The 12 Best Practices in Contract Management

The future of procurement - driving downstream benefit realisation

WHITE PAPER

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Dr Sara Cullen, University of Melbourne

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PROJECTS	TENDERS	BUDGETS
PROCESSES	COMPLIANCE	SRM

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Foreword

In procurement industry research, contract management consistently rates as a top three issue for procurement managers – particularly now, as a raft of new compliance requirements are added to the ongoing burden of ensuring supplier performance and benefits realisation arising from proactive category management work. Yet, contract management functionality has always been at the core of Open Windows systems – ever since we started the company in Melbourne in 1994.

Today, we offer a wider range of support to busy procurement teams of all sizes, large or small, and a price range to match every budget. Our new generation modular procurement system offers nine modules specifically designed for each module to be used individually, or as part of a wider solution – whether integrated to your ERP/P2P systems or stand-alone. Open Windows software is currently used by state governments, local councils, major resource companies and SME's to enable their contract management capability.

The new generation of modular contract management systems can easily be set up to mirror your exact business processes to help ensure delivery of the growing list of corporate demands from your external resource base. They can even manage multi-party contracts, offer visibility to multiple contract tiers down your supply chain and automatically report compliance from direct supplier inputs. They can also offer buyers mobile dashboards, category planning support and even an SRM database, capable of capturing supply market intelligence – just like sellers use CRM technologies.

New technology has always enabled Open Windows to develop each new generation of contract management software systems. Our cloud based software today is easy to use and entirely Microsoft compatible and also offers eAlert technology to never miss a deadline on any contract, single-data-entry technology that works across all our nine modules and flexible workflow process design to match exactly your internal business process.

So we can design to need, or you can just 'plug and play' our software suite to immediately enable business benefits realisation. Simply, we enable on-time and accurate delivery of goods and services - whilst simultaneously increasing financial control, risk management and agreement compliance through the integration of sourcing, eTendering & contracting online in a modular environment specifically designed for procurement managers in Australia and New Zealand.

Open Windows is proud to sponsor this new whitepaper, written by the venerable Dr Sara Cullen, and the associated webinar recording (available online) – also presented by Sara, together with the former CEO of CIPSA, Jonathan Dutton.

I hope you enjoy the paper and are able to implement the elements right for you.

Adam McInnes
Founder & CEO

Introduction

As the procurement profession matures, contract management increasingly offers the greatest potential for procurement to make a difference for their organisation.

It is where the 'rubber hits the road' for procurement stakeholders – where risk is greatest and where suppliers and the procurement team become truly accountable for the deals they have done.

At the half-way stage of the purchase process (immediately post contract), it is the capture of business benefits that truly matter. Especially as the maturing procurement profession realise that savings tend to zero over time. This is when risk quickly becomes the real issue and delivering real value can begin.

Increasingly good procurement process and software are becoming indivisible. Yet, buyers need not fear the gradual automation of procurement.

ERP and P2P systems are becoming more sophisticated and more capable by the day. But a raft of other systems and cloud based software services (SaaS) are filling the supply chain with new capability.

Automating task orientated work like contract administration, process management, data-entry, compliance fulfilment can bring real benefits.

Most beneficial is that it allows busy buyers more time. Time to use much more strategically and more profitably for their organisations: time to build relationships, time to invest in the marketplace, time to realise more benefits, and time to source innovation.

As the business outsourcing trend continues to grow and workforces reduce further in size, organisations of all shapes and sizes become more dependent on their external resource base -their suppliers.

Having the ability to better manage contract delivery will only enable the capture of wider business benefits - especially for organisations with direct supply lines dependent on longer term service based contracts.

Contract management may even be the new frontier for procurement – the new place to generate real value for your organisation.

Jonathan Dutton
Interim Sales & Marketing Director
Open Windows Software

Executive summary

Today's procurement organisation is under constant change, as organisations move from a traditional pyramid structure to a diamond-shaped one. Strategic sourcing, category management, and supplier relationship management are all part of today's procurement kit bag. Not only does procurement need to buy better, manage demand better, and understand markets better, it now has to manage the contracts that it puts in place. It no longer stops halfway through the contract lifecycle.

Contract management has historically been the domain of the business; procurement's job was to get the right provider at the right price. No more; old silos have been cracked wide open.

The business hasn't managed contracts particularly well and now it's up to procurement to lead the way. As your organisation moves towards greater levels of contracting, and becomes more dependent on third parties, contract management becomes one of its core activities. It can't be left to people to do in addition to their 'real job'.

An investment in contract management is the only way a contract's benefits can truly be realised and its risks managed. Merely signing a contract isn't sufficient for any commercial deal of importance (whether that be due to value or risk).

This paper explains the 12 best practices in contract management that yield results. These are divided into four key areas.

CONTROL

1. **Ensure performance** - set, review, and monitor KPIs
2. **Watch over the finances** - budgets, billing and payment, total cost of contract, and financial trends
3. **Record keeping and reporting** - real-time audit trails and reporting to stakeholder
4. **Audit compliance** - of both parties adherence to contractual documents

INTERACT

5. **Invest in the relationship** - strong SRM at all levels
6. **Orchestrate the CM network** - of your people so they act within the contractual framework as a cross-functional team
7. **Handle disagreements and disputes** - prevent and treat internally and not through third parties

ADAPT

8. **Gauge issues and risks** - ongoing identification, prioritisation, tracking, and resolution
9. **Manage variations** - written, verbal, and behavioural-based (estoppel) variations

PLAN

10. **Forecast demand and supply** - business needs and changes, provider capabilities, etc.
11. **Maintain market intelligence** - over your providers and the market as a whole (e.g. technology, prices standards, market conditions)
12. **Drive continuous improvement** - within both parties and the interfaces

Not every organisation, nor every contract, needs to be best practice. But to progress from passive and reactive contract administration to the proactive leadership in contract management required today, every procurement organisation needs to contemplate how it will rise to this crucial role.

Procurement's new role is as a partner to the business in getting the results it needs and as a partner to the provider market in working competitively, yes, but also collaboratively in getting nonstop value.

