Effective Contract Management:
Signing the Contract is Only the Beginning
Greg Edmonds – Managing Director

www.charleskendall.com.au
31% of companies have no formal processes to measure procurement savings. (Aberdeen Group, 2007)

<10% of procurement departments, in the opinion of CFOs, do an “excellent” job of projecting, implementing, and tracking their cost saving initiatives. (Aberdeen Group, 2007)

Most CFO’s see Procurement’s only added value as cost savings, they over looked the other areas of key responsibilities such as supplier risk management. (supplymanagement.com, 2015)

20% of a company’s market value can be instantly destroyed by supplier infractions committed across the extended supply network. (Corporate Executive Board’s Procurement Strategy Council)

31% rated the relationship between procurement and finance as weak or non-existent. (AMR Research 2009)
Key Findings

- Could not demonstrate Value for Money
- Multiple contracts for the same service
- Did not ensure procedures and process were followed by business units
- Accountability for Contract Management unclear
- Only 21% had details performance plans
- Departments lacked capability and capacity to manage contract performance
Value for Money and Performance Management

Value for Money

• Departments could not demonstrate they achieved value for money.
• Poor performance management and poor planning for contract expiry weakened the value for money.
• Contracts extended without demand and supply market analysis
• Multiple contract for the same goods and services.
• No risk assessment or business needs analysis conduct before extension of contracts.

Performance Management

• 62 contracts audit.
• 41 contracts did not show any signs of performance management.
• Only 21% had detailed performance management frameworks.
• 22 contracts had regular documented meetings with suppliers.
• Risks not managed through the contract life cycle.
Governance and Capability

Governance

- 57 contracts extended without any reviews.
- Audited departments did not have the governance arrangements and systems to manage all awarded contracts consistently.
- Did not ensure policies and procedures were applied by business units.
- Lack of governance structure for contract renewals.
- Did complete a contract register or have centralised records for contracts and contract activities.

Capability

- Audit departments did not have the necessary contract management skills.
- Significant gaps in capability and capacity to demonstrate value for money and manage contract expiry.
- Insufficient resources to take contracts back to market.
Contract Management
Contract Management of suppliers forms part of the Procurement Function.

The main aim of contract management is to ensure that goods or services are delivered on time, at the agreed cost and to the specified requirements.

Effective contract management relies on 3 separate, but interrelated factors:

- **Managing service delivery** ensures that a contract is being delivered as agreed, to the required levels of performance and quality.

- **Managing relationships** keeps the relationship between the two parties open and constructive, aiming to resolve problems early and focus on continual improvement.

- **Managing contract management** provides governance, performance management and accountability through tracking and recording delivery.

All three factors must be managed effectively and consistently if the contract is to succeed.
10 Pitfalls to Avoid in Contracting

1. Lack of clear scope and goals. **Result:** #1 Cause of claims and disputes
2. Adversarial approach to negotiations. **Result:** Loss of trust, low innovation
3. Contracts do not build in flexibility, governance terms. **Result:** Weak and contentious change and performance management
4. Contracts difficult to use or understand. **Result:** Users see contracts as irrelevant to business needs
5. Limited use of contract technology. **Result:** Inefficiency and loss of quality in performance and analysis

- Commercial team involved late. **Result:** Extended lead time, wrong form of contract
- Protracted negotiations. **Result:** Competitive exposure and delayed revenues
- Negotiations focus on risk allocation. **Result:** Loss of economic benefit, contract used as a weapon
- Poor handover to implementation team. **Result:** Commitments and obligations missed and misunderstood
- Weak post-award process and governance. **Result:** Repetitive issues and errors causing value loss

