



# A Case for Performance Based O&M Contracts

Part 3 of 3

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## The O&M Business

In Part 2 of this article, we discussed the benefits of performance-based contracts for users, service providers, and a sample formula to make this happen practically. In Part 3, we will now see what prevents the O&M industry from achieving SLA based contracts.

O&M services are provided by service providers and OEMs. OEMs also, in turn, engage the services of service providers who have spent considerable time and derived satisfaction and pride from resolving issues and complaints of end users. Every now and then these service providers start their own business. The difference between working as a service

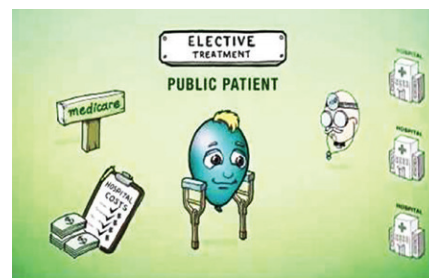
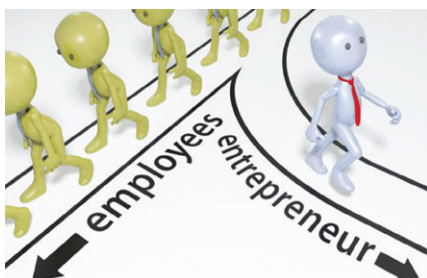
provider under an organization and working on one's own is crucial.

From the outside, it appears that the service provider is making a lot of profit, since:

1. The cost of service mainly comprises labour and manpower, which is cheap in India, especially if you hire freshers.
  2. The cost of an office is minimal, as your residence can double as the registered office.
  3. Conveyance charges are limited to monthly petrol bills.
- Looks simple, but is it?

To understand the O&M business, one has to understand that this business is really like a hospital business combined

with an insurance business. It requires the capability to provide the best diagnosis, suggest the remedy and treatment in the fastest time possible, backed with an insurance provider who provides relief to the patient to cover the cost of service. This assures the hospital that



## About the Author

**Rakesh Sahay** is a Founder Director of Veratvatva Engineering Consultants, which is involved in Ultra High Efficiency building and campus designs in both commercial and industrial sectors. He is a BEE Accredited Energy Auditor and GRIHA Certified Trainer with over 20 years of experience in auditing, commissioning and performance engineering of facilities, in addition to design. He also practices energy targeted and profit sharing SLA driven Operation and Maintenance.

the expenses would be covered by the insurance company, so they can deliver the critical services without bothering about the cost.

Both these businesses are viable only for big players and big capital market owners. Why are small players are not able to provide an insurance back up? Where does the money come from? What is the amount collected and disbursed every term? How are premiums decided?

In HVAC services, the service provider is the doctor and hospital as well as the insurance provider. The annual service charges are akin to the premium. The cost of equipment in question is much higher than the service charges collected.

A service receiver or provider or OEM rarely estimates the risk involved, risk covered, and the maintenance contract amount to be charged. Service providers are not equipped to estimate the financial risks. Nor can the clients estimate the risk involved in the downtime of the HVAC system before negotiating the charges. The stakeholders generally do not understand that there is risk coverage of the business that is being served by the HVAC system and that they are playing a small part in a much bigger picture.

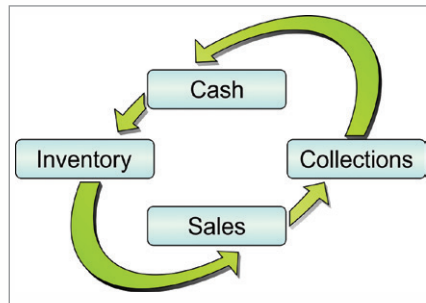
Today's O&M business is being run just in terms of man, machine and money. Unfortunately, the client or end user, especially the purchase and finance departments, while expecting the moon in terms of service, are happy in the comfort levels of the earth and do not want to change the status quo.

