THE SCIENTIFIC ART OF Contract Negotiations

BANISH ANXIETY ABOUT NEGOTIATING CONTRACTS WITH ADVICE FROM THE FRONT LINES

Contract negotiation melds science and art. You can apply standard techniques and responses to various approaches used by vendors' sales teams when you're acquiring products or services — that's science. You employ these standard techniques and responses in ways appropriate to your personality to create the most beneficial outcome for your institution — that's art. The approaches and considerations discussed in this article can work for any size institution and for any manager acquiring products from desktop computers to large Unix/NT servers, networking equipment to phone switches, individual or multi-station software licenses to campus-wide software licenses, or various vendor services.

An important premise underlies successful negotiations: vendor sales teams are neither your best friends nor your worst enemies. Through the sale of a product or service, they can help you achieve your goals. On the other hand, the initial offers typically suggest they aren't looking out for your best interests. You need to adjust your perceptions of the sales force's motivations and focus on what you're trying to accomplish — the best product or service for the best price.

The sometimes elaborate dance involved in acquiring products or services doesn't have to be onerous or distasteful. You can consider many options and practical "can-do's" when negotiating for goods and services within the information technology spectrum. Much of our experience derives from successful negotiations with both hardware and software vendors on behalf of the University of California at Davis.

By **Kent Kuo** and **Nancy Wilson**

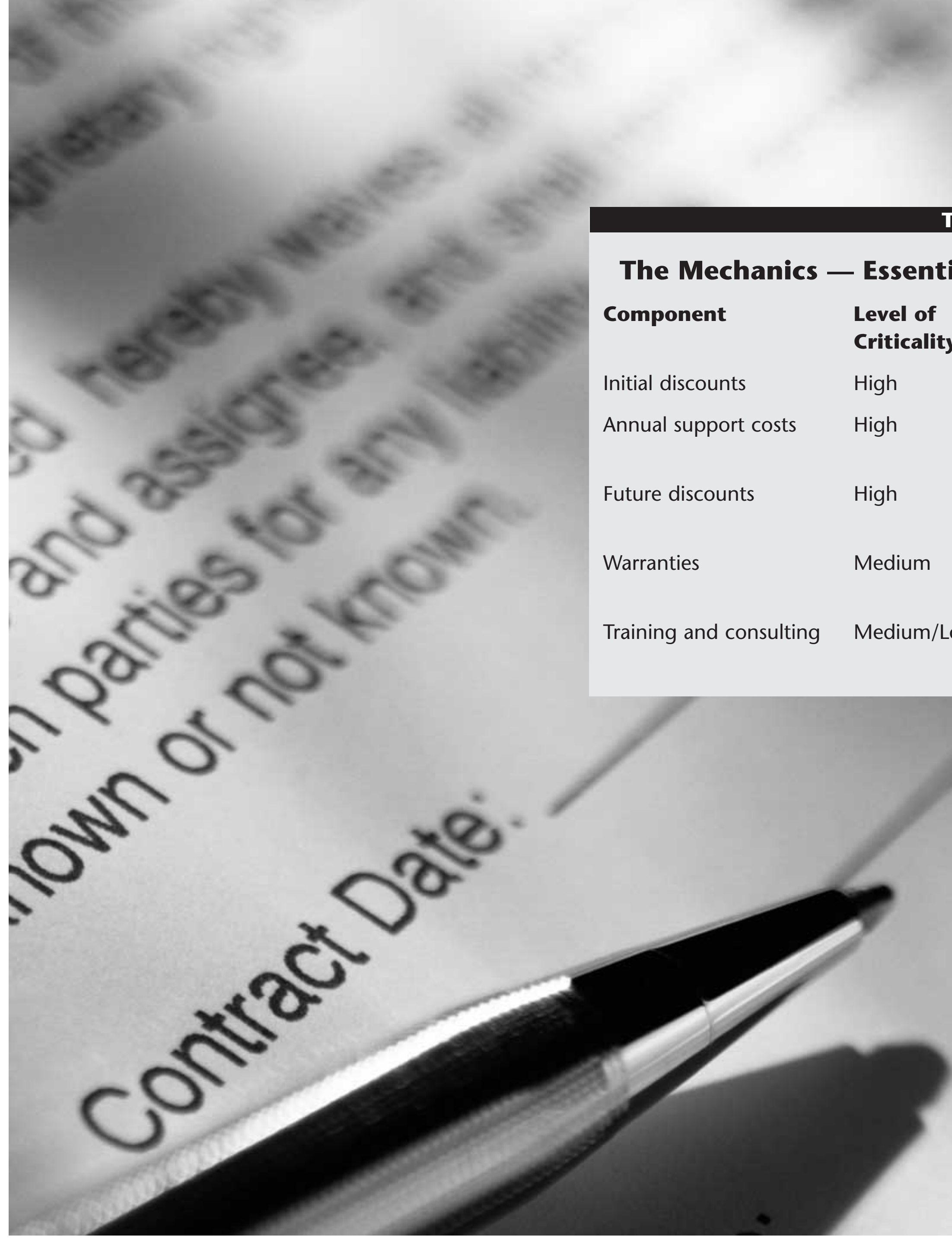

Table 1

The Mechanics — Essential Components to Negotiate

Component	Level of Criticality	Outcome Desired
Initial discounts	High	Go for 30–90 percent off list price
Annual support costs	High	Aim for 15–20% of net cost with 5–8 percent cap on increases per year
Future discounts	High	Apply to all products available under agreement for 3–5 years
Warranties	Medium	Specify performance measures and remedies
Training and consulting	Medium/Low	Discount off normal training offered by vendor; on site and off site

Knowing what's possible and good techniques for handling the sales force can lead to the outcomes you wish.

The Mechanics of a Negotiation

Negotiations begin with the mechanics. Which components are negotiable and which aren't? What expectations can you reasonably have and successfully complete a negotiating session? For example, many of us think the acquisition process ends with the selection of a vendor from a Request for Proposal (RFP) released by our institution. Practically, this is when the negotiating process actually begins. Now you can affect the final purchase price, ongoing support costs, and associated terms and conditions that define your institution's relationship with that vendor. In Table 1, "level of criticality" designates which items to actively negotiate and where to hold firm to your objectives. It highlights items important to you versus those you could give up in exchange for acceptance of your terms on the highly critical components.