Average 9.2% value erosion

Source: IACCM, 2014
# Procurement Process

## Procurement/Strategic Sourcing Steps

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<tr>
<th>Step 1</th>
<th>Step 2</th>
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<th>Step 4</th>
<th>Step 5</th>
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<tbody>
<tr>
<td><strong>Procurement Planning</strong></td>
<td><strong>Tender Development</strong></td>
<td><strong>Tender Period</strong></td>
<td><strong>Tender Evaluation</strong></td>
<td><strong>Contract Award</strong></td>
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<tr>
<td>- Needs assessment</td>
<td>- Scope of Work / specification</td>
<td>- Issue Tender Documentation</td>
<td>- Compliance check – mandatory criteria</td>
<td>- Negotiation planning</td>
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<td>- Stakeholder engagement</td>
<td>- Conditions of Tender</td>
<td>- Briefings</td>
<td>- Technical/Commercial evaluations</td>
<td>- Conduct negotiations</td>
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<td>- Supply market analysis</td>
<td>- Draft contract</td>
<td>- Tender clarifications</td>
<td>- Short-listing</td>
<td>- T&amp;Cs</td>
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<td>- Risk assessment</td>
<td>- Commercial model</td>
<td>- Tender submission</td>
<td>- Tenderer interviews</td>
<td>- Price</td>
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<tr>
<td>- Develop Contract Strategy (high value / high risk)</td>
<td>- Consider performance measures and KPIs</td>
<td>- Tender Evaluation Plan</td>
<td>- Tender Evaluation Report</td>
<td>- Tender Evaluation Report</td>
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Most procurement departments’ involvement finishes at contract award.
Procurement Process (Incl. CM)

**Contract Management**

**Step 6**
- Implementation
  - Mobilisation and implementation activities
  - Deliverables acceptance testing
  - Incumbents transition-out plan / transition-in plan
  - Establish record and document management
  - Contract Management Plan (all values)

**Step 7**
- Contract Management
  - Compliance
  - Performance measurement and management
  - Reporting
  - Communication
  - Acceptance of goods / services and payments
  - Change/variation management
  - Dispute management
  - Relationship management

**Step 8**
- Contract Extension / Closeout
  - IP / data
  - Practical completion / final completion
  - Handover
  - Settlement of final payment/accounts
  - Return of securities/guarantees
  - Performance Assessment
  - Market Analysis
  - Closeout report
  - Lessons learnt
Significant Savings Through Implementation

**Average Savings Leakage 21%**

- Organisations have moved their focus to Contract Management, there is huge potential through monitoring performance and compliance to ensure benefits that were previously identified are delivered.
- Capability and execution for performance management of suppliers and contracts is still very low

Source: Direct Materials Sourcing, Aberdeen Group (May 2007)
Value Leakage From Supplier Management Efforts

- Resources Wasted
- Efficiencies Not Leveraged
- Problems Not Anticipated
- Performance Backsliding
- Suppliers Misdirected
- Opportunities Untapped

Total Potential Supplier Relationship Value

“Net” Supplier Relationship Value

Performance in Contract Management

- At 30%, this suggests no formal contract management in place.
- Visibility of contracts may be a significant contributing factor to poor performance.
- Spend under management leave significant cost exposure.

- The average yearly savings by Best in Class procurement teams is 12.8%, compared to All Others of 5.6%.
- 91% Best in Class procurement have Performance Reporting and Contract KPI’s, compared 49% of All Others.
Performance in Contract Management

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- Visibility of contracts may be a significant contributing factor to poor performance.
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<tr>
<th>Metric</th>
<th>Best-in-Class</th>
<th>All Others</th>
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<tr>
<td>Percentage of purchasing transactions compliant with contracts</td>
<td>85%</td>
<td>30%</td>
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<td>Percentage of contracts stored in a central, searchable repository</td>
<td>78%</td>
<td>34%</td>
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<td>Percentage of on-contract spend</td>
<td>70%</td>
<td>29%</td>
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<tr>
<td>Percentage of contracts renewed annually</td>
<td>56%</td>
<td>25%</td>
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The **average yearly savings** by Best in Class procurement teams is **12.8%**, compared to All Others of 5.6%.

