

# The Contract Scorecard

Successful Outsourcing by Design

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# Introduction

*'We are drowning in information and starving for knowledge.'*

Rutherford D. Roger

## About this Chapter

This chapter takes you through the basic purpose of the Contract Scorecard and explains some of the underlying research behind the concept as well as its predecessor concept – the Balanced Scorecard.

## Purpose of the Contract Scorecard

Organizations that are veterans at contracting know that the success of a deal is not just about cost, but that the quality of the work matters too. They also know it is more than just getting value for money; it is about making sure that the relationship between the parties is productive and not dysfunctional. Furthermore, they know that having a contract is not an end in itself – merely a means to achieve a desired goal or goals.

Success can rarely be defined by only one criterion, and never from only one person's perspective. While some people in your organization prefer things cheap, others will want them fast. Some will forgo both to get better quality. Yet others will prefer to work with providers they can trust. Success is multifaceted and everyone has a different opinion. So how can you balance all your stakeholders' needs and still drive results-orientated contracts?

A Contract Scorecard is a very useful tool if you want to focus your contracts, and your stakeholders, on results. It enables you to articulate the myriad of

different outcomes that different stakeholders want and then ascertain the degree to which these have been achieved.

It does this by ensuring that the parties not only establish how the quality of the work will be evaluated, but also what the financial outcomes will be judged by, how the relationship is conducted between the parties and if the deal achieves its strategic aims. In sum, a Contract Scorecard defines and then measures the overall success of the deal from a holistic view.

As such, the Contract Scorecard provides you with a key instrument for guiding the details of the contract to put in place the vital contractual provisions. It further expresses these goals in a measurable form so that they are not merely idealistic thinking, but instead are outcomes that are regularly tracked and assessed. As people who are experienced with contracts know, active management of the desired goals delivers results, not the contract itself.

## **Research Base**

The Contract Scorecard was developed as part of my PhD examining 107 contracting arrangements over the last decade and categorizing the key attributes in which success was sought. That research focused initially on examining what success is, and then looked at how organizations achieve it.

The 107 cases are contract initiatives in which I worked with in various organizations (client and providers) across 51 countries covering Asia-Pacific, the Middle East and Europe. These deals represented over US\$11 billion annual spend. The largest was US\$1.5 billion per annum and the smallest was worth US\$0.2 million per annum.

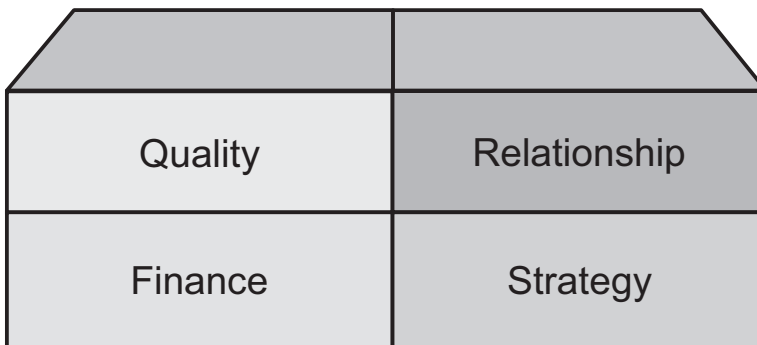
The cases included the full spectrum of outsourcing initiatives, ranging from information technology and communications (IT) outsourcing, to business process contracts covering such areas as human resources, corporate property, call centres and accounting, and many operational contracts, dealing with maintenance, construction, logistics and so on.

Of the case organizations, 60 per cent were in the commercial sector and 40 per cent in the government sector. Within the commercial sector, over 60 per cent of cases were in the finance (insurance, banking, stock broking and so on), ICT (information, communication and technology), or utility (water, electricity

and gas) industries. Within the government sector, the cases were chiefly state government agencies and departments, followed by federal government agencies and departments, then local governments (that is, city councils).

As you would expect, the research I conducted involved examining many sources of evidence including systematic analysis of the related working documents (plans, contracts, reports, evaluations, minutes, reviews, audit findings and so on). It also included regular interaction and discussion with 20 different types of stakeholders and participants, ranging from Managing Directors and CEOs, CFOs and CIOs, to employees and advisors (for example, legal, financial advisors, probity and consultants of all kinds).

The Contract Scorecard was created from both my direct involvement in these cases, when working as a consultant, and from what I learned by observing and discussing the experiences of stakeholders and participants when I was an observer (for instance, when conducting detailed case studies on behalf of clients). It consists of four quadrants (see Figure 1.1), each of which contains one aspect that must be addressed by anyone who wants to design a contract that delivers what their organization really wants. By addressing all four aspects or quadrants, you will be able to design and drive the best possible outcomes for your contracts. These quadrants are: 1) quality; 2) financial; 3) relationship; and 4) strategic, and they are fully described the next chapter.