Deep Discounts

One major consideration when negotiating an acquisition or contract with a vendor is your budget. Nothing is more disappointing than to find you underestimated what a product would cost or what sort of educational discounts a vendor might offer you. A fundamental if sometimes frustrating fact is that the more money you have to spend, the greater the influence you have on the size of the discount the vendor will accept. Sales teams don't just look at the net revenue you provide; they have an easier time convincing their executive management to approve additional concessions if the deal has a high pre-discount list price.

Not surprisingly, the discount possible also depends on how much margin exists relative to the product you're acquiring and the degree of competition in that industry. In hardware, for example, you can expect to see discounts ranging from 20 percent for desktop systems (depending on volume) to 60 percent for servers. We've often seen discounts as high as 30 percent off list price regardless of how much you spend. Good discipline in negotiating the price can land you discounts of 60 to 90 percent. Foresight can help you extend these discounts to multiple years.

What Can I Do at a Small Institution?

Typically, small independent or private educational institutions rely more on tuition, fees, and various endowments to support their educational missions. These schools may also have applied for various federal or state grants to fund many strategic objectives. Given this environment, where funding is a constant question with regard to technological investments, is it realistic to assume that the techniques and approaches laid out in this article still apply?

Well, yes. Even though a small institution faces many challenges when it comes to acquiring products and services, these techniques and approaches can be leveraged with other extension strategies to achieve a satisfactory outcome. Extension strategies can include a number of possible vendor or consortium collaborations to work a deal.

Consortium: Find other small, independent institutions willing to cooperate to acquire various goods and services. An example is the nonprofit Oregon Educational Technology Consortium (http://www.oetc.org).

Reference site: Offer to serve as a reference site for the vendor in exchange for concessions associated with the acquisition of the products. You'd want to temper this with some clause that ensures that the products work as advertised.

Beta site: If you have a strong stomach, you can offer to provide your institution as a beta site, where you stay current and deploy the current release of a system in exchange for lower initial and ongoing expenses.

In the end, vendors aren't known for giving things away (that aren't obsolete, that is). Working a deal requires accepting that a vendor wants to benefit in some way, usually by making a profit. Having adequate funds helps motivate the vendor to provide you with a good deal. The greater the volume, the more leverage you have to change contractual terms and conditions, not to mention price, in your favor.

