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Negotiating ERP Implementation Agreements for Success

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Critical Issues in Sourcing
BUSINESS & TECHNOLOGY SOURCING WEBINAR SERIES

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- Advised on more than 300 significant outsourcing transactions valued at an aggregate of more than $100 billion

RECOGNIZED MARKET LEADER

CHAMBERS & PARTNERS	THE LEGAL 500 UNITED STATES	IAOP INTERNATIONAL ASSOCIATION OF OUTSOURCING PROFESSIONALS
"Band 1" ranking in IT/Outsourcing for ten consecutive years (Chambers 2004-2014)	Named "MTT Outsourcing Team of the Year" in 2014 and ranked in the top tier from 2010 thru 2014	Ranked as one of the top law firms in 2009 thru 2014 on The World's Best Outsourcing Advisors list for The Global Outsourcing 100™

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Speakers

Paul Roy is a partner in the Business & Technology Sourcing practice in Mayer Brown's Chicago office. He represents clients in a broad range of onshore, nearshore, and offshore information technology and business process outsourcing transactions. He regularly advises clients on the outsourcing of IT infrastructure services and support, application development and maintenance, network management and support and help desk/call center services.
Paul also advises clients on the outsourcing of finance and accounting functions, HR/employee services, CRM and financial services operations, among other business process functions.

Paul Chandler is counsel in the Business & Technology Sourcing Practice in our Chicago office. He represents clients in connection with the outsourcing of information technology functions and business processes. In addition, Paul assists clients that are working to develop, license, market, distribute and acquire rights in a wide variety of technology-related products, services and intellectual property, including computer software and hardware, open source software, databases, cloud services and telecommunications systems. He also represents clients interested in forming technology joint ventures and other strategic alliances.

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Topics

- ERP Implementation Project Failure – A Very Common Problem

- Why Do ERP Implementation Projects Fail?

- How Can The Contract Promote Success?

- Key Takeaways

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ERP Implementation Project Failure – A Very Common Problem

- "Successful" Projects Are the Exception
  - Various studies report successes in the range of 10-40%
  - A recent study estimated successes as low as 6-7% (based on-time and on-budget)
  - An extensive academic study found 70% of projects did not achieve their estimated benefits, and 40-60% can be classified as failures.

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ERP Implementation Project Failure – A Very Common Problem

- Adverse Consequences of Failure Can be High
  - Inability to ship product
  - Inability to accurately invoice and track financial performance
  - Lost sales
  - Drops in stock price
  - Shareholder suits

EXAMPLES:

Hershey and Nike
Reported $100 million in lost sales and significant stock price drop

Avon
Abandoned ERP project after spending $135 million

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What Makes ERP Projects Different?

- **BACKGROUND:** What makes ERP different from other software implementation projects?
  - Ambitious Enterprise-Wide Goals
  - Enormously Complex at a Detail Level
    - Stages are interdependent and share common elements
    - User, financial, operational, technical and legal perspectives
    - Success requires joint effort
  - Requires Business Process Transformation
  - Retirement of Legacy Systems

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Why Do ERP Implementation Projects Fail?

- **Most Common Reasons for Failures**

  – Lack of clear understanding of what the company wants to achieve

  – Lack of a detailed *and feasible* plan for achieving what the company wants

    - E.g., phased review of the current IT environment and overall business, functionality and technical requirements

    - Staffing and timing commitments for consultant and company resources

  – Underestimating the effort required by the company's management and personnel

    - Results in delay, overworked staff and turnover which drains the knowledge pool

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Why Do ERP Implementation Projects Fail?

- Ineffective or inexperienced consultants

- Insufficient training of company personnel impacted by the project

- Unplanned customizations (reports, interfaces, forms, and enhancements)

  – ERP system misfit and over reliance on customizations

- Insufficient testing

  – Frequent symptom of lack of resources and lack of planning

- Inadequate project management

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How Can The Contract Promote Success?

Key Contract Principles:

Clarity

Processes

Incentives

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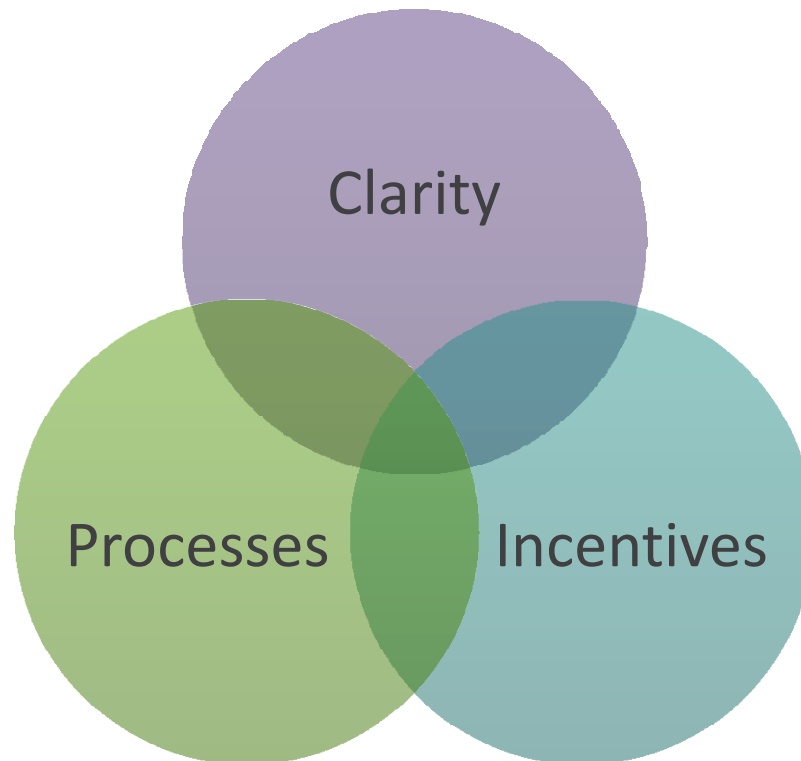
Contract Should Reflect Business Drivers

Goals
- Grow revenue

Strategy
- Supplier of choice
- Act as a one company

Plans
- Streamline processes
- Implement ERP system

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Design / Blueprinting

Development / Realization

Testing

Rollout and Go-Live

Support and Maintenance

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- **Risk: Moving too quickly to implementation**

  – Business team wants to "get it done"

  – Business view is that contract is a legal document that "goes in the drawer"

  – Risk of "vendor lock-in"

- **Contract Strategy:**

  – Design statement of work as a project plan with legally binding commitments, so that it's a part of the planning phase

  – Start with a robust template to minimize time required

  – Involve people who have experienced in ERP projects

  – Sell benefit of rigorous commitments and high-value contracting

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- **Risk: Expansion of scope, cost and duration**

  - End users prefer more functionality and customization to accommodate past practices, rather than new processes

  - Implementers profit more from bigger projects

- **Contract Strategy: Align incentives and shared risk/reward**

  - Scope includes Major Scope Parameters

  - Customer has control over what is implemented

  - Budget is set early and does not change unless a Major Scope Parameters changes

  - Bonuses for early and under-budget performance

  - Holdbacks, credits and rate reductions for late or over-budget performance

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- **Risk: Complexity**

  – Stages are interdependent and share common elements

  – User, financial, operational, technical and legal perspectives

  – Success requires joint effort

- **Contract Strategy: Modularization**

  – Solution

  – Activities

  – Deliverables

  – Responsibilities

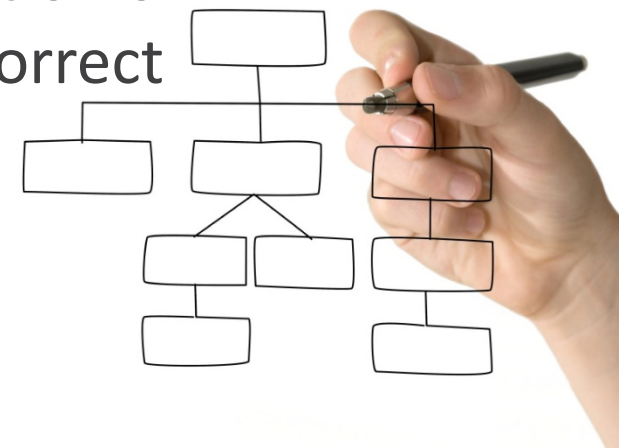 – Staffing

  – Pricing

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Project Plan

- Develop a detailed and feasible project plan

  – For each phase, the plan should milestones and acceptance criteria for the activities and deliverables I mentioned on the preceding slide

  – Tie the plan to the contract, using defined terms and milestone dates from the contract

KEY POINT: A significant part of the value of a plan is the understanding gained by the parties in developing the plan.

