

The 8th RIGHT

The imperative of the
RIGHT CONTRACT MANAGEMENT



WHITE PAPER

open windows software

modular procurement

Dr Sara Cullen, University of Melbourne

Do you **manage contracts** or do they **manage you?**

DO ANY OF THESE PROBLEMS SOUND FAMILIAR TO YOU?

- **Missed deadlines** and decision points, with renewals by default
- Inconsistent information and **no single source of data**
- **Lost contracts**, missing paperwork and poor compliance
- Long contracting cycles, endless delays and **cost blow outs**
- High risk contracts with heavy liabilities and **no audit trail**
- Non-compliant contractors and a **lack of accountability**
- Heavy reliance on **time-consuming manual administration**, open to human error
- **Negligible supply chain tier management** and due diligence
- **Reactive** variation **processes**
- **No visibility** into overall contract data

Take control of your contracts with **CONTRACT MANAGEMENT AUTOMATION**

In theory, the risks of managing contracts reactively are fully understood. But in practice too few organisations are managing contracts proactively and often not until a risk becomes a reality does the importance of contract management set in.

Open Windows contract management automation provides an integrated software tool to effectively manage down the risk of non-compliance, improve the capture of business benefits and save time so you can manage supplier contracts proactively rather than just administer contracts.

Open Windows Modular Procurement Software Suite

Our modular software suite allows you to build a solution that meets your needs and budget, with the flexibility to easily integrate additional modules as you grow.



PROCESSES

The flexibility to design a contract management process that's right for you



CATEGORIES

Integrate upstream category management with downstream contract management



PROJECTS

A complete project mgt suite directly aligned with your contract mgt system



SOURCING

Formulate strategies that link business case, sourcing templates & SRM



TENDERS

eTendering fully integrated with contract management using single data entry



CONTRACTS

A real-time contract register, searchable database & multi-tiered contract mgt facility



COMPLIANCE

Ensure 100% compliance in this risk-mgt module including real-time audit trails



BUDGETS

Manage your project budgets, contract cash flows and variations in real time



SRM

Build strong relationships with suppliers using direct data entry by contractors



CONTENTS

Foreword – Adam McInnes, Co-Founder & CEO, Open Windows Software	2
Introduction – Jonathan Dutton, FCIPS, Interim Sales & Marketing Director, Open Windows Software	3
Executive Summary	4
<hr/>	
Background – The Seven Rights	5
1. The Right GOODS	5
2. The Right QUANTITY	5
3. The Right PLACE	5
4. The Right TIME	5
5. The Right PRICE	6
6. The Right SOURCE	6
7. The Right WAY	6
Delivering Success - Eighth Right: The Right CONTRACT MANAGEMENT	6
<hr/>	
The Eighth Right – The Right CONTRACT MANAGEMENT	7
The Right CM STRATEGY	7
The Right CM INVESTMENT	9
The Right CM PEOPLE	10
<hr/>	
Conclusion	12
About the Author	13
<hr/>	

Foreword

At Open Windows, we are passionate about the business benefits of automation. Once the burden of administrative responsibilities is lifted from harassed buyers, they can become truly strategic in their approach and make a much bigger difference for their organisations.

This will become the only way in the future. As organisations outsource more and more, they must look to automation to help manage the workload. Especially as stakeholder expectations on organisations continue to grow exponentially.

The key to managing your supply chain to higher standards is good contract management – an area of endeavour too often overlooked in the past.

Our series of white papers over the last year or so has been extraordinarily well received. Each one has offered a different perspective on improving contract management practices – but all from a more practical point of view.

The 10 Critical Pitfalls in Contract Management

The 12 Best Practices in Contract Management

The 7th Right – The new urgency of buying in the Right Way

The 8th Right is the second white paper written for Open Windows by the venerable Dr Sara Cullen from the University of Melbourne and The Cullen Group. We are once again grateful for her contribution and are looking forward to a series of events that will promote the work and help people improve their contract management practices and take advantage of the clear business benefits that will inevitably flow to them as a direct consequence.

All the Open Windows white papers are available to download free on our website, www.openwindows.com.au, as is a wide range of relevant content in the form of blogs, articles, videos and sales material that will help you examine your own contract management needs in more detail.

In addition, you will also find details on our website of the many events that we host and participate in, which help people consider the relevance of better contract management practices for their own organisations. Hopefully, I will see you there!

Adam McInnes

Co-Founder & CEO

Open Windows Software

Introduction

The entire premise of the 8th Right is right – that in order to deliver the Seven Rights well, you need the Eighth Right first. Good contract management is essential to deliver the ever-widening range of business benefits that stakeholders are increasingly demanding from their organisations.

