11) Contractors and contracts

General remarks

A project can seldom be executed with in-house resources only. Indeed, **specific competencies** required for certain tasks may be unavailable within the project team. Furthermore, it is sometimes more cost-effective to use **specialized contractors** to do a job within a limited time-frame than to hire specialists who may not be occupied full-time on the project and/or for whom there might not be a suitable position available at the end of the project.

Some companies may enforce a **policy** whereby hiring of personnel should always be consistent with the company's line of business. For example, most content publishers are not in the business of developing software or designing user interfaces or hosting websites, so if they undertake a project that requires software development, user interface design and website hosting, they will generally have the corresponding work done by contractors (or service providers).

In some cases, a contractor may belong to the same company as the project team. For example, a company's IT department may be awarded a contract for the execution of a project owned by another department.
In principle, such **intra-company contractors** should be put in competition with external contractors, unless the company's management wants to give preference to in-house resources, as a matter of policy or for other reasons.

> *Hachette Multimedia's participation, from June 2002 to November 2004, in a large European project ("CELEBRATE") subsidized by the European Commission, consisted in designing and producing a hundred or so "Learning Objects" for schools, in English and in French.*
> *Participation in this project was authorized by top management at Lagardere Active Broadband (the group that Hachette Multimedia was part of) on the condition that software development for the Learning Objects would be done by another company belonging to Lagardere Active Broadband, so that the bulk of the subsidy would benefit the group, as opposed to external contractors.*

Here are a few areas of activity for which contractors may be used: writing, proofreading, translation, art direction, graphic design, animation development, user interface design, software development, testing, website hosting, online payment system.

Statements of work and estimates

For most contractors, a formal **statement of work (SOW)** will need to be provided in order to describe the project and the work that is expected to be done. The SOW may reuse parts of the **overall requirements specification** document.
In the case of a **call for bids** or **call for tenders** or **invitation to tender (ITT)** or **request for proposal (RFP)** or **request for quotation (RFQ)** made available or sent to several potential contractors, the SOW should be the same for all candidates, in order to facilitate the comparison of the various **responses and estimates**.

The SOW should contain information about the context of the work to be done with respect to the overall project. If it must include confidential information, the companies or individuals to be consulted must be required to sign a **non-disclosure agreement (NDA)**, drafted by the Legal department or a legal adviser, before they receive the SOW.

The SOW should be **detailed, exhaustive and unambiguous**. The PM should require equally detailed, exhaustive and unambiguous proposals and price quotations from respondents. The PM may impose a **fixed format for responses**, so that they can be easily compared.

In particular, respondents should be required to specify for each task or work package documented in the SOW not only the price but also the **number and profile of persons** who will be **assigned to the work** and the time it is expected to take (this should give the PM an idea of the cost per hour or per day of the people to be involved in the work).

If the SOW includes multiple (possibly successive) **versions** of a product and/or **maintenance**, the respondents should be required to make the corresponding prices explicit.

Note that **prices** quoted by a contractor generally include a **profit margin**, which is an acceptable practice. The existence of a profit margin may provide **room for negotiation** (although obtaining a lower price than initially quoted may have negative consequences, as explained further on in this chapter).

Selection process

The process of selecting contractors obviously starts with making a list of companies or individuals to be contacted, except for a public RFP, in which case it is generally posted on a website for anyone interested to read and take action upon.

There are several methods for **identifying contractors** to include in the list of potential candidates:

> ➢ drawing on experience with contractors the company has dealt with on previous occasions;
> ➢ picking from a list of approved vendors;
> ➢ considering intra-company candidates;
> ➢ networking (asking around, using any available channel, such as the PM's networks and, by extension, his contacts' networks);
> ➢ searching the web;
> ➢ using the "Yellow Pages" (not the best method!);
> ➢ following recommendations.

Selecting candidates (individuals or companies) that other people **recommend** is generally a good approach. However, some people may want to do a favour to a friend or family member who is a freelance or works for some company, but who may not be the best candidate. The PM will need expert judgment and diplomacy to deal with such embarrassing recommendations…

As much information as possible should be obtained concerning potential candidates before consulting them, in order to avoid wasting time with companies or individuals that don't **meet the basic requirements** which should have been identified and listed in the "Procurement plan".

Responses from potential contractors are generally received by e-mail (or "plain old mail"). Some candidates may insist on presenting their response during a meeting with the PM. However, it is preferable to **analyze responses before any meetings with respondents**.

