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Learn the Do's and Don'ts of Contract Negotiation

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IT leaders can achieve contract savings of 20% or more by applying a disciplined, standards-based approach to their engagements with vendors. These guidelines will enable IT leaders to assume the initiative in contract negotiations, potentially saving large amounts of money.

Gartner foundational research is reviewed periodically for accuracy. This document was last reviewed on 3 February 2015.

Key Challenges

- An additional competitive bid from multiple resellers and/or alternative vendors, as technically feasible, could add 10% to 20% or more in savings to a contract.
- The more time allocated to the negotiation process, the greater the potential savings.
- First-proposal submissions are sometimes as much as 20% above the price that can be negotiated during a deliberately extended period of negotiations.
- Resellers sometimes bid systems with as little detail behind the pricing as possible to avoid negotiations.

Recommendations

- Demand a detailed, line-item breakout of component pricing and discounts aggregated into product categories.
- Use a standardized history log of all vendor transactions, for continuity and consistency, and to avoid backsliding.
- Exercise your right to solicit more than one bid, despite a vendor's selection and preferential treatment of a business partner.

- State clearly what your budget allows, especially if you're budget-constrained; you may be surprised how flexible vendor concessions can be.

Introduction

If approached methodically, server and system RFPs and negotiations can be highly beneficial, and can produce in additional savings of 5% to 20%. Don't offer an automatic "yes" to requests by departmental managers for selected equipment. A thorough analysis of technology life cycles and compliance with corporate contractual terms and conditions are needed, and can result in capital expenditure (capex) and operational expenditure (opex) savings. With the increased trend toward virtualization, contracts have become increasingly complex, especially as costs can include software licenses based on virtual machines (VMs) and management tools, as compared to the older, nonvirtualized 1-1 ratios of applications to servers.

Analysis

Significant server contract reviews can enable IT leaders to make comparisons and negotiate substantial cost savings. IT leaders benefit from Gartner's exposure to RFPs and quotes, and further benefit can be derived from our familiarity with market trends, technology life cycles and obsolescence factors through Gartner models and constructs, such as server Market Clocks and Hype Cycles, blade Magic Quadrants and Best Practices research. List versus discount data in contract proposals provides an important basis in negotiations. We have also discovered that some procurement and contract organizations simply do not assert enough rigor and demand in negotiating with vendors.

More often than not, the vendor's reseller "calls the tune" regarding the format, content and organization of the response. Often, there's a lengthy reseller relationship, and users appear reluctant to appear too pushy. Thus, vendors that respond, usually with the low bid, are delighted by users' quick acquiescence. Our experiences have led us to identify the following do's and don'ts of contract negotiations and pricing. Users are encouraged to add to the list from their experiences, to create a comprehensive framework for how to proceed in optimizing cost savings.

The Do's

Ask for detailed pricing breakouts. Know the list, extended and discount pricing (by line items and group categories), such as central electronic complex, storage, software licenses, software maintenance and hardware maintenance. Too often, we see no breakout of list and discount pricing, with everything bundled together. It's similar to going to the supermarket and having each item scanned, but the cash register receipt only shows the total cost.

Maintain a historical database in a standard file format to compare and contrast historical pricing and discounts. We've seen some clients start backward, at lesser discounts than previously received, because the reseller was not aware and started again, or the reseller felt it was time to gain back some lost revenue and margin. Another factor is how aggressive you are in comparing

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vendor list pricing with the competition. It helps to evaluate cost/performance data — for example, industry standard benchmarks, such as TPC, SPEC and Gartner's own Ideas integrated vendor performance comparisons (see Note 1).

Ask for additional complementary services, such as testing, installation, decommissioning, disposal and education credits. We have seen such services added at no extra charge in higher volume expenditures of $500,000 to $1 million and more. These services can be especially helpful to IT organizations that are implementing green IT corporate strategies.

Aggregate separate regional contracts into larger global contracts. Quite often, volume discounts justify centralizing purchasing contracts. However, user experiences and feedback tend to confirm that the desire for benefits is often difficult and complex to implement organizationally.