Business, in general, has decided that the supply side is a good place to obtain value, and they are backing their belief by outsourcing more and more of their needs to suppliers.

Yet consumers today want much more assurance of provenance than ever before. They are deeply concerned about where things came from and how they got here; consequently, so are boards and shareholders, voters and governments. Everyone wants better standards and faster, cheaper, safer, greener options.

This means organisations have to ensure better standards. And that means more rigour in supplier selection and closer management of supplier delivery; not just direct suppliers, but their suppliers too, all the way down the supply chain – even to the original source of raw materials in some cases.

Recent high-profile examples have illustrated the brand/reputational risk that lingers deep down the supply chain. Unforgiving consumers and shareholders will not readily accept excuses for unpalatable slip-ups as they may have done in the past.

This requires proactive, hands-on and professional contract management. As Dr Cullen says in this white paper, the days of ‘hire and forget’ supplier management are long gone. Organisations now have to invest in contract management in order to ensure the outcomes they want.

But investing in good contract management is a great deal. Research from IACCM suggests that around 9% of revenues can be wasted through poor contract management at both ends of your business – with suppliers that make up your costs, but also with your customers that bring in your revenue.

Because supply chains today run right through the firm, we are all one step in someone’s supply chain. Good contract management all along the supply chain benefits everyone and attacks our common enemy of waste.

The Eighth Right of good contract management is ultimately the most important procurement Right.

Jonathan Dutton, FCIPS
Interim Sales & Marketing Director
Open Windows Software

Executive Summary

Great procurement work can be undone by poor contract management. Great contract management can salvage poor procurement. If both are great, we've hit the jackpot.

What constitutes great procurement has often been defined by the Five Rights:

1. ensuring the *right goods*
2. of the *right quantity*
3. turns up at the *right place*
4. at the *right time*
5. at the *right price*.

A recent Open Windows white paper written by Jonathan Dutton suggested building onto the Five Rights of procurement. He explained the Sixth Right – buying from the *right source* and the urgency of a new Seventh Right – buying in the *right way*.

This white paper adds the Eighth Right to this list of imperatives. Not only to purchase in the right way, but also to manage the resultant contract in the right way. Only then can we actually get full value from the entire sourcing initiative.

Procurement teams are increasingly stepping up to deliver the results designed to be achieved in the procurement process. They aren't just buying wisely, but delivering the business outcomes intended at the outset of any purchase.

This is a whole new world for procurement.

Procurement must rise above its traditional transactional mindset to a line of sight encompassing the entire contract lifecycle. It must transcend merely supporting the business in a siloed fashion to drive and deliver actual business outcomes – making business decisions, not just purchasing decisions.

Most businesses are spending around 70% of their annual revenue on the external supply of goods and services, with services procurement increasingly outstripping goods¹. The underinvestment in contract management, founded on old paradigms of set-and-forget commodity contracts, can no longer be tolerated by organisations depending upon the strategic, operational and financial outcomes justifying procurement from third parties.

But what exactly makes up the right contract management? This white paper helps you answer that question by outlining the necessary thinking to develop the right contract management strategy, investment and people. The jackpot is just around the corner from there.

¹ <https://www2.iaccm.com/resources/?id=9596>

Background – The Seven Rights

As market volatility and complexity drive the growing pace of change, our traditional definitions of the Five Rights of procurement have also continued to evolve:

1. The Right GOODS

The right goods also includes the right services today as the procurement of services has outstripped goods. This Right is often a delicate balancing act of minimising shortages of materials and labour against minimising unnecessary costs, stock obsolescence, and skill accessibility. Uncertain supply markets, fast technological or social change, unpredictable labour actions, shifting production and lead times, and volatile shipping routes, climate events, or exchange rates (in the case of global purchasing) all contribute to the challenge.

The right goods/services is unconditionally more than ensuring the number of items in a box matches the packing slip or the third-party labour that show up has the right skills. In today's environment, it is about ensuring demand is satisfied by supply through supply chain reliability, efficiency, and optimisation.

2. The Right QUANTITY

This Right is often a delicate balancing act of minimising shortages of materials and labour and minimising unnecessary costs and stock obsolescence. Uncertain supply markets, fast technological or social change, unpredictable labour actions, shifting production and lead times, and volatile shipping routes, climate events or exchange rates (in the case of global purchasing) all contribute to the challenge.

The right quantity is no longer about ensuring that the number of items in a box matches the packing slip. In today's environment, it is about working for optimisation (which can involve rather complex algorithms) and ensuring supply chain reliability and efficiency.

