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Good practice contract management framework

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- getting the best from the Government's £30 billion estate;
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- helping achieve delivery of further government policy goals, including innovation, equality, and support for small and medium enterprises; and
- driving forward the improvement of central government capability in procurement, project and programme management, and estates management through the development of people skills, processes and tools.

Good practice contract management framework

This good practice framework for contract management (the framework) was developed in parallel with the National Audit Office report on *Central government's management of service contracts* and was used during the fieldwork stage of the report to benchmark central government's contract management performance against good practice. The framework will provide the foundation for the Office of Government Commerce's revised guidance on contract management.

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Overview

1 This good practice framework for contract management (the framework) was developed in parallel with the National Audit Office report on *Central government's management of service contracts*, which was published in December 2008 (HC 65, Session 2008-09) and is available at www.nao.org.uk. The framework was used during the fieldwork stage of the report to benchmark central government's contract management performance against good practice.

2 The National Audit Office found that while there are examples of good practice, central government's management of service contracts is not consistently delivering value for money. The report estimated that better contract management could potentially generate savings of between £160 million and £290 million a year across the organisations surveyed through reduced contract expenditure. As well as financial savings, better contract management could bring improvements in the quantity and/or quality of services, the avoidance of service failure, and better management of risk.

3 The framework is a good practice guide for managing a broad range of contracts. It is particularly relevant for contracts where services are delivered over a long period of time (five years plus) where customers need to ensure that service levels and value for money are maintained over the duration of the contract. The framework will provide the foundation for the Office of Government Commerce's revised guidance on contract management. The Office of Government Commerce will also develop supplementary guidance, specifically appropriate to the most complex forms of contract, during 2009.

4 The framework covers the stage where a contract has been signed and the service is up and running. It does not cover the tendering/contract award stage or some of the specific issues that arise when a contract expires or is terminated, for example, relating to the disposal of equipment or handover to a new supplier. Guidance on these areas, and on issues such as contract management skills, is available on the Office of Government Commerce's website – www.ogc.gov.uk.

5 The framework complements guidance provided by the Operational Taskforce within Partnerships UK for the management of PFI contracts during their operational phase. The framework does not, however, cover all the issues which may arise in relation to PFI contracts, which involve an added degree of complexity, for example in their arrangements for refinancing, managing contract variations, risk allocation and contract termination. Further guidance for managers of PFI contracts is available on the Partnerships UK website – http://www.partnershipsuk.org.uk/PUK-OTF.aspx.

6 The framework comprises:

- Section 1 which outlines the activities that organisations should consider when planning and delivering contract management;
- Section 2 which discusses how to evaluate the risk and value opportunities inherent in contracts; and
- Section 3 which illustrates how the activities from Section 1 and the evaluation from Section 2 can be brought together to develop contract management plans and priorities.

7 The National Audit Office employed two experienced procurement professionals to develop the initial framework. The framework was then tested at four workshops with representatives from government departments and other public bodies, specialist procurement organisations, IT suppliers and facilities management suppliers.
The framework was refined in the light of feedback from the workshops. Further discussions were then held with the Office of Government Commerce, the Chartered Institute of Purchasing and Supply, and Partnerships UK to finalise the framework.

Section One

The good practice contract management framework

Introduction

1.1 The framework defines the four blocks – structure and resources, delivery, development, and strategy – comprising 11 areas (**Figure 1**) that organisations should consider when planning and delivering contract management, together with the key activities that fall under each of the 11 areas.

Figure 1
The good practice contract management framework

1.2 The focus of the framework is on the activities to be undertaken during the operational phase of the contract, i.e. after the contract has been awarded and once the service is up and running. The framework has particular relevance to service contracts (covering information and communications technology, facilities management and business processes) where service levels and value have to be maintained and improved often over long contract periods.

Contract management in context – the effect of the tendering/contract award phase

1.3 Whilst the framework focuses on the operational phase of the contract, contract management success and the activities undertaken are strongly influenced by what has happened during the tendering/contract award phase, in terms of both 'hard' outputs, such as the terms and conditions that have been agreed, and the type of relationship between customer and supplier that has been established during the tendering/contract award phase. In this way, the tendering/contract award phase and the contract management phase should be seen as a continuum rather than distinct phases, with contract management planned for from the start of the procurement process. Some of the key issues that can influence contract management include the following.

