Ensure knowledge       │
│  transfer               │
└─────────────────────────┘
```

Each of these points will be discussed and specific suggestions offered.

Develop a Good Business Case

As a client, your ability to provide clear specifications to your vendor is critical to your project success. How well your vendor can scope the project

depends a lot on how accurately you can define your project deliverables and specifications. Unfortunately, requirements do change over time, and it is not an easy task to define requirements clearly at the start of the project. However, we must also recognise that constant changes in requirements make it difficult for your vendor to work effectively, and this can cause delays in your project.

What are some of the things which you, as a client can do to provide better project specifications? Most importantly, you must understand your own business requirements. To do that, it is not enough to rely only on IT employees. Rather, you should involve employees from all impacted functions, and draw on their practical expertise and business contexts of their work areas. A team of cross-functional experts should be formed to work on the project definition as early as possible. This would ensure that all the necessary expertise is present and that the specifications are complete. The vendor can also be brought in as early as possible: they are likely to have worked on similar projects and can bring in valuable insights from their experiences. Vendors can be involved to help with proven methodologies such as Joint Application Design to elicit better requirements. Finally, insist that 'softer' aspects such as training plan, documentation, communications plan and implementation plan are clearly spelt out and agreed upon in the contract. Very often, whether 'softer' deliverables are explicitly negotiated for is key to what makes or breaks the successful completion of an IT contract.

As a vendor, you would need to be able to scope the project accurately. This is one area clients complain most about. If you fail to estimate the contract scope accurately, then you may end up having to absorb additional costs which are incurred on the project. As far as possible, build buffers into the contract to accommodate scope changes and avoid having to levy your clients with high additional charges later on.

What are some other things which you, as a vendor, can do to improve this area? You can take the initiative to work with your client to define their requirements. You can also introduce them to proven methodologies such as Joint Application Design, and facilitate the joint sessions with them. On your part, you must also build up expertise in project scope and estimation skills. Given the pressing demands of work, it is often hard to resist the temptation of moving straight from one project to another, without reflection and learning from it. Conduct more post-contractual reviews of completed projects, so that you can build up a repertoire of expertise on the accuracy of your estimations. You can then develop some structured methodologies based on these past experiences to improve the skills in project scope. Invest in developing total quality management principles and collect contract metrics (eg man hours/days per function points).

After all is said and done, we must recognise that our ability to define clear specifications and accurate project scope also depends on the nature of the products or services being contracted for. If all else fails, one should try to build more flexibility into the contract by employing more contingent pricing, that is, pricing based on the contingency of a certain event occurring.

Table 3 — How to Develop a Good Business Case

As a client, you should:
1 involve more cross-functional experts during project definition to build business case;
2 bring in vendors early to help define project;
3 use proven methodologies in project specifications, such as Joint Application Design;
4 conduct more joint discussion sessions with vendors;
5 define all deliverables clearly in the contract; and
6 insist on the soft deliverables in the contract (such as documentation, communication plan, implementation plan, etc).

As a vendor, you should:
1 take the initiative and be very much involved in the early stages of defining the project with the client;
2 conduct more post-contractual contract reviews to build up experience base for estimating future project scope;
3 adopt better estimation methods using software metrics; and
4 use contingent pricing to increase flexibility in pricing.

Determine Fair Compensation

As a client, your vendor expects you to pay fair compensation for their work. In all fairness, this is often easier said than done. What is fair compensation? How does one evaluate different bids, especially if the price gap is wide? It is important to recognise that vendors are in the business to make a living. If they are underpaid, they would just end up cutting corners along the way.

Part of the problem lies in the difficulty of assessing the quality of IT services. It is always easier to value and pay for products than for services. To overcome this problem, a change in mindset is required. One should resist the temptation to simply go for the lowest bid in a tender. Instead, carefully evaluate the quality of the services being offered. To determine how much a project should

cost, conduct a financial assessment of how much it will cost if it was undertaken internally: include costs of manpower, infrastructure and other overhead costs, then compare the internal pricing with the proposal offered by the vendor. If the vendor's price is significantly higher or lower than the internal pricing, beware. Insist that the vendor price their services explicitly and demonstrate the value of these services.

As a vendor, determining the price to charge is often not the difficult part. Given the keen competition in the IT industry, you are likely to have no choice but to charge very competitive prices. Sometimes, you may even have to resort to underbidding just to win the contract. The difficult part comes later, when you have to persuade your clients to accept price changes or to waive penalties. Collecting payment can also be an issue.

To overcome this problem, you should go beyond simply meeting the client's specifications. Instead, you should demonstrate value-add to your clients: be prepared to identify and price your services specifically, to demonstrate where your value-add comes from. At the outset of the contract, lay out clearly the terms and conditions for payment, and the specific milestones to which payment is tied. Schedule milestone meetings where you can obtain approval of senior client management for payments.

Table 4 — How to Determine Fair Compensation

As a client, you should:
1 never go simply for the lowest bid, beware of very low bids;
2 compare external prices with internal pricing; and
3 evaluate quality of services offered.

