

THE PRICE NOBODY CHARGED · CHAPTER THREE

The Clause in the Drawer

An unused clause is a promise to oneself that broke, and the remedy is a decision, taken in the open.

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THE LICENCE

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A NOTE BEFORE YOU READ

This work is offered for education and leadership development. It is not legal, financial, accounting, investment, medical or psychological advice; take the advice of a qualified professional who knows your circumstances. Companies and events are described from the public record as the author understands it; characterisations are the author's analysis. Examples are illustrative, and no particular outcome is promised to any reader.

ABSTRACT

An unused clause is a promise to oneself that broke, and the remedy is a decision, taken in the open. It is eight o'clock on a Wednesday in March, and the commercial manager of a firm that supplies cleaning chemicals to food factories has a contract open on her desk. It is a five-year supply agreement with the firm's second-largest customer, a maker of chilled ready meals, signed four years ago. The new finance director asked last week for a list of every contract with a price-indexation clause, and this is the fourth she has read this morning. Her coffee is going cold in a mug with the customer's logo on it, a gift from their last site visit. Clause nine is the one she was looking for. On each anniversary of the agreement, the prices in the schedule move with a published index of chemical costs, up or down. The anniversary is the first of March. It has passed three times. The prices on the invoices are the prices in the original schedule. The index has risen every year.

CHAPTER THREE

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Eight o'clock, the third anniversary

It is eight o'clock on a Wednesday in March, and the commercial manager of a firm that supplies cleaning chemicals to food factories has a contract open on her desk. It is a five-year supply agreement with the firm's second-largest customer, a maker of chilled ready meals, signed four years ago. The new finance director asked last week for a list of every contract with a price-indexation clause, and this is the fourth she has read this morning. Her coffee is going cold in a mug with the customer's logo on it, a gift from their last site visit.

Clause nine is the one she was looking for. On each anniversary of the agreement, the prices in the schedule move with a published index of chemical costs, up or down. The anniversary is the first of March. It has passed three times. The prices on the invoices are the prices in the original schedule. The index has risen every year.

There is more, now that she is reading slowly. Clause twelve sets a minimum annual volume, with a charge for any shortfall; the customer fell short in the second year when it closed a line, and no charge was raised. Clause fifteen sets payment at thirty days, with interest on late payment; the customer pays, on average, at seventy-odd. She has known the customer's head of procurement for nine years. They were at a trade dinner together in January. She feels it in her chest, the small drop of realising that a conversation she has avoided without knowing it has just become unavoidable.

She is a composite, drawn from the way these mornings are described in the research below and in the house's own practice, and no firm is meant.

Ammanuel Santa Anna's *High Frequency Workbook* is written about a person's relationship with money, and it lists, among the reasons people undercharge, a sentence that describes the commercial manager's chest exactly:[9] "Raising your prices feels like hurting someone. Negotiating a salary feels like being aggressive." She does not think of clause nine as a price rise. She thinks of it as something she would have to do to someone she likes.

This chapter makes one claim. The terms a firm has already agreed, and does not apply, are among the largest sources of revenue it has earned and not collected, and they go unapplied less from carelessness than from a well-founded fear of what applying them will do to a relationship. The answer is not to enforce every clause. It is to make every unused clause a decision, taken in the open, at the time it falls due.

Sixty-eight interviews in Wisconsin

The best-known study of how businesses actually use contracts was published in 1963 by a law professor at the University of Wisconsin, Stewart Macaulay.[10] He wanted to know what contracts did in practice, so he asked. His method, as he described it, "involved interviewing 68 businessmen and lawyers representing 43 companies and six law firms," and all but two of the companies had plants in Wisconsin. His preliminary

finding is in the first lines of the paper: "businessmen often fail to plan exchange relationships completely, and seldom use legal sanctions to adjust these relationships or to settle disputes."