Indeed, the **first step in the response evaluation process**, as far as the PM is concerned, should consist in reading each of the proposals and checking whether it is complete and complies with requirements in terms of content and format. If it does not meet these conditions, the respondent should be contacted immediately and asked to send a new, complete and/or compliant version of his document.

When all proposals have been received (at the latest by the deadline set by the PM) and reviewed, the PM should **plan a meeting** with each of the respondents retained in the **short list**, ie those that have not been eliminated as a result of the first step of evaluation.

Each of these "first meetings" should preferably take place at the respondent's offices, so that the PM can get an idea of the kind of company he is dealing with.
Respondent's staff liable to work on the project should attend the meeting.

At some stage, the PM should **meet the "boss"**, ie the company's CEO or, in the case of a very large company, the head of the department where the work would be performed.

It is generally difficult to **avoid having to deal with a salesperson**. The rule to follow consists in **double-checking what the salesperson claims** by consulting people who would be directly involved in the work (a salesperson's job is to win contracts, not to do the work that the contracts entail!)

The PM should obtain and check **as much information as possible** concerning the candidate: previous projects and achievements, references, etc., and should enquire about other projects the candidate would have to execute in the same time frame as the project being discussed.

It is advisable to perform a **due diligence investigation** of a company before retaining it as a contractor, particularly if the work to be done by the contractor is critical to the project.
Such an investigation may be carried out by the PM's company's Finance department or by a Due Diligence consultant. Indeed, contracting with a company that may go out of business before the work has been completed may have dramatic consequences!

The way a potential contractor **reacts** to the SOW is another good test: the contractor's questions, requests for clarification, comments, etc. are to be taken into account in its evaluation. The absence of **relevant feedback or questions** from a potential contractor may indicate that the SOW has not been fully understood!

In the case of software development, candidates should be asked to indicate which **tools** they intend to use, and to justify their choice. They should also be asked to describe possible **technical constraints and dependencies** and to indicate how they would deal with related **risks** they may have identified.

> *One of the candidates for the development of the first version of the EHM proposed to use "PDF technology". The candidate was thanked for his time and promptly dismissed!*

A candidate's **geographical proximity** to the project team may be an important selection criterion, in particular when complex software development is involved, and even more so when substantial amounts of structured content need to be integrated with the software.
Such projects indeed require frequent meetings between the project owner and the development contractor. Although means of communication such as e-mail, wiki, videoconferencing, VoIP, etc. are very effective, distance may render collaborative work and project control difficult and costly.

> *The Hachette Multimedia Dictionary and Atlas were developed by a contractor based in Florida. At the time (1995-1996) there was no such thing as a wiki or Skype, so communication with the developer was done by fax, by AppleLink (an e-mail system for Apple and Apple partners, including publishers and developers) and by phone (in the afternoon and evening, Paris time, given the 6-hour time difference). On a number of occasions, it had been necessary to send several members of the project team to Florida to work with the developers, at a significant cost.*
> *Because of that experience, as well as for other reasons, the development contractor I chose for the first version of the EHM was a company based in Paris, France!*

Choosing a contractor involves **objective criteria** such as:

> ➢ the detailed proposal corresponding to the SOW,
> ➢ previous achievements,
> ➢ references,
> ➢ company size,
> ➢ financial situation,
> ➢ geographical location,
> ➢ the "price tag" and the detailed pricing breakdown.

Subjective criteria may also be applied, for example:

> ➢ the impression given by the company's personnel,
> ➢ the work environment in its offices,
> ➢ the degree of confidence displayed by its employees during discussions.

As regards the "price tag", many companies tend to practice "**low-bidding**" in order to win contracts. A contractor may decide to set a low price by **reducing its standard profit margin**, which might be dangerous for the contractor in the long term, but may not necessarily jeopardize the project.

A low price may also be obtained, sometimes involuntarily, as a result of **underestimating** the resources and time required to execute the contract, which generally has a negative impact on the project. Indeed, when confronted with reality, the contractor will usually try to reduce its project-related costs by sacrificing something, for example by assigning fewer people to the work, by limiting the duration of internal testing, etc.

As a rule, **the lowest price should not systematically determine the choice of a contractor!**

> *In 2005, Hachette needed to make a series of 15 or so CD-ROMs compatible with Windows XP, in order to be able to keep them on the market. An RFQ had been sent to two development contractors. One of the quotations was roughly ten times lower than the other! A quick analysis of the situation (involving a discussion with both developers) revealed that the lower bidder had completely misunderstood what the work consisted in!*

A useful tool for making the final choice of contractor is a **summary table comparing the candidates** with respect to the main criteria, whether objective or subjective, then weighing the "pros and cons" and finally **eliminating candidates** one after the other until there's only one left.