The Modern Era - Goodbye Pyramid, Hello Diamond

With increased competitive global markets, and the need to be agile, the shape of the organisation is being transformed from a pyramid to a diamond (Figure 1) as we outsource more and more.

Pyramid structures are heavily populated with employees, most of who are at the bottom of the pile. Diamond-shaped organisations replace the heavy bottom of the pyramid with third party providers.

The benefit of the pyramid is that employees continually build valuable, organisation-specific experience as they move higher up the pyramid. The pyramid is strong on retained knowledge, but it is also costly.

Managers recruiting to fill the lower ranks must compete with providers who court these recruits with richer career paths and the opportunity to work with many more of their peers. When recruiting fails, or head count restrictions are imposed, the pyramid then tends to fill skill and resource gaps with expensive local contract workers (staff augmentation).

The benefits of the diamond include lower costs, access to providers with best-of-breed skills and products, and greater flexibility because the supply market can more easily adapt to increases or decreases in volumes.

Diamonds replace staff managers with subject matter experts (SMEs) and project leads. Most importantly, quality assurance and governance come to the fore - to design, oversee, and coordinate commercial agreements and relationships with multiple providers. It is here that procurement's future lies.

Managing a diamond is all about getting the right providers, under a fair and flexible contract, and managing them well. Many providers will be changed frequently; others will be retained for many years. All will need to work closely with your organisation, and often with each other. Underpinning this will be enabling technology, coupled with informed buying (rather than just tenders), and driven by contract management par excellence.

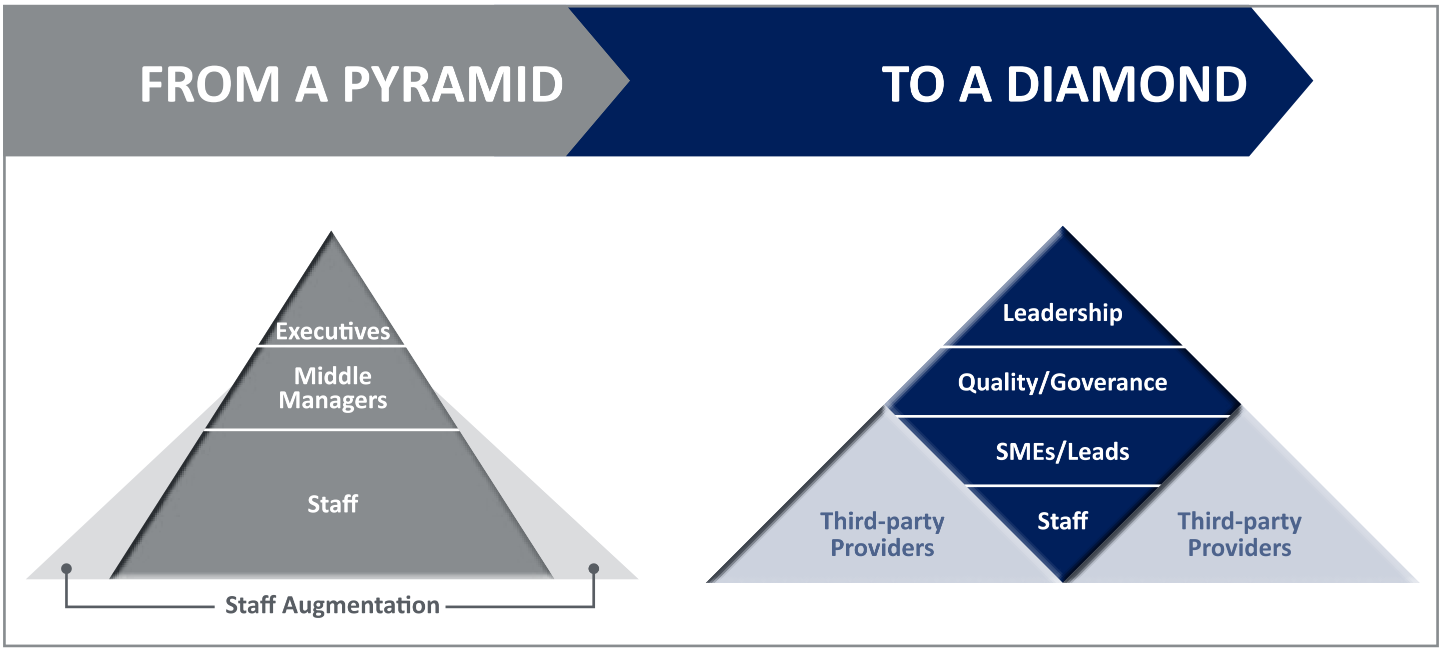


Figure 1: Pyramids to Diamonds[1]

1 Adapted from Jim Lammers, Express Scripts and from Sandy Ogg, Unilver.

The 12 best practices of Contract Management

A quarter century of studies demonstrate that contracts can't be let and then not managed. As your organisation increasingly moves towards contracting, contract management needs to become one of its core activities.

Studies over the years have consistently shown that, on average, 6% of the annual value of a contract is invested by the client in managing domestic contracts and 12% for offshore/international (once cases in crisis were removed - which have very large costs).[2]

It's important to recognise that contract management is an investment, not a cost - just like procurement. It's an investment in getting the benefits that the deal was designed to achieve and minimise the risks over the period it runs.

Contracts are not abdication of the need to drive results and mitigate risks. A contract only provides recourse in the event of breach - the document itself can't manage the deliverables, the relationship, the financials, and the benefit realisation.

Contract management represents a different way of managing. Managers have to learn to manage outputs rather than inputs, use negotiation and relationship management in place of direct control, and rely on periodic planning and reviews to take the place of day-to-day oversight. Specifications and SLAs replace job descriptions. Control via contracts replaces control via employment. Invoices are paid, rather than salaries.

It's about controlling key aspects, managing interactions between people (particularly with service contracts), adapting to changing conditions, and being future focused through continuous planning - all this is encapsulated in the 12 best practices.

