



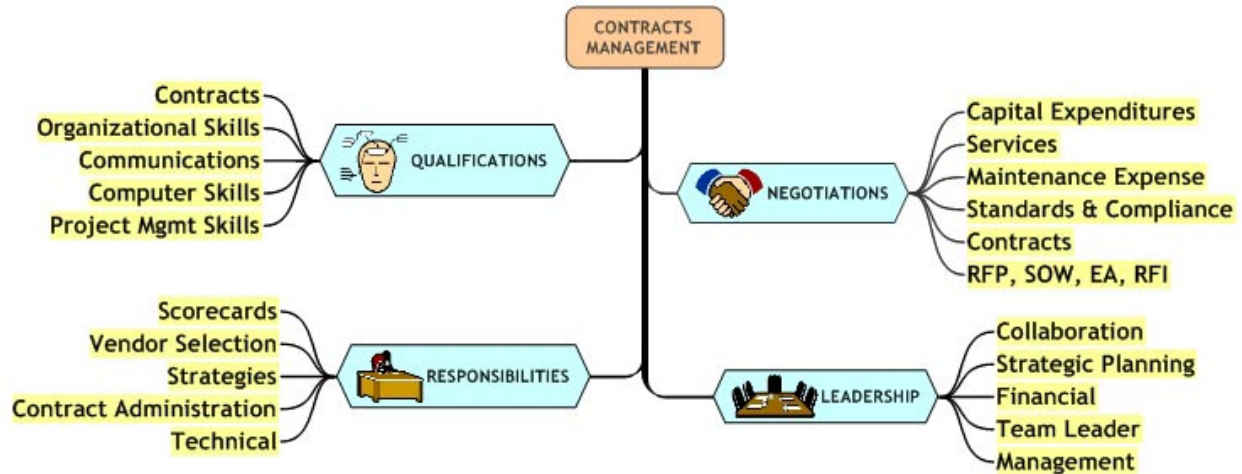
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Contracts Management

What Is It? Who Needs It? How Should It Be Implemented?

WHAT IS IT?

Contracts Management is the process of establishing a formal method of dealing with vendors, contract negotiations, and the renewal/cancellation of existing agreements. The diagram below depicts the activities involved in contracts management and their linkages.



Contracts Management is most successful when set up as a centralized function within an enterprise. The scope can be limited to just technology contracts, typically 75% of any organization's spending, or expanded to include all corporate spending. The process can be established in as little as 6-8 weeks, but can take up to 6-8 months depending on the level of cooperation within the enterprise.

WHO NEEDS IT?

The reasons for establishing a Contracts Management process include the following:

- #1 Runaway expenses associated with ongoing maintenance costs, new equipment or software.
- #2 Conditions, such as periods of rapid business growth, where a manager needs to quickly make one-time technology decisions, but has not been trained or is prepared to source products.
- #3 When spending must be reduced or standards established within a department or the entire enterprise.

In the case of runaway expenses, most companies and department managers do not have an exact idea of how much to budget for next year's maintenance fees. Most managers simply add 10% to their existing

costs and hope it covers all unknown increases. Very often a contract is overlooked or the language does not provide protection from unlimited rate increases. Best Practices for Contracts Management suggests that you:

- First, identify and collect all contracts, agreements, etc, into a centralized area and put into a database that can be queried using the proper tools.
- Second, establish current and future charges based on contract language. At this point you are simply finding all the contracts and costs associated with the contract.
- Third, create a tickler process that will alert you to upcoming contract renewal dates or termination. Typically, most agreements require 60-90 day notice to make changes or to terminate. Set your system up to begin notification at monthly intervals starting 150 days out.

In periods of rapid business growth, more often than not, an upgrade or new product is needed yesterday. This puts additional pressure on the responsible manager to quickly find and buy a product. By having a Contracts Management process already in place, many upgrade costs can be pre-negotiated at "best price" prior to needing it. For a new product, the Contracts Management point person would be involved early on in any technology discussions. That person would source several vendors and be prepared to issue RFIs or RFQs quickly and in a standard format.

Many companies today are reviewing cost reduction as a means to help the bottom line. For example, in the case of a low-margin company with a 2% gross margin, a \$100 reduction in spending is equivalent to \$5,000 in new revenue to the bottom line. Cost reduction is a benefit of a good Contracts Management process. By establishing standards for hardware, software, telecommunications, and services, you reduce your costs by increasing your discounts.

HOW SHOULD IT BE IMPLEMENTED?

Implementation of Contracts Management can occur in many forms. The crucial points are that you have a process that identifies all of your contracts, and that these contracts are managed centrally. The Contracts Management process must fit into your organizational structure and style, and therefore should be customized to fit your needs. There are several inexpensive tools today, that when combined, can help manage the process.

Industry experience is a plus but not a necessity to perform Contracts Management successfully. The author of this report has served quite successfully in several IT Assessments and Contracts Management roles in many disparate industries. He has been unconstrained by accepted industry norms and has often brought new and useful insights to environments limited by "but we've always done it that way" thinking.

An important element of Contracts Management is Vendor Negotiation and Management. Below are some helpful hints in dealing with your vendors.

Assemble resources with the right skills. Build a team and make sure everyone on the team knows their role throughout the negotiating process. Find a numbers person to assess ROI and TCO - especially someone who can evaluate the costs over the lifetime of a potential deal. Recruit someone who knows the vendors' marketplace - both their suppliers and competition. Get a technologist involved (if it isn't you) to assess the underlying technology. Most of all, attract a skilled negotiator; someone with real experience in your industry.

