Principles for service contracts

Contract management guidelines

managing the relationship

critical success factors

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managing risks

contingency planning

handling problems

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Principles for service contracts

Contract management guidelines

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Management summary

About these guidelines

These guidelines cover the issues involved in managing long-term service contracts following contract award. The main areas covered are managing service delivery (formal governance), managing the relationship, contract administration, seeking performance improvements, and managing changes. This guidance does not cover the process of creating a commercial arrangement.

These guidelines are aimed at public sector managers responsible for managing long-term commercial arrangements with the private sector. It aims to help them manage the contract and the relationship to give value for money and improve performance.

This document is intended as a guide for management rather than practitioner level guidance.

Overview

Contract management activities can be broadly grouped into three areas.

- **Service delivery management** ensures that the service is being delivered as agreed, to the required level of performance and quality.
- **Relationship management** keeps the relationship between the two parties open and constructive, aiming to resolve or ease tensions and identify problems early.
- **Contract administration** handles the formal governance of the contract and changes to the contract documentation.

All three areas must be managed successfully if the arrangement is to be a success.

In addition, good preparation and the right contract are essential foundations for good contract management. The arrangement must also be flexible enough to accommodate change.

A key factor is intelligent customer capability: the knowledge of both the customer's and the provider's business, the service being provided, and the contract itself. This capability, which touches all three areas of contract management, forms the interface between supply and demand; that is, between the business area and the provider.

Managing service delivery

Managing service delivery means ensuring that what has been agreed is delivered, to appropriate quality standards.

The contract should define the service levels and terms under which a service is provided. Service level management is about assessing and managing the performance of the service provider to ensure value for money. Considering

service quality against cost leads to an assessment of the value for money that a contract is providing.

As well as assessments of whether services are delivered to agreed levels or volumes, the quality of the service must also be assessed. Quality metrics will have to be created that allow the quality of service to be assessed, even in areas where it is hard to quantify.

A key part of assessing the service provided is the baseline, or level from which service levels and improvements are measured. This will need to be agreed before the service commences. Benchmarking, or comparing performance across different organisations and providers, is another useful way to gauge improvements or pricing levels.

Managing risk is another important aspect of managing service delivery. The fulfilment of the contract may be endangered by several kinds of risk; some within the provider's control, some outside it. Identifying and controlling (by avoiding or minimising) the risks to a contract is a vital part of managing it. This includes those risks that have been transferred to the provider under the contract.

Business continuity plans and contingency plans help prepare the customer organisation for the situation where the provider cannot deliver. They are an important part of managing risk.

Managing the relationship

As well as the contractual and commercial aspects, the relationship between the parties is vital to making a success of the arrangement. The approach to this will vary depending on the contract, but it is important that the specific responsibilities are not neglected, even though there may not be a nominated individual assigned to the role of relationship manager.

In long term contracts, where interdependency between customer and provider is inevitable, it is in the interests to make the relationship work. The three key factors for success are trust, communication, and recognition of mutual aims.

Management structures for the contract need to be designed to facilitate a good relationship, and staff involved at all levels must show their commitment to it. Information flows and communication levels should be established at the start of a contract, and maintained throughout its life. The three primary levels of communication in a contractual arrangement are operational (end users/technical support staff), business (contract manager and relationship manager on both sides) and strategic (senior management/board of directors).

The right attitudes and behaviours, based on trust rather than adversarial models, should be encouraged.

There should be set procedures for raising issues and handling problems, so that they are dealt with as early as possible and at the appropriate level in the organisation.

Contract administration

Contract administration, the formal governance of the contract, includes such tasks as contract maintenance and change control, charges and cost monitoring, ordering and payment procedures, management reporting, and so on.

The importance of contract administration to the success of the contract, and to the relationship between customer and provider, should not be underestimated. Clear administrative procedures ensure that all parties to the contract understand who does what, when, and how.

The contract documentation itself must continue to accurately reflect the arrangement, and changes to it (required by changes to services or procedures) carefully controlled. Responsibility for authorising different types of change will often rest with different people, and documented internal procedures will need to reflect this.

Management reporting procedures control what information is passed to management about the service; this can range from a comprehensive overview of all aspects to solely reporting 'exceptions' to normal service. Arrangements for asset management must also be considered.

Seeking improvements

Service delivery management, relationship management and contract administration should keep both contract and relationship running smoothly, and providing the value for money represented by the contract at its outset. The customer will almost certainly want to aim for improvement over the life of the contract as well; ideally, the requirement for improvement will be built into the contract.

A good working relationship will help make improvement a reality, based on the principle that improvement is good for both parties, not just a means for the customer to drive down costs.

Incentives motivate providers to improve by offering increased profit or some other benefit as a reward for improved performance or added value. Benefits based payments, where payment is dependent on the realisation of specific benefits to the customer, are a more sophisticated form of incentive. Normally built into the contract terms, it is vital that incentives are balanced and encourage appropriate provider behaviour.

It may be appropriate to aim for continuous improvement over the life of a contract, perhaps expressed through a capped price that decreases year on year. A plan could be developed with the provider detailing how improvements will be made.

Managing changes

A successful arrangement requires a mutual commitment to meeting evolving business requirements and adapting to changing circumstances. Properly managed change can be a good opportunity to improve the service.

Drivers (reasons) for change during contracts can come from a range of sources, both internal and external. Whatever the drivers, it is important to realise the implications of change for the contract and all parties involved. There could be implications or concerns in areas such as continuing value for money and the possibility of moving beyond the original scope of the requirement.

Change is easier to deal with when preparations are made. Not every possibility can be foreseen and planned for, but it is desirable that the contract include some flexibility as well as procedures for handling changes.

Areas where change might be necessary include performance metrics, service functionality, service infrastructure and workload.

Construction contracts

Construction contracts are fundamentally different from major service contracts. There are various types of construction contract. The choice of contract depends on the basis of pricing and the contract strategy that best meets the project objectives. The various types offer different ways of handling pricing, risk transfer, responsibility for performance, cost certainty, and complexity.

The main customer-side roles involved in handling construction contracts are the project manager and the project sponsor. The project manager manages the contract on behalf of the customer, co-ordinating the design and construction and managing claims and disputes in an impartial manner. On large-scale projects, the project sponsor fulfils a higher level, less hands-on role, overseeing the project manager and monitoring budgets (among other duties).

1 Introduction

1.1 Scope and purpose of these guidelines

These guidelines cover the issues involved in managing long-term service contracts following contract award. The main areas covered are managing service delivery (formal governance), managing the relationship, contract administration, seeking performance improvements, and managing changes. The issues discussed will also be relevant to partnering deals (partnerships or PPP) and PFI deals. The material in these guidelines may also be useful to shorter term contracts, although many sections will not be relevant to such arrangements.

This guidance does not cover the process of creating a commercial arrangement. It is assumed that the reader is familiar with procurement procedures and principles, that the needs have been carefully determined and documented, that the contract to be managed is well constructed, and that the provider has been carefully selected and their tender properly evaluated before contract award. For contract management to be successful, it is vital that these foundations are in place. For more detail on what happens before contract award, please see the procurement workbook in OGC's Successful Delivery Toolkit.

While the main focus is on contracts with commercial providers, the principles in this guidance will be equally applicable to arrangements with in-house providers.

This guide is aimed at public sector managers responsible for managing long-term commercial arrangements with the private sector to ensure value for money, improve performance and build a productive relationship. It gives an overview of the issues facing contract managers and relationship managers (and members of teams fulfilling those functions). It is not intended as a practitioner level guidance and therefore does not deal with all the components and requirements of formal contract management.

The guidance is generic – that is, its principles are intended to be applicable to all major contracts; this helps to achieve common understanding, increasingly important where integrated projects may involve business change, IT and new build. However, construction contracts are fundamentally different from major service contracts; their characteristics are outlined in the Achieving Excellence briefing *Procurement and contract strategies* (in preparation). Similarly, contracts for system developments are different from service contracts because they involve key milestones and development phases rather than a 'steady state' of operational services. Guidance on system developments, typically in collaboration with partners and suppliers, is in preparation.

Terminology

In this guidance, the term 'customer' is used to denote the buying organisation, normally a government department or other public body.

The term 'provider' refers to the company providing services under the contract. It may equally apply to a consortium of provider companies or to a prime contractor who subcontracts service components.

'Partnership' and 'partnering' are used to denote a long term arrangement between a public sector department and a private sector company. It does not mean a partnership in the sense of a legal entity.

'Intelligent customer' denotes a capability of the customer organisation in understanding both customer and provider businesses fully. It does not necessarily imply that a nominated individual or team will become 'the intelligent customer' (although this may sometimes be the case), but rather refers to certain skills, experience and capability that must be available on the customer side to make a contract and relationship work.

'End user' means the people who actually use the service, either in their everyday work as departmental staff or as members of the public.

1.2 What is contract management?

Contract management is the process that enables both parties to a contract to meet their obligations in order to deliver the objectives required from the contract. It also involves building a good working relationship between customer and provider. It continues throughout the life of a contract and involves managing proactively to anticipate future needs as well as reacting to situations that arise.

The central aim of contract management is to obtain the services as agreed in the contract and achieve value for money. This means optimising the efficiency, effectiveness and economy of the service or relationship described by the contract, balancing costs against risks and actively managing the customer–provider relationship. Contract management may also involve aiming for continuous improvement in performance over the life of the contract.

1.3 Getting the contract right

This guidance concerns customer activities following the award of a service contract, not the procurement process that leads up to the award of contract. But a key point is that the foundations for contract management are laid in the stages before contract award, including the procurement process. The terms of the contract should include an agreed level of service, pricing mechanisms, provider incentives, contract timetable, means to measure performance, communication routes, escalation procedures, change control procedures, agreed exit strategy and agreed break options, and all the other formal mechanisms that enable a contract to function. These formal contract aspects form the framework around which a good relationship can grow. If the contract was poorly constructed, it will be much more difficult to make the relationship a success.
The contract negotiation process must take account of the requirements for

contract management. It is vital to build a contract that not only identifies clearly the obligations of the provider (and indeed the customer), but also enables a productive relationship built on good communication and mutual trust. While the contract must be built on a firm formal and legal foundation, it should not be so restrictive that it precludes flexible, constructive management of the relationship between customer and provider.

The material relating to OGC Gateway Review 3 (Investment Decision) and Gateway Review 4 (Readiness for Service) will help in assessing organisational readiness for a new contract or service to begin.

1.4 New approaches, new attitudes

Good contract management goes much further than ensuring that the agreed terms of the contract are being met – this is a vital step, but only the first of many. No matter what the scope of the contract, there will always be some tensions between the different perspectives of customer and provider. Contract management is about resolving or easing such tensions to build a relationship with the provider based on mutual understanding, trust, open communications and benefits to both customer and provider – a 'win/win' relationship.

Increasingly, public sector organisations are moving away from traditional formal methods of contract management (which tended to keep the provider at arm's length and can become adversarial) and towards building constructive relationships with providers. The management of such a contract, in which the specification may have been for a relationship rather than a particular service, requires a range of 'soft' skills in both the customer and the provider.