CONTROL	INTERACT	ADAPT	PLAN
1. Ensure performance - set, review, and monitor KPIs **2. Watch over the finances** - budgets, billing and payment, total cost of contract, and trends. **3. Record keeping and reporting** - real-time audit trails and reporting **4. Audit compliance** - of both parties to contractual documents	**5. Invest in the relationship** - strong SRM at all levels **6. Orchestrate the CM network** - of your people to act within the contractual frame-work as a cross-functional team **7. Handle disagreements and disputes** - prevent and treat internally and not through third parties	**8. Gauge issues and risks** - ongoing identification, prioritisation, tracking, and resolution **9. Manage variations** - written, verbal, and behaviour-based (estoppel) variations	**10. Forecast demand and supply** - business needs and changes, provider capabilities, etc. **11. Maintain market intelligence** - over your providers and the market as a whole (e.g. prices, technology, market conditions, standards) **12. Drive continuous improvement** - within both parties and their interfaces

2 Cullen, S., Lacity, M. and Willcocks, L. (2014) Outsourcing: All You Need to Know. White Plume Publishing, Melbourne

CONTROL

1. Ensure performance

Performance management is not just perusing the KPI reports submitted by the provider and then applying penalties or rewards. That alone is insufficient, as KPIs never tell the complete story and can be easily manipulated.

Successful performance, and the ultimate benefit realisation of the contract, is comprised not only of the provider's outputs, but that of its inputs and processes as well - all contributing to the desired outcomes.

Input performance. Inputs are the resources used to carry out a contract and have a significant bearing on the processes that are adopted and the outputs that are produced. A human resource performance review covers ensuring the right qualifications of staff, assessing their training and support, checking that individual performance reviews are aligned to the goals of the contract, productivity, and staff turnover trends and issues. Physical resource reviews cover the facility and technology platforms. If the contract requires 'best' or 'industry' practice, this requires a benchmarking exercise to establish what is best or industry practice and compare to what is in place.

With input reviews, the goal is to ensure the provider is using the right resources as defined in the contract. If input specifications have been left out, or ill-defined, this may present an unacceptable risk as in the following case.

CASE STUDY:
Getting the work done any way possible

A power plant maintenance provider supplemented its dedicated workforce with temporary staff from a labour-hire company. Although the contract stated that only certified personnel were to work on certain items of equipment, the temporary labour had no such certifications. Due to the cost and time it would take to get the temporary workers certified, combined with the financial recourse available to the client if the provider fell behind schedule, the provider sought legal advice as to whether it would be in breach of the contract if the temporary workers performed a substantive part of the work.

The lawyer provided an opinion whereby the provider would not be in breach because the contract stated only the provider's employees needed to be certified and these were not employees as defined in the contract. However, the provider must use certified labour where it was required in law. That was all that the provider needed to hear, and they proceeded to use the labour hire resources whenever and wherever needed to get the work done.

Process performance. Performance measures over the provider's processes will represent the bulk of the KPIs in a contract (e.g. turnaround times, response rates, delivery times, availability, etc.) Accordingly, it's these types of KPIs that procurement is most familiar with and probably is what is being done in your organisation now.

Process KPIs tend to be self-reported by the provider rather than calculated by the client. If that is your case, then no review is more crucial than the one that checks whether the KPIs are actually measuring what you understand was the agreed performance. Without doubt, you'll find a few surprising things about the calculations which will need correction or even renegotiation.

Output performance. Outputs represent the quantity of the produced goods and/or services. The review would examine current trends against historical trends to detect anomalies as well as patterns. An output review isn't party specific. It looks at quantities, explanations, trends, and what both parties need to do to manage quantities better.

Outcome performance. Outcomes are the end results you want from the inputs, processes, and outputs. For example, you may want a call centre to answer a lot of questions (outputs) in a very efficient and accurate manner (process), using qualified staff and current technologies (input). The end result you may be seeking is a satisfied caller, who then remains a loyal customer and does not switch to a competitor (outcome).

Outcomes, however, by their very nature, are never the result of a single party, or the results of a single event; rather are shaped by numerous interrelated actions and events. Continuing with the example of a call centre, a customer's loyalty is achieved not only through a good (outsourced) call centre, but also through your organisation's high quality goods and services, its accurate billing, its responsive management, etc.

2. Watch over the finances

The accuracy of billing is where most clients begin in this area, comparing actual work to billed work, actual third-party invoices to claimed expenses, and so on.

However, it's also useful to examine whether there are practices in place that create unnecessarily high costs. The case below is an example of both inaccurate billing and bad practices - which combined, led to into much higher costs.

CASE STUDY:
An insurance company checks the bills

Just for assurance, a Contract Manager decided to use a redeployed systems programmer, who had a bit of spare time on his hands, to review mainframe CPU processing consumption and related billing. The programmer obtained recent source data and discovered two very costly practices had been allowed to occur.

First, the wrong times for peak and off peak usage were being used. Second, batch programs were being run at more expensive peak times if the provider had spare capacity during those times (rather than at the specified non-peak periods). How long this had been occurring was anyone's guess, as the old source data had been deleted long ago.

Another thing to review is the timing of billing and payment.

Clients do want providers' invoices on time, despite some providers that may believe otherwise. Very few clients, and more pertinently, their accountants, are ever delighted to receive invoices after the books have been closed on a project or for the reporting period.

Ensuring you pay on time is also important, not just to take advantage of available discounts and to avoid late payment interest charges, but so that you are not in breach of the contract. Many clients are notorious for late payments (intentional or just bureaucracy at work). Once you have this reputation, providers may feel it's necessary to hedge their prices higher to cater for the additional financing costs they are required to bear.

However, financial management does not end at billing. It involves the total cost of the contract. Even in a relatively simple deal, the total cost can be surprising, and is a key concept that needs to be well managed.

The total cost of a contract represents the amounts your organisation pays out to the provider plus your internal costs. The point is to consider the *full* cost, not just the money paid to the provider.

To show how this works in practice, Table 1 provides an example from a simple three-year equipment and support contract. The planned outlay to the provider was about $3 million, but the total cost of contract was over $4 million (comprising the full-time equivalents involved in mobilisation, contract management, and exit, as well as the retained cost of old equipment leases that either have to continue or be paid out in full).

