

Best Practices In Commercial Contracting Key Initiatives That Are Driving Competitive Advantage

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Best Practices in Commercial Contracting	132
1 Introduction	132
2 Achieving “Good” Contracts And Relationships	132
3 What Has Changed?	134
4 Tackling The Breakages	136
5 How Does This Relate To Compliance?	136
6 Are Standards Rising or Declining?	138
7 Managing Commitments	139
8 What Does This Mean For Contracting?	141
9 Emerging ‘Best Practices’	141
10 Conclusions	146
Selected Bibliography and Reference Sources	146

Best Practices in Commercial Contracting

Key Initiatives That Are Driving Competitive Advantage

Society and the law are demanding higher quality and integrity in business commitments and are exacting tougher penalties on those who fail. Business managers and executives must consider the impacts on their contracts and related commitment procedures, to ensure their suitability and responsiveness in changing conditions. Lawyers must also reevaluate the role they should play in supporting a more holistic and balanced approach to the management of risk. Traditional organization and methods are no longer adequate. This paper looks at how they must evolve.¹

1 Introduction

Contracts lie at the heart of most business relationships, certainly within Western cultures and economies², and increasingly among all companies or entities that seek to operate in an international market. “Good” contracts and relationships are universally recognized to represent core business value, since they determine key aspects of financial performance. In this context, the term “good” typically depends upon securing and maintaining an appropriate balance of interests that motivates all parties to ensure on-going success.

Different parties naturally approach issues and opportunities with a position that is based on their specific experiences, norms, knowledge, risk tolerance, perceived role, power and interests. This is the case whether they are engaging as a buyer, seller, sub-contractor, alliance or joint venture partner; it equally applies to internal and external ‘stakeholders’ – legal, finance, engineering or product management on the one hand; regulatory authorities, shareholders and competitors on the other.

In a world where the number of inter-relationships and the extent of choice seem to be ever-increasing, how do we ensure effective and timely reconciliation of conflicting interests, to enable the emergence of ‘good’ contracts that form a base for healthy and mutually rewarding relationships?

2 Achieving “Good” Contracts And Relationships

Successful transactions and relationships have always depended on effective internal and external mechanisms to define the terms on which they will be based – and to ensure that these mechanisms remain sensitive to shifts, such as changing needs, altering values, new technology or markets.

¹ The primary sources for this paper are the extensive research and benchmarking studies undertaken by the International Association for Contract and Commercial Management (IACCM) and its member companies over the period 1997 – 2005. Other major sources for reference, confirmation or that support the hypotheses advanced in this paper are either cited in the work, or appear in the select bibliography in Appendix I.

² In the US, for example, research by Aberdeen Group indicated that 85% of business to business relationships are covered by a documented agreement or contract. (Aberdeen Group Contract Management report, 2004).

These mechanisms must enable effective interface or discussion between the parties, to ensure that the balance of interests and relative power of contributing parties is well understood. We will call this aspect “cross-talk”³. It may be enabled electronically, or through document exchange, or via direct discussions. The best method for conducting cross-talk depends on the relative complexity and scale of the divide between positions, and the clarity with which each party has expressed its position.⁴

At this point, it is worth noting that the traditional, face-to-face discussions that typically underpinned complex or important relationships are fast eroding, to be replaced by electronic communications. Indeed, a recent IACCM survey⁵ revealed that in the United States, nearly 85% of business-to-business negotiation is now ‘virtual’. In cultures such as Scandinavia, it is lower - around 40% - but increasing fast, as technology permeates further, remote working becomes more frequent and geographical distances between trading partners increase.

The second mechanism that must exist is the ability to reconcile differences – or indeed determine when differences are most likely irreconcilable in the time or with the resources available. This mechanism must operate at the outset and through the lifetime, or term, of the agreement. We will call this aspect “integration”. While underlying data and management information to support this capability is increasing through automated tools and resources, its interpretation and associated action remain dependent on human skills and intelligence.

It is important to observe that integration does not always depend on agreement on each element of the underlying deal. This is especially true of the contract terms, where relative power, differing perspectives on importance, or influences in respect of timing may result in agreement to disagree, or acceptance of a unilateral position. In such cases, once side has been successful in persuading the other that the overall relationship has far more value and significance. In the words of one top executive “We always explain to our clients that it is long-term collaboration that matters – and collaboration occurs in spite of the contract”.