A key concept is the relationship that is documented in the contract, not just the mechanics of administering the contract. Agreements, models and processes form a useful starting point for assessing whether the contract is underperforming, but communication, trust, flexibility and diplomacy are the key means through which it can be brought back into line. Adversarial approaches will only increase the distance between customer and provider.

1.5 Critical success factors

The following factors are essential for good contract management:

- **Good preparation**. An accurate assessment of needs helps create a clear output-based specification. Effective evaluation procedures and selection will ensure that the contract is awarded to the right provider.
- **The right contract**. The contract is the foundation for the relationship. It should include aspects such as allocation of risk, the quality of service required, and value for money mechanisms, as well as procedures for communication and dispute resolution.

- **Single business focus**. Each party needs to understand the objectives and business of the other. The customer must have clear business objectives, coupled with a clear understanding of why the contract will contribute to them; the provider must also be able to achieve their objectives, including making a reasonable margin.
- **Service delivery management and contract administration**. Effective governance will ensure that the customer gets what is agreed, to the level of quality required. The performance under the contract must be monitored to ensure that the customer continues to get value for money.
- **Relationship management**. Mutual trust and understanding, openness, and excellent communications are as important to the success of an arrangement as the fulfilment of the formal contract terms and conditions.
- **Continuous improvement**. Improvements in price, quality or service should be sought and, where possible, built into the contract terms.
- **People, skills and continuity**. There must be people with the right interpersonal and management skills to manage these relationships on a peer-to-peer basis and at multiple levels in the organisation. Clear roles and responsibilities should be defined, and continuity of key staff should be ensured as far as possible. A contract manager (or contract management team) should be designated early on in the procurement process.
- **Knowledge**. Those involved in managing the contract must understand the business fully and know the contract documentation inside out ('intelligent customer' capability). This is essential if they are to understand the implications of problems (or opportunities) over the life of the contract.
- **Flexibility**. Management of contracts usually requires some flexibility on both sides and a willingness to adapt the terms of the contract to reflect a rapidly changing world. Problems are bound to arise that could not be foreseen when the contract was awarded.
- **Change management**. Contracts should be capable of change (to terms, requirements and perhaps scope) and the relationship should be strong and flexible enough to facilitate it.
- **Proactivity**. Good contract management is not reactive, but aims to anticipate and respond to business needs of the future.

1.6 What can go wrong, and why

If contracts are not well managed from the customer side, any or all of the following may happen:

- the provider is obliged to take control, resulting in unbalanced decisions that do not serve the customer's interests
- decisions are not taken at the right time – or not taken at all

- new business processes do not integrate with existing processes, and therefore fail
- people (in both organisations) fail to understand their obligations and responsibilities
- there are misunderstandings, disagreements and underestimations; too many issues are escalated inappropriately
- progress is slow or there seems to be an inability to move forward
- the intended benefits are not realised
- opportunities to improve value for money and performance are missed.

Ultimately, the contract becomes unworkable.

There are several reasons why organisations fail to manage contracts successfully. Some possible reasons include:

- poorly drafted contracts
- inadequate resources are assigned to contract management
- the customer team does not match the provider team in terms of either skills or experience (or both)
- the wrong people are put in place, leading to personality clashes
- the context, complexities and dependencies of the contract are not well understood
- there is a failure to check provider assumptions
- authorities or responsibilities relating to commercial decisions are not clear
- a lack of performance measurement or benchmarking by the customer
- a focus on current arrangements rather than what is possible or the potential for improvement
- a failure to monitor and manage retained risks (statutory, political and commercial).

See the high level Best Practice Guide for top management: *How Major Service Contracts Can Go Wrong* for more information.

2 Overview

Contract management consists of a range of activities that are carried out together to keep the arrangement between customer and provider running smoothly. They can be broadly grouped into three areas.

- **Service delivery management** ensures that the service is being delivered as agreed, to the required level of performance and quality.
- **Relationship management** keeps the relationship between the two parties open and constructive, aiming to resolve or ease tensions and identify problems early.
- **Contract administration** handles the formal governance of the contract and changes to the contract documentation.

All three areas must be managed successfully if the arrangement is to be a success: that is, if the service is to be delivered as agreed, the formal governance properly handled, and the relationship between customer and provider maintained. Although possibly handled by different figures or departments within the customer organisation, the various areas of contract management should not be separated from each other, but form an integrated approach to managing service delivery, relationship and contract together.

In addition, the arrangement must be flexible enough to accommodate change, and the process of change must be prepared for and managed.

A key factor in all these areas is intelligent customer capability: the knowledge of both the customer's and the provider's business, the service being provided, and the contract itself.

2.1 The customer–provider interface

Figure 1 opposite shows how contract management functions with intelligent customer capability form the link between those who need and use the service and those who provide it – that is, between demand and supply.

The business manager identifies and articulates the business needs that the service should meet. Users of the service provide feedback on how the service and the relationship are going, and may also request the contract manager to make changes to the service.

In the centre of the diagram, providing the functional layer that supports the customer's business and the service provider, contract management activities keep the arrangement running smoothly. Intelligent customer capability (see right) in all three areas provides an expert interface between the customer and its providers.

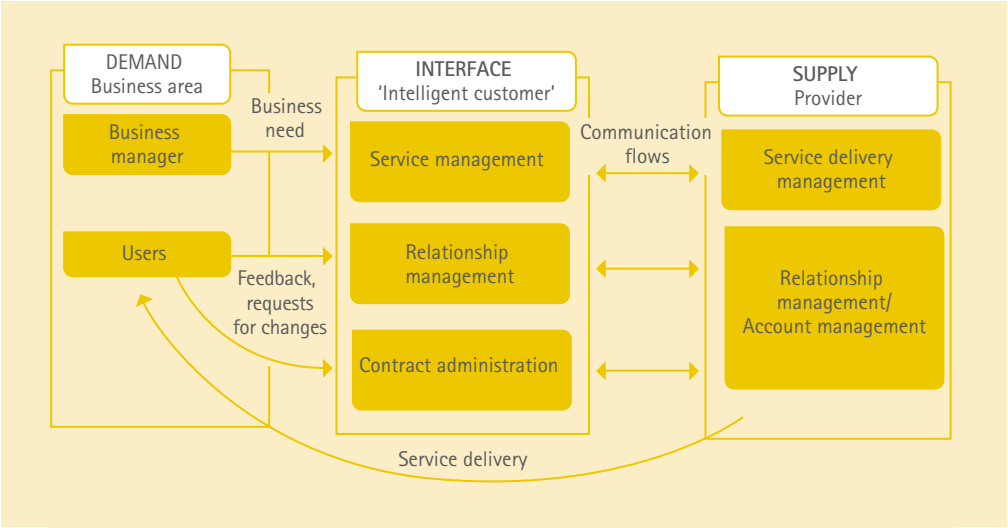

Figure 1
Contract management functions, in the centre of this diagram, form the link between business managers and users on the customer side and the provider organisation.

Contract management consists of a combination of roles and responsibilities. The main task areas are service delivery management, relationship management and contract administration. Who carries out these functions depends on the nature and scale of the contract. However, it is likely that there will be, as a minimum, a nominated individual responsible for managing the contract on the customer side and one on the provider side.

How much additional resource is required to manage the contract depends on its scale, complexity and importance. For smaller or more tactical arrangements, two or more areas may be covered by the same individual: for example, the contract manager takes on responsibility for administering the contract and building a relationship. Alternatively, a contract management team may be created.

Where contract management expertise is not available in-house, it may be appropriate to buy in advice from professional consultants, or even appoint a professional contract manager. Such arrangements must be clearly defined to ensure that ownership of the arrangement as a whole continues to rest with the customer organisation; it is also important to safeguard commercial confidence when third parties are involved.

2.2 Intelligent customer capability

Intelligent customer capability combines in-depth knowledge of the department and its business and understanding of what the provider can and cannot do. It is vital that the individuals or teams responsible for managing contracts on the customer side have this kind of capability. The aim is to reduce misunderstanding between customer and provider and to avoid problems, issues and mistakes before they happen.

Intelligent customer skills and experience must also be retained for the whole life of the contract, so that the organisation does not end up without enough understanding and knowledge of the services being provided to manage them effectively, or carry out an effective recompetition (the process of replacing the existing contract arrangements with new ones through a competitive procurement exercise).

Intelligent customer capability enables the organisation to achieve the following goals:

- gain a common understanding between customer and service provider(s) of service expectations and possible achievement
- use service quality monitors as a basis for demonstrating ongoing value for money and service improvements
- manage ongoing change and the effect on relationships with providers
- assure consistency and conformance with standards and procedures
- build flexibility in service arrangements, including contracts, in order to deal proactively with unexpected changes and demands
- establish suitable baselines from which to track performance relating to service delivery and service improvement
- understand and influence the factors which preserve and enhance relationships to achieve maximum business benefit
- ensure that business continuity plans are kept up to date to reflect changes and new service provision.

2.3 The contract management lifecycle

Figure 2 opposite shows the contract management lifecycle.

The lifecycle begins with setting direction: high-level objectives and policies for the organisation. This leads to the identification of business needs that can be fulfilled by acquiring a service. Once the service is acquired, a period of transition leads into contract management. There is an ongoing analysis of business needs, to routinely ensure that the service provides what the business really needs.

When the contract ends, for whatever reason, the recompetition process includes a re-examination of business need, the performance of the existing arrangement, any new requirements, and the options for sourcing. Thinking from this stage may feed back into high-level direction setting as well as into the process of acquiring a new service: a process that mirrors the original acquisition but with the benefit of all the lessons learnt from acquiring and managing the previous contract.

