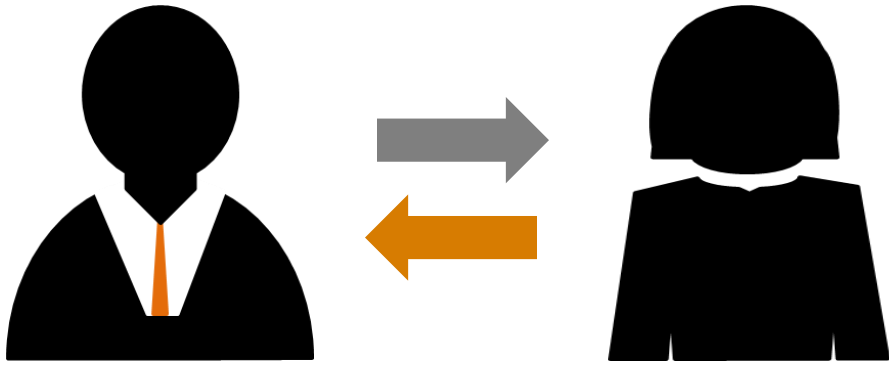

Services Negotiations

A major question that often arises in the Cloud Service Provider (CSP), Managed Service Provider (MSP) or Outsourcing domain is "how & where do I begin to negotiate the services contract?" This short presentation seeks to provide an outline of commercial negotiation and to present the Top Ten areas of focus for the services' negotiations. The aim is to provide help both parties avoid (or at least alleviate) deadlocked or protracted situations.

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What is Negotiation?

Before commencing on the suggested Domains on which to found a commercial negotiation it is worth briefly reflecting on negotiation as a subject, especially:

a) If you are new to this subject; or
b) You are new to commercially negotiating managed services contracts; or
c) You are interested in reading more on the subject

So what is negotiation – well it can take many forms:

- A form of dispute resolution
- A discussion between two or more parties who are trying to work a solution
- A bargaining for a price in a bazaar or market
- A bartering situation for goods or services

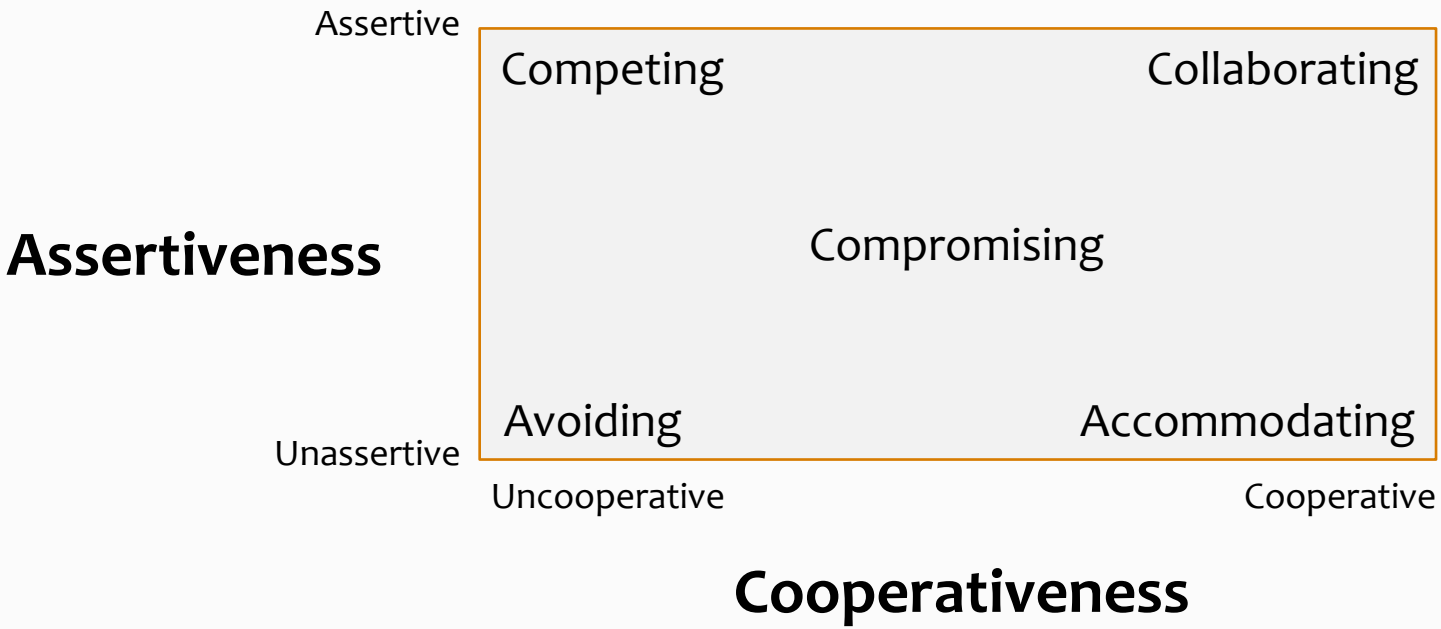
Myths or Facts?

