

Supporting local public services through change

Contract optimisation

Getting value for money from contracts and spend with third parties is an ongoing challenge for most organisations. This is increasingly true in today's economic environment where reducing costs and conserving cash are the priority. Often the largest opportunity to quickly yield savings is to optimise the value in existing contracts. By having commercially-efficient contracts, effectively managing these throughout their operational life and minimising waste in business activities with suppliers, an organisation can typically save between 5% to 15% of contract spend.

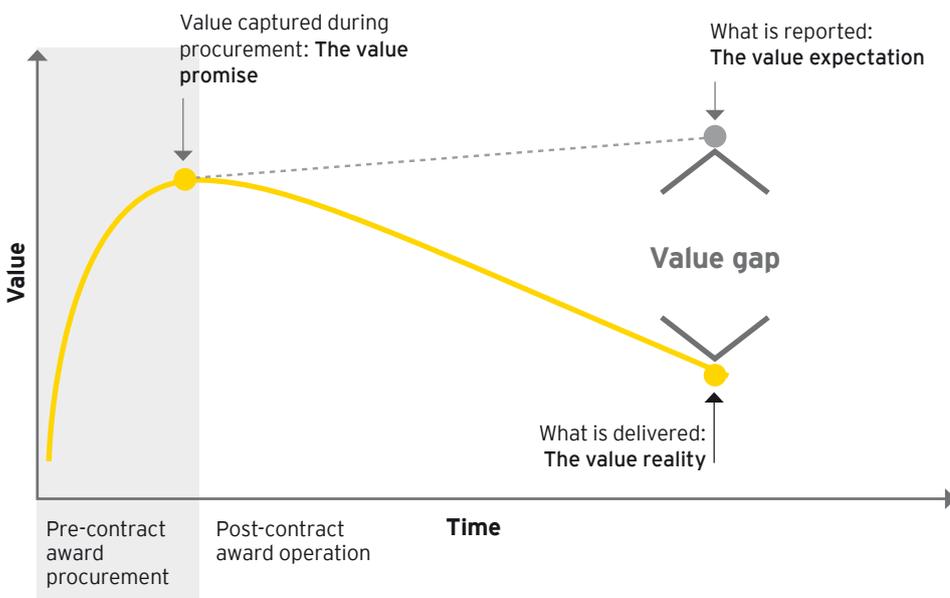
Identifying areas for cost saving

Contracts in the yellow zone are most at risk of value leakage and therefore offer the best opportunity for savings.

	Value leakage		
	Low	Medium	High
Contractual complexity	Clear and transparent contracts	Some complexity in commercial schedules and charging regime	Contract charging regime is complex and difficult to understand
Performance subjectivity	Performance and delivery can be objectively evaluated	Some subjectivity in evaluating contractual performance	High subjectivity in complex services or bespoke products
Perceived risk	Low risk/high control comfort	Some risk/inconsistent control environment	High risk/lack of control

Value erosion chart

Understanding the difference between the reported expectation and the delivered reality provides leverage to close the value gap.



Why are there cost saving opportunities in contracts?

Opportunities exist in contractual arrangements because commercial inefficiencies and waste manifest themselves during the operational life of the contract. The value captured during the procurement pre-award phase is often lost over time due to:

- ▶ Ineffective contract management
- ▶ Commercially inefficient contracts
- ▶ Scope creep and delivery and quality failures
- ▶ Poor or perverse incentives
- ▶ Bad planning and demand management
- ▶ Ill-informed buying
- ▶ Miscommunication and rigidity in managing the relationship

On longer term arrangements there is also the risk that the contract has not evolved with the organisation and now no longer delivers what the business needs. Understanding the difference between the reported expectation of value and the reality of value actually delivered provides leverage for rectification and cost recovery.

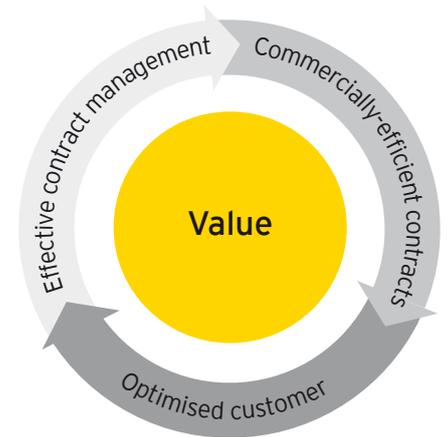
Achieving savings, recovering cost and enhancing value

We identify where value is being lost and provide pragmatic advice and assistance in capturing value and achieving savings

Drawing on our commercial experience and work with organisations in the public and private sectors, different industries and across categories of spend, we have developed an approach to the process of achieving savings, recovering cost and enhancing value from your existing contracts.

