Reducing Value Leakage in Complex Contracts
Leaky Faucet Syndrome

Bottom Line Impact
-9% to -45%

IACCM
Aberdeen Group
IAOP
Let’s Talk!

• What ways have you (your organization) lost contract value from conception (initiation of the business case) to close out (end of the relationship)?

• Think about things like:
  • Incomplete specifications
  • Non-value added change orders
  • Poor contract management
  • Etc.

• What type(s) of contract has the greatest risk?
What is a Performance-Based Contract?

Typically, performance-based contracts contain the following five critical components:

1. Performance Work Statement (PWS) a.k.a. Performance-based Statement of Work (SOW),
2. Quality Assurance Surveillance Plan (QASP),
3. Performance-Based Metrics,
4. Contractual incentives (positive and/or negative), and
5. The right pricing arrangement.
What is an Outcome-Based Contract?

Typically, outcome-based contracts build on contain the elements of performance-based contracts by following these 5 rules from Vested Outsourcing:

1. Outcomes-based vs. transaction-based business model,
2. Focus on the what and not the how,
3. Clearly defined and measurable Desired Outcomes,
4. Pricing model incentives are optimized for cost/service tradeoffs, and
5. Insight vs. oversight governance structure.
Opportunities for value leakage appear at every step in the process...

Compelling business need (for change)

- Develop strategy
- Evaluate risks
- Define business needs/measures
- Create solicitation package
- Issue RFx

Develop strategy
- Evaluate bids
- Perform due diligence
- Down-select for negotiations
- Alternate proposal consideration?

Evaluate bids
- Establish targets and plan
- Manage risks and opportunities
- Negotiate contract(s)
- Approval to award

Negotiate
- Perform pilot(s)
- Implement transition plan(s)
- Transfer assets, processes, people
- Commence service delivery

Transition
- Implement governance
- Monitor performance
- Institute change management

Govern

Late engagement with procurement
Misalignment of business need with sourcing strategy
Lack of mature supply base

Inappropriate make/buy decision
Unrecognized risks
Neglected SMEs
Over-engineered requirements
Lack of measures

Evaluation as a “math game”
Incomplete due diligence
Stakeholder interference

Lack of process
Lack of risk register
Poor negotiation playbook
Inadequate negotiation skills
Lack of discipline
Rush to sign

Environmental “surprises”
Transitioning too much at once
Disagreement on acceptance criteria
Unmeasurable SLAs

Governance as an afterthought
Lack of innovation
Poor operational execution
Low adoption rates
Invoicing errors
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Defining the Compelling Business Need

Enterprise Strategy

Business Unit Strategy

Sourcing Strategy

Procurement Plan
Outlining the Business Objectives

Examples of the “why”:
• Improve margins
• Accelerate innovation
• Improve speed to market
• Access to critical skills or technology
• Ability to focus on “core” work
• Convert from CapEx to OpEx
• Remediate technical debt
• Incumbent performance
Alignment starts at the business objectives which then leads to the relationship type, which then dictates the contract requirements, which then dictates that contract structure, and finally, the level of management.
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Develop

- Define business needs/success measures
- Develop sourcing strategy
- Create procurement plan(s)
- Evaluate risks and opportunities
- Develop the solicitation package
  - Create/tailor Terms & Conditions
  - Develop SOW/SLAs
  - Design Pricing Structure Templates
- Issue RFx
Assure that bidders clearly understand what is expected of them

• Align all SOW requirements with Sourcing Strategy and Statement of Direction
  ✓ Leverage SMEs for technical specifications
  ✓ Assure stakeholder buy-in
• Avoid over-engineering requirements or mandating unnecessarily custom solutions
  ✓ Describe “what” is needed but let suppliers define “how” to perform the work
  ✓ Guard against scope creep, keeping tradeoffs amongst cost, schedule, and quality in mind

• Baseline capabilities and assure that metrics are reasoned, reasonable, and achievable
• Assure that intent is clear regardless of who reads the contract (especially if it’s a judge)
• Assure interoperability amongst contract elements (i.e., SOW, SLAs, T’s & C’s, and Pricing)
• Levy enforceable requirements (i.e., “shall” vs. “will” vs. “may”)
• Build enough runway and start early
Getting supplier performance right...

CSF (enterprise outcome measure)

SLA (highest priority measure(s) that drive the Supplier’s results) OR

SLO (if Supplier doesn’t own end-to-end) OR

OLA (if multiple Suppliers)

Process metrics (as needed to monitor that KPIs can/will be met)

Operational metrics (as needed to collect data for process improvement, root cause analysis, training, etc.)

