

Unpacking Relational Contracts – the way out of the contracting paradox

Ghislaine Gunge
CSC Director Contract & Commercial
Management
IACCM Board Director



Recently Released!



- Explains the why, what, how and when of relational contracts
- Download your free copy at <http://info.iaccm.com/new-paper-interest>

Ten key Points

1. Why is Relational Contracting on the Rise?
2. The Contracting Paradox
3. Not a New Model
4. What is a Relational Contract?
5. A Hybrid Approach
6. Nine Tenets of a Relational Contract
7. How to Create a Relational Contract
8. The Contracting Continuum
9. The Benefits
10. The Challenges

Why is Relational Contracting on the Rise?

- Rise of the new economy – VUCA and more complex contracts that demand strategic relationships, flexibility and collaborating for innovation
- Weaknesses in transactional contracts lead to value leakage
- Growing social and economic research scientifically supports the underlying theory of relationship concepts
- Enterprises are looking for a competitive advantage, beneficial to both commercial partners

The Contracting Paradox

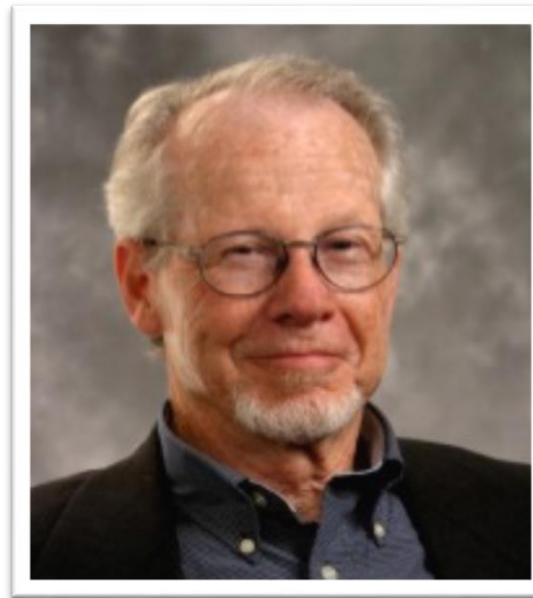
We write contracts to plan, but we cannot really plan.



Not a New Model – Driven by Big Thinking



MacNeil and Macaulay



Oliver Williamson



Hart and Holmström

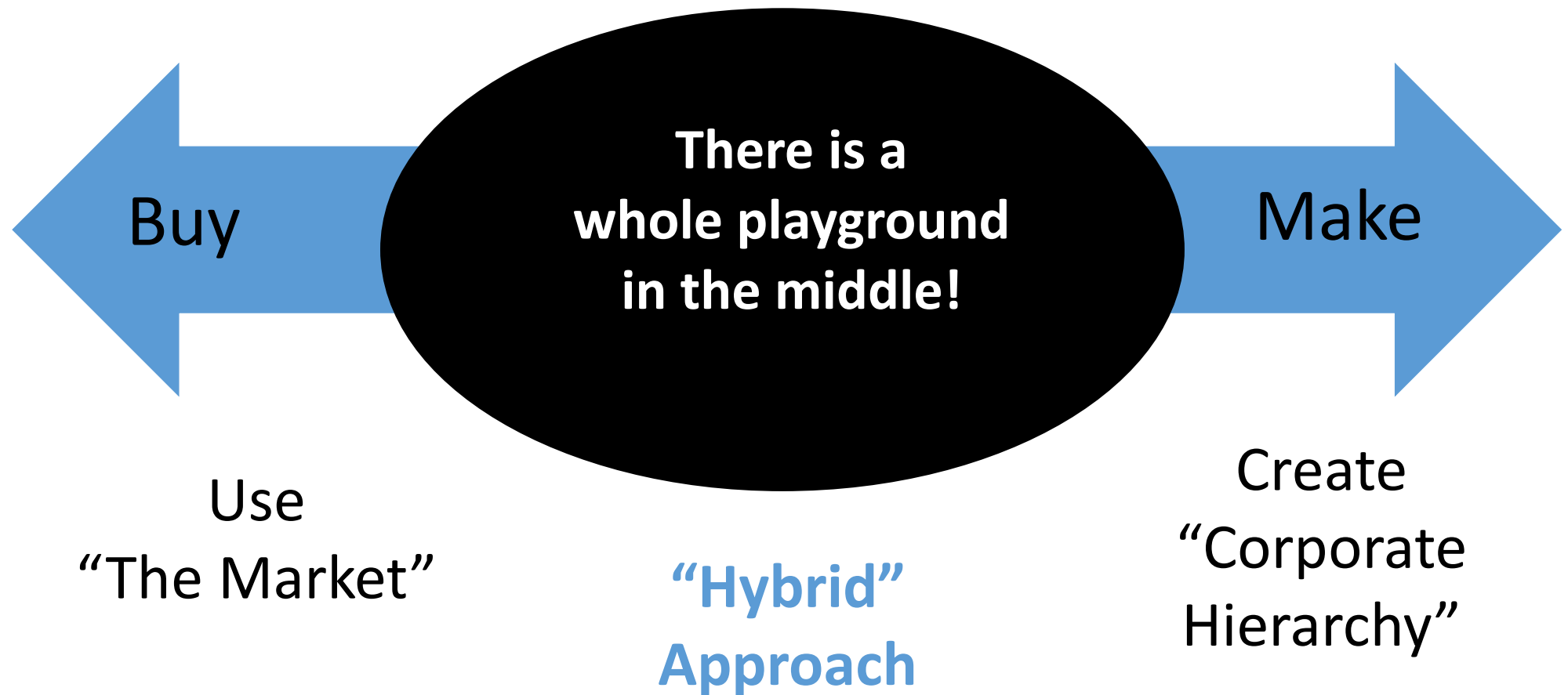
What is a Relational Contract?