3. The Right PLACE

The fact that products and services will always need to be delivered where needed makes this Right a perennial one. It is the way in which this is done that requires procurement to have greater logical proficiency.

Modern-day logistics is changing with technology and increasingly global sourcing options. Robots pick from warehouses, and drones or driverless vehicles might be delivering products. Products may come from anywhere in the world. Labour can be delivered via the cloud to the right place, with global teams working side by side through virtual team technologies.

So, the question of the right place has not changed, but the mechanisms on offer to deliver it certainly have.

4. The Right TIME

The right time needn't always be the quickest. There are many right times to buy – driven by market lulls, sales bonus periods and product lifecycles. Timing can also be made more challenging when new vendor acquisition and on-boarding is a cumbersome process taking many months, if not up to a full year.

With time being of the essence for most management objectives today, the desired time can easily compromise the right time for all the other six Rights to occur. In fact, the drive for speed most commonly results in one or more of the other Rights being compromised.

Delivering on time increasingly demands a continuous focus on lifecycle efficiency and organisational coordination, as well as market intelligence and sound contract management practices and systems.

5. The Right PRICE

Securing all the Seven Rights at the right price is what many believe to be the sole purpose of procurement. Interestingly, perhaps this view is often espoused more by procurement than the business. The business is often much more sensitive to failures of the other Rights such as quality, quantity, place and time. Procurement's myopic focus on price or cost issues could even be their ultimate undoing. Cost savings are quickly eroded when these Rights fail – too often resulting in the lowest price often becoming the highest cost to the business.

In other words, it is not so much an issue of the right price, as it is of the right value. Perhaps this Right should be retitled accordingly.

6. The Right SOURCE

There is now an ever-increasing focus on buying organisations' social responsibilities for the integrity of their providers down the length of the supply chain. Most of us have seen photos of children in developing countries hand-stitching footballs, burnt apparel brands scattered among the charred remains of a textile factory and suicide prevention nets fixed along the rooflines of a computer manufacturing plant. Such stark evidence of previously hidden supply chain operations means that corporate responsibility can no longer be demarcated based on contractual boundaries. Consumers and voters, as well as boards and shareholders, are increasingly holding us all to account.

More compelling, however, is that being able to demonstrate the right source offers an opportunity for brand differentiation in the eyes of the customer, as well as workplace differentiation in the eyes of employees.

7. The Right WAY

The right way is all about demonstrated transparency. Not only building a strong process, but letting that strong process be seen. Underpinning this is a strong governance model involving and supporting all stakeholders in the organisation (not just procurement). This requires an intelligent lifecycle process framework enabled by technology, the sourcing of talented procurement leaders and the development of high-calibre professionals.

This is not, however, just about fraud avoidance, preventing bad press and minimising other risks. It is about recognising that modern organisations are increasingly dependent on their providers to achieve business outcomes and shareholder value. This cannot be achieved through the Seven Rights alone – there is an Eighth Right which is increasingly critical to every organisation's success.

Delivering Success – Eighth Right: The Right CONTRACT MANAGEMENT

The first Seven Rights set in place the prerequisites for procurement success. Actually, delivering that success is what the Eighth Right is all about.

Often it feels like procurement celebrates too early. Contract signature is seen as an end-point of the work, not a start-point of the work. The benefits built into the business case, or benefits hard-won from hungry suppliers in negotiations, are too rarely delivered in full.

Decades of studies across the globe demonstrate that goods, projects and services cannot be contracted for and then not managed by the client while expecting a positive outcome.

The Eighth Right requires just as much attention as all of the previous Seven Rights to ensure that the contract is successful.

But the way in which people manage contracts and providers varies enormously from one person, to another, from one category to another, and from one organisation to another.

The range can vary from a passive administrative viewpoint, focused on ticking compliance boxes, all the way to strategic relationship development and collaborative innovation to forge the best outcome.

Which one is right?

For many contracts, a set-and-forget approach may be the most pragmatic, and indeed much of the administrative box ticking will soon be done through robots (software automation). For others, however, this would be the death knell of value realisation.

The Eighth Right – The Right Contract Management

Getting the right contract management takes strategy, investment and people. Firstly, from the perspective of the whole organisation and its contract management culture. Secondly, at the contract type or category management level in how those contract types and categories are managed. Lastly, for many important contracts and provider relationships (strategic, high-risk, high-value contracts, etc.), it is also at the individual contract or provider level.