Example: IT Service Desk

Performance against desired outcome
  • Productive, happy employees

Performance against desired result
  • Customer satisfaction
  • Resolution rate

Performance against processes
  • First call resolution
  • Average speed of answer
  • Call handle time
  • Use of self help

Performance against tasks
  • Negative abandon rate
  • Contact escalation percent
  • Number of automated password resets

= Buyer (or Vested deal)  = Supplier

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Choose the best solicitation approach for the business need...

Maturity Level Needed (by both Buyer and Seller)

<table>
<thead>
<tr>
<th>Maturity Level</th>
<th>Key Characteristics</th>
<th>Outcomes</th>
<th>Options</th>
</tr>
</thead>
<tbody>
<tr>
<td>Stage 4 –</td>
<td>• Strategic partnerships</td>
<td>Create and sustain an innovation culture leveraging Suppliers</td>
<td>RFS, RFP, RFI</td>
</tr>
<tr>
<td>Trusted Advisor</td>
<td>• Champion of change</td>
<td></td>
<td></td>
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<tr>
<td></td>
<td>• Strategic alignment</td>
<td></td>
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<tr>
<td></td>
<td>• Strong influence with the business</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Stage 3 –</td>
<td>• Strong process maturity</td>
<td>Deliver business value through strategic sourcing</td>
<td>RFS, RFP, RFI</td>
</tr>
<tr>
<td>Contributor</td>
<td>• Strong negotiation skills</td>
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</tr>
<tr>
<td></td>
<td>• Continuous alignment</td>
<td></td>
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</tr>
<tr>
<td></td>
<td>• A seat at the table with the business</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Stage 2 –</td>
<td>• Silent supporting partner</td>
<td>Deliver on-time support</td>
<td>RFS, RFP, RFI</td>
</tr>
<tr>
<td>Order Fulfiller</td>
<td>• Minimum negotiation skills</td>
<td></td>
<td></td>
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<tr>
<td></td>
<td>• Minimal consulting skills</td>
<td></td>
<td></td>
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<tr>
<td></td>
<td>• Modest goal alignment</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Stage 1 –</td>
<td>• Minimal understanding of the business</td>
<td>Deliver basic procurement services</td>
<td>RFS, RFP, RFI</td>
</tr>
<tr>
<td>Ad Hoc Nuisance</td>
<td>• Minimal process maturity</td>
<td></td>
<td></td>
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<tr>
<td></td>
<td>• Minimal engagement model</td>
<td></td>
<td></td>
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<tr>
<td></td>
<td>• Limited productive relationships</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Supplemental Staffing

Typically via RFQ

Qualified workforce acquired from a supplier

Outsourcing Value Proposition

Managed Services

Typically via RFP

Performance agreement with a Supplier

Outsourcing

Typically via RFP

Long term, results-oriented business relationship with a supplier

“Vested” Outsourcing

Typically via RFS

Long term business relationship with jointly designed solution to a buyer’s business imperative

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EXAMPLE PROVIDER SELECTION PROCESS

Phase 1
- Bid List
- ~ 10-12

Phase 2
- Bidder’s Conference
- Conduct initial compliance check and remediation
- ~ 5-6

Phase 3
- Conduct onsite and offsite due diligence
- Perform detailed evaluation and recommendation
- ~ 3-5

Phase 4
- Conduct negotiations
- ~ 1-2

Number of bidders
- ~ 10-12
- ~ 5-6
- ~ 3-5
- ~ 1-2

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EVALUATING & SCORING BEST PRACTICES

**Note: weighting percentages are examples only; actual weightings tie to the business need and procurement plan.**

Sourcing Strategy → Procurement Plan → Evaluation Criteria & Weightings → Technical Solution (e.g., SOW, SLAs) 40%

Business Proposition (e.g., T's & C's, Risk) 20%

Pricing/Competitiveness (e.g., Price, TCO) 30%

Competitive Advantage (e.g., Innovation, Speed to Market, Cultural Fit) 10%

Consensus Recommendation → Negotiations

Don’t let it become a “math game”

Identify gaps to carry forward into negotiations
Goal: A High Value Deal

Cost too much for the value!