This approach remains typical in situations where one party is perceived as having significantly greater power than another; however, while it may be expedient in terms of speed and advantageous to one party in terms of their acceptance of deal (transactional) risk, it damages trust or integrity and is therefore contrary to risk interests over time. Other parties to the deal or relationship will consistently seek ways to redress the balance of power and

³ The term ‘cross-talk’ comes courtesy of Richard Christou, Chairman of Fujitsu Services, delivered in a speech to the IACCM EMEA Conference, held in Munich on September 12th 2005.

⁴ ‘Cross-talk’ is made significantly easier if all parties have described the nature of their concern, rather than simply issuing rigid rules or ‘no-go’ areas. This facilitates potential reconciliation.

⁵ Cf. “Patterns in Negotiation”, IACCM July 2004.

assert their interests – ultimately, if necessary, through the demise of the inflexible party.⁶

Case Study: New Cost Cutting Scheme Worries Suppliers

Planning Perspectives' OEM Benchmark Survey shows that a combination of better manufacturing and engineering practices, as well as better and more collaborative working relationships with suppliers contribute to the overall success of the Japanese (compared with US owned auto-makers).. "Everyone is always looking for the silver bullet but there really isn't one," said Dr. John Henke, marketing professor at Oakland University in Rochester, Mich., and president of Birmingham, Mich.-based Planning Perspectives, Inc., which specializes in studying buyer-supplier relationships at major U.S. corporations. "We've seen that in every industry and company we have studied good overall performance results from better management of key processes across a company. It really gets down to a question of culture. Which company's management can rally the troops to accept nothing less than continuous improvement in everything they do, from providing their customers high quality goods, to being efficient internally in all operations, and to having good working relationships with their suppliers?"

3 What Has Changed?

So far, there is nothing revolutionary in what this paper is expounding. The twin aspects of “cross-talk” and “integration”, while useful concepts, are simply ways of defining activities that have always underpinned good and lasting relationships. In some cultures, they have been supported by extensive written documents, such as contracts. In others, the need for discussion and documentation has been limited by the existence of a large body of statute law, regulating relationships and limiting the room for debate. In a third group – primarily where codification of law has been less relevant or necessary – relationships are formed and governed through informal (though potentially intricate) methods and social norms.⁷

⁶ There are of course many instances of the balance of power issue throughout social and political history; but in an industrial context, it has been shown that companies or industries that consistently abuse their ability to exercise power to a point that exceeds ‘fairness’ suffer in terms of performance and enable the growth of competition. Examples come from the technology sector, where companies such as IBM and Microsoft have faced not only damaging perceptions of ‘arrogance’, but also specific anti-trust investigations driven in large part by their trading terms, relationships and practices. In another example, Professor John Henke has undertaken regular reviews of the automotive industry and the trading practices of the major vendors in relation to their supply base. His findings have been all too clearly reinforced by the retreat into Chapter 11 bankruptcy of Delphi, one of the largest automotive supply companies, while this article was being written. See for example The Detroit News, May 31st 2005 “GM-supplier relations erode: Manufacturers say automaker doesn't care about their financial struggles.

⁷ Although this third group includes many developing nations and economies, that is not exclusively the case. Japan is of course the most notable of the economically advanced nations where relationships have tended to be governed by mechanisms based on socio-

Relatively small communities that share common understanding of principals such as rights and responsibilities, and have a high degree of interdependency, may be able to dispense with the need for extensive discussion or documentation and instead base their dealing on mutual trust, respect and the need for reputation. In situations where everyone knows the rules and their ability to prosper depends upon honoring those rules, there is no purpose in allocating time or resources to lengthy debate or writing and recording. Similarly, geographic proximity and a common language typically facilitate continued dialogue and the resolution of problems, misunderstandings or changes.⁸

This approach begins to break down once deals or relationships start to cross borders or move into new forms of relationship, unfamiliar to one or more parties. As we go outside our established culture, norms, experience and knowledge, we maintain standard assumptions at our peril. Frequently, we don't even know what we should be asking – because we may have no established way of analysing the differences between our norms and those of the other party. Should we remain silent – and find out as we go along? Or should we ask questions – and perhaps risk alienating the other party or discovering things that may significantly impact our potential for reaching agreement?