Contract management issues do not suddenly become relevant at the moment the contract is signed; they need to be considered at an early stage. Ideally, they should

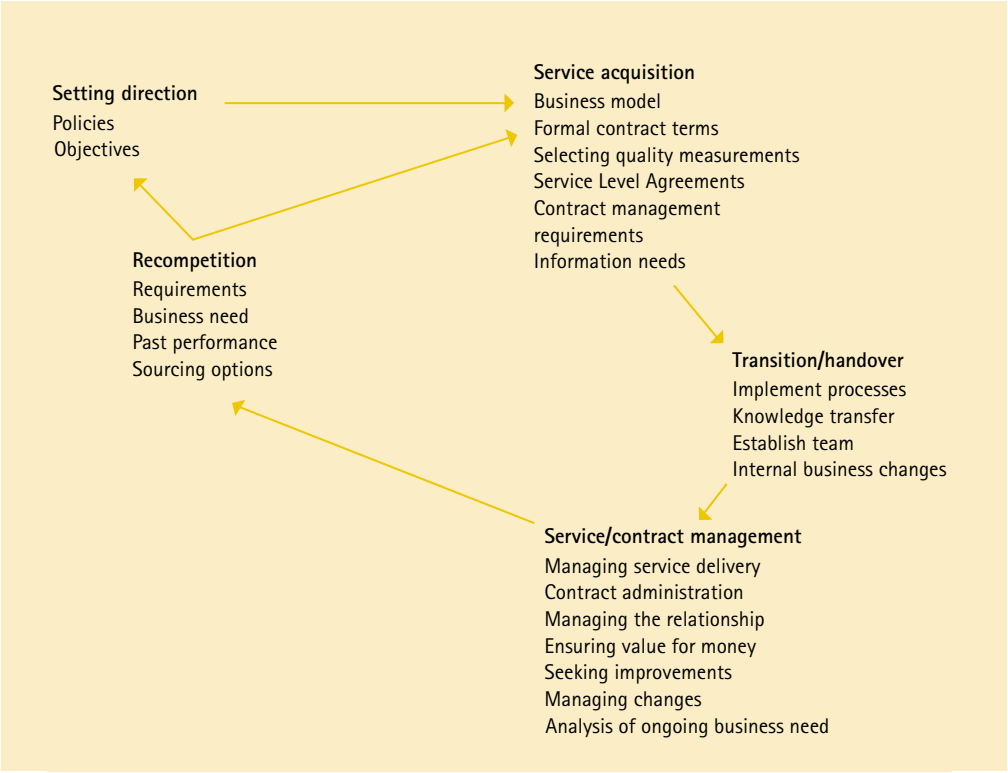

Figure 2
The contract management lifecycle, from setting direction through acquiring and managing a service, round to recompetition and a return to the origin

be considered before the creation of the output based specification that forms the basis for the procurement process. The questions to consider are:

- are we being realistic about whether we could manage a contract that delivers this requirement?
- do we have suitably experienced people, and will they (or their equivalents) be available for the duration of the contract?
- will there be adequate 'intelligent customer' capability for us to understand all the technical and business issues?
- is our organisation culturally ready to work in a new way with a provider if it is necessary (because a partnering arrangement is sought, perhaps)?

The key contract management issues that are anticipated can be included in the specification documents; they will have a bearing on the subsequent procurement strategy.

3 Managing service delivery

This chapter deals with the practicalities of contract management: ensuring that what has been agreed is delivered, to appropriate quality standards.

When an organisation has awarded a contract, it must monitor whether the service is being delivered to specification. This means being able to check two things:

- the service does what it was required to do – that is, the service is being delivered well, to the agreed standards and price
- the costs of the service are no higher than expected.

At the most basic level, the service must fulfil the terms of the contract. If it does not, something is seriously wrong. It should not require any sophisticated measuring techniques to detect this. But the question of how well the service is being delivered is much finer. For example, it is easy to determine whether a telephone call is answered within a certain time, but much more difficult to measure whether the caller was happy with the result of the call.

Although numerical or statistical methods of analysis will be useful for many aspects, there will be others where standards are more subjective. It is the customer's responsibility to ensure that the quality of the service is satisfactory and that methods for determining this are up to the job. These measures may already be in place, or it may be necessary to create them.

Hand-in-hand with quality goes the question of cost. Improving quality may mean greater cost; reducing costs may mean compromising quality. Balancing the trade-off between cost and quality is what is meant by ensuring value for money.

Responsibilities for managing service delivery and for managing customer obligations must be clear and appropriately apportioned between the organisation and its service provider.

The provider's perspective

The provider is driven by the terms of the contract and the payment/reward mechanisms it sets out. They may be free to vary the means by which the service is provided – for example, to reduce their costs, to reduce the risk of failing to meet targets or to improve the flexibility of their infrastructure.

They will almost certainly apply their own parameters to performance metrics, so as to leave a safety margin, and may implement internal controls to identify problems well before they compromise contractual performance levels.

The provider wants to supply successful and valued services and will expect to make an adequate return on its investment in providing services; their attitude to

this will depend on the nature of the arrangement. If the contract focuses on economy, the provider may respond by running it 'lean and mean', with short-term profitability measures, and a reluctance to undertake long-term investment. Alternatively, if it is within the framework of a long-term partnership, there may be a more open attitude to investment, evolution and to disclosure to the customer of internal issues and performance details.

3.1 Service level management

Service level management is the process of managing the performance provided to the customer as specified in the contractual performance metrics. Where the provider is in-house, a Service Level Agreement is used instead of a contract, as a legal contract is not possible between Crown bodies. In such situations and any arrangement where the provider is another public sector body, the customer should check the status of their providers in respect of contracting/SLA arrangements.

In order to meet customers' business needs and gain optimum customer satisfaction whilst meeting the provider's business goals, the provider has to optimise the relationship between cost and quality of the services delivered. Service level management plays an important role for the provider in balancing cost and quality of services in order to provide the customer with best value for money.

Well-structured service level management will help the provider to:

- quantify benefits and costs
- ensure that responsibilities are clearly defined and agreed
- charge for services delivered efficiently and fairly
- clearly define services and their deliverables (useful if services or service components are to be subcontracted)
- ensure that the services provided comply with the agreed business requirements
- have a better knowledge of current and future customer needs.

Service levels

There should be a detailed agreement of the required service levels and thus the expected performance and quality of service to be delivered. The contract should define the service levels and terms under which a service or a package of services is provided.

It should state mutual and individual responsibilities. By clearly stating the required and agreed quality of services, both customer and provider know and understand what targets have to be met in the delivery and support of services. If agreed service levels are not achieved, both parties should pre-agree some compensation to the customer. Similarly, the customer may receive benefit if the service provider exceeds agreed service levels and could agree a regime of bonus payments by way of incentivising the provider. A 'balanced scorecard' approach to performance measurement helps to make agreements on the level of service work well.

Flexibility

Wherever there are formal agreements, on service levels as elsewhere, there is often a need for some flexibility. This is particularly true in the early stages of an agreement:

- each party's requirements must be reasonable – neither the customer's business nor the service provider will meet the highest standards overnight
- each party's requirements need to be realistic – in terms of technology, organisational capability, and cost
- exception procedures must be catered for – neither customer nor service provider can be expected to meet the requirements under all circumstances
- there should be a mutual understanding of required service levels – both customer and provider must be aware of the other side's benefits, costs and risks associated with meeting or not meeting a service level. This is vitally important when finalising this part of the contract.

3.2 Measuring quality

Managing service delivery involves more than simply gauging whether services are being delivered to agreed levels or volumes, or within agreed timescales. The quality of the service being delivered must also be assessed. Health and safety issues are an important consideration for many contracts.

The required standards expected under a contract will normally be clearly described in the contract documents. It is important that both parties agree a predefined scope in the base contract. The following notes give a brief outline of the issues involved in selecting performance measures.

Determining metrics for quality

Measuring service quality means creating and using quality metrics – measurements that allow the quality of a service to be measured. Some aspects of service quality that could be assessed are:

- completeness
- availability
- capacity
- reliability
- flexibility
- timeliness
- responsiveness
- security
- standards
- usability
- accuracy
- auditability
- satisfaction.

There may be others that are applicable; there may also be a need to modify, add or remove service quality metrics during the lifetime of the service.

It may be too expensive or time-consuming to measure a given aspect; the time and resource implications must be borne in mind. If a measurement requires intelligent customer capability, a person or team who has that capability will need time to devote to the task.

Binary assessment

Some aspects of a service can be assessed in a binary way. These aspects are either adequate or inadequate, with nothing to be gained by improving them beyond the level of adequacy. An example would be compliance with standards; if the service complies with the relevant standards, then it is satisfactory in that respect: no additional work need be done in that area.

Even though the quality of certain aspects is a binary consideration, some flexibility in how it is assessed may be desirable, particularly in the early stages of rollout. It may not be productive to point out a minor transgression on (for example) standards if the provider has worked hard to bring the service 'on stream' within a short timescale.

Numerical assessment

Some service aspects are measurable numerically; they can be counted and measured in a simple, mathematical way. Examples would be capacity, throughput, transaction volumes and accuracy.

It is relatively simple to create service metrics for numerical aspects; quality is expressed numerically, and there is a set numerical value, or proportion, that is deemed acceptable.

During the acceptance period or piloting of a service, it is possible that reliability, accuracy and other such aspects may fluctuate. It is important to stipulate an appropriate period and duration over which to gauge quality. Too short a period might give an unfair picture; on the other hand, too long a period may be similarly misleading.

It may be desirable to stipulate a desired rate of change in a metric – for example, to process 100 licences a week for the first month and to seek a 2% increase on that figure in each following month. This would be a requirement for continuous improvement (see section 6.2).

The baseline

The baseline is the existing level at which the service is being delivered, either internally or through existing arrangement. The baseline is normally established in the business case and subsequently recorded in the contract. Performance measures, and any improvements in performance, are tracked against the baseline.

It is important to set the baseline accurately in order to gauge how well the service performs, and how much value the new service is providing compared with previous arrangements. Since the provider's targets and performance will be calculated relative to the baseline, they will take a keen interest in this. Customer and provider must work together to set baselines at a level that accurately reflects the service the customer is currently getting and forms a fair basis for performance measurements.

Subjective assessment

Some aspects of a service will be hard to measure because they involve subjectivity: usability and flexibility, for example. However, it is still important to agree what is to be measured and how the information will be acquired – through user surveys, perhaps. Subjective aspects should not be neglected simply because mathematical techniques cannot be applied to them; it is a question of gathering information and analysing it with as much objectivity as possible.

It may be that something that is quantifiable can provide a 'handle' on a much less tangible aspect. Such a measure is known as a proxy measure, since it acts as a substitute for a measure that cannot easily be created. For example, an indication of 'staff morale' may be provided by a measure of staff turnover rate.
The assumption is that there is a correlation between the measure and the less measurable phenomenon that lies 'behind' it.

It is the subjective aspects of a service that are gauged over the longest term, and where hindsight will offer the clearest perspectives. They are also likely to be the aspects that offer the most pertinent lessons to be taken forward to the acquisition of future services.

Legacy services

When a number of previously contracted services are being brought together into a single agreement, or where significant cultural and process change is being sought, it may not be appropriate to set new quality measures immediately. Instead, it may be best to start operation of the contract with a limited range of overarching, outcome-based metrics that offers especially strong leverage in business terms (an outcome/standard-based designation approach). There should also be provision in the contract for the joint evolution of a fuller, more focused set of metrics and associated diagnostic and remedial facilities and processes during the early stages of the contract.

3.3 Value for money

Quality measures and metrics provide information about how well a service is performing. But of course it is no good providing a perfect service if the costs are prohibitive. Ensuring value for money is about the trade-off between service quality and cost. A key objective for the management of any contract is to ensure that it continues to achieve value for money over time.

Value for money provides the common ground for very different services to be compared and their relative value to the organisation to be gauged; it is possible to ask of any service, 'is it good value for money?' and the implied (often unspoken) question, 'would the money be better spent elsewhere?'. Assessing value for money gives the customer organisation the opportunity to consider, in relation to a given service, whether the same investment elsewhere would deliver better or greater value.

Effectiveness, efficiency and economy

Value for money comes from the effective, efficient and economic use of resources.

- **Effectiveness** is sometimes expressed as 'doing the right things'. It is a measure of the extent to which objectives have been achieved.
- **Efficiency** is sometimes expressed as 'doing things right'. It is a comparison of output with the input required to produce it.
- **Economy** is concerned with obtaining the same goods or services more cheaply.