Value Maximization Point

Cost too little, risk losing value!
Performance-Based Contracts And Risk

Levels of Interdependence

的关系

Levels of Complexity

高

High

Risk to the organizations

To Help Reduce Value Leakage:

1) Be very clear on acceptance criteria.
2) Ensure that the price does not encourage change orders.
3) Don’t be in a rush to sign (make sure all the stakeholder’s reviewed the risk profile(s)).
4) Look for missing and/or incomplete T&Cs.
5) Look for “unreasonable” T&C’s that increase the price without adding value.
The legal clauses included in the contract and that parties commonly negotiate are designed to allocate losses in a risk event between the parties, not necessarily minimize, monitor or control the risk.
Conditional Acceptance, which is also referred to as qualified acceptance, happens when the buying organization (called an offeree in legal terms) tells the offeror (who in this case is the supplier) that it (the buyer) is willing to agree to the supplier’s offer provided that some changes are made in the offeror’s terms or that some condition or event occurs (such as meeting contract requirements).
The supplier must accept the terms and conditions to be held accountable for meeting those terms and conditions. The customer accepts the supplier’s products or services only when the product or service meets the conditions laid out in the contract. This is important. The conditions have to be laid out in the contract. *That means those terms and conditions must be in the contract to begin with.*
Risk Checklists (one document-4 parts)

1. Financial considerations
2. Hybrid contract considerations
3. Intellectual property considerations: Custom software
4. SaaS agreement considerations

RISK CHECKLISTS

INSTRUCTIONS

Identifying risk is a good thing to do. The goal of any risk analysis is to identify, document and monitor the risk in order minimize the possibility of the risk event happening and associated loss to your organization. Thoroughness is a proactive posture that protects your organization.

Start the process to identify the risks by answering questions in the Requirements Checklist, or something similar that outlines the requirements and performance standards. To fill out the template, follow the columns from left to right. Use the colors at the bottom of the template (red, yellow, green) to designate the level of risk. The colors will give you and your stakeholders a quick visual impression of the risk.

Once you’ve identified the risk, its probability and severity, determine how frequently you will monitor the risk. Finally, in the last column, locate the contract provision associated with the risk in column A. For example, if the supplier delivered “non-conforming” services, the “Corrective Action Plan” and warranty language are corresponding contract provisions.

YOUR ROLE

Identifying risk is an iterative process. As you conduct the analysis, you will either use this template or build your own risk assessment tool. Your role is to work collaboratively with your organization’s leadership, Subject Matter Experts, the legal department, and any other department that can provide input on issues pertaining to risk.

If you do not know—ask for help.

Your organization owns the risk. Therefore leaders need to be aware of the risk and possibility of associated losses. If it is not within your delegated authority to accept a risk, set up a meeting to discuss risk with your organization’s leadership. Use the Risk Monitoring template and/or this checklist, or a similar tool when discussing risk with the leader. Traceability is a very important part of your organization’s risk plan.

YOUR ORGANIZATION’S POLICY

Follow your organization’s internal policies to prioritize risk. Your organization may have its own template, policies and processes. Have work within your organization’s policies, and modify the template and analysis for the work you do for your organization. This analysis checklist and the template is ONE way to identify and monitor risk. This is a good overall introduction, and the expectation is that you will build on these documents for the work you perform.
Sample Questions: Risk Checklists

Some potential areas of concern are:

- Is the supplier providing goods/services directly to the customer or providing goods/services to the community on behalf of the customer?

- Is the supplier buying goods for the customer from another supplier (original equipment manufacturer)? If yes,
  - Is the supplier passing through warranties from the manufacturer?
  - Is the supplier purchasing from a distributor?
  - Or, is the supplier using their own warranty provision to warrant the materials?

- What are the customer’s obligations to the supplier (technical drawings, approvals, etc.)? List obligation requirements that when missed can create a risk event.
Risk Monitoring Template; Completed It Becomes the Risk Register

<table>
<thead>
<tr>
<th>Questions and Answers from the Requirements Checklist</th>
<th>Describe Risk Description / Reason</th>
<th>Probability of Occurrence (High/Med/Low)</th>
<th>Describe Impact on Project</th>
<th>Severity (High/Med/Low)</th>
<th>Immediate Short-Term or Long Term</th>
<th>Mitigation Plan</th>
<th>Frequency of Monitoring (daily, weekly, monthly, quarterly, annually)</th>
<th>Responsibility to Party</th>
<th>Target Date to Resolve</th>
<th>Status</th>
<th>Corresponding Contract Provisions to Mitigate the Risk</th>
</tr>
</thead>
<tbody>
<tr>
<td>From the contracts requirements checklist * Is the vendor providing goods/services directly to the community on behalf of the agency?</td>
<td></td>
<td></td>
<td></td>
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<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Probability of Occurrence/Severity</td>
<td>High</td>
<td>Medium</td>
<td>Low</td>
<td>Timeline for risk event</td>
<td>Immediate</td>
<td>Short-term</td>
<td>Long-term</td>
<td>Frequency of Monitoring</td>
<td>Daily</td>
<td>Weekly</td>
<td>Monthly</td>
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</tbody>
</table>
Download Risk Checklists and Risk Monitoring Template Here

