

## Chapter 2

# The Management of Services Contracts

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### ABSTRACT

*The management of services creates a new and exciting development in business relationship management. It is a field which grows as organizations increasingly seek to specialize and also replace in-house service delivery with contractual relationships with suppliers. This chapter explores many of the attributes and challenges of planning, developing, and managing service contracts within complex supply chains.*

### INTRODUCTION

The growth of contracting out or outsourcing and off-shoring has led to a sharp rise in the procurement of services in both public and private sectors over the past 15-20 years (Hypko, Tilebein, & Gleich, 2010; Vitasek & Ledyard, 2010). Many economies have shifted to a predominantly services model leaving manufacturing and agriculture in their shadow. This chapter examines the challenges associated with the definition, measurement and management of services contracts. It uses a procurement and supply chain management perspective to link the elements of business strategy, business process and services management.

This aspect of services management has been largely unrecognised in the management literature. Indeed Roels, Karmarkar, & Carr (2010), suggest that even though the service sector is developing quickly, research in the field has focused on the more tangible elements. As will be argued in this chapter, the complex terms and conditions of a service contract are often daunting to establish, as the parties seek to scope the precise nature of their intentions into a working contract (Hypko, et al., 2010; Ng & Nudurupati, 2010; Ng, Maull, & Yip, 2009; Matthyssens & Vandenbempt, 2010).

Services contracts are an everyday event in our lives. We hire taxis, have our clothes laundered and have our automobiles serviced. The task is seemingly simple. We hire a taxi and expect to be delivered safely to our designated destination

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in a suitable amount of time and for a fair price. But imagine the number of potential issues that can get in the way of this type of contract. The driver may talk too loudly or drive too fast or too slow. It may be peak hour and the traffic becomes clogged so travelling time and costs rise and despite the driver's best efforts you arrive at your destination late and the taxi charges are double the expected amount.

These contractual uncertainties create personal irritation, but are usually quickly forgotten, because the basic terms of the contract are clear: the amount of money involved is comparatively small, the start and end points of the journey are usually well defined and the price per mile or minute is well advertised. The issues that cause most difficulty are those which are subjective: driver capability, the buyer's perceptions of speed, driving standards and the chosen route to the destination. These terms are implicit within a typical contract for the services of a taxi but are not clearly defined by the parties and they are subject to the risk of delay and misadventure. In a perfect world, there would be just one possible route between the start and end points of the journey, drivers would always drive in the same way and at a constant speed, there would be no traffic to create delays and the price could be predetermined with pinpoint accuracy. As we all know, and mostly accept, reality is quite different.

This simple example demonstrates how the exact definition and measurement of service output can be difficult to elaborate in plain language or in ways that explicitly describe the expectations of both the service provider and the end user of the services. The origin of these difficulties were discussed by Parasuraman, Zeithaml and Berry as long ago as 1985, namely that there are "three features unique to services: intangibility, heterogeneity, and the inseparability of production and consumption" (Parasuraman, Zeithaml, & Berry, 1985).

The chapter begins with a discussion of the procurement planning process which is designed

to investigate and document the scope, delivery and performance standards of the desired services. This is followed by a discussion of the nature of service supply chains and concludes with a review of the role of contract management.

## **THE PLANNING OF SERVICE CONTRACTS**

Contract management, an emerging business discipline in itself, is only now being more widely used by organisations to manage their entire range of buying relationships – especially those associated with services. The formation of a service contract is seemingly identical to that associated with the procurement of a physical product. In the latter case, a detailed specification of the product is prepared and potential suppliers are invited to demonstrate their ability to provide the product at a competitive price. These potential suppliers will also attempt to demonstrate their capacity to meet the product specification in the given time at the required quality for a particular price. A tender or Request for a Quote (RFQ) may be issued and on the basis of this competitive comparison, the buyer will make a decision to buy from one or more potential suppliers. Once a contract has been agreed upon and executed, the parties shift to the contract management phase and the performance of the supplier will be monitored until the terms of the contract have been satisfied by all parties.

New, complex or innovative products may be described in terms of their outcomes (Ng & Nudurupati, 2010; Ng, et al., 2009), thus permitting potential suppliers to apply their ingenuity to satisfy the buyer's potential requirements. The basic measure of performance of the contractor will be directly related to the conformity to specification and ability to meet the schedule within the agreed price parameters. The buyer is usually able to evaluate the product, often at multiple stages of construction, to arrive at an estimate of earned value (the monetary value at any stage of

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