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Allocate Responsibilities Between the Parties

- Determines who is responsible for each activity

- "Responsible", "Collaborating", "Informed"

- Avoid "Joint Responsibility"

- Avoid jargon/undefined terms

- Avoid assumptions without clear description of outcome if assumptions proves to be incorrect

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Schedule [___]
Responsibilities Matrices

Activity	Phase 1: Design		Phase 2: Blueprint		Phase 3: Rollout #1		Phase 4: Rollout #2		Phase 5: Rollout #3		Phase 5: Rollout #4		Phase 5: Rollout #5	
	Supplier	Customer	Supplier	Customer	Supplier	Customer	Supplier	Customer	Supplier	Customer	Supplier	Customer	Supplier	Customer
Data														
Remove obsolete and duplicate data from legacy system to be converted from legacy systems	NA	NA	R	C	R	C	R	C	R	C	R	C	R	C
Update and cleanse data to be converted from legacy systems	NA	NA	R	C	R	C	R	C	R	C	R	C	R	C
Create common global customer master	NA	NA	R	C	R	C	R	C	R	C	R	C	R	C
Create common chart of accounts	NA	NA	R	C	R	C	R	C	C	R	C	R	C	R
Create common material master	NA	NA	R	C	R	C	R	C	C	R	C	R	C	R
Create common vendor master	NA	NA	R	C	R	C	R	C	C	R	C	R	C	R
Define common set of asset classes	NA	NA	R	C	R	C	R	C	C	R	C	R	C	R
Define legal entities	NA	NA	R	C	R	C	R	C	C	R	C	R	C	R
Update Master Data in Legacy Systems, as required	NA	NA	R	C	R	C	R	C	C	R	C	R	C	R
Define laptop requirements, select hardware compatible														

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Deliverables

- Acceptance Criteria

  – Format and substance requirements

  – Substance is often the output of a prior stage

- Acceptance Procedures

  – Conformity to acceptance criteria

  – Time allowed for your review

  – "Deemed Acceptance"

  – Require correction of errors

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Deal Structure Alternatives

- The structure chosen should fit the project, and the company's skills, risk tolerance and selected provider.

- Three categories of structure:

  - "Assist"

  - "Deliver"

  - "Shared Risk"

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Assist Structure

- Quick starts
- Company can make changes at its discretion

Benefits

- Company bears entire risk of budget overruns and schedule delays

Risks

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Deliver Structure

Benefits

- Consultant commits to scope of work on a specified schedule and fixed fees
- Incentivizes fast and efficient work

Risks

- Company bears risk of not clearly defining required outcomes
- Frequent change orders if scope is not complete and correct

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Shared Risk Structure

Benefits

- Aims to align incentives and create a spirit of partnership
- Shares risk/rewards if consultant works above or within a target budget

Risks

- Requires more sophisticated contracting and governance to address changes in scope and effect on target budget and incentives, including clearly defined desired outcomes

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How Can the Contract Promote Success?

- Define Processes for Interactions Between the Parties

    – Governance

        • Executive Commitment from both parties

    – Change Control

    – Dispute Resolution

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How Can the Contract Promote Success?

- Other Ways to Mitigate Risk

  – Personnel provisions

    - Key Personnel

    - Minimum consultant qualifications/ERP experience [Note this should also be a factor in how the company selects its own resources for the project.]

    - Right to see resumes/interview candidates

    - Right to remove ineffective consultants

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How Can the Contract Promote Success?

- Lawyer's critical roles:

- During negotiation:

  – Explaining risks and failure factors and how the contract addresses the risks

- During negotiation:

  - Training

  - Check-in/Monitoring

  - Involvement in changes and disputes

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- ERP projects promise compelling benefits for companies, but failure rates are high.

- The enormous complexity exceeds "typical" IT projects and is often underestimated by companies.

- Careful and detailed planning is key to reducing project risks.

- The right deal structure aligns incentives on quality, cost and duration, positioning the project for success.

- Role of the contract in promoting success.

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QUESTIONS
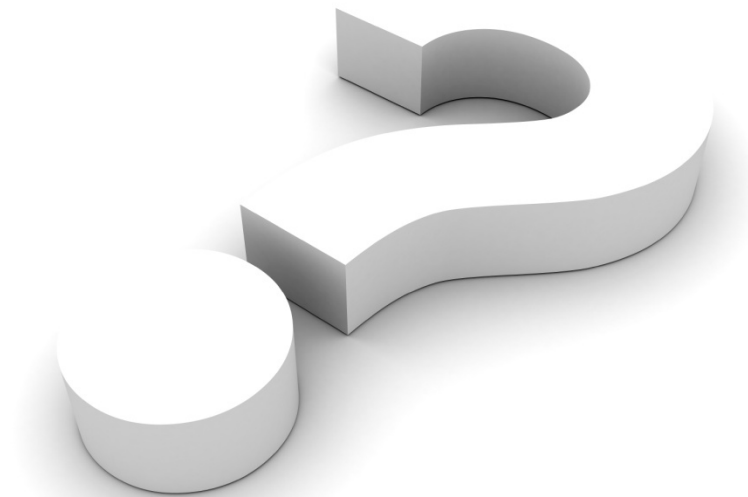
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