- Whether contract management staff have been involved in the earlier tendering/contract award phase.
- The style of the tendering process. An adversarial tendering process may lead to a more adversarial or confrontational relationship during the contract management phase, although good working relationships between the staff on both sides who will manage the contract can be developed at the same time that separate, sometimes tough, negotiations are taking place to finalise the contract.
- The 'cultural fit' between customer and supplier. For example, if one party feels comfortable working in a very process-driven, detailed manner, while the other prefers a more open, high-level relationship, then developing successful contract management will be more challenging.
- A contract where one party feels they are disadvantaged by the terms and conditions, or the commercial terms, of the contract may lead to more adversarial contract management.
- Key hard outputs that have a major impact on the design and effectiveness of contract management – such as key performance indicators and service level agreements – are often determined during the tendering/contract award phase.

The framework

1.4 The key activities to be undertaken under each of the 11 contract management areas are set out below. The numbering is not intended to indicate that the activities should be executed in a sequential manner. Indeed, many of the areas and activities are relevant throughout the contract management phase.

1.5 As discussed in more detail in Sections 2 and 3, not all of the 11 areas are equally relevant to all contracts. Generally, the more developmental and strategic areas and activities (areas 8 to 11) become increasingly important the higher the contract risk and the greater the opportunity to add value.

Structure and resources

Area 1: Planning and governance

Preparing for contract management and providing oversight

1.1 There is a planned transition from the tendering/contract award phase to the contract management phase, and a handover to contract manager; the cost of contract management is included in the business case and budgets.

1.2 Contract ownership is clear, with the budget holder, senior responsible owner (SRO), and contract manager clearly defined; there is continuity of governance as far as possible.

1.3 There are well defined processes and a clear contract management plan, with a focus on outputs and a 'whole life' approach to performance.

1.4 Overall ownership of contract management across the organisation is clear, with a 'contract management senior responsible owner' with responsibility for driving organisation-wide contract management performance.

1.5 Contract management processes are aligned with, among others, wider organisational governance processes, operational boards, and risk structures.

1.6 Contract management issues and performance are reported through the governance structure with senior level engagement.

1.7 Regular assessment and evaluation takes place to ensure that the cost of contract management activities is justified and proportionate to the benefits obtained.

1.8 Knowledge management is embedded, capturing key data and lessons from contract management process and experience both within the organisation and more widely.

1.9 Professional contract management guidance is developed, or identified from external sources, and made available to contract managers.

Area 2: People

Ensuring the right people are in place to carry out the contract management activities

The contract manager (or contract management team)

2.1 The contract manager has continuity (ideally through involvement during the tendering/contract award processes) and a handover from the staff responsible for the tendering/contract award.

2.2 The contract manager has a detailed knowledge of the contract and other relevant issues, such as service level agreements, and ongoing supplier performance.

2.3 The contract manager has the appropriate skills (both specific contract management skills and more general commercial awareness and expertise), with access to relevant training and development. Experienced contract managers are utilised on key contracts.

2.4 Contract managers have accurate job descriptions, roles are positioned at an appropriate level and salary, and there is a career path for contract management staff.

2.5 Contract managers have clear objectives and reporting lines and their performance is managed through reviews and appraisals.

2.6 The contract manager has appropriate delegated authority to manage the contract effectively.

Wider staff issues

2.7 Balanced contract management teams are brought together, with an appropriate range of skills; the teams may vary in composition over the life of the contract to meet specific needs.

2.8 Contract management is adequately resourced, in proportion to the importance of the contract (primarily but not exclusively its cost), and there are enough staff to carry out the required activities.

2.9 The organisation has a contract management 'community' allowing contract managers to share good practice. The community also plays a role in the wider government contract management/procurement community.

Area 3: Administration

Managing the physical contract and the timetable for making key decisions

3.1 Hard copy contracts are stored and logged, and are easily accessible when required; for complex contracts, a summary and/or contract operations guide is produced.

3.2 Contract management software is used for recording key information, to give, for example, search capability; relevant ongoing contract management information and documentation is retained and managed.

3.3 There are mechanisms in place for identifying key contract 'trigger points', such as notice periods.

3.4 There is regular and ad hoc reporting of contract management information.

3.5 There are mechanisms in place for handling administration around contract closure or termination.

3.6 The customer considers the cost of contract management activities to the supplier, and the cost is proportionate to the contract size and risk.