Of course, there are many times when dominant interest groups (especially those in Sales, but often including target-driven executive management) prefer this 'ignorance is bliss' approach. They would like to close the relationship and worry about the details later. Unfortunately, those 'details' may be so significant that they will in fact destroy the relationship – perhaps at major cost and exposure to the company. Obvious examples include situations where companies have exposed their intellectual property, or have destroyed their ability to enter an important market through an inappropriate distribution relationship, or have encountered major losses in performing on a contract with unexpected complications and service obligations.

Even when we are operating in familiar geographic and cultural surroundings, there is significant risk when we move into unfamiliar forms of relationship. Outsourcing is a primary example of that. Indeed, the point is rapidly illustrated when we consider that some 70% of outsourcing relationships fail to meet business goals and objectives. How can so many sophisticated international corporations, with their armies of lawyers and other professional resources, attain such a high rate of failure?⁹ The answer, I will suggest and seek to demonstrate, is because of a breakdown in their methods of 'cross-talk' and 'integration'.

economic, rather than legally defined, factors – as evidenced by the remarkably low number of qualified attorneys.

⁸ While national or regional groupings – such as Scandinavia – are the main examples of this, it may also apply within industry or trade groups.

⁹ Based on published industry data from Outsourcing Institute, Boston Consulting Group, CXO Forum and others – 2004 / 2005. See listing of sources in Appendix.

4 Tackling The Breakages

Two massive breakages are impacting today's agreements and relationships. One – the driving force – is communications technology, “the digital revolution”. This is affecting not only *how* we must do things, but also *what* we must do. This ‘what’ is increasingly dominated by a dramatic surge in operational workload and major gaps in our knowledge and understanding, and in the expectations of our trading partners, as we are forced into new interfaces and new ways of thinking.

All societies and all social groups are being steadily exposed to each other, with increasing inter-dependence. This globalisation of relationships is forcing re-assessment of the way we do things and the knowledge we require to do them. We have to ask ourselves, do I any longer truly understand the positions and interests of all the parties? Do I have the ‘cross-talk’ mechanisms in place to facilitate this understanding? Do I have the ability to ‘integrate’ what I discover – the power and authority, tools, systems and resources?

There are some who will say ‘this doesn't affect me – I only operate within my traditional boundaries. I don't need to do things differently or learn anything new.’ Let's spend a moment considering that statement:

1. ‘Traditional business’ must surely represent a rapidly diminishing area of opportunity. Few nations or businesses remain isolated for long – and how are you planning to remain employable once the change catches up with you?
2. Few companies or organizations – whether buying or selling goods and services - are unaffected by shifts in world trade or regulation. Whether through UN Treaties and Conventions, or regional directives (e.g. within the European Union) or changing international standards (e.g. convergence of accounting standards, industry regulation through Basel II or the Hague Convention, agreement on common e-commerce standards), any business or professional that maintains an attitude of immunity exposes both themselves and their company / organisation to risk. They are certainly not behaving as a ‘cross-talker’ or ‘integrator’.

Enabling the right cross-talk and integration is at the heart of risk management. Together, they offer the mechanisms for reducing uncertainty and controlling consequences through effective management and oversight.

5 How Does This Relate To Compliance?

In this era where Corporate Governance so often hits the press, there are many who will ask where contracting and relationship management fit in the context of compliance.

Compliance is not new. Developed countries have for many years regulated relationships based on social or political policy and values; these regulations

may be designed to foster open competition, or they may be deliberately constraining and protective.¹⁰ Obvious examples where measures seek to protect the public good relate to bribery and corruption, or responsibility for actions that cause physical harm, or standards of proficiency, education or safety.

In all countries, with or without regulation, ‘reputation risk’ has acted as a spur for compliance. Although not foolproof, it provides the incentive to operate within local custom and norms (even when those customs and norms may not be desirable from an overall social development perspective). People are driven by the wish to avoid unpleasant consequences that could range from direct and personal retribution (e.g. from cheating a local warlord), to erosion of sales or supply due to a loss of confidence by potential customers and suppliers (e.g. if service, payment or delivery promises are consistently missed).