**Figure 1.1** Contract Scorecard – quadrants

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## Roots of the Concept

The basic idea of a scorecard is, of course, nothing new. People and organizations have been ‘scorecarded’ for years. The concept hit the corporate scene in the early

1990s, following development of Balanced Scorecard by Robert Kaplan and David Norton. The Balanced Scorecard was the result of their study, which set out to capture and measure the attributes of successful US companies (Kaplan and Norton, 1992 and 1996). They categorized success attributes as: 1) financial results; 2) efficient internal business processes; 3) learning and growth of staff; and 4) satisfied customers. The Balanced Scorecard has since proliferated into many forms and spawned an entire global consulting industry. As I wrote this, a search on Google for 'Balanced Scorecard' yielded 2 670 000 results!

If your organization is employing a form of the Balanced Scorecard for its internal operations, that is all well and good. However, if your organization pays a large portion of its expenditures to external parties, you may be leaving a great deal of your structure unscored, as illustrated below.

#### **A REGIONAL BANK SCORES ONLY PART OF THE PICTURE**

A fast-growing regional bank had a decentralized management style, empowering staff to contract with whom, and how, each staff member saw fit. These contracted expenditures were not systematically tracked or controlled – it was up to the buyer to manage whatever they bought in whatever manner they saw fit.

An insightful manager, after gaining substantial cost savings from better design and management of the contracts in their area, thought the techniques they employed could be useful in other contracts in the bank. Their initial guess at external spend with suppliers was approximately 30 per cent of the bank's annual outgoings. A brief assessment of the accounts payable ledger found that the actual spend was about 80 per cent.

The bank had been investing very heavily in a minor component of its outgoings including staff, but nothing on its major outgoings. It had a very large human resources (HR) department and employed many leading HR techniques such as 360-degree evaluations (a performance evaluation that includes an assessment by staff, colleagues and supervisors), leadership training and capability assessments, mentoring programmes and the like.

Meanwhile, it had no contract management area, no 'informed buying' capabilities, and didn't track any form of results from the over 400 providers it engaged.

While the Balanced Scorecard is a useful tool for your organization's internal operations, a different scorecard is required for your organization's contracted operations. With regard to contracting arrangements, the Contract Scorecard is a method used to evaluate the success of the arrangement in a similar holistic

manner to the Balanced Scorecard – the technique encourages organizations to think more strategically about what constitutes success, go about setting up measures, and then drive them.

## Structure of this Book

This book is intended to help you understand the concept, design the scorecard that you want for each contract, develop practical key performance indicators that will work, select your options when performance is good or bad and develop the key contractual schedules that underpin the scorecard.

Chapter 2, 'The Quadrants of the Contract Scorecard', takes you through each of the quadrants of the Contract Scorecard. In doing so, different ways of measuring each quadrant are explored and 23 different example Key Performance Indicators (KPIs) are given.

Chapter 3, 'The Steps in Developing KPIs', takes you through each of the seven steps that develop KPIs that will work. A note of caution – seven steps sounds easy, but each will take more time and effort than you might think.

Chapter 4, 'Schemes for the Consequences of KPI Performance', takes you through possible incentives and disincentives (the 'carrot' and 'stick' options) that you might choose to invoke if KPI performance is good or if it is poor. These are not just monetary options; non-monetary options are given as well.

Chapter 5, 'Planning the Contract Scorecard', takes you through some key planning considerations including choosing your Contract Scorecard quadrants (each contract does not necessarily require all of them), designing your Scorecard Blueprint (where you intend to specify your chosen quadrants in the contract) as well as the best time in the contract lifecycle to prepare your scorecard.

Chapter 6, 'The Quality Specification – The Service Level Agreement (SLA)', helps you design the contract schedule that specifies the work (what you want for your money) including both parties' work-related accountabilities, the detailed specifications, reporting and the quality KPIs. The chapter appendix includes an example schedule.

Chapter 7, 'The Financial Specification – The Financial Schedule', helps you design the contract schedule that is all about the money. This addresses costs, reimbursables, invoicing, payment, charges, benchmarking and the financial KPIs. The chapter appendix includes an example schedule.

Chapter 8, 'The Relationship Specification – The Governance Charter', helps you design the contract schedule regarding the inter-party relationship by imposing a commitment on both sides to manage the deal in a diligent and agreed manner. It covers the management roles and responsibilities of each party, the meetings and reviews, and the processes surrounding issue, dispute and variation management – all of which are critical to the success of your deal. The chapter appendix includes an example schedule.

Chapter 9, 'The Strategic Specification – Unique Contract Schedules', helps you design the contract schedule(s) that articulates the strategic goals of the deal and details the provider's obligations in assisting you to achieve them. As these schedules can be quite large and varied, only a few examples have been included, one for each type of strategic goal (innovation, business contribution, alignment and underlying business practices).

The last chapter, Chapter 10, summarizes with a few thoughts.