Contracting as a Strategic Competence

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Are You One of Those Companies People Would [Rather Not] Do Business With?

By Tim Cummins, Executive Director, International Association of Contract and Commercial Managers

A group of senior Sourcing executives recently told me which company they viewed as a benchmark for best practices in contract management. This was endorsed when I read an article in Business Week hailing that company as an industry leader. So I decided I would call their head of Procurement and get the inside story.

I was expecting to hear that everything was great, that processes were stable and under control, that contracting was just a breeze…But instead I was told that they have just embarked on another round of major improvement, that they feel certain key areas have seen dramatic improvement, but they are concerned that internal partnerships and replication of solutions remain key weaknesses. Cycle times for the RFX and negotiation activities have been cut to approximately one fifth of their former length – but there is more that can be done. "And then, of course there is all the stuff we need to do around Sarbanes-Oxley and the legislation affecting our finance subsidiary…".

Clearly this is a company that plans to retain its benchmark status. And a group where contracting has a clear vision, mission and key executive support.

Contracting is not typically associated with strategic vision. Most see it as a specialist activity and an unfortunate, but inevitable, cost of doing business. At best, executives think contracting is an essential risk management or control procedure; at worst, they believe it inhibits or slows business decisions. Very few view it as a source of competitive advantage or differentiation.

There are certainly some companies where negative perceptions are well-founded, where the process and organizations controlling deal making and relationships are indeed inflexible, bureaucratic and lacking creative thought. Just ask most contract negotiators or relationship managers and they can quickly give you a list.

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My aim in this paper is not to deliver a theoretical analysis of functional reengineering. Instead, I will focus on how 'best practices' in contracting impact business performance and therefore why this area needs to be a strategic competence. My approach is to offer some real-life illustrations that either inspire you to action or persuade you that things are pretty much under control.

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What Do We Mean By [‘Best Practices’]?

Everyone knows that ‘good’ contracting plays a role in keeping financial risks at an acceptable level and in ensuring transactions or deals can be implemented or enforced. However, the ambition of leading corporations goes far beyond this. They have recognized that a wide range of business performance issues can be tracked to failure in understanding and developing appropriate terms and conditions and deploying adequate contract and negotiation skills or capabilities.

True ‘best practices’ are not just about staying abreast of the competition, or even marginally ahead. They are about executing on a vision that is revolutionary in its nature and represents a quantum leap in performance. There could be a number of areas such a vision could address, but let’s pick speed and innovation – generally viewed as two of the critical characteristics of the successful business.

And in setting that vision, let’s remember that new technologies enable information flows, collaborative working, replicated solutions, shared knowledge, real-time reporting and measurement on an unprecedented scale. And it is applications such as these that, when added to traditional contract and legal skills, enable a transformation in what we do and how we do it.

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CASE STUDIES

Here are just three examples of companies with ‘visions’ regarding their contracting:

Corporation A (Automotive) wants to reduce today’s cycle time for complex RFX / negotiations from an average 27 weeks to an average 8 weeks.

Corporation B (Technology) wants more than 80% of its sales in the business to business market to be done through electronic ;’click-through’ contracts within 2 years.

Corporation C (Technology and Services) is aggressively moving to integrate ‘total relationship’ information into every major deal that it negotiates. Procurement will be measured on its success in growing sales revenue.

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Developing AND maintaining [terms] related TO market needs

It may seem obvious, but vendors who 'clothe' their products and services with terms and conditions suited to their selected markets have a much easier time selling. And the real winners are those who regularly audit market reaction and watch out for opportunities to create new or differentiated terms.

Our research suggests that the links between product / service development and the contracting process are often extremely weak. Offerings come to market without adequate understanding of the terms that each specific segment or sector may require. License terms, warranties, pricing options, integration or customization options, service and support packages – typical areas where the 'one size fits all' mentality is applied.

The result? Reduced competitiveness, increased negotiation, greater risks, higher costs of bidding and management (because managing non-standard negotiated terms always costs more). And of course, cycle times are increased – meaning lost revenue, higher cost and greater risk of successful intervention by competitors.

This weakness also means a lost opportunity, because companies like these are not viewing innovative contracting as a possible source of competitive differentiation. They are allowing themselves to be seen as slow, inflexible, bureaucratic – and therefore less attractive to do business with. Let's look at a recent example.