The Right CM STRATEGY

The right contract management (CM) strategy will be different for each type of category and contract. As an example, one often-neglected type of contract is vendor panel contracts.

A strategy challenge example – vendor panels

There are typically two general types of vendor panels: a pre-qualified list and a strategic panel. The former merely provides a faster way to buy and tends to be very set-and-forget by those that set it up. It is administrative in nature and merely provides a passport to sell to your organisation. More strategic panels pass the test of the Seven Rights and have been through hard due diligence to ensure that they do so.

The entire premise of having a more strategic vendor panel in place is to lock in continuous competition within a mini-market of the most suitable, best-value providers available. This panel is your organisation's chosen subset of the actual market, and it must remain competitive, just like the full market. There is competition during the panel selection process, of course, but more importantly, competitive tension is maintained and managed after the panel signs up to the contract. The panel members should fight over each job, giving continuous best value for money.

But more often than not, one provider gets most of the work and the rest are left discouraged and disappointed because they were practically shut out.

CASE STUDY:

A well-known mining company had nearly 50 panels. However, none of them actually operated as a true panel. Instead, each panel had one vendor that provided the majority of the work and equipment. The other panel members were really just there in case of an emergency (labour or supply shortage of the primary provider) and to act as a threat to the preferred provider for poor performance.

On the few occasions when the 'bat-signal' was flashed in the sky, the other panel members knew the client was in a tight spot. Also, knowing that regular, ongoing work was improbable given the client's historical spending patterns, there was no real incentive to offer any resources at the low panel price.

So, the panel ultimately didn't operate as a panel; it was a sole supplier arrangement with emergency backup, and the emergencies played into a seller's market. The client had to pay special on-call rates to get the augmentation. Interestingly, the client was angry with the panel for being opportunistic (which it was, as there was no work coming from the panel arrangement). This further locked in the primary provider, effectively increasing the company's dependency on it and encouraging even higher emergency rates from the others.

To draw a comparison, you wouldn't go through the considerable effort of setting up an e-trading account to buy shares in the open stock market and then only invest in one stock. So why set up a panel for and only buy from one vendor? If that is the case, you're overweight in that vendor's 'stock', but not because the vendor is outperforming the others.

To get a balanced vendor portfolio, the CM focus and resultant strategy would be to ensure that there is a portfolio spread of panel members in use, along with constant refresh based on market changes – just like you would manage a stock portfolio.

To do this, the contract management would continuously check the percentage of work each member of the panel has been awarded since the panel was formed. Alerts would be created to see if there is one provider scooping up most of the work. It is likely that this is not necessarily because they are the best value for money, but rather because they became the most familiar and tapped into the panel clients' habit of buying the known and familiar. If the portfolio becomes overweight, the CM focus targets the diagnosis of the cause and root cause correction.

Moreover, you wouldn't buy stock only once every three years (the typical duration of a panel contract), so neither should your panels remain static. Accordingly, it is good practice to regularly drop poor performers and pick up new 'stock' that could outperform incumbents.

Forming a CM strategy

There are many forms of CM strategies out there. All include the following four components:

1. The **strategic focus** everyone involved is required to concentrate on, in terms of the core objectives of the contract.
2. Which **CM best practices** will be adopted, as well as which ones won't. There are 12 of these to consider from a strategic viewpoint², and inevitably your organisation might have a few more of its own that are special to its needs.

You will not need to fulfil all best practices all the time for every contract. Thus, identifying which practices will be adopted to deliver the results is equally important as identifying which aren't necessary to do so. This brings a useful best practice transparency to stakeholders and tactical direction to all involved.

3. Clearly defined **roles within the CM network** (representing your people who will have dealings or contact with the provider after the contract is signed). This cross-functional team varies significantly from contract to contract and category to category. It can include various head office functions (e.g. legal, IT, finance, etc.), end-users, project teams and many others.

To ensure the success of these CM roles, it is critical that the people filling the roles are reviewed on their performance in normal HR performance reviews. So, for example, contract owners are assessed on their provision of strategic direction, dispute minimisation, collaborative initiatives, etc. Accounts payable is assessed on the percent of payments made as per the terms of every contract.

This ensures that CM roles are recognised beyond the often-limited audience of a CM strategy and that the successful achievement of the role is part of each individual's accomplishments for the organisation.

4. A realistic **budget** to execute the CM strategy, including business-as-usual contract management plus periodic projects (e.g. innovation initiatives, value realisation analysis, etc.).