Delivery

Area 4: Managing relationships

Developing strong internal and external relationships that facilitate delivery

Roles and responsibilities

4.1 The contract manager understands his/her own role and has clear visibility of well-structured roles and responsibilities on the supplier side.

4.2 The respective responsibilities of the contract manager and the supplier are clear, and potentially defined in a 'joint statement of intent' or similar document.

Continuity and communications

4.3 Continuity of key supplier staff is desirable (ideally through involvement during the sales process); where this cannot be achieved, there is a handover from the staff responsible for the tendering process.

4.4 Both regular structured and informal communication routes between the contract manager and supplier are open and used; customer and supplier staff are co-located where appropriate.

4.5 Users are given clear expectations and an understanding of the contract and the services/performance to be delivered (for example, through newsletters or briefings).

4.6 Communications between the contract manager, supplier and other stakeholders (users of the contract and others such as technical experts) are effective; and stakeholders are involved in contract management processes where appropriate.

4.7 Problem resolution processes are well defined and used, and are designed to ensure minor problems do not escalate and cause relationship issues; a 'blame culture' is avoided (for example, through the use of a 'relationships charter' or similar document).

Area 5: Managing performance

Ensuring the service is provided in line with the contract

Service delivery

5.1 Service management is well structured; baselines are understood by both parties, and suppliers understand the service they are required to deliver. The contract manager ensures that the customer organisation provides the supplier with the information and contacts needed to deliver the service.

5.2 A performance management framework is in place when the contract is signed. The framework is comprehensive, objective and provides incentives for the supplier to meet or exceed agreed performance standards.

5.3 Service levels agreements are in place, and are linked to business needs, understood by the supplier, and monitored by the contract manager and/or end users.

5.4 Supplier performance is assessed using clear, objective and meaningful metrics, linked where appropriate to the Office of Government Commerce's 'Common Assessment Framework' for monitoring suppliers.

5.5 Reporting is as far as possible on a focused, 'by exception' basis, with supplier self-measurement and reporting where appropriate but with independent checking mechanisms to alert the customer to performance issues (for example, user feedback).

5.6 Clear processes are in place to handle operational problem resolution and resolve issues as quickly as possible.

5.7 Where appropriate, user compliance with the contract is monitored and managed to ensure maximum operational effectiveness and value for money.

Feedback and communications

5.8 Regular and routine feedback is given to suppliers on their performance.

5.9 There are clear contact points for service users both within the supplier organisation and with the contract manager. Users understand what the contract is intended to deliver, and are involved in the assessment of supplier performance where relevant. Users understand escalation routes where issues arise.

5.10 Changes in user requirements are captured and considered as part of formal change and contract management processes.

5.11 There are formal performance reviews with suppliers, with documented improvement plans agreed where necessary, covering both operational issues and adherence to key contractual requirements, for example, on data security.

Area 6: Payment and incentives

Ensuring payments are made to the supplier in line with the contract and that appropriate incentive mechanisms are in place and well managed

Payment and budgets

6.1 Payment mechanisms are documented and are clear and well understood by all parties (including incentives, penalties, and non standard charges).

6.2 Payment processes are well defined and efficient; appropriate checks and authorisation processes are in place for paying invoices.

6.3 The costs of the services delivered and contract management costs are mapped against budgets and allocated appropriately.

6.4 Payment changes after the contract is let, for example from contract variations or benchmarking/market testing, are made using contractual provisions and demonstrated to provide value for money.

Payment and incentive mechanisms

6.5 Incentive structures (financial or non-financial) relate clearly to desired outcomes, and are well managed and governed, with appropriate checks and approval mechanisms.

6.6 Service credits or equivalent mechanisms are well managed and governed, and proportionate to supplier profitability.

6.7 Where open-book or similar financial/pricing mechanisms are used, the process is managed professionally and fairly.

6.8 The contract manager takes action where necessary to avoid the organisation being ‘locked in’ to onerous commercial terms throughout the contract period, such as price escalation or ‘compulsory’ maintenance payments.

Area 7: Risk

Understanding and managing contractual and supplier risk

Processes and plans

7.1 Contractual/supplier risk management is in place with clear responsibilities and processes, identification of who is best placed to manage risk, and supplier involvement where appropriate.