If you only focused on the external payments, you would miss 30% of the cost of this contract (and probably where such focus could give you much greater results).

TOTAL COST OF CONTRACT (in thousands)

		Normal Contract Operations				
	Mobilisation	**Year 1**	**Year 2**	**Year 3**	**Disengagement**	**Total**
Provider Charges	**$250**	**$825**	**$852**	**$881**	**$125**	**$2,933**
Internal Costs						
Mobilisation costs	**$78**					**$2,933**
Retained costs		**387**	**164**			**$2,933**
Contract Management	**$40**	**160**	**160**	**160**	**80**	**$2,933**
Disengagement costs					**24**	**$2,933**
	$118	**547**	**324**	**160**	**104**	**$2,933**
Total cost of contract	**$368**	**$1,372**	**$1,176**	**$1,041**	**$229**	**$4,186**

Table 1: Total cost of contract example

When total costs are unknown and untracked, it can lead to suboptimal decision making ... or to idealistic, naive decision making, as illustrated in the next case.

CASE STUDY: Cost isn't always what it seems to be

A European telecommunications company was advised by its consultants to form a service delivery JV (joint venture), rather than a traditional outsourcing arrangement for all of its IT services, as it *"was the best way to ensure compatible goals."* So it did. While the telco had formed other JVs in the past, to enter new markets, this was the first in which the JV would be providing services back to the company. Management did not investigate how equity/service JV relationships work in practice and did not set up any form of retained competencies, contract management, or even JV oversight.

The telco was quite surprised to discover that its partner would sell labour and equipment to the JV at inflated cost to make an immediate profit rather than wait to split the profit from in the form of JV dividends. Management later put in a contract management team and an independent JV oversight board, but this was nearly two years after the JV had been operating; after significant cost escalation and inadequate service.

3. Record keeping and reporting

One of the main functions of contract administration is to have a systematic repository and log of records and decisions. This is invaluable if any aspect of the arrangement is questioned by either party or an external body (e.g. auditors, regulators). Procurement excels at this during a tender.

But, all too often, the paperwork side of things can be put aside after the contract has been signed - people are focused on delivery, not documentation. But without documentation, you have no evidence of what has occurred, as the next case illustrates.

CASE STUDY: KPIs met but dissatisfaction grows

An international airline contracted-out its IT support services (networks, desktop, fleet management and helpdesk). Stakeholder satisfaction surveys were yielding poor results and there was a general feeling of dissatisfaction with the provider. Yet, the KPIs were showing reasonable performance, certainly of a standard that did not warrant the animosity exhibited.

A root-cause analysis determined that the main factor was that both the provider's sales staff and its operational staff were making unwritten promises to various client personnel and not carrying them out or following them up. These promises included access to global research, technical briefings, facilitation of special interest groups, to name a few.

Neither party maintained records of the discussions nor had evidential correspondence, thus an initiative was undertaken to gather all the unrecorded promises. Once this was completed, the provider realised it could not meet the unfulfilled expectations and also retain its profit margin. The first step was to prioritise the promises and determine which the provider could perform at minimum cost. From among the promises it couldn't execute cost effectively, the client was invited to choose those that it was willing to pay extra for. Lastly, to stop this problem from occurring again, the provider instituted a *"no promises unless supported with a variation"* procedure and instituted a minutes and review procedures for all meetings.

Reports serve as analysis summary tools, evidencing the degree of success of the arrangement, providing KPI and operational indices, and identifying areas for improvement.

Documentation is also critical in that it captures discussions, provides evidence of commitments and changes, and assists in resolution of disputes. It can be used as evidence during any legal proceedings, and captures the history of the arrangement.

Examples of the items requiring such diligent control include:
- agendas and minutes of meetings,
- all financial data,
- approvals and signoffs,
- audit reports and findings,
- correspondence and discussions between the parties,
- customer satisfaction surveys,
- changes to practices and understanding,
- issue logs,
- precursor documents (request for tenders, bids, etc.), and
- reports - performance, progress, audit, etc.

4. Audit compliance of the parties

Conducting audits isn't something every procurement organisation focuses on. There are usually so many pressing needs, and fires to be fought, that review and compliance processes are often overlooked. But making the practice of compliance audits a core part of contract management signals to everyone that the contract isn't to be treated as a 'set and forget' document and that compliance matters.

Your organisation has likely made a significant investment in its contractual documents. But if checks are not performed, then the wisdom of making that investment is highly questionable. What gets checked, gets done. What does not get checked is apparently of such minor importance that it's not worth seeing if it has been carried out. It will usually be treated by the provider accordingly, as the following case demonstrates.

CASE STUDY: Performance goes both ways

After four years into a five-year contract, the first compliance review was conducted by an independent audit firm that was paid for by the client, a large federal government department. The scope of the review was to determine the degree to which the provider was compliant with the contract.

The auditors found that the provider was only 40% compliant with the contract. Work totalling $200,000 a year had not been performed, many KPIs were not being reported, many reports were not being generated, and the list went on.

More interesting was the auditor's finding regarding the root cause of the provider's non-compliance - it was the client. The client did not follow up on missing work, unreported KPIs, missing reports, did not ask for performance reviews or planning forums, and so on. The key finding of the audit report was that the client did not install any governance over the contract, so the provider was allowed almost complete discretion in what it did. Yes, the provider was grossly non-compliant with the contract but the client was grossly negligent in its governance responsibilities. Because of this audit, the client put in place a seven-person contract management team, led by a senior contract manager along with contract management policies and procedures, and a detailed continuous review program.

This case also highlights that, while it's natural to concentrate on reviewing the provider since they are the ones you are paying to do the work, the success of a contract needs both parties. Merely looking at one party will not give you the full performance picture. A true review examines both parties' obligations, seeks root cause for adverse findings, and prevents recurrence. Shining a light into one room will not let you see the whole house.

So a better question isn't, *"Who should be reviewed?"*, but *"What obligations of each party will be reviewed?"*.