The value/cost ratio

Getting value for money means optimising the ratio between value and cost. Depending on how precisely the quality of services can be quantified – that is, whether metrics are predominantly numerical or not – it may be possible to express the value/cost ratio very precisely. In other circumstances, the concept of value may be more subjective.

It is also important to track actual benefits achieved and costs against what was planned, to ensure that the right level of resource has been assigned to a service.

Types of cost

The following types of cost need to be considered when assessing value for money:

- **one-time costs**: the costs of setting up a service in the first instance, including infrastructure investment, consultancy fees, and so on
- **unit costs**: costs incurred on a per-transaction basis, for example a fee charged every time a particular service is used
- **recurring costs**: costs incurred on a regular basis, for example a flat fee charged every month to cover provision of a service
- **internal costs**: the internal overhead of managing a service, including staff time cost, accommodation, facilities required and so on. Sometimes referred to as 'organisational' or 'attributable' costs (that is, those portions of the organisation's overheads that can be 'attributed' to this service)
- **qualitative costs** associated with the provider's ability to deliver without additional customer effort.

Benefits realisation

There should be mechanisms in place for measuring the achievement of benefits set out in the business case.

3.4 Risk

Risk is defined as uncertainty of outcome, whether positive opportunity or negative threat. In the area of contract management, the term 'management of risk' incorporates all the activities required to identify and control risks that may have an impact on a contract being fulfilled. It is important to note that it is the customer's responsibility to maintain the service wherever possible.

Types of risk

Many risks involved in contract management relate to the provider being unable to deliver, or not delivering to the right level of quality. These could include:

- lack of capacity
- key staff on the provider side are redeployed elsewhere, eroding the quality of the service provided
- the provider's business focus moves to other areas after contract award, reducing the added value for the customer in the arrangement
- provider's financial standing deteriorates after contract award, eventually endangering their ability to maintain agreed levels of service.

The arrangement may include some agreement on how the provider will replace key staff, including giving the customer some input into the process of selecting replacements.

Other risks to the contract are beyond the provider's control. They include:

- demand for a service is much greater than expected and the provider cannot cope
- demand for a service is too low, meaning economies of scale are lost and operational costs are disproportionately high
- staff on the customer side with 'intelligent customer' skills are transferred or move on (possibly to the provider)
- the customer is obliged to make demands that cannot be met, perhaps in response to changes in legislation
- *force majeure*: factors beyond the provider's control disrupt delivery; for example, premises cannot be accessed because of a natural disaster
- fundamental changes in the customer's requirements, perhaps as a result of changes in policy, make the arrangement a higher or lower priority or change the level of demand for the service
- the customer's inability to meet their obligations under the contract.

Managing risks

Where risks are perceived or anticipated, customer and provider should work together to decide who is responsible for the risk, how it can be minimised and how it will be managed should it occur. The customer will be aiming for business

continuity in all possible circumstances, although it is unlikely to be cost-effective to plan for every possibility, and a certain level of risk will have to be accepted.

Questions to consider for each individual risk include:

- who is best able to control the events that may lead to the risk occurring?
- who can control the risk if it occurs?
- is it preferable for the customer to be involved in the control of the risk?
- who should be responsible for a risk if it cannot be controlled?
- if the risk is transferred to the provider:
  - is the total cost to the customer likely to be reduced?
  - will the recipient be able to bear the full consequences if the risk occurs?
  - could it lead to different risks being transferred back to the customer?
  - would the transfer be legally secure (will the transfer be accepted under common law)?

Risk transfer

When a provider is made responsible for managing a risk, it is referred to as having been 'transferred' to the provider. It is important to remember that transferred risks still have to managed by the provider, and cannot be forgotten about simply because the contract obliges the provider to deal with them. Providers will want payment for managing or taking on risks; ideally this will be built into the contract.

A key point is that business risk can never be transferred to the provider. Although the provider may be under severe financial pressure for non-fulfilment, this will not compensate the department for failing to fulfil its obligations and deliver key outcomes. For example, a critical service may fail, endangering the lives of citizens. Although the provider failed to deliver, the ultimate responsibility remains with the department. It is essential to consider the whole supply chain when analysing the risks to a contract.

While a relationship based on trust, openness and communication is desirable, a customer with too much 'hands-on' involvement in the provider's business can end up taking back transferred risk, by not allowing the provider to take responsibility for managing it. This take-back is itself a risk to the contract, closely linked with the issue of intelligent customer skills. A full understanding of what the provider can and cannot do should enable the customer to strike the right balance between 'hands-on' and 'hands-off' styles of contract management.

3.5 Benchmarking

Benchmarking of providers is the practice of making comparisons between providers with the aim of ensuring continuing value for money, getting better performance, and improving business practices (in addition, organisations may seek to benchmark their own internal processes against those of others).

Benchmarking may involve measuring the provider against the best in their industry, making comparisons between similar processes and/or comparing prices for similar services. Benchmarking providers helps to offset the risk, in a long-term service arrangement, of underlying pricing and tariffs getting progressively out of line with market or industry norms. It also helps to identify and prioritise areas for improvement.

Some organisations encourage (or even require) prime-contractor providers to benchmark the companies they use as subcontractors.

At a higher level, it may also be possible to benchmark the extent to which different arrangements are achieving their desired returns on investment, outcomes or impacts. The basis for benchmarking or the means for identifying areas to benchmark would be a tool like the Business Excellence Model. Again, this will be primarily about learning from other organisations' successes and, in conjunction with providers, translating those lessons into programmes of action or better ways of working.

3.6 Business continuity

A major part of contract management is considering what will happen if the service fails or is interrupted. It will normally be the provider's responsibility to manage service continuity, and this will be stipulated in the contract. However, the continuity of the business that depends on the service should be a jointly handled responsibility, agreed through liaison between customer and provider.

Contingency plans

This is about maintaining critical services under a range of contingencies, ranging from minor breakdown of service components right through to disasters such as loss of a building.

Ideally, such planning is done top-down:

- identifying which services must be maintained in which circumstances
- a business contingency plan is drawn up that specifies how the business will continue its critical services under a range of disaster scenarios
- the consequent requirements for continuity for each critical service to the business are then derived
- service continuity plans may then be developed. Where services are provided by external providers, they may be responsible for such plans. The service contracts need to embody provision for such contingency arrangements. The tendency for providers to 'gold plate' such features – or to promise non-existent facilities that they believe will never be needed – needs to be watched for.

The above process may need to be iterative – the costs of a comprehensive contingency provision may prove prohibitive.

The contingency plans need to be audited and tested from time to time. The costs of this may be significant.

Reviewing business continuity plans

In drawing up the contract, the customer should have considered the effect of a major breakdown in the service as part of the risk analysis activity undertaken in service planning. These plans for ensuring business continuity need to be tested periodically. The contract should set out provider responsibility in this area.

Reviews of business continuity plans should include:

- planning for action by the service provider to ensure continuity of service, where the provider is required to maintain the service. This is a service which the provider offers, planned in consultation with the users of the service and management
- planning by the customer to ensure continuity of service when the service provider cannot maintain the service, or when the organisation decides to terminate the contract; there may need to be provision for the service to be taken over at short notice by another provider.

4 Managing the relationship

A successful relationship must involve the delivery of services that meet requirements. The commercial arrangement must be acceptable to both parties – offering value for money for the customer and adequate profit for the provider. But as well as these contractual and commercial aspects, the relationship between the parties – the way they regard each other and the way in which their relationship operates – is vital to making a success of the arrangement.

Managing the relationship comprises a discrete set of responsibilities and activities that, for larger contracts, may be assigned to a nominated individual – the relationship manager – or to a team. Even if the responsibility for managing the relationship is to be met by the same individual or team responsible for managing service delivery, it is important to ensure that the specific tasks of relationship management are carried out.

The approach to managing the relationship will vary depending on the type of contract. There is no one style that is appropriate for every contract, or for every provider. For some non-strategic contracts, a more tactical approach may be suitable. For long-term strategic contracts, the emphasis on building a relationship will be much greater. In fact, the requirement for the original procurement may have been for a relationship enabling certain outcomes to be realised, rather than for a specified set of services to be provided.

4.1 Why relationship management is important

Contractual arrangements may commit the organisation to one provider or small number of providers to a greater or lesser degree, and for some time. Inevitably this involves a degree of dependency. The costs involved in changing provider are likely to be high and, in any case, contractual realities may make it highly unattractive. It is in the organisation's own interests to make the relationship work.

The three key factors for success are:

- mutual trust and understanding
- openness and excellent communications
- a joint approach to managing delivery.

There must be mutual trust between customer and provider if the relationship is to work. The factors that help to establish the relationship and achieve the right benefits include:

- the provider gaining greater insight into the organisation's business and management style, and therefore more often pre-empting changed requirements and/or making proactive suggestions/contributions, in the expectation that this may improve the service and/or provide other sources of

mutual benefit; it may also incidentally bring them more business. In addition, the provider may also become more efficient and, therefore, cheaper for this type of service

- the provider feeling more confident in investing for the longer term – for example, in more flexible infrastructure, staff training and so on
- the customer gaining from knowing the provider's strengths and weaknesses, and focusing contract and contract management effort into those areas where they will bring most return on effort.

Factors that can limit the scope of such a relationship include:

- a clash of corporate cultures, where business goals and planning horizons of the contracting parties are so different that there is little scope for mutual trust or regard – however, this may be safeguarded by suitable weighting in the evaluation process
- concerns that the incumbent provider may challenge attempts by the customer to test value for money, or compete work that the provider feels falls within the scope of the relationship on the open market, or withdraw co-operation in other ways. Public sector organisations are typically shy of publicity, and are reluctant to tackle such challenges head-on
- difficulty in the formal procurement process in placing sufficient weight when assessing bids on intangible factors, such as 'do we feel that we can form a lasting, trusting relationship with this bidder?' It is often perceived to be difficult to justify accepting a higher priced bid because you believe it brings specific benefits
- the risk that the provider may not feel under pressure from potential competition and that their services may therefore deviate from best value
- risks to the provider that, if a high proportion of their turnover is dependent on one customer relationship, they may be vulnerable to pressure to squeeze margins
- risks to the customer that, if their business or services are critically dependent on a single provider, they may become vulnerable to price rises or to the departure of the provider from the marketplace for whatever reason
- concerns by the customer that too much business may overload the provider's management capability, resources or financial capitalisation.

Key factors for management structures

Factors to be considered in establishing management structures for the relationship include:

- the need to ensure that the relationship is championed at senior levels in both organisations

- recognising that the attitudes and actions will lead the tone of the relationship, as demonstrated by senior management. The 'message' comes from the top
- ensuring that governance arrangements are equitable and relationships are peer-to-peer. If not, imbalances will occur
- a large number of formal management levels should be avoided, but some differentiation is required between the relationship management level and a strongly managed contract management level that acts in support and is subservient to it
- there should be a place for long-term strategic issues to be considered as well as the more day-to-day service delivery aspects. These are best separated to avoid urgent and pressing matters constantly swamping the longer view
- formal committee structures should not be seen as overly rigid
- roles and responsibilities should be clear and staff involved in managing the relationship need to be suitably empowered
- escalation routes should be understood and used properly – encourage an approach that seeks to resolve problems early and without escalating up the management chain unnecessarily.