7.2 Risks are formally identified and monitored regularly, with mitigating actions developed and implemented where possible, and ‘obsolete’ risks removed from consideration where appropriate.

7.3 Escalation and reporting routes are in place for risk governance.

7.4 Contingency plans are developed to handle supplier failure (temporary or long-term failure/default); exit strategies are developed and updated through the life of the contract.

Contractual terms

7.5 Contractual terms around termination are understood and monitored by the contract manager.

7.6 Contractual terms around warranties, indemnities and insurance are understood and monitored by the contract manager.

7.7 Contractual terms around security and confidentiality are understood and monitored by the contract manager, particularly issues relating to the security/confidentiality of personal data.

7.8 Dispute resolution processes are in place, including agreed adjudication procedures, mediation, and arbitration.

Ongoing supplier risk management

7.9 The contract manager monitors the supplier’s financial health and business performance (including through the use of credit rating agencies).

7.10 The contract manager monitors the supplier’s compliance with contractual ‘non-performance’ issues (for example, on tax and sustainability targets).

Development

Area 8: Contract development

Effective handling of changes to the contract

Change processes

8.1 The contract is regularly reviewed (with a view to updating where necessary) to ensure it meets evolving business needs.

8.2 Processes are in place that clearly lay out the governance of contractual change – who needs to approve what and how it will happen – with a focus on effective and prompt change implementation.

8.3 There are clear processes for the management of minor changes and contract variations, with a focus on the cost/effort being proportionate to the importance and value of the change.

8.4 There are more rigorous processes to handle major contractual changes, including clear approval mechanisms and accountabilities, and controls to demonstrate that changes offer value for money.

8.5 Where appropriate, value for money testing of existing services takes place through benchmarking or other processes.

8.6 There are processes to cover the introduction of new services under the contract, including market testing where necessary.

8.7 Dispute handling processes are in place to handle change related issues.

Processes for different types of change

8.8 Both parties have a clear understanding of the arrangements for any extension of the contract (both scope and time) and related issues.

8.9 Processes are in place to handle commercial (financial) changes to the contract in a fair and structured manner.

8.10 Price changes are managed fairly and effectively with the use of mechanisms such as benchmarking, competitive tendering (for example, for major additional works), or other techniques such as open book pricing as appropriate, to test value for money.

8.11 The rationalisation of specifications and demand management are considered as options to achieve better value for money.

Area 9: Supplier development

Improving supplier performance and capability

Processes

9.1 Processes are in place that clearly set out how supplier development activities will be planned, managed and governed.

9.2 Clear processes for benefits measurement and capture are in place to ensure that supplier development is focused on continuous improvement and achieving value for the customer organisation.

9.3 The customer organisation understands what motivates and drives the supplier and how supplier development fits with the supplier's goals.

Improvement activities

9.4 Supplier operational performance improvement activities (for example, 'Lean' and '6-sigma'), with potential input or assistance provided by the customer organisation.

9.5 Joint working or shared activities between the two parties for the benefit of both the supplier and customer (for example, process improvement, shared training, task forces or joint project teams).

9.6 Supplier improvement activities relating to wider government initiatives, with input or assistance provided by the customer organisation (for example, on sustainability, disability employment issues, use of SMEs (Small and Medium Sized Enterprises) and BMEs (Black Minority Ethnic suppliers)).

9.7 Shared risk reduction programmes or activities.

9.8 Supply chain development activities (for example, the development of second/third tier supplier performance).

9.9 Shared management activities (for example, supplier boards) to drive performance improvement.

Strategy

Area 10: Supplier relationship management

Having a programme for managing and developing relationships with suppliers

10.1 A supplier relationship management programme is planned and structured with appropriate governance and senior ownership.

10.2 A benefits realisation plan is in place for supplier relationship management; there is a clear sense of what value is to be generated for both parties.

10.3 There is a focus on capturing innovation from the supplier where necessary or valuable.

10.4 Knowledge management issues are addressed, including knowledge capture from suppliers.

10.5 The supplier relationship management programme considers all the supplier's interactions across an organisation and on a pan-government basis, including work with the Office of Government Commerce.

10.6 Board level supplier/customer organisation interfaces and relationships are planned and managed in line with overall supplier relationship management objectives.

