Negotiating a Vendor Contract

Contract negotiation is a key activity that frequently fails to receive the preparation or attention it deserves. This very important step in the purchase and implementation of any technology solution is often treated as its own activity, separate from both the selection and implementation phases. This disjointed approach does not sufficiently acknowledge the need for buy-in and support from the implementation team. It also does not consistently ensure the agreement is based on the critical areas identified by the selection process, and usually fails to contribute to the relationship-building begun during the selection phase.

Instead of being treated as entirely separate activities completed by unique teams, the negotiation is best managed as an integrated part of the process. After all, it is the piece that bridges the selection and implementation activities, and it affects how your organization will work with the selected vendor for years.

As part of the selection process, the organization should have identified whether it wants to just work with its vendor or be in partnership with the vendor. The key differences between these relationships are how the parties are expected to work together and whether there is vested interest in the success of the respective partner entity.

The organization also needs to define what is needed and desired from the vendor as part of the relationship—not only today, but also in the long term. There is an increasing expectation that a vendor should be a partner and not just a service provider. In those cases, the negotiation process is no longer simply about getting the best price and timing the last “x” but is about negotiating an agreement that provides long-term success for all parties. With the proliferation of startup and smaller vendors, too many tightly negotiated deals could jeopardize the stability of the vendor and its ability to provide enhancements over the longer term or even to stay in business.

One of the preliminary steps for the negotiation process is to identify the negotiation team. Many organizations use a “one-size-fits-all” approach, where a contract or vendor-management group steps in to take responsibility for the negotiation process. This method can be impersonal and ineffective by treating every negotiation the same, without taking into account whether this entity is a vendor or a partner. Individuals familiar with this approach advise caution about utilizing the services of a contract group to negotiate a partnership with a vendor relationship.

Lew Semones, chief financial officer of Senderra Funding LLC, Charlotte, North Carolina, says, “[Contract] groups are tasked with beating the vendor down. They are not the right people to build a relationship on or base the relationship on going forward. The contract group is not vested in the ultimate solution.”

It is recommended that the organization be represented by only one to two people during the actual negotiations.

It is recommended that the organization be represented by only one to two people during the actual negotiations.

- Whether the agreement is based on transaction fees, and any price reductions that can be expected as volumes increase, as well as determination of any minimum fee levels.
- The impact of any merger or acquisition on the agreement and fee basis.
- In cases where the application will be customized by the vendor, the organization or both parties, additional factors need to be considered during the negotiation. These include:
  - Who will be completing the enhancements?
  - What is the scope of work and timetable for delivery?
  - Who has responsibility for which components during the enhancement delivery process? What are the parameters for acceptability of the enhancements (testing criteria or other)? How will the enhancements be handled as subsequent versions and releases are provided?
  - Does the vendor guarantee backward compatibility, or are additional costs incurred with each release to re-apply the customization?
  - Are there areas of the application that may be customized by the organization, and others that require vendor support or do not permit customizations?
  - What success factors are used for any customization being requested of the vendor, time frame, functionality, etc.?

Although partnership is the key word, it is still important to have some leverage in the negotiation process. As Semones notes, “The vendor needs to know you have legitimate choices, [and are] not just playing them against each other. Keep two or three vendors involved when going through the negotiation process. If you just negotiate with one vendor, don’t think they don’t know that, too.”

Debbie Shatz is a director with CC Pace, Fairfax, Virginia. She can be reached at shatz@ccpace.com. Barbara Michels and Bill Lehman, directors with CC Pace’s mortgage consulting practice in Fairfax, contributed to this column. They can be reached at bmichels@ccpace.com and blehman@ccpace.com. CC Pace is a financial services consulting firm that custom-designs solutions to achieve both measurable bottom-line results and significantly improved business processes for clients.