Today’s governance regulation is therefore the continuation of a trend, albeit an accelerated trend, with far more immediate worldwide impact than in the past. There is also greater formalisation, with standards now documented and their imposition overseen by external authorities – sometimes by treaty or convention (for example, the United Nations) and sometimes self-appointed (e.g. US or EU claims to ‘extra-territorial’ authority).¹¹

“Compliance” is a vehicle to ensure “integrity”. It is viewed as desirable because it accelerates world trade and supports profitable business. Of course, these advantages are why others see such moves as highly undesirable and a threat to their interests (‘terrorist’ organizations threatened by loss of power and control over their communities are the most extreme example). The reasons that regulation is increasingly the path chosen to drive compliance are:

1. Standards are rising;
2. Expectations regarding the speed of change are more aggressive (especially in the United States);
3. Old methods based on trust, common understanding and reputation cannot work – or at least could not be achieved in an acceptable time-frame.

Therefore the pressures for corporate governance and compliance are in fact also the result of the influences already mentioned – that is, technology that enables global relationships, between people or organisations that do not fully share cultural values or norms. “Compliance” is just one aspect of “commitment management”.

¹⁰ At a national level, this conflict in approach is starkly evident in the European Union, with the dramatic differences between a country like the UK that espouses open trade, versus behaviours in France or Germany, where techniques ranging from protective cross-shareholdings to specific government intervention attempt to limit ‘foreign’ holdings or equitable access to strategic opportunities.

¹¹ Examples range from Revenue Recognition rules and Sarbanes-Oxley, to Environmental legislation and data privacy rules in the EU. International agreements include examples like Basel II and existing or pending UN conventions like UNCISG, or anti-corruption, or emerging standards on electronic commerce.

For the present, regulated compliance is important because it attempts to create a core, common rulebook – a few basic rights and obligations (mostly obligations) in an uncertain world. For those of us involved with contracts and negotiation, they have introduced new concepts and limitations; they have also created new uncertainties – especially with regard to the expectations of the regulatory authorities.¹²

Essentially, that is the role that contracts and the contracting process should perform – bringing certainty where it was lacking or was perhaps open to varied interpretation. And because right now there is so much uncertainty and potential for different interpretation, businesses need experts who are motivated and trained to manage ‘cross-talk’ and ‘integration’, to ensure understanding and oversee results – and who accept accountability for outcomes.

Case Study: The Cost of Risk Avoidance

A New York Times article in mid-2003 featured a softening by Microsoft of its third party indemnity provisions in customer contracts. An Associate General Counsel explained how, after extensive review, attorneys at Microsoft recognised that they were protecting against ‘a phantom menace’ and had therefore revised a clause that ‘for years’ had ‘stuck in customers’ throats’ and added ‘60 – 90 days to many corporate negotiations’.

There are many who hail this move as responsive to customer needs. Others see it as a systemic failure in risk management. While it is certainly true that Microsoft had been well-protected against the ‘phantom menace’, at what cost? Confrontations like this would certainly have impacted its reputation and customer perceptions of ease of doing business; and what about the additional resource cost, fighting such needless battles (attorney time is not normally noted for being cheap); then there was the cash flow impact, delaying sales on average by 60 – 90 days.

Risk management is about balancing consequence and probability. Here is an example where consequence was managed without regard to probability – and as a result, other risks and exposures became inevitable. Lack of balanced cross-talk and integration, failure of ownership and accountability, combined with a transactional view of the world, caused initial failures in risk management. These same weaknesses then led Legal to view this situation as a positive outcome – to the point where they felt it merited a story to the press!

6 Are Standards Rising or Declining?

It is important at this point to address the assertion made above that ‘standards are rising’. In what sense is this meant and what evidence do we have to support such a claim? After all, many members of the general public would see the

¹² Lack of precision and the absence of any body of case law leave organisations uncertain about required standards to ensure compliance. These uncertainties affect initiatives in areas like Corrupt Practices, and also in a range of security and governance requirements – data privacy, Sabanes-Oxley, HIPAA are examples. The dilemma for buyers and sellers is to know when they have acted with ‘due diligence’ in protecting against risks in key areas of performance and the liabilities that might flow from non-performance.

frequent press stories of corporate greed and corruption as evidence of declining standards.