91% Best in Class procurement have **Performance Reporting and Contract KPI's**, compared 49% of All Others.
## Role of Performance Management

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<th>Role</th>
<th>Description</th>
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<td><strong>Monitoring</strong></td>
<td>• Measure and record actual performance against contract requirements.</td>
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<td>• <em>Must have a clear understanding of customer requirements and expectations.</em></td>
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<td><strong>Control</strong></td>
<td>• Identify gaps between planned target and actual performance.</td>
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<td>• Develop countermeasures to close gap.</td>
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<td><strong>Improvement</strong></td>
<td>• Identify critical improvement opportunities.</td>
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<td></td>
<td>• Set targets for improvement.</td>
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<td><strong>Coordination</strong></td>
<td>• Information for decision making, leading indicators.</td>
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<td>• Internal communication across processes.</td>
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<td>• External communication with stakeholders.</td>
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<td><strong>Motivation</strong></td>
<td>• Align behaviour and encourage transformation.</td>
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<td><strong>Manage Risk</strong></td>
<td>• Reduce impact of risks to the organisation.</td>
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<tr>
<td><strong>Improve Future Opportunities</strong></td>
<td>• Successful performance will increase opportunities for future business.</td>
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How to Effectively Manage Contractor Performance

This diagram shows performance management as a cycle of activities, proceeding from a consideration of strategic aims through performance management and on to the review stage.

While this cycle indicates the order in which some activities will be undertaken, in practice they may not be successive stages but iterative loops; for example, the stage of performance monitoring and measuring is an ongoing process.
Contract Visualisation

- Contracts tend not to fail due to legal, technical or business expertise.
- Contracts fail due misunderstandings, misinterpretations, accountability, responsibility and failure to accurately describe the contract scope.
- Contract Visualisation helps parties align goals, accountability and processes through charts, graphs, swim lane diagrams, etc.
Performance Management Success

Ensure KPIs will drive **delivery of the requirements**.

Have the **systems** in place to **monitor and report on KPIs** so that poor performance can be tracked and corrected.

**Promptly** respond to performance issues.

**Tools** to determine **risks** and manage risks throughout the contact.

Manage **scope**.

Effective **communication** and **performance review/progress meetings**.

Encourage **stakeholder feedback**.

Conduct regular **progress checks** to ensure supplier is (at least) meeting their contractual obligations.

Utilise the **Contract Management Plan** (and maintain it).

Strong **relationships**.
Managing Suppliers for Specific Contracts

Identification of Suppliers for Contract Management
### Identifying Categories & Suppliers for Management

#### Supply Market Opportunity

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<tr>
<th>Leverage</th>
<th>Strategic</th>
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</table>
| • High expenditure area  
• Many existing alternate products and services  
• Many qualified supply sources  
• Good and services are readily available  
• Commercial involvement can significantly impact price |
| • Strategic to profitability and operations  
• Low to medium qualified supply sources  
• Large expenditures  
• Design to quality critical  
• Complex specifications |

<table>
<thead>
<tr>
<th>Routine</th>
<th>Bottleneck</th>
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</thead>
</table>
| • Many existing alternate products and services  
• Low value  
• Small individual transactions  
• ‘Anyone’ could buy it  
• Unspecified items for everyday use |
| • Very complex specifications requiring complex manufacturing or service processes  
• Few alternate products available  
• Few qualified sources of supply  
• May have big impact on on-going operations or maintenance  
• New technology or untested processes involved in provision of the product or service |

#### Business criticality/risk

| “What is the potential for product substitution? i.e. technical complexity of category?” |
| “What is the number of sourcing options?” |
| “How much buyer leverage is available for this category?” |
| “What is the relationship of this category to the strategic imperative?” |
| “What is the time sensitivity of this category?” |
| “How important is reliability?” |
| “How closely is this category linked with the company’s profit?” |
## Typical Strategies

<table>
<thead>
<tr>
<th>Supply Market Opportunity or Size of Spend</th>
<th>Business Criticality/Risk/Impact</th>
</tr>
</thead>
<tbody>
<tr>
<td>HIGH</td>
<td>HIGH</td>
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<tr>
<td>LOW</td>
<td>LOW</td>
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</table>

### Leverage

**This is a good place to be**

**Characteristics**
- Transactional, low/medium value items
- Purchased frequently
- Typically many suppliers

**Category Strategy**
- 1-3 year agreements
- Encourage new entrants
- Bid frequently

### Strategic

**Create value via mutual self interest**

**Characteristics**
- High Visibility within business
- Effects most/all sites
- Critically effects operations
- Senior Management is a key stakeholder
- Seek to drive value beyond cost