Convert all international price lists to U.S. dollars. Most vendors use the U.S. dollar list price as a base and uplift international pricing (the euro, the pound and the "international dollar"). Uplifts are the markup a vendor makes for a specific sales region or price list, and can range from 5% to 20%, depending on the volume of product, the channel and the region. Thus, a deal in Europe that is discounted 35% off a euro price list may only represent a 20% real savings off a U.S. dollar price list. Clients in more-remote regions may buy off a U.S. dollar price list that is also uplifted — this is the international or uplifted U.S. dollar price list. These uplifts were traditionally used to allow for varied distribution and localization costs; now, they exist to help pad currency fluctuations and smooth out a vendor's forecast.

Request loaners or evaluation units through transitions and cutovers from legacy hardware to new upgrades. This eliminates duplicate and overlapping payments for the same production systems. Check independent software vendor (ISV) agreements when running applications on multiple systems simultaneously.

Write into the contract that pricing be subject to price reductions and promotions, when and as they occur. Often, the vendor may have price cuts or promotions that might apply (for example, to memory) that can lower the overall total cost of ownership (TCO). You may be able to write in price protection on parts for a given period, such as 30, 60 or 90 days.

Pay attention to the vendor's urgency to have you sign the order by a deadline. This usually means the vendor is trying to meet a sales quota, quarterly financial or year-end targets, or other internal milestones that give more power to the buyer in driving more-aggressive pricing. Know the vendor's fiscal year.

Pay attention to turnover in vendor account management. You may face instability in support and response, potentially affecting service quality (delivery times, future road map discussions, administration problems, etc.) that, in turn, affects time to production or uptime.

Add a risk clause for investment protection if the supplier goes out of business. If a supplier enters bankruptcy or is acquired, then ensure that continuity is maintained by having contingency alternative suppliers. This especially applies when dealing with smaller resellers.

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Demand price list auditing to validate reseller pricing against OEM official price lists. Recognize that, although few resellers will cheat by changing prices, some may factor in "costs" of doing business in the original pricing.

Exercise your legal rights for compensation in cases where server hardware downtime exceeds minimal acceptable service levels. If downtimes exceed agreed-on service levels, then calculate compensation as credits toward future purchases (perhaps on different models).

Study technological life cycles. Know how the product technology compares with its competitors, when the current product model is likely to be upgraded, what the difference in price/performance is likely to be and whether the vendor is hastily clearing inventory. Negotiate accordingly.

Create a matrix with the fiscal year details of every vendor you have, and include known financial results, if possible. Potential for discounts will be much greater at the end of a fiscal period (especially fiscal year end) and/or when vendors are not hitting market targets.

Check the support contracts and license models for virtualization and multicore deployment. Nearly half of all new workloads are being implemented in a VM, with nearly all multicore and/or multisocket platforms. ISVs and application providers may have complex, conflicting support and licensing issues. Clarify this exposure as part of a system refresh.

Negotiate a not-to-exceed maintenance contract price post-warranty at the time of purchase to improve opex savings.

Check for references from the reseller and the vendor. Clients should seek references in similar markets, geographies and technology implementations; these can be obtained from the vendor. This helps determine the risk and experience of implementing a project, and, indeed, helps differentiate leading-edge versus "bleeding-edge" and mass-market deployments. Getting new references for new architectures, systems and designs is crucial.

Consider becoming a reference. Not all new vendors and technologies are easily referenced. If any associated risk is classed as acceptable, then becoming a reference can be worth between 5% and 10% extra savings in a deal. However, this can sometimes be used and abused by the vendor, which may want to flood a reference with calls (thus tainting the reference).

The Don'ts

Don't accept the first offer. It's commonly acknowledged that vendors and resellers are testing the climate for easy or hard-to-negotiate wins. Discounts that often start low can wind up as much as 10% to 20% higher after an extended contract negotiation period. However, you must have your arguments lined up.

Don't go with a single vendor without comparing alternatives. Rationalizing selecting one vendor or one technology may seem a way to tactically take advantage of a higher discounted price. Although, tactically, the vendor will offer more-competitive pricing for exclusivity, in the long term, the pricing will go adrift and increase due to new technology introductions and market dynamics. Keeping a second vendor close to the RFP process keeps vendors alert and competitive with each other.