### The Businessmen

Another issue faced today is the service providers themselves. They start the business thinking that it is run based on the quality of work and relationship. However,

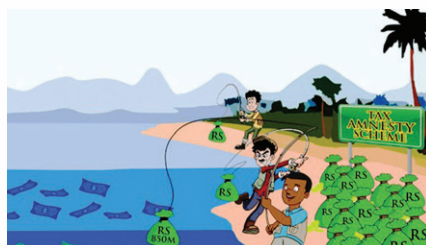


they cannot be more wrong. Business is run on money, by money and for money. That is the apparent truth. But, in reality, today's business is run on the money of the service provider, by the quality and pressure of relationship of the client and for taxes and penalties to the government.



How many service providers understand the value and meaning of working capital? What is the cost of money? What are the taxes? When are they due? When do they have to file returns? What is the cost of filing returns? What is penalty for late filing? How much is the financial cost every year on late charges and penalties?

The chartered accountant or the auditor asks them to pay some amount as penalty, and they pay. The logic of paying penalties is that the government interest charges and penalties are lower than the interest rates at which the service



provider gets the loan from pawnbrokers in the local market, often against family jewellery as mortgage. Sometimes the service provider, in order to minimise his taxes, asks the auditors to reduce his profits in the books. This helps him reduce his taxes, but also makes his account books look bad, and hence no bank risks giving him loans.

One such service provider had a regular turnover of over Rs.1.5 crore, but had a profit of only Rs.2.5 lakh per annum. He failed to raise a Rs.25 lakh loan from banks

at 15% reducing balance, and was forced to take the loan from a pawnbroker against family jewellery at 48% interest (Rs.40 per thousand per month as the rate goes). Now, he cannot even convert the loan, as Rs.12 lakh of interest has to be paid every year without any reduction in the principal amount. Would it not have been prudent to honestly show the 10-12% profit that one should be getting, and pay 33% tax, which would have amounted to Rs.5 lakhs, and get the loan at 15% reducing balance for a 5 year tenure with an EMI of Rs.45,000 per month and clear off the loan in five years?

Many such service providers have tried to run businesses, taken loans to provide services, and then wound up in severe losses and debts. The situation is not very different from a farmer's plight when he borrows money from a loan shark.

### Technical Knowledge



Very few service providers invest in knowledge and learning after they start their career as an entrepreneur. Very few invest in the skills and knowledge of their trainees or apprentices, fearing that once their competence is upgraded, they would leave for better prospects. The service provider community has been losing competence and thereby the pride in their profession.



Rarely is there a succession plan in place. Who can they trust? Hence, there is hardly any knowledge sharing. People struggle to even collect relevant data to evaluate plant performance, leave alone carrying out a root cause analysis. It is convenient to blame water quality, power quality or the increase in load and resets and restarts. After a couple of years of not solving any problems on the site, the service provider jacks up the service rate with the intention to exit and someone else takes the bait without understanding the trap he is getting into.

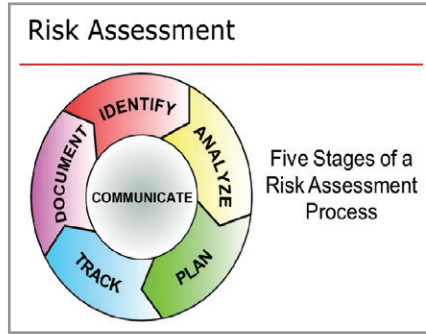
Earlier, this used to happen with packaged and split AC servicing and contracts, but now is becoming common even in large central plants of the magnitude of 8,000 TR. Plants running without capacity control, AHUs running on control valves in bypass modes, VFDs not functioning, sensors giving wrong readings, etc., are commonplace.

**Service Level Agreements**

While booking a sales order, the sales department commits to seven days for replacement of a large centrifugal or screw compressor, and 4 hours for minor complaints. The complaints are hardly ever resolved within such times, with the exception of simple actuator bypass or valve throttling or damper opening (temporary solutions, which become permanent).

While the end user wants to incorporate clauses of uptime, energy, complaints, etc., does he understand the implications of the clauses? Is the service provider capable enough to understand the clauses? Or the risks involved in terms of monetary commitment to fulfill the obligations of the SLA? Does the end user evaluate this capability while selecting the service provider?

