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Contract Lifecycle Management

Prof. Douglas Kinnis Macbeth

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Douglas K Macbeth

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Contract Lifecycle Management
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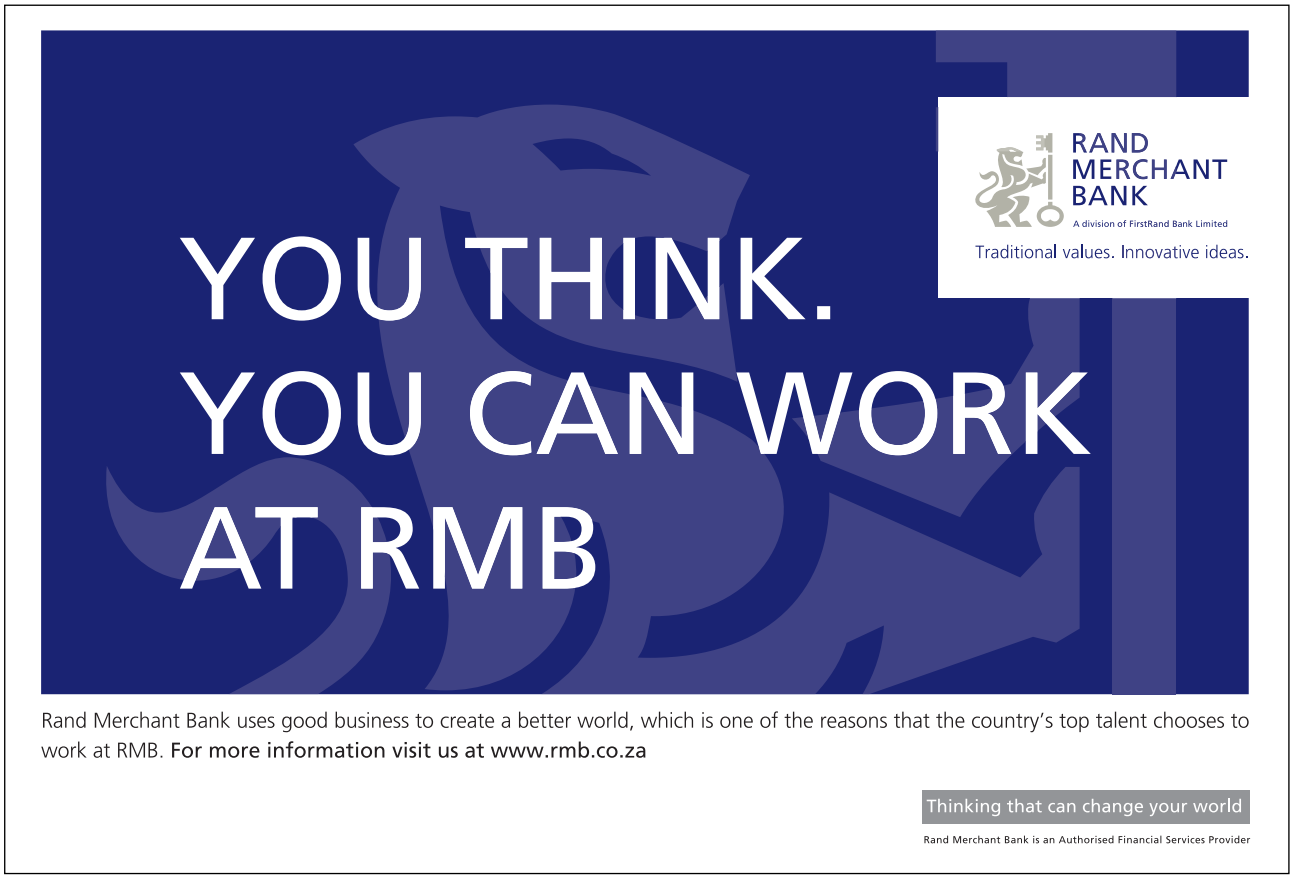

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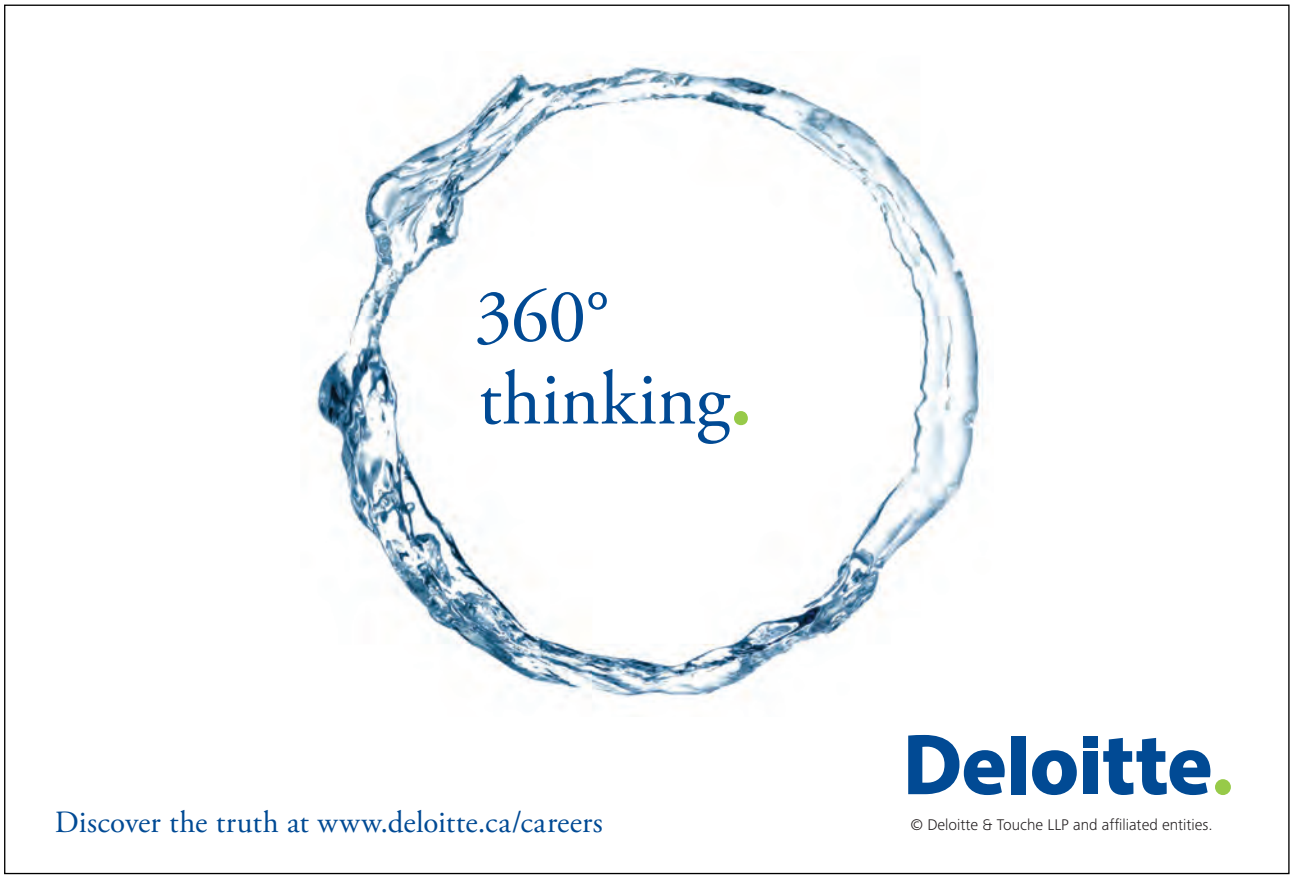

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Preface

Following an early career formation as a mechanical engineer in electricity generation and then as a production manager in consumer durable production and a variety of academic posts, initially in the UK and then internationally, I began (in the early 1980s) to research topics associated with operations management, Japanese management, customer supplier relationships and supply chain management.

The consulting company I created in 1990, SCMG Ltd, continues this work to this day but it was not really until David Barton of Royal Bank of Scotland Group Operations Contract Management commissioned the University of Southampton and SCMG Ltd to explore what best practice in Contract Management was in practice that the understanding built up over these years found a new and appropriate home.

We had been focusing on the possibilities of managing the customer supplier relationship as part of a sourcing strategy to select suppliers with whom the buyer could have a productive interaction but the work with David and his team demonstrated the gap in our approach (and in many businesses) which occurs if we do not properly connect the sourcing decisions with the contract management ones. Our customer supplier relationship understanding and models helped inform what good contract management practice was. This was supported by extensive desk and practical research with RBS to inform the development of a Contract Management Benchmarking process which has been completed by around 150 organisations to date. Two conferences have been held with representatives of many different organisations participating and case study materials are being generated to take our collective understanding forward to deliver better contract performance results in the organisations. Thanks are also due to David for permission to use the two diagrams in Section 5 Operate which section discusses the benchmarking process and provides links to the benchmarking survey. The interaction with RBS Group will continue to extend and develop and I believe that what David started will have a major impact.

This book has grown out of my reflections of this new understanding and builds on an increasing awareness that we need to manage our businesses in ways which recognize more explicitly and clearly the reality of complex sets of interactions between groups inside our companies as well as in the wider network of interacting and interdependent organisations outside our immediate boundaries.

Please see this publication as part of a wider work in progress and please consider joining us in this most exciting journey.

Douglas Macbeth
December 2012

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Introduction

Most businesses are to some (often very large degree) reliant on external resources to supply goods or services required as part of the overall offering to their customers. It is the payment from the final consumers, which allows the payment for these goods or services delivered from the upstream supply chain (where upstream suggests close to the source of the materials as in a river flowing down to the sea or in business terms the consumer marketplace). These resources are external to the company in focus and the business interactions of expectations and promises (on both sides), are subject to contracts, which although they can be verbal, are most often documented legal agreements.

Business with customers is also conducted through contracts in some form or another but on the supply side, which is the focus here, there are actually a number of processes involved both in the buying organization and in the supplier and there are mutually interacting processes as well. Time plays a part and delivery of the agreements and promises can justify the continuation or modification of a contractual agreement. These contracts can be extended, re-negotiated and further developed and of course contract termination is also possible for a variety of reasons.

Clearly the legalities of contract law, practice notifications and formalities are required and these can vary by the chosen legal jurisdictions finally settled on by the parties. However this book is not directed at these issues, rather we are interested in how businesses can obtain best performance and value from an agreed contract which at least delivers the minimum agreed requirements and ideally, improves on these as a mutually advantageous process.

Stages in the contract lifecycle.

We have seven stages in the overall lifecycle

1. Need identification and requirement specification
2. Make or Buy and if Buy then Sourcing strategy
3. Sourcing process and contract award
4. Initiation and Implementation into operation
5. Contract monitoring and improvement
6. Contract end game options
7. Contract de-brief and capture of lessons learnt

We will discuss each in turn.

For the purpose of brevity and to label each chapter the graphic below captures the sequence.