Overall, companies today are expected to make more extensive commitments; they must be transparent; and they face larger penalties or consequences if they fail to honour their commitments or to operate with openness and honesty. Examples for the growing extent of commitments can be drawn from a variety of sources, such as the level and nature of warranties and performance undertakings, the demand for specific (and often customised) service levels, the responsibility to protect personal data or to consider the interests of employees and the environment. Moving on to transparency, they must consider and declare the possible consequences that may arise from use of their product or service, or disclose areas of their business practices. Again, examples abound. They range from worldwide action on bribery and corruption, to the use of child labor; they must publicise drug, tobacco or alcohol side-effects, and open accounting practices and material risks to scrutiny. Transparency today even includes the need to warn people that spilling a hot drink could result in burning!

Finally, the consequences of failure to operate at acceptable standards have become more onerous and more immediate, whether in terms of regulatory or social oversight. At both governmental and non-governmental (NGO) level, companies and public agencies are subject to closer scrutiny and heightened likelihood of exposure – even for things that may not transgress current law. Where there is legislation, courts worldwide are growing more likely to impose heavy penalties on companies and their leaders if they mislead others or damage them, whether deliberately or not. The much-publicised cases of Enron, MCI, and Parmalat represent the extreme. There are many more instances where inadequate disclosure, attempts to falsify, or even rumors of impropriety have led to action or loss of market confidence – Shell, Credit Suisse, KPMG, Andersen and ABB are recent examples.

7 Managing Commitments

The issue of standards stretches far beyond the courts. In today's digital networked economy, the greatest harm can often arise from damage to reputation ("reputational risk"). Instant transmission of information on a global scale means a world increasingly without secrets. Failure to match social expectations of responsible or ethical behaviour carries a high price – and companies must ensure their practices and the practices of their suppliers, business partners, franchisees and outsourced providers will stand up well in the glare of publicity. British Airways, BP, ABB, Exxon, McDonalds, Coca-Cola, Carnival Cruise Lines, Telstra, Chinese testing laboratories, South American computer manufacturing plants, Indian call centres – these are among a host of companies that have had to engage in rapid damage control, often because of external contracted relationships, because of 'failures' (or alleged failures) in their social or regulatory responsibilities.

The truth is, companies and public bodies can lose confidence and revenues at a much faster rate than in former years, and be punished for a much wider range of ‘sins’. Certainly, many of history’s business heroes (and politicians or public servants) would not fare well under current business practices and standards.¹³ But on the positive side, those with a strong and differentiated image can communicate rapidly to a much wider audience – and hence build a global reputation and drive revenue growth at a much faster rate than was historically possible.

We summarise all this as ‘commitment management’ – that is, the ability that a company or organisation demonstrates in evaluating its needs and capabilities to operate in selected markets (or in accordance with its appointed mission); its ability to develop and document those needs and capabilities; and its ability to negotiate, manage and update those commitments to ensure successful delivery against agreed targets or goals.¹⁴

The importance of effective commitment management varies according to the strategic significance of the product or service being acquired, or the relationship being established. Frequently, organizations do not adequately understand or shift their behaviours to reflect this. For example, many Legal or Finance departments tend to issue blanket rules and policies that constrain discussion or drive confrontation, in situations which truly require a more collaborative style and approach. Attitudes and rules that may be entirely logical in the acquisition or supply of commodities or standard services are then applied to strategic supply relationships. Whether acting as buyer or seller, it is critical to understand the negative impact that will flow from applying one-sided commodity terms to a strategic transaction or relationship.

This principle of ‘commitment management’ is the key outflow from the adoption of ‘best practices’ in contracting.

It is important to emphasise that the contracting process is not a vehicle for the creation of corporate or organizational capabilities, but that it must accurately reflect them. Failure to achieve this means a risk of either over-commitment (things that cannot be done, or cannot be done affordably) or under-commitment (missed opportunities for higher value and a stronger negotiating position). Experts who expect to be consulted during the contracting process have a responsibility to ensure their advice is more than academic; it must be based upon business realities.

¹³ Recent works on Henry Ford and Andrew Carnegie are but two of many examples; *see* Bibliography.

