Recommended Practices for Subcontractor Management

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Agenda

• Introduction & Context
• A Subcontractor Management Case Study…
• Recommended practices across the engagement phases:
  • Pre-proposal
  • Proposal
  • Contracting
  • Pre-delivery
  • Delivery
• Conclusion / Q&A
Recommended Practices in Subcontractor Management

Context

Today’s complex solutions often mean… partnering with 3rd parties to offer our clients the right solution to meet their needs.

What if?

You have a critical reliance on a subcontractor and…

they do not or can not deliver?

Examples:

• Cannot give you the A-team you saw and were promised at bid time; their resources are over-committed
• Unable to produce a project plan and schedule for their work; unclear team structure without defined escalation path
• Subcontractor’s team are strong Subject Matter Experts, but little to no experience with projects of this size
• Subcontractor schedule slipping; do not portray the commitment and sense of urgency needed to succeed
• Any project overrun or delay may impact subcontractor’s ability to meet their payroll
Recommended Practices in Subcontractor Management

Context

- Early Risk Management is key to proactively mitigating Subcontractor risk
  - Iterative process through-out the engagement lifecycle
  - The Due Diligence never ends!!!

- Utilize proven recommended practices – Journey Through Phases

  This document:
  - Provides key considerations to ensure that subcontractor risks are appropriately identified and mitigated
  - Highlights key success factors for all life-cycle phases

A note on terminology

- In this session, Subcontractor refers to a 3rd party relied on for some aspect of engagement delivery, whether it be as a prime or as a sub
- May be referred to as: Partner, Supplier, Vendor, etc.
- No specific distinction made between scenarios in which subcontractor is chosen by your organization vs. “Client-imposed”
  - Recommendations should generally apply in both scenarios
  - Some recommended mitigation tactics will not be available or more difficult to implement in a “Client-imposed” scenario
PrimeCo Inc. is looking to bid on an important opportunity with one of its major clients.

PrimeCo is an established multinational firm with a solid reputation and proven capabilities in project delivery and system integration. It has a high level of expertise in the client domain.

PrimeCo has a preferred solution that meets the majority of the bid requirements, however lacks one fundamental component.

PrimeCo has surveyed the market landscape for a complementary solution that can be integrated into its own.

Among the candidates, SubCo, a small overseas subsidiary of SomeOtherFirm has what appears to be the best available technology. Other alternatives exist, including with in-country firms, however their technology is not as advanced nor as complementary to PrimeCo’s.

PrimeCo has approached SubCo to obtain further information on their solution as well as explore SubCo’s interest in a potential joint bid. It has received positive feedback from SubCo.

What are the steps that PrimeCo should perform before deciding whether or not to move forward in putting together a joint proposal with SubCo, where SubCo would act as its subcontractor?
Recommended Practices in Subcontractor Management

Pre-proposal phase

- Perform Due Diligence on Subcontractor credentials
  - Obtain available information about subcontractor from your organization’s Corporate Sourcing / Procurement team
    - Experience and references in other engagements / BUs / geographies
    - Existing commercial agreements that can be leveraged
  - Verify capabilities and past experiences: check client references, talk to current and past clients
    - Review sub-contractor project/client history
      (current or previous lawsuits, project failures, client break-ups, etc.)
    - Look for evidence of how they manage projects
    - Observe management style, work ethics, quality, culture, standards and ensure that they are compatible with your organization’s values
    - Visit their premises and walk around; sit in on a walkthrough or status meeting
  - Verify financial viability (annual reports, credit rating reports, news bulletins, etc.)

These activities are essential to gain a true pulse on our subcontractor’s ability to deliver
To help evaluate potential risks and to identify associated contingency plans

- Sign appropriate non-disclosure agreement early
  - Allows team to openly share available information
  - Provides level of comfort that confidential information will not be inappropriately shared if relationship does not mature into the next phase (teaming agreement)

- Work to create partnership based on trust, commitment and communication
  - Start sharing openly and align on principles that will form basis for negotiation
  - Get clear understanding of mutual commitments, expectations and concerns
  - Get highest level of Subcontractor management involvement & sponsorship
  - Establish Joint Internal Steering Committee early: Ensure availability of senior level resources to actively participate

- Be cautious about Subcontractors located in different geographies
  - Local delivery capabilities might be limited
    - Timely assignment of key Subcontractor resources might be inhibited by travel restrictions or other work regulations (VISA, work permit, etc.)
  - Subcontractor pricing might not be competitive due to additional geography-related cost impacts
    - Travel & Lodging, currency exchange risks, possible additional tax liabilities (personal & corporate), etc.
  - Management approach, culture as well as legal & commercial standards might not align
Entering the Proposal phase

- PrimeCo Inc. has performed the necessary due diligence on SubCo and decided to move forward to the proposal phase, with SubCo as its subcontractor.
- As part of jointly entering the proposal phase, PrimeCo and SubCo will need to establish a Teaming Agreement…

What is a Teaming Agreement?

