Procurement solutions

Mind the Gap

the reality of good contract management
While the level of spend under contract varies by sector and category, in most organisations at least 50 per cent of all third party spend is governed by contracts, or legally binding agreements between the parties to offer – and accept – goods or services.

Despite this, many organisations do not have clear contract management practices or roles and responsibilities, with supply chain relationships being managed in an ad hoc and sporadic fashion. Best in class contract management arrangements involve the continuous evolution of the contract, building and sustaining excellence within client-supplier relationships and an ongoing assessment of whether the terms of the contract and service delivery mechanisms are right for both parties.

It is estimated that the lack of robust contract management practices within organisations costs the UK hundreds of millions of pounds in lost savings opportunities each year, and procurement functions have a key role to play in plugging this gap.

This best practice guide highlights some of the key challenges – and opportunities – facing procurement teams as organisations try to get the most out of their contract and supplier relationships, and identifies some of the levers and tools readily available to support effective contract management.

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Contract management is widely recognised as one of the core components of a best-in-class procurement function. True contract management covers the whole spectrum of contracting activity. It encompasses contract administration – the process of authorising the contract and any variations – and continues through the life of the relationship, with a focus on constantly analysing delivery and supporting continual improvements. It has always been a joint effort between the supplier and the client, but one where there is often an unequal commitment.

Historically, the focus within organisations has also been unequal, with a bias towards the initial contracting phase. This activity is generally carried out by the procurement function, who then hand over the responsibility of ongoing performance monitoring to operational managers. Resource pressures and low levels of investment have meant that for many organisations, contract management is limited to simply ensuring the organisation gets the goods and services it specified during the tender phase.

However, the nature of contracting arrangements is changing, driven by a number of factors:

- The challenge of an expanding base of SME suppliers, who may be highly flexible, but have a more volatile presence in the market
- There is an equal trend towards consolidating spend amongst a smaller number of suppliers to maximise buying power, inevitably leading to a number of business-critical contracts
- Innovations in the e-procurement market are giving organisations the tools and techniques to streamline and enhance contract administration and monitoring.

These challenges combine with the constant pressure to deliver savings, and a growing awareness of the inherent risks associated with service delivery via external contracts.

On the basis that many organisations are looking to procurement functions to deliver substantial cost reductions from third party spend, as well as limit their exposure to risk, it is little wonder that procurement professionals are now taking a lead on contract management to create in-contract cost reductions and develop effective and efficient processes to support the wider organisation.
Procurement functions play a key role in the delivery of consistent savings from third party spend, and given that the additional value a new contract can deliver can be made or lost within 18 months of contract award, contract management is a critical part of the procurement cycle.

The value curve, below, illustrates the financial impact that contract management can have – from maintaining the benefits at sourcing, through to delivering a visible step change in contract performance.

The primary benefit for any organisation is the ability to enhance their financial position created from the sourcing exercise and mitigating the risk of operations. The initial benefits or savings that new contracts bring can be weakened by scope creep, incurring hidden costs or from the organisation reverting back to old ways of working.

Based on experience, these are a few examples of where savings made by organisations during the sourcing phase have subsequently been lost following a contract award:

- The supplier is requested to work in ways that add cost to the service – for example needing to react to work orders with no time to plan
- The supplier being asked for – and supplying – goods or services that are not part of the specification
- The supplier introduces new ways of working that, in effect, create a higher cost solution for the client.

To get contract management right requires resources and time, both of which many organisations are short of. However, with the potential benefits being so significant this is an investment area organisations should not overlook.
Active contract management tackles these issues, and also delivers:

**Risk mitigation:**
It helps protect the organisation from the residual liabilities that lie with the organisation and from the risk (in the public sector) of challenge if the scope of services changes dramatically from that specified during the sourcing exercise.

**Internal compliance:**
There is a direct correlation with increased off-contract spend and low levels of contract management. Not only does this mean that the time and effort put into sourcing in the first place is lost, it also generally results in additional costs to the organisation in terms of invoice processing, managing suppliers and, of course, from potentially inflated prices of goods and services through spend fragmentation.

