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The truth about your B2B contracts

Avoid common myths across the contract lifecycle

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Introduction

In today's dynamic business landscape, effective B2B contract management is crucial for driving organizational success. However, many companies fall victim to pervasive myths that hinder their ability to optimize contracts throughout their lifecycle. These misconceptions can lead to suboptimal decision-making, missed opportunities, and strained relationships with partners and clients. By debunking these myths, businesses can unlock a range of benefits, including improved profitability, stronger partnerships, and enhanced adaptability.

To help businesses navigate these challenges, we have identified the most common myths that arise during each stage of the contract lifecycle:

- Negotiation and drafting
- Execution and monitoring
- Review and renewal

By examining these myths through the lens of the contract lifecycle, we can provide a more targeted and actionable approach to avoiding them.

As trusted advisers to enterprises across sectors, KPMG LLP has conducted thousands of interviews with professionals involved in the contract negotiation process, on both sides of the bargaining table. Our experience has consistently revealed significant value erosion, with realized margins sometimes underperforming their potential by as much as 25 percent to 40 percent on average over the life of the agreement. This value erosion can be attributed, in part, to the persistent myths that plague each stage of the contract lifecycle, specifically in negotiation and drafting, execution and monitoring, and review and renewal.

In the following sections, we will explore these myths in detail, providing insights and strategies to help businesses optimize their contracts and unlock hidden value. Debunking these misconceptions and embracing a lifecycle-oriented approach to contract management can foster stronger partnerships, improve profitability, and drive long-term success. Having outlined the critical role of effective contract management, let us now explore the initial stage of the contract lifecycle: negotiation and drafting.

Negotiation and drafting

The negotiation and drafting stage lays the foundation for a successful B2B contract. However, businesses can fall prey to myths that can lead to suboptimal terms, missed opportunities, and strained relationships down the line.

Myth 1 Price locks and caps mean there is no opportunity for adjustments

Customers routinely add price locks, which prevent price escalations or price caps that add a ceiling to any price escalations to their contracts with suppliers. A prevalent misconception in B2B contracts is that once pricing terms are set, that is the end of the discussion. This fails to consider the intricate dynamics of market changes, competitor actions, and customer preferences. For instance, a company may have price locks and caps in place and dismiss the need for regular market analysis and customer willingness to pay assessments. This oversight can lead to scenarios where a business is forced into less profitable terms while competitors adapt more effectively to market conditions. For example, the customer may pay more per unit if you can offer future growth incentives, inventory guarantees, etc. Different factors come into consideration when thinking through price escalations in general, such as whose paper the contract is on, are there intermediaries (e.g., sourcing consultants) that are running the negotiations, are there different price escalations for material and labor, what customer segment does the customer belong to, and so on. A deeper understanding of these factors should allow companies to gain the confidence to negotiate better price escalation terms around locks and caps.

Case study

A global leader in the elevator and escalator industry found that even with price locks and caps in their contracts, there was still room for adjustments. By conducting regular market analyses and customer willingness-to-pay assessments, they identified opportunities to offer future growth incentives and service guarantees to customers in exchange for higher per-unit prices. This approach led to a 7 percent improvement in realized margins over the life of the agreements

Myth 2 If you have a clause for inflation, there's no need for concern

It's often overlooked how significantly varying rates of price escalation can affect profitability. Businesses assume that minor differences in rates are inconsequential and will generally "even out." However, even small variations can cumulatively lead to significant profitability impact. For instance, a service provider should consider hourly labor cost plus the cost of fringe benefits and taxes, including, without limitation, welfare, pension, paid holidays, vacation, insurance, etc. In cases where labor is unionized, union contributions should also be factored into the contract. Timing of these price escalations is almost as important as the magnitude of increase and should generally follow the first invoice in each year.

Myth 3 Default terms and conditions should not be regularly reconsidered

This myth is grounded in the misconception that legal agreements are set in stone and that any attempt to revisit the terms and conditions is futile. In practice, however, the business landscape is constantly evolving, and what was competitive at the agreement's inception may no longer be so months or years down the line, particularly if using "boilerplate" language. Legal agreements are designed to outline the framework of a business relationship, but they also include mechanisms for renegotiation and amendment. Encouraging open communication can reveal opportunities to better align with current market conditions, technological advancements, and changes in business strategy. Far from being a sign of mistrust or dissatisfaction, seeking to potentially refresh contract terms can demonstrate a commitment to maintaining a relevant and mutually beneficial relationship. Maintaining open communication can foster trust and lay the foundation for long-term partnerships. It is essential not to assume limitations within a contract but to explore and negotiate terms that reflect the current and future business environment.