The key to unlocking the value in contracts is to develop a granular understanding of the drivers underlying the commercial relationship. We analyse how the contracts are operated, benefits are delivered and costs are incurred. Then we investigate how these activities impact on the broader organisation's cost base.

To achieve this we talk to the people who operate the contracts and analyse real operational and cost data to bring clarity as to how the contracts are actually utilised. This allows us to draw a fact-based picture of what is happening in the organisation, how effective commercial processes and controls are in practice, and how contracts and services are functioning. We use our leading practice frameworks to benchmark existing governance processes and controls, and to assess the contracts' commercial structure. This provides the basis on which we identify where value is being lost and provide pragmatic advice and assistance in capturing value and achieving savings.



At the heart of our approach is the value cycle, where we recognise that value is dependent on:

Developing an approach to suit your organisation

We work with you to create an approach based on your specific circumstances and needs.

Pathways to enhancing value

Enhance the commercial strength and cost-efficiency of contracts: review your contracts' commercial structure and compare this to leading practice. Recommend improvements in commercial schedules, SLAs, KPIs, charging mechanisms, and value assurance levers.

Minimise wasteful activities and spend: assess your organisation's maturity as an optimised customer. Assess how contracts, spend and services are delivering value. Identify and eliminate waste in these value delivery processes and in contracted activities.

Improve commercial skills and capability: training and skills transfer targeted at specific user-needs: on contract governance, the commercial structure of contracts and optimising value from suppliers. Coach and assist key staff in live negotiations.

Confirm contract and performance compliance: identify and recover over billing and/or under performance against agreed contract terms.

Tighten controls over the operation and business use of contracts: compare existing contract governance processes and controls to leading practice. Develop a gap analysis and implement a programme for improvement and rectification.

- 1 Having commercially cost-efficient contracts
- 2 Managing those contracts effectively throughout their operational life
- 3 Minimising waste in the business' activities with its suppliers (what we call being an 'optimised customer')

Sustainable cost savings across a portfolio of contracts

The challenge: management wanted to reduce operating costs without downsizing the scale of their business. They had already rationalised their workforce, reduced headcount and streamlined their internal operations. They felt that they should be getting value from their suppliers as all contracts had been competitively tendered.

Our approach: we performed a high level risk/opportunity assessment of their current contracts, benchmarked the significant contracts' commercial structure and compared their contract governance to leading practice. We considered the typical areas of waste in a supplier/customer relationship and assessed the organisation's maturity as an 'optimised customer'. We used the resulting gap analysis and our experience of similar contracts to develop a set of value leakage hypotheses, which are then used to direct our data analysis and detailed investigation.

Value delivered: overall **saving of 10%** of the total annual contract spend:

- ▶ Eliminated wasteful expenditure on contracted services which were no longer needed/relevant to the business or had been over-scoped or were over-delivered compared to real business requirements. We helped improve contract governance and renegotiate selected contracts to eliminate this waste – **saving 3%**.
- ▶ The real impact of some of management's decisions and business activities had resulted in costs being incurred by suppliers who in turn had built this into their charges. We were able to minimise wasteful business activities and renegotiate reduced prices, whilst increasing the suppliers' margin – an 'optimised customer' outcome – **saving 4%**.
- ▶ We identified and helped recover non-compliant performance and over-billing errors. We assisted management in rectifying their 'purchase to pay' internal controls – to ensure that this leakage would not recur in future – **saving 3%**.

Driving business performance through greater transparency and enhanced control of contracts

The challenge: management were concerned that they did not have real control over their contract spend and that commercial risks were not clearly reported or understood. There had been high profile legal disputes with key suppliers which could have been resolved more positively and at less cost if the issues had been reported to senior management sooner. There were a number of overheating (increased spend but little contracting control) contracts with spend significantly greater than expected. In addition, operations that were central to achieving the business' strategy had been fully outsourced. Here management felt that they did not have full visibility of the facts and lacked the information to effectively take action and regain control if needed.