**Increased understanding to prepare for future sourcing exercises:**
In addition, procurement functions learn more about the services provided and the way the wider organisation uses contracts in place. This speeds up future sourcing exercises at the planning stage by providing plenty of ‘real life’ data to compare to specified requirements.

**Improved supplier relations:**
Finally, effective contract management goes hand-in-hand with sound supplier relationship management, which in turn reaps numerous benefits. By working collaboratively with suppliers throughout the contract term, organisations can often identify service improvements – both in terms of delivery, and process efficiencies – that ultimately result in additional savings or financial gains.
There is no ‘one size fits all’ for carrying out contract management. The effort put into contract management, and the extent to which each part of contract management is relevant to your organisation will depend on many factors, including the size and scope of the spend and contract base, the level of business-critical activity that is delivered via contracts and the existing relationships with suppliers.

However, organisations that excel in contract management have two things in common:

1. They recognise the importance of the *administrative process* – preparing and authoring documents, getting sign off; storing the relevant documentation effectively; and harnessing the relevant contract metadata in procurement systems – and create a seamless administrative and management function that is integral to the overall procurement life cycle.

2. Contract management is an integral part of the procurement cycle, even when the day-to-day monitoring and supplier engagement is led by personnel outside the procurement department.

Viewing the contract management process through the prism of the sourcing cycle helps provide a focus and purpose to each of the building blocks of contract management. It also shows the extent and range of the contract management process, starting well before the contract is signed, and continuing up to the point that the contract is to be renewed.

Below, we explore the components of contract management, and identify some of the key considerations, tools available to support managers and frequently deployed techniques.

Good contract management starts with **sound planning for delivery**, and needs to be considered at the same time as developing the sourcing strategy. The skills and resources that will be needed to manage the contract should be identified, and involved in the process while the specification for work and draft contractual documentation is being drawn up.

**Authoring** and developing contracts generally requires expensive and time-consuming legal input depending on the complexity of the contract. The challenge is to develop a template that meets most of the business requirements, which is current and ensures the latest ‘essential’ clauses are utilised based on legislative requirements or lessons learned from previous contracts.
Software that can automate the contract drafting process by using standard contract clauses that can be ‘dragged and placed’ reduces the amount of legal input required, allowing legal teams to focus on the unique aspects of more complicated contracts.

Use of contract management software also makes the negotiation and approval process more streamlined, with the ability to allow users to review and approve contract changes via a routed workflow and use e-signatures to reduce the paper trail. This is an essential part of the administration process, which is further supported by software that stores contracts electronically to give organisations visibility and awareness as the contract moves into the monitoring phase.

Although the principles of the payment mechanisms need to be considered when developing the sourcing strategy and established in the contract, there is an opportunity to leverage the supplier’s knowledge post contract, and work together to develop the machinery and methodologies that will support monitoring during the life of the contract.

This includes developing sound performance measures that drive the desired service delivery levels and behaviours within the contract.

Regularly monitoring performance information and spend against budget or contract value are essential roles for any operational manager. Key parts of these tasks include:

- Setting up appropriate targets for the supplier
- Checking invoices against payment terms and service specifications
- Challenging variances between delivery and specification
- Reviewing risks and risk allocation to ensure the split is appropriate.

Monitoring service performance should be seen in light of the requirement to continuously develop the relationship with the supplier. It is good practice to engage with key suppliers frequently to not only review the contract, but gain their feedback on innovations in the market, service improvements that could be introduced and opportunities for additional value delivery.

This is part of a continuous programme of activity, and facilitates a regular review of the contract. This more formal process is an opportunity to consider any service credits or incentives that are due, the possibility of contract extensions or price reductions.

Using the feedback from contract monitoring and reviews helps inform future sourcing strategies. For example, it gives the organisation regular information about individual suppliers’ performance, and the effectiveness of the original sourcing strategy.
Contract management is inextricably linked to supplier relationship management. Supplier relationship management is about creating the right relationship with suppliers to ensure that both parties get the best value from the relationship, which equally forms the bulk of the contract management work post-award.