CASE STUDY

A major software company recently changed provisions related to third party indemnities. In a press interview, their Assistant General Counsel commented on how this change would make it much easier to do business and close deals. He estimated that disputes over these provision shad – on average – increased negotiation cycles by 60 to 90 days with most major corporate customers. He also observed that they resulted in a 'bitter taste' in the mouths of their clients.

The staggering part of this interview came when the representative commented that the terms in question had been in place "for about 10 years" and, on investigation, had proven to be protecting against a phantom risk.

Because this was to do with contracts, no one seems to have questioned the costs of this fundamental failure in contracting competence. In deed, in most companies it is probably not even viewed as a failure. If a product manager was similarly out of touch with the market, how long would they be in a job? Why are executive expectations of their contracts staff so low? Where is the accountability for contribution to company image and profitability?

OK, so that couldn't happen in your company? Then let's move to another example.

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Enabling [Information] Flow

It may seem obvious that people need information to support timely and quality decision making. But if it is so obvious, why do so many corporations starve key staff of the information they need to do their job?

Contracts are one of those areas full of mystique. The professionals who 'own' contracts are often concerned that increased knowledge or understanding will somehow lead to rampant empowerment and crazy busy decisions by under-qualified employees or power-hungry managers. While that is possible, it can also be controlled. And while they may be right to safeguard the high risk legal terms (liabilities, indemnities, intellectual property), the knock-on is that this tends to eliminate or confuse ownership, process and information on ALL terms. Our analysis shows that on average nearly 80% of the terms in business-to business contracts are not really areas of significant legal concern and typically do not come within their area of review – they are the business and financial terms and this includes key documents like Statements of Work, Specifications and Service Level Agreements.

The consequences of poor information transfer range from bad decisions, failure to meet contract obligations, more disputes and longer cycle times. With today's technology, there is no excuse why those involved in contracting – product or business unit staff, project managers, procurement, finance, legal – cannot be handled as a community of interest, with controlled access to the areas where they need tools or information to perform their allotted task. These tools and methods need to include easy identification and access to subject matter expertise – on-line or physical.

Stifled information flow once again detracts from our two chosen characteristics – speed and innovation. It slows down decisions, causes endless hours correcting mistakes and ensures there is no meaningful way to monitor the contracting process. In respect of innovation, the stifling occurs in both directions. The professionals often finish up occupying an ivory tower, out of touch with the day to day realities of the operational staff and therefore never adjusting terms, processes or practices on a timely or proactive basis.

CASE STUDY

A global manufacturer relied on a wide range of outsourcing relationships to support major elements of its infrastructure and operations. Executive management felt that many of these were not yielding the results they expected and attempts to improve service levels just seemed to result in increased disputes with the providers. They concluded that weak contract management skills – both negotiation and implementation – were a significant factor.

continued

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CASE STUDY *continued*

Analysis showed nearly 300 man-years were occupied with dispute resolution each year. However, further investigation revealed this was less to do with post-award contract management skills and more related to poorly written and communicated contracts. Also, the implementation teams had little visibility of the subject matter experts who might be able to help / advise regarding disputed items; hence there was little replication and the vendors had a distinct advantage in 'picking off' local issues.

Negotiations showed a pattern of drift. It was hard to gain executive focus to clearly define up-front requirements. Teams struggled to establish a clear negotiations strategy. Those responsible for contracting were often brought in at the tail-end 'just to get the ts&cs finalized'. They found themselves with limited room for negotiation (many deal terms were already set) and under pressure to settle fast; often there would be a major change of requirements during this process, causing the process to start over again.

Cycle times were very long but this did not lead to superior contracts; it actually resulted in uncertainty and frustration. Often, the negotiations were rushed to a conclusion through executive mandate. Creative linkage between requirements and contract terms (especially areas like Statement of Work and Service Levels) was typically missing.

And as a final indicator of the lack of structured process, there was no consistent approach to dissemination of the contract terms. In fact, there was no linkage to determine who would be handling the project in most locations, so in general these people had no access to the contract documents.

[Improving] Governance AND Risk Management

Risk avoidance is not risk management. And a culture that motivates risk avoidance in its contracts professionals creates an environment where overall performance will suffer and opportunities will be lost. Sure, there is a need for checks and balances, but these must be part of an integrated and cooperative (rather than combative) organizational model.