Area 11: Market management

Managing the wider market issues that impact on the contract, but lie beyond the supplier

11.1 Processes are in place to evaluate and review options around delivering services in-house or outsourcing.

11.2 Market intelligence is used to maintain an understanding of the market and of alternative suppliers (to inform benchmarking, contingency planning and re-competition strategies).

11.3 The capacity and capability of potential suppliers is analysed, and linked to wider government analysis, for example, by the Office of Government Commerce.

11.4 There is ongoing evaluation of emerging technologies and practices, and identification of opportunities from both immediate and parallel market sectors.

11.5 Market making is undertaken where appropriate to stimulate competition and ensure the requirements can be delivered by the market; there is an understanding of issues such as switching and bidding costs.

11.6 A re-competition strategy and plan is put in place in a timely manner; the contract manager feeds into strategy development for the 'new' procurement process.

Section Two

Assessing the appropriate level of contract management

2.1 As set out in Section 1, the framework comprises 11 contract management areas and over 80 key activities that organisations should be considering when managing a contract. However, not all of these areas and activities are relevant for every service contract. The level of resources devoted to contract management and the type of activities undertaken should be proportionate and justified by the potential benefits they may deliver.

2.2 For each contract, organisations therefore need to assess the potential benefits of contract management. This can be done using two dimensions.

- The benefit that can be obtained from effectively managing the risk inherent in the contract.
- The potential additional value that can be obtained from effective contract management.

2.3 As the level of risk increases, the benefits which may be derived from reducing these risks through enhanced contract management also increase. A contract that has little inherent risk attached to it and little opportunity for additional value would not need or justify a large amount of contract management resources, as the benefits that could be achieved from greater contract management would be small. This may be the case even if the annual expenditure on a contract is substantial, although small improvements on a major contract can, of course, be significant.

2.4 Even if contract risk is low, the potential to generate additional value from the contract can justify increasing levels of contract management resources and activities. Extra value could come, for example, from cost reduction through process development, or from persuading a supplier to increase service levels without additional cost.

Managing contract risks

(a) Identifying contract risks

2.5 The initial stage in any risk management process is to identify the key risks. In the case of service contracts, the key risks can be categorised into three broad areas.

- **Service failure** – the most obvious and common risk is that the supplier does not deliver the service to the standard or timeliness specified in the contract. Service failure can range from a relatively minor shortfall against required service levels to complete failure. Minor failure could be driven by, for example, the customer providing unclear specifications, a lack of supplier capability, or a supplier cutting corners to improve profitability. At the extreme, financial or other problems could cause the supplier to go out of business, unilaterally withdraw from the contract, or be unable to deliver the service.
- **Reputational damage** – even if the service is provided as specified in the contract, there is a further risk that the supplier in some manner causes harm to the customer organisation's reputation. For example, the supplier may act illegally or in a manner that conflicts with government policy. Supplier problems could result in sensitive or personal information not being kept secure, or a supplier may be dealing with vulnerable citizens where poor performance would have operational implications and cause reputational damage to the customer organisation.
- **Additional cost** – this category of risk covers cases where the contract costs more than expected or budgeted, and those costs do not represent value for money. The amounts paid to the supplier may increase as a result of changes in the quantity or quality of the services delivered or their prices. For example, user demand may be higher than expected. In such cases, additional costs may be reasonable and offer value for money. But it is vital that processes are well managed so that value for money is tested and achieved on this additional expenditure. The internal costs of the customer organisation may also increase. For example, poor user perception of the service could lead to more work being done internally by the customer's staff rather than by the supplier, with consequent additional costs.

(b) Quantifying contract risks

2.6 Once the core risks associated with a contract have been identified, the scale or importance of each risk needs to be quantified. This can be done by assessing two elements.

- The likelihood (probability) of the risk materialising.
- The impact if the risk does materialise.

The likelihood of the risk (probability)

2.7 Understanding the likelihood of the risk materialising is key to assessing its relative importance. A risk may have a huge potential impact, but if the likelihood of it happening is very small, it may not be worth devoting much effort to managing or reducing the risk. In terms of service contracts, a variety of factors can influence the likelihood of the key risks materialising.