¹⁴ There is increasing recognition – for example, through the Harvard Negotiations Project - that the ability to define needs and capabilities, and then to explore their optimal linkage, lies at the heart of good contracting. It is fundamental to ‘interests-based’, as opposed to ‘positional’, contracting and negotiation. With today’s speed of change, successful organizations ensure continued oversight of changing needs and capabilities, to ensure contract sand relationships are actively managed and updated throughout their life-cycle. *See* later section detailing Best Practices. For illustrative work, read *Getting Past Yes: Negotiating As If Implementation Mattered*, Danny Ertel, Harvard Business Review, November 2004.

What this paper has sought to illustrate is that today's fast-changing and increasingly competitive environment has dramatically shifted the importance of commitment management. Since contracts are the traditional vehicle through which these commitments are defined and managed, it is probable that the contracting process will be impacted by such changes – and therefore may need some revision, or perhaps fundamental re-engineering. It is this that we will now move to explore.

8 What Does This Mean For Contracting?

Evidence increasingly points to the fact that contracting in most companies is under stress. This includes both objective measures – for example, contract production and negotiation lead-times, the frequency of negotiation – and subjective opinions – for example, the experiences of those in the contracts community or the perception by executive management that contracts are 'a roadblock'.¹⁵ These experiences are resulting in growing pressure to revise key aspects of contracting. Frequently their first manifestation is through organisational change, a belief that the issue can be fixed by a change in reporting line or pressure for more localised 'empowerment'. In truth, such initiatives have no significant impact; the real issue in many corporations is that contracting remains a series of fragmented activities, with no overall ownership or control, and where terms and conditions frequently fail to reflect core business policies, practices or organizational capabilities.¹⁶

It is from this environment that a new wave of 'best practices' are beginning to emerge, as leading companies – and some Government bodies – steadily appreciate that contracting competence is a potential source of competitive advantage or, more normally, that failure to fix its current inadequacies represents a serious source of competitive disadvantage. In today's environment, a company cannot afford to be 'difficult to do business with' and it cannot afford to force frustrated staff to make unauthorized commitments because internal procedures are too slow, cumbersome and bureaucratic, or simply because no one knows the answer.

9 Emerging 'Best Practices'

In recent years, IACCM's attention has turned to the question of 'best practice'. Given the situation outlined above, it has proven difficult to establish reliable measurements that show consistent superior performance. Indeed, few corporations capture data that would enable quantitative analysis of their performance, unless in very specific areas such as billing accuracy or percentage

¹⁵ Evidence has been collected through a variety of IACCM studies and benchmarks, together with those from analysts and other external research agencies, including Aberdeen, Gartner, the General Counsel Roundtable. See Source List for citation of relevant studies and reports.

¹⁶ Cf. *The Status of Commercial Contracting*, IACCM January 2005.

of compliant contracts. It is rare to find companies that can specify the frequency with which particular topics are negotiated, or the percentage of contracts experiencing disputes, or the proportion that achieve or exceed their initial goals. In general, substantive measurements are only available in companies with highly standardised forms of agreement, typically in consumer or commodity environments.

When we look at companies handling more complex projects or engaged in business-to-business relationships, the measurements tend to become more qualitative – customer or user satisfaction, for example – or subjective – negotiated savings achieved. While Purchasing tends to have more robust forms of measurement, even they struggle when dealing with items like services, solutions or projects.

Since best practices are generally seen as relying on benchmark comparisons¹⁷, does this shortage of measurement data mean that efforts in this area are doomed – or at the very least, so subjective that they have no value? Our work has led us to conclude that is not the case; there are indeed practices that lead to superior and measurable performance; among them are the practices that enable the measurement to occur – on the basis that ‘if you cannot measure, you cannot improve’.

So the first item on our list of best practices is, perhaps unsurprisingly, the issue of ownership and accountability for the contracting (or ‘commitment’) process. Companies must recognize that contracting is a process, not a series of unconnected steps that result in the creation of a document. Increasingly, in our electronic era, there may never be a consolidated ‘document’ with a physical signature. “The contract” is a series of commitments and promises that reflect the relationship and obligations between two or more parties; its content may be created through a variety of mechanisms, recorded at varying times and involving a range of different stakeholders. Someone must then manage the consequences of those commitments, ensuring adherence, suggesting or overseeing change. The frequency of those changes – for reasons we have expounded elsewhere in this paper – is increasing; hence the need for regular ‘audits’ of term standards, contract structures and existing agreements – our ‘best practice number two.