If the budget is insufficient, which it often is in immature contracting organisations, then there are two options. The first option is obvious – get adequate funding. Barring that, the second option is to go back to #2 and remove all the best practices that cannot be delivered under the current budget. It is better to be good at a few things carefully determined rather than be bad at many things due to unachievably high expectations and a lack of resources.

This is covered more fully in the section on the right CM investment.

Timing of the CM strategy

The time to decide what needs to be done and by whom is not after the deal has been signed. It is tempting to wait until the contract is agreed and then try to make a go of it with whatever resources you might have on hand, but this approach assumes a level of effortlessness regarding contract management that rarely exists.

This fatal flaw has left some organisations with out-of-control costs, inadequate monitoring, long delays and poor results. The following case study exemplifies exactly that.

CASE STUDY:

A state-based insurance company entered into a strategic partnership with an IT service provider. The board, believing that the provider was now its official IT department and would therefore act accordingly, saw no need to retain any in-house IT capability. So, it outsourced all of its IT people, processes, technology and strategy to the provider.

After the transition was completed, the soon-to-be-exiting CIO realised that no thinking had taken place regarding managing the provider. He commissioned a study to determine what prudent management should be in place and was startled with the level of basic management required alone.

He proposed the resultant CM strategy to the board, but was overruled. Instead, the board put the provider in charge of its own contract on behalf of the insurer. Unsurprisingly, the provider was more than happy to provide this additional service to, in effect, police itself.

Five years later, the IT strategy was non-existent, and IT costs were up to 70% higher than market prices. The board members involved in the original CM strategy decision were retired, and the organisation rebuilt its capabilities, beginning with the hiring of a CIO and a new provider.

This case highlights the fact that many organisations will try to do anything to save a couple of dollars in the contract management areas needed for success. Yet, these same organisations seem to have no limit when it comes to funding failure.

² See <https://www.openwindows.com.au/white-papers/the-12-best-practices-in-contract-management/>

The Right CM INVESTMENT

An earlier Open Windows white paper explained the 12 best practices of contract management. These are fantastic things that deliver results, but cost money in terms of people and systems to do them.

This is contract/vendor management as an investment, not a cost.

It is an investment to get the benefits that the contract was designed to achieve and minimise the risks it was designed to mitigate. A contract only provides recourse in the event of breach – the document itself cannot manage the deliverables, relationship, financials or benefit realisation. If there are not sufficient funds or resources to manage it well, then it will be managed poorly for no other reason than scarcity of time, skills and people.

If the investment is so meagre as to leave no alternative other than to manage the arrangement poorly, one has to wonder why anyone would bother to have a contract in the first place.

An economic view of investment

The right investment is driven by having the right strategy. But it is also driven by the desired return on the transaction. Transaction cost economics (TCE) can explain exactly why. TCE concerns itself with the total cost of contract and is comprised of the cost of finding the right supplier, negotiating the right deal and then managing the contract.

On average, organisations invest 16% of a contract's annual value on the first two TCE components. An average of 6% of the annual value is then invested by the client in managing domestic contracts and 12% for offshore ones (excluding failed contracts, which have very large costs; in some cases, far in excess of contract value)³. Averages are not 'right' of course, but do provide a place to start an investment conversation.

CASE STUDY:

As an example of the TCE conversation in practice, I was recently asked to give my opinion on a 5-year, 750-page contract that a financial institution recently signed. It was a renegotiation of an existing deal; done so because it was believed a re-tender would cost too much and do little more than yield the incumbent as the winner. The principal saved the significant tender costs, but spent a considerable 15% of the \$72-million contract on the renegotiation with consultants and an external legal firm.

Subsequently, the contract was largely ignored because very little (0.7%) was invested in actually managing the newly agreed contract. Only resources to conduct invoicing administration and service level penalty management were assigned, and thus only these were addressed.

Looking at this case from a TCE perspective, this contract should not have occurred. Firstly, 30% of the value went to the provider by way of profit margin, then 15% to external parties to transact it. Next to nothing was invested in arguably the most important transaction component – managing the darn thing. Spending 45% above the actual cost and investing nothing to ensure it was well spent is unlikely to be a sound economic decision for any organisation, let alone one that specialises in financial transactions.

Return on investment

The obvious point of knowing the TCE for any contract is to minimise transaction costs that don't have a return on investment. It's about balance.

With the 0.7% post-award investment in the previous case study, you could argue that the pre-award investment should have been significantly less (perhaps 90% less) since there would be little return on that investment (ROI). The negotiation and contract should have focused on the things that would be managed – invoicing rules and service levels along with the penalty scheme. Beyond that, the ROI diminishes.