- A teaming agreement is an arrangement between separate business entities to come together as a group in order to perform the duties associated with a particular project.
- This process usually begins shortly after an agency announces an invitation to bid. Each team member then has a specific set of responsibilities relating to the bidding process and, upon award, will perform a predefined portion of the project.
- In a teaming agreement, one member of the team always acts as the prime contractor for the project, while the remaining team members are subcontractors.
When is a Teaming Agreement Used?

- Teaming agreements are vital when bidding for substantially large contracts by state and federal government agencies.
- Under the bidding guidelines, large businesses are required to submit a small business contracting plan with the bid proposal that must include teaming agreements for the various small business listed.
- Teaming agreements might also be used in situations where small businesses cannot compete for a bid alone.

More on Teaming Agreements...

- **Requirements:**
  - A contract that must specify the parties involved in the agreement, the actual project under consideration, definitions of the activities to be completed, and specialized instructions and definitions of the activities to be completed by both parties.
  - In the event that a team consists of more than two business entities, it is not necessary to list these entities beyond the prime contractor and the main subcontractor.

- **Advantages:**
  - Allows small business owners to maintain complete control over their operations and to limit the overall liable exposure of the small business.
  - By teaming, small companies can bid on and complete lucrative large projects that they could not have done otherwise.
A Subcontractor Management Case Study…

Entering the Proposal phase

- What are the key provisions that need to be included in the PrimeCo-SubCo Teaming Agreement for PrimeCo to properly protect its interests and manage its subcontractor risk?

- Beyond the Teaming Agreement provisions, what other considerations does PrimeCo need to take in order to achieve the above objectives?

Recommended Practices in Subcontractor Management

Proposal phase: Draft Teaming Agreement

- Get an early indication of pricing
  - Ask for a pro-forma quote
    - For services, ask for expected daily rates
    - For product, ask for license and maintenance costs
  - Ensure that type of pricing matches your commitment to client pricing
    - Do not accept T&M for a piece of work you must deliver in fixed price
  - Insist on pricing in the currency of the prime bid
  - Make sure that you have an alternate supplier in case pricing is not acceptable
    - Now is the time to start negotiations on acceptable pricing

- Obtain written commitments as soon as you decide to team up
  - Insist that Subcontractor signs a Teaming Agreement without delay
    - If they refuse or delay, look for an alternate supplier
  - If your organization has a standard teaming agreement, use it!
    - Note that different versions will likely be available for different countries
      - Use appropriate geographical version
    - Do not alter standard legal wording (e.g. applicable law) unless approved by your legal team
    - If your organization is prime, do not accept the vendor’s form of agreement
• Make sure you are dealing with the right subcontractor counterpart and legal entity
  - Some subcontractors have local subsidiaries
  - They may not have the capacity to back their commitments
  - If so, require the parent company to make the commitment
• Clearly describe the subcontractor scope of work in the appendix
  - Most important: should be the focus of the team until it is done
  - Do not leave scope of work undefined: could expose you to claims
  - Include deliverables in sufficient detail to gain accountability for all proposal commitments
  - Advise upfront that you will require a binding proposal from the Subcontractor for their scope of work prior to the bid submission

In a complex bid, make sure you are not promising the same scope of work to more than one partner!

• Implement appropriate risk sharing model with Subcontractor
  - Agree on flow-through of Terms & Conditions
    - Type of Pricing, Basis of Payment, Penalties, Liabilities, Sharing of Overruns, Acceptance…
    - General Rule: Match subcontract pricing to your contract pricing or better
      - OK to pursue fixed price or tightly managed T&M to a ceiling, even if you are on T&M model
      - Never contract for T&M with sub if you, as prime, are on a fixed price contract
  - Currency risk: Ensure that subcontractor costs and your revenues are in the same currency
    - Otherwise you may incur significant losses on currency fluctuation
    - Consult with your finance team for further support on currency risk
Recommended Practices in Subcontractor Management

