

Nyden on Negotiation Checklist for Drafting a Gainshare Agreement



Checklist for Drafting a Gainshare Agreement

Introduction

Parties use gainshare mechanisms when the economic environment demands the customer lower supply chain costs by eliminating redundant and unnecessary processes. Gainsharing is an economic incentive to the supplier to propose reducing its costs and its revenue, without risking a decrease in quality. The U.S. Federal Acquisition Regulations have a gainshare mechanism called Value Engineering (F.A.R. 48). Some federal agencies have publicly documented their approach to mandatory and voluntary Value Engineering.

Structuring a gainshare model is a collaborative process. When customers and suppliers reduce costs, both parties split the gain from those saved costs. For the supplier the gainshare is pure profit. Typically, for the customer the gainshare is cost avoidance.

Use this checklist if you are interested in including any type of gainshare arrangement in your next complex contract.



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Purpose



What business objective is this gainshare framework accomplishing? What is the purpose?

- Go beyond savings to things like, removing the redundancy of ABC process, systemizing XYZ, automating LMOP process.
- For example, “to reduce _____ without sacrificing operational safety. . .”



What obligations does the supplier agree they have to perform for a successful gainshare?

- Again, think high level at this point to ensure that the purpose (removing unnecessary redundancy in ABC process) is something that the supplier has full control to improve, change or alter to meet expectations.



Is the gainshare a mandatory obligation or voluntary action?

- A mandatory obligation will require a thorough process to baseline, propose, analyze, approve, implement and pay out.
- A voluntary action does not require as robust a process, as it is a suggestion rather than a contractual obligation.

The rest of this checklist will help think through a mandatory gainshare process. Most suppliers are clear on the proposed cost saving actions but both parties are unclear in these areas.

Baseline



Who will conduct the research for the baseline? (Specifically, who at the buying company? Is there a person or a team who has access to the information to establish the baseline?)

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Is this Baseline a one-time static snap shot? Is it a rolling snap shot over a time period?



How are the elements included to be defined?

- Contract costs or acquisition costs to purchase XX service?
- Supplier acquisition costs for equipment or capital investment?
- Other cost savings?
- Cost avoidance?
- Third-party costs?
- Service fees?
- Add to this list for your own circumstance.



Assumptions that may affect the price/cost and how “savings” will be calculated.



- Variations in customer service consumption?
- Variations in end user (or consumer) consumption of supplier’s services?
- Variations in supplier service (sub-supplier) consumption?
- How will acquisition costs be calculated in the savings?
- How will the parties determine collateral savings (lower electrical consumption by automating a machine)?

How will the supplier demonstrate potential savings?



Does the buying company have a process in place already to track savings? If yes, use that method. If not:

- How will the supplier propose demonstrable savings against the baseline?
- What should the proposal contain?
 - Business case and spreadsheet analysis?
 - Mock P&L?



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- Considerations such as hard costs – equipment, soft costs – people, or IT costs (people, software and hardware)?
- Type of savings (acquisitions savings, cost avoidance, reduction in Total Cost of Ownership)? Often companies have different accounting processes so the supplier's categorization (classification) may not match the customer's categorization. Make sure that the categorization is aligned.
- Add to this list for your own circumstance.



How is the savings calculated – the actual method.

- When anticipated (immediately or over a time period)



Who at the customer will review the gainshare proposal for approval?



Who at the customer will approve the gainshare pay out process? Is that the same person?



In a mandatory gainshare, will the supplier be able to take a rejected proposal to a higher level in the customer's hierarchy? (An appeal of sorts.)



How long does customer need to approve the proposal?



What audit process will the customer use to validate the savings?

Performance



How does the supplier's performance affect the gainshare?




Could the customer experience service disruption during any enhancement?




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- Can the customer tolerate the anticipated level of disruption?
- What are the metrics for the “disruptive time”?
- How long can a service be disrupted?
- Who will be impacted by any disruption?

 What is the process for determining if the disruption affected the anticipated cost savings? (In other words, did the service disruption trigger unanticipated costs by the customer thereby eliminating the gainshare pay out?)

Customer's Accounting Process

 What is the customer's preferred process for paying out a gainshare?

- Monthly credit against an invoice?
- Annually as a lump sum along with any other earned bonuses or credits?

 What approvals must be in place to make the payment in accounting since it is likely not a routine process? Any special forms or signatures needed?

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Ways to Connect:



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Website

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