



INPUT vs. OUTPUT REIMBURSABLE CONTRACTING STRATEGIES

Aligning Service Supplier Performance to Core Business Objectives

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2 SIDES, ONE COIN

In his book, *The Art of Problem Solving*, Russell Ackoff makes a simple yet powerful statement: **"No Choice, No Problem"**!

Contracting for Services is particularly demanding in terms of choices and therefore manifests itself as contracts which are relatively problematic to manage effectively.

The contrast between contracting on an Inputs Reimbursable - versus Output Reimbursable Basis is similar to the two sides of a coin – worlds apart.

INPUT REIMBURSABLE CONTRACTS:

To most organisations, the concept of contracting services on so-called "Cost plus Fee" terms is well known and constitutes a popular choice amongst most Procurement Professionals.

A supplier is usually contracted to perform a range of services such as painting, cleaning, painting, scaffolding, thermal insulation, dredging, general labour, welding, waste management, warehouse management, material management, planning and scheduling of work, tools control for which a Work Team (using a relatively constant set of tools, equipment & consumables) is required. Key features of this type of contracts are:

- Fixed Monthly Payments: Normally increasing at a steady rate over time – CPI or Industry based escalations.
- Labour Timesheets: Used as Primary Control Mechanism of Input. These are normally compared to invoices prior to authorisation of payment.
- "Performance Measures": Usually detailed in terms of "input specifications" pertaining to specific behaviours or features expected from people (skills), consumables, tools, and equipment.
- Work Scope: No or Limited Scope of Work details are made available by the Client Organisation. Suppliers usually keep detailed records of work performed for a particular client. This "recording of scope" is normally driven by aspects such as: Legislation; "Proof of Work", Client Satisfaction & Compliance to Specifications. It is hardly ever shared and even less frequently used in the management of the relationship between a client and its supplier.

At face value, Input Reimbursable Contracts seem relatively easy to manage with a typical "end of assessment period rush" to submit input verification data (timesheets, weigh bills, & other documentary proof) in order to justify payment claims.

OUTPUT REIMBURSABLE CONTRACTS:

An emerging concept, where measurable outputs are used as primary control mechanism, is quickly gaining ground amongst leading businesses.

The basic tenets of this approach are as follows:

- An Absolute measure of output is used to order, assess and effect payment for Services for example m², m³, or any other suitable measurement.
- All inclusive prices per output unit are agreed prior to contract finalisation, allowing for various special circumstances such as economy of scale and accelerated response times to be factored into the offerings of suppliers.
- "Outcome" based bonuses and penalties are often included and it is typical to see formulas prescribed for the calculation of performance metrics such as Safety, Housekeeping, Customer Satisfaction, & Quality.
- Measurement & Testing of Specifications Compliance are Primary Controls and are typically integrated into Measurement of Outputs.



- Measurement of Compliance to Specifications and Verification of Payment Claims forms part of a process.
- The management of inputs and the production deployment thereof shifts from the client to the supply organisation.

It would be normal but misleading to assume that Output Reimbursable option are a lot more complicated to operate and control than Input Based Contracts as the “end of payment period rush” is now distributed throughout the period in the form of “output receipts”.

Practice has however proven exactly the opposite to be true, as the end-to-end flow of the process from order to payment, seamlessly encapsulates compliance testing and payment claims assessment at logical and fully integrated intervals. As this process allows for the measurement of all required compliance testing, total risk management (including financial risks) improves exponentially by comparison.

IMPACT ON CORE ORGANISATIONAL GOALS

Contract Management Solutions (Pty) Ltd strives to design solutions which approach the concept of **The Ideal Design**, meeting the following criteria:

1. **Technological Feasibility:** The design must be able to perform using existing & readily available technology;

2. **Operational Viability:** Must meet criteria of Operational Simplicity, where a “normal” person with average abilities can perform the work at above average standards.
3. **Continuous Improvability:** According to this principle the process must be robust but flexible in order to facilitate seamless integration with existing business procedures.

Over the past 5 years it was proven that our design philosophies paid off as detailed in the following case studies:

- **ELECTRICITY GENERATION PLANT**

This South African plant is part of a fleet of Power Generation Plants, operated by Non Governmental Organisation. When the original cost analysis was performed on the Input Reimbursable Contract, the cost per ton of scaffolding calculated to ZAR27600 or approximately €2300 per ton. After the CMS Optimisation this cost has been reduced to an average of ZAR5500 (€458) per ton! An improvement of 80% in direct costs of the service! The same results were achieved when other services such as Painting, Thermal Insulation, Welding, & Rigging, were subjected to the same methodology.

- **OIL REFINERY**

The Refinery needed to improve the accuracy of Capital Project Costing. The Output Based

Contracting Strategy enabled the Plant to achieve this objective without the need to review costs at the end of every project and allowed for 100% accuracy of allocating costs. In addition, average savings 75% were reported due to the overall improvement in productivity.

CONCLUSION

The maturity of a company with regards to contract management drives the type of contract to be used. Input based contracts require a less mature approach but are more costly. Companies that are matured enough to manage output base contract will benefit from a more competitive costing but will have to accept that they will go into a partnership rather than pure contracting.