INTERACT

5. Invest in the relationship

A dysfunctional relationship commonly leads to increased costs and deteriorated service. Unfortunately, each party has a tendency to blame the other for its dysfunctions, but rarely looks at their own contribution.

The individuals in both parties need to exhibit constructive behaviours. In this sense, analogies that liken the commercial relationship to a marriage are appropriate. As many of us know, it takes two to have a good marriage and to make it work - or not, as the next case demonstrates.

CASE STUDY: And the war begins

A telco's tendering team made a large investment in its relationship with the provider during the bidding and negotiation process. The client's contract managers, when they were handed the deal to run day-to-day, were traditionally adversarial and stayed that way; disputing all claims for out-of-scope work, disputing all bonus claims, disallowing any requests for excusable delays, etc.

The provider quickly changed tack and set up its defences. This included not performing work until a variation was signed off (a very long process in the telco), refusing to scale up KPIs that were being achieved with little effort and reporting only the minimum information that was explicitly defined in the contract, not the plethora of information available in the system (unless the client paid handsomely).

The contractual documents are important, but relatively superficial, drivers of day-to-day behaviour. Instead, it's the actions of both parties, in interpreting and operationalising the contract, that cause the deal to triumph or fail. As shown in Figure 2, the true behaviour drivers are the underlying values held by the individual parties and the people involved in the agreement. It's the submerged part of the iceberg that procurement's SRM needs to focus on.

Figure 2: Getting below the surface[3]

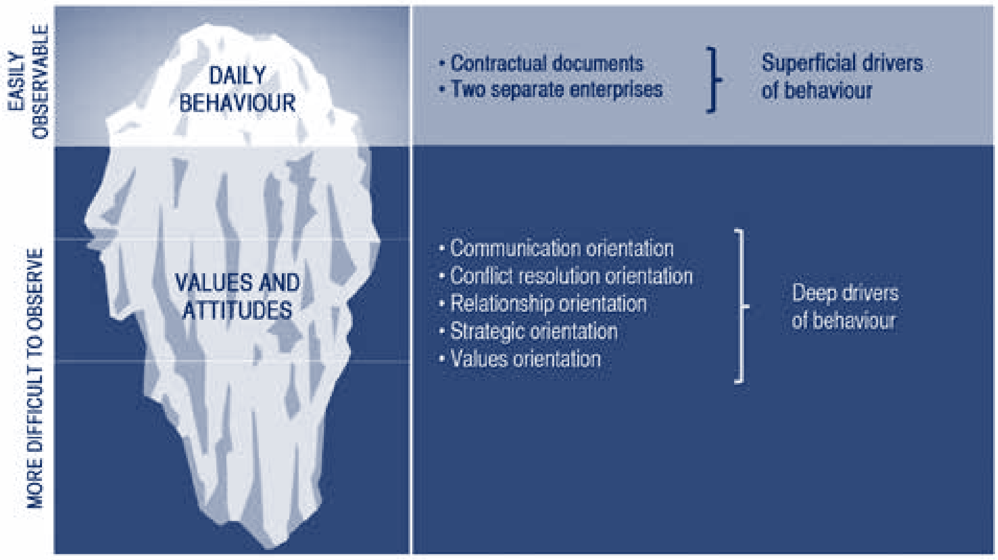
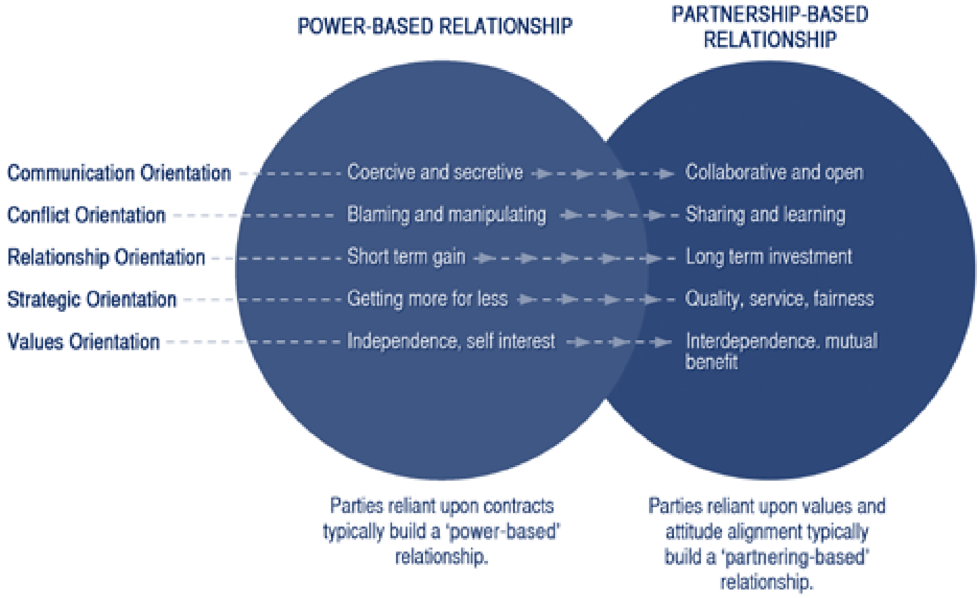


Figure 3: Power versus partnering[3]



In most cases, the parties want to move from a power-based relationship that is reliant on the contract, to more of a partnering one that is based on the underlying values and attitudes of the key people in the parties (Figure 3).

Partnering is a style of relationship, not a form of contract. Moving away from a power-based relationship does not mean there is a different contract, just a greater relationship investment.

Most of the investment required comes after signing the contract, when true partnering behaviours are required to make the deal work.

The investment is geared towards:

- ensuring strong interpersonal relationships at multiple levels in both parties,
- joint problem solving and opportunity discovery techniques,
- knowledge sharing and capturing solutions, and
- gaining a deep understanding of each party's strengths and limitations as well as the political environments in which they operate.