Depending on the extent and importance of the work to be contracted, the final choice, proposed by the PM in agreement with the appropriate subproject manager(s), may need to be approved by the PM's management.

Once the **choice** has been made and validated, the **PM takes responsibility** for it.

Contracts

A "**procurement contract**" is awarded to each of the contractors selected for the project. The contract may be a simple purchase order or a more complex and exhaustive document.

A contract is a **mutually binding legal agreement** that obligates the "seller" to provide the specified products or services in compliance with terms and conditions, and obligates the "buyer" to compensate the seller for said products or services.

Contracts are generally drafted by the Legal department or a legal adviser. The PM may however draft a contract himself using a previous one as a starting point and adapting it for the new project and contractor. The contract prepared by the PM will however **need to be reviewed and approved by Legal (and Finance)**.

Finalizing a contract often involves **negotiations before mutual agreement** is reached and the contract is signed. The PM generally participates in the negotiations, but does not necessarily lead them, in particular as regards financial and legal issues, which require experts in those fields.

A contract must be **exhaustive and detailed**. Here is a non-exhaustive list of topics usually covered in a contract (or its appendices):

  ➢ statement of work and deliverables,
  ➢ procurement schedule,
  ➢ pricing,
  ➢ payment schedule, terms and conditions,
  ➢ roles and responsibilities (of buyer and seller),
  ➢ subordinate subcontractor approval,
  ➢ transfer of rights and ownership,
  ➢ inspection and acceptance criteria,
  ➢ warranty, maintenance and support,
  ➢ change request handling,
  ➢ penalties,
  ➢ limitation of liability,
  ➢ insurance,
  ➢ confidentiality,
  ➢ termination and dispute resolution.

A contract should **provide for all contingencies** such as the contractor's failure to complete execution of the work, to comply with the schedule, to meet the quality requirements, etc., and it should specify the corresponding **penalties and damages**.

For certain types of service provided by contractors, a "**Service Level Agreement**" (**SLA**) may be necessary in order to clearly specify, and quantify, the **levels of service required by the client from the contractor** as regards for example availability, support, response time, etc.
The SLA may also specify the **penalties** that will be applied if the contractor does not meet those levels of service.
The SLA may be part of the contract or an appendix.

In cases such as software development work, the contract should clearly specify whether **ownership** of the final application or system is to be transferred to the client or retained by the developer, and whether any **licence fees** will have to be paid by the client to the developer.
The contract should also specify whether **source code and documentation** is to be provided by the developer to the client.

The **compensation** for the service provided by the contractor may be a **flat fee** (fixed amount), possibly paid in several **instalments**, the first one usually paid upon signature of the contract, and the final one paid upon acceptance of the project deliverables in their final form, or at the end of the warranty period.

As mentioned in the chapter concerning the "P&L", a contractor's fee may be divided into a flat fee and a **proportional fee** (eg a percentage of gross or net revenues generated by the product), and, in some cases, a **licence fee**.

An additional fee is often charged by the contractor for **maintenance** beyond the warranty period (unless maintenance is covered by the fee corresponding to the development work).

Proportional fees are generally more complex to manage than flat fees, since they require execution of tracking, accounting, reporting and payment processes beyond the end of the project.
Contracts involving proportional fees may however have the advantage of reducing the initial cost of a project, sharing the risk of failure or lower-than-expected success of the resulting product, and motivating the contractor to do its best to ensure the quality of the product.

> *In 2004, it had become evident that both the CD/DVD-ROM and online versions of the EHM required a complete redesign and redevelopment to ensure compatibility with their environment and increase their attractiveness in a highly competitive market.*
> *However, Hachette Multimedia did not have the necessary budget to do that.*
>
> *The software development company that had been consulted during the feasibility study phase of this project was very excited at the prospect of such a challenging and interesting development project (it had previously developed an online version of both the EHM and the Hachette-Oxford dictionary).*
>
> *Talks with this company finally led to its accepting to be compensated for its work with a purely proportional fee (no flat fee), on the condition that a substantial advance payment would be made. Thanks to that financial arrangement, the project was approved by Hachette Multimedia's management, and was successfully completed.*

Reaching an agreement on a contract may take a long time, so it may be **tempting to start work before the contract is signed**. Doing this is **risky and certainly not recommended**, but it may be necessary if the schedule is tight and there is strong mutual trust between the parties involved.

Throughout the execution of a contract, **minutes** of important meetings should be taken and **decisions confirmed in writing**. These documents should be **filed for reference** in case of a dispute or litigation.