*A legally enforceable written contract establishing a **commercial relationship** within a **flexible contractual framework** based on social norms and jointly defined objectives, prioritizing a relationship with continuous **alignment of interests** before the commercial transactions.*



A Hybrid Approach

Oliver Williamson's Nobel Prize winning work suggests organizations should create "hybrid" contracts that are flexible frameworks for more complex/dynamic situations.



Nine Tenets of a Relational Contract

IACCM research suggests relational contracts should include nine relational “tenets”.

1. Communication
2. Risk Allocation
3. Problem Solving
4. No-blame Culture
5. Joint Working
6. Gain and Pain Sharing
7. Mutual Objectives
8. Performance Measurement
9. Continuous Improvement

*See Appendix 1
of White Paper*

Relational tenet	Description
Communication	A defined framework for communication planning – what, when and how – and a forum established for monitoring the effectiveness of communications and driving future improvement.
Risk allocation	Ensuring that the allocation of risk under the contract does not act as a disincentive to collaboration and that there are methods established to deal with the unknown or unexpected.
Problem solving	Agreeing on principles for the way that problems or future misalignments and change requirements will be identified and resolved, including clarity over review and escalation procedures and paths.
No-blame culture	Establishing operational principles that focus first on resolution and the principle ‘we are in this together’, but with clarity over individual roles, responsibilities and accountability for performance.
Joint working	Defining the benefits and rationale for joint working and establishing criteria to determine when and for how long it is required.
Gain and pain sharing	Ensuring the allocation of risk and reward provides each party with the right incentives for success and for introducing added-value through continuous improvement and innovation.
Mutual objectives	Aligning goals and objectives across the parties to ensure consistency or understand different interests; establish where there are areas of uncertainty and the likelihood of changes in objectives over time.
Performance measurement	Determine the measures and performance indicators that are critical to success for each party and ensure there are methods for shared data gathering and review.
Continuous improvement	Develop a framework for delivery of continuous improvement and verify that the necessary mechanisms exist; for example through the approaches established for communication, gain share, performance measurement.

How to Create a Relational Contract?

- Focus on the relationship, not the deal
- Establish a Partnership instead of Arms-Length Relationship
- Embed Social Norms in the Relationship
- Avoid and Mitigate Risks by Alignment of Interests
- Create a Fair and Flexible Framework

When? The Contracting Continuum



DIMENSION	TRANSACTIONAL CONTRACT	RELATIONAL CONTRACT
FOCUS	The commercial transactions	The commercial relationship
RELATIONSHIP	Arms-length relationship	Partnership
SOCIAL NORMS	Disconnected from social norms	Mutually discovered and agreed social norms are explicitly included as contractual obligations
PRIMARY RISK MITIGATION MECHANISMS	Risk mitigation by use of market power and state power	Risk mitigation and avoidance by creation of continuous alignment of interest
PLANNING	Aims for completeness, i.e. tries to have contract clauses covering all future events of the relationship	Accepts that complete planning is not possible and aims to create a fair and flexible framework for managing change and uncertainty

The Benefits

- Lower value leakage rates (global average 9.2%)
- Greater quality of contracts – fewer/smaller disputes
- Increased agility and flexibility
- Mitigating and preventing risks from materializing – and avoiding the need to allocate risk

The Challenges

- Arming yourself with facts about transactional and relational contracts
- Involve the right stakeholders
- Start with the lower-risk contracts and call it a pilot
- Be very forgiving and patient with nay-sayers and skeptics

Summary

Rising
complexity

Flexibility,
innovation

Reducing value
leakage

Strategic
relationships

Contract or relationship
or integrated?

We cant plan for unknown
unknowns...

...but we *can* anticipate that
there will be unknown
unknowns, and prioritise a
relationship with alignment
of interests

First step... take a look at
the whitepaper!

IACCM – setting the Global Standard

ghislaine@gunge.com

Ghislaine Gunge

+33 6 63 34 82 64

www.iaccm.com



<http://info.iaccm.com/new-paper-interest>

Thank You

Q&A