The detail is what has kept the paper in print for sixty years. Macaulay describes the battle of the forms, in which a buyer's purchase order and a seller's acknowledgment carry different and inconsistent terms on the back, both are filed, and both sides believe they have a contract. A manufacturer of packaging audited its own orders for five days in four different years to see how often it had failed to agree terms with its customers; in 1953 the figure was 75.0 per cent of orders, and in 1956 it was 59.5. Purchasing agents expected to cancel orders freely; sales managers accepted that they would be cancelled. Lawsuits were rare. Macaulay also noticed where the care in a contract tended to go: "It is likely that businessmen pay more attention to describing the performances in an exchange than to planning for contingencies or defective performances or to obtaining legal enforceability of their contracts." The product and the price are specified closely. What happens when something changes is left to the telephone. And the reason was not ignorance of the law. It was the relationship. One purchasing agent, in a passage Macaulay quotes at length, put the attitude that ran through his interviews: "You don't read legalistic contract clauses at each other if you ever want to do business again. One doesn't run to lawyers if he wants to stay in business because one must behave decently." Another businessman put it more briefly: "You can settle any dispute if you keep the lawyers and accountants out of it. They just do not understand the give-and-take needed in business."

It is a study of one state, in one decade, built on interviews, and Macaulay called it preliminary. Its strength is that it reports what people did, in their own words, rather than what the law assumed they did. Read now, it is less a description of 1960s Wisconsin than of a disposition that most commercial managers will recognise in themselves. The contract is written to be put in a drawer. The relationship is conducted by telephone. Clause nine is, in Macaulay's sense, a legalistic clause, and the commercial manager has not read it at the customer for three years, because she wants to do business again.

What Macaulay saw as decency has a cost he did not set out to count. The give-and-take he admired is real, and it keeps relationships alive. But give-and-take implies both directions. A clause that is never applied, by a supplier that never asks, is not give-and-take. It is give.

What it costs to change a price

The commercial manager's reluctance has a second source, and it is measurable. Changing a price, even one the contract allows, is work.

In 2004 a team of five researchers, Mark Zbaracki, Mark Ritson, Daniel Levy, Shantanu Dutta and Mark Bergen, published a study of exactly that work at a large American industrial manufacturer and its customers.[11] Economists had long theorised about the cost of changing prices, usually as the physical cost of printing new price lists, which they called menu costs. The team measured it directly. They found that the cost of adjusting prices was "a much more complex construct" than the literature had recognised. Beyond the

menu costs, they identified managerial costs (gathering information, making the decision and communicating it) and customer costs (communicating with customers and negotiating with them). Their abstract gives the proportions plainly: "the managerial costs are more than 6 times, and customer costs are more than 20 times, the menu costs." In total, at this firm, price adjustment cost 1.22 per cent of revenue and a little over a fifth of its net margin. And the study closed on a finding that every commercial manager knows from the inside: the team documented "managers' fear of antagonizing customers."

It is one firm, studied in depth, and the proportions belong to it. Their significance is not the exact figure. It is the shape. Most of the cost of changing a price is not in the system. It is in the conversation with the customer, and the managers who must hold that conversation feel its cost in advance, which is why they put it off. A firm that wonders why its indexation clauses go unused has its answer in that study. Applying the clause is cheap. Telling the customer is expensive, and the person who must tell them is rarely measured on whether they did.

The fear, it turns out, is not irrational. In 2010 the economists Eric Anderson and Duncan Simester published the results of a field experiment run over twenty-eight months with more than fifty thousand customers of a retailer.[12] They wanted to know what happened when customers bought a product and later saw the same retailer sell it for less. The customers bought less from the firm afterwards. The effect was largest among the firm's most valuable customers, those who had bought most recently and at the highest prices. It is a study of retail customers and of falling prices rather than rising ones, and its setting is a long way from a supply agreement. But it shows something important for the commercial manager. Customers keep their own ledger of how a supplier has treated them on price, and they act on it, and the ones who act most are the ones a firm would least like to lose.

So the drawer has two reasons to stay shut. The relationship, which Macaulay's businessmen were right to protect. And the cost and risk of the conversation, which Zbaracki and Anderson measured. Neither is a reason to leave clause nine unread. Both are reasons to read it differently.