But such an investment isn't necessary with all your providers, as they have varying degrees of importance. For example, a global survey of 73 organisations reported that only 60% of providers were 'important/very important', and 40% 'somewhat important/ not important'

It's important to recognise that only a portion of the providers will warrant the relationship management investment required; the rest are just not important enough.

3 Cullen, S., Lacity, M. and Willcocks, L. (2014) Outsourcing: All You Need to Know. White Plume Publishing, Melbourne

6. Orchestrate the contract management network

Contract management is not the sole domain of one person, or one function such as procurement. There is a network of individuals who are utilised, known as the Contract Management Network (CMN).

The CMN represents the group who has dealings or contact with the provider after the contract is signed. This cross-functional team ranges significantly in each deal. It can include various head office functions (e.g., legal, IT, finance, etc.), end customers, project teams, and many others.

Unfortunately, for many clients, not everyone in the CMN is familiar with the contractual documents (or for that matter, has even read them). And most people act according to their individual needs and wants, not in accordance with an agreement.

For example, accounts payable may pay according to its own rules rather than the rules in the contract (and put your organisation in breach); business units may make demands and requests outside of the scope (and soar costs); and executives may demand to be treated as VIPs and prioritised above other work (and crash the KPIs) … the list goes on.

It's important to have the CMN clearly defined, briefed on the deal, and trained up on the contract. The hospital case explained below shows what can happen when this did not take place.

CASE STUDY:
A hospital plans well, but drops the ball

The contract was thoughtfully prepared with ongoing contract management requirements in mind. It had clear responsibilities and performance measures, specified a variety of regular meetings with attendees and agendas, and detailed a comprehensive reporting regime. After the contract was signed by the parties, management assigned it to an employee (who had no job specifications, training, or experience in contract management) with the instructions to *"administer this."* She diligently rubber-stamped every invoice. Not one performance review took place, or meeting, and contractor reports were never opened, let alone reviewed, as she did not know what to review for. She was too busy with her real job of procurement, and had several dozen other contracts to 'administer' as well.

You will find many examples of CMN structures once you start looking. Be aware there is no best structure for a CMN; each network is unique to each organisation and each contract. Furthermore, organisations tend to have their own nomenclature for titles within such a network. The important thing is that the roles, and related accountabilities, are defined and the individuals act as a team.

7. Handle disagreements and disputes

Think of disputes that occur as mushrooms. To grow and spawn they need an environment that is dark and full of 'fertiliser'. Your goal is to create an environment that is well lit and has little fertiliser.

Disputes are not usually caused by a single particular issue, but are generally triggered after an accumulation of misunderstandings, disagreements, and adverse events that eventually lead the parties to start throwing mud at each other. The case below shows how seemingly superficial events can create a fertilised field ready for disputes.

CASE STUDY:
Disputes begin the first week

A state government and a provider had just signed a 'partnering' BPO deal whereby the provider would not only maintain the facilities operated by the department, but also manage leases and other tenants as well.

On the first day of the contract, the provider's full-time account manager asked the client's director where his office would be. He had assumed that as it was a partnership, he and the director were to be colleagues, and he would have an office near the director. That was the arrangement in other deals with other clients.

This request came as a surprise to the client's director for a number of reasons. First, the provider's office was only a few blocks away so there was no logistical basis for the request. Second, he only expected to see the provider if his help was needed. Third, there was a shortage of space that was known to the provider.

However, the director was not going to be ungracious and refuse. Due to the space shortage, he had difficulty locating one but did track one down. It was in the basement and not particularly welcoming. He felt he was being quite congenial first by not refusing and second by not charging the provider for rent.

However, the account manager took the gesture as an overt signal that the relationship was not going to be a 'partnership' after all. Quite clearly, the client intended a master-slave relationship and was going to try to take advantage of them. As a defensive move, he put the word out that the client was not to be trusted and the provider's staff were only to comply with the letter of the contract.

The first test of the relationship came in the first week, when something had to be done urgently, but was out of scope. The account manager refused until he had a signed purchase order. He was not going to fall for the old trick of doing something without a PO, only to find out later that the client's accounts department would refuse to pay. When the director heard about this, his worse fears were confirmed. Partnering was just sales rhetoric; providers really do not implement it in practice. As his defensive move, he was going to make sure they complied with everything to the letter in the contract. It was the only way to manage providers.

Disputes soon percolated, raised by both parties regarding what the other was not doing in accordance with the contract. However, because of the original 'partnering' approach taken, not much effort went into the contract and it was full of ambiguities, conflict, and silent areas (where the contract said nothing). It was, in fact, a 'contract-light'. Since the contract was not of much help, it came down to who believed who said what during negotiations (for which minutes were not kept). Debates over who said what and mutual blaming kept going for a year until the provider sold its business to another organisation and the client and the new provider negotiated a "real contract."

The most critical dispute management skill is the ability to stay out of disputes - not as an avoidance technique; but rather, as a careful cultivator who ensures that 'mushrooms' have no chance to grow. What is needed is the skill to prevent battles, not to fight them.

Too many contracts do not specify an internal inter-party escalation process, prior to getting third parties involved. With no agreed escalation, disputes can too quickly be dispatched to third parties. While most contracts will state that the parties have a duty to try to resolve a dispute prior to seeking alternative dispute resolution, such contracts do not go far enough in specifying what that process should be.

Dispute management is very similar to issue management. That is, there is a formal process for raising, recording, and resolving disputes that arise. Disagreements are normal, and must be treated as business as usual, rather than be allowed to fester and become personal.

Once a dispute is resolved, the work is far from over. If you can't imagine ever saying you are sorry to the other party, you may not be able to recover from a dispute. If the parties still have to work together, baby steps are required. This involves just trying to do simple, non-controversial things together in an attempt to rebuild respect and, one day, trust. Parties that have recovered often end up having a stronger relationship than they had before. New understandings are made, better ways of communicating are put in place, and better problem solving techniques are utilised.

Alternatively, if both parties can't put a dispute behind them, both will inevitably become expert mushroom growers.

ADAPT

8. Gauge issues and risks

Good issue and risk management in contracts is essential and must be similar to the productivity required for good project management. There must be a formal process for raising, recording and resolving issues and ensuring these are logged and tracked.