- The technical or operational complexity of the services being delivered.
- The complexity of the terms and conditions of the contract. More complex, or non-standard, terms and conditions require more effort to understand, control and update than do concise or standard terms and conditions.
- The number of changes required to the contract over its duration.
- The number of internal users or other stakeholders within the customer organisation.
- The extent of the geographic area covered by the contract.
- The extent to which one party feels they are disadvantaged by the terms and conditions, or the commercial terms, increasing the likelihood of disputes.
- The nature of the supplier itself and its business model. The probability of supplier failure or performance issues may depend on:
  - the supplier's internal business configuration, for example, there is higher risk if a supplier provides services from a single site that is vulnerable to supply interruption;
  - the supplier's dependency on key staff, third party suppliers or other key stakeholders in the delivery of the service;
  - the experience of the supplier in working with the particular customer organisation or in the sector concerned, for example, a supplier who has never worked in the public sector is likely to carry inherently more risk as a supplier to government than one who is experienced in that sector; and
  - the supplier's experience in delivering the service in question.

The impact of the risk

2.8 Along with the likelihood of the risk materialising, the overall importance of the risk is dependent on the impact were the risk to materialise. A risk with a significant potential impact is clearly more serious and worthy of attention than one that has only a limited effect. Impact can be considered under the three key risk headings identified above.

- Service failure can generate a wide range of potential impacts. At the extreme, a service failure by a critical supplier could mean the customer organisation has in turn to stop providing services. In the public sector, poor supplier performance could result in the customer not achieving policy objectives or PSA targets, or in the public who use the service suffering delays and inconvenience. A less serious service failure (perhaps a service that does not fully meet the standard or specification required) could generate a more minor loss of efficiency or effectiveness within the customer organisation.
- Reputational issues can also have an impact on the customer organisation. While damage may arise from service failure as described above, this is not necessarily the case. A service contract may be delivered to specification but if, for example, the supplier is found to be using illegal immigrants, there will be reputational damage and impact for the customer organisation as well as for the supplier. Quantifying such an impact is, however, often difficult.
- Additional cost is the third key potential impact. The impact of contract expenditure being greater than forecast or budgeted can be considerable, whether it occurs through poor control, changing requirements, or through unbudgeted but contractually allowed price increases (for example, where the charges are uprated for inflation). The internal costs of the customer organisation can also be affected, whether direct contract management costs or wider costs driven by contract issues. In general terms, the risks associated with a high value contract will usually have greater potential impact, but the specific terms of each contract can also affect the potential costs.

Combining likelihood and impact

2.9 By bringing likelihood and impact together, organisations can assess the importance of risks, prior to any mitigating actions. Importance can be assessed by scoring each element and then multiplying the two scores to arrive at a final 'risk score'. For instance, likelihood and impact could be rated on a (very simplified) scale such as:

0 Zero likelihood / zero impact

1 Low likelihood / low impact

2 Medium likelihood / medium impact

3 High likelihood / high impact

2.10 Applying such a scale would award a risk with a low probability but a high impact a score of 3 (1 x 3), while a risk with a high probability and medium impact would score 6 (3 x 2). A process such as this can therefore give some overall rating and ranking of each risk both within a specific contract and across a portfolio of contracts.

Identifying opportunities for additional value

2.11 In addition to managing risk, the other aim of enhanced contract management is capturing additional value, above and beyond that defined in the original contract. Additional value generally falls under the headings of service or cost; reputational added value is more unusual although not impossible to achieve.

2.12 In terms of service, extra value can arise from a supplier providing higher service levels than expected or specified, at no additional cost. This may have a value to the customer organisation, although this is not always the case. A 99 per cent service level may be more than adequate, and achievement of 99.5 per cent may bring no further value. For example, a call centre reducing the time it takes to answer calls by five seconds may not even be noticed by the callers.

2.13 A service provided in a different or innovative manner can also bring value to the customer organisation and may not always have a cost to the supplier. Indeed, there may be alternative service delivery models that provide a 'win-win' opportunity: lower costs to the supplier and better service to the customer.

2.14 Value improvement through lower costs may come about through contractual mechanisms, such as benchmarking against market prices, or through negotiation with the supplier. Cost reduction may also arise from supplier or mutual action that enables the customer organisation to refine its own internal process or reduce other costs.

2.15 The potential for value improvement in a contract can be assessed in a similar way to assessing the risks. Opportunities need to be identified and then quantified in terms of their feasibility (similar to the 'likelihood' assessment under the risk heading) and their potential size or impact.