Myth 4 The best contracts are those that maximize your benefit

Perhaps the most insidious myth of all—and a common misconception—is that the most successful contracts are those that are heavily skewed in favor of one party, typically the one with greater negotiating power. This win-lose mindset overlooks the long-term value of building balanced, sustainable relationships that offer mutual benefits. Contracts that are too one-sided can lead to dissatisfaction, reduced cooperation, and may ultimately be unsustainable, as the disadvantaged party may seek to exit the relationship or underperform. Instead, the most effective contracts are those that create win-win scenarios, where both parties feel their needs and interests are adequately addressed. By fostering a spirit of collaboration and mutual respect, companies can develop agreements that not only meet their immediate goals but also lay the groundwork for long-term partnerships and shared success. This approach can lead to more stable, long-lasting relationships that can weather market fluctuations and changing circumstances.

By addressing these misconceptions during the negotiation and drafting stage, businesses can create contracts that are more flexible, adaptable, and mutually beneficial, setting the stage for successful long-term partnerships.

Having established more flexible and adaptable contracts in the negotiation and drafting phase, we must now ensure these agreements are effectively brought to life. The transition from theory to practice in the execution and monitoring phase is where these carefully crafted terms are put to the test, ensuring compliance and adaptability in real-time business scenarios.

Execution and monitoring

Once a contract is in place, the focus shifts to execution and monitoring. This stage is critical for ensuring that the terms of the agreement are being met and that both parties are deriving value from the relationship. Vigilant monitoring and proactive management are essential to ensure the success of the contract throughout its lifecycle. However, several myths can hinder effective contract execution and monitoring, leading to missed opportunities and suboptimal performance.

Myth 5 Contract price escalation terms are indicative of actual performance

Many businesses operate under the illusion that the contract pricing terms are automatically or consistently followed. What tends to be ignored are the practical challenges in enforcing these terms. In reality, companies often fail to implement these escalations due to oversight, lack of clear process, or fear of straining customer relationships. For instance, a supplier may hesitate to enforce an agreed-upon price increase, fearing customer backlash or competition. This reluctance can lead to significant revenue losses over time. Vigilant monitoring and transparent communication about these clauses are crucial to ensure they are effectively realized, balancing firmness in adherence with maintaining strong customer relations. Establishing clear processes, systems, and communication channels can facilitate the implementation of price escalation clauses and help maintain the contract's intended value.

Myth 6 Noncontracted spend is adequately addressed through broader list price increases

A frequent refrain is that noncontracted spend can be adequately managed by just raising the list prices and omitting the intricacies of market adjustments. For example, a business may increase list prices in response to market changes, assuming this will adequately cover noncontracted spend. However, without a detailed analysis of actual spend versus contractual agreements, this strategy may lead to inefficiencies and lost profitability opportunities. A thorough review should include examining the percentage of spend that is contractually locked versus the percentage subject to market adjustments, ensuring that both contracted and noncontracted spends are optimally managed in line with market dynamics and profitability goals. Conducting a detailed analysis of actual spend versus contractual agreements can help identify opportunities for cost savings and optimization.

Case study

A specialty hydrocarbon products manufacturer discovered that varying rates of price escalation significantly affected profitability. By carefully considering factors such as projected regional labor costs when negotiating contracts, they were able to secure more favorable price escalation terms. The company also ensured that the timing of these escalations followed the first invoice in each year. These efforts resulted in a 15 percent increase in realized margins over the average contract lifecycle.

Myth 7 The contracted price is the only way to extract value from the product or service

The belief that adhering to the contractually agreed price eliminates any further opportunities for value extraction is a narrow viewpoint that overlooks the multifaceted nature of business transactions. Beyond the base price of a product or service, there are numerous areas where additional value can be leveraged, contributing to overall profitability. For instance, terms related to shipping, handling, expedited delivery options, payment terms, scope changes, minimum commitment, and after-sales support services can provide fertile ground for renegotiation or optimization. By thinking creatively about the components of a contract beyond the simple exchange of goods for payment, businesses can differentiate themselves from competitors and strengthen their market position.