Three anniversaries, nobody's diary

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Three anniversaries, nobody's diary

It is worth tracing how a clause like clause nine actually goes unused, because it is almost never a decision.

The agreement was negotiated by the commercial manager's predecessor and signed by the managing director. It was scanned by the legal team and filed in the contracts folder. The price schedule was keyed into the billing system by an administrator, who set the prices and had no field in which to record that they were due to move each March. The first of March is in nobody's diary. The finance team, which sees the margin on the account fall a little each year as chemical costs rise, reads it as a market problem. The account manager, who visits the customer every month, does not know clause nine exists, because nobody gave him the contract; he was given the price list. The commercial manager knew in the abstract that the agreement had indexation, and assumed that billing applied it.

Each of these people did their job. The clause fell into the space between the desk that signed it, the desk that filed it and the desk that bills from it. It is the same space the discount below the invoice (Chapter 1) falls into, and the same space a professional firm's unbilled week falls into: the place where a promise the firm made to itself is held by nobody.

Santa Anna's canon on governance begins its account of broken promises with three short sentences that fit a supply agreement as well as a board: "Promises break. This is not a possibility to be guarded against. It is a certainty to be prepared for." A contract is a set of promises made in both directions. Some of the customer's promises, the volume and the payment terms, have broken. Some of the supplier's promises to itself, to apply the index on the first of March, have broken too. Neither side has said so. The canon's point is that the breaking is not the failure. The failure is the silence afterwards.

The canon goes on to distinguish two ways of meeting a broken promise. "Conventional accountability treats broken promises as failures requiring consequences." The other way treats them as ruptures to be repaired. For the commercial manager, conventional accountability would mean a letter, three years of indexation back-billed, a shortfall charge and an interest claim, sent by the finance director. It would be legally sound. It would also, by every finding in this chapter, cost the firm its second-largest customer.

Not a problem, a polarity

The commercial manager's difficulty has a shape the house's Luminous 100 names well. In its account of Barry Johnson's polarity management, the entry begins: "Some challenges aren't problems to solve but polarities to manage". Enforcing contracts and keeping relationships is one of them. A firm that enforces every clause, every time, gets the revenue and loses the give-and-take Macaulay's businessmen depended on. A firm that enforces nothing keeps the warmth and loses the revenue, and in time loses the warmth as well, because the supplier who never asks begins, privately, to resent the customer who never offers.

The canon's chapter on conflict describes what holding only the relationship pole looks like from the inside, in a passage that reads like a commercial manager's year: "We smile when we are angry. We agree when we disagree. We swallow truths that need to be spoken and speak pleasantries that need to be swallowed." She was pleasant at the trade dinner in January. She did not mention clause nine. She did not, at the time, know she was not mentioning it, which is the most expensive kind of silence there is.

Getting the benefit of both poles is not a compromise between them. It means applying the contract in the way the relationship deserves: early, openly, specifically, and with room to choose. The canon's account of repair gives the choice its exact form. "Repair is not complete until the governance body moves forward — either with a revised commitment that addresses the original breach, or with a conscious decision to release the commitment if circumstances have made it no longer viable." Read at a supplier's desk, that sentence offers three honest answers to an unused clause, not one. Apply it. Revise it, together. Or release it, consciously, and say so.

The buyer's side of the table

Before the commercial manager picks up the phone, it is worth sitting for a moment on the other side of the table, because the conversation she fears is not the conversation the buyer will have.

The head of procurement at the ready-meals firm has a manager too. She has a budget for cleaning chemicals, agreed in the autumn, and a finance director who asks every month why the cost of goods has moved. She negotiated the supply agreement four years ago and knows, in the abstract, that it has an index in it. She has assumed for three years that the supplier would apply it, and has budgeted, some years, for a rise that never came. The unspent money went elsewhere. She did not raise it, because a buyer is not paid to ask suppliers to charge more.