Section Three

Linking the good practice framework with the risk and value opportunity assessment

3.1 This section outlines how the good practice contract management framework (Section 1) can be applied to develop contract management plans and priorities, based on the risk and value opportunity associated with the contract (Section 2). **Figure 2** illustrates a high level view of how the contract management focus widens as the potential risk and value opportunity increase.

Responding to risk

3.2 The purpose of contract management is to manage the risks and exploit the opportunities inherent in a contract. Risk management activities fall into four categories.

Figure 2
Contract management priorities

- Risk reduction – taking action to reduce (mitigate) the likelihood and/or impact of the risk.
- Risk elimination – reducing the likelihood or impact of the risk to zero.
- Risk acceptance – acknowledging the risk but taking no action, either because the risk is not that great in terms of likelihood or impact, or because there is nothing practical that can be done about it.
- Risk transfer – taking action to transfer ownership of the risk to the supplier or to a third party (for example, through insurance).

3.3 In developing contract management plans, the customer organisation should consider the various contract management activities and select those that respond most appropriately to each risk identified. The greater the potential risk and/or value opportunity, the more sophisticated the contract management activities and greater the resources that can be justified (**Figure 3**).

Figure 3

Widening contract management focus as the potential risk and value opportunity increases

Structure & resources

Governance

- Transition from tendering process
- Clear ownership
- High level governance

People

- Appropriate staff resource
- Training and development
- Job description and objectives
- Wider contract management community

Administration

- Storage and records
- Reporting
- Key trigger points

Delivery

Relationship

- Supplier continuity
- Supplier liaison
- User feedback
- Problem resolution processes

Performance

- Service management
- Service level agreements
- Performance metrics
- Performance reviews

Payment

- Invoice checks
- Incentives/penalties

Risk

- Risk management

Development

Contract development

- Negotiation of changes/ new terms
- New services
- Value for money testing

Supplier development

- Development plans
- Value measurement and capture
- Supplier Boards
- Shared training
- Innovation

Strategy

Supplier relationship management

- Structured relationship management programme
- Senior relationship governance

Market management

- Market intelligence
- Market capacity and capability issues
- Re-competition

Increasing potential risk and value opportunity

3.4 For example, the more operational contract management activities (areas 1 to 7 of the framework covering structure and resources, and delivery) address common risks, often relating to supplier performance failure. Monitoring against key performance indicators, for example, is designed to reduce the risk of suppliers failing to deliver services as required or, if they do fail, to pick this up quickly and prompt remedial action. A contract that has major risk in terms of potential cost overrun may require management focused around areas such as control of internal demand, careful budgeting and payment, and well managed change processes.

3.5 More sophisticated contract management activities can be the appropriate response to more subtle risks. For example, getting close to a supplier through 'supplier relationship management' may give early warning of an important strategic change in the supplier's business that could affect its ability or appetite to provide the service.

3.6 If unacceptable risks remain, even after mitigating action has been taken, customer organisations should consider widening the scope of their contract management to include further development activities. For example, if there is a significant risk that a supplier could go out of business, merely monitoring the supplier's financial performance may not be sufficient mitigation, and development work to identify alternative sources of supply may be necessary.

3.7 **Figure 4 on page 26** at the end of this section illustrates in more detail how the relative focus on the 11 contract management areas that comprise the framework may widen as the risk and value opportunity increase.

Responding to value opportunities

3.8 As well as managing risk, contract management should address potential value opportunities. Not every contract will have such an opportunity, but most complex service contracts will have the potential to deliver further value above that contained in the initial contractual terms.

3.9 As with risk, different contract management approaches can be appropriate to pursue such opportunities. For example, performance management may stimulate service improvement above that defined in the initial contract; benchmarking or market testing can drive cost reduction during the life of the contract; and supplier development activities may generate opportunities for mutually beneficial process improvement.

The resources required for contract management

3.10 A further factor to consider in developing contract management plans is the type and level of resources required, as this will vary for different types of contract. In broad terms, operational risk may require a considerable quantity of contract management resources, while managing more sophisticated risk or value opportunities can require higher skill levels and capability rather than simply more resources.

Developing contract management over time

3.11 Contract management activity may need to change over time, depending on the nature and complexity of the service being provided.

- In the case of simple services, the service will be delivered immediately once the contract has been agreed and will probably be a standard 'off the shelf' service. In this event, the required contract management approach should also begin immediately and is likely to remain fairly unchanged throughout the life of the contract.