Myth 8 Contracts are “black-and-white,” so status quo is the only way to interact with the client

This myth presumes that contracts, once signed and initiated, dictate an unalterable course of action for the duration of their term. However, the reality is that contracts often contain gray areas and unexplored opportunities for flexibility that can be beneficial for both parties. The execution of a contract is not always as straightforward as it seems; there are often provisions for adjustments, such as price-matching clauses, overage fee, or order schedule, which can be activated in response to market changes or competitive pressures. Engaging in open dialogue with clients about their evolving needs and how the contract can be adapted to meet these changes can lead to improved service delivery; enhanced client satisfaction; and potentially, increased revenue. Maintaining flexibility and adaptability throughout the contract lifecycle is crucial for capitalizing on new opportunities and navigating changing circumstances. Businesses that view their contracts as living documents, rather than static agreements, are better positioned to adapt to changing circumstances and capitalize on new opportunities.

In Figure 1 on the following page, we have provided a list of potential commercial levers to adopt in pricing, commercial and operational terms.

Figure 1. Using contracts to capture value and profitability

Potential levers to adopt in pricing, commercial and operations terms

Pricing	
Pricing **aligned to value** and accurately reflect time and materials to optimize profitability	❍ Indexed pricing
Integrated **pricing flexibility** to accommodate unforeseeable macro-economical and operational challenges and **cover exceptions to minimize leakages**	❍ Price escalation ❍ Additional charges ❍ Overage fees ❍ Invoice of overcharges ❍ Invoice for violations
Build-in incentives to increase consumption, retention or extension	❍ Rebates and discounts
Pricing to **secure commitment** and cover the cost basis	❍ Prepaid pricing ❍ Minimum commitment ❍ Price lock
Proper **payment and invoice terms** and financing options offered to minimize credit risk and accelerate cash collection	❍ Payment discount ❍ Payment schedule ❍ Payment due ❍ Invoice timing ❍ Partial invoice
Consider other **pricing implications**	❍ Taxes and other fees

Commercial and operations	
Work and/or product specifications are detailed and clear to both parties	❍ Service level ❍ Order schedule ❍ Fees in the order
Delivery obligations are fully accountable in timing and financials	❍ Delivery approach ❍ Delivery charge ❍ Delivery date
Terms **conducive to changes** of all circumstances	❍ Scope changes ❍ Specification changes ❍ Cancellation
Customers have limited discretion for termination, and **effects are fully accounted for**	❍ Termination for convenience ❍ Termination with or without cause ❍ Early contract termination ❍ Cause to termination ❍ Maintenance termination related charges
Renewal is streamlined to minimize disruption and promote	❍ Limited extension ❍ Component extension

As contracts are monitored and refined, companies must prepare for review and renewal. This stage is not merely procedural but a strategic opportunity to reassess and realign agreements with current business objectives.

Review and renewal

The review and renewal stage is an opportunity to assess the performance of the contract, identify areas for improvement, and make necessary adjustments to ensure continued success. However, many businesses view this stage as a mere formality, failing to recognize its strategic importance. By debunking the myths surrounding contract review and renewal, companies can unlock hidden value and strengthen their relationships with partners and clients.

Myth 9 Most contracts don't need to be regularly reviewed

Another common myth in B2B contracts is the assumption that self-reported "satisfactory" contracts do not require further review. This often stems from a superficial understanding of contract performance. For example, a company might consider its existing contracts satisfactory based on stable but unoptimized returns. However, without a deep, analytical review of these contracts, the company may miss out on opportunities for enhanced terms, greater efficiency, or more favorable conditions in response to market shifts. Regular, in-depth contract reviews can help identify areas for improvement and ensure alignment with evolving business goals.

Case study

Our client, a manufacturer of electronic components, was experiencing massive growth due to innovations such as 5G, and aggressive investment in building of new data centers. This rapid expansion led to a very complex contracting environment, often leading to our client leaving money at the time of renewals, due to lack of insights into commercial terms. We leveraged the KPMG Ignite platform to analyze 24 commercial terms based on business priority for financial, service, and supply chain functions. We then extracted data from a diverse set of more than 10,000 commercial documents, along with relevant annotations—corresponding to more than 80 percent of revenue. We helped them understand the sources of revenue leakage and prioritize them in terms of potential impact and feasibility to renegotiate during renewal, and thus build a systematic way to approach renewals to claim their fair share of the value they were delivering to their customers. During renewal negotiations, the company not only presented these findings but also proposed revised terms that better aligned with emerging industry standards.