You may have heard some of these phrases and its worth reflecting in their validity or not as the case may be:

- Good negotiators are born – not really! We've all certain met people who you would consider naturally gifted at negotiating but experience shows that they also tend to be well prepared in advance with a clear strategy formulated. Never a truer statement than "fortune favours the prepared mind" (L Pasteur);
- Negotiators can be taught – indeed they can! A good negotiation strategy with well thought through and articulated benefits for both parties is the key to gaining substantive agreements;
- Good negotiators take risks – yes they do – but its best if they don't! There are times when the best laid plans diverge and in these moments there can be a perceived need to take a risk. The best negotiators pause for reflection and counsel at these junctures rather than acting in the moment;
- Good negotiators never lie – yes they do but minimally! Lying is such a strong word but there are many types of lie, a lie by omission, an outright untruth, etc. Many re-negotiations in particular rely on the subjugation of truth in return for a better long term outcome;
- Good negotiators never give in – oh yes they do! Negotiation is not equal to winning. This is often the most difficult concept to acquaint participants with. A good negotiation results in agreement and good will across the parties. Ill will and recriminations are not a suitable or sustainable outcome;
- Conflict is bad – oh no its not! In a similar vein to lying, a negotiation by its very nature is a conflict situation. The key is to remain emotionally detached from the commercial conflict. State the reasons for affront rather than being drawn into emotive or impassioned argument.

The Theory of Negotiation

It is worth reviewing some work on the theories about negotiation if you are to spend time in sales or negotiation for your organisation. There are many resources available and this model from Pruitt in 1991 is an excellent way to think through negotiation.



Pruitt, D 'Strategic Choice in Negotiations' (1991, Harvard Business Review)

Types of negotiating – Distributive Bargaining

Definition:

A competitive negotiation strategy that is used to decide how to distribute a fixed resource. The parties to the negotiation each assume that there is not enough to go around and that the underlying resource cannot be expanded, resulting in a situation where the more one side gets the less the other achieves. Also called "zero-sum", "win-lose" or "claiming value" bargaining.

- Originally derived from employment relations work by Walton & McKersie
- Parties view themselves as opponents
- Both parties aim to maximise their own interests
- Both parties are solely concerned with the current situation/negotiation
- Common Features:
  - Making threats
  - No disclosure of objectives
  - Distortion of information

Types of negotiating – Positional Bargaining

Definition:

A negotiation strategy that involves holding on to a fixed idea, or position, of what you want and arguing for it exclusively, regardless of any underlying interests. The classic example is haggling over price or a "Moroccan Bazaar" approach.

- Often the first approach to any negotiation
- Drives entrenchment behaviour around respective positions
- Usually results in a mechanical "splitting of the difference" solution
- Considered less constructive & adversarial
- On the face of it, it is unlikely to result in a "win-win"

Types of negotiating – Integrative Bargaining

Definition:

A negotiation strategy in which the parties collaborate to find a "win-win" solution to their dispute. This strategy focuses on developing mutually beneficial agreements based on the interests of the disputants. Interests include the needs, desires, concerns, and fears important to both sides. Also called "interest-based bargaining".