What she fears is not the index. It is a surprise. Three years of indexation presented at once, as a back-bill, would land in the middle of her budget with no warning and no explanation she could give her own finance director other than that she had not been watching. A shortfall charge for the year the line closed would arrive two years after the closure was announced, which would make her look as if she had hidden something she had in fact discussed with the supplier at the time. The commercial manager imagines the buyer as the person who will be angry. The buyer, if the supplier gets this wrong, will be the person who is embarrassed.

This changes the conversation. A clause applied every March, on a date the buyer can put in her diary, at an index she can look up herself, is the easiest kind of price change there is to budget for. It is the clause applied once every four years, by surprise, that is hard. Zbaracki's finding, that the customer side of a price change is the most costly part of it, is about this. The cost is not in the change. It is in the negotiation that a surprise forces, and a change both sides could see coming needs very little negotiation at all.

The *High Frequency Workbook* says of money conversations that they are rarely about money alone: "Money work is emotional work. It is somatic work." The commercial manager's chest and the buyer's budget are both part of the call she is about to make. Knowing that the buyer has her own reasons to want the clause applied properly is what lets the commercial manager make the call as a colleague rather than a creditor.



The register and the call

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The register and the call

What the commercial manager does next is the practice this chapter is about.

She starts a register. It is a single sheet for each live contract, and it lists only the clauses that move money: indexation and price review, minimum volumes and shortfall charges, payment terms and interest, rates for changes and extra work, rebate conditions, the dates of renewal and expiry. For each clause it records three things: the date it next falls due, the person who will act on it, and what was decided last time. The finance director agrees that the register, not the contracts folder, is the place a clause lives once it is signed. The first full pass, across the firm's forty largest contracts, takes her and an administrator most of a fortnight. It is the first time anyone has read them all.

Then, for each unused clause, they take one of three decisions, and write it down. *Apply*: the clause is sound and the firm will use it from the next date it falls due, after telling the customer. *Revise*: the clause no

longer fits, because the index is the wrong one, or the volume was set for a business the customer no longer runs, and the firm will propose a change. *Release*: the firm decides, on purpose, not to use the clause, for a reason it can state, and tells the customer it has done so. The third decision is the one that surprises people, as the named gift does in a professional firm's scope ledger (Chapter 2). It does not cost the firm more than silence does. It costs exactly the same, and it turns a leak into a gesture the customer can see.

For the ready-meals customer the decisions are these. The indexation will apply from this March, at the index's current level, without recovering the three years missed; those years are released, in writing, as the firm's own oversight. The volume minimum will be revised, because the customer closed a line and the old figure no longer describes its business. The payment terms will apply, with the interest clause released for the past and kept for the future.

She rings the head of procurement before anything is sent. The conversation has an order, and the order is most of the skill. She names the clause and the date, and says plainly that the firm did not apply it and that the missed years are the firm's to absorb, not the customer's. She says what will happen from now, and why. She asks about the line that closed, and proposes a new minimum that fits the business as it is. And she asks about the payments, as a question, not an accusation. It turns out that the customer's payment run has been set to seventy-five days for every supplier for two years, by a finance team that never told procurement. The head of procurement had not known either.

The call takes forty minutes. It is uncomfortable for the first five and ordinary after that. The canon on acknowledgment insists that agreements are kept alive by being attended to, that they are "not pro forma rules posted on a flip chart and forgotten." The register is the firm's way of attending to them, and the call is what attending sounds like. Zbaracki's customers were right that a price conversation is costly. What the commercial manager discovers is that most of its cost was in the three years of not having it.

There are predictable ways for this to go wrong. The register becomes a legal exercise, and the first a customer hears of it is a letter. Past years are back-billed by default, which recovers money once and loses the account. The account manager, who holds the relationship, is left out, and learns about clause nine from the customer. Or the register is built once and never read again, and the next anniversary passes like the last three. Each failure has a cure in the order of the work: the register first, then the decision, then the call, and only then the invoice. Chapter 7 carries the register and the call as a run sheet, with the clauses to look for, the three decisions, the order of the conversation and the signs that it is failing, and Chapter 6 places it in the order of a first ninety days.