One often thinks a contract is there to be used if necessary, so you should write everything you can into it. But that's not how it really works in practice. Nor is that perspective necessarily shared by the courts. Contracts are not to be managed at a party's convenience (including the convenience of not managing it). Contracts are expected to be managed as a reasonable organisation would, rather than with only what a time-poor contract officer is able to squeeze in. The lack of management equates to decreasing powers of enforcement.

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

Actions speak louder than words

Estoppel operates alongside, and is often pleaded as an alternative, to a contract. It prevents a party from asserting a claim inconsistent with a position that the party previously took, either by conduct or by words. It's the law's way of saying, "you can't have your cake and eat it too". For example, if the provider was to deliver goods to a specific location in the contract but the buyer accepts delivery at the new location, the buyer would be estopped from later claiming non-conformance. It acts as a variation by conduct (rather than a written or verbal variation).

The *course of performance* works with estoppel and refers to the pattern of behaviour between parties occurring after a contract has been signed. For example, if the people involved believe that flexibility should be shown rather than strict adherence to a contract, and behave flexibly as a result, then it becomes an accepted course of performance. This will almost certainly be a good thing for outcomes, but bad for enforceability.

One may try to argue that explicit contract terms should prevail over the course of performance, but the predominant view is that no contractual term is so clearly defined that a party cannot demonstrate what is intended by the way in which the parties actually carried it out.

Lastly, there is another related legal concept, the *course of dealing*. It's similar to course of performance, but refers to a recognisable pattern of previous behaviour between the parties. If you have more than one contract with a provider, are extending an existing contract or signing a new one with a provider that you've used before, then past conduct can be used to interpret current dealings and future expectations. The idea is that the parties drew up the contract in view of the customary manner in which they had previously transacted business.

The course of dealing establishes a common basis of understanding for interpreting the contract and the expected conduct. So for example, if the parties had previously ignored penalty clauses as adversarial and counterproductive, then it would be reasonable to assume this will continue. A party can rely on this past behaviour continuing unless the other party states otherwise (and acts on it).

If the corporate mantra is to "keep the contract in a drawer", then you can assume there is a great deal of *estoppel*, course of performance and course of dealing going on.

Creating a practical contract and a realistic CM budget

If the contract clauses that your organisation is relying upon are not being taken seriously enough to be managed well, why should the court take them more seriously than your organisation has? Even more of a concern, why should the provider?

The CM investment is not just for value realisation, although such investment is critical to achieve it. The investment is also required to keep the contract alive and worth the investment in creating it in the first place.

Consider going through the following exercise to make sure there is a practical contract and a realistic plan to manage it:

1. Put a budget against each provision/clause you will rely on – within the terms and conditions and all schedules (specifications/statements of work, financial schedule, OHS schedule, etc.). The budget encompasses resources to manage the related issue from provision invocation to successful conclusion.
2. Get rid of the provisions you're not going to rely upon. Having unnecessary provisions often just increases your costs (if providers price in additional perceived risk) without giving you much in return.
3. Get rid of the provisions that have a low ROI. These are the ones that are not practical, and thus have little probability of ever being used.
4. Add in provisions needed for success, not to address failure (e.g. relational aspects, innovation, agility and refresh, etc.) along with the budget to make them happen.
5. Compare the required CM budget to the actual CM budget. As CM is chronically underfunded, we can assume this will be the case. Your choice at this stage is to either get rid of the provisions you don't have the budget to manage or get more budget. If you do neither, estoppel and the course of performance and dealing may do the former for you by making enforcement tough if not impossible.

The result of this exercise is a contract fit for purpose, rather than one largely designed just to obtain internal signoffs.

This exercise will demonstrate why the CM strategy must be prepared before a contract is developed, not after it is signed. The contract is then designed to fit the way it will be managed and has a clear ROI. It's not designed to be left unmanaged, unloved and with a serious enforceability problem.

The Right CM PEOPLE

Of course, it is not just managing the contract that we invest in; it is managing the providers, stakeholders and our own colleagues. The investment includes ensuring the provider is delivering, that the stakeholders are practical and proactive and that our own people are enablers rather than barriers to success.

There are many titles involved in contract management and many people involved in the CM network across an organisation. Let's call them 'offices'. These offices can be anywhere and everywhere, or they can be nowhere with no one in them.

CM offices

Picture a few collections of cubicles spread about a typical office premises.