Myth 10

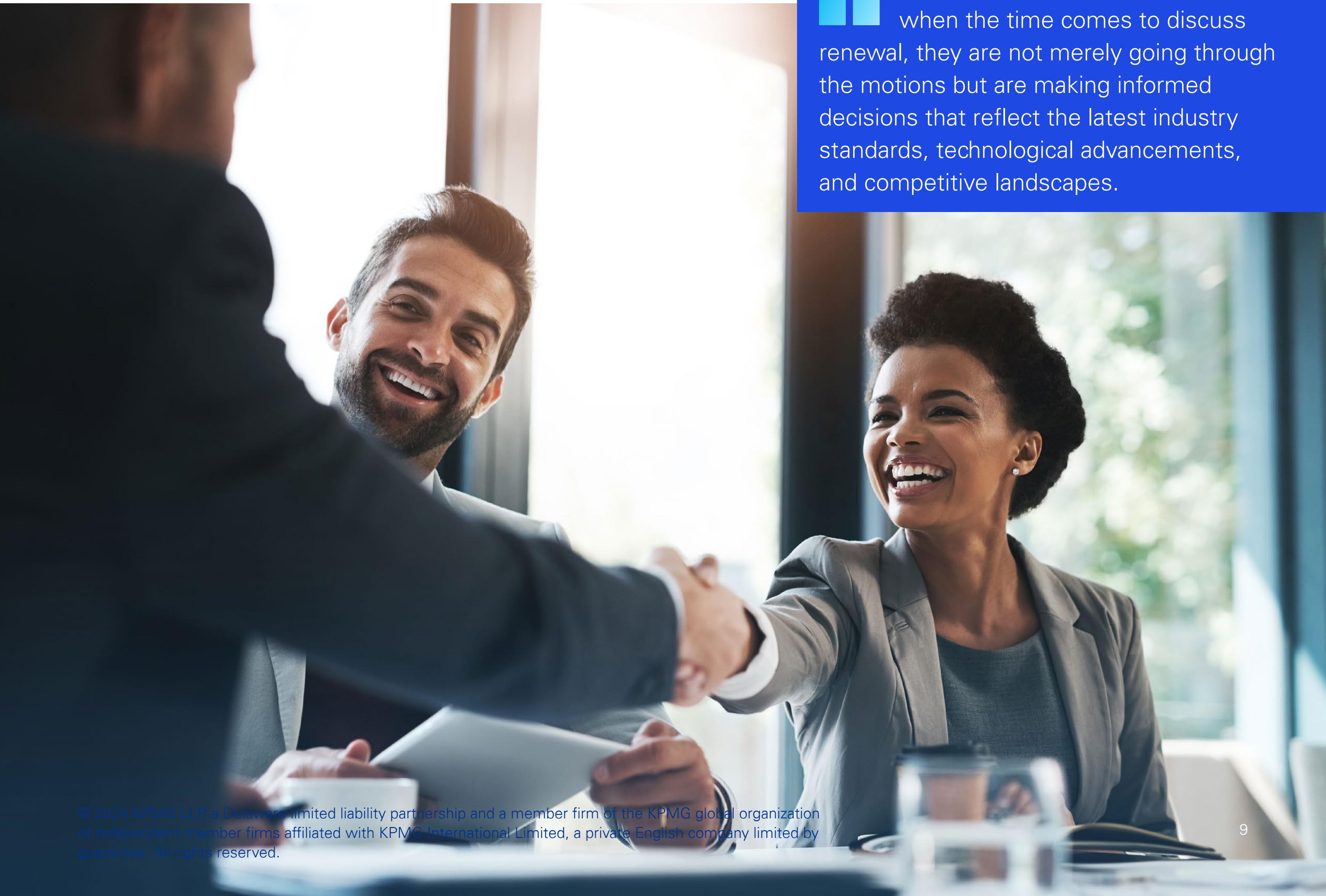
Contract renewals are just formalities and don't require strategic consideration

This myth underestimates the strategic importance of contract renewals, treating them as mere formalities rather than critical opportunities for reassessment and realignment. The misconception lies in the belief that the renewal process does not demand thorough preparation or strategic forethought, and that it simply involves re-signing on the dotted line. However, effective contract management requires that strategic considerations for renewals begin well before the actual renewal date.

The renewal period should not be the first time a contract is reevaluated; instead, strategic consideration of the contract's terms, performance, and alignment with current business objectives should be an ongoing process. A proactive approach to renewals can help businesses maintain a competitive edge and strengthen long-term partnerships. By doing so, organizations can ensure that when the time comes to discuss renewal, they are not merely going through the motions but are making informed decisions that reflect the latest industry standards, technological advancements, and competitive landscapes.

Debunking this myth highlights the importance of seeing contract renewals as strategic milestones (inflection points) within the broader context of continuous contract lifecycle management. This perspective encourages businesses to regularly review and negotiate contract terms, ensuring that agreements remain relevant, competitive, and aligned with evolving business goals well in advance of the formal renewal process. By addressing these misconceptions during the review and renewal stage, businesses can unlock hidden value, strengthen partnerships, and ensure their contracts remain aligned with evolving business goals and market conditions.