Proposal phase: Draft Teaming Agreement

- Other special considerations for the teaming agreement
  - Identify named Subcontractor personnel
    - Make sure that there is a penalty for removal / not supplying – often your choice of subcontractor depends on these key personnel
  - Include the project management methodology and governance model to be used throughout the engagement
    - Make sure that your – or at least adequate – quality processes will be followed
    - Provide for visibility into how work is performed to allow progress to be measured
    - Ongoing Project Audits: Subcontractor to make all necessary resources available for on-site project audits (e.g. documentation, reports, software, etc.)
  - Ensure adequate knowledge transfer to your team
    - Request product training – ideally at no additional charge
    - Consider integration of members from your organization into subcontractor teams
  - If there is any doubt (technical, financial) as to subcontractor’s ability to deliver
    - Require a performance bond relative to the value of the work being performed
    - If a software product is being delivered, code should be put into escrow; so that you may obtain code and complete work in event of default by sub

Proposal phase: Other key activities

- Re-assess prior Due Diligence findings on Subcontractor’s ability to deliver
  - Assess Subcontractor’s project management expertise & availability
  - Identify and acknowledge subs strengths and weaknesses early
    - Identify a mitigation strategy to deal with their weaknesses
    - e.g. If a sub demonstrates no project management abilities; build the cost of a PCO into your estimates
  - Perform a technical assessment on their solution (due diligence)
  - Pursue approach to co-locate teams
    - Ensure desk space at Subcontractor premises for at least one of your resources
    - Set an expectation that you will be visible and present
  - Monitor level of cooperation, expertise and responsiveness of Subcontractor staff involved in proposal phase
    - Early indication of possible challenges and risks during delivery
    - Escalate issues early with senior management of Subcontractor; look for prompt action to address root causes prior to start of delivery
    - If Subcontractor management is not responsive and/or problems persist, closely examine alternatives
Recommended Practices in Subcontractor Management

Proposal phase: Other key activities

- Have alternatives ready to go…
  - In the event you cannot reach a satisfactory agreement or price
    - May need to negotiate in parallel with more than one sub/supplier
  - Identify and price a Plan B for project delivery, if Subcontractor cannot meet commitments e.g.
    - For your organization to take over subs’ client deliverables
    - Alternate suppliers and sources of expertise
    - Define ramp up time for replacement staff
  - Ensure that Subcontractor Statement of Work is well defined for you to draw on if you need to perform or transfer this work

A Subcontractor Management Case Study…

Prior to Proposal submission

- The PrimeCo-SubCo Teaming Agreement is now in place and PrimeCo has performed a technical assessment of the SubCo solution component.

- Furthermore, PrimeCo is satisfied with the level of commitment and collaboration received from SubCo to date, has taken necessary measures to reinforce SubCo’s project management capabilities, ensure visibility into SubCo’s delivery and implement basic knowledge transfer.

- With the proposal deadline on the horizon, what key steps should PrimeCo take prior to submitting its proposal, in order to properly manage its subcontractor risk heading into the next phases?
### Recommended Practices in Subcontractor Management

**Proposal phase: Prior to submission**

- Confirm Subcontractor pricing
  - Obtain written quotes and commitments from Subcontractor prior to including related cost and estimates in your proposal
    - Too late to negotiate once you have provided your price to the client
    - Do not rely on informal quotes: they are usually not binding
  - Ensure Subcontractor pricing is supported by a detailed Statement of Work
  - Ensure that Subcontractor price is:
    - Firm and valid for duration of your bid price validity
    - Inclusive of all services necessary for any 3rd party product integration/customization
    - Includes all tasks/components necessary to meet engagement requirements
- Consider conducting 2nd estimate review for all Subcontractor provided estimates
- Ensure appropriate contingency is included on all Subcontractor costs
  (based on results from due diligence on Subcontractor)
  - e.g. Dedicated role for Subcontractor management to ensure sub meets delivery commitments and to escalate issues pro-actively
  - Effective Subcontractor management takes time
- Allow sufficient time for iterative price negotiations to ensure price fits within envelope and represents best offer

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### A Subcontractor Management Case Study...