**Category Strategy**
- Longer Term Agreements
- Build relationships

### Don’t use too many resources here

**Characteristics**
- Transactional, low value items
- Purchased infrequently
- Many sources

**Category Strategy**
- Few/no Agreements
- Obtain quotes only
- Automate order and payment process
- P-card/E-Catalogues

### Ad-hoc activity where opportunity exists

**Characteristics**
- Limited alternatives
- High Switching costs
- Impacts operations or maintenance

**Category Strategy**
- Medium/Long Term agreements
- Identify and manage supply risks

### Business Impact

- Expense Base Impact
- Failure Impact
- Customer Value Impact
- Product differentiation impact
- Leading Technology Impact
Lifability Management Activity

Delivering value from the four category types requires varying of activity through the procurement lifecycle

**Strategic Spend Categories**
Strategic categories that impact profitability and operations benefit from well defined category strategies, strategic sourcing and supplier management activities. Innovation is important.

**Bottleneck Spend Categories**
Procurement value for highly complex and strategic categories, with few qualified sources of supply, is driven from supplier and contract management to manage an on-going relationship rather than strategic sourcing.

**Leverage Spend Categories**
High expenditure in readily sourced goods and services with many supplier alternatives lead to opportunities to gain value by developing a category strategy and better deals through strategic sourcing. Little on-going supplier relationship management is required for less critical goods and services.

**Routine Spend Categories**
Many existing alternate goods and services with low total spend value that do not require detailed category strategies or high levels of effort in negotiation. Once a contract is established, the primary procurement activity is ensuring suppliers of goods and services meet contractual obligations.
Governance

Governance structure for procurement which will also provide the review schedule for plans

Responsibilities

- The final stage of the escalation process before the CEO
- Convenes bi-annually unless an urgent requirement arises
- Execute Procurement Delegations as appropriate

- A category council is formed for all major categories & meets quarterly
- It works together to develop the best outcome
- Execute Procurement Delegations as appropriate

- If consensus cannot be obtained by the cross-functional teams, the issue is discussed at this level to obtain stakeholder agreement
- Execute Procurement Delegations as appropriate

- The cross functional teams work together to source the most appropriate products and services at the operational level
- Execute Procurement Delegations as appropriate

Procurement Role

CEO

CPO

Category Council

CFO, CEO and Business Leaders

Executive Manager

Manager

First Level Escalation Process

Business Segment Role

Manager

Cross Functional Teams

Business Representative

Category Manager

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Contract Extension
Contract Extension

Before the expiry date of the contract
Negotiations for contract extensions should commence and be agreed before the expiry date of the contract.

Possible changes with an extension
An extension to the contract period can also be accompanied by a change in price, personnel, and/or services or other elements of the contract.

Reassessment of internal needs
Internal needs analysis should be conducted to ensure the contract is still reflective of the current or future requirements.

Market Analysis
External supply market analysis should be conducted to ensure that the market has not significantly changed since the contract was first implemented.

CONCLUSION
Contract extensions that start late can place the entity in an inferior negotiating position. This shortens the time available to assess whether it still offers the best value for money. In effect, limited time restricts an entity’s ability to assess the need for a contract, test the provider’s price in the current market, and/or modify contractual terms and conditions.
Internal Needs / Requirements Assessment

• What are the required goods and / or services?
• Why are the goods and / or services required (what is the outcome)?
• How widely are the goods needed (across organisation or single user)?
• Is the requirement discrete or does it require additional goods or services for full implementation (e.g. on-going service or maintenance / follow on reports etc)?
• Are there any interdependencies with other goods and/or services?
• Are the goods or services able to be bundled to achieve greater aggregation of demand and improved operational benefits?
• How does this requirement support business and how important is this requirement in supporting the business?
• What is the volume of the need? Is it a one-off need or ongoing? Is it constant or fluctuating? Will it change over time?
• Are there any alternative ways to satisfy the need or to reduce the need? Are there alternative goods / services that may better meet the need
Supply Market Complexity Assessment