An 'open' relationship – one in which people feel able to share problems, plans, concerns and so on – is often cited as a benefit or an aspiration for partnership approaches. Information sharing is the key to developing an open relationship.

4.2 Communication

Good communications are always the make-or-break in managing a relationship. Many cases of mistrust or concern over poor performance in a service relationship result from a failure to communicate at senior management level, or from each party's failure to understand the business goals or intentions of the other.

Information flows

Many procurement projects are marked by an almost overriding concern not to expose 'our' (the customer's) thinking, position or concerns to providers for fear that providers will exploit such information for their own ends and to the detriment of 'our' interests. Encouraging the sharing of information can involve a significant change in practice; however, there should be a realistic balance between openness and reserving negotiating positions.

After contract award, the relationship can be developed partly by engendering a culture of information sharing:

- the objectives should be made explicit and discussed openly. This should have been a feature of the procurement phase but there is a need to keep these in view and revisit them from time to time

- sharing plans and information about potential future directions can help ensure the parties develop the relationship in line with changes in business need. This should be a two-way process. An understanding of where the provider sees its business going is as important as the customer's expectations if divergent positions are not to evolve unexpectedly
- concerns about the relationship – whether about performance, progress, or people – should be discussed frankly. If this is not done there is a risk that problems increase in seriousness instead of being addressed early.

Sharing information with providers may raise concerns about how information will be used. There may, for example, be a concern that information about the customer's plans, finances and resources will be exploited by a provider for its own commercial advantage. Willingness to share information openly depends largely on the element of trust.

These issues may be of particular concern where a multiple provider strategy has been adopted, but it depends on individual circumstances. Providers involved in the relationship may otherwise be competitors and sharing of ideas and information between them may be regarded as counter-cultural. If providers are in fact to remain in competition (for example, if the customer's strategy is to establish relationships with several providers and to allocate work over time through ongoing competition), it should not be expected that providers will be willing to share information with each other. If several providers are expected to operate in a collaborative manner, establishing principles and ground rules is important.

Information about how the provider views the customer should also be sought. Here again, a candid approach should be encouraged – although there is a need to avoid being defensive about criticism. The focus should be on providing and seeking information with a view to improving the relationship over time rather than apportioning blame.

Communication levels

In a large-scale service arrangement, the relationship between customer and provider operates at different organisational levels, with channels of communication running 'horizontally' between equivalent levels in each.

An example arrangement with three formal levels of communication is shown in figure 3 overleaf. Here a partnership arrangement has been created with a provider of IT services, enabling the customer's long term business strategy to be moved forward. This large-scale arrangement has information flowing at several levels.

At the strategic level, the customer's senior management and the board of directors of the provider company discuss the partnership, its management, and any initiatives within it that they could promote or initiate. They also promote the relationship, not least by demonstrating commitment to it and 'leading from the front'.

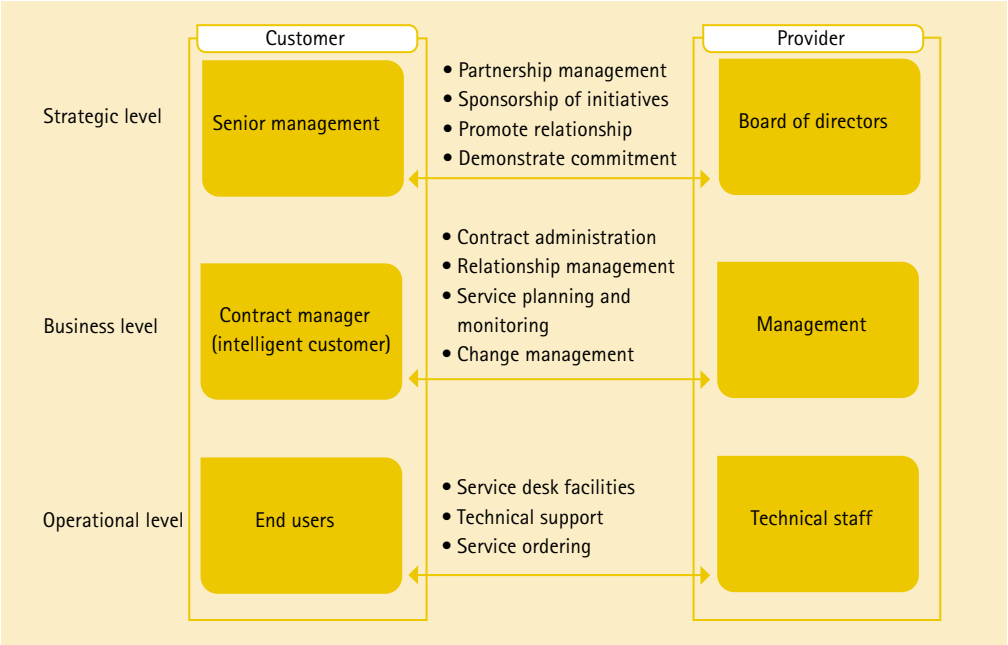

Figure 3
A partnership between a public sector organisation and a private sector company, with the three levels of communication and the issues discussed at each level

At the business level, the contract is formally managed. Services are planned and their delivery is monitored. Changes to the contract are managed at this level and most issues that arise will be dealt with here.

At the operational level, the service is delivered. Staff in the customer organisation order or call off components as they require them and receive technical support as required. The provider provides the service to agreed levels. Day-to-day problems in the delivery of services may be resolved here; if this is not possible, they can be escalated to the contract manager.

An important point is that the arrangement should be managed in such a way that these levels of communication are preserved even when problems arise. In terms of this diagram, diagonal lines of communication should be avoided. For example, if an end user feels the service is not being delivered to the required standards, they should refer this to the contract manager, who will liaise with the provider's management. It would not be appropriate for them to go 'straight to the top' and liaise directly with the provider's management; doing so will undermine the customer's contract manager. Similarly, it would be inappropriate for technical staff on the provider side to complain about their workload to the contract manager in the customer organisation.

So a combination of 'vertical' communication between levels within each organisation and 'horizontal', peer-to-peer communication between organisations is the ideal. It is part of good service provision management to ensure also that these arrangements are the best, as well as the prescribed, option for those with problems, and that no-one feels that going 'straight to the top' is the only practical way to resolve them.

Another type of communication is that provided by the service provider's service or account manager function, which may operate at all levels. This has strengths and weaknesses: while it can provide a good channel of communication between the provider and users of the service, it can also allow users to request (or expect) changes to be made based on their feedback. These changes, if implemented, may not be in line with the strategic direction that the service should be moving in. They may also have technical or financial implications, for example if a user prefers to use a favoured software application that is incompatible with other systems in place.

Consistency in communications

Consistent communication through the levels is important, or differences in perspective may mask problems in the relationship. For example, even where senior management regards the relationship as successful, serious disagreements and disputes may arise, and the relationship deteriorate, at the middle management level.

While there may be agreement at the strategic level about direction and overall progress, people involved on a day-to-day level may be concerned more with short-term aspects that may have a very different impact on the strategic view. At this level people may have direct responsibility for monitoring service performance and authorising payment, for service delivery and revenue generation, and be managed as cost or profit centres. As work groups and individuals, their objectives will tend to be set at the level of relatively short-term financial and delivery performance.

4.3 Culture

Good communication is an enabler of a particular culture between customer and provider: one built on openness, trust and mutual benefits. Communication will pave the way for more openness between the parties and the individuals involved in the relationships. In addition, the way people involved in the relationship act and the attitudes they hold about other organisations in the relationship, and about the concept as a whole, are crucial. Attitudes and behaviours, as well as the discipline of good communication, are vital to creating a productive culture in a relationship.

Attitudes and behaviours

Behaviours are the manifestations of the attitudes of those involved in a contractual relationship. The right attitudes will lead to the right kind of behaviour. In general, it is helpful to develop attitudes and behaviours that:

- respect the contribution of others
- do not emphasise the power of formal authority
- take a longer term view, with attention to long term as well as short term benefits
- look for benefits for all parties and focus on gains for the group
- recognise the interdependence in the relationship and that the customer may directly influence the provider's ability to meet its objectives.
- are collaborative and inclusive rather than adversarial
- are concerned with the success of the relationship rather than achieving one side's objectives in isolation
- are built on openness about strategies, plans, concerns and opportunities
- empower of the provider to undertake certain activities, rather than persisting in close hands-on supervision
- proactively seek to anticipate change and make improvements, rather than passively meeting existing needs and monitoring performance
- create a pervasive relationship that operates on many levels, rather than confined to operation through a single interface.

Everyone involved in the relationship should be ready to learn from the mistakes and experience of others. The emphasis in providing and accepting feedback on performance should be on using such information as a basis for improvement rather than penalty.

Those managing the relationship will clearly have a major influence on the way it develops and is perceived by people in the other organisation. Careful thought should be given to identifying the skills and attitudes of staff who will fill key posts and to the behaviours and personal attributes that are required and will be encouraged. This is not to say that customer teams should become a 'soft touch'. Commitment to managing the relationship and to long-term success requires active and assertive, not passive and submissive, behaviour.

Trust

Trust is often seen as a defining characteristic of the relationship between customer and provider. Trust in this context may mean having confidence in the other party in relation to any or all of the following:

- capability to 'do the job' well
- goodwill – that both parties have the interests of 'us' and the relationship at heart as well as their own
- integrity – that the provider will act and speak in a way that is honest
- commitment to the relationship – beyond the letter of the contract.

While contractual and commercial arrangements may lay the basis for a relationship that is built on common objectives and shared rewards, trust is a feature of the relationship between people. Trust cannot be mandated within the contract and although it may be anticipated (the customer may expect or intend to operate on a basis of trust), ultimately it has to be built and 'earned' through actions and behaviours, rather than assertions, and is tested when problems and disagreements arise.

Trust can seem a very intangible concept, but tangible efforts can be made to try to engender or promote a spirit of trust within the relationship. The principle and expectation that trust should be a feature of working relationships may be stated publicly and made a feature of internal awareness campaigns. Commitment of senior managers to the relationship must be visible and communicated throughout the organisation and reiterated throughout its duration. Providers will make a judgement on whether senior management have the authority as sponsors in their organisation to drive the relationship forward.

Assessing the relationship

As well as measuring performance against financial and service performance measures, a means of assessing other aspects of the working relationship and management processes should be put in place. This will be valuable in highlighting aspects that are perceived to be working well and those that require attention. For example, periodic assessments might address aspects including:

- the extent to which the provider is involved, or invited to become involved, in internal planning or other activities
- how well the management structures are seen to be operating
- how successful communications are seen to be
- the degree to which information is shared freely and openly between the parties
- whether feedback channels are seen to be working across boundaries and up and down organisational hierarchies
- whether conflicts are being avoided or resolved effectively

- whether financial and performance measurement systems are accessible to both parties
- the extent to which adequate monitoring information is being provided, and its quality
- user satisfaction and perceptions of the relationship.