For example, a recent purchase we negotiated on behalf of the UC system involved getting an initial 90 percent discount on a multi-campus software product, with 85 percent discounts for anything purchased the first year and 75 percent for each succeeding year of a five-year deal. Achieving this wasn't absolutely straightforward, however. The vendor sales team said the CEO turned down our request for a multi-year discount beyond the first two years. We told the vendor sales team that the entire deal was off unless they met that condition. While some campus constituents expressed concern over this tactic, within a few days we got the remaining three years of deep discounts.

To make these sorts of pronouncements requires confidence in the reasonableness of the terms, open communication with your upper management teams, and strong nerves. This example had a pre-discounted list price of $11 million dollars, with an actual out-of-pocket price of $1,100,000. A two-year deal for $1.1 million isn't cost effective if you have to negotiate a new deal in two years instead of five, but it's easy to lose sight of that in the middle of negotiating a deal.

Most campuses can't afford even the net cost of such products. Still, this example demonstrates that steep discounts are possible, even if you need to pool with other higher education institutions to get there (see the sidebar "What Can I Do at a Small Institution?").

Other techniques for getting deeper discounts than first offered appear in the "Vendor Approach" section below.

Maintenance and Support Costs

Even if you didn't get the deep educational discounts you expected, you can find other ways to bring your overall costs down. When researching comparable deals at other institutions, we've been surprised by how many people thought the maintenance and support costs from hardware and software vendors were non-negotiable. If you talk to the vendors, they clearly want you to believe that particular myth.

Well, it's not true.

Maintenance and support costs *are* negotiable. We've found that sales teams often report within different parts of a vendor's organization. This benefits your institution when the sales teams sacrifice the interests of their maintenance arm in exchange for revenue from the sale. One major point to watch for is whether the maintenance and support costs depend on the list price or on the net or post-discounted price. We regularly negotiate with all vendors that the institution will only pay maintenance and support costs on the net price, and we push very hard to have those percentages average between 10 and 15 percent of net. In some cases we're willing to go as high as 20 percent of the net price rather than pay on the list price.

In one situation, a vendor flatly refused to establish the maintenance and support according to the net license price or to lower the maintenance and support percentage rate below 15 percent. We said the deal was off. Within five minutes we had both voice and e-mail messages dropping the maintenance rate to 10 percent if we would agree to use of list price. If a vendor adamantly refuses to go with the net price, then we insist on deeper discounts (as compensation) on the purchase price in combination with a lower (in this case, 10 percent) percentage on the annual maintenance and support fee. We also require either a five-year maintenance schedule that defines the fees exactly or a cap (such as 5 percent) on how much maintenance and support costs can increase above the previous year's amount.

Another example involved a vendor who agreed to set the maintenance costs based on the net license price and a year later tried to invoice us against the list price. We quickly pointed out the details in our contract that limited the maintenance both to the net license price and to a five-percent maximum cap for year-to-year increases in the maintenance costs. Our next invoice had the maximum five percent increase over the previous year.

Of course, some vendors offer fixed maintenance costs dependent not on the price but on the service provided. For example, many vendors now calculate the cost of telephone support and offer you an hourly rate for this support. Or for a fixed annual price you can receive unlimited support.

Future Discounts

Let's say you got a good deal through these negotiations, then found you underestimated either the number of licenses you needed or the size of the system you acquired. A good contract will include the option of adding more licenses at the same or slightly lower discount for the next one to five years. A great contract defines the products available under that contract and offers affiliate institutions or remote locations the opportunity to purchase off of that contract at those same discounts. One caution, however — it's very difficult to get any vendor to agree to discounts on a set of future products not yet available. If such products don't exist yet, we've found that no vendor will list a specific percentage discount greater than 20 percent because they don't know if the margin will make this possible. Another caution — we've found that setting this discount for future products can actually hurt the institution if it settles for 20 percent instead of waiting and negotiating better terms later.

Warranties and Remedies

With all negotiations you'll need to talk about vendor warranties. Basically, two types of warranties exist, express and implied. Implied warranties aren't part of your agreement, but exist in governmental laws. Express warranties are those that you and the vendor agree upon and put in writing as part of the contract.

When looking at warranties, you'll want to focus on the critical functions of the product and services. For example, you may want a warranty against viruses or a specified level of performance that you want to maintain. If you want 24-hour, seven-days-a-week support, make sure it's included in your contract and establish a remedy if it's not met. (This could include a discount on your maintenance costs for that year or a refund.) In most cases, you should be able to get published information in the areas you want to warranty. If the vendor can't provide you with this information, a red flag should go up, and you should ask why. Finally, all warranties should have a remedy. What will happen if a problem comes up? Without a remedy, the vendor faces no consequences if a problem occurs.

