

# Signed, sealed... now to deliver

by Rob Cooke and Glenn Davidson



## Building successful performance-based contracts

**A** GREAT DEAL OF money is at stake when government agencies negotiate contracts with external service providers. Across a wide range of categories, public sector organizations engage in contract services with a vast number of vendors, and the value created from those performance contracts is vital to the overall success of the agency.

Contract negotiations, especially with first-time contracts, can sap considerable time, energy and resources from both sides. In spite of best intentions, too many agencies and vendors are tempted to view the signed contract as an end point instead of what it actually is: the beginning of a long-term relationship that must be tended and managed to the mutual benefit of both parties and the people they ultimately serve.

The tendency to emphasize contract negotiations over contract governance and vendor relationship management leads to a surprising degree of unhappiness and dissatisfaction over time with the services received. Research has shown that, with fully half of all vendor contracts, clients indicate they are not receiving the full expected value from the contract.

One reason for the dissatisfaction: many government procurement executives fail to look past the financial and legal documents to see that a vendor relationship is, in fact, a series of *human* relationships that must be approached with both art and science – managed, that is, with a combination of human values as well as more rigorous governance structures and principles.

The importance of relationship management and governance to effective contracted services is known by most everyone. A recent Conference Board study, for example, found that 97 percent of respondents indicated that they should have paid as much attention to contract governance as they did to contractual service levels. Another international study

found that 40 percent of buyers and providers believe that ongoing management of relationships was the most important factor for a successful outsourcing program.

The problem, therefore, isn't rooted in a lack of knowledge or awareness; it is rooted in a lack of will: the willingness to invest in the structures and principles necessary to manage the contracted services arrangement effectively in the long run.

The ability to derive maximum value from a service provider relationship involves creating synergies between two essential elements: relationship management on the one hand, and contract governance on the other. These constitute the “art and science” of managing the arrangement. Neither element alone is sufficient. Both work together, creating synergies that energize the overall relationship and see the contract through the rough points that will inevitably occur.

### Governance

Contract governance concerns the structures, capabilities and processes that enable executives to steer the client/provider relationship over time toward optimal outcomes for all stakeholders. Governance provides the oversight and metrics that ensure that obligations on both sides of the contract are fulfilled: that the work of the provider is performed to specifications and requirements of the contract, and that the government entity

provides the cooperation and resources necessary to keep things running smoothly. Three key components comprise an effective governance structure:

- **Managing contract commitments.** This includes a heavy emphasis on tracking the financials of the contract. Commitment management includes billing and payment approvals, reconciling billing with services delivered, consumption forecasting and tracking, financial compliance to the contract and the recommendation of appropriate penalties.
- **Managing service provider performance.** Client organizations must assume responsibility for managing service provider performance, with reporting capabilities and systems – daily, weekly, monthly and annually – that enable providers to easily input data into performance reporting programs. Performance management is about tracking and analyzing performance, and then escalating and resolving performance issues if and when they occur. Leading organizations learn from those performance issues; they perform “root cause” analyses to improve their management capabilities and ensure that the same problem never occurs twice.
- **Managing risks.** Clients must continually identify and quantify potential risks associated with the delivery of services and develop mitigation plans for risks that have both high impact and a high likelihood of occurring. Potential risks to be considered include service provider business disruption, unexpected additional

### What type of provider relationship is appropriate?

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Transactional	Enhanced	Collaborative	Partnership
§ Commodity price	§ Some customization	§ Customized/individualized	§ Shared risks & investment
§ Interchangeable product	§ Flexibility/levels of service	§ Process & data integration	§ Deeply integrated
§ Highly specified deliverables	§ Special knowledge	§ Solutions oriented	§ Mutually dependent
		§ Shared rewards	

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costs, poor service quality and the inability of the service provider to meet an organization's changing needs over time. Effective risk management also includes reviewing and monitoring security, disaster recovery and business continuity plans.

## Relationship management

If contract governance is the “science,” relationship management is the “art” of creating value from provider relationships. Relationship management is about working together to continually align the expectations of both parties to ensure sustainability of the relationship. Unless a sound, workable and trusting relationship is in place, no level of contract governance processes will be effective – even the best train engineer will be ineffective if the train is off the rails.