- Objectives of both parties:
  - To create as much value as possible
  - To claim as much values as possible for their respective interests
- Parties share information
- Parties avoid using threats or power
- Encourage "brainstorming" or "though shower" sessions
- Hard on issues, soft on people
- Focus on interests and not on positions

Types of negotiating – Good Faith Bargaining

Definition:

Generally refers to the duty of the parties to meet and negotiate at reasonable times with willingness to reach agreement on matters within the scope of representation. Often used in the context of Collective Bargaining between Unions and Employers.

- Plays a limited role in the UK
- Concept first introduced into UK Law as part of "The Unfair Terms in Consumer Contract Regulations 1999"
- A key component of other jurisdictions contract law, US, Germany, France, etc.
- Lord Ackner, famously noted:

  "The concept of a duty to carry on negotiations in good faith is inherently repugnant to the adversarial position of the parties involved in the negotiations. Each party to the negotiations is entitled to pursue his (or her) own interests, so long as he avoids making misrepresentations" in Courney & Fairbairn Ltd. V Tolaini Brothers (Hotels) Ltd. [1975]

Key Negotiation Skills

- Anchoring – establishing a reference point (anchor) around which a negotiation will revolve
- Framing – directing observers to focus on a specific feature within an issue thereby creating a frame around the feature which is at issue, this can be helpful in constraining or containing the discussions
- Listening – take notes and analyse every statement, especially emotive ones
- Watching – take note of body language, protestations, histrionics, theatrics and analyse these post-meeting
- Questioning – ask questions, ask for clarifications or qualifications to ensure there is a shared understanding
- Patience – take your time and use time to your advantage
- Urgency – when you need to, inject urgency purposefully
- Logrolling – exchanging items of differing importance to maximize mutual benefit
- Silence – probably the most under-rated negotiation tool, expect bad news at times and receive it with silence

Plan, Plan & Plan

1. Plan your strategy in advance – never ever enter into a negotiation unprepared
   - Plan for several iterations of the negotiation
   - Have a series of Best Alternatives to a Negotiated Agreement (BATNAs)
   - Prepare what you think the Zone of Potential Agreement (ZOPA) could be & test this hypothesis as part of the negotiation
2. Mix the theoretical approaches
3. Never ever be afraid or reluctant to say "No"

Further Reading

- Binmore, K 'Game Theory – A very short introduction' (2007, Oxford University Press)
- Carrell, M & Heavin, C 'Negotiating Essentials – Theory, Skills and Practices' (2007, Prentice Hall)
- Fisher, R Ury, W & Patten, B, 'Getting to Yes. Negotiating Agreement without Giving In: The Secret to Successful Negotiation' (2003, Houghton Mifflin Company)
- Thompson, L 'The Mind and Heart of the Negotiator' (2009, Pearson Education Limited)

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The Starting Point

Negotiating commercial agreements is often a cumbersome task for businesses. This is especially so when it comes to termed services engagements for information technology services. It is often hard to find common ground if both parties are approaching the commercial discussions with entrenched notions of "how to win" in the negotiation. This often leads to "deadlock" situations with consequences for the relationship. To avoid such occurrences the following presentation was developed as a tool for use just prior to the specifics of the negotiation.

Purpose:
The purpose of the remainder of this deck is to highlight the Top Ten areas of focus for both parties to:

- Help both gaining agreement either prior to or during the negotiations; or
- Act as a primer for those unused to commercial negotiation of services contracts.

When you could use this pack:
This type of pack, with appropriate changes, could be most useful either:

a) As an inclusion within the Request for Information (RFI), Invitation to Tender (ITT), Request for Quotation (RFQ, Request for Proposal (RFP) phase; or
b) Presented for discussion on the first day of negotiations prior to specific discussions.

