News

Information & Communications Technology

Saving Cost: Mitigating Risk, Minimising Liabilities and Maximising Savings

ICT departments are being asked to shelve investment plans and reduce costs, to support the need to save money and conserve cash. In this article we look at how that can be achieved against a background of supplier contracts which at best may not provide for the cost reduction activity required, and which at worst, if breached, could give rise to claims for damages which may seriously undermine cost saving objectives.

ICT professionals are in the thick of things when it comes to saving cash

The slowdown in the global economy has swept like a wave across the world. Starting in the US property sector, it has moved steadily through financial services, causing cash and credit to dry up, before proceeding down the high street as consumer confidence evaporated, and finally washing over the manufacturing and service sectors. As James Dean famously said in A Rebel Without A Cause, “we are all involved”.

But some are more involved than others. ICT professionals responsible for managing the requirements of business for technology and technology services are right in the thick of things, as companies strive to save money and conserve cash. Programmes for ICT transformation and modernisation are being shelved or scrapped, unless the return on investment is immediate. Software, hardware and middleware is being retained beyond planned dates for retirement or refresh. On top of that ICT professionals are being asked to reduce cost. And of course all of this is to be achieved without any material degradation in services, whether delivered by internal or external providers.

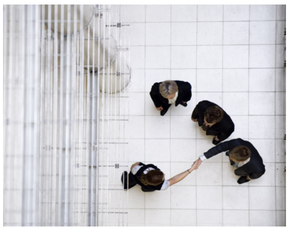
ICT estates are supported by a complex web of services provided by internal and external suppliers, involving a host of interrelated dependencies, risks and liabilities. Relationships with those suppliers are regulated by contracts which specify the rights and liabilities of not just the customers, but also the suppliers. They determine what a supplier is entitled to supply, when, in what volumes, and what the supplier is entitled to be paid. Broadly speaking they are fixed and cannot be changed without the agreement of both parties.

Many of the contracts which underpin your ICT estate will have been negotiated and signed before the current crisis impacted the economy generally and specific businesses in particular. It is unlikely they anticipated or are flexible enough to accommodate the slowdown or the changes that you need to make to meet savings objectives. Acting unilaterally by imposing change without the agreement of the supplier carries a high degree of risk, in that it may prompt a claim for breach of contract and for damages.

The dynamics at work are as follows:-

- The change imperative – the need to reduce cost to meet the objectives of the business;
- The continuity imperative – the need to maintain service;
- Supplier expectations – the returns which a supplier anticipates over the contract lifecycle; and
- The contract – the formal terms which dictate what can and cannot be done.

There are a number of components in delivering success. First a clear view needs to be established of the position you want to get to (Change Outcome) understanding in particular what sort of change is required to deliver the required savings. The three principle change variables are cost, volume and service/product, and the three are dynamically interdependent. Once the Change Outcome and the necessary changes required are known, then an impact analysis can be carried out to establish the extent to which those changes can be accommodated within the current contractual landscape. The output of this exercise will identify the constraints and limitations imposed by the contract and which will have to be managed carefully to avoid breach claims.



Legal risks have to be assessed, understood and planned for to avoid breach claims.

The typical issues are as follows:-

- Exclusivity – are you bound to use the incumbent supplier or can you go elsewhere for some products and services?
- Minimum quantities – prices may be based upon assumptions regarding minimum volumes and the contract may be breached or the price may go up if those volumes are not met;
- Fixed term – a contract may be for a fixed period of time with no right to terminate before the term has expired, meaning you are locked in to that arrangement;
- Fixed prices – most contracts are for fixed prices and do not provide for variation, except to reflect inflation and significant cost fluctuations impacting suppliers (not customers);
- Consumption – sometimes contracts are not consumption based, meaning that changes in volumes are not reflected in changes in spend;
- Cost of change – where service change is required to deliver the savings, the cost of that change is unlikely to be specified.
- Limitation of liability – if you breach the contract, your liability may not be limited, particularly if you contracted upon the suppliers standard terms.

Identifying the contractual issues in this way will enable the commercial and legal risks associated with the proposed change to be assessed, and the development of a plan for securing the specific changes required from each supplier whilst at the same time mitigating those risks. Where the contract allows for the proposed change (eg, a right to terminate on notice without cause), then the position is more straightforward. If it does not, then the position is more complex.

In those circumstances a negotiation will be unavoidable, and the key therefore is to build negotiating leverage. This can come from a number of sources, including your buying power (even on a reduced spend basis a supplier may want to maintain a long term relationship and be prepared to relinquish short term advantage) and moral jeopardy (if supplier performance is poor but not sufficient to justify termination, pressure can be applied to change).

Much can be achieved, but the risks have to be properly assessed, understood and planned for before action is taken. We are hosting a breakfast seminar on this subject on 31 March 2009, and will forward registration details to you shortly.

FURTHER INFORMATION

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