As a vendor, you should:
1 never focus on simply meeting specifications;
2 demonstrate value-add for services provided; and
3 define clear milestones for payment.

Build a Close Working Relationship

Whether you are a client or a vendor, investing time to build a close working relationship is one of the most important things you have to do. Never avoid this time investment, as it is time well spent. A good working relationship will make it much easier to get things done. It is always better to try to come to a mutual compromise than to keep reverting back to your legal contract. A good relationship will also help one to reduce potential disputes, and help to resolve conflicts at the project level before they escalate out of proportion and require legal recourse.

What are some of the things one should do to develop this close working relationship between client and vendor? Most importantly, both parties have to make special efforts to build a strong coherent team comprising employees from both sides. A project can only be successful if the team works together towards a common goal. The team members must be able to identify with one another and see themselves as being part of the project team, instead of focusing on their organisational identity. Otherwise, the team may well degenerate into a 'we-versus-them' battle, with both sides focusing on their organisational loyalties.

How can we eliminate this 'we-versus-them' mentality? To do this, ensure that everyone on the team is treated equally, whether they are your own employees, or your client's or vendor's employees. There must be no special preference given to either party. For example, one should insist that all project team members follow the same working hours and enjoy the same working conditions. No differential treatment should be allowed.

A strong team spirit can be built only if there is mutual understanding among the members. Encourage more interaction amongst project team members. Pay attention to simple things, such as the seating of members together, having lunch or dinner together and organising of special get-together sessions. These simple things go a long way towards breaking the ice and building close friendships amongst project team members.

Table 5 — How to Build Strong Relationships

> *As a client or a vendor, you should:*
> 1   promote strong team spirit;
> 2   build project commitment rather than organisational commitment;
> 3   never provide differential treatment to certain team members;
> 4   insist all team members follow the same working hours;
> 5   physically seat team members together in the same room;
> 6   encourage informal social interactions, eg have lunch or tea together; and
> 7   organise more informal events to facilitate interaction.

Manage Human Resources

Any organisation is only as good as its people; similarly, the success of one's project depends on the quality of the staff working on it. As a client, you must carefully evaluate the quality of the staff your vendor assigns to your project. Insist on being given the right to review and approve all vendor staff.

What must one look out for in the vendor staff? The vendor staff should have adequate relevant experience, not just with the particular industry, but also wider cross-industry experience. Look beyond their technical skills. The vendor staff should have good business and interpersonal skills, as well as a good working attitude. Special attention should be paid to their project management skills. Often, the quality of the project manager can either make or break one's project. A good project manager must be able to manage sub-contractors and handle multiple tasks with often conflicting priorities. One should insist that the vendor assigns a dedicated project manager to work on the project, and ensure that this is clearly spelt out in the contract. Recognise that vendor staff turnover is a fact-of-life which cannot be avoided. Insist that the vendor make a firm commitment in the contract to minimise staff turnover, and to replace any departing staff with someone of at least equivalent expertise. Insist on an adequate notice period, and exercise the right to approve any replacement staff.

As a client, it is often hard to balance your operational work and heavy demands of the project. However, one must recognise that poor quality staff can seriously jeopardise your project success. It is strongly recommended that one assigns the best staff to work on the project; relieve them from their operational duties as far as possible, so that they can work full-time on the project.

What about the vendor? As a vendor, getting your client's time commitment on the project can be a major challenge. You have probably experienced the frustration of convincing your client to release their 'best' client staff to work on the project. Instead, the project gets staffed with 'second-class' personnel, who are so busy with their operational duties that they have little time to work on the project.

Can anything be done to resolve this dilemma? One could take a proactive role by negotiating with your client's top management. Identify specific client staff personnel that you need help from. These client staff must be experienced in their work area and be able to work well with your own staff. They must also have strong project management and communication skills. It is important to insist that they be released from their operational duties to work on the project — include this in the contract. During the project, try to physically locate the project team at a different venue. This can help to reduce interruptions for your client's staff.

Table 6 — How to Manage Human Resources

> *As a client, you should:*
> 1   assign your most competent staff to the project;
> 2   ensure your staff has adequate experience, good technical and business skills, good communication skills and good work attitudes;
> 3   build up your staff's project management skills;
> 4   remove operational duties from your staff and let them work full-time on the project;
> 5   agree with vendor on key vendor staff who will be working on your project;
> 6   insist and exercise your right to review and approve vendor staff assigned to your project;
> 7   agree on notice period in the event of vendor personnel leaving the project; and
> 8   insist and exercise your right to review and approve new vendor staff in the event of replacement.
>
> *As a vendor, you should:*
> 1   train your staff in project management skills;
> 2   assign a full-time project manager to the project;
> 3   ensure your staff has adequate experience, good technical and business skills, good communication skills and good work attitudes;
> 4   make good-faith efforts to minimise staff turnover;
> 5   ensure project continuity and high-quality replacements in event of turnover;
> 6   insist on key client personnel who are dedicated to the project; and
> 7   agree with client on the time commitment of client project staff.

