

ERP implementations: case study

Background: Customer is a large, multinational distributor of pharmaceuticals. To improve its sales growth without increasing head count or operating expense, it decides to acquire a new ERP solution designed to improve its order taking, fulfilment and distribution processes. It engages Supplier, a large systems integrator, to carry out the project, from the blueprint scoping phase through to implementation of the solution. Customer is responsible for sourcing the hardware component, based on the technical design document to be prepared by Supplier during the blueprint phase.

Procurement process: The procurement and tender process have been poorly managed by Customer. Supplier has been appointed on the basis of price and previous experience in the pharmaceutical sector: in its proposal, Supplier has stated that it has carried out similar implementations for a number of other distributors of pharmaceuticals. Supplier provides a customer reference. The Customer's procurement team follow up on this with a couple of phone calls, but do not pay a site visit.

Customer's in-house legal team have not been consulted until the last minute, after Supplier has been selected and has started the blueprint phase. As a result, Customer has lost most of its leverage in the contract negotiations, and is forced to accept Supplier's standard legal terms with minimal amendment.

Issues: during the project, the following issues arise:

1. **Sourcing difficulties:** the Customer is sourcing the hardware platform from a third party vendor. The third party vendor is experiencing problems – there is a worldwide shortage of one of the hardware components – and this has caused significant delay to the implementation project. Supplier is ready to test and install some of the software modules. Supplier is being paid on a time and materials basis, and is threatening to redeploy its staff on other opportunities. Supplier is unable to give any guarantee as to when those staff will be available for redeployment to Customer's project.

2. **Costs over-run:** the hardware manufacturer eventually supplies the hardware, and the initial modules have been tested and implemented.

(a) **On-shore/off-shore mix:** Supplier has provided a 'good faith' estimate of the overall project cost to the Customer. Supplier's estimate is based on the assumption that most of the configuration and build work would be carried out off-shore by the Supplier's Indian subsidiary. The Supplier's Indian subsidiary has suffered staffing difficulties, and Supplier has had to carry out a significant amount of the configuration and build work in the UK. This has significantly increased the overall cost of the project. Supplier's position is that the estimate given was just that, that the costs increase is outside its control, and that Customer must bear the additional costs.

(b) **Scope creep:** To compound matters, changes to the functionality of several of the core software modules have been requested by some of the senior business users. Those users were not part of the Customer's business reference group (who internally must sign off on all changes to functionality) and, Customer says, were not empowered to request or authorise those changes. Customer also claims that the

bulk of the costs overrun is down to Supplier using the project as a training ground for inexperienced consultants. Supplier denies this and is insisting that these requests amount to a change in scope and that Customer must bear the costs.

3. Project timetable acceleration: during the project, Customer wins a significant new supply contract with a major chain of high street chemists. This new business will lead to a significant increase in the volume of orders that the solution will be required to handle. The new contract will, however, require the project timetable to be accelerated by 3 months to ensure that the solution is up and running by the time the contract starts. As a result, Customer and Supplier agree to reduce the testing phase, by not testing non-customised parts of the solution.

4. Go-live: the solution eventually goes live, and experiences problems from the outset. The solution (hardware platform and software) cannot handle the volume of orders received by Customer (particularly with the orders received under the new contract), some orders are duplicated, while others are missed altogether. Despite several attempts to correct the problems, the errors continue, and Customer eventually loses a series of contracts, including the lucrative contract with the high street pharmacy. Customer estimates that this has cost it in the region of £40 million in lost sales, and that it will cost a further £10 million to modify the solution so that it can handle Customer's order volumes.

Customer subsequently discovers that Supplier's previous implementations in the pharmaceutical sector have involved different modules of the solution to those chosen by Customer.

5. Claim: Customer brings a claim against Supplier for breach of contract, negligence and misrepresentation, and is claiming the costs of correcting the solution, together with the lost sales attributable to the solution failure. The contract contains the Supplier's standard warranty that the Solution will meet the Business Requirements Specification, and the Supplier's standard liability provisions. "Indirect and consequential loss (including loss of business, revenue and data)" is excluded and direct loss is capped at the contract value (£25 million). The Business Requirements Specification (which was not reviewed by either party's lawyers) contains a loose statement that the solution will be capable of handling Customer's order volumes.

Supplier denies liability and, in the alternative, seeks to rely on the liability terms, including the exclusion of liability for lost business and revenue.

Questions:

- 1. What processes and procedures could the Customer have followed (a) before contract signature and (b) during the project to help avoid these difficulties?**
- 2. What contractual protection could the Customer have sought to help avoid these issues?**