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Figure 1 Contract Lifecycle

Customers are the reason businesses exist. The marketing people have long claimed this and Peter Drucker captured this perfectly when he indicated that the purpose or core requirement of a business is to create a customer and in addition that business has only two functions – marketing and innovation, the first to meet the core requirement and the second to continue to delight the customer. These two concepts are at the heart of this book.

However as customer needs and wants and their supply expectations become ever more demanding and driven by quickly evolving markets and technologies, it is no longer possible for one organization, irrespective of its size, to be able to meet all of their customers' demands through the use of their own resources. In the days of Henry Ford and his Model 'T' car it was possible to own all of the factors of production from raw iron and rubber tree resources through every value adding stage in the process of designing, making, selling and delivering the product to an increasing volume of customers. Since then the products and services offered to customers have increased in complexity and often require leading edge technologies to be brought together to provide the 'solution' the customer requires. However as the technologies become more specialized and as they require more focused and expensive investments in research and development, then it naturally falls to those who wish to specialize in these areas to take the technology forward and offer their specialised services to a range of customers who integrate these into offers that the ultimate consumers wish to buy in the market place. Thus companies have moved from the Ford style of Vertically Integrated type of business model to one where the company which actually sells to the consumer may in fact do very little of the actual product or service work themselves and have moved to a more virtual model where they coordinate the work of others to satisfy the consumers. This is described as the Systems Integrator model.

The process of moving from producing internally to using an outside supplier is described as outsourcing and we will discuss this more in Process Stage 3 but one point to recognize here that there is often a mistaken belief that moving such activities from inside a company to another company as an outsourcing service provision contract places risk with the supplier where it is best able to be managed. The reality is that this is untrue. Outsourcing does not remove the business risk for the brand company doing the outsourcing, when problems occur. When a consumer complains they do so to the brand company not the distant supplier who they often do not know and cannot contact. Thus risk is NEVER outsourced. The activity might be outside the organization for some time but the risk to business continuity and reputation never moves and therefore the outsourcing contract has, if anything, to be more carefully managed than if the activity had stayed in-house.

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This is brought into focus in the process which in the UK public sector is described as Public Private Partnerships. This has been used by successive governments to build new schools, hospitals and prisons, for example, on the basis of awarding contracts to Design, Build and then Operate the facilities over say 30 years. This is seen as a way of taking the investments off the government's accounts and getting buildings built that would not have happened since there was not enough of the taxpayers' money able to be used because of shortage and competing priorities. In effect, the avoidance of the up front investments are mortgaged to the operating payments paid to the contracting company over the life of the contract. However, suppose the construction company building a much-needed hospital fails and the business cannot continue. There may be some recovery of the commercial risk if there is any money left after the liquidation but what about the fundamental risk to provision of hospital services? The patient need has not disappeared, it is still there and so the people running the hospital service are absolutely responsible for handling this risk and finding a solution to its occurrence.

To take a different set of examples, many well known brand companies in electronics sell products that they have done little to design or manufacture themselves. Look at the back of an iPhone and you will see alongside the Apple details, the words Designed by Apple in California Assembled in China. What is not stated and was not well known until 2011 was that the company doing the assembly in China was the massive company Foxconn. Why that came into public visibility were a series of worker suicides in the manufacturing plant and the subsequent investigations into, and resultant improvements to the employment and welfare conditions being experienced by the predominantly young men working there.

Many readers will recognise the marketing slogan of Intel inside but before this marketing masterstroke few buyers of PCs cared what the processor was that powered their computers. Intel have created a huge market share on the basis of making their part of the component supply chain visible and desired by the end users. Few other component companies have achieved this result. For example, how many of us know whose engines are powering the aircraft we fly in?

No one company can do everything to design and build a complete aircraft and so there are extensive and interlinked contracts between large and small companies to contribute their expertise, products and services to the integrated systems that we fly in. However when a Rolls-Royce aero engine exploded while powering a Quantas Airlines Airbus A 380 then suddenly the world looked carefully at what Rolls-Royce was doing to fix the engine and make sure others did not suffer the same fate. However Quantas had to deal with the passengers who suffered the in-flight trauma and the subsequent grounding of the rest of the fleet of six aircraft for safety checks to be made. The other airlines flying with these engines (80 engines in total) all had to have their engines checked with more passenger disruption.

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On another level we have the Macondo well disaster in the Gulf of Mexico where a combination of individually very low probability failure events happened in series causing an explosion that killed 11 people immediately, injured another 17 and polluted the Gulf of Mexico with 4.9 million barrels of oil at huge cost to wildlife, habitat and coastal commercial businesses. While the final outcomes are still emerging, the main players of BP who owned the drilling rights to the well; Transocean who were doing the drilling and responsible for the mechanical safety equipment to shut the well down after a blowout and Halliburton, who provided what is called 'Mud' used to seal the pipeline. BP blamed a complex and interlinked series of mechanical failures, human judgments, engineering design, operational implementation and team interfaces. The parties all had a special type of contract used in oil exploration and production which aims to avoid one party suing another for a failure and so each indemnifies the other that there will be no attempt to recover damages when a major incident or disaster occurs. This is intended to avoid taking all contractual disputes to the legal courts at enormous costs to all but the lawyers and fighting out the details of who caused what and what costs can be recovered. However the US government is also involved in determining the final financial settlement and who will pay. Some have put the final cost to BP at over $65 billion to settle all the claims and court cases and even then it is not clear if they will be allowed to operate in these waters again. Meanwhile assets sales are needed by BP to fund the potential liabilities.

These examples demonstrate a fundamentally important truth that supply chains are often invisible and irrelevant to consumers until something goes wrong. When this happens as with Apple or child labour with Nike some time ago or the recent case of supplier parts for Toyota braking systems, then consumers want to know more about these business interactions and how they were allowed to happen and especially what will be done to avoid the issues in the future. Effectively what is happening is that the reputation that the brand may have built up over many years for high product quality and safety is put at risk. The damage to the brand reputation causes expensive remedial action to solve the problem but more importantly to recover the new perception that the brand owners did not consider their customers' values and expectations properly when they engaged and contracted with the suppliers they chose or failed to manage the suppliers' performance according to the contract requirements.

Thus the contracting process lies at the heart of all that business is about. Who the contract is with and how they perform might determine success or failure in the eyes of the business customers next along the supply chain and in the worst case scenario, impact the final consumers and attract the attention of the world's media.

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However there are a number of parts of the organization which have an interest in the contract and this needs to be recognized and managed properly for there is a great tendency in many organisations for a process of sub-optimisation to take place. This is an effect where a sub-set of the organisation maximises its performance but at some cost to another part of the business or indeed to the objectives of the business as a whole. This highlights the split between being efficient locally but being ineffective at the overall system level.

Businesses need to see the 'big picture' and make sure that sub-optimisation is not allowed to happen but often this also requires the performance measurement process to change from local to big picture measures for it is a truism that people 'perform according to how they are measured' or perhaps 'actions follow the bonus criteria'.

Contract Management has suffered historically from this silo effect where the Purchasing or Procurement activity or function sets up the contract and then 'throws it over the silo wall' to the people who are now tasked with making the contract live up to the promises made when the contract was negotiated and agreed. This separation into the silos is the threat that this book seeks to address and to suggest alternative ways to realise the opportunities offered by gaining control and advancing best practice ways to both manage at the system level and deliver real and improving business benefits.

Contract Management is about seeing and managing the big business picture over the whole of the contract lifecycle.

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1 Need Identification and Requirement Specification

Contracts are created because someone in the organization has recognized that the ultimate customer has some realized want or need, (or can be persuaded through a marketing activity that they will have a want or need), for the goods or services that we intend to produce. Thus there is always a customer or final consumer for all sourcing and delivery situations.

However there is fundamental issue in that often customers do not know they want something until the reality is put in front of them. That is to say, they do not always have the vision of what might be possible that a technical expert may have. In the innovation world this is the difference between market pull and technology push.

Market pull is incremental where the customer says in effect 'I want the same only better'. For the supplier this is a low risk option since there is no great technological leap to create and the likelihood is that if the customer needs and wants have been properly understood and somehow realized then the customer is likely to buy.

Technology Push comes from bright ideas from people who know how a particular technology can be made to take a step change and create a whole new product or category unimagined by the customer. This however is high risk since it is always possible to move more quickly than the customer is ready for. However when this works whole new markets can be created and the world can be changed. Which customers for example demanded that there be a product to deliver music to anyone anywhere as a personal and easily transportable sound system until Sony produced the Walkman. The technical experts inside Sony and the business managers responsible for the investment decisions believed that if they produced the product the market would be created from nothing and so it proved. Since then of course we have had Apple who not only designed and delivered the capability to play music on their iPod and later their mobile phone, they also created the complete music delivery system through the iTunes downloading store. Both product and delivery system were needed to make the concept work but here again the experts had the vision that few if any customers could have articulated.

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The key message here is that whichever innovative path started this process, someone on the supply side has to decide that the direction is both technically possible and commercially attractive (given some business assumptions about potential income and expenditure), so that the general requirement can be translated into a firm statement of intent.

This can be a highly creative process in some senses but can also be about the hard slog of transferring a 'vision' into the reality. Edison said 'Genius is 1% inspiration and 99% perspiration' so this aspect cannot be regarded as in any way automatic or simple. It is often also a recursive path. Edison again reckoned to have invented and tested 3,000 different theories and numerous materials before setting on the final filament in his electric bulb. Such processes are expensive in time and personal effort so anything to make it more effective is to be welcomed.

Thus we need to move into detailed design to translate the basic concept into a complete specification of what the desired outcomes should look like and how overall performance will be achieved as well as detailed decisions as to the detail of materials, production methods, performance and quality standards to be met to translate concept into market reality.

All of these decisions require trade-offs decisions however and therein lie more issues to recognize. The idea of a trade off is that often by deciding to do one thing well it can require that some associated issue has to be done at less than optimum levels. In other words, excellent A implies less than excellent B. An example might be weight of a battery in a laptop computer that can be related to the life of the battery charge so that reducing weight might suggest a shorter battery life. If this relation is true we would need to revisit the original specification to see what the customer would be ready to accept, before we can sensibly make the decision. The need to do this re-cycling of decisions is both expensive in resources (especially time) and also dangerous in movement of specification. This becomes an even bigger issue if contract discussions are already underway (or worse have already been agreed) based on the previous understanding of requirements.

The design process is a fundamentally important stage since it is here that both performance and cost is established. In effect the designer is defining what others have to do and what they have to spend to do it. However often it is difficult to have enough information readily to hand for the designer to do this evaluation on their own. Ideally a cross organizational set of information tools and their human input information providers would work in harmony to evaluate each change in requirement from the customer end and evaluate the decision impact across internal and external supply chains so that a final decision can in some way be 'optimised'. This is a non-trivial task and too often the different functional groups do their bits largely independently and someone then has to try to bring it altogether as a project later. The dangers are obvious but think again of the poor supplier who has been given information on which their plans have been built and which potentially now have to be radically changed in a short space of time.