Provide Strong Leadership

At the outset of the contract, determine whether the client or vendor leads and directs the project. As a client, one must ensure that one's vendor understands his roles and responsibilities clearly. To reduce ambiguities and avoid critical

activities being overlooked, define explicitly one's own roles and responsibilities, and the vendor's roles and responsibilities. Pay special attention to issues of project leadership, responsiveness, and feedback.

As a client, one must be intimately involved in the project. Never rely on the vendor to make all the major decisions — the client should be the one making these decisions. Spell out clearly in advance the various milestones one needs to track during the project. Insist that the vendor provides you with regular updates, and schedule regular meetings to review the project status. Encourage your vendor to update you on any project problems or developments informally. That way, you can reduce lag time and resolve problems early.

As a vendor, one would have to contend with some clients who adopt a totally hands-off attitude to the project. Such clients expect that, since they are paying the vendor, the latter should 'do all the work' - solve all their problems and make all the decisions for them. This should not be allowed to happen. Discuss this explicitly with the client, and convince them of the need for their active involvement. Never be tempted to make decisions for them in the interests of time, in order to speed up the decision process. Rather, agree with the client and set up proper procedures and regular meetings, so that critical decision points can be identified and put forward to senior client management. Provide the client with regular updates on the progress of the project. Engage them in ongoing discussions and provide them with spontaneous feedback, especially if problems arise. The client would not like to be surprised by the unexpected.

#### Table 7 — How to Provide Project Leadership

As a client, you should:
1. define each party's roles and responsibilities clearly at the outset of the project;
2. insist on regular update meetings with your vendor;
3. never rely on the vendor to make all the decisions; and
4. be closely involved with and make all major decisions on the project.

As a vendor, you should:
1. define each party's roles and responsibilities clearly at the outset of the project;
2. insist that client leadership make all major decisions;
3. schedule regular update meetings with the client; and
4. initiate more informal discussions on project progress or any problems faced.

Ensure Knowledge Transfer

The final and often the most critical area of concern is the issue of knowledge transfer. As a client, one must carefully consider this issue of knowledge transfer during initial negotiations with the vendor. One must ensure that at the end of the project, the vendor does not leave the client groping in the dark in learning how to use or maintain the system. At the outset of the contract, the client should insist that the vendor transfer their valuable know-how to the former's staff. The client's staff should be assigned to work together with the vendor, so that one party can learn from the other. The types of skills and knowledge one expects to learn from the vendor should be clearly spelt out. Ensure that there
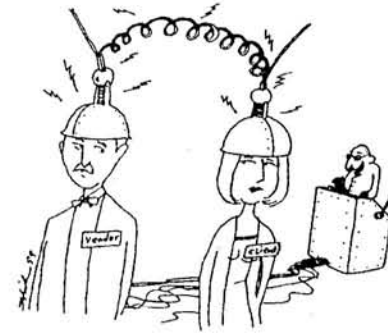
is adequate documentation of the system so that the client's internal staff is able to make use of the documentation and pick up the operation and maintenance of the system once the vendor leaves. Make sure these are incorporated into the contract in detail.

As a vendor, the issue of knowledge transfer from the client is also very critical. Often, systems do not meet the expectations of clients because of poor transfer of business knowledge to the vendor. Negotiate this explicitly with the client. Ensure that the client provides all the necessary information for the job to be carried out. If necessary, include know-how transfer, especially the client's business processes, within the scope of the contract.

Table 8 — How to Ensure Knowledge Transfer

As a client or vendor, you should:
1. make knowledge transfer expectations explicit in the contract;
2. specify details of the skills and knowledge you expect to learn from the contract;
3. agree on the ways of transferring knowledge, and factor in man-days for the transfer to occur; and
4. insist on proper documentation as mechanisms for knowledge transfer.

CONCLUSION

In this chapter, psychological contracts or various 'implicit' expectations clients and vendors have of each other in an IT contract have been discussed, including specific actions which can be taken to better meet these expectations.

What is most important about psychological contracts is that, although they are often implicit and only reside in the minds of the contracting parties, these expectations can ultimately surface in the course of the IT contract. The trick, therefore, is to make as many of these psychological contracts as explicit as possible. If these expectations are not made explicit, different expectations may arise between client and vendor, and this is likely to lead to subsequent disputes.

Arriving at a set of mutually agreed upon expectations is very much a negotiation process. Good negotiation is one that highlights the positions and interests of each party, and arrives at a 'win-win' solution, where both parties gain something from the process. This is especially important in the IT

contracting context. Both parties must ensure that not only their own interests but also the interests of the other party are adequately considered and protected.

Despite all good efforts to make expectations explicit and to meet expectations, disputes may still arise. When faced with such situations, it is important that both parties try to work through the disputes harmoniously. The primary goal in any business contractual arrangement is not simply to resolve disputes, but to *survive* them. It is important that the business relationship is not severely impaired, so that both parties can still work together and complete the project at hand.