The gain is plain once the register exists. It is the revenue the firm's own contracts already entitle it to, from the next date each clause falls due, less whatever the firm decides, openly, to release. It is measured against invoices the firm already raises. And because the missed years are released rather than reclaimed, it is a gain the customer can live with, which is the only kind worth measuring. How such a gain is counted

honestly, and why the person who negotiates a price should not be paid in a way that teaches them to give it away (Chapter 5), is a question of incentives and measurement as much as of contracts.

Building the register

The register takes a fortnight to build and a few hours a month to keep. The book can carry the finer points of both.

The first is where the contracts are. In most firms the signed agreements are in a legal folder, but they are not the only place terms live. Macaulay's battle of the forms is still fought every day: the terms on the back of a customer's purchase order, the terms on the firm's own acknowledgement, the price schedules attached to emails, the side letters agreed by a previous sales director. Start with the forty largest customers by revenue and, for each, gather everything that could set a price or a payment: the agreement, its schedules and amendments, the standard terms each side claims, and any letter that changed them. Where two documents disagree, note it; the disagreement is itself a term nobody has settled.

The second is what to read for. Only the clauses that move money go into the register. Price review and indexation, with the index named and the date. Minimum volumes, shortfall charges and take-or-pay terms. Payment days, discounts for early payment and interest on late payment. Rates for changes, extra work and urgent orders. Rebate conditions and their thresholds. Charges for delivery, packaging, storage or returns that the contract allows. Renewal, notice and expiry dates. Everything else in the contract matters, but it belongs to the lawyers, and a register that tries to hold all of it will hold nothing for long.

The third is the calendar. Each clause in the register has a next date and a named person, and the date goes into that person's diary with a month's notice. That one step, putting the first of March in somebody's diary, would have saved the commercial manager three years. It is so simple that most firms assume it has already been done.

The fourth is the three decisions, and the reasons that justify each. Apply, when the clause still describes the business and the customer was told when the agreement was signed that it would be used. Revise, when the clause no longer fits: the index has drifted from the firm's real costs, the volume was set for a business the customer no longer runs, the payment days are out of line with the market both firms work in. Release, when the firm decides that the relationship, the history or its own oversight makes the clause wrong to use for a period. A release is written down with its reason and its period, and the customer is told. A release without a period becomes the old silence with a signature on it.

The fifth is the past. The question every commercial manager asks first is whether to recover what was missed. The default this book recommends is to release it, openly, as the firm's own oversight, and to apply the clause from the next date it falls due. There are exceptions, and they are decisions for the firm's leadership and its advisers rather than for a register; nothing here is legal advice. But a firm that reclaims years of

missed indexation from a customer who budgeted in good faith on the invoices it received will usually recover the money once and the relationship never.

The sixth is the order of the call, which is most of the skill. The person who holds the relationship makes it, with the commercial manager if she is not that person. Name the clause and the date. Say what the firm did not do, and that the missed period is the firm's to absorb. Say what will happen from now, and why. Ask about the customer's side, because there is nearly always one, as the seventy-five-day payment run showed. Confirm it in writing, in a few lines, the same week, and only then change the invoice.

And the decision that most changes the result is keeping the register alive. It is read once a month by the commercial manager and the finance director together, in a half-hour meeting with one agenda item: what falls due in the next sixty days, and who is calling whom. Chapter 6 places the register in the middle weeks of the ninety days, and Chapter 7 gives the register page, the list of clauses to read for, the three decisions with their criteria and the order of the call.

Eight o'clock, the next March

It is eight o'clock on a Wednesday the following March, and the commercial manager has the register open, not the contracts. It shows the ready-meals customer's indexation due on the first, at the index published in February, and a note beside it that the head of procurement was told in January, by phone, what it would be. The revised minimum has been met. The payments arrive at thirty-four days on average, since the customer's finance team reset its run.

There are nine other dates in the register this month, each with a name beside it. Two are marked *release*, with a sentence explaining why.

The mug with the customer's logo is on the desk, and the coffee in it is still hot.

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