Unresolved issues can be disputes waiting to happen if left to fester, thus sound issue management can make or break a deal's success.

Issue management is focused first on prioritising the issues so that high priorities are solved first. Otherwise, people can lean towards solving the easiest issues rather than the important ones. Second, the issue is assigned to an individual to solve it, not just a party. Individual accountability is crucial to getting it solved. Third, the focus is on permanently solving the issue, rather than temporary workarounds. Finally, the actual resolution (any of the four T's - treat, transfer, tolerate, or terminate) is documented before the issue is closed out.

Having an issue management system is very beneficial as a record of the entire life of the deal. This history is invaluable if key staff at either party are replaced. New people can get quickly across the key issues - both past and current - by reading the issues log, resulting in handovers that are more efficient. It also creates a knowledge base of lessons and solutions for other contracts, as well as future generations of this contract.

The question of 'what's an issue?' will often arise. Record something as an issue when:

- a party wants something solved, or a decision made - an issue record provides a systematic way to raise concerns;
- a decision needs visibility - if you want evidence that an understanding, agreement, or resolution has occurred. It does not matter whether something is solved in five minutes, only whether you want a record of it;
- something needs further investigation - issue management provides a tracking process for open items; and
- someone raises a good idea - a way of improving something is also a good use of issue records; it doesn't just have to be about problems.

9. Manage variations

Variations are a natural occurrence. They can occur verbally (e.g. over the telephone), in written form (e.g. email), as well as through the parties' behaviours (known as estoppel). Some variations will be 'official' (written and signed by both parties); however, the bulk of variations will comprise countless incremental changes to scope, practices, personnel, and soon occur on a day-to-day basis.

Managing variations is similar to managing issues. That is, there is a formal process for raising, recording, and resolving variations that arise, and these are logged and tracked using a documented form.

At some point, you may want to consider releasing a new version of the contract if the number of variations becomes so great as to make the contract no longer understandable. Never be afraid to release a new version when the old one becomes unreadable.

CASE STUDY: Variations become unmanageable

A fourth generation maintenance contract had one binder for the contract and three binders for the agreed variations. The variations evidence included in those three binders, copies of emails, correspondence, and on occasion, a signed variation agreement. However, it was nearly impossible to know the current conditions of contract as many of the variations related to previous variations but none of the documents were cross-referenced. Inevitably, the parties agreed to rewrite the contract and re-sign it.

Most certainly, incorporate variations into the next contract if flaws were corrected and good solutions discovered. Otherwise, the old obsolete contract, which didn't work, is put back out to tender yet again.

PLAN

10. Forecast demand and supply

Successful contracts can't be guaranteed by the document alone, as not all uncertainties can be specified at the time the contract is signed. Your business and organisation will change, as will your providers' businesses. The longer the contract duration, the more things will change.

Planning is an ongoing part of contract management. Not only do you need to constantly forecast your organisation's demand for the provider's goods and/or services and its capacity requirements (and fluctuations), but also changes to its business that may affect the arrangement. It is surprising how little attention is paid to regular forecasting of requirements and changes after a contract has been signed (and the limited reconciliation of contracted requirements to the actual requirements that eventuated).

CASE STUDY: Unmanaged 'scope creep'

As often happens in a major ERP implementation, a bank suffered enormous scope creep, driven by numerous requirement changes occurring on nearly a daily basis. Eventually, the ERP project blew out from $200 million to $800 million with only one module implemented in a single test site.

The bank called in an independent party to review how this had been allowed to occur. The bank's personnel did request the changes, formally and informally, and the provider put them into the project. Neither party acted as a devil's advocate, or set out a requirements updating process. Eventually the project was brought back inhouse and scaled down after much negative publicity and both parties filing lawsuits.

11. Maintain market intelligence

Procurement's initial evaluation of a provider when awarding a contract becomes obsolete very quickly in today's economic climate. Large global companies, as well as smaller local ones, can radically change during the life of a contract.

The longer the contract, the more likely that the entity that signed the contract will not be the same entity at its end - it will grow or shrink, have new divisions and drop divisions, have new debt structures, change owners, buy other companies or get sold to one, get into financial difficulties (and hopefully out of them), etc.

These changes can happen quite fast, and with no notice to your organisation.

CASE STUDY: A takeover during mobilisation

A contract was awarded to the 'best value for money' bid. It was a well-known provider, and thus the evaluation team did not think it necessary to conduct a company/financial due diligence. Shortly upon commencing mobilisation, the provider was taken over by another company. This company had also bid, but was evaluated as the least preferred bidder in a race of five providers.

It was well known to both providers that this takeover was to occur (and to various industry watchers), but not to the client. The inevitable rationalisation of the winning provider's staff commenced almost immediately, and key personnel from the original provider were replaced by the new one. These new personnel had a very strict style of operating and interpreted the agreement differently to the predecessor. Scope debates and price variations became normal operations.

The rapidity of change warrants ongoing awareness of what's happening with the providers you depend upon (as well as the ones your providers depend upon) and not merely relying on a single evaluation done years before.

Other changes will happen as well - technological, industry standards, regulations, price-performance ratios - that render your contract obsolete all too quickly. For this reason, benchmarking has become a highly desired practice by clients.

There are three approaches to benchmarking:
- independent consultant,
- partner organisations, and
- procurement's own 'database' of its providers.

First is the use of independent consultants. The key to getting value from the exercise is to scope the consultant's data to a best-fit with your data. Defining what you believe to be 'apples-to-apples' is the only way you can be assured of getting something even fruit-related. The case below shows this problem.

CASE STUDY:
Lack of meaningful benchmarks

A power company's CIO believed benchmarks were readily available and simple to apply; it was merely a matter of finding a consultant. He asked the consultants who were working at the company at the time if they had benchmarks and what it would cost. Happy with the answer, the CIO set the benchmarking project in motion.