Case Study

In the early 1990s, International Business Machines embarked on a major, worldwide advertising campaign, using the banner “big solutions for a small planet”. The implications of the advertisements were that IBM would provide integrated products and services on a worldwide basis – an astute response to growing market demands. However, the reality was very different. Behind the marketing lay powerful business functions – product management, finance, legal – that fiercely resisted the implications of this new ‘promise’. Contracts were national and sought to prevent overseas movement of goods; the terms made interoperability a customer responsibility under the ‘selection and use criteria; there

¹⁷ Rosabeth Moss Kanter (Editor) *Best Practice: Ideas and Insights from the World’s Foremost Business Thinkers*, Perseus Publishing, 2003.

were dramatic variations in pricing, which was based on national markets. Customers who sought to buy ‘globally’ or top purchase ‘solutions’ faced frustration and obstruction – and this contributed significantly to the major threat that IBM faced at the time of Lou Gerstner’s appointment. It represents a classic example of how a company with great products can be almost destroyed by its inability to offer the right commercial terms and capabilities.

To remain competitive, all companies must regularly update their products and services – features, functionality, sources of value and difference. Often they forget that the commercialization process requires tight integration with terms and conditions. Not only must the ‘clothing’ of the product or service be appropriate to the market at the time of product or service launch, it must also remain up to date to ensure competitiveness. A simple example of this might be the scope or duration of warranty. Others include the form that warranty service may take, replacement policies, payment terms, performance undertakings or the scope of permitted use. In IACCM’s work, we have encountered frequent examples where internal policies or procedures had become out of line with market needs and practices – for example, enterprise use definitions, geographic licensing practices, service levels or inter-operability.

Most lawyers and contract professionals see their primary role in terms of risk management. Our best practices work has demonstrated the inadequacy of performance by most such groups and professionals. They demand high levels of *control* over the process by which contracts are created, but deny *responsibility* for the quality of outcomes. They focus on risk avoidance and containment, to a point where they often increase the *probability* of risk occurring, or in fact generate alternative risks – like loss of business or failure to realise the total size of the available opportunity. Our observation is that the focus on transactional risk is a major contributor to this weakness, the belief that every deal is different and there is limited space for replication, sharing or empowerment of others in the business. Best practice groups focus on enabling others through tools, education and training, and then monitoring their performance to ensure risks are contained and on-going improvements are achieved. They look to invest their skills not in mundane and repetitive transactional activity, but in high-value, genuinely innovative relationships or situations.

Many of the remaining items in our ‘Top Ten’ best practices flow from the characteristics described above, but one is more fundamental – it is the practice we call ‘value-chain focus’. This relates to points made earlier in the paper – the need for a more focused and integrated view of ‘commitment management’ across the organisation. When business capabilities or product performance are enabled by external supply relationships, these must be designed and negotiated in a way that supports organizational capabilities and on-going flexibility. There has to be a seamless flow-through of commitments from suppliers on one side, to customer and market requirements on the other.

1. *Ownership and Accountability for the Contracting Process*: Best practice corporations are making contracting a defined and managed process, not a series of fragmented activities that produce a consolidated set of

documents or focus on risk containment. They ensure that someone in the organisation feels ownership for the effectiveness of the process from bid inception to contract close-out and is accountable for the quality of its results. *OBSERVATION*: The isolated best practice examples are either in smaller corporations (less than \$2bn annual sales) or within a specific geography (the UK leads in this characteristic).