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Don't be subjected to one-reseller-only pricing. You have every right to seek a second bid from among the vendor's preferred resellers. The reason the vendor passes on preferred pricing to a selected reseller may vary, but the primary goal is not to begin a bidding war and let in unwelcome gray importers and other unauthorized suppliers. Vendors will often assign the first-responding reseller to an RFP and designate that reseller for preferential pricing. Procurement specialists responsible for multiple divisions and geographies may want to subject an RFP to alternative resellers as a validation check on pricing and discounts.

Don't be lured by multiyear contracts (such as maintenance). Unless incentives are provided in additional discounting (at least 10%), multiyear discounts may save some labor in contract renewal, but could eliminate fresh bargaining for higher levels of discounts later. Instead, negotiate limits on annual maintenance cost increases. One exception may be when the assurance of long-term support is tenuous due to mergers and acquisitions, when a guaranteed long-term support contract may minimize risk in discontinuity.

Don't sign a contract without clear lines of communication in support. Know the vendors/resellers support and escalation process, including contact names, time frames and various geographical dependencies. This should include the three levels of support: help desk, escalation/proofing and engineering changes.

Don't accept technology older than the current generation without a thorough evaluation of residual values. Some attractive offers may not be as attractive, if the technology is old and creates the need for larger configurations and higher software licensing, and will lead to faster obsolescence and earlier upgrades.

Don't advertise that an RFP is a noncompetitive bid. Some organizations may go so far as to institute a reverse-auction bidding process to get the lowest pricing; however, in all cases, having the vendor think it's "the only game in town" is a disincentive to offering generous discounts.

Don't focus only on capex savings — also look at potential opex costs. Often, sensitive deals will highlight potential upfront savings related to capital savings. In assessing these situations, analyze not only potential operations impacts and costs, but also transition costs to any new platform or system.

Don't get pressured into minimum annual spending to lock in discounts. The economic climate has changed, budgets are under pressure and vendors are fighting for fewer budget dollars.

Don't let vendors create a tight lock-in with new integrated systems, converged and fabric-based infrastructures. These systems have changed the market and vendor landscape. Vendors offer value in capex, opex and soft benefits such as faster time to useful deployment, but the relationship is subject to the vendor's road map, components, maintenance and other services in an inclusive contract. This makes the line item breakout even more important. Compare to a multivendor, best-of-breed integratable approach.

Don't renew a system sale without considering other architecture and application issues. If a project is being renewed in years three to five, then do not just get the same system and architecture as before, as a default. Many applications, from ISVs and ERP vendors alike, are being modernized to new application frameworks. Likewise, most ISVs now develop on Linux and/or Windows. Moving to mainstream platforms that accommodate this application shift should result in a refresh driven by the application architecture, not just by the system vendor.

Conclusions

Make these do's and don'ts part of your best practices in conducting vendor negotiations on server procurements. Make these guidelines expandable and flexible as your experience and Gartner guidance in cost optimization expand. View the process as holistic, comprising pricing and discounts, vendor relationship, support process and commitment, and technology competitiveness — all integrated into well-defined contract terms and conditions. Combine these guidelines with the suggested transaction history repository, developed in a standard format across divisions, business units and geographies, although the amount of work to get there may be intense. Worst case, start the process again and require, through governance, that divisions and units follow the prescribed policy in RFPs, and ensure that responses to RFPs meet standard corporate guidelines.

Recommended Reading

Some documents may not be available as part of your current Gartner subscription.

"Magic Quadrant for Blade Servers"

"When Two Server Vendors Are Better Than One"

"How Integrated Systems Challenge the Rules for Life Cycle and Procurement Planning"

"How to Negotiate Lower Storage Acquisition Costs"

Evidence

This research is an updated version of "Server Contract Negotiation Best Practices: The Do's and Don'ts."

Note 1 Ideas Benchmarks

RPE2 is a vendor- and architecture-agnostic benchmark of benchmarks. It covers all x86, IA-64, and RISC server variants, including current and obsolete server models, spanning more than 24,000 server models from all major vendors. RPE2 serves as the foundation for many product comparisons and price- or energy-related performance analysis within the Ideas products.

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