Building the relationship with the supplier can take many forms including formal and informal channels, such as those outlined below:

<table>
<thead>
<tr>
<th>Formal channels</th>
<th>Informal channels</th>
</tr>
</thead>
<tbody>
<tr>
<td>Progress / status updates</td>
<td>Communications through programme resources</td>
</tr>
<tr>
<td>Strategies implementation</td>
<td>Build feedback mechanisms to measure the effectiveness of communications process</td>
</tr>
<tr>
<td>Issues / concerns</td>
<td>Communications flow in multiple directions</td>
</tr>
</tbody>
</table>

Such a communication network can have many positive effects on the contract, from developing a mutual understanding of the drivers and delivery mechanisms deployed, to providing a method of escalation for issues before they become delivery failures. It also supports innovation within the contract by joint work to tackle emerging challenges.

The nature of the relationship you want with suppliers needs to be considered at the sourcing stage (to ensure that the right type of contract is put in place) and embedded into the contract management processes. The supplier continuum, below, provides a useful illustration of the range of relationships that you may have with suppliers, and how the level of integration and mutual understanding grows.

There is a focus, in both contract management and supplier management on the long-term, strategic contracts, and quite rightly as these tend to be responsible for the highest areas of spend and most business-critical services. But, as the continuum shows, there is a relationship in all contracts, and as such the connections and interactions with each supplier needs to form part of an overall approach to contract management.
Most organisations carry out some level of contract management, ranging from frequent “light-touch” reviews to an intensive, forensic examination of the core deliverables.

Often though, the effectiveness of the contract management arrangements vary across the organisation, with pockets of excellence being off-set by “un-owned” contracts that have no strategic or operational oversight.

Use the checklist below to see if there are opportunities for improving the contract management function within your organisation:

<table>
<thead>
<tr>
<th>Organisational Factors</th>
<th>Contract Specific Factors</th>
</tr>
</thead>
<tbody>
<tr>
<td>Is contract management considered at sourcing?</td>
<td>Are the terms and conditions of the contract (and their impact on operational activity) understood?</td>
</tr>
<tr>
<td>Yes</td>
<td>No</td>
</tr>
<tr>
<td>Is there a single, codified view of all contracts?</td>
<td>Are risks and contractual terms regularly reviewed to ensure they are appropriate for the organisation?</td>
</tr>
<tr>
<td>Yes</td>
<td>No</td>
</tr>
<tr>
<td>Are contracts stored electronically and easy to retrieve?</td>
<td>Are penalty clauses or incentivisation arrangements invoked?</td>
</tr>
<tr>
<td>Yes</td>
<td>No</td>
</tr>
<tr>
<td>Do all contracts have a named contract manager, who has the right knowledge and skills to manage the contract effectively?</td>
<td>Is service performance regularly reviewed? Is this done in partnership with the supplier?</td>
</tr>
<tr>
<td>Yes</td>
<td>No</td>
</tr>
<tr>
<td>Are there well-defined contract management processes that are followed across the organisation?</td>
<td>Is billing information and payment-related performance regularly reviewed, and are contract clauses adhered to?</td>
</tr>
<tr>
<td>Yes</td>
<td>No</td>
</tr>
<tr>
<td>Are contract management processes reflective of wider organisational operating procedures?</td>
<td>Are communications between the client and supplier effective? Do both parties achieve the outcomes they need to enable them to deliver?</td>
</tr>
<tr>
<td>Yes</td>
<td>No</td>
</tr>
<tr>
<td>Is there evidence of continuous improvement, either in service delivery or efficiencies and savings?</td>
<td></td>
</tr>
<tr>
<td>Yes</td>
<td>No</td>
</tr>
</tbody>
</table>

**1 Culture and tools are in place to manage contracts effectively**

**2 Enhancements at organisational level are needed to support contract management**

**3 Processes and working practices are in place to manage contracts effectively**

**4 Additional processes or resources are needed to evidence contract management**
There are a number of factors that combine to support organisations in implementing and using effective contract management techniques.