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The scope of consideration is also extending as we begin to talk of re-cycling, cradle to grave or whole life costs and the minimizing of ecological impact so that as the Brundtland Report put it:

'*Sustainable development is development that meets the needs of the present without compromising the ability of future generations to meet their own needs. It contains within it two key concepts:*

- *the concept of* ***needs****, in particular the essential needs of the world's poor, to which overriding priority should be given; and*
- *the idea of* ***limitations*** *imposed by the state of technology and social organization on the environment's ability to meet present and future needs.'*

The world's poor have particular and important needs but more affluent customers are also beginning to press for this kind of thinking to be applied to their purchases and the sources used to provide them.

The significance of this extended timeline and scope of decision making is that the requirement might change over the time considered and so we need to think both about the product and service over the lifecycle but also the methods and sources used at each stage as well. Is it likely that one supply contract with one supplier will be enough to cover all of the variation needed? If not, we have just complicated the contract management challenges greatly.

There is also an added dimension which results from the decisions made in the next process stage on whether the item is going to be produced or delivered by staff employed by the design authority or whether this capability is to be sourced and obtained through market transactions and performed by others.

If the internal option is decided then full details about everything will be required whereas if a supplier if going to provide this, the details can shift towards definitions of what are required in performance terms and the supplier can be left to decide the details of how this is to be achieved. Whoever the person is and where they are located, someone is still required to define the details of what has to be done, how, using what resources and measured in what way.

A further set of considerations relates less to the formal specification of the item or service and more to do with the expectations of how the goods or items are to be delivered. In effect the users of the contract goods or services also have to specify the details of the delivery process in terms of a number of dimensions which can include timing, location, response times for problems and possibly also to include the expectations in terms of continuous improvement in innovation and cost reductions over the life of the contract. The specification therefore needs to include a definition of the required Service Level Agreement (SLA). Such a specification should also define how performance is to be measured and reported and define who is required to provide, analyse and report on the performance levels along with statements of implications, remedies and processes to recover from any failures.

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2 Making or Doing Internally or going to the Market

Markets are old institutions having evolved from the initial bartering approaches of farmers making a surplus that they could then exchange for other commodities. The market is where the evaluation of choices and the checking of quality and of course crucially, the negotiation of transfer values (prices offered and accepted), can take place. Markets can also be efficient if there are enough suppliers, customers and trustworthy and available information to use in the decision process. These are the essential assumptions of the classical economics approach that sees markets as the most efficient mechanism through which to enact trade. Markets are the stereotype single transaction focused approach, unless of course both customers and sellers return frequently to the same marketplace in which case reputational issues also become important. Even in competitive markets both sides tend to have a concern that the deal might not have been as good as it could have been. However in repeating transactions the opportunity to profit maximize on the one transaction is replaced by the realisation that a steady and more guaranteed income over an extended number of transactions is often a more sustainable business model. We trade possible short term gains if we 'win' over the other party for a possibly reduced but repeating gain over time in which both parties win something of value to both. The so called 'win-win' outcome.

Markets also stimulate competition between providers of the same commodity and so drive innovation and value, if they work as they should. For these reasons classical economics looks to markets as the most efficient form of business trade but the assumptions needed to enable good results are actually quite restrictive and not universally applicable for repeat, business to business transactions.

Inherent in the view of the market as a hostile 'dog eats dog' and 'winner takes all' environment, is that one cannot afford to trust the other party since they are absolutely out to get what they can without regard to how that might damage one's own interests. All business requires certain minimal levels of trust to function but in the market the communication of information (which might otherwise engender trust) is deliberately restricted as a form of weakness which might be taken advantage of by the aggressor counterparty.

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Thus transactions in the market place have recognized, if not always realized, threats. These include not actually owning the items being transferred or not being financially sound so that commitments entered into cannot be followed through. Of great concern when trading with unknown companies and in unknown territories, is whether the Intellectual Property (IP), about which discussions are taking place, might be stolen and used against the IP owner's interests. It is an often repeated anecdote that suppliers in some parts of the world can be working on the day shift for a foreign customer and on the night shift producing the same products, to the same quality standards and labeling, for the black market. Of course this is both a breach of contract and illegal but these terms mean nothing if the rule of law cannot or will not be enforced.

In these circumstances of concern should a customer company work in such a market place? When these threats are seen to be too high then the tendency is not to use the market but to produce the items using one's own facilities and work people. This is to avoid the BUY option in favour of the MAKE option. Of course if we are talking about services rather than products we can change the MAKE to DO it themselves.

In the MAKE or DO choice all of the activities and responsibilities stay in house and all assets are owned by the focal party.

In effect this decision between BUY and MAKE defines the boundaries of the firm/company or organization and it was this concern which drove the early work by Coase and then Williamson which came to be called Transactional Cost and Economics. Originally there were two extreme choices in this approach, either: inside the firm boundaries (vertical integration, bureaucracy or hierarchy) or outside in the market. In recent times we have begun to realize that there is a middle ground where the cooperation between buyers and sellers can allow for some of the coordination benefits of the internal solution to be realised without owning the other parties' resources, which also means that the using party avoids the investment needed to replicate the other party's resources.

Another key assumption in this approach, referred to earlier, is that the other party will do anything to take advantage of any weakness and therefore it is sensible to use resources to protect from actual or perceived potential attacks. Protection of this kind requires the use of resources to create early warning systems, protective barriers and sometimes first strike capabilities. If this language sounds warlike that is precisely the mindset of those who think this way. The cost of these transactional activities help to decide whether they are so great that it makes more sense to avoid them by not choosing the market option at all.

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One concept that was developed in this theory that still has relevance is the idea of asset specificity. The example could be where a buyer asks a supplier to invest in a special piece of equipment for which only that buyer has a need. This asset becomes specific to that buyer/supplier relationship. The benefit to the customer is guaranteed supply while for the supplier there is a guaranteed sale to that customer. In effect both sides are locked-in to this relationship and are saving money and concern. However by locking in in this way they are deliberately not able to take advantage of alternative opportunities which might arise in the future. They are trading off security for flexibility. By not investing in capacity the buyer also gains the flexibility to cancel the contract and move to a new relationship without the capital cost of the equipment. The supplier of course has to factor this into their considerations of whether the lock-in is economically beneficial.

The Make or Buy decision is also influenced by the organisation's view of their strategic direction especially in terms of the fundamental logic of how they intend to enable growth. At one extreme is a market or opportunity driven approach which says that if there is a demand we can invest in the resources to satisfy that demand. The opposite extreme says that the resources we already have and use effectively can be built on to move into new markets. The Resource Based Theory recognizes perhaps more realistically than the opportunity driven one how much capability in particular is in existing people and their skills which have created the conditions for success already and that to ignore that to start all over is an inherent risk. However that is precisely what entrepreneurs do in building businesses from nothing. They recognize an opportunity and built capability to satisfy that opportunity. As in many other areas of management there are no correct answers but perhaps ones that seem to apply better in certain conditions at certain stages of a life-cycle.

It does raise the issue of what the essence of a business is in terms of its core capability or competitive advantage. This helps focus the dual questions of what is it that we do and how do we compete with the corollary question, what is it that we do not do. Often asking the second question helps clarify the answer to the first of course. Core capability or competitive advantage addresses the issues around how we win orders from customers and what we have to do to be in the list of sources to be considered. In addition, we also need to know how we can protect any advantages we identify and for how long. Anything that we do to positively differentiate our business from our competitors and which they cannot easy copy and replicate in supply is our competitive advantage and is core to our future success. The further logic is that all competitive advantage activities should always answer the question with a MAKE or DO response and all others could be bought in the market as a BUY option.

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What must be realized in this discussion is that customers do not care about such choices. They buy a package of goods and services as a bundle in which all aspects are equally important and customers often do not know or care who made which part where in the world as long as their performance expectations are satisfied. It is only when things go wrong that customers begin to worry about supply chain issues as we discussed earlier. The key message here is that regardless of which company is actually doing the activity the brand company dealing with the final customer has to manage all of the outcomes of the activities and coordinate the offer to the customers. We talked before of the inability to transfer risk to the contracted suppliers, now we are emphasising that we cannot transfer the responsibility to manage these activities even if the reality is that this is done less at an operational level of detail and more in a monitoring and oversight way.

For the Buy option there is very likely a formal contract in place and therefore the need to manage all aspects of that contract but even if the MAKE option is taken and there is no formal contract between parts of the same organization nevertheless there is still the need to coordinate the activities of the internal suppliers. In that sense therefore the activities of contract management apply internally as well as with external suppliers. If we are seeing here that contract management of external suppliers often fails to deliver against the promises there is an interesting question relating to who will internal supply situations are managed. One's suspicions are that there will be less detailed oversight in these situations but this perhaps is another research agenda to be investigated.

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The boundary of the firm established by the make/buy decision is however somewhat permeable over time and activities can move across it as the evaluations of threat and opportunities change with market and economy developments.

Thus activities once done in house under a make decision can be reappraised and seen to be longer core to competitive advantage and moved outside the boundary as an out-source. Some times this is done moving the assets and people no longer seen as core, (but still required for the customer product/service bundle) to an outside provider for whom this set of activities is core to their business model. In this way the activity can be developed and the people offered better growth and career prospects than would be the case if they had stayed in the back-water of their position in the outsourcing company. In the UK, employment terms and conditions are protected for a period of time under the Transfer of Undertakings (Protection of Employment) (TUPE) legislation. However since there is often a perceived cost reduction for the outsourcer in this process (especially if the transfer is from the public sector to the private one where retirement pension benefits are often less attractive to staff), the pressure will be on inside the new organization to reduce the salaries and conditions for transferred staff over a relatively short timescale.

In some cases the outsourcing to an external company is across some territorial boundary (not exclusively over a sea boundary) and in this case it is referred to as off-shoring. However a company can also decide to transfer some of its activities off-shore without losing ownership of the assets but often this is because the employment terms and conditions in the new location are much cheaper than in the original location.

In many case the off-shoring is driven by the real reduction in labour costs in the new geography but this is a transient benefit as wage inflation in such countries soon erodes the cost reduction possibility, to be replaced by a shortage of skilled staff as other outsource service providers recruit from the same pool of labour which also tends to inflate the costs of wages. It is also worth noting the proportion of total costs represented by labour costs. In many manufacturing products for example materials costs are much more significant than labour ones.

A geographically dispersed supply chain raises other issues of capability, distance and time to react to changes along with language and cultural difference and there might also be concerns about the protection of IP as discussed earlier or even of political stability and infrastructure development to match the growth of the economy. For all sorts of reasons what seemed like a good decision to outsource and/or off-shore can be later evaluated as not fit for the current demands and the decision might be to try and reverse the process. This is not always easy as the skills to understand how that activity has developed and to be able to bring it back home as it were, might no longer be inside the company. This is even more concerning if technological or other developments have ensured that activities seen in the past to be non core are now realised to be part of a competitive advantage issue but cannot be repatriated easily.