Training and Consulting

In some cases the vendor will offer to sell you a set number of educational training units in return for a good discount. We've found this unnecessary. Much like maintenance costs, the training component of a vendor's organization often reports up a separate management line from the sales teams. As a result, the sales team will agree to contractually obligate their company to a decent discount on training to make the sale.

One reason to consider a discount over the life of the contract, not just a set number of training hours, relates to ongoing staff development. We've found that it's not enough to train your local staff just at the beginning of a major project. Turnover occurs enough to warrant an occasional new person going to class a year or two after the initial acquisition, or even training a whole new cadre of staff three years later. Good discounts on training needed during the life of the contract also help to defray the institution's total cost of ownership.

Vendor Approaches to Negotiating

Understanding the components of good negotiating proves essential to your success. Now comes the fun part — recognizing vendor approaches and how your actions can diffuse them during your negotiation. It may surprise you how many vendors consistently use the same approaches, some obvious and some subtle. We guarantee that you'll come across a few of these tactics, if not all, during your own negotiations.

Vendor Approach: How much do you have to spend?

This is probably the most common question asked at the beginning of negotiations. Basically, they want you to divulge whether you have deep pockets. Never let them know your budget or you'll never know if you're getting a good deal.

Your Action: Ask the vendor to provide a document with the list prices for you to review.

With this you show your interest in the best prices without divulging your budget. Keep restating that you want the best price.

In a recent case, we worked with a vendor to purchase additional modules for an existing system. We pursued this negotiation as if it were our first contract. Once we agreed on the modules and functions needed, it was time to talk about the dollars. As in every negotiation, this vendor's representatives asked us our budget for this project. We asked them what they wanted for this package, never revealing how much we had available. They came back with a 30 percent discount, which we felt still wasn't enough. We indicated we weren't satisfied with this discount and wanted something deeper. The sales team told us this was probably the best offer, but they would check with their manager. By the next day, they had a new offer. After review, they threw in a couple of the items for free and discounted our user licenses. Feeling that this was acceptable, we got it in writing.

Vendor Approach: If you hurry and sign, you can take advantage of our sale price.

Composition of the Negotiating Team

A well-structured negotiating team has several roles. An institution can concentrate these roles into one person or delegate them to as many people as desired. Different institutions also have different arrangements when it comes to the role of the purchasing department, which generally tries to get the best price for the institution. We've found that a good understanding (if not ongoing relationship) between purchasing and IT is essential to working the deal. Many times purchasing has a predefined template of institutional terms and conditions (such as indemnity clauses) that protect the institution. On the other hand, IT professionals or the lead business unit staff usually have a better feel for the product composition, margins, and negotiable versus non-negotiable elements. Paramount is having only a single voice or stance between the institution and the vendor. Arguments in front of the vendor can hurt your cause, and the vendor will exploit the situation by siding with whichever side will gain them the best price. Prior to going into a negotiating session, each person must understand his or her respective role and not undermine or contradict the lead negotiator in front of the vendor.

Lead negotiator: This person channels the needs and desires of everyone else into a single coherent negotiating strategy. Some people like to collect all of the issues and present a single demand. Others like to parse out the issues to the vendor over several days with a standard "oh, by the way." Each method depends on the personalities involved, but typically the vendor reps would prefer to know all the issues up-front rather than having to go back to management every two days with what they see as new demands. Also in favor of the single approach, you can toss a few red herrings into the larger mix of issues. By these we mean items that you would be willing to negotiate down or out in exchange for concessions elsewhere. This tactic comes from Henry Kissinger's proposed strategy of "linkage diplomacy."

Secondary negotiator: Sometimes it helps to have a tag-team approach to negotiating. You could consider doing a good guy/bad buy routine, where the first negotiator hits the vendor hard with the requirements and the second negotiator salves any hurt egos. Having someone who's considered reasonable by the vendor helps ensure that hard stances don't drive the vendor away from the deal completely. Another approach might be to have the first person introduced to the vendor as the negotiator and, if things heat up and the vendor wants to go over that negotiator's head, introduce the "senior negotiator" (who has been involved the whole time) into the process.