**Entering the Contracting phase**

- With the proposal submitted and prospects of winning high, PrimeCo and SubCo must enter a contractual agreement.
- What are the key contractual provisions that PrimeCo should pursue to protect its interests and continue to manage its subcontractor risk?
Recommended Practices in Subcontractor Management

**Contracting phase**

- **Protect yourself against Subcontractor financial stability risks**
  - Negotiate ability to perform financial audits at least on quarterly basis
  - If Subcontractor is part of larger group, include parent guarantee in contractual terms
  - Ensure that Subcontractor has appropriate Errors & Omissions Insurance coverage
  - If Subcontractor experiences financial difficulty and does not meet its delivery commitments, ensure you can take necessary measures to meet contractual commitments to the client
    - Ability to invoke early termination clause
    - Subcontractor to provide you with all Work in Process
    - Ability to assume ownership of these materials
    - Ability to directly recruit subcontractor resources
    - Handling of transition costs to another vendor
  - If subcontractor is acquired, then the acquiring company must agree to meet the existing commitments of the teaming agreement so that you can meet your delivery commitments
  - If subcontractor is considering selling its interests, obtain first right of refusal to purchase the company to protect your interests and ability to meet contractual obligations

- **Leverage your Sourcing team to negotiate final Subcontractor agreement**
  - Obtain better terms and conditions by leveraging your organization’s full purchasing power

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**Recommended Practices in Subcontractor Management**

**Contracting phase**

- **Intellectual Property provisions**
  - Clear ownership must be defined as part of agreement
  - If a software product is being delivered, code should be put into escrow
    - Protect your ability to obtain code and complete work in event of default by sub

- **Agree on payment conditions that protect your cash-flow**
  - General Rule – Flow-down of payment terms from main contract or better
  - Subcontractor gets paid only when you get paid
  - Tie all payment milestones (and any associated holdbacks) to:
    - Your acceptance of deliverables based on pre-defined acceptance criteria
    - And also on ultimate client acceptance of deliverables

- **Ensure that there are no gaps between main and sub contracts**
  - Validate mapping from main contract to subcontract
    - Requirements & Responsibility matrix
    - Terms & Conditions matrix
    - Reflect any changes/amendments immediately
    - Ensure that associated contract change management process is agreed with Subcontractor
A Subcontractor Management Case Study…

**Pre-delivery and Delivery phases**

- Congratulations! PrimeCo and SubCo have won the contract. Now all they have to do is deliver…
- What are the actions that PrimeCo needs to continue to undertake vis-à-vis its subcontractor SubCo, heading into and throughout the Delivery phase, in order to favor a successful project execution?

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**Recommended Practices in Subcontractor Management**

**Pre-delivery phase**

- Actively manage your Subcontractor — this is key to delivery success
- Have an internal kick-off workshop to validate project plan and agree on governance model (organizations, responsibilities, plan, deliverables, communications…)
- Document internal governance model and pursue implementation from day one
- Achieve Subcontractor awareness and alignment with your project management, quality and communications processes
- Agree on mechanism to obtain regular Subcontractor status reports against agreed project plan and service levels
- Implement effective issue & risk monitoring process with Subcontractor and agree on associated escalation mechanism
- Establish regular internal Steering Committee meetings that you facilitate
- Involve representatives from Subcontractor in relevant meetings (i.e. synergy group, project reviews, etc.)
- Staff your team with experts (in-house or independent) in the Subcontractors field of expertise to verify quality of delivery
- Embed some of your resources on Subcontractor team to keep pulse on Subcontractor delivery (also allows for knowledge transfer)
- Set expectations for regular project audit of Subcontractor (on-site) work in support of your quality assurance commitments
Recommended Practices in Subcontractor Management

Delivery phase

- Continuously validate Subcontractor’s ability to deliver
  - Ensure continued role & responsibility for Subcontractor management
  - Look for evidence of commitment
    - Listen carefully for new issues and risks; the warning signals are usually there
    - Review and verify Subcontractor status reports against agreed project plan and service levels
    - Continuously re-confirm and monitor Subcontractor evidence of capability as well as delivery quality
  - Closely monitor issues & risks with Subcontractor as per risk management process
  - Ensure that escalation and resolution mechanism is effective
  - Make the Internal Steering Committee an integral part of the visibility process
  - Conduct financial and on-site quality audits periodically in support of your quality assurance commitments

- Enforce agreed communication model with Subcontractor
  - If you are prime, strive to control all client communications
  - Address issues around agreed communications model immediately
  - Clearly communicate and validate roles as defined
    - i.e. RACI - Responsible, Accountable, Consent, Informed Matrix
  - Ensure regular presence and visibility on Subcontractor premises

The Due Diligence never stops!!!

Questions