Source multiple vendors. Always negotiate with more than one vendor at a time, and don't keep this a secret from the other vendors. In fact, drop hints about the deals their rivals are offering. Make the vendors compete for your business and you'll always get a better deal

Even as you down-select to one vendor, maintain negotiating leverage by telling your leading candidate things like

“the deal is yours ... if you make these changes,” and then set deadlines for your top pick to agree to those concessions. Any time you indicate a preference to a particular vendor without qualification, you squander your advantage.

Control the clock. Set a timeline to do the deal. For one thing, vendors won't take you seriously if you don't. For another, if you set the deadlines, you can always revise them to maintain control or put additional pressure on the vendor to deliver. Usually a vendor is more concerned about closing a deal to fill a quarterly or annual quota. Find out when they close their books and they are more apt to give you a better deal towards a quarter or annual end.

Keep control over negotiations. Your management needs to support the negotiation team and help prevent any end-runs around the negotiating process. Prepare your company's management team to reinforce the message to the vendor that they deal “only with the negotiating team.” Make sure the vendor understands that they will be dropped from further consideration if they ignore this message and try to circumvent the process.

Vendor agreements. Vendor agreements are frequently little more than giant disclaimers. Only your deal-specific documents will actually describe the deal that you want, and ensure that you get what you pay for. A good substitute is contract language that your legal staff has pre-approved. This will save time in the legal review process and put the burden on their legal department, not yours.

Keep it simple. Make it easy for the members of your team, and more importantly, the ultimate decision makers at your company, to understand the value of the deal you've negotiated. Establish scoring criteria for various offers in advance. Track RFP replies on easy-to-read, single-page term sheets, and when you present your choice to your Executive Team, provide them with simple “stoplight” charts—green (yes), yellow (maybe), red (no).

USE OF AN INTERIM CONTRACTS MANAGEMENT (CM) EXECUTIVE

An effective way of establishing Contracts Management in an enterprise is by bringing in an experienced Contracts Management specialist on an interim basis. An Interim Contracts Management Executive would evaluate existing processes, procedures, and determine areas needing improvement. This would typically involve the following:

1. Organizational overview – gaining an understanding of who purchases product (direct and indirect), who the decision makers are, and the departments involved in purchasing decisions.
2. Evaluation of IT spending patterns.
3. Evaluation of corporate spending.
4. Audit of bill paying processes.
5. Evaluation of current capital expenditures, and analysis of lease versus buy alternatives.
6. Meetings with management on budgets and forecasts.
7. Reviews of departmental budgets for cost reductions.
8. Analyses and recommendations for best price / performance solutions.

The Interim CM Executive must be over-qualified in several regards including integrity, maturity and interpersonal skills, and have extensive, relevant, highly successful experience. There can be no on-the-job learning except, of course, with regard to the detailed specifics of the job at hand. A CM should swiftly bring to bear a powerful reservoir of experience-based concepts and alternative approaches to getting things done in a highly professional and effective manner.

THE CRITICAL SUCCESS FACTORS WHEN USING A CM EXECUTIVE

[1] - The role of the CM Executive must be made clear to everyone involved. The role must be very clearly defined as interim in contrast to anything of a "temp-to-perm" or "acting" nature. A successful Interim CM Executive is, in virtually all cases, demonstrably over-qualified for the role he or she is being asked to play. The expected duration should be widely communicated along with any specific areas of focus such as a troubled project, a set of ineffective processes, or something similar.

[2] - The Interim CM Executive must have easy and swift access to the person to whom the position reports. The "highest and best use" of an Interim CM Executive's expertise is to let him/her quickly establish and institute the Contracts Management process so that it can be sustained after the Interim CM Executive leaves. This can only be accomplished with (a) an open and ongoing dialogue with the senior executive to whom the interim position reports, and (b) the highly visible support of that executive for the Interim CM Executive's actions.

CASE STUDIES

ONE -- A California hospital had purchased several million dollars in a software product from one vendor five years earlier. Their attempt at implementing the software failed, but the bills kept rolling in. Two problems existed: how to reduce ongoing costs of maintenance; and how to get out of a complex contract. Within two months, an Interim CM Executive reviewed, collated, and organized over 2000 pages of contracts and invoices onto spreadsheets and other summary documents. This effort resulted in the elimination of \$1.2 M of unnecessary maintenance charges annually and a very favorable settlement with the vendor that returned \$4.0 M in credits and refunds against the \$10.0 M already spent.

TWO – At this same hospital, maintenance agreements for ageing mission-critical information systems were out of compliance with the vendor. Whenever problems occurred, the existing staff simply called the vendor and asked them to fix the problem on a very expensive time and material basis. The Interim Contracts Management specialist negotiated a proper correction to address the root causes of the problem and saved \$200,000 in the process. This resulted in continued maintenance and fixes to problematic systems so that these mission critical systems can be operated reliably until they are replaced.

THREE – A very large Financial Institution wanted to centralize procurement in order to reduce costs. An additional benefit was the creation of a single tracking system for all contracts, corporate and IT, in one database. Their challenges were regional and political boundaries that inhibited cooperation. The task was to create a position of Director/VP of Contracts Management with overall responsibility for IT and corporate contracts. The Interim CM Executive was successful in getting all departments to cooperate, aligned all decisions into one area, and hired the permanent Director of Contracts Management. In this case, an Interim CM Executive was highly successful in laying the foundation for the eventual position. The success was due largely to an outside expert who had no vested interest in the political issues surrounding consolidation issues.

This report was prepared by the Systems Consulting Consortium, Inc. (SCC) as a service to our past, present, and future clients. SCC provides Interim Contracts Management services of the kind described herein. The case studies are based on our firm's recent experience. For more information about SCC, please visit our website at www.scc.cc or contact us directly.



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