This presentation is provided as an *aide memoire* only and should (if required) be changed to suit the specific commercial stance of your organisation.

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#1 – Negotiation Tone I

It is often thought that this particular area "goes without saying" and that to mention it would be considered rude or unpalatable. Experience has shown though that without discussing this single aspect openly it can become a gnawing feature of many negotiations.

The founding rationale for expounding this area, indeed to have it as Domain#1, is that both parties have already committed substantial sums to the bid process by this stage. Those costs though are highly likely to be dwarfed by the costs associated with fine-grained negotiations, final pricing, commercial considerations and contract production.

Another key feature of many negotiations is often the 'one-sidedness' of the approach. This is often manifest under three instances:

i. Services providers or customers who are hardened to negotiations and have "seen it all before";

ii. Customers who are outsourcing or out-tasking services for the first time are unaware of what is to come; or

iii. Both parties are new to termed services negotiations.

#1 – Negotiation Tone II

The outcome of i, ii or iii is often that one or both parties consider the negotiation akin to a game where winning is the key goal. This can lead to a behavioural stance exhibited by a "threat" or "positional" based approach from one or both parties with consequences for the relationship as a whole. Once this type of behaviour begins it can become entrenched very quick and exhibited as:

- Periodic or constant "walkaway" announcements;
- Periodic or constant "deadlock" positions;
- Purposely missed meetings;
- Unresponsiveness to communications; and
- Purposeful delays.

Domain#1 seeks to lay a foundation to avoid such behaviours and to build a more amiable, collegial and cooperative basis for driving the negotiations.

#1 - TONE

In the full cognisance, recognition and respect of either parties right to depart from these negotiations at any time, both parties agree to minimise the use of brinkmanship, to isolate and quarantine deadlocks, to cooperate in resolving all other aspects efficiently, and to return to the quarantined items in the final phases.

#2 – Term I

When negotiating a managed service or outsource it should be clear to both parties at the outset that the perspectives of each are generally polar, in that from the perspective of the:

- Service provider the longer the term the better the revenues, profitability and operational efficiencies;
- Customer the shorter the term the more flexibility they can achieve and the greater the risk mitigation from "lock-in"

This polarisation of intent can cloud the discussions with both parties teams angling for a particular term criteria. Once again this can lead to misunderstanding and friction if not decided early, preferably before entering into formal negotiations. Many customer procurement organisations prefer to keep their options open but this leads to vendor hedging, especially when asked for a matrix of pricing & commercial options.

While on the surface it would seem inappropriate to yield on a negotiation point it can be far more costly in the long run to enter the negotiation on the intent to change (usually reduce) the term near the end of the negotiation with the consequences of ill-will or bad faith.

#2 – Term II

For instance, if the customer reduces the term near the end of negotiations this usually (will) result(s) in:

a) Changes in the commercial pricing that reflect the emotions of the service provider rather than the reality of the shift;
b) Changes in the commercial terms that reflect a hedged position rather than the reality of the risk profile; and
c) The service provider scalping the cost and subsequent quality of delivery to meet the new term pricing constraints

If, on the other hand, the service provider decides to leverage the time the negotiation has taken and their perception of the weakened position of the customer (usually after protracted negotiations) then this usually (will) result(s) in:

a) Entry into transition or transformation with ill-will;
b) Retrenchment to positional bargaining; or
c) Breakdown in negotiations

In either case, experience shows that neither party benefits in the long run.

#2 - TERM

Both parties should enter the negotiations with an agreement in advance as to the length of the engagement.

#3 – Termination for Convenience I

Terminations are a common area of contention during negotiations. This is very similar to the aspect of Term in #2. It is likely that the customer will want the right to terminate at their convenience without recourse at any time following the commencement of the services agreement. This is not an unusual situation to face. The motivation for this stance is usually "vendor lock in" driven and the clause is called a "termination for convenience" is the general remedy that customers seek to mitigate their risk.