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A utility company we worked with had taken the view that it would be better for them to concentrate on sourcing and supplying energy rather than worry about keeping up to date with the rapidly changing Information Technology world. They therefore contracted for a ten year service support arrangement with an IT service provider, TUPE'd their staff across to the other company and thought they had been very clever. In the space of a few years they realized that what they had not understood was that a core capability for a utility company is being able to offer effective and innovative billing arrangements to their customers which were highly dependent on how the IT world was developing but they were no longer in control of IT developments since they had contracted with the service provider in a rather static and unimaginative way. In the end they had to re-negotiate the contract with the outside provider and began to recruit their own IT specialists to build the new billing systems.

Outsourcing also raises fundamental issues of control and influence. In theory if all activities are done in house (vertically integrated) then all groups are pulling in the same direction. Once the activity has been outsourced then the company is only one customer in very many and might have to wait in the queue for the service to be provided. Their proportion of the service provider's turnover may not be very significant and so they can lose influence over them. This is a demonstration of the Agency Theory effect. By outsourcing to a third party the company (the Principal) hopes that the third party will act in all ways as their Agent. That is, they are expected to react as an agent for their principal and reflect the same choices as the principal would make but in the outsourcing case the third party has a number of principals to act as agent to and so conflict, even if it is not inevitable, cannot be assumed not to occur some of the time.

Here again we have the rationale that if an activity is really important to the firm's future they cannot simply expect another party to see it as important as they would themselves. So if there is no possibility of doing it themselves they better pay very close attention to how the contract is being managed so that the agent is aligned as far as possible with the interests of the principal.

Another reason to consider outsourcing is to avoid decisions in the short term when the future is not so clear. This would often be the case with new product introductions especially ones at the leading edge of unproven technologies. By outsourcing the production of new items, the focal company avoids the investment decisions which may be difficult to reverse. They therefore can wait until trends become clearer in the marketplace and dominant solutions become evident and volumes begin to grow. In effect the focal company is taking a series of options on the future and hedging its bets. One concern in this scenario is that by failing to make a commitment to a particular supply chain it may be the case that when this decision is finally made the relationship is no longer one where a focal company can be the most important customer. It might be that this particular supplier's preferred customers have made formal commitments to this now crucial supplier so that our focal company is not in a position to exert the influence it now wishes to.

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Another situation where supply chains are important and the outsourcing option is more sensible is when the global market demand is so great that any incremental process to increase the production rate would require investments that would be very difficult to obtain or justify. The rate of change in many marketplaces and the nature of global competition suggest that the traditional approach of step-by-step expansion and internationalisation over many years is simply not feasible. In innovation terms demonstrating to the world that something is possible often means that others can copy the solution in some fashion, so in order to stay ahead of the chasing pack it is often necessary to be a Born Global organisation. This means seeing the global marketplace as one opportunity and a global supply chain solution as the means to satisfy that opportunity. This seems to be the case in some parts of the pharmaceutical industry where if a blockbuster drug can be invented and developed then the market will be global and the opportunities need to be grasped at the global level before copycat products can compete in that demand space.

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However the old model of internationalisation by careful expansion had the merit of only moving limited distances across the geography of a market space. Often this meant that the understanding and perhaps cultural heritage of the new market was perhaps not so different from that in which the expanding company was first established. However this is clearly not the case if the company is aiming to be global from the beginning. Then cultural differences, business regulations, different attitudes to work and often to gender equality, impact the kinds of opportunities that can be easily obtained. As the business world becomes populated with more multinational companies we move from a concern about ownership nationality to worries about how these incredibly powerful companies treat their local environment, employees and suppliers and increasingly wonder where they pay corporation tax if indeed they pay any tax at all, for it is very easy for such companies to move money around the world so that their overall tax bill can be minimised. This can be legal in principle but may be seen as unacceptable to the countries and their governments in which profits are made but in which no tax is paid. Of course corporation tax is not the only contribution that some companies make to the host country. By employing people, buying products and services and supporting infrastructure developments and educational programs such companies make direct contributions through their employees taxation as well as by the local spend.

In many cases the most important contribution (sometimes demanded by the local government) is the transfer of knowledge to the local community. For the incoming company however there is a threat to their future competitiveness since by allowing such transfers to take place they can be creating the conditions for a competitor company to grow and challenge them in the global marketplace. This process is reinforced and accelerated by the practice in many government procurement agreements that when a purchase decision is made for major pieces of equipment there is an expectation and requirement to offset the outward flow of capital by a decision to source goods or services locally in an agreed proportion of the outward flow. Unless the inward investor agrees to these conditions then the contract cannot be awarded and the sale is lost. The inward investor is therefore faced with a difficult decision particularly since often these arrangements are used by emerging economies are these are attractive for their growth prospects and the potential markets are very large and commercially attractive. Such companies therefore try and spend on low technology issues to protect their IP and competitive advantage. However over time such things cannot be protected and global companies are always running the risk of creating their own competitors.

In summary then we can see that the make or buy decision is fundamental to the near-term and long-term strategic direction. It is seldom a simple choice of relative cost to produce internally or source from the marketplace. It does require, a well-developed strategic vision, not only of the focal company's possible future actions but also an insight into what others in the competitive environment might also do. This decision therefore needs as much good information and detailed analysis as the organisation can bring to bear. It argues for a much more integrated view of the choices available than would be normally possible in any single function like procurement. This again argues for a more integrated and cohesive approach to contract management and a strategic approach to the sourcing decision if the buy option is the one chosen.

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3 Sourcing / Selecting the Supplier and Contract Award

This stage is best divided into three parts Plan, Source and Award.

PLAN

We have reached this stage with full specifications approved and the fundamental decision to buy from the market place, but the pre-contract work is not yet completed.

As is normal with all expenditure, we should create a business case to justify the expenditure. It might be that this has been done before the specification stage but not necessarily, so it can be completed here. Such a business case will define how the expenditure will contribute to an agreed strategic direction and will also argue for and eventually obtain approval of a budget to cover the expenditure. Business cases can be to reduce operational cost, support strategic developments in new products or services or add more value in current contracts. However to inform the sourcing strategy we also need to evaluate the criticality of the contract in terms of the implications and impact of any complete failure of supply or less than agreed performance outcomes against the service level agreement (SLA) discussed in Process Stage 1: Need Identification and Specification.

This planning stage also needs to facilitate agreement on the relative importance of all of the specification metrics and their relative weighting in the selection decision. This needs both to be agreed and well documented as it will be required to make the weightings clear to any potential bidder for the work referred to in the contract documents (to be discussed shortly) so that they can make an informed choice about whether to bid and at what value. The concepts of order qualifiers and order winners hinted at earlier is also relevant here since the order qualifiers are required to allow for the removal of bidders as being not competent as possible candidates and who should not be in the consideration list. Order qualifiers include trading history, experience in the commodity in question, capability and capacity indicators, quality and or standards approvals achieved; experience in the appropriate sectors and services probably with case study references available and underpinned by indicators of trading history and financial stability. These criteria can be used to perform due diligence investigations on potential suppliers and can form the basis of a pre-qualification questionnaire (PQQ). Order winners by definition should be weighted higher than the qualifiers in the evaluation process since this is what differentiates them from the rest of the bidders and will allow for the rational choice of them as best able to meet requirements.

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For private sector organisations there are large measures of freedom about the processes involved in sourcing and selecting suppliers. In Europe for public sector organisations, including government agencies and major utilities, the EU procurement directives will apply. The essence of these directives is to create equal opportunities for all suppliers regardless of origin around the world to allow them to bid for and win contracts across all of the nations of the European union. To facilitate this process information must be provided about impending contract opportunities and offer the opportunity to register interest and potentially bid against contract documents to be provided. The logic of this process is to provide clear and unambiguous requirement specifications, qualifying criteria (including the possible use of a PQQ) along with information about weighting factors and submission processes to all potential bidders and to share information in a transparent fashion across the whole supplier community who have registered an interest. This includes the interesting case where the answer to an enquiry from any supplier has to be provided along with the original question, to all other suppliers. In this way the informational requirements of a pure market are maintained. For suppliers this means that they have to be very careful when asking questions in case some unique solution idea that they have is exposed to their competitors.

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While many regard these directives as excessively bureaucratic they do offer some best practice messages which include: the need to plan carefully and define precisely the agreed specifications and service level agreement requirements; weighting and scoring factors used in the award decision; communication processes; delivery and timing requirements; and information about the winning bid and the possibility of informational feedback to the unsuccessful bidders. Even without the legal requirement to comply with EU directives many organisations essentially follow the same procedures. However the big difference is that even after the winning bid is selected and communicated there is, under the EU regulations, the possibility of a challenge to the overall process by the unsuccessful bidders. This was demonstrated in 2012 in the UK government's procurement process to decide who would be given the franchise to run the major west coast rail link from London to Scotland. A new bidder was awarded the contract however the incumbent operator Virgin Rail challenged the evaluation process and, following an investigation, the challenge was essentially upheld and the contract award was cancelled. Virgin are now expected to run the franchise for another 24 months while another competition is organised. In the meantime the cost to the UK taxpayer has been estimated to be at least £40 million to compensate the bidders for the failed process and some estimates to include the disruption of other award processes put the costs above £100 million.

The EU directives are also useful in highlighting possible sourcing strategies. There are three main categories. These are *open* where the contract opportunity is widely publicised and all potential suppliers are free to apply. This means that evaluation of bids can be a very difficult and lengthy process. However if all we need is the lowest cost supply of a standard commodity this can make some sense but not if the workload to perform the valuation is too great, by having so many to choose from, in comparison to the cost reductions. When the items or services to be sourced are more complicated or the capability of the supplier is critical then a 2 stage process is indicated which is called *restricted*. The first of these stages is usually the completion of the PQQ and this is used, as indicated earlier, to remove those potential suppliers who really do not meet the qualifying conditions. At the end of the 1st stage successful bidders are invited through an invitation to tender (ITT) on which the bid will be evaluated and an award decided. In some cases a supplier presentation of their ideas can be used either before or after the final award decision. Some argue that the difficulty of evaluating such presentations in a truly objective way suggests that presentations should be used to confirm a decision rather than help make it. The 3rd strategy is described as *competitive dialogue*. This suits situations where the buyer is not completely clear or competent to define appropriate requirements and specifications. They therefore engage with selected suppliers and work with them to define the specifications. They should of course make clear from the beginning whether being part of the dialogue provides any form of guarantee of further work or whether there will be a competitive bidding process once such specifications are clarified. Again the reality is that if the supplier is being consulted without any guarantee of a return on their investment then they may not be as completely open in offering their expertise and may be the case otherwise. Most reasonably complicated procurement processes will probably take the two-stage form.