> Organizations can ensure that when the time comes to discuss renewal, they are not merely going through the motions but are making informed decisions that reflect the latest industry standards, technological advancements, and competitive landscapes.



How KPMG can help

The contract lifecycle is a complex and multifaceted journey that requires a strategic, proactive approach to maximize value and minimize risks.

By debunking the myths associated with each stage of the lifecycle, from negotiation and drafting to execution, monitoring, and renewal, we can help businesses develop a more comprehensive and effective approach to B2B contract management. Addressing these misconceptions can lead to increased profitability, enhanced adaptability, and stronger partnerships in the long run.

Our extensive research and real-world experience highlight the importance of challenging conventional wisdom and embracing strategies that prioritize adaptability, transparency, and mutual benefit. By viewing contracts as living documents that require ongoing attention and optimization, organizations can transform their contractual relationships into powerful drivers of growth and success.

With numerous contracts to potentially review and optimize, it can be challenging to determine where to focus your initial efforts. While every company's situation is unique, here are a few general guidelines that tend to point toward opportunities to realize value:

Prioritize key players: Focus on contracts with strategic customers that have a significant impact on your business operations or revenue. Small improvements in these critical relationships can have an outsized impact.

Dust off old agreements: If a contract is more than a couple of years old and hasn't been reviewed recently, there's a good chance that market conditions, business needs, or competitive dynamics have shifted.

Check for changing of the guard: When contracts were negotiated by individuals who are no longer with the company, there may be undocumented context or opportunities for improvement that are worth exploring.

Reassess during transitions: Contracts related to business areas that have recently undergone leadership changes should be reviewed to ensure alignment with new strategies and priorities.

Do your homework: Develop a list of commercial asks while building the negotiation strategy. Focus on key "gives" and "gets" with a clear rationale for the ask.

As the business landscape continues to evolve, it is essential for organizations to stay informed about emerging technologies and strategies that can help them address the challenges posed by these myths. In our upcoming companion piece, we will explore how Generative AI (GenAI) and other innovative tools can be leveraged to revolutionize B2B contract management. We will dive deeper into the practical applications of automation, traditional AI and GenAI, and other tools in B2B contract management. In the meantime, feel free to reach out to learn more about how we can help you optimize your contracts and drive meaningful impact.

Authors

Sudipto Banerjee
Principal, Strategy – Pricing and Commercial Excellence Leader
KPMG US

Sudipto (Sudi) is a Partner and leader of the Pricing practice for KPMG. He brings over 25 years of experience working with clients across industries, including industrial goods, automotive, life sciences, technology, and consumer goods. He specializes in commercial transformation, including pricing (strategy, execution, and enablement), sales growth (demand drivers, sales force effectiveness, channel management), and marketing effectiveness (ROMI, and promo effectiveness).

Himanshu Mishra
Advisory Managing Director, Strategy – Pricing and Commercial Excellence
KPMG US

Himanshu is a Managing Director in the Pricing and Commercial Excellence practice and brings over 19 years of experience working with clients across consumer packaged goods, retail, and TMT (technology, media, telecommunications) industries. He has specialized in commercial transformation, including pricing (strategy, execution, and enablement), marketing effectiveness (promotion effectiveness and planning). and sales transformation (demand evolution, sales force enablement, channel management).

James Ruedlinger
Director, Strategy – Pricing and Commercial Excellence
KPMG US

James is a Director in the Pricing and Commercial Excellence practice and has over 8 years of experience helping clients within technology, media & telecommunications, industrial manufacturing, healthcare & life sciences, and aerospace and defense. Significant experience in developing willingness to pay models, pricing and packaging strategy, price and costing optimization, go to market strategy, SSP module development, and forecasting/revenue recognition model development.

Eric Wirth
Director, Strategy – Pricing and Commercial Excellence
KPMG US

Eric is a Director in the Pricing and Commercial Excellence practice and has nearly two decades of B2B-centric experience in consultative and in-house roles for Fortune 500 companies as a subject matter expert across healthcare, life sciences, and consumer staples domains, including M&A integrations, new product introductions, and multinational deal negotiations.

We would like to thank our contributors:
Walker Evans, Weier Jin, Martin Kaestner

For more information, contact us:

Sudipto Banerjee
Principal, Advisory
+1 404 907 6173
sudiptobanerjee@kpmg.com

Himanshu Mishra
Managing Director, Advisory
+1 408 367 5764
hmishra2@kpmg.com

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