- **Delivery office**— comprising superintendents, subject matter and technical experts, project managers, supply officers and business leads, all ensuring the work is being performed in the way the client needs it.
- **Supplier relationship management (SRM) office** – covering the SRM spectrum ranging from the most basic leveraging spend to developing the right interparty interpersonal relationships to supplier market development.
- **Performance office**— housing service level managers and performance analysts, not only ensuring performance, but also ensuring the performance management schemes are working to drive the right behaviours in both parties.
- **Financial office** – comprising financial controllers, expert estimators, spend analytics and, of course, accounts payable, who all ensure the right financial outcomes, budget results and payments.
- **Administrative office** – home to the contract administrators, compliance assurance and governance officers, all driving consistency and transparency.
- **Innovation and knowledge office** – driving the innovation lifecycle and shared knowledge creation warehouse that powers continuous improvement, intelligent learning organisations and business-focused advancement.

In some cases, such as category management, one person acts as all these offices for the category in which they are the expert. In other cases, these offices are decoupled and spread across organisations in a siloed manner.

The effect of this decoupling is that, for example, accounts payable pays in accordance with its own processes rather than in accordance with the contract (thus putting your organisation in breach), business units make demands and requests outside of the scope (thus increasing costs) and management asks to be treated as VIPs to be prioritised above other work (thus crashing the KPIs) ... the list goes on.

Whatever the case, it is the people that deliver results, not contracts. These people need to be acting in concert, with professionalism and acumen.

Acting in concert – the psychological contract

There is the written contract, and then there is the unwritten one. In an ideal world, you wouldn't want them to be too far apart. But this is rare, if not impossible. No contract is perfect, and no one can truly predict the actual turn of events that may occur.

To have the CM network act in concert, it starts with a shared psychological contract (PsyCon). The PsyCon represents the individually held beliefs about how parties are supposed to act,

what each party's obligations are and even the scope when this is ambiguously constructed in the written contract.

It can be guided, in part, by the person's interpretation of what's in the contract (insofar as he or she has been privy to it), but is influenced more by beliefs, assumptions and interpretations. At the heart of the PsyCon is a philosophy – not a process, tool or formula. It is the spirit of the agreement.

Irrespective of what the written contract might say, it's the PsyCon that people operate under, uphold and hold others accountable to. You might use the written contract to litigate, but it will be the PsyCon that is acted upon in practice. Its breach can have severe consequences for a relationship.

When relationships are adversarial, the contract is often selectively employed in an adversarial manner, despite the existence of partnering provisions. When the relationship is collaborative, people ignore many of the punitive clauses as contrary to the spirit of the agreement (the collective PsyCon).

PsyCons can be quite a challenge to live up to, since they are unwritten and each individual holds his or her own unique view. This is why a shared PsyCon is imperative, starting in your organisation. This happens when people begin to exchange opinions and expectations, and then values are shared and understandings become consistent within a group.

PsyCons can be a force for good or evil. When left undisturbed, negative PsyCons can infect others, as the next case illustrates.

CASE STUDY:

A group of procurement and contract managers in a telco branded themselves the “toe cutters”⁴. They took great pleasure in getting penalties out of suppliers. One stated, “If we get penalties equal to our salaries, then we're self-funding. But if we get penalties greater than our salaries, then we're actually a profit centre”.

Every individual who joined the group was indoctrinated into this philosophy. Despite it being rather perverse – wanting failure and poor performance as contract outcomes – the group was able to thrive for a decade before eventually being unwound due to the damage that was inflicted on supplier relationships and the client's brand in the supplier market.

The written contracts stated that the client could seek financial recourse for poor performance, and it had the KPIs and formulas to calculate such recourse; however, it was never the intention that it would become the driving imperative in its supplier relationships. It was the “toe cutter” clan that made it so.

⁴ A toe cutter is slang for a standover man. As the name implies, this involves painful removal of the digits of one's foot.

To have the CM network working at optimal levels, it is crucial that a shared constructive culture exists. This means having positive PsyCons that are shared and consistent. If the CM network is consistent in carrying out the PsyCon with proven results, it can become the 'way we do things here', because of demonstrated positive outcomes, not because of being held hostage to ineffective traditions.

Governance – CM leadership pairs

Critical to the formation and management of any contract is the quality of the relationship between the parties. We tend to put a great deal of effort into defining governance structures and the related management processes. Far less consideration is given to the actual people within those structures.

But the people selected to lead make or break contracts, more so than the structures erected to govern.

Leadership is something you hear about constantly. The vast number of leadership quotations one is bombarded with in corporate offices, educational programs and on social media attests to its enduring interest and importance.