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Risk is a fundamental consideration in all business activities but is especially important for the buy decision. Risk takes many forms from natural disasters through those created by people making mistakes or deliberately for reasons of criminal activities or through political motivation. However the whole range of business-related mistakes or misfortunes and sometimes the deliberate or unanticipated consequences of political decisions have impacts on supply chains across the globe. Supply chain risk is increasingly of concern given the practice over many years of reducing inventories and implementing aspects of just-in-time delivery. The whole concept of just-in-time is a trade-off of reducing inventory while increasing delivery frequency and is inherently creating a more fragile system so that any interruptions can have widespread impacts in a very short space of time. Here again we have a situation where decisions made in one part of the business for often good reasons creates potential problems for another part of the business but too often these interactions are not recognised or acted upon. Thus in contract management terms evaluation is required to identify potential risks of interruption in the supply chain passing through a particular supplier. This last sentence emphasises the fact that the immediate supplier may not be the source of the problem which lies upstream of them in the overall flow. For projects with multiple separate sub contract agreements the risk has to be considered at both the project and the individual contract levels. Of course identifying risks, which by their very nature are uncertain and often difficult to quantify, is only the beginning of the challenge. The risk management processes therefore should consider whether it is possible to avoid the risks completely or to live with a probability of their occurrence and then plan actions which would mitigate or reduce their potential impact. Some of these considerations can be built into the contract agreement, especially those aspects which might provide forewarning of critical incidents becoming more likely. However other mitigations may be required as a result of contract failure and these need to be planned and actioned in a timely fashion but will always incur additional time and cost penalties for which financial recovery strategies might be applied as part of the contract agreement, for the supplier who created the problem. This is not always feasible of course especially for the supplier whose business fails during the contract award period. Once all of the buyer organisation members are as comfortable as they can be with the risk estimations we can move to the activities associated with finding an acceptable source of the goods or services.

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SOURCE

We previously discussed sourcing strategies but we must also recognise that many businesses have already dealt with a many suppliers, a number of whom will have proved to be very satisfactory historically. They may already have been found to be effective partners in previous contracts and so the new contract opportunity might in some circumstances almost be awarded without too much new work being done. The danger is that this might miss the opportunity to find a new supplier whose capability and value contribution is potentially greater than the incumbent. Many organisations therefore choose to open up the opportunity to new suppliers. In the public sector this will be a requirement under the EU procurement rules. Two considerations must be borne in mind at this point. The first relates to the incumbent supplier who might see a threat to their continuing involvement with the buyer organisation and this needs to be managed carefully, especially if that supplier has other contracts in operation with the buyer organisation. There are always costs involved in a decision to change suppliers for existing operations and these switching costs are often substantial in reality but difficult to fully quantify in practice. In that sense therefore any new supplier has to provide a significant cost benefit to the buyer to more than recover the switching costs. Any potential new supplier must be properly evaluated so that the comparisons with others can be fully justified and explained both internally and potentially to unsuccessful bidders. The pre-qualifying questionnaire process discussed earlier tries to do this and performs a due diligence process for commercial soundness along with attempts to quantify supplier capability and experience. The intention at the end of this exercise is to get to a point where choices based on cost or value can be made in the belief that all other considerations are equivalent.

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In situations where one supplier is to be replaced by another, the planning of the switching process is an important consideration and in anticipation of this clauses in the contract may be used to try as best as possible to ensure that the transfer can take place without impact on the downstream customers. Even with such clauses in place it can be a challenge to enforce them as the supplier being replaced has little remaining commitment to the buyer or the contract.

We have previously discussed some of the issues around contract award but we also need to be clear on what are the overall objectives and criteria. In some cases the lowest delivered cost will be sufficient and this may be appropriate to reverse auction processes for example where a process of visible but not identified bids have the effect of steady reducing the prices until no more movement is achieved. An alternative approach is to award on the basis of the most economically advantageous tender (EMAT) as used in the EU procurement processes. This is the outcome of the weighted criteria discussed before. This recognises that factors other than price are important to the buyer.

With careful drafting of the contract bid documents this can allow for local benefit aspects to be included even for public sector work. Local benefit impacts can be achieved by suppliers who are not necessarily local but commit to delivering these local benefits as part of accepting a contract which might be related to recruitment of local labour or purchase of resources or support to infrastructure developments. In this way there is no discrimination against any supplier regardless of their home base but an evaluation of their commitment and management processes to deliver the local benefit. Other aspects to be evaluated will be the supplier's willingness to agree to performance monitoring metrics and communication processes along with rectification and dispute resolution processes.

Once all of the communication processes around the final tender submission, tender evaluation and contract award decision have been made internally then communications to successful and unsuccessful bidders should be done as soon as possible. Whether or not there is a compulsory standstill or cooling off period after the contract award date, best practice still suggests the need to offer debriefing information to the unsuccessful bidders. For this to be a robust process communications and decision logs will provide an audit trail to manage and inform the feedback process and protect against any legal challenges from unsuccessful bidders. Dealing professionally and considerately with unsuccessful bidders offers them the opportunity to learn how to make a better bid next time and can enhance the reputation of the buyer organisation as being competent and fair.

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4 Implementing the Contract Award

Once all of the contract award details have been communicated to winners and losers we then have to make plans to implement the contract award and the initial focus is internal. Different organisations take different views about where best to locate contract management in the overall organisational structure. Given that procurement/purchasing have been involved at the early stages and leading up to contract award, many organisations will choose to locate contract management activities inside the procurement function. However there are different dynamics at work in finding a good source and assuring best value at bid evaluation to actually operating the contract details on a day-to-day basis. This recognises another agency problem in that the procurement function is acting as an expert agent for some other user who needs the contract outcomes to support their activities and deliver service to their customers. The skills needed to source and select suppliers are not usually the skills needed to manage the delivery of the service provided and so the danger is that once the contract is awarded or let it is "thrown over the wall" to the operational function and procurement moves to the next challenging sourcing situation. This attitude is often described as "let and forget". If however, this contract eventually needs to be replaced or renewed then purchasing will need to be involved again and the new sourcing decision should be informed by data about how the current contract was delivered and whether contract requirements were the best they could have been, were achieved or indeed exceeded. It makes sense therefore for that there be some dialogue between these disparate functions if the organisation operates in this way. Even in this situation, purchasing will often be required to take action with a supplier who fails to meet contract conditions and therefore often they cannot really forget about the about contract management implications.

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All formal contracts are structured with due consideration of legal implications and often legal advice will have been used to agree the precise wording of the contract, so there is some logic for contract management to be associated with the legal department. However the skill sets will be completely different, so while there will be a role for legal oversight there is little sense in using lawyers to perform day-to-day management. In organisations with many contracts to create and manage there is however a large information processing activity which might be best located inside the legal function. Indeed in many web-based searches for contract management sources one is likely to find advertising for database management and search software so that contracts can be located and checked easily and the need for some preplanning for contract renewal can be flagged using the database calendar. It is often also useful to check that similar terms and conditions are being applied with suppliers who have a number of contracts with different groups in the buyer organization, since these will often vary and rationalization of these variations might be a quick benefit from looking with more care at the contract management processes.

For almost 50% of the respondents to the 2011 survey on Contract Management Benchmarking (see later for details) a separate function had been created to concentrate on contract management in order to "ensure that we address our obligation to supervise the execution of the products and services that the supplier is contracted to provide and adequately manage the reputational, regulatory and operational risks" as one organisation defined the role and to "drive value from suppliers by managing performance and risk".

There is independent evidence to suggest that many contracts fail to deliver in practice what was so hard-won in negotiating the contract initially. Dedicating resources to the contract management activity as a separate functional area is a concentrated effort to avoid the potential degradation of performance over the life of the contract. Indeed the quote above recognises the potential to increase performance above the levels initially contracted for but this is only achievable if the terms of the initial contract set that out as a desired outcome with suitable measurement and gain sharing processes, agreed by both sides at the start. If this is not done the danger is that the increased cake is not fully realised because the parties are arguing about the size of their slices.

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What can impact the organisational choice decision is the strategic importance or high-volume of a particular contract. For many service businesses there is not much in the way of product flowing in as a result of contract agreements however there may be many outsourcing contracts where the third-party supplier is responsible for delivering services as the buyer's agent and delivering these services directly to the buyer's internal and external customers, including at the customer's premises. The previously defined SLA's, performance metrics and conflict resolution processes must now be managed carefully and each stage of this particular contract's life-cycle needs to be planned, monitored and reported upon. For contracts that are part of a suite of related programs it is sometimes the case that some contracts will end for particular suppliers but the activities have to be picked up by another supplier with a new contract. In these circumstances, detailed plans to manage the transfer of contracts require great care and some diplomacy in their operation. As in all aspects of management large amounts of knowledge as to how things work and how to make things happen reside in the heads of the people doing the activities themselves. This tacit knowledge is very difficult to transfer but for consortia of contract operations this may be crucial for all parties to maintain progress. Any new supplier cannot have this information since they did not share in the earlier transactions which created it and so the challenge for the contract management process is to reduce, if possible, the proportion of tacit knowledge, make it explicit where possible and induct, train and mentor the new supplier to bring them up to speed as soon as possible.

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5 Operating the Contract

In this process stage we will discuss five important sets of activities before outlining a model of contract management that was produced with the sponsorship of the Royal Bank of Scotland Group Contract Management function working with the University of Southampton Management School and the consultants SCMG Ltd on a project to create a contract management benchmarking process and results.

Relationship management issues need to be defined at the beginning of this operational phase. The critical concept is that both customers and suppliers have a range of counterparties with whom they will have contracts but not all of these have the same monetary or strategic value. Both parties try and subdivide their total range of contracts into those which are high risk and high value and therefore justify the allocation of most attention and the highest class of resources; others will be representing lower risk and lower value contracts, for example the supply of commodities such as stationery, and these justify only the minimum level of commitment and resource sufficient to avoid any interruptions in the flow of goods or services into the organisation. There are other combinations of these features and overall we can talk of a portfolio of relationships and therefore different levels of intensity of contract management attention and action. These approaches are based on and developed from the original work by Kraljick (1983) as part of his argument that purchasing should become more strategic and it has since been applied by many others including Bensaou (1999) and Macbeth (2002).

The strategic or mission-critical contracts will justify close monitoring, frequent meetings and discussions and different forms of mutual support. This will be especially the case for contracts that have the potential to innovate and reduce operational cost and/or add significant new value for the customers downstream and it is in these areas that the more collaborative, interactive and long-term focused relationships are most appropriate. It is often these relationships that enable a customer to engage with and utilize the real expertise of the suppliers especially in innovation terms since the supplier will be the real expert because the buyer has chosen not to be.

For more tactical purchases the contract is essentially a market driven one with price as the main criteria but with due attention paid to quality and delivery performance to mitigate the risk of a supply failure since even the cheapest of items or services can, if they are not delivered properly, impact customer service and the buyer's reputation for reliability. It is often this type of relationship (actually a minimal relationship since both parties keep their distance from each other) where the sourcing option of reverse auctions makes sense.

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However for the close relationship contracts sometimes the legal format does not set a sufficiently collaborative tone. Inherent in the logic of legal contracts is the need to define failure and processes to evaluate and recover compensation of some kind. This thinking process, while necessary, seems to assume the same kind of adversarial behaviour and transaction costs we discussed earlier. It is often said in business that the best thing to do with the contract is to put it in the filing cabinet and hope that you never need to read it again, for if you do the relationship has probably already failed and all that will now happen is that the lawyers will be paid again but this time to fix the problem in some way. Given this recognition by both sides, what can happen is that a less formal partnership or relationship agreement or memorandum of understanding can be struck which emphasises the positive objectives, ways to resolve conflict without resort to legal action and commitments to work together for mutual advantage. This agreement is usually made very public with high-level organisational support on both sides and made in a very visible and believable way so that any perceived failure is seen as reputational damage and for that reason great efforts are made to avoid such an outcome. These collaborative agreements can even be established across multiple contracts contributing to some common project and have been used to good effect in industries such as construction, shipbuilding, electronics and financial services.