Generally, the end user splits the operations, which are contracted to one common building service provider, and maintenance that is awarded to another specialist service provider. The common building service provider normally employs electricians to keep the building operating and, in rare cases, employs HVAC&R specialists. Even when he employs



specialist technicians, he limits himself to calling the service provider when he faces a problem, rather than adding value by finding out the issues and creating history documents for the specialist service provider to carry out a root cause analysis and get a permanent resolution.

Data logging is not accurate as the operations team often writes data sitting at the plant room table instead of visiting the location. Often, the instruments do not work (especially the temperature and pressure gauges), yet the logbook is filled. With all this, the SLA is of no value.

The SLA does not go through the external auditor of the service provider to demand a contingency fund for meeting the risks. The service provider is not aware that this is important, or that such risks exist. Perhaps they are blissfully unaware and sign off with the intention of providing services for 2-3 years and then walking out.

**The Solution**

The two main stakeholders are the client and the service provider. Both have a role and responsibility in the success of the business.

**Client**

- The end user or the client has to be conscious of the value of the service provider.

**“GOOD WORK  
AIN’T CHEAP,  
CHEAP WORK  
AIN’T GOOD.”**  
- NORMAN “SAILOR JERRY” COLLINS

- The value should be understood based on the risks associated with the business or dependency of the business on the proper functioning and operation of the HVAC system.
- The preparedness of having standby systems, relevant spares, technically sound operations team and technically sound technicians, since they are the ones who would attend and solve the issues.
- Based on this, the cost of service and risks must be evaluated, and not blindly on the cost per TR irrespective of age, usage, risks involved etc.

If you think it's expensive to hire a professional, wait until you hire an amateur.

- If some replacement or rectification is suggested, it should be budgeted and implemented. At one site, even the chilled water pipe leakage was not taken seriously, since pipes were buried and hence the problem was also assumed to be buried.
- Be serious about energy conservation and push for energy reduction, including sharing the savings and giving incentives; it would help the plant to run efficiently and thereby reduce the wear and tear, leading to lower breakdowns.
- Invest in proper temperature and RH recorders and improve the objectivity of the SLA in terms of maintaining a set value.

**Service Provider**

- Learn the finance of the business. Honest businessmen certainly need to understand it. Dishonest ones will anyway know how to manage.
- Learn and understand the law and adhere to it. Pay your taxes in time and plan properly.
- Invest in upgrading technical knowledge and adapt to the latest technologies. One service provider does not

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# BE SO GOOD THEY CAN'T IGNORE YOU

~STEVE MARTIN

believe in readings taken from thermal imagers and infrared sensors, and relies on pipe surface temperature measured with his old mercury thermometer.

- Train the team to create value in your organization by taking care of issues, even without your presence. Even the best of service providers needs family time.
- Understand the commercial and liability clauses mentioned in the works order.
- Take pride in your team's achievements and dissemination of knowledge.
- Being extra conservative can only restrict growth.

- Employ an accountant and carefully follow the incomes and expenses.

### **Drawing up the SLA**

Once both the parties are serious, the service level agreement can be written down objectively and followed. Penalties and incentives can then be discussed and agreed upon with the commitment of meeting the goals and achieving more.

- Performance parameters should be clearly defined.
- Constraints, if any, should be resolved and removed, rather than introduced as escape routes in the SLA.
- Invest in good quality instruments and calibrate them regularly. These are the backbone of a service provider.
- Have a proper finance plan to meet the contingency or any investment to commit higher performance levels.
- Do not take orders at low costs, assuming you will get more orders. Remember more orders will come, if at all, at the same or lower costs

only and further increase the loss and financial commitments.

- Remember the energy cost of an efficiently run 1,000 TR plant is Rs.2.5 crores annually as compared to O&M cost of only Rs.25 lakh. A 3% saving in energy amounts to Rs.7.5 lakh, being 30% of the contract value.

### **Conclusion**

There are so many inefficient plants operating all over the country. All it takes is commitment to conserve



energy, knowledge of how to conserve energy, instruments to measure, evaluate and monitor the performance, ability to take risks, and command over the technical and commercial matters to push through a contract, and finally the zeal to earn the incentive. ❄