Researcher: This person does in-depth research with other institutions. We've found it valuable sometimes to discuss with other institutions what sort of results they've gotten with negotiating similar deals across the country. It helps to know if what you're asking for is reasonable relative to similar deals. This person can also look up similar products and the vendor's current stock prices, fiscal quarter periods, fiscal year-end period, and organizational structure. It can also help to actually read contracts that others have negotiated, and this person can get copies gathered and distributed to the negotiating team. This person can also act as a conduit with management during the actual negotiating process.

Budget analyst: It's always important to have someone running the numbers. Is the proposed offer within the allotted budget? Sometimes the vendor will run several scenarios by you. It helps to know the total cost of ownership relative to each of those scenarios.

Obviously, the sooner the vendor can make a sale, the sooner the sales team can move on to a new customer. Don't let this common ploy rush you through your decision-making process. We have yet to see a vendor let a sale go if the terms are reasonable.

Your Action: Stay with your game plan and negotiation process.

Most campuses think this stage is fast and easy because they assume the price quoted is probably the best price for the best product. Not so obvious is that during this process a good negotiating team could in fact leverage the institutional funds to stretch over longer periods or to get even better conditions. This won't happen if you must negotiate the deal in just a couple of days. A good negotiating team should be allowed as little as one week and as much as a month to pin down the details of a solid contract. In a multicampus deal, you should allot even more time for each campus to work through the local requirements. Even in those cases, however, there should be one lead negotiator (see the sidebar "Composition of the Negotiating Team").

Vendor Approach: It's the end of the year, and we're willing to make you a great deal.

The vendor knows your year-end date and tries to leverage this in proposing an offer that you just can't refuse. Again, you're likely getting a good deal in one area while sacrificing in others.

Your Action: Find out *their* year-end and quarterly reporting dates.

Don't feel pressured when the sales team tells you they must have a signed agreement by a certain date or the price will increase. Stay with your game plan and try to schedule negotiations close to their key dates to take advantage of quota milestones. We made the best deals for our institution when the vendor was trying to make quarterly or year-end quotas.

Vendor Approach: Who is your decision maker?

You need to understand the objective behind this question. There's nothing more important to the vendor during negotiations than knowledge of your internal operations. Working outside your negotiating process, the vendor has a better chance of achieving the goals of maximizing profits and minimizing risks.

Your Action: Limit the vendor's access to your organization, keep your senior management team apprised of the status of the negotiations, and stick to your objectives.

Recognize that you and the vendor reps aren't friends at this point; you're not enemies, either. You also need to understand that you and they have different objectives. Your objectives are clear — you don't want them to maximize profits and assume little risk in this endeavor. On the other hand, you want to minimize your costs and ensure that you have warranties provided by the vendor to minimize your risk. In a good negotiation, neither of you will achieve the extremes of these conflicting goals. Instead, you'll find a compromise between them that satisfies both sides.

Additionally, you should make sure you know who's making the decisions for the vendor. Some of the most frustrating negotiating sessions result when the vendor sends someone without authority to negotiate. This quickly becomes apparent when that person has to keep going back to management. If you have a tight timeframe, let the vendor know that the next negotiating session must include someone who can make on-the-spot decisions for the vendor. On the other hand, if you have a situation where the vendor wants something from you that you aren't prepared to provide, you can employ the same tactic by saying, "I need to check with management."

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Vendor Approach: Try this product for 45 days free!

The vendor hopes to capitalize on your busy schedule or hook you so that you must have the product right now, thus reducing your leverage in negotiating. If you've ever signed an agreement to get 10 free CDs for the price of one, you know the end result of accepting this type of offer — you get the free CDs, but end up paying for additional CDs that you didn't want.

Your Action: Don't accept a trial offer that limits your reviewing time before you must make a purchase.

If possible, complete your negotiations without a trial offer. Alternatively, make sure that someone takes responsibility for returning the product before the trial period ends.

Vendor Approach: This is absolutely our best price.

The vendor hopes you'll accept this as truth and complete the negotiations because it simply isn't necessary to keep going.

Your Action: Don't believe it! Ask them to prove it to you.

Ask the vendor reps to put it in writing or add a "most favored nation clause," which basically assures that you receive discounts or other contract advantages negotiated with other customers. If you're still uncomfortable, not knowing for sure that you got the best price, ask for an independent audit clause. This works best if you and the vendor agree on a reputable third party to perform the audit. Finally, don't accept this price until you hear a firm "No" for anything lower, and don't be afraid to walk away if the price kills the deal for you.

Vendor Approach: If we give this price to you, we'll have to pass it on to our other clients.