Most such assessment factors are largely subjective but it is perceptions of how each party sees the relationship that matter. As with any change programme, it is helpful to monitor changes over time and to reflect back progress in a way that helps people see the development that has taken place. A willingness to learn from mistakes, to be open about causes of conflict or poor performance and to be prepared to agree counter measures can all help towards improving the relationship over time.

The spirit of cooperation and partnership should characterise the relationship throughout. However, this must be tempered with commercial realism. Both parties need to retain a healthy sense of their own and their partner's objectives and strategies. If done openly in cooperation it will help to build mutual trust.

4.4 Handling problems

However good the relationship between customer and provider, and however stable the services being delivered, problems may arise. So procedures for handling these should be agreed; clear reporting and escalation procedures help keep the heat out of the relationship. The objective is a relationship in which customer and provider co-operate to ensure that problems are recognised and then resolved quickly and effectively.

The relationship manager should ensure that the provider has problem management procedures in place, including escalation procedures within the provider's organisation, and that these are used when needed. These procedures should seek to prevent problems as well as to resolve them.

The contract must define the procedures for undertaking corrective action if, for example, target performance levels are not being achieved. The customer response to non-performance should be commensurate with the severity of the failure. For certain types of service failure, the contract may specify the application of 'service credits'; procedures are required to calculate these and to enforce them.

Apart from service performance issues, problems can arise in a number of areas and for a wide range of reasons: clashes of personality; slow or incorrect submission of invoices; slow payment of invoices; problems with contract administration procedures.

Whatever the nature of the problem, it is vital that:

- problems are recorded as they occur, in order to highlight any trends and to help in assessing overall performance and value for money
- the provider is notified of problems by an appropriate route and at an appropriate level
- approaches to resolving problems are clear and documented
- escalation procedures are followed.

Escalation procedures

If a dispute cannot be resolved at the level where it arises, it will be necessary to involve a higher level of authority. This escalation process needs to be managed.

Escalation procedures should allow for successive levels of response depending on the nature of the problem and the outcome of action taken at lower levels. The levels for escalation should match those of the interfaces established between provider and customer. Every effort should be made to resolve the problem at the lowest practicable level.

For more serious problems, the contract should specify the circumstances under which the organisation would have the right to terminate the contract. The contract manager must consult senior management and purchasing/ contractual advisors as soon as this possibility arises.

The contract manager should collate information on the number and severity of problems, as well as the way they were resolved, during the life of the contract. This information will provide useful input to service reviews.

The contract manager should periodically arrange for a check on the financial viability of the service provider, as well as continually monitoring any changes in ownership of the provider. Where potential problems are identified the contract manager should seek specialist advice as soon as possible.

Normally, most problems should be resolved before they become major issues; contract managers and service managers on both sides should meet regularly to raise any issues promptly as they occur. In extreme cases, where agreement cannot be reached, the customer and provider should seek the assistance of mediators before resorting to legal action.

For further information on this topic, see the OGC publication *Dispute Resolution*, available online in the OGC Successful Delivery Toolkit at www.ogc.gov.uk/sdtoolkit

5 Contract administration

Contract administration is concerned with the mechanics of the relationship between the customer and the provider, the implementation of procedures defining the interface between them, and the smooth operation of routine administrative and clerical functions.

The importance of contract administration (both customers' and providers' procedures) to the success of the contract, and to the relationship between customer and provider, should not be underestimated. Clear administrative procedures ensure that all parties to the contract understand who does what, when, and how.

Contract administration will require appropriate resourcing. It may be that the responsibility falls on a nominated individual. If not, and the responsibility is shared across a contract management team, it is important that all members of the team deal promptly with contract administration tasks, particularly during the early stages of implementation.

5.1 Elements of contract administration

The procedures that combine to make up contract administration are as follows:

- contract maintenance and change control
- charges and cost monitoring
- ordering procedures
- payment procedures
- budget procedures
- resource management and planning
- management reporting
- asset management.

These procedures will need to be designed to reflect the specific circumstances of the contract and the organisation. Bear in mind that additional administrative procedures may also be needed.

5.2 Contract maintenance

Contractual relationships evolve and must respond to changes in the business environment. It follows that the contract document itself must be capable of evolving efficiently and effectively, through formal change control procedures and by mutual consent, in response to changing requirements. It is preferable to update documentation as changes occur rather than relying on informal arrangements. Even in good relationships, conflicts over detail (project deadlines and so on) do occur.

Keeping the contract documentation up to date is an important activity, but it should not be a burden. The effort required may be reduced by ensuring that the contract is sufficiently flexible to enable changes to the requirement and pricing mechanism within agreed parameters without needing to change the contract documentation.

Procedures should be established to keep the contract documentation up to date and to ensure that all documents relating to the contract are consistent, and that all parties have a common view. For a large or complex contract, or a situation where a number of Service Level Agreements (SLAs) are covered, a formal document management procedure is critically important; some form of change control procedure is needed for all contracts (see below).

Applying document management principles involves:

- identifying all relevant documentation (including contract clauses and schedules, SLAs, procedures manuals etc)
- change control procedures, and ensuring no changes are made without appropriate authorisation
- recording the status of documents (current/historic, draft/final)
- ensuring consistency across documents.

New service descriptions and/or SLAs will have to be produced for any services that are introduced during the life of the contract – the introduction of new applications software into operational use for example. If there is a change in the customer's organisational structure which affects the boundaries of existing services – for example the creation of a new business unit that is still supported by the departmental contract – the contract must be reviewed and revised as necessary.

The contract manager acts as the interface between the service provider and the rest of the organisation in handling requests for incorporating new requirements into the service contract. A preliminary investigation into the new requirement, possibly with the assistance of the service provider, will usually be required to determine whether it should go forward in the formal change control procedure.

It is particularly important that additional demands on the service provider should be carefully controlled. In many cases orders for products or services may only be submitted through the contract manager. In other cases, especially where budgets are devolved, business managers may have authority to submit orders within specified budgetary and technical constraints.

Formal authorisation procedures will be required to ensure that only those new requirements that can be justified in business terms are added to the service contract.

5.3 Change control

Changes to services, procedures or contracts may have an effect on service delivery, on performance, on costs and on whether the contract represents value for money. So the specification and management of change control is an important area of contract administration. Change control procedures should be included in the contract. The respective roles and responsibilities of both parties in the change control process must be clearly identified, along with the procedures for raising, evaluating, costing and approving change requests.

A single change control procedure should apply to all changes, although there may be certain delegated or shortened procedures available in defined circumstances – such as delegated budget tolerance levels within which a contract manager would not have to seek senior management approval. However, flexibility needs to be built into this procedure to deal with issues such as emergencies. A change control procedure should provide a clear set of steps and clearly allocated responsibilities covering:

- requesting changes
- assessment of impact
- prioritisation and authorisation
- agreement with provider
- control of implementation
- documentation of change assessments and orders.

Responsibility for authorising different types of change will often rest with different people, and documented internal procedures will need to reflect this. In particular, changes to the overall contract, such as changes to prices outside the scope of agreed price variation mechanisms must have senior management approval. In many cases it will be possible to delegate limited powers to authorise minor changes which affect particular services or Service Level Agreements using agreed processes.

There should be an agreed procedure for placing additional demands on the service provider; these will include the specification of the requirement, the contractual implications, the charges for the additional service, and the delivery timescales. This procedure should be used in consultation with those responsible for monitoring the service.

Appropriate structures need to be established, with representatives of both customer and provider management, for reviewing and authorising change requests. These may fit in with existing management committees, or may require new change advisory roles.

5.4 Management reporting

Requirements for service performance reports and management information should have been defined before and during contract negotiations, and confirmed during the transition period of the contract. It is likely that information requirements will change during the lifetime of the contract, which should be flexible enough to allow for this. Where possible, use should be made of the provider's own management information and performance measurement systems.

Information may be required about all performance measures or only about exceptions – that is, instances when performance differs from what was expected. 'Exception reporting' minimises the time the customer needs to assess performance and ensures attention is focused on areas that need it most. For many business managers a summary of the service they have received along with a note of exceptions is normally sufficient. However, the ability to access more detailed performance figures should be retained to facilitate trend analysis and investigation of exceptions.

Information from the provider about service performance may be sent to each business unit or to a central point – probably the contract manager – for distribution. The contract manager may be required to provide additional quarterly or annual reports on the service to customers.
During the early stages of the contract the contract manager should ensure that all information flows between the provider and the customer organisation, and between various internal groups, are identified and tested.

5.5 Asset management

If ownership of assets used in the delivery of services is retained by the customer, then the customer will have responsibility for those assets.

In many cases day-to-day management of assets will be carried out by the provider, but the contract manager should ensure that:

- the organisation's asset register is kept up-to-date
- any third party use of assets is recorded (for example if the provider is able to deliver services to other customers)
- upgrades and replacements are planned and budgeted for.

The contract manager will be responsible for liaison with the provider on administration, upkeep and maintenance of assets.

6 Seeking improvements

Delivery management, relationship management and contract administration, if done well, should ensure that the service delivers the levels of quality required, and that customer and provider build a constructive, open relationship. But these disciplines can only ensure that things are delivered as required when the contract was signed. The customer will almost certainly wish to seek improvements in the service over time.

Ideally, the requirement for improvement should be embodied in the terms of the contract. This can be at a number of levels, from simple price or turnaround time improvements to encouraging innovation in the way services are delivered.

The provider should be involved in these considerations, and a good working relationship will be a huge help in making improvement a reality. As always, it should be remembered that the provider must benefit too. Seeking improvements is not about extracting more from the provider against their will, but about working together to improve quality, performance, value for money, or other aspects in such a way that benefits both parties.

The provider will almost certainly be seeking improvements internally. If prices are fixed, they can increase their profit by improving efficiency; if profits are shared, they are motivated to improve economy. But the terms of the contract may not necessarily encourage them to seek improvements in areas that benefit the customer. Part of the improvement process should be to aim for alignment of objectives, so that customer and provider are working towards the same things, and both deriving benefits when they are realised.

The rest of this chapter discusses some options for ways of seeking improvements.

6.1 Incentives

Incentives to improve are normally built into the contract terms. The aim of incentives is to motivate the provider to improve by offering increased profit, or some other desirable benefit, as a reward for improved performance or added value.

It is important that incentives are balanced. They should not emphasise one aspect of performance at the expense of other, perhaps less visible, aspects. The aim is value for money at all levels, rather than simple cost savings.

Some examples of incentives are:

- guaranteed or fixed levels of capacity, allowing the planning of investments and improvements by the provider
- revenue sharing, profit sharing, or tariff reduction

- commercial opportunities in related areas (carefully regulated by the customer)
- opportunity for innovation: the deal gives the provider the chance to implement or devise new solutions that will improve their standing
- key performance indicators (KPIs) for recognition and reward.