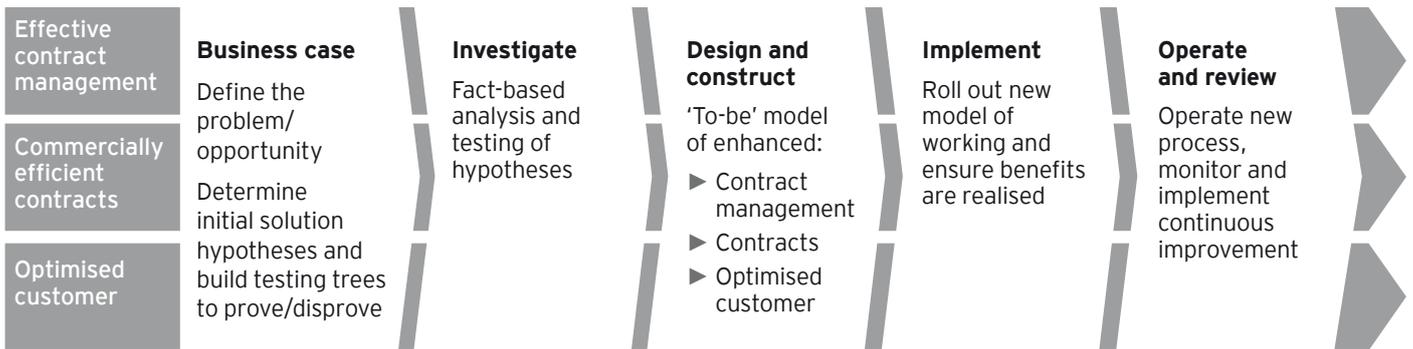
Our approach: we investigated and benchmarked the organisation's existing contract management processes and commercial capabilities against leading practice. We reviewed the company's contracting and risk transfer policies and compared those to the existing contracts. We reviewed the overheating contracts and established the reasons for the rise in expenditure. We assessed their maturity as an 'optimised customer' in their dealings with suppliers.

Value delivered: together with management we developed and implemented a detailed action plan for improvement that resulted in:

- ▶ Reduced expenditure and better value for money from contract spend through enhanced governance and contract management processes and controls.
- ▶ Informed decisions through improved management information and reporting of contract risks.
- ▶ Better alignment between the overall business strategy, procurement guidelines, contracting/risk transfer policies and the commercial structure of contracts.
- ▶ Greater control over contract spend and outsourced functions that were central to achieving the overall business strategy.

Methodology and tools: delivering sustainable improvements and savings

Our specialist team is supported by a proven approach, methodology and tools that accelerate the delivery of sustainable benefits to our clients.



Find savings

Contract review programme and category savings insight register	Contract comparator benchmark	Contract management health check
Proven programme and specific category experience of where savings are likely and how best to prove their existence and quantum.	Compares a contract's commercial structure to leading practice principles. Gap analysis informs hypotheses testing tree build and improvement programmes.	Benchmark contract governance against leading practice. Gap analysis informs hypotheses testing tree build and improvement programmes.

Deliver savings

Optimised customer framework	Contract management best practice framework	Contract commercial principles framework
How businesses can drive efficiency through their suppliers and eliminate wasteful costs. Focuses on the main areas of waste in a customer/supplier relationship.	Comprehensive guidance on what good contract management looks like. Covers 14 areas and 90 distinct tasks needed to effectively operate a diverse portfolio of contracts.	Commercial principles that should be considered when negotiating a contract. Covers 19 areas needed for a contract to be cost/risk efficient and commercially fit to deliver value for money.

Supporting local public services through change

Why EY?

EY has a multi-disciplinary team focused on the local government sectors. We have extensive experience of assisting local public sector bodies to deliver significant improvements for both them and the citizens they serve.

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Simplicity: our approach involves an initial assessment to quickly identify and focus on actions to actually realise savings and/or help to deliver the strategic change you need.

Collaborative: we will work alongside you and equip your team with the knowledge to effectively monitor, review and achieve savings in the future.

Experienced: the products are tried and tested, reduce cost and realise greater cashable savings in a shorter period of time.

Risk and reward: our commercial offer is grounded in the tangible benefits delivered to you.

About EY

EY is a global leader in assurance, tax, transaction and advisory services. The insights and quality services we deliver help build trust and confidence in the capital markets and in economies the world over. We develop outstanding leaders who team to deliver on our promises to all of our stakeholders. In so doing, we play a critical role in building a better working world for our people, for our clients and for our communities.

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