The second area of interest is *risk management*. Some of this work should have been done at the earlier specification stage and now the task is to put the controls into place to monitor potential risk events. While the concept of risk has an upside as well as a downside it seems that many use the word for only the downside issues. Thus some argue for the concept to be redefined so that the risk refers to unpleasant outcomes whereas the other concept or more general concept of uncertainty allows for pleasant outcomes, or the upside. We will return to this shortly. One of the challenges of risk evaluation is the very nature of supply chains and its networks of interacting parties which has the unfortunate effect that a distant, unanticipated event can occur for which no reasonable monitoring approach would have had any chance to identify its occurrence. However the chain effect transmits and can magnify the effect as each link in the chain feels its impact. This process can take months before a particular customer realises the problem and of course by this time it may already be too late to create new coping or mitigation processes.

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It is infeasible and uneconomic for all organisations to scan all of the potential hazards across geographical and technological horizons on a continuous basis and so one approach is to make use of the supply chain to act as the eyes and ears of the other parties in the chain. However it does mean that all of the relevant or potential issues have to be efficiently communicated across each of the links of the chain and that all members in the chain are motivated to communicate the information downstream to their immediate customers and onwards to final customers. There is a problem however in normal attitudes and behaviours relating to potential problems. A supplier who recognises an emerging issue might defer communicating that fact and try to fix the problem. Higlighting emergent issues which they are trying to fix might be perceived as a lack of capability on the supplier's part to manage and fix the problem. Not communicating the potential problem however increases risk levels since if it is not fixed there is even less time to react by the customer so there must be a clear understanding that identifying potential problems is the correct thing to do as well as communicating the attempts being made to fix the problem. In this way the immediate customer is given some time to consider their options and possible mitigations (hopefully not to be used if the supplier solves the problems as intended) but ready to move into action if the worst happens. There also needs to be clear agreement about mitigation and coordination processes to deal with these unfortunate events. This can be seen as a business continuity or disaster recovery process and may have a variety of different organisational levels involved depending on the severity of the incident. Once the major problem is overcome it is also necessary to undertake a full debrief of all the parties involved to see what can be learned to avoid any repetition in the future or to re-evaluate mitigation strategies to react quicker and in a more cost-effective way if such events are possible even if not amenable to forecasting approaches.

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There has been recent discussion and a book about the "Black Swan" events (Taleb 2010) whose occurrence is highly unlikely but whose impacts can be dramatic. By definition businesses can do little in advance of these but need to react effectively when they do. The well documented story (Mukherjee, 2008) of the problems in a chip manufacturing plant run by Philips and which was supplying both Erikson and Nokia at a time when these companies had 40% of the world market in mobile phones, is a case in point. What started off as a minor fire in the production area which was quickly put out, created circumstances which caused Erikson to suffer a major loss of market share and financial loss while Nokia gained market share and dealt with the problem according to well established supply crisis procedures. Some days after the fire Philips communicated to both customers about the incident and indicated that there would be a two-week interruption in supply. Nokia's supply monitoring process had already identified an interruption in the flow and had triggered a set of investigations and mitigation strategies which included cooperating with Philips to find alternative factories to keep the product flowing, redesigning the chip itself so that others could produce it and cooperating with other suppliers to provide alternative capacity. Ericsson lacked the monitoring processes and seemed to have been satisfied with the statement that the interruption to supply would only be temporary. By the time the full scale of the problem was realised by Ericsson Nokia's mitigation and recovery was well underway leaving no room for Eriksson to recover effectively. The impact on Eriksson's business was so severe that they eventually exited the marketplace for mobile phones. Nokia saw the supply interruption as in some ways normal and coped with it with a combination of alertness, good information and even better managerial response. What was a disaster for Eriksson turned out to be a market benefit for the competitors through fundamentally different approaches to supply chain risk.

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A different set of behaviours and attitudes is required to deal with upside uncertainties which produce positive outcomes which were not anticipated. Here again the challenge is to see this in a bigger context and not just enjoy the moment but rather investigate the processes by which the positive outcome was obtained and try to understand the ways in which these circumstances could be recreated on a more controllable and repeatable pattern for future and ongoing benefit.

The nature of the business relationship will affect all of these behaviours and the efforts involved in training, awareness raising, business condition monitoring and collaborative planning and problem solving probably only makes sense for those strategic or mission-critical relationships discussed already. In all business 'stuff happens' and much of management is about sorting out the negative impacts and making progress towards objectives so even tactical contracts will require some degree of interaction and joint planning to mitigate supply interruptions.

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It is a reality of global supply chains that the downside risks seem to increase and the fact that time zones and delays along with geographical distances complicate communications and planning processes, might actually justify some reappraisal of outsourcing strategies especially ones where off shoring is also a feature. Sustainability issues and concerns about carbon emissions and the impact on climate change might also suggest a reappraisal of these strategies. Many organisations have chosen to source materials and services from distant suppliers in different geographies and time zones often on the basis of perceived lower cost however there is a real concern that these decisions are made with an incomplete understanding of all the total supply chain or total requisition costs involved. As these factors become more apparent then perhaps the sourcing decisions might tend to look for more local solutions and the weighting factors of the sourcing decision criteria will change again. The third aspect relates to *operational details* inside the buyer organisation in terms of dealing with invoicing and payment as agreed and specified in the contract documents. Often the buyer's systems will require the creation of a new supplier record with all the details required to deal with purchase orders and invoicing transactions. It is therefore necessary for the contract can be put into practice and that all of the information processing and system set up is completed internally so that when the start button is pressed, goods or services can be delivered and appropriate payments made. There can therefore be the requirement for the contract management function to create all of these database records, ensure the contract details are recorded in appropriate places and to manage calendars of review and reporting events as laid down in the contract. Internal communications will also have to be created to inform all interested stakeholders of the new contract, contact details of relevant individuals and their roles as well as identifying the internal people who will be responsible for managing this particular contract. As part of a relationship portfolio approach, organisations may have different levels of oversight and here again the names and responsibilities of each of the parties at these different levels needs to be identified and communicated to all concerned and the individual diaries need to be updated to incorporate the required review meetings scheduled in the contract. Systems to monitor performance and create and communicate reports of performance need to be updated and once the contract begins the data needs to be properly collected, analysed and communicated.

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Particular contracts may have penalty clauses included in them on an escalating basis when performance is less than agreed but such issues are seldom simple to deal with as failure often has multiple interacting causes and practice indicates that often customers create conditions which are difficult for suppliers to deal with and stay within the boundaries of the contract award. If such things happen it is reasonable for a supplier to argue that the failure was not all their responsibility and therefore penalties are not appropriate. The discussions about appropriate actions therefore need to be carefully managed for any perceived unfairness by the supplier will affect their future behavior, often in ways which are unseen by the customer but which might impact overall performance dramatically. Penalty clauses therefore have the potential to radically change the nature of the working relationship and so it is important to evaluate the real benefit of using them. On a more positive note, the contracts which encourage innovation also need to be monitored as well and while the original contract should have discussed issues of the benefits to be shared and what proportions when there is performance improvement, this still needs good data and good discussion and communication about these issues and timely payment needs to be made of any due reward in whatever format has been agreed.

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As well as the operational monitoring processes usual in all contracts it is also likely that a process of audit will also have been approved on some agreed basis and so this set up activity also needs to interact with those responsible for auditing. These audits can take a variety of forms of course including auditing IT security, financial viability and performance, health and safety issues and can include training and recruitment of key staff in positions of high responsibility or potential security threat. It is the nature of auditing that some element of surprise in timing is important to avoid any potential attempt to present a good picture to the auditors. However, one of the rules of the contract management activity is not to impose unreasonable demands on their suppliers but to counsel on what might be seen as appropriate timings for audit visits. This last discussion brings into focus one of the roles of the contract manager who in a sense acts as the supplier's representative inside the buyer firm. The contract manager is therefore is trying to maximise the opportunity for the supplier to do a good job in satisfying the internal customers and for that supplier to be dealt with fairly so that the relationship can continue to be an effective one and that both sides can live up to the promises made in the contract agreement.

The fourth topic in this section relates to *continuous improvement*. Part of the quality message for all businesses is that everything can be made better so that all contracts should have some element of continuous improvement in them but for the more tactical purchases the opportunities may be more limited. For the strategic contracts continuous improvement should be an expectation, after all, the suppliers delivering these types of contracts are the ones with most experience and capability and are the ones who can make technology push a reality. However collaborative relationships are two way processes and one can argue that there are really three parties in a customer/supplier relationship since we have two sets of actors in each organisation plus we have their interaction in the relationship processes as well. Change and improvement is possible in all of these areas but of course the interdependency means that any change has to be considered for its impact on the other parties and most changes will also require the involvement of these other parties to support it and make it effective. The requirement for change can come from a cost focus to reduce the resources employed to deliver the existing contract or it can come from the market end from internal or external customers who are recognising new requirements or asking questions about the best way to deliver the goods or services. From a supplier's point of view there is a concern in this however since we can be talking about what is known as 'specification creep' and if the changes are large enough a supplier could be justified in saying that what is required is a new contract with new payment terms to reflect the additional work. This requires careful negotiation and recognition from each party of the legitimate concerns of the other. Good contracting, good contract management and good relationship building can make this a positive process for all concerned but the danger is still there that a customer reverts to adversarial behaviour to extract more than fair value from an existing contract. When multiple change opportunities are recognized, the relationship process is again important to decide on the priority to be assigned to each opportunity.

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One approach to recognising opportunities is to change a linear chain of relationships where one party is dependent on its immediate customer's understanding and recognition of opportunities to a more group or networked based approach where a company may be able to see one or two stages downstream or upstream to interpret the requirements from their expert point of view. This might allow a requirement to be evaluated in a more rounded way than is possible inside one customer organisation dealing with one supplier.

Once opportunities or requirements are identified then projects can be created around them and the tools and techniques of process improvement can be brought to bear in a coherent fashion for mutual benefit.

The final set of activities we can group together under the heading of *customer satisfaction***.** To some extent all customers are unique but there are a number of generic headings that cover the issues of concern to most customers. Here again some of this thinking should have been incorporated in the original specification of the requirements and of the service levels expected to support the delivery promise. Each of these will have its own appropriate metrics, many of which will be specialised to particular industry sectors and concerns so that the balance may change from sector to sector. This is both expected and to be welcomed, for it is often in the balance that competitive advantage can be obtained. A number of these topic areas are themselves quite difficult to define and can be somewhat subjective and dependent on customers' perceptions. This is especially a consideration when services are provided as they are essentially intangible and very dependent on the person delivering the service. Goods are somewhat simpler being able to be physically inspected and measured. Service level expectations can actually be part of the definition of quality and the delivery context becomes very important. For example IT support to desktop equipment might require the same technical capability but the required response time for mission-critical equipment, more or less continuously in use, will be much shorter than for other less critical equipment. The contract specifications for these two simple examples will be much different and will need to be managed in appropriate ways.