2. *Terms and Structure Audit and Update*: Best practice corporations ensure the on-going competitiveness of their terms and the ease / efficiency with which contracts are finalized and updated / changed. They have systems in place to capture internal data and to monitor competitive practices. They ensure that time is being spent in the most productive areas, not repetitively addressing the same issues. *OBSERVATION*: Less than 3% of corporations have systems or market intelligence mechanisms that generate competitiveness indicators for their terms. Less than 15% have a readily accessed portfolio of contract structures that maximize internal efficiency and ease of doing business.
3. *Integration with Product Lifecycle Management (PLM)*: Best practice corporations have aligned their contract resources and tools with Product Management / Marketing to ensure that products and services are clothed with terms and offering capabilities that enable competitiveness throughout the product life-cycle. *OBSERVATION*: Less than 10% of corporations currently have clearly designated contract resources interfacing with product commercialization; less than 5% have defined resources, processes and methodologies to support PLM.
4. *Portfolio Risk Management*: Best practice corporations move beyond a situational analysis of risk to ensure that their internal systems enable a balance between consequence and probability, that risks are also viewed and monitored as a portfolio, and that risk mapping techniques are used throughout the contract and negotiation process to support highly visible enterprise risk management data that covers both contractual and relationship risk. *OBSERVATION*: Approximately 20% of corporations are considering ways to address risks at a portfolio level. Less than 0.5% have progressed to using mapping techniques for overall contract and relationship risks.
5. *Value Chain Focus*: Best practice corporations have addressed the integration of buy-side and sell-side contracting to ensure efficient, synergistic relationships that support responsive delivery capabilities against shifting market / customer requirements. *OBSERVATION*: Nearly 20% of corporations have some degree of integration between sales contracting and procurement. Several leaders are exploring more formal consolidation into a Supply Chain organization.
6. *Electronic Contracting Strategy*: Best practice corporations assess the potential scope of electronic tools and systems that could streamline their contracting process, from inception to close-out, and develop a holistic strategy towards the acquisition, development and implementation of those tools, including integration with other enterprise applications and strategies (for example, e-commerce). *OBSERVATION*: approximately 50% of

- corporations have implemented some element of an electronic contracting process, but less than 2% have an electronic contracting strategy.
7. *Self-help Skills Assessment and Development Tools*: Best practice corporations are implementing tools and support that give substance to employee development and effectiveness, at both functional level and by extension to 'empowered' workers who need to perform a contract negotiation or contract management role. *OBSERVATION*: While internal assessment and development counseling are relatively common, few corporations have automated the process by which employees can self-assess or find a variety of on-demand resources to support learning and development. Less than 3% undertake any form of external benchmarking to validate their investments or to set parameters that might establish competitive advantage.
 8. *Strategically Aligned Measurements and Reporting*: Best practice corporations are using sophisticated tools and techniques to create more refined measurement and motivation systems that incent collaborative behaviors between internal functions. They also determine key performance indicators that are maintained and adjusted to support corporate goals and strategies, drawing from established and respected methodologies. *OBSERVATION*: Less than 25% of corporations have developed the data capture systems needed to support collaborative measurements or associated reporting. Less than 2% have introduced refined measurement and reporting systems that support linkages between contracting and achieving key corporate strategies.
 9. *Pro-active Change Management*: Best practice corporations focus efforts on building their post-award contract resources and capabilities to drive optimum performance. This is differentiated by the pro-active identification of need / opportunities for change, thereby reducing disputes, maximizing financial results and cementing relationship values. *OBSERVATION*: Less than 12% of corporations have highly skilled or motivated post-award contract management resources with the role, status and measurements needed to achieve or exceed intended results. There is only a handful where these resources are well aligned within an end-to-end contract and negotiation process.
 10. *Differentiation and Sources of Value*: Best practice corporations have commitment management groups that can describe their differentiated role (relative to other internal groups) and the values they provide (in terms of specific, measured contributions to business performance and tied to corporate strategy). They also have methods to disseminate this information in an effective manner that creates internal awareness and understanding of their role and contribution. *OBSERVATION*: More than 70% of commitment management groups do not feel that their role and contribution is adequately understood. There are approximately 2% with innovative approaches that are in process of implementation.

10 Conclusions

Contracting and those responsible for its performance face a period of dramatic change. As with other business functions, they will either adjust or have adjustment imposed upon them. Already we see the wave of off-shoring and outsourcing changing the face of corporate organisation – and the lawyers and contract managers are not immune.¹⁸

The commitment management community – buy side and sell side – must become much more effective and efficient at enabling business capabilities. They cannot be roadblocks and they cannot remain focused on risk avoidance or risk containment to the exclusion of creativity and innovation. The shape of ‘enterprise risk’ has changed. To remain competitive in global markets, Western companies have to become more efficient and more imaginative than their emerging rivals. They must deliver unique value propositions that will increasingly depend on original ideas, superior methods and skills. Traditional roles or individuals that impede the speed or creativity of the business will be replaced. These are the messages that come loud and clear from IACCM research. These are the needs and imperatives that underlie the new best practices in commercial contracting.

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¹⁸ Forrester Research, September 2005.

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