The more effective relationship management practices begin by defining the exact type of relationship most appropriate to the service contract along a continuum of possible relationships (see figure p. 4).

At one end of the continuum is a basic transactional relationship, suitable for commodity products with highly specific deliverables. In this relationship, the parties have less need to understand specific details of each other's processes, because price is the primary value proposition. A buyer of commodity services simply wants to know that the services will be provided at approved service levels and at the best price. Cheque processing, for example, or travel and expense claims processing, are provided in a similar fashion to all customers, and little customization of services is necessary. A transactional relationship is appropriate here.

Moving to the right on the continuum, an “enhanced” relationship becomes appropriate when there is some customization and expertise required to provide a service that is somewhat unique to each client. In this enhanced relationship, both sides of the contract must have a degree of understanding of each other's processes, even though only minimal process changes on either side will be possible.

A “collaborative” relationship – the third type – is appropriate when the client is looking for customized expertise and for services that are integrated into their processes. In these cases, joint planning and sharing of information is required, and service providers are obliged to develop a high degree of knowledge about their clients' processes and people.

Finally, other kinds of client/provider relationships are built upon actual shared risks and investments, and the services are both unique to the client and deeply integrated into the client's operations. This kind of interaction requires a “partnership” relationship, where client and service provider become mutually dependent and must work together collaboratively to ensure the success of their mutual interests.

Knowing the type of relationship is crucial to being effective at long-term management while preserving the original business case for the contract. Relationships are not

“one size fits all.” Some relationships will require dedicated resources and others will require only a general kind of oversight.

## Keys to success

Based on our work with government procurement agencies across the country, here are some of the most important keys to success when pursuing enhanced capabilities in contract governance and vendor relationship management.

- **Lead from the top.** If effective service provider management is a matter of will, then the vision and expectations for cre-

ating effective governance and relationship management structures must be set by organizational leadership. Some estimates suggest that effective contract governance can add from 3 percent to 10 percent of the annual contract spend. Ongoing responsibility for making that extra investment needs to be assumed by senior executives.

- **Build relationship management and governance into the business case.** Few business cases for shared services, outsourcing and other service provider relationships include ongoing management costs. Many organizations are “penny wise and pound foolish” when it comes to allocating resources to contract governance and relationship management. An effective business case must take the long view.
- **Invest in the necessary training.** Contract managers are typically trained in financial analysis and contract negotiation, not in the capabilities necessary to tend a relationship. Program management skills are essential, as are leadership skills to gain and hold trust.
- **Appoint dedicated resources to manage the most important relationships.** Provider relationship management, especially for interactions with providers to the right on the relationship continuum,

is not a part-time endeavor. It requires a dedicated and ongoing focus and a special capability.

- **Create an ongoing communications program for the most essential relationships.** Communications vehicles are important to ensure that leadership stays in touch and that all parties are working in synch. Effective communications push out leadership statements, but also pull in opinions and feelings from the field.
- **Establish a governance committee with regular meeting dates.** A governance oversight committee, comprised of personnel from both client and provider, ensures that someone is always tending to the performance of the contract. Regular meetings are essential, though the timing may vary. At some points, weekly meetings may be necessary. In maintenance mode, monthly meetings may be more appropriate.
- **Conduct regular relationship “health audits.”** In addition to regular meetings focused on performance, regular “health audits” for the overall relationship are essential. A certain resistance to such audits must be managed and overcome. Relationships do not deepen over time by chance. They must be worked at. Decision-making protocols and conflict man-

agement/resolution methods must be refined as time goes on.

Two trends in government service continue along a collision course today. The reliance on service providers and shared services initiatives is only going to increase. Likewise, scrutiny over government performance is going to intensify. In that environment, agencies must labour to overcome a short-term focus on the negotiated contract and work from a longer-term vision of the value produced over time from the relationship. Service provider management is increasingly a high-stakes game to be won by those willing to put in place the governance structures and relationship management principles that can produce the greatest value from the contract. *MM*

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