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Contracts will have features equivalent to a unit cost to provide the goods or service but this is seen from a customer's viewpoint. The supplier has a different concept where they are evaluating the customer on how much it costs the supplier to serve the needs of that particular customer. This is part of the portfolio evaluation that suppliers undertake in considering the attractiveness of the customers and which informed their tender proposal which won the contract. However this is the implied threat of specification creep where an initially attractive customer becomes more difficult, demonstrates their own lack of control or consideration such that the cost to serve overpowers the cost benefit of supplying. Sometimes suppliers will live with this pain but they will look for opportunities to find a more comfortable business relationship which may be with other customers or in some circumstances actually become competitors of the customer. This happened in the laptop business of IBM where over some years the outsourcing of manufacturing to Acer reached the point where having gained the expertise to produce the laptop under contract to IBM, Acer decided that being a supplier did not reward them enough for the difficulties of managing the contract. They effectively walked out on the relationship but by that time had learned enough to create their own laptop product and market it in competition to IBM. Perhaps this was always the strategy and IBM had no alternative but it would be nice to know how the supply contract was managed leading up to the creation of their own competitors.

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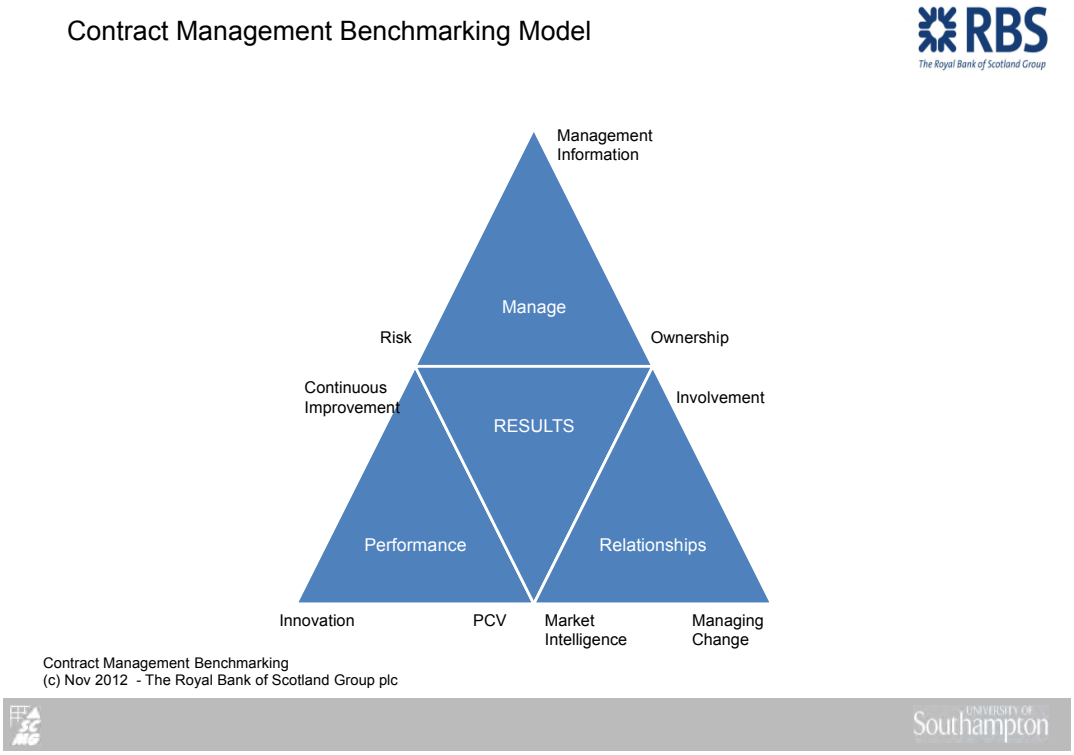
Given the importance of risk in all of these considerations, customer satisfaction measures of perceived risks and risk management actions will be very important along with evidence that all compliance to financial, environmental, sustainability and corporate social responsibility requirements is at a high level across all of these agendas.

For those contracts where innovation is an expected outcome, measures of proactive suggestions from the supply-side and responsive and cooperative support to customer requests will also be important.

The final part of this process stage section will discuss the Contract Management Benchmarking Model copyrighted by RBS group. (see http://www.cmb2012.com)

This model takes the form below where the Contract management *RESULTS* are enabled by the appropriate actions on the three interacting sets of agendas grouped into three categories of *Manage, Performance and Relationships.*



The results section largely follows the same pattern as our customer satisfaction discussion above with measurements of Quality, Cost, Service Levels and Delivery, Customer Satisfaction, Innovation, Risk and Sustainability.

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Manage has three sub-sections of Management Information to inform decisions, Risk as discussed above and Ownership, which defines who owns the contract management approach and what roles and responsibilities are assigned to whom.

The three sub-sections of Performance include Continuous Improvement as incremental improvement and Innovation as step changes as we have already discussed along with a category called here CPV. This stands for Cost, which is different from the Price being charged and both are different from the Added Value being contributed.

Relationships include Involvement about how the various stakeholders in the extended chain are included in processes; how Market intelligence is gathered and shared both on the demand and the supply side and what processes are used in Managing Change across all of the activities.

These categories are expanded into detailed questions for self assessment and submission to the facilitators and reports produced for each individual respondent to the survey and plotted against averages and highest scores so that participants get information to evaluate their relative position in the community of respondents.

Also demonstrated on the web site is a Maturity grid that captures, in a concise fashion, the key expectations of best practice in each of these categories. This is reproduced below but if the text is too small please visit the web site above for more information and hopefully to take the survey and join the expanding community of organisations from many different sectors who have already completed the survey, received their results and in some cases contributed case studies of their own practice as a process of sharing experiences, comparing practice and mutual support to developing their own organizational procedures in the direction of best practice.

The benchmarking process will be repeated in 2013 so if the search engine cannot find the above URL please try CMB2013.com.

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Contract Management Maturity Grid

Categories	Your %	Av %	Min %	Max %	Traditional <25%	Transitional 25% to less than 75%	Best Practice >75%
Manage	76	53	15	81	Contracts are managed at arms'-length. Contract Management is not considered strategically important or is managed as part of an existing or other function. There is little or no joined up thinking in terms of sourcing, procuring and managing contracts which are awarded on a "let and forget" basis. Contracts are considered discretely and with little or no reference to the rest of the business or business issues and key drivers. Contracts are considered tactically with an undifferentiated view to how or who manages the contract on behalf of the business. Decisions are made using a limited range of criteria that reflect traditional measures or that are specific to individual contracts.	Key contracts are identified and prioritised on the basis of Risk and Value although the business case for managing contracts across the contract management lifecycle is not well developed or considered across the business. Decision making is informed by customer / supplier interactions that address specific contract issues but these are considered discretely and lessons learned are not shared or applied to other contracts. There is good awareness of the Contract Management lifecycle but this tends to be considered intermittently or on the completion of discrete stages or steps rather than on a continuous basis.	Contracts are managed with an informed view of Risk and Value (or impact). Risk and value are considered as part of a differentiated portfolio which recognises the impact and opportunity of managing contracts consistently but recognising the different implications that each contract may have on the business. The portfolio of contracts is reviewed on a regular basis with a consistent approach to risk which considers all contract stakeholders' perspectives. Contract Managers have a pivotal role in terms of managing the interface between the business and contractors or suppliers and are involved in decision making across the lifecycle of the contract from sourcing to exit or renewal.
Performance	69	33	6	77	Performance criteria are limited or not clear. There is an inconsistent approach to Contract Management which is driven by individuals as opposed to a consistent or corporate approach. Performance targets reflect a traditional focus on price and there is no or limited formality, reporting or reviews of contract metrics or key performance indicators. Performance is static or reflects agreed performance levels with no drivers or incentive to improve or innovate. Performance measurement is not an integral part of the Contract Management process, if it has been defined at all. Continuous improvement or Innovation are not features of the Contract. There is little or no corporate or strategic input to contracts.	Performance is managed proactively but not consistently between contracts. The range of performance criteria includes traditional measures like price and delivery and some wider criteria that reflect wider issues specific to the contract. Performance is reported functionally but the upward reporting or corporate visibility of contract performance is limited to a narrow range of specific contracts. Performance is measured but tends to be collected rather than used proactively or as a basis to drive improvements. Strategic input is limited to specific or high profile contracts only.	Performance is considered and managed to consider a holistic view of performance and a range of key cost and performance contract drivers. Performance management of contracts includes a range of metrics and key performance indicators that are agreed, measured and improved on a joint basis with contractors or suppliers. Suppliers are engaged early in performance discussions and there is a clear understanding of what constitutes excellent performance in terms of benefits for the different contract stakeholders. Performance is measured, reported and used to drive performance improvement - improve performance and reduce total cost at each stage of the contract lifecycle process. This includes mutually agreed targets and a challenging environment that considers both process improvement as well as innovation. Suppliers are rewarded and incentivised to improve performance.
Relationships	88	53	12	88	Relationships are not well developed with contractors or with internal stakeholders. There is limited information available about markets and categories within the business or that is considered as part of the Contract Management lifecycle process. Interaction with stakeholders is limited particularly with respect to sourcing and procurement colleagues. Changing requirements are not identified and interactions are limited to problem solving or addressing failures or problems. Suppliers' views are not considered and there is little or no constructive interaction in terms of relationship building, discussing opportunities and problem escalation and resolution.	There are clearly defined relationships with key internal stakeholders and with suppliers. The view of the market place and different spend categories is limited or driven by legacy issues or precedent. Although Relationships are well defined they tend to be reactive and focus on problem solving although opportunities in terms of continuous improvement and innovation are considered but are not necessarily sustainable features of the relationship. Wider issues about the market place are considered but decision making reverts to traditional approaches in terms of buyer power and traditional measures as well as cost. Relationships are static and focused on managing the contract and related issues as opposed to improvement and innovation.	Contracts are considered in terms of the market place and dynamics of different categories regarding competitors, alternative sources and substitutes. Decision are made in the context of understanding markets, the supply base and suppliers or contractors available in the market. Relationships with key stakeholders are defined, managed and monitored to ensure all views are considered on a regular basis including sourcing colleagues, specifiers and end users. The changing nature of service provision is considered and suppliers are involved in discussions that will impact them (or vice versa) and these are reviewed on a regular basis at both a strategic and operational level. Relationships are collaborative. Suppliers are involved early in decision making.

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The numbers at the left are indicative of the results from the first benchmarking exercise in 2011 with a set of results for a fictional participant.

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6 Options at the end of the Contract

We have three main options at the end of any contract. The first relates to *continuing* the contract with or without a redefinition phase. The second option concerns *replacing* a current supplier who for a variety of reasons is no longer regarded as competent to deliver the contract. The third and final *exit* option is to simply recognise that the requirement, which was translated into a contract, is either satisfied or no longer relevant as the market situation has changed.