https://jn_be28.gr8.com/

RISK CHECKLISTS

INSTRUCTIONS

 IDENTIFYING RISK IS A GOOD THING TO DO. THE BEST WAY TO ANALYZE IS TO IDENTIFY, DOCUMENT AND MITIGATE THE RISK IN ORDER TO MINIMIZE THE POSSIBILITIES OF THE RISK EVENT HAPPENING AND MINIMIZE THE RISK TO YOUR ORGANIZATION.

Here the process to identify the risks by assessing questions in the Risk Impact Checklist in something similar that outlines the implications and outcomes. The fill-in-the-blank risk monitoring template follows the elements below right. Use the column on the bottom of the templates text. Yellow-gray to determine if the risked role. The colors of the way you are your stakeholders a plan (visual) to prevent or avoid the risk.

Once you've identified the risks, identify and determine how frequently you will monitor the risk. Finally, you will outline how the contract protection is associated with the risk in order to prepare a visual summary of the contract and highlight the key terms that may have an impact on the contract. This document and analysis should be completed before entering into the contract. The number of your project is very important in your organization's risk plan.

YOUR ROLE

IDENTIFYING RISK IS A GOOD THING TO DO. THE BEST WAY TO ANALYZE IS TO IDENTIFY, DOCUMENT AND MITIGATE THE RISK IN ORDER TO MINIMIZE THE POSSIBILITIES OF THE RISK EVENT HAPPENING AND MINIMIZE THE RISK TO YOUR ORGANIZATION.

If you do not know—seek for help.

Your organization knows the risk. Therefore, the risk must be aware of the risk and possibility of associated events. If you are from the department and receive a request, set up a meeting to discuss risk with your organization's leadership. Use the Risk Monitoring template and in the check list, and you will be able to discuss risk with the leader. It is essential for any important role in your organization's risk plan.

YOUR ORGANIZATION'S POLICY

Offer a written policy or standard policies for risk. Your organization may have its own internal policies and procedures. Please work within your organization's policies, and modify the template to fit the needs of your organization. This includes check lists and the template. CII ways to identify and monitor risk. This is a good research methodology, and the organization is to you within this document for the work you perform.
Compelling business need (for change)

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To Avoid Fumbling The Project, Focus on Transition

- Should this supplier perform pilot(s). How would that work? How would phasing in different sites or departments work?
- Develop and then implement transition plan(s). Are there “TBD”? When will those be determined?
- What is the phasing process to transfer assets, processes, people? Which are critical path? Which are tied to milestone payments? Which are dependent on the customer or another third-party supplier?
- How much of a “runway” is needed to commence service delivery?
Look for and fix unworkable metrics of any kind

1) Buying companies set the wrong unit of measurement.
2) Buying companies set the wrong target.
3) Selling companies use the wrong baseline after launch.
4) Selling companies agree to unachievable year over year process improvements (when what will be needed at some point is an innovative approach).
“Commercial contractual risk management involves the calculated actions to reduce the severity, frequency, and unpredictability of damages, losses and claims.” Calculated actions include strategic (systematic and ongoing plans and associated contract language) and operational (plans and contract language for this transaction).

From:
Governance Structure
Tiered Governance Model

- **OPERATIONAL MANAGEMENT GROUP**
  - Oversees day to day operations in each location.
  - There will be several working management groups (for example, regional service delivery management groups, or project-based transformation groups).

- **JOINT OPERATIONS COMMITTEE**
  - Provides direction regarding service delivery.
  - Monitors progress of the outsourcing relationship and scope of work.
  - Responsible for service quality across all locations.
  - Sets continuous innovation and implementation priorities.

- **BOARD OF ADVISORS**
  - Provides overall sponsorship, vision and goals.
  - Sets strategic direction and feedback regarding progress against desired outcomes and overall performance.
  - Make decisions related to escalated issues and grant approval of large transformation projects.

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Table Talk!

• Choose **one** of the five phases in the buying process (that we just covered) list three things that your organization has done or you think it should do to reduce value leakage.

• For example, for the “negotiate” phase, one way to reduce value leakage would be to have all the key stakeholders review a list of known risks and the mitigation plan for each before contract execution.
Want to learn more? I have a ton of free resources!

www.jnyden.com