Financial incentives should offer rewards to both parties that fairly reflect any investment they have to make to achieve the saving in the first place.
Target incentive mechanisms are often used where work is task based.
The provider is given the incentive to submit optimal resource estimates for a task. This provides for the sharing, in predefined ratios, of the risks and benefits of the provider exceeding or undercutting those original estimates.

6.2 Continuous improvement

Public sector managers are under constant pressure to improve. In contract management, this translates into a need for continuous improvement in the performance or value for money of providers' services. Continuous improvement should be part of improvement for the business unit as a whole, improving the performance of the contract management team as well as the service covered by the contract itself.

It is important that continuous improvement is seen as being desirable and beneficial for both parties, rather than as a means to drive down prices.

Requirements for improvements in service are often built into an outsourcing contract, the rationale being that a provider should be able to achieve economies of scale that the customer alone cannot. Indeed, achieving improvements may be one of the main motives that the organisation has for outsourcing a service.
One way to embody this principle contractually is through a capped price for the service that decreases year on year, obliging the provider to improve efficiency to preserve their profit margin. A carefully framed contract can provide for change. Incentives such as profit sharing can be built into the contract to encourage improvement where it is possible rather than enforce it at the risk of compromising quality.

There will also be the opportunity from time to time to exploit 'break-out' improvements – perhaps radical changes in the service, or the way in which it is delivered, based on technology innovation. Again, the provider needs to be motivated to pursue such opportunities – possibly by being in a position to share the benefits (and the risks).

It may be appropriate to identify a target for the level of performance improvement sought over, say, the next year, and to develop a plan in conjunction with the provider that will achieve or exceed that level of improvement.
Suggestions for improvements could come from the users of the service – for

example, from information provided by the service desk, from the service provider, or from the contract manager. Some contracts employ bonus schemes to direct the provider's efforts towards the customer's priorities for service improvements.

Improvements could be expressed in terms of developments such as:

- improved customer satisfaction, as measured – for example, by independent surveys
- more efficient ways of providing the specified service
- useful additions to the service
- eliminating aspects of the service that are no longer required
- use of new technologies that would provide a cheaper and/or more effective service
- changes in procedures or working practices (in customer or provider organisation)
- changes in the interface between the customer and provider organisations.

Targets for continuous improvement must be realistic. Techniques such as Balanced Scorecard, Business Excellence Model, ongoing stakeholder analysis, benchmarking (see section 3.5), and the Goal/Question/Metric approach may be helpful in determining targets.

6.3 Benefits based payments

If the organisation is moving through a major business change, the main priority will be achieving the benefits from implementing particular change programmes. If providers are helping the customer to achieve business change, their incentives should be linked as far as possible to the customer's objectives, so that they have an interest in the customer's success. This can be achieved by making payments to providers dependent on the realisation of benefits to the customer organisation.

This approach has the advantage of giving the provider incentives to deliver and also of ensuring that individual investments are well planned, achievable and will deliver value. Because they are conducted as discrete exercises, the concerns about guaranteeing value for money over time are largely overcome. Instead of hazarding guesses about the future at the outset of a contract, there is a clear business justification with robust benefits identified on each occasion.

A comparable technique is business benefits based contracting. When calculating the distribution of cost savings and any charges to be levied, this approach takes into account for each programme both parties' investment, direct costs, overheads, risks borne and benefits share or planned return.

For all these processes, the emphasis is on collaboration in terms of opportunity spotting and programme implementation; and on agreement in terms of construction of the investment case and articulation of both parties' risks and rewards. It is also likely that there will need to be joint involvement in the ongoing benefits realisation process including Post Implementation Reviews. Most such arrangements are likely to be underpinned by a joint 'open books' process.

6.4 Added value

Adding value means bringing something to the arrangement that is genuinely worthwhile to the organisation and beyond what was originally envisaged in the contract. Contractual arrangements that add value can be highly beneficial to the organisation; however, care needs to be taken to ensure that the essence of the contract does not change – thus incurring the risk of potential challenges under EC procurement rules.

Added value can occur at three levels:

- business benefit: identifying new opportunities for ways to benefit the customer's business
- capacity/capability: infusing new skills, methodologies, and capabilities in the service delivery
- economy: better, more efficient and cheaper services through economy of scale or rationalisation.

A provider's contribution to all three should be readily capable of identification throughout the contract either at the outset, on an ongoing basis or for individual programmes. This might also form a useful measure with which to assess their performance.

Any incentives put in place for the provider should encourage them to add value where they can.

7 Managing changes

The only constant is change. It's a cliché, but it goes to the heart of the problems that can beset large-scale contracts. A successful arrangement requires a mutual commitment to meeting evolving business requirements. What's more, properly managed change can be a good opportunity to alter or improve the service.

7.1 Drivers for change

The drivers for change during the term of a contract can come from a range of sources.

Internal drivers for change could include:

- evolving business requirements
- the organisational restructuring of either party
- significant revisions to the corporate strategy/business objectives of either party.

External drivers could include:

- developments in technology (things which were not possible become possible, and therefore desired, or necessary to maintain the 'market' efficiency of service provision)
- economic trends that affect the profitability/value for money of the relationship – from the perspective of the customer or the provider
- the need to provide electronic forms of service delivery to meet customer expectation
- changes in legislation or legal interpretation.

7.2 The implications of change

The importance of understanding the implications of change from the perspective of both parties cannot be overemphasised. Change to a contractual arrangement affects the scope and thus the viability of the contract, for either or both parties. To an extent both parties are taking a calculated risk when they enter long term contract arrangements that the cumulative effect of change over the term will balance out for both. It may not necessarily be so, especially over relatively short periods, and both parties need to remain conscious of the impact on themselves and on their partners. Joint planning of change is vital if risks are to be minimised.

It is essential that both parties have realistic expectations of what the contract will deliver at the outset: that the contract is neither intentionally nor inadvertently 'over-sold' by either party. This 'foundation of realism' is essential if the expectations generated by both the customer's and the provider's business cases are to be met. This is not as straightforward as it may seem, as there is often a tendency within both customer and provider organisations during the

procurement phase to 'over-sell' the prospects for the contract in order to gain the necessary management approvals to proceed. This temptation must be resisted if the viability of the contract is to be maintained for both parties.

Care must also be taken not to distort the original competition, particularly the original value for money equation, as this could conflict with domestic procurement policy and EC rules.

If change reduces the scope

If the cumulative effect of change is to reduce the scope of the contract, clearly the customer will be concerned about the overall profitability of the relationship from its perspective (since, all else being equal, economies of scale will be reduced). In legal terms the customer must ensure that it is not open to claims from the provider for misrepresentation about (for example) the volume of business likely to result from the award of a particular contract or of 'false prospectus' – that is, encouraging an expectation which is not fulfilled – or potential challenges under EC procurement rules. In any cases of doubt specialist legal advice must be sought.

If change increases the scope

If, on the other hand, the cumulative effect of change is such as to significantly increase the scale or the scope of the services provided, the customer must have a concern that it continues to achieve value for money from the relationship overall.

The customer must also ensure (assuming the contract to be subject to public procurement law), that the developments do not take the resulting contract outside the scope of the original OJEC advertisement, or outside the permitted extensions to existing contracts. The framing of the original OJEC advertisement will have a strong influence on later situations where change increases the scope of the contract. In order to prevent this, it is important that the requirement set out in the OJEC is sufficiently broad to allow for some changes in scope and/or volumes.

Again, in any cases of doubt specialist legal advice must be sought.

7.3 Preparing for change

Changes are always easier to manage when they are planned. Even where they occur without warning, it is often possible to foresee what might happen and plan for what can be done. Change in external factors may make change hard to avoid; however, alteration of the service and/or its underlying infrastructure is always voluntary. It may not always be most effective to make incremental changes to a service that is running smoothly – it may be better to accumulate such change requirements for a while and then make them en bloc. According to the type of provider relationships involved, the provider(s) may be closely involved in planning the changes, or may even be entirely accountable for them.

7.4 Types of change

The following sections examine four types of change that pose particular challenges for contract management:

- changes to performance metrics
- changes to service functionality
- changes to service infrastructure
- changes to workload.

Changes will always need to be negotiated with the provider(s). Where there are several providers involved, special care may be needed over the knock-on effects of changes.

Changes should not be scheduled during critical business periods, such as year-end or cyclic workload peaks.

Changes to performance metrics

Changes to performance metrics may be required for several reasons:

- business service requirements may alter – for example, an electronic messaging and Intranet service may become more critical to an organisation once the users have ceased to rely on paper backups
- the metrics may be found in practice to be inappropriate. For example, a messaging service may be based on an existing telecommunicationss contract which defines availability at the electronic circuit level. The end-to-end messaging service may become unreliable, even when the underlying circuits are meeting contract specification for availability
- the metrics may be difficult to measure reliably. Alternative approximations may need to be identified
- the provider may be unhappy with the metrics and may press for changes that may not be to the customer's advantage
- changes to the service infrastructure may enable better metrics to be used.

Particular care is needed when changing performance metrics, as exception reports may indicate service failures, leading to claims for service credits and so on, when, in fact, the changes are proceeding as planned. The new metrics may depend upon a period of accumulated service history, and it may be that the service is, in effect, running for a period with no effective metrics. This requires a basis of trust between customer and provider.

Changes to service functionality

Changes to service functionality may be required for several reasons, including:

- changes to the organisation's marketplace
- changes to the organisation's product/service strategy
- internal business structural or process change
- proactive suggestions by the service provider(s)
- imposed policy or legislative change.

In all cases, it is likely that there will be consequent changes to the service processes and metrics, leading to a contract variation that will need to be negotiated with the provider(s). Key principles of this re-negotiation are that:

- the contract(s) should have been negotiated to provide for such change
- when seeking changes to the service supplied, these should be specified in outcome-based terms, so as to allow the provider to propose innovative solutions where appropriate
- changes to service function will almost always lead to changes to the performance metrics
- sometimes there may arise a threshold where a series of incremental changes leads to an accumulation of short-term expedients that together are unsatisfactory. At this point, a more drastic overhaul of the service infrastructure may become a better proposition
- the customer should always beware of the possibility of the provider seeking to increase their profitability – solutions and the associated costs proposed by the provider should always be rigorously audited for best value.

As with changes to performance metrics, there may be anomalies in contract management and reporting during periods of functional change.

Changes to service infrastructure

Changes may be required to:

- business process
- technical infrastructure.

Selection and timing of such changes may be wholly or partially at the discretion of the provider(s). If the customer requires the provider to make changes to the service infrastructure, they should remember that, by limiting the provider's discretion, they may be, in effect, relieving the provider of some of their contractual obligations, to the point where the provider may be able to disclaim responsibility for a subsequent service failure.

Major change may require the re-activation of a programme management mode of operation for a period.

Changes to workload

Business workloads may increase to the point where the customer believes that the provider is gaining increased economies of scale – leading to an opportunity to renegotiate unit costs. However, there may be a different perception from the provider; they may have the view that the unforeseen increase in workload is leading to the need to replace capital items early, leading to an increase in unit costs. Such negotiations are always much easier if the provision for such changes has been embodied in the underlying contract(s).