Clearly as a service provider your risk in terms of asset purchases, third party agreements and/or resource hiring in support of the agreement are too great to provide such a termination for convenience. That said, as a provider you may also want to have such a clause reciprocally to protect your interests. Why? Management, attitude or approach change at the customer. The key here is interest sharing, relaying to the customer your concerns as a service provider while also recognising their concerns not to be locked in to a bad service.

In general the resolution is:

i. Identify an acceptable period following commencement where the termination for convenience clause is not in effect (rule of thumb 20% of the agreed Term)

ii. Identify an acceptable monetary sum to enable either party to exercise the termination for convenience clause.

#3 – TERMINATION FOR CONVENIENCE

Both parties should assent to a reciprocal right to "Terminate for Convenience" following an adequate notice period and a period of non-validity of the clause.

#4 – EXIT I

It is often joked in a tongue and cheek manner that "you should never get into a marriage without planning the divorce". #4 is such a principle. The notion that anyone would enter into a medium to long term services agreement without planning for the eventual end is unthinkable. However, this often happens.

Jointly agreeing an "Exit Plan" or "Exit Strategy" is a must before signing any agreement. The Exit Plan should identify clearly the obligations of both parties on termination at end of term, when convenience is exercised or in the event of termination for cause or breach.

This includes such areas as:

- Support & assistance
- Documented plan
- Documentation transfer
- Data transfer
- Asset transfer
- Resource transfer (if applicable)

#4 - EXIT

Both parties should agree and document the principles of “Exit” as part of the negotiation.

#5 – BENCHMARKING I

Benchmarking is often an onerous negotiation domain within managed services or outsourcing agreements. As with some of the previous domains this becomes an areas of contention due to the expectation differences often exhibited between the parties' understanding of why to implement or request such a clause.

The difficulty with benchmarking services are enormous, simply finding a "comparator" service set that matches closely enough the service being provided is difficult enough, without then having to identify the specific "basket" of comparative elements – too narrow a focus means an illegitimate compare, too broad with the same result.

Here are three examples difficulties with benchmarking:

i. The first example is "when" – meaning when to carry out the first benchmark. If the service required (as pretty much all do) a period of on-boarding, then a subsequent period of run to get a comparative sample is required. If the service is a medium term service of, for instance, 5 years then it is likely that the first benchmark cannot actually take place until month 12 at the earliest and often month 18 with the results available in month 14 or 20 – leaving only 40 months to effect the changes and "re-baselining";

#5 – BENCHMARKING II

ii. The next difficulty that many customers find is that should a compare somehow be proven to be adequately aligned or representative in some manner, then the transformational effort to meet the benchmarked environment is too costly to achieve in the remaining term and subject to change management at their expense;

iii. The final difficulty with a benchmark clauses is that once a transformation plan is agreed to "get to the target state" it obviates any subsequent benchmark until such time as the project is finished. Often the project takes longer than planned and if the agreement (see point i)

#5 - BENCHMARKING

Any benchmark or market rate assessment should be procured jointly from an objective third party.

#6 – Performance I

Once the service is in "business as usual" mode and all initial transition and transformation projects are complete then the customer will (most likely) want transparent visibility as to the performance of those services. Today this is much more than a monthly or quarterly review session with real-time availability of information concerning the operation of the services often a pre-requisite to winning a bid.

Performance management is a broad area but at a minimum there will be an expectation by the customer, which should be mirrored by the service provider of having plain, clear and unobscured views of areas such as:

- Service level agreement attainment broken down by service;
- On-going projects status updates;
- In-plan service changes; and
- Emergency service changes.

The quid pro quo for service providers is that the information is equally available from an evidential aspect.

#6 - PERFORMANCE

Performance of the services should be monitored and performance measurements, including service levels, should be transparently available in reasonable time to both parties.

#7 – Service Levels I

Service levels are also a keen area of focus for both parties when negotiating a services agreement. The primary motivation for customers behind mandating an ability to track and monitor the performance of the service as a whole, often today in near real-time, should be a desire to understand the operating efficiency of the service and be able to justify to their Board that the engagement of an external services partner is yielding the desired results. From a service provider perspective the need to monitor and measure the system is critical to proving the service is delivering in accordance with the design and expectations.