Many corporations today suffer from a 'them' and 'us' mentality, where contracts professionals (buy or sell side) are portrayed as business inhibitors, rather than partners in success. This results in avoidance. Symptoms range from decisions being made without proper authority or review, to introduction of contracts staff at such a late stage that their ability to add value is virtually eliminated.

> *Achieving an environment of 'controlled empowerment' in contracting depends upon a range of tools that support communication and information flow.*

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In truth, contracts are the lifeblood of every corporation. Without them, there is no business. Winning them is essential; performing on them is critical. So how can any company be relaxed about the process by which they are created, the quality of input and thought that goes into their production, the assessment of their consequences to business performance and their propensity to affect the overall health of the corporation?

Achieving an environment of 'controlled empowerment' in contracting depends upon a range of tools that support communication and information flow. In this era of Corporate Governance concerns, executives should want to make this investment if only because of their need to know what is going on. But tools alone are not enough. Where vision becomes really important is that it drives the goals that inspire change and the metrics that require it.

CASE STUDY

A major vendor in the telecoms industry suffered along with its competitors when the downturn struck. Like the rest of the sector, it quickly became apparent that many contracts were based on faulty assumptions and poorly assessed risks. In the dash for growth, 'winning the deal' was everything and traditional processes had been ignored or overridden.

Analysis revealed a wide range of issues. In truth, 'contracting' was not really a process, but a set of loosely connected activities performed by a core staff group with diverse reporting lines and few clear measurements. Reporting lines varied, but many key staff were driven by Sales. Most negotiations were highly customized since there was an internal culture that this 'flexibility' was needed to be competitive.

The lack of standards and process resulted in limited sharing of knowledge or approach; the pressure to be responsive meant there was never time to undertake proper analysis or investigate innovative, lower risk solutions.

Here, the externally imposed need for speed exceeded the capabilities of the contracting process to respond, resulting in a series of bad business decisions. Some of these could have been contained by an organization and structure that enabled or encouraged innovation; but lack of sharing, information / knowledge capture and inadequate teaming all combined to ensure such opportunities were missed.

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Summary

These are just three of many examples that could be cited to illustrate the consequences of poor contracting and the opportunities for those who decide it is time for change.

As demonstrated at the beginning of this paper, some corporations are recognizing that a holistic view of contracting is an important driver for improved business performance. As a cross-business activity, it is in fact an extremely powerful tool to identify and remedy some of the key fault lines in business process and organizational integration. And among the results are greater speed and more innovation.

At IACCM, we have access to many examples and case studies. Our benchmarks and surveys provide member companies with critical insights and ideas for improvement. We also work closely with many of the key vendors who can assist in executing change and improvement programs.

Grasping the opportunity for change in this area opens an exciting array of potential improvements and areas of value-add. Whether you are interested in vendor contracting or procurement, these are some of the items you should consider:

[Grasping the opportunity for change in this area opens an exciting array of potential improvements and areas of value-add.]

From	To
Cost and risk focus	Strategic contributor and competence
Control and monitoring	Driving innovation (our own and our suppliers)
Bottleneck in time to market	Committed partner in product introduction
Reactive to change, requirements	Proactive modification of process, practice and terms
Image as inhibitors, bureaucrats	Enablers, partners in executing superior deals and relationships

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As we move into 2004, IACCM will continue to work with its corporate members to develop and execute on many of these ideas. That work will take several forms:

- Research projects on special issues or current performance
- Our continued benchmarks of contract and negotiation process and organization
- 'Communities of Interest' that enable executive members to conference (phone and web) on a regular basis and share issues, ideas and techniques
- Rolling out our web based training and occasional web casts that describe current best practices on bid management, contract development, negotiation and contract management.
- Our regional conferences and executive meetings where we introduce leading-edge speakers and peer-led workshops on the major issues confronting the community today

These are just some examples of how we plan to assist corporations in finding practical and low cost solutions that drive their performance and assist in the execution of better deals.

IACCM is a not for profit professional association dedicated to improving corporate performance in contracting and negotiation. Members come from more than 450 corporations in over 80 countries. For more information, see www.iaccm.com

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