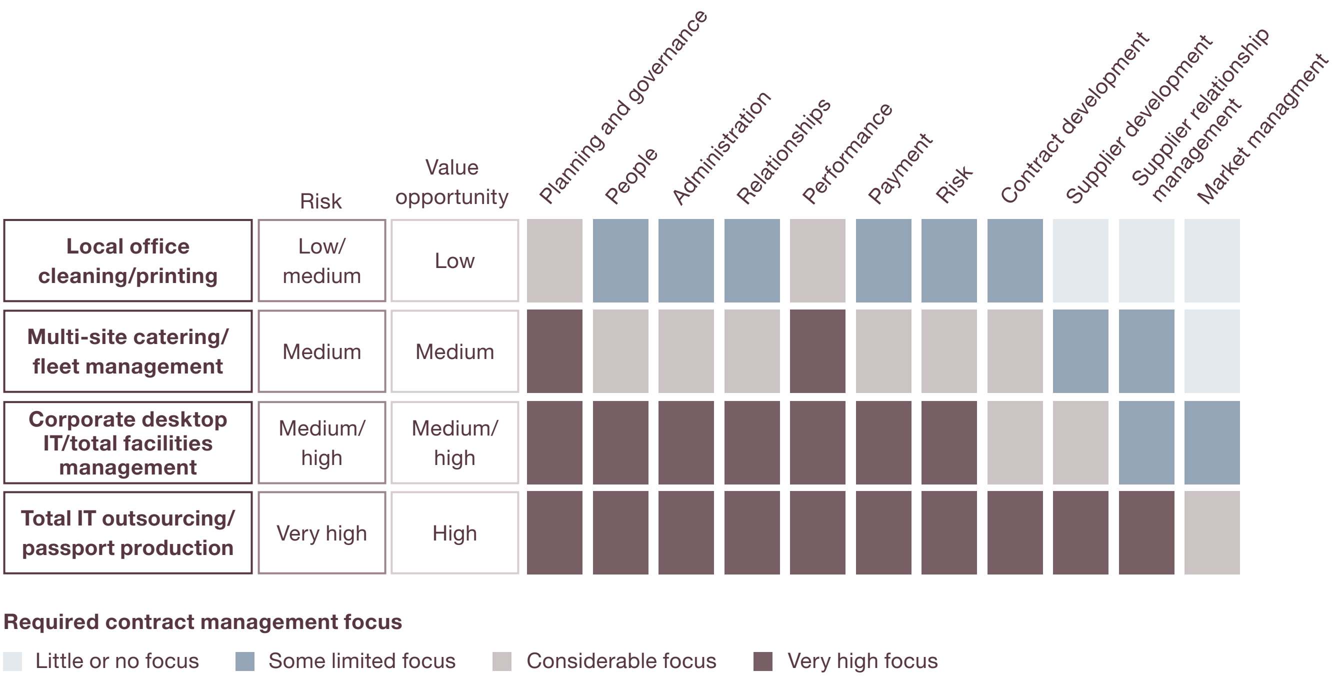
- For more complex services, there may be a need for a transition period where the full service is not delivered immediately once the contract has been agreed – for example, where a new supplier is taking over a catering service that has previously been delivered in-house or by another supplier. The focus of contract management activity will therefore need to change as the contract moves from transition to delivery phase.

- Very complex services usually require longer periods of development and transition, with the customer organisation needing to vary its contract management approach quite significantly over the course of the contract. For example, delivering a major customer facing service may require the development of systems prior to live delivery. There is a parallel here with construction contracts, where the 'development' phase can encompass the entire contract. A design, build and operate contract is a direct parallel to many major service contracts.

3.12 The approach presented in the framework is designed to be robust and flexible enough to handle all these options. For example, during the period of contract transition, 'delivery' is often the key area of activity, where delivery relates to the activities that the supplier (with input from the customer organisation) must undertake to prepare for service delivery. Contract management during this period may well focus on the risk of delays to the service going live and on the need for contingency plans. Once the service delivery period is under way, delivery activities will remain important, but other factors may become more relevant to address continuing risk or opportunity, with areas such as performance management, contract development and supplier relationship management assuming a higher priority.

Figure 4

Analysis of typical contracts and the required contract management focus



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