As can be seen in theory this aspect should exhibit shared intent and be easily negotiated. However, experience shows that both customers and service providers often approach service level discussions from a negative perspective for some or all of these reasons:

1) Primary thoughts focused on micro management or supervision of either party of the other. When exhibited by customers this tends to come in the form of onerous service levels requiring "five nines availability" or "five minute recovery from a severity level one issue". Service providers tend to defend the other end of the spectrum and often approach service levels with trepidation clinging to unsustainable negotiation positions on the fear that they will be micro-managed or fined for non-delivery;
2) Another common feature is the introduction of as many service level metrics as possible to robustly measure each facet of the service; and/or
3) The final attribute is often the assignment of "service credits" or some form recompense in the event of failure to achieve the service levels.

#7 – Service Levels II

The results of the forgoing are varied but in general the following problems arise during negotiation or latterly during service delivery:

a) Far too many personnel focused on managing reports as opposed to managing the service. Situations have been experienced where the metrics are all "green on the chart" but the end customers users are experiencing very bad service from their perspective. In the worst instances this generally then spirals into a change request to add more service levels simply hardening the initial situation;

b) The loss of momentum in delivery with increasing amounts of time spent pouring over the innumerable measurements in the hope of identifying small degradations from the requirement, leaving less and less resource available to plan and implement upgrades and feature additions to the starting point services. In the worst situations change control grinds to a halt and the service as a whole remains in a "time lock" with little or no innovation delivered during the term of the service;

c) A "service level game" where the service provider is left in a situation of choosing which metric to fail on regularly. The credits become viewed as a standard cost element or a "cost of doing business" with zero incentive provided to the provider to rectify or resolve the underlying root cause.

The bottom line is that service levels and service reporting should be sufficient to monitor the performance of any contract but should not become 'too much of a good thing'.

#7 – SERVICE LEVELS

1) Service levels should not be designed to be onerous, should be jointly agreed as achievable, and are provided in recognition and cognisance that a 'failure to achieve' a service level is an exception and not a common occurrence;
2) The minimum number of necessary service levels to introduce should be the goal, equally the minimum number of reports;
3) Service credits should be formed on the basis of being an 'incentive to resolution', not as a punitive compensation mechanism; and
4) For customers, never incentivise retained IT personnel on the basis of service level management, reciprocally for service providers, never incentivise solely on the basis of service level achievement.

#8 – Technology Currency I

Domain #8 is a growing area of concern in managed services or outsourcing contracts. The requirement is for "technology currency and innovation". Historically this tended not to be a major focus during negotiations but as third party service provision has become more common and lessons are being learned from past experiences this is now becoming a central point of discussion. The question appears simple enough "how can the service be enhanced or matured during the term so as to bring incremental technology advantages into the service as standard?"

From the customers perspective the motive is to understand how the 2013 service will look by 2018, for a five year deal. Their valid concern is that the service will not languish in the past with their competitiveness negatively impacted due to ancient technology. Another concern is that the assets transferred or even procured by the service provider should not be 'sweated' to failure but be updated in an appropriate time frame.

From the service providers perspective their primary concern is that to facilitate the service they need to make asset purchasing and resource training decisions which have long term commercial impacts. They recognise the need to introduce innovation but this is normally viewed as part of the change management procedures and solely at the expense of the customer.

#8 – TECHNOLOGY CURRENCY

Recommended innovations and operational enhancements during the term of engagement, which, when implemented, result in higher levels of efficiency and economy, are to be incentivised through a gain share mechanism that bestows a higher proportion of the gain to the originator of the innovation.

#9 – Governance I

Governing, managing, delivering and auditing the services are a critical area for both parties. Finding the 'goldilocks' point between too much and too little governance is key to delivering a stable and efficient service. In a similar vein to service levels (see #7) this domain is too often approached with a negative connotation being viewed as policing rather than being designed from the outset to engender teaming, collaboration and innovation.