**Appropriate strategic oversight and governance arrangement**
Strategic contracts are best managed by a dedicated contract manager, with senior strategic oversight with ultimate accountability for ensuring value from the contract. Typically, a Procurement Board, consisting of operational leads, finance representatives and procurement leaders in the organisation can provide the framework for the management and escalation of contract issues and risks.

Setting individual contract managers targets relating to the development and delivery of the contract, in line with corporate objectives is also helpful. This provides a constant and consistent focus on resources to drive contract value, mitigate risks and increase compliance and understanding of the value of the contract.

**Having the right skills and capacity**
It is perhaps obvious that having access to contract managers with skills and experience suitable for each contract is essential. The role of a contract manager is multi-faceted and can cover a combination or elements of various roles and responsibilities from contract drafting in the planning phase through to ensuring an effective contract close out or renewal in the sustain phase. The key skills required will need to cover service delivery management, relationship management and contract administration.

There is a challenge in most organisations to identify the best place for contract management responsibilities to sit. Contract management requires both excellent commercial acumen, and a sound understanding of operational service delivery, and as such, responsibilities can be split between operational teams and the procurement function. Irrespective of who “owns” the contract, up-skilling the contract manager to provide both the understanding of the commercial deal, and the service delivery mechanisms is essential.

Critical success factors

The elements of success
Know the contract

Again, this is perhaps an obvious statement, but clearly one of the most important to your contract management teams and organisation. Supplier contracts cannot be managed effectively without having sight of up-to-date key information contained within the contract, or awareness that there is an agreed contract in place. For this reason, the contract manager needs access to legal support to develop an understanding of the commercial aspects of the deal and to be able to work with delivery personnel to gain knowledge of how the contract functions.

The adoption of contract management software across the business to act as a central repository will enable information to be shared amongst the disciplines that interact on any given contract. Current, comprehensive and accurate record keeping of dialogue between the parties to a contract with regard to changes and other communication associated with the contract and their storage is essential.

With the availability of information and level of automation provided from an integrated system, the contract management task can transition from a reactive to a more proactive process; with the generation of automatic reports that can enable the senior management within an organisation to understand and challenge performance across a range of contracts in their ownership via the governance process described above.

Standardise processes

Although each contract will need to be managed differently to derive the most value from the supplier and delivery mechanisms, developing a standardised methodology that can be adopted across the organisation delivers multiple benefits:

- They offer some assurance that the key elements of contract management are being adhered to by contract managers working, potentially, outside of the procurement function
- They facilitate a sharing of knowledge, and enable best practice to be shared across multiple contracts as processes are updated
- They support business continuity by enabling contract managers to support each other during natural peaks in workloads.

Standardised processes should reflect the variations in effort and intensity required by different contracts, and provides a reference point for non-commercial managers to use to support the contract management process.
In the current climate we are being asked to do more with less, so ensuring that your scarce resources are focussing and engaging at an appropriate level with regard to activity and frequency is key if you are to drive the value proposition beyond base expectations and unlock innovation, or achieve continuous improvement gains.

By using a supplier segmentation model, you can align suppliers and contracts to the overarching strategic needs of the organisation, and develop contracts and relationships that drive value. Segmentation also enables organisations to formulate appropriate contract management strategies for each part of the supply chain. Getting this step right will ensure that you spend time with the right suppliers, the ones who understand your business and the importance of creating value together. Equally, it means you do not waste precious resource on non value-adding activity. The typical supplier segmentation matrix below helps identify where to focus the effort in contract management:

There will inevitably be a small number of critical suppliers (tier one) for your business and clearly these require most attention, with senior strategic oversight, real investment in time to enable regular meetings and communication, the development of performance matrices and continuous improvement plans.

Tier two suppliers still require regular monitoring and interaction, with a focus on opportunities to introduce innovation that will not disrupt the business.