8 Roles and responsibilities

This section outlines the roles involved in contract management and the tasks for which they are responsible.

This section focuses on individual contracts and agreements, since that is the focus of these guidelines. However there are other, more senior and wide-ranging roles that will have an impact on contract management; for example, business unit manager and programme manager.

8.1 Senior management – customer and provider sides

There should be a Senior Responsible Owner (SRO) who is responsible for the successful outcome of the contract, which includes overall responsibility for the relationship as well as for individual projects or programmes to be delivered through the contract. This individual must be a senior manager, with authority to take major decisions on behalf of the customer organisation. Note that the title of the role is generic; in construction projects it is referred to as Project Owner; the title Programme Director is another application of exactly the same role in a programme management context.

There should be a correspondingly senior role on the provider side, often referred to as the Industry Executive. This individual should have similar responsibilities for the success of the contract from the provider perspective and a senior level of authority in their organisation.

8.2 Contract manager – customer side

For smaller contracts, a single individual may be enough to carry out all contract management responsibilities. For larger contracts, a contract management team may be required. It will be necessary to assess the management structures proposed for each contract to be managed, and ensure adequate staff resources are available to make them work.

The size of the contract management team may have to change over the life of the contract. The early stages are often more demanding in terms of management time.

The main functional responsibilities of the contract manager (or contract management team) on the customer side are to:

- track the interpretation of business requirement into contractual provisions
- act as a single point of contact for all formal and legal correspondence relating to the contract
- maintain the specification of contract performance metrics
- monitor contract performance and report at overall service or business outcome level

- monitor subordinate performance metrics as appropriate
- represent the customer's interests to the provider at contract level
- oversee operation of the contract(s)
- determine and take remedial actions by agreement with the provider
- negotiate remedies with the provider
- escalate contract problems as necessary
- maintain/develop contract specifications.

8.3 Contract manager – provider side

The main functional responsibilities of the contract manager on the provider side are to:

- track the interpretation of the business requirement into contractual provisions
- monitor contract performance and report at service/business outcome level as appropriate
- monitor subordinate performance metrics
- identify and manage exceptions
- represent the provider's interests to the customer
- respond to changing customer needs
- marshal and apply the provider's resources
- determine and take remedial actions by agreement with the customer
- negotiate remedies with the customer
- escalate problems as necessary
- operate the contract to specification
- operate subordinate services/contracts
- maintain/develop service components
- set/maintain/develop infrastructure strategy according to the contractually allocated responsibilities
- maintain/develop supporting infrastructure according to the contractually allocated responsibilities.

8.4 Relationship managers – customer and provider side

The main functional responsibilities of the relationship managers on the customer and provider side are identical. They are:

- encourage an atmosphere of trust, openness and communication and an attitude based on working together and shared objectives
- proactively look for ways to improve the relationship wherever possible

- ensure that all stakeholders in the arrangement feel that they are involved, that their views are important and that they are acted upon
- establish and manage a communication framework and ensure that it is used effectively
- establish and manage communication flows between customer and provider, and ensure that they are used
- ensure that communications at all levels are peer-to-peer
- manage the dispute resolution process
- resolve 'soft' tensions between customer and provider, that is, situations where tension is felt or perceived but no formal issue has yet arisen
- 'manage upwards' to ensure that senior management are informed about issues before they escalate, and can intervene as appropriate
- establish regular reporting procedures, both formal and informal, and ensure that they are used
- organise forums, working groups, seminars, roadshows, training sessions, and other information-sharing activities involving staff from both the customer and the provider side
- promote understanding of each other's business practices and common techniques

It is vital that relationship managers have the authority to make or suggest changes to the arrangement – working practices, communication flows, the contract itself – to ensure that the relationship is safeguarded.

8.5 The people who use the service

Where the service is of a type delivered to end users, who may be citizens, staff in the customer organisation, or staff in other organisations, the main functional responsibilities of end users are to:

- utilise the service
- report incidents, problems and issues promptly and accurately
- monitor customer aspects of service quality
- escalate problems as necessary.

Annex A
Case study: building a partnership

This case study looks at the issues encountered by a central government department in their partnership with a major service provider. It provides practical perspectives on setting up a partnership, managing the relationship, and resolving tensions.

The partnership arrangement that the department set up with their provider shows how different objectives can be aligned and form the foundation of a good working relationship between customer and provider.

Objectives

The department's objectives in setting up a partnership were:

- to improve value for money
- to shorten the development lifecycle to achieve faster delivery
- continuity of career development and employment for staff transferred to the provider
- access to the skills and technologies of a world-class organisation.

These objectives were set out in the department's Invitation to Tender and raised in negotiations. Bidders were asked to explain how they would meet these objectives and also what their own objectives were. In the winning provider's case they were:

- to make a reasonable profit
- to grow their business in UK government by using the department as a reference site
- to enhance their European skill base.

There was mutual 'buy-in' to both sets of objectives of both parties, and the contract included some enabling elements:

- value for money guaranteed; a fixed volume of capacity; price capped and decreasing year on year
- reasonable profit – an agreed maximum profit margin, enshrined in the contract
- profit share if the provider achieves better profitability, for example through improved efficiency
- open book audit access to help create openness in the relationship.

Openness in the contract is fundamental to establishing the right kind of relationship. While there is a contractual right for the department to inspect their provider's accounts, they share their financial and strategic plans so that the provider understands the current position and plans for future investment.

How it worked out in the early stages

Culturally, the arrangement was new and different for both parties. It took around two years to get things right and move the right people into the right roles. Staff involved in managing the contract required very different competencies and styles from those in a traditional adversarial arrangement. To build a win-win position, they had to be very positive and make use of strong negotiating skills.

The department faced two difficult issues, which tested the relationship. Firstly, a benefits evaluation exercise required detailed investigation of the value of assets. The second issue related to baselining the development and delivery capacity transferred to the provider.

The contract stipulated that the provider would deliver the service for a capped price that decreased year on year. This required ongoing improvements in efficiency. In the event of changes in productivity or the levels of manpower required, the department would need to assess whether these had resulted from efficiency gains or whether they simply reflected changes in business volume.

Baselining was used to agree the basis for these assessments, but the exercise proved difficult to validate. Start-up volumes were needed to establish the baseline at the outset of the contract. Work was broken down into groups (for example, software development, desktop installations, output production) against a productivity baseline expressed in man-days and output volumes. Live operations were more difficult to assess: a concept of net processing power used to deliver live and development services was agreed.

Once the issues of benefits evaluation and baselining had been resolved, the contract moved into a phase where things were smoother and more productive. However (as with any working relationship) both sides had to have a commitment to make the relationship succeed. A key feature of that success was for objectives and principles to be explicit on both sides.

Communication

Six months before the contract went live, the contract team on the department's side set up its processes and documented them so that everyone involved would know how things were to be done.

A Partnership Goals Forum meets quarterly to assess the status of the contract and the relationship. This forum uses the Balanced Scorecard approach to measure progress against both sides' objectives. Factual information and subjective reporting are agreed in this forum, together with decisions on how to manage issues as they arise. A key aim is to be as objective and impartial as possible, rather than rely on opinion.

There are also six-monthly board to board meetings between the department and provider. These are used to discuss strategic issues and to ensure continued buy in to the partnership ethos from the very top.

Business units are closely involved in stating requirements, determining manpower orders and managing productivity. Some areas that are traditionally kept within the contract management domain are 'laid off' to the business areas. To make this happen, a programme of seminars and roadshows was arranged to explain to the business areas how all aspects of the partnership should come together – the ethos, processes, the roles of service managers and project managers. This programme has since evolved into a joint modularised education programme with the provider. All new staff are now trained as they move into the relevant business areas in both the department and the provider organisation.

The pace of change in e-business

The department is looking at a programme of change where e-business can create staff savings through enhancing data capture and cheque processing, call centres and telephony. The department expects its provider to use its expertise as an IT provider to help achieve this.

An issue here is the pace of change in e-business; the business is pushing to deliver quickly, which could create tensions about delivering value for money. A compromise has to be struck between the speed of business change and the need to follow sensible processes, taking account of the relationship between the provider and their third-party providers.

Efficiency

Efficiency is important to both parties. There is a quarterly examination of productivity and forecasts, with regular feedback on the changing productivity position and action taken as required. Through the use of acceptance testing, productivity is improving steadily.

Operational application software services are measured in function points; this encourages the provider to build in better efficiencies in, for example, quality.

Benchmarking

Benchmarking is another important and sometimes difficult issue. The department has now benchmarked around 80% of contract costs. The principle applied when benchmarking is 'if the department had to purchase through the open market, what price would they have to pay?' If the provider can improve on that price through their global purchasing power, this means value for money. When the provider can beat the benchmark, they split the proceeds of the difference with the department.

With software productivity, most benchmarking has gone reasonably well. The department's major systems present some difficulty because there is little comparison available on a like-for-like basis.

Increasingly, the department is seeking to encourage the provider's third-party providers to benchmark as well.

There is a constant need to revisit costs; this is done on a partnership basis, where both sides analyse and work together to resolve issues and concerns. In the early years the emphasis was on working through actual costs and keeping the relationship going; now there is a consolidated baseline of productivity. Having established the relationship, most issues can be resolved through everyday dialogue. Open book accounting is critically important in this.

Recompetition

The department needs to create genuine competition for a new partnership contract, otherwise there might be commercial pressure to break the contract up into smaller components provided by multiple companies. This could lose many of the advantages of the current streamlined arrangement.

One option at recompetition is to move towards a PFI arrangement. However, there is a possibility that PFI could focus on financing arrangements and pricing mechanisms rather than on the need to build a partnering relationship.

Another consideration is the volatility of the IT sector: requirements, technology and pricing can all change rapidly. In a partnership, the sharing of this kind of risk can be represented commercially.

Further information

The following sections provide references to related publications that can provide more information on the topics covered in this guidance.

OGC guidance

- *How major service contracts can go wrong*
- *Managing partnering relationships*
- *Risk Management Guidelines*
- Dispute resolution guidance
- *Guide to the Appointment of Consultants and Contractors*
- Successful Delivery Toolkit

(all available online at www.ogc.gov.uk)

Commercially published guidance

OGC IS management and business change guides

These guides provide background on business change and the issues around acquiring and managing major service contracts.

- *How to manage Business Change*
- *How to manage Service Acquisition*
- *How to manage Service Provision*
- *How to manage Performance*

Available from Format Publishing and The Stationery Office.

OGC IT Infrastructure Library guides

- *ITIL Service Support*
- *ITIL Service Delivery*
- *and others*

Available from Format Publishing and The Stationery Office.

Other publications

Managing the relationship to secure a successful partnership in PFI projects: Report by the Comptroller and Auditor General. National Audit Office. HC 375 (available online at www.nao.gov.uk)

Treasury Taskforce Technical Note Number 6: *How to Manage the Delivery of Long Term PFI Contracts* (available online at www.ogc.gov.uk)

Further information

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