From the customers perspective they wish to understand the status of the service as a whole. This can often lead to the implementation of regular scheduled service reviews. Very quickly those reviews revert to a type of game play where the object is to "win". Many years of bitter experience still provides no answer as to what is won or what winning is but the battle quickly becomes polarised and entrenched. The service provider is often equally culpable with the focus of every discussion being drawn back to the Key Performance Indicators (KPIs) or Critical Success Factors (CSFs).

The end result is that both parties tend to forget that the actual consumer or end customer of the service should be the focus of every meeting rather than point scoring over achievement of a metric.

Careful design by both parties is required for governance with a focus on ensuring appropriate segregation of duties within a hierarchy of increasing objectivity, ultimately with linking to dispute resolution (Domin#10) where the lead is taken by either a third party or empowered executives not involved in the day-to-day operation.

#9 – Governance II

Audit requirements especially those with external regulatory bodies are often a contentious period for service providers and customers alike. The audit process though should also be designed to be 'sufficient' to examine and report on the efficacy of the service as a whole, or limited to the specific area of the service under the regulatory umbrella and not as a policing exercise to reveal a "gotcha!" Requirements for change coming from the audit should be implemented in accordance with the agreed change control procedures albeit escalated above other requirements already on the list.

The final critical aspect of governance, and ultimately one which should seldom occur, is the right to 'step-in' or 'take-over' the services in the most extreme of circumstances. From the customers perspective they will need to know that consistent failure to remedy a failing or poor service provision can be brought under newly appointed controllers. From experience the debates on this point tend to revolve around "when" or "at what point" this action can be taken.

#9 - GOVERNANCE

- The governance & management framework should seek to provide adequate 'segregation of duties';
- The governance & management framework should provide a hierarchy of increasing objectivity from the day-to-day operational activities;
- Satisfactory service delivery to the end consumer or customer is at all times the primary obligation and object of both parties;
- In the interests of efficiency and effectiveness the services operations leader should have sufficient empowerment to act swiftly in the event of exceptional circumstances;
- Where a conflict of interest is anticipated this should be shared openly between the parties and remedial action taken to avoid such situations;
- Given adequate notice, a right to audit and inspect the delivery service should exist;
- Regulatory, statutory and other bodies should be listed in advance and managed over the term; and
- A remedy of intervention should be available and planned in advance where consistent inadequacy of service delivery is experienced, insolvency is expected or adverse circumstances have come into existence.

#10 – Dispute Resolution I

The final domain in this Top Ten is that of dispute resolution. This could be viewed as a component of governance but as a core element of maintaining customer relations this is identified here separately.

Once again, the motives of both parties should be to deliver the optimum of service to the end consumers or customers of the service. Too often the focus becomes the IT functions of the service provider or the customer pitted against each other in struggle of the techies. Recriminations can abound with both parties defending their actions, their approaches, their technology implementation, their software choices, etc. Tremendously detailed technical or commercial documents are often passed back and forth to be poured over.

From experience the motivations of both parties when it comes to disputes can become grotesque and base very quickly, with personal affronts and even attacks on both sides.

The key design points are, in the first instances to provide an escalation route designed to achieve resolution. The next aspect is "feedback" – this is critical – the end customer or consumer or the service representatives from the customer side must be kept up to date effectively on where in the escalation cycle the dispute is. Too often escalation fatigue can set in or worse escalations become viewed as entirely ineffective, perhaps even a "fob off". Finally, remove emotion and increase objectivity as the escalation increases. Consider introducing personnel not associated with the day-to-day operation. Consider an external third party, an arbiter or a professional dispute resolution firm as the ultimate escalation.

#10 – DISPUTE RESOLUTION

- A ‘Dispute Resolution Process’ should be jointly agreed in advance of the commencement of any services;
- The ultimate form of dispute resolution is the joint appointment of a ‘named’ objective, unbiased third party arbitrator; and
- The decision of the arbitrator is final and binding.

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