Areas of low spend are prime areas to be managed locally or outside of the strategic procurement function, freeing up capacity within the procurement team to focus on the key areas of spend or strategic importance.
Some of the typical levers available to organisations when managing contracts are listed below. There is a particular focus on delivering in-contract savings, but the levers should also be seen in the wider context of understanding the contract and building the relationship. Which levers will be the right ones to pull will depend on a number of factors, including:

- The complexity and risk to business of the contract – a contract that is delivering business-critical services should not be seen as completely “off limits” in relation to the levers identified below, but the approach may be different.
- The maturity of the contract – renegotiating a recently let contract can be challenging, and equally minimal benefit is gained from installing incentive arrangements if the contract is due for renewal.
- The scale and nature of the contract – introducing a complex payment mechanism in short-term arrangements will reap few rewards for either party while certain types of contract will lock both parties into particular behaviours.

### The levers

#### Benchmarking

Although benchmarking can be challenging for suppliers, and benchmarked data is not always readily available, it is an essential tool in procurement department’s armoury in ensuring the organisation is achieving value for money and the contract price remains competitive throughout the life of the engagement.

#### Incentivisation

Incentive schemes can encourage suppliers to over-perform against the original specification or minimum service. They can also be used to encourage continuous improvement, with stretch targets being put in place and reviewed annually. The focus when developing incentive schemes should be on getting more for the same (or less), rather than allowing suppliers to identify opportunities for increasing their revenue.

#### Service credits

Service credits, in comparison to incentive schemes, need to be included in the original contract, and performance against the terms rigorously monitored to identify any penalties or paybacks that are needed. Key for contract managers is to understand the contract and payment mechanisms, to ensure they can be used effectively.

#### Volume rebates

Many suppliers make provisions for volume rebates, and these can be introduced in-contract with the agreement of all parties. It is therefore particularly important for contract managers to monitor off-contract spend, and ensure internal compliance to increase the use of the correct procurement routes.

#### Supporting innovation

Suppliers often welcome the opportunity to test new business ideas in real life, and by becoming guinea pigs, organisations can gain substantial service improvements and efficiencies within the processes involved in delivering the contract at no extra cost.
Establishing contract management arrangements cannot take place in a vacuum, and most organisations will already have a series of processes and activities that support contract management.

As such, one of the first activities for any organisation when developing their approach to contract management is to review current practices and capabilities across the organisation. The diagram below shows a typical contract management audit process that can be used to highlight areas for focus:

This process allows organisations to understand the effectiveness of current arrangements. Once this understanding is in place, appropriate processes and tools can be developed that support the delivery of the organisation’s strategic goals through ongoing contract management.
Contract management is playing an increasingly important role in the procurement life cycle as organisations seek to reduce third party expenditure while maintaining service standards. At the same time, more and more business-critical processes and services are being delivered by third parties, increasing the importance of constantly monitoring not only performance, but exposure to risk.

The contract management process provides a framework for assurance and review, with each stage adding value to an organisation’s response to contracts. Clearly the framework should be tailored to suit individual organisations and contracts. Organisations should consider the potential value that could be derived from each contract, and flex the core components of the ongoing management process – the development of the supplier relationship and review frequency of the contract – to maximise the contract’s potential.

Acknowledging that contract management activity is already likely to be taking place, procurement professionals have a key role to play in harnessing that activity and developing the foundations to facilitate continual performance improvement and savings delivery throughout the life of a contract.
As the procurement solutions business in Capita, we offer expertise in transforming procurement services, driving innovation and efficiency, releasing working capital and realising cashable procurement savings in public sector and private sector organisations. We are actively engaged across all market sectors.

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- We have access to 200+ procurement professionals and 100+ commercial experts
- Access to a global shared service infrastructure
- Responsible for over £8 billion of live client sourcing projects
- Typical ROI Range 4:1 – 15:1

To discuss more about how contract management can add value to your organisation, contact Capita Procurement Solutions at procure@capita.co.uk or on 033 0024 9322.