But upon receipt of the voluminous report, the CIO struggled to find any meaningful information. When he queried the attributes of the source data (age, industry, location, etc.) and the method of scope alignment between his organisation and the data set, he was told all that was confidential. Having no way of knowing if the benchmarks represented current data, were in his industry, had comparable scope, and were from local or international sources, he threw the report out. But he still had to pay $100,000 for it. Here, the benchmarking yielded nothing but a strong desire not to go through it again.

Because consultants are the most expensive option, many choose a few select organisations that they 'partner' with. Your goal is to partner with other organisations from the same, or similar, industries as yours or with reasonably similar scale and scope of contract. While there will be less data points than a consultant's database, the data you collect will be more meaningful. It allows you to do a detailed 'apples-to-apples' comparison, as well as investigate detailed explanations of differences and solutions.

Lastly, some clients create their own database using supplier panels. By having a number of providers compete on a regular basis for various contracts or 'work orders' over a defined period, you are, in effect, continuously benchmarking each contract.

12. Drive continuous improvement

Most clients expect that their providers will continually improve, innovate, or carry out some form of 'value adding' as a normal part of a contract without having to say so explicitly in a contract. Many are also bitterly disappointed when this does not occur.

Yet, after you examine some of the typical clauses in this area, you will see that it can be difficult to understand what the client expects the provider to do and how the parties will work together to add value.

Let's take the following innovation clause that was contained within the 70 pages of general conditions (which also had 32 additional schedules) from an actual agreement.

CASE STUDY:
Sub-optimal innovation clause

22.1 With the view to be more efficient, to reduce unit costs and overall costs incurred for the Services, the Customer seeks to encourage the Contractor to identify opportunities to introduce new technologies and/or processes. This may have the effect of improving services, reducing costs and may result in lower fees and charges for the Customer and lower outgoings for the Contractor.

22.2 Where the Contractor identifies an opportunity that may produce a financial benefit for both parties, the Contractor will prepare and submit a business case to the Customer outlining the opportunity and how the financial benefit will be shared between the parties.

There are a number of observations that can be made after looking at this clause, to see if it would actually have driven continuous improvement:
- The client merely *"sought to encourage"* innovation - hardly an actual requirement.
- The innovation concept acts as a softener to the real objective; cut costs. But the provision is written to avoid the subject.
- If there was a financial benefit, it has to be shared in some way (to be worked out later). Sharing costs was not even contemplated, which infers the cost was to be borne by the provider unless they were able to get some money from the client.
- Within the 70 pages of the contract, this was the only clause devoted to the subject in all of the contract documents. One could infer it was not important, or that it had just been thrown in as an afterthought.

Conclusion

If you were a provider, how much effort would you put into innovation, where it will reduce your revenue and the costs are all yours (but gains have to be shared), given that it appears unimportant to the client? The answer is what most clients actually get from such a clause. Zero.

In another example, shown in the next case, the price configuration (fixed lump sum) combined with an obligatory annual cost reduction, prevented any improvement at all.

CASE STUDY: A deal motivating the provider not to improve

An insurance company found out that providers might not routinely put in a continuous improvement process, particularly when under a fixed price with little margin. In this case, by the end of a seven-year contract, the entire IT infrastructure and related practices were obsolete and effectively not supported anywhere in the industry (i.e. the desktop fleet had not been changed in the seven years). The contract had a 12.5% mandated annual cost reduction, capped profit, and capped labour; all driving the provider to retain obsolete technology and prevented any improvement.

If nothing improves over the term of a contract, most clients would take that as a sign the provider isn't too interested in them as a client. It doesn't have to be cost reduction; it can be waste reduction, risk reduction, process simplification, and improved delivery.

Evolution, in the context of continuous improvement, encourages (productive) non-compliance with the contract. For this reason, some shy away, particularly if the contract has been used against them in the past. This is why a formal process of continuous improvement is required - that focuses on both parties, and not just the provider. The key tenet is to do first what is best for the client and then agree a fair return for the provider.

Modern contracts can be out of date before the ink is dry. Price-performance formulae move on, as does technology, and the competition. Most importantly our volatile and ever changing world continually shifts the context around our deals. So, client needs are fluid and ever changing. Envisaging months or often years ahead of time, when the contract is signed, is even more difficult. This means that contract management, as opposed mere contract administration, is crucial.

But it cannot be approached in too legalistic a manner. Studies have found that over-reliance on the contract contributed significantly to failure in many deals - leading to inflexibility, over-legalistic interpretations, lack of responsiveness to current issues, and many more problems.

Mature clients build relationships, have clear objectives, and maintain flexibility on contract in the face of dynamic market conditions and changing business demands. The wise customers review and update contracts regularly with their providers, but are also able to build relationships that serve to soften contracts when they get in the way.

Just how much a client needs to invest in ensuring benefits are achieved, costs are contained, and risks are mitigated is a question far too many clients do not answer until the degree of under investment becomes apparent - in surprise problems, surprise costs, surprise responsibility confusion, surprise scope interpretations… the list goes on.

For this reason, this whitepaper has been devoted to helping understand that it is not the contract, in so much as it is the contract *management* that matters.

The modern procurement organisation, by not just embracing contract management - but by leading best practice, is an important force in creating and sustaining value to the business. As savings tend to zero over time and 'upstream' value is better captured by a proactive and strategic procurement approach, so stronger 'downstream' contract management will realise latent business benefits in future.

It has never been a more exciting time for procurement as it moves to its strategic role across the full commercial landscape of the modern business to drive better outcomes for all.

About the Author

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Sara specialises in the design and management of commercial agreements. She has consulted to 150 commercial and government sector organisations, spanning 51 countries, in over 195 contracts comprising $18 billion in contract value. She has run educational programs across Asia Pacific and the Americas for 5200 participants.

A widely published author, Sara has written over 135 publications to date. She has been featured in such publications as the Australian Financial Review, BRW, the Bulletin, Directions in Government, the Financial Times, Information Economics Journal, Insurance Directions, Oxford Handbook, Outlook India, and Strategic Asset Management. Her expertise is globally recognised and she performs peer reviews for the Harvard Business Review, California Management Review, and IEEE Transactions on Engineering Management.

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