You do not, however, hear too much about leadership in the context of contracts. Leadership is absolutely critical for high-performance contracts; however, it is different from the typical management narrative of a single individual who inspires and influences others. The difference is that it takes effective leadership pairings, not a sole leadership figure. Leadership pairing between the parties is not just at the top; it needs to cascade through the formal bi-party hierarchy.

Leadership pairs are tasked with acculturation – the process by which two or more cultures merge to form a cohesive culture.

Successful leadership pairs truly enjoy working together, described as chemistry. Effective leadership pairs consistently display the following behaviours and attitudes:

- **Focus on the future.** The leadership pair focuses on where they want the relationship to go, not where the relationship was.
- **Action-oriented.** The pair isn't afraid to use their powers. They act swiftly to remove, or workaround, obstructions from people, processes or contracts.
- **Spirit of togetherness.** The pair presents a united front to stakeholders in their respective organisations. Saying one thing in public and another in private doesn't occur.
- **Transparency.** The pair is open and honest about issues, not just to each other, but to all and sundry.
- **Problem solving.** The pair seeks to diagnose and fix problems; they don't seek to assign blame.
- **Outcomes first.** The pair does what's best for the client, then ensures fair remuneration for the provider, and always produces a fair agreement.

- **Trust.** As a result of all of the above behaviours and attitudes, the leadership pair feels secure and confident in each other's goodwill, intentions and competency.

The relationship is crucial at the individual level, not just the organisational level. Successful contracts are dependent on the people who execute them in the field and whether they click or clash with their counterparts. Moreover, the perceived violation of PsyCons hinders the chances of long-term partnerships being formed and results being achieved.

In practice, leadership pairing is required at bottom and middle, as well as the top management levels. Modern contracts are full of adaptive challenges that require experiments, discoveries, adjustments and innovations from many different functions within the parties involved – not just the buyer's contract owner to the provider's account owner, but to the buyer's contract manager and the provider's account manager, the buyer's contract administrator to the provider's account administrator and the buyer's accounts payable lead to the provider's accounts receivable lead.

When both parties have the right people, anything is possible. Leadership pairs with shared positive PsyCons make this possible time and time again.

Conclusion

The intensifying dependence on our providers and increasing strategic nature of the work they perform means that the responsibility of management transcends the traditionally more administrative role.

Contract management is now a profession, complete with degrees offered by universities around the globe and numerous professional associations. It is no longer just a task.

The Eighth Right recognises this and raises the professionalism of everyone involved in the contract lifecycle.

The right CM strategy ensures your arrangements are planned to be managed in a professional and robust manner. The right investment allows this strategy to materialise. And the right people make it happen in practice, not just in theory.

"We are what we repeatedly do. Excellence, then, is not an act, but a habit." Aristotle

About the Author



Dr Sara Cullen

Dr Sara Cullen is the managing director of The Cullen Group. She is a fellow at Melbourne University, an associate at the London School of Economics and on the ANZ Board of the International Association for Commercial and Contract Management. Previously, she was a national partner at Deloitte as the global thought leader for the outsourcing practice.

Sara has consulted to 150 organisations, spanning 51 countries and comprising \$18 billion in contract value. She has run educational programs across Asia Pacific and the Americas for over 6,400 participants.

A widely published author, Sara has written 19 books and 126 publications. She has been featured in such publications as the Australian Financial Review, Directions in Government, the Financial Times, Information Economics Journal, Insurance Directions, Oxford Handbook, Outlook India and Strategic Asset Management.

She is recognised by the Global Sourcing Association (UK) as one of the world's foremost thought leaders in their A-list of trailblazers. Her in-depth knowledge is globally acknowledged, resulting in research reviews for the Harvard Business Review, the California Management Review, Journal of Information Technology and IEEE Transactions on Engineering Management.

© The Cullen Group. All rights reserved. The moral rights of the author have been asserted.

DISCLAIMER: This work is proprietary to The Cullen Group and is licensed in perpetuity to OPEN WINDOWS for its own marketing use only. This work is produced in good faith and represents the personal opinions of the author and those quoted and/or cited. Faults and omissions are not intended, and anyone with corrections or claims of omission is free to contact the author through the website www.cullengroup.com.au. Nothing in this work represents formal legal or commercial advice, which should be sought separately from suitably qualified sources in interpreting the recommendations and conclusions in this work. The Cullen Group, the author, nor Open Windows accept any liability nor offer any indemnities or warranties regarding the content of this work.

open windows software
m o d u l a r p r o c u r e m e n t

P: **1300 73 90 73** International: **+61 3 9819 5088**
635 Glenferrie Road, Hawthorn VIC 3122, Australia
E: **info@openwindows.com.au** W: **openwindows.com.au**