Portfolio contracts: How to negotiate with your customers, not with your own people

A sales executive at one of my large pharmaceutical clients recently lamented to me that his sales people spend more time negotiating internally than they do with customers when trying to create customer contracts. Whenever a multi-division contract is up for bid, the sales person has to create projections and presentations for each division, obtain and incorporate feedback and then re-present. In the end, a single division can (and often does) veto the whole deal by declining to participate… even if the deal is good for the company as a whole.

It's a common problem.

The reaction that most companies have is "This process is broken!" They then embark upon a noble effort to build an effective and efficient contract management process with expensive supporting technology.

While noble, this effort is misguided. If you want to fix this problem, you need to follow the money. Long, complex contracting processes are just symptoms of a bigger problem. The real issue is one of incentives and responsibilities. People in divisions are often compensated based on the performance of their respective divisions. In these cases, divisions will push back on any deal that impacts their financial results negatively, regardless of whether it's good for the corporation as a whole. They're not being bad corporate citizens; they're being paid to act in this way. Unfortunately, this can be a barrier to organizations' entering into good contracts.

Generally, there are three options for addressing this issue:

1. *Reorganize P&L responsibility by customer segment rather than by product* – While potentially very effective, this is likely a tremendous undertaking that is likely to be met with significant pushback.
2. *Change the compensation of divisional leaders such that it focuses primarily on overall corporate-wide results; not just divisional ones* - While this may help address contracting, it introduces a series of other problems that are likely to impact profitability.
3. *Move multi-division contract decision-making and accountability out of the hands of divisions* - This is often the most feasible.

However, making option #3 effective requires three key ingredients:

- *Clear and appropriate roles and responsibilities* - Establish a contract evaluation group outside of the divisions and empower this group to make contract decisions on behalf of the company as a whole.
- *Incentives aligned with organizational goals* – Measure and pay the contract group based on some combination of contracted sales results and overall organizational results. More importantly, develop a mechanism that ensures that divisions are not penalized (or too highly rewarded) when contract deals are made on their behalf. In addition, ensure that sales people are paid heavily on the contribution margin they create rather than just volume sold.
- *Objective deal evaluation methods* – Create universal and clear mechanisms for evaluating deals such that 95% of all prospective deals can be assessed automatically without a sales person having to present to another person.

The results of such a program will be that more valuable deals are approved and less time and energy is spent in the approval process.

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