One of the major concerns about the end of a contract is that the supplier may become more worried about the funding situation after this contract has ended and so might begin to spend more effort prospecting for replacement clients and the focus moves more to marketing and sales than to contract delivery. In the private sector it is therefore important that discussions are opened well in advance of the nominal end of the contract period so that the supplier understands where they are and what they have to do in order to move into a replacement contract. If this is done well and for good reason, based on performance, then the contract replacement process can be largely seamless with no discernible impacts to downstream customer satisfaction. The case for public sector contracts is that contract end means what it says. In the private sector it is sometimes possible for the contract to roll forwards perhaps with some redefinition of scope and SLAs and financial considerations. The time to perform this renegotiation can also be used to evaluate what worked well and what may be improved on both sites to make future performance even better.

In the public sector, subject to EU procurement rules, the requirement is that contracts will end and that a new tendering process will be established. At this stage the logic of non discrimination against potentially new suppliers means that in theory all of the good performance of the incumbent supplier has to be disregarded in the process of evaluating all of the new tender bids. One can argue that this minimises the learning opportunities, and therefore ignores the new tacit understanding created on both sides of the contract relationship.

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The underpinning concept of the procurement rules would seem to be that market challenges produce better results in the longer term but this is essentially impossible to prove empirically. There is certainly evidence that before the procurement rules (and even now in some circumstances) that the business to business relationship between buyers and suppliers was too comfortable and unchallenging and therefore was not providing full value for the expenditures involved. One might argue that we are forced for reasons of political dogma or through selective application of economic theory to operate only one kind of market transaction when the essence of this book is that there can be more choices available but, at present, these choices can only be used in the private sector.

Identifying the need to replace a current supplier is not a single stage process. If the contract monitoring and management process has been effective there should be an audit trail of less than satisfactory performance, failures of remedial actions to be effective and processes of escalation to higher levels of decision maker on both sides of the relationship to try and recover the situation. The decision to replace a supplier is therefore recognition of a series of failures and it is worth detailed analysis of the causes and effects that brought the situation to this crisis point. Again we can think of three parties involved in this process. The buyer, the supplier and the relationship/contract and contract management process. If the causal analysis is not completed well there is a great danger that the same mistakes will simply be repeated with a new supplier. We have discussed earlier the particular problem of replacing one supplier responsible for one contract in a programme of work involving other suppliers and other contracts. The time pressures in this situation mean that all of the activities have to be compressed to minimise the consequential damage to the overall programme of work. However this time compression has the obvious risk that all of the detailed analysis of the previous failure will not have taken place by the time the new situation has to be activated. To some extent, the opportunity to pre-qualify a number of suppliers as in some ways interchangeable within a framework of possible contract requirements might make the switching out of the failed supplier and the switching in of the new supplier slightly easier but the whole induction process is no less stressful.

The final option sounds the simplest and that is the exit from a completed contract. For a failed supplier being replaced there are particular issues around the transfer of information and possibly even equipment to the new supplier where the attitude and behaviour of the exiting supplier is crucial to the process continuity and avoidance of disruption in the flow of service to the customer.

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For the contract, which has run its course and for which there is no requirement to continue in any form then continuity is not relevant but an efficient closing out of the contract process still has to be done. There may still be issues of recovery of information or equipment and there may still be considerations of intellectual property to be properly managed so that the supplier cannot use any information gained in inappropriate ways with other customers. All of this will have been defined in a properly constructed contract at the beginning of the process but without day-to-day involvement the buyer has no visibility of what the supplier is actually doing after the end of the contract. Reputation is an important consideration and the buyer organisation will be trying to persuade the supplier to see their behaviour in terms of reputation in their sector and hold out the possibility of reengaging with the supplier when or if the circumstances change in the future. Suppliers often need the goodwill of a successful contract to be demonstrable in their marketing approaches to other buyers and, recognising that new buyers may undertake due diligence with the current buyer organization, should suggest to the supplier that their exit behaviour will have impacts across the network of organisations within which they operate.

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7 Lessons Learned for the Future

This final process stage is in some ways in the wrong place since it is fundamental to progress, innovation, continuous improvement and effective contract management for all parties to look for opportunities to analyse processes and performance to identify the requirement to improve and to explore ways to make that happen. However this may often be a more informal process taking place in daily interchanges and putting it here as our stage 7 is to emphasise that there should be a formal review at the end of all contracts and projects. As we have seen for contracts that are being renewed the analysis process can be joint between buyers and suppliers and this has much to recommend it for it is easy not to realise the impact that one's behaviour is having on the other party however in many cases the lessons learned can only really be driven by one party.

Whatever the circumstances, the need is to have a comprehensive set of data, decision processes and outcomes, aligned with performance criteria so that we can learn which things worked, to what degree and in what circumstances so that good history can be repeated and bad history used to identify alternative decisions so that performance is better the next time round.

This work will inform internal training and development and should inform the contract specification writing process for similar contracts in the future. It is here that whoever is responsible for contract management should be re-engaging with the purchasing or procurement activities so that the lessons learned can be properly incorporated in any future sourcing exercises. In this way what we have laid out as linear process is actually more like a continuous improvement spiral with performance against all of the criteria being improved each time we go round the loop.

Even if the supplier is not involved in this process after an exit perhaps, they should also perform the same critical evaluation so that next time they enter a tender competition they are better prepared to anticipate issues and suggest solutions to the potential customer and thereby engender belief in their capability to serve. The supplier organisation as we have been talking about them are however also customers to their suppliers so what they learn by facing in one direction downstream, they should be able to apply in the opposite direction upstream. In this way all networks of organisations can improve to their mutual benefit.

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8 Summary

Thinking about managing contracts from this life-cycle view has emphasised a number of key issues.

- Businesses and therefore contracts between businesses operate in complex interconnected and interdependent ways.
- Capable suppliers are looking for intelligent customers with whom they can grow and develop in a sustainable and mutually satisfactory way.
- Sharing information, objectives, and requirements and allowing the other party to present their own ideas for consideration and agreement is likely to provide a better basis for writing contracts which can be delivered to the satisfactions of all stakeholders.
- Recognising the legitimate concerns of the counterparty in a contract and working together to provide a satisfactory outcome is more likely to produce that outcome than believing and acting is if one party always has the power to force the other party to accede to their demands. The location of power can change quickly and past pain can be returned with interest.
- Not all business to business relationships and therefore all contracts require the same level of mutual support. Simple market relationships for commodities still makes sense when the market can be made to be efficient.

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- Contract managers have to be aware of different sourcing and relationship strategies and have the capability to align these to the needs of particular contracts. However not all individuals will be able to exercise the complete range suggested here and so the contract management function has to allocate people with the appropriate skills for particular circumstances.

It is the rationale of this book that the activity of contract management, wherever it is located inside an organisation structure, has not been sufficiently in focus to deliver the business benefits that the best practitioners achieve. Thinking about these issues across the life-cycle should make it possible for more organisations to develop their critical thinking about how best to manage contracts. Given the proportion of total expenditure represented by external contracts in many business areas then there can be little doubt that there are real opportunities to make a significant difference to those businesses by ensuring that as a minimum the contract performance lives up to the promises made in the contract itself and future contracts build in requirements and procedures in terms of risk and cost control and ideally cost reduction alongside processes to enhance the value add demonstrated to customers at the end of the chain.

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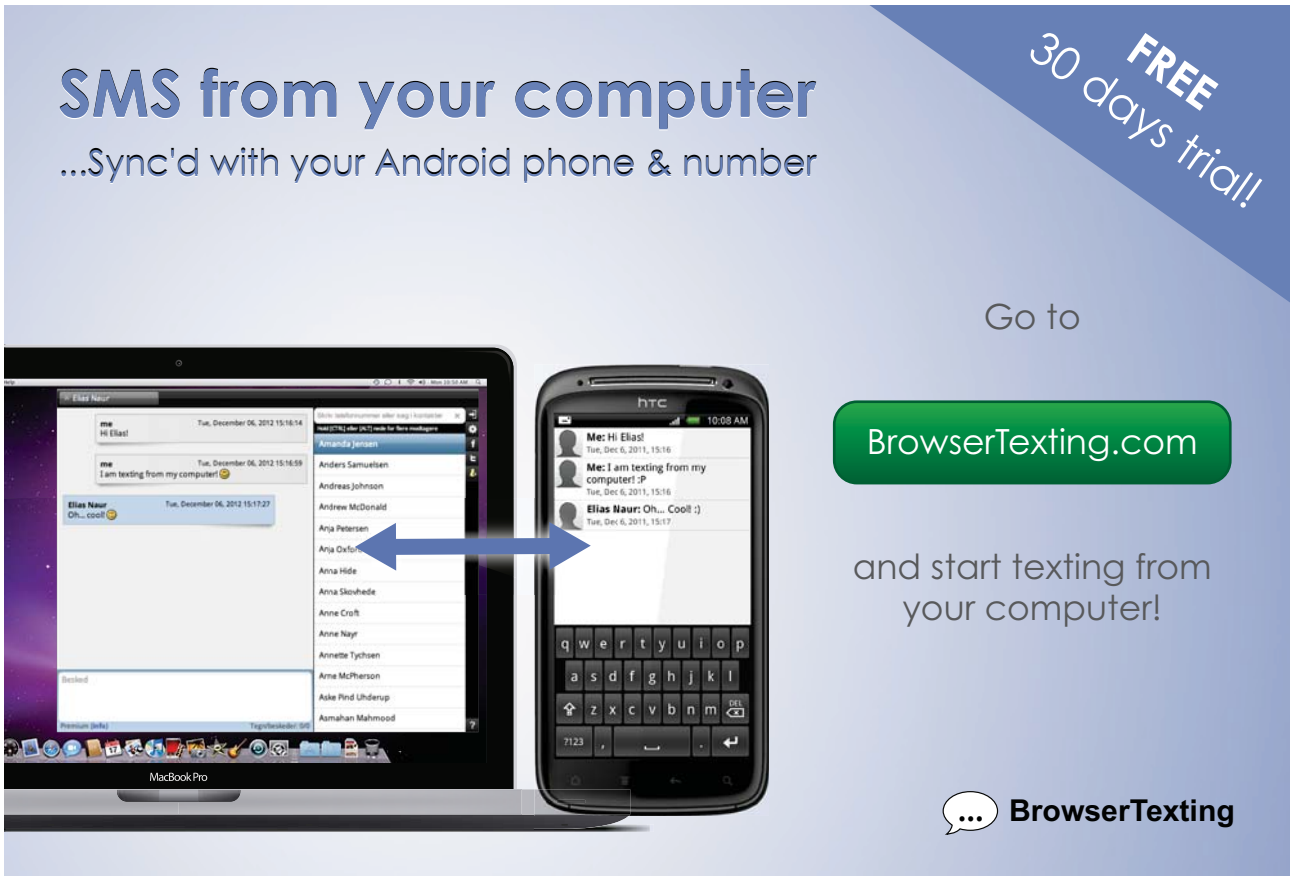

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