- **Threat of Entry**
  - Barriers to entry
  - Proprietary learning curve
  - Economies of scale
  - Existing relationships
  - Capital requirements
  - Brand value and loyalty
  - Switching costs
  - Access to distribution

- **Bargaining Power of Suppliers**
  - Supplier concentration
  - Importance of volume to Supplier
  - Switching costs
  - Size of supplier
  - Threat of forward integration
  - Size of buyers
  - Buyer Volume
  - Buyer information
  - Substitutes availability
  - Threat of backward integration
  - Price sensitivity

- **Bargaining Power of Buyers**
  - Availability of substitutes
  - Buyers willingness to substitute
  - Brand value and loyalty
  - Switching costs
  - Perceived level of differentiation

- **Intensity of Rivalry among Existing Suppliers**
  - Growing market
  - Shakeout underway
  - Urge to go public
  - Costs primarily fixed
  - Growing price competition

- **Pressure from Substitutes**
  - Capital requirements
  - Brand value and loyalty
  - Switching costs
  - Access to distribution

- **Low / Medium / High**
Improving Capability in Procurement
Capability Assessment

- Commercial Acumen
- Analysis & Reporting
- Contract Management
- Category Management
- Strategic Sourcing
- Procurement Project Management
- Negotiation
- Contract Development
- Managing Supplier Relationships

**Contract Management**
Ensuring the effective operational management of suppliers and contracts to deliver our business objectives

Why is this capability important? Effective Contract Management ensures that the value of a contract is realised by managing operational supplier relationships and operational risks & issues efficiently and effectively, as well as ensuring that suppliers deliver to contract commitments, including terms and conditions.

1. **Contributes to Contract Management**
   - Understands the role contract management plays within the procurement lifecycle
   - Manages timely resolution of supplier and operational issues in line with contractual requirements
   - Escalates appropriate issues to supplier relationship management

2. **Supports Contract Management**
   - Applies category knowledge and commercial acumen to resolve escalated issues in line with contractual requirements and ensures ongoing supplier relationship health
   - Actively identifies patterns in supplier performance (good or needing improvement), resolves at an operational level and ensures recognition through supplier relationship management
   - Effectively manages agreed KPIs in accordance with contract schedules or conditions
   - Manages all elements of operational contract management for less complex contracts to ensure compliance and minimise risk

3. **Manages complex contracts for Operational Performance**
   - Manages the operational performance of more complex contracts in line with ensuring business objectives are achieved through supplier performance
   - Proactively identifies opportunities to enhance contractual arrangements and achieve improved performance by suppliers and maintain relevance / currency of contracts in changing circumstances
   - Recognised by business stakeholders as providing value through effectively managing supplier operational performance

4. **Leads contract management**
   - Actively champions contract management throughout
   - Acts as a role model for best in class contract management practices
   - Views as vital to achieving best value in long life cycle total cost of ownership contracts by business stakeholders
   - Consistently innovates in approach to setting and realising contract management strategies
   - Builds long-term contract strategies that are aligned with business objectives

**Competency Levels**
Each capability is broken down into levels of performance. The levels of performance increase in complexity and are cumulative.

**Competency Indicators**
These are illustrations of what you might see when an individual demonstrates the capability at that level. They do not represent an exhaustive list.
Position Capability Expectations assist individuals to meet the requirements of their current role, as well as prepare for future roles, by defining the minimum level of capabilities expected for each role.

### Procurement Capabilities – Technical capabilities defined in the Procurement Capability Model

<table>
<thead>
<tr>
<th>Category Manager</th>
<th>Procurement Capabilities</th>
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<td>Commercial Acumen</td>
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**Expected Capability Level** – Capability level expected to perform the role successfully.
Tips and Take Aways

- Central and searchable repository for contracts.
- Visual KPI and process board for key suppliers.
- All key suppliers and major contracts to have a contract management plan.
- Defined accountability and responsibility for contract performance.
- Governance and relationship process.
- Create a risk management process for contracts.
- Create a compliance to contract report as part of the contract management process.
- Contract Manager capability development plan.
Thank You

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