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 disparate 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 dotting the last "i," 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 when utilizing the services of a contract group to negotiate a partnership vs. 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; there is no opportunity to build a relationship, nothing to work 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, with additional support and involvement of the selection and implementation teams taking place behind the scenes. Selection-team members contribute insight about the critical decision criteria used in the selection of this vendor and any promises made, while the implementation team members—such as the project manager and business leads—are involved. This ensures they understand and are on board with the terms being set. The involvement of these team members is particularly crucial when any customizations or enhancements are being requested as part of the agreement.

As the vendor selection is based on information and assurances provided during the selection process, should any of the information not be accurate or expected functionality not be available, the team might have selected a different system. Therefore, the contract agreement should ensure the organization is protected and that any promises made or information provided should be a part of the final contract. This is usually done by attaching to the final contract the request for proposal (RFP) response collected from the vendor during the selection process.

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If an RFP process was not used, the critical functionality required from the application and reviewed in talks with the vendor should be documented in writing as part of the agreement. Semones prefers the latter approach. "It's important to identify the five or six essential items you need from the application for the agreement," he says. "You can work through the rest the best you can as part of developing the relationship."

Some areas we have found that deserve careful attention during negotiations include:

- Determination of what, if any, costs are associated with adding or reducing the number of users or transactions, and the subsequent impact on maintenance fees.
- The costs associated with accepting new bug fixes, releases and versions from the vendors, and the services and support included with maintenance and any activities that can incur additional costs.
- The terms or service-level agreements providing the organization with timely and appropriate responses in case of system issues or downtime.
- The types of ongoing training services available to the technical and/or business personnel.
- 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?
- Does the vendor support the organization while investigating issues with a new release where customizations were developed?
- 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."

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