The vendor reps don't want to set a precedent that might force them to offer this price to other clients.

Your Action: Focus on the issues that make this deal different from the standard contract.

If this doesn't work, ask the vendor reps for a list of precedents granted other customers. If they truly do keep track of this information, they should be able to provide it. If they cannot produce a list, then question their logic. If all of the above fail, you may need to take a temporary break from negotiations to do your own fact-finding. You should have a list of other customers who use their products. You'll be surprised at how much information you can obtain from other customers that can help you in negotiating a good price. Also, this will definitely get the vendor sales team's attention. The last thing they want is for you to walk away while they're still interested.

Vendor Approach: We can't give you anything better than the federal government contract (GSA pricing — General Services Administration, the federal government's purchasing agent).

The vendor wants you to think that all contracts negotiated must have terms less favorable than those under the federal contract. Hmmm, this seems to come up only if you negotiate for less than the federal government contract. The vendor reps are really saying that they have a corporate policy, which they're using as an excuse not to "go one better" unless it's financially lucrative. In other words, they won't give better terms than GSA on small deals, but will consider better terms on deals that offer what they would consider serious revenue.

Your Action: All contracts are different. Unless your contract is exactly the same as the federal government contract, the GSA price is irrelevant. Ask for a copy of the federal government contract if they insist that the two are the same.

Being aware of vendor approaches before beginning negotiations takes you halfway to a fair playing field with the vendor. So, continue to learn about various vendor approaches as much as possible, as you can be assured that vendor negotiators undergo constant training. You may not hit a home run every time, but you will definitely increase your batting average with this knowledge.

After Negotiations End

We've discussed a number of tactics and mechanics to help you complete a successful negotiation. Now, what do you do after you've signed the agreement? Many of us simply put the agreement aside and go on with our business, often forgetting to revisit the terms to ensure that the vendor successfully meets all of our hard-earned concessions. This isn't a good idea.

First, set up a system to manage the contract and the deliverables. This will ensure compliance with your vendor and your users. At this point, you should have already addressed who will manage the contract and the personnel involved in the management process. The personnel involved should not be chosen based on the dollar amount of the contract, but on the complexity and skills needed to carry out the necessary tasks.

Next, set up routine reviews of the contract and take immediate action if any discrepancies show up. You should have performance measures and vendor contacts established to address problems. By doing this, you'll reveal problem areas before they become true problems.

Many commonsense techniques can be used to work a deal. It all comes down to some fundamental truths. First, if it's not written into the deal, it's not part of the deal. We've been hurt by salespeople who disappear after concluding the deal, making all the verbal assurances null and void. Get it in writing if you want it to mean anything.

You need to adopt an attitude that fits your personality, yet effectively persuades the vendor to go the extra mile.

For example, one of our campus projects aimed to improve the ability to share information through a distributed file system. The university had an existing contract for a software package to provide this capability and contacted the vendor to find out if the changes proposed would affect our contract. The vendor essentially rewrote our contract and established new pricing. Their new quote would have increased our licensing fees by $80,000 and our annual support by an additional $20,000 per year. This shocked the project team. They brought in departmental staff responsible for negotiations in their unit. After a detailed review and many discussions with the vendor, we pointed to details in the written contract that meant we wouldn't have to pay additional charges for this project.

This negotiation highlights several techniques discussed in this article. Namely, if it's not in writing, it's not in the contract. Rewriting after the fact isn't an option. Additionally, this vendor tried to stampede us into accepting the new quote or face a price increase by using the "you must take action by this date" technique. Neither tactic worked. Throughout the negotiation we felt confident that if we kept the lines of communication open and worked with the vendor, we would both come to an agreement that would satisfy everyone. In the end we did.

It's all about attitude. You need to adopt an attitude that fits your personality, yet effectively persuades the vendor to go the extra mile in terms of price, support, or other considerations that affect the overall total cost of that product or service for your institution. Do your research. Know what you are negotiating for and consider how you'll manage the contract when the negotiating process is complete. If the vendor sales team immediately agrees to your stipulations, you probably could have gotten more.

Finally, remember each team's roles during the negotiating process and carefully consider what issues might influence your decision to walk away.

Think of the items in this article as the basics from which you can develop your own style. While many see negotiating as a necessary evil in acquiring the goods or services their institution needs, it can also be entertaining and rewarding. So don't lose your sense of perspective or your sense of humor. These can be your greatest assets in getting a good deal. *e*

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