



# Managing External Services

## Maximize External Services ROI Through Innovative Management Process

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## Introduction

Every business is under pressure to find ways to increase revenues while at the same time reduce costs. One opportunity that has evaded businesses is in how they manage their external services. With the inherent difference between services and goods management most companies have adopted the philosophy that the contractor is the expert and requires little over sight.

Research has shown that top performing companies that have embraced a process to manage their external services have increased the quality of the deliverables and reduced costs over 10%. Up to now most companies expend little effort towards managing their External Service Providers. Most of that time is spent addressing issues after the services have been performed and invoiced. Leading edge Companies realize the risks and costs that non management represents and have chosen a different direction.

### How much does mismanaging external service providers really cost?

Using the traditional methodology an External Service Provider is hired, work is performed, a manual invoices is received and processed by AP for payment. The methodology does not contain a single management process step directed towards ensuring the right work was done for the right price.

The cost of non management is poor quality, time delays, cost over runs, repairs and re-work and lost reputation. Taken singularly or combined, all these symptoms erode the profitability of the Company and destroy the value of hiring the External Service Provider in the first place.

Poor management of External Services Providers can also siphon money from the Company in other forms:

- Lack of real time information forces business decisions to be made on incomplete date,
- Poor cash flow management and the heavy dependency on accruals
- Redundant or ineffective business processes creating inefficiencies within the Company and Service Provider.

To start managing your External Service Providers and achieve the expected ROI the Company must adopt a consistent, uniformly applied set of guiding methodologies. These methodologies start with the prequalification of potential service providers and end with rating the service provider's job performance.

This paper presents the steps and value of actively managing your External Services Providers to optimize your investment. It is directed towards those individuals who want to learn more about the management of External Services.

### **Does your Company ever...**

Struggle with selecting the right External Service Provider

Been dissatisfied with Contractor Performance

Overpaid Vendor invoices

**...Then you understand the value of Managing External Services**



## Executive Summary

### Managing External Services

#### Key obstacles to a successful process

- **Choosing** the “Right” External Service Provider
- **Poorly** defined the Scope of Work presents opportunities for misinterpretation and errors
- **Inefficiencies** in the procurement process
- **Different** methods of managing External Service Providers across a company
- **Lack** of visibility of timely costs
- **Excessive** time spent reviewing and matching invoice documents
- **Perception** that the current process is not broken, so don't change it

### Business Improvement Opportunities

#### Areas to address

- Prequalifying service providers based on a pre-established set of guidelines
- Establishing Master Service Agreements to streamline the procurement process
- Establish a company wide methodology for managing the External Service Provider's work output against the agreed scope of work milestones and specifications
- Process to validate the External Service Provider's costs against contract rates
- Only pay for accepted work. No more, no less.
- Transparency and accountability of stakeholders

### Benefits of Active External Service Provider Management

#### Immediate ROI opportunities

- Operational or functions units available for production as scheduled
- Minimize down time due to rework
- Leverage the buying process through Master Service Agreements
- Improved quality and workmanship
- Improved cost visibility for better decisions
- Improved cash flow management
- Take advantage of early payment discounts
- Eliminate invoice reconciliation issues with vendors
- Reduced the use of estimated services accruals
- Reduced legal disputes on service acceptance or payment

**“Service Spend as a percent of total spend ranges from 30% in manufacturing to 70-80% in financial services and other industries”**



## Challenges of Managing External Services

### Who is responsible?

In many cases the answer to this question is dependant on defining what are the processes that influence managing External Service Providers? Depending on whom you ask, or which part of the organization they work in, the answers will vary. Common responders will tell you that the responsibility to manage External Service providers belong to procurement, human resources, project management, finance or health and safety. In truth the responsibility is spread over many segments of the company. Unfortunately, this fragmented approach leads to a dysfunctional and inefficient set of processes that leaves the company and vendors confused and disgruntled.

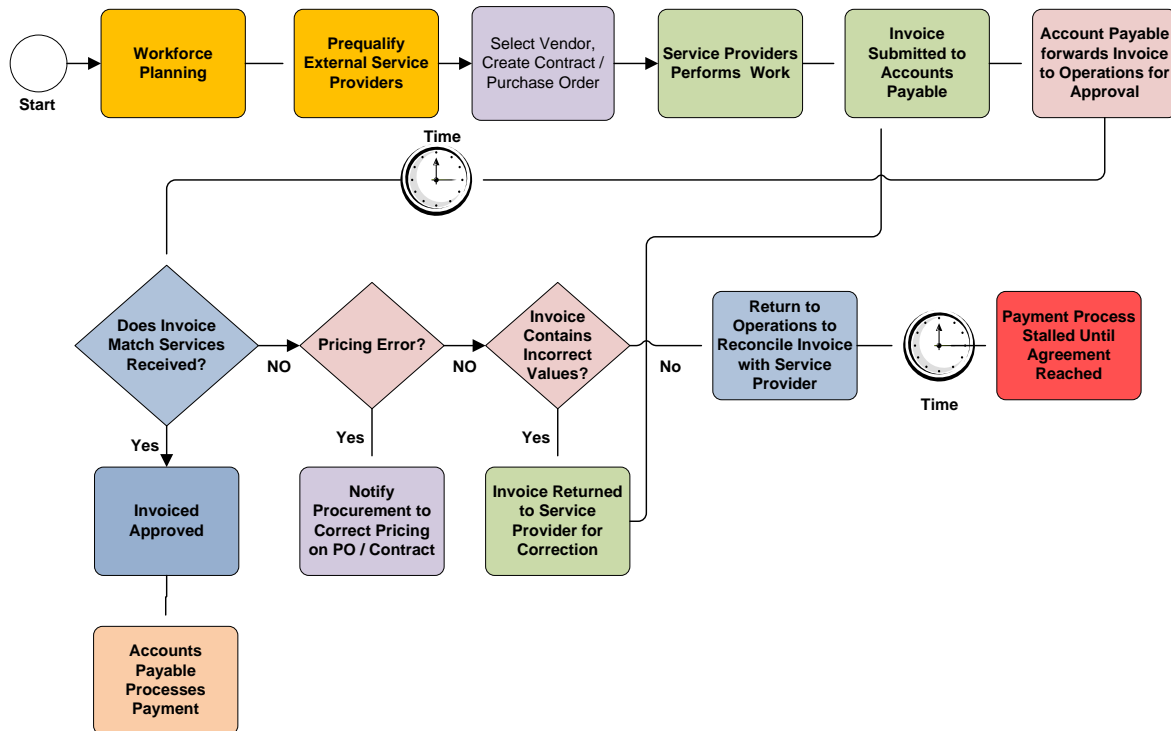
### What is the problem?

When a company decides to engage External Service Providers to supplement their work force they have made the decision based on economic reasons. The value proposition demonstrated a reduction in costs if the action was taken. The problem in most cases is that the company is ill prepared to actually manage the external work force. They soon realize that managing services is completely different from managing goods and that the level of effort required to achieve the desired controls is significant and costly.

Lack of proactively managing your External Service Providers can cause the following:

Issue	Impact
Selecting a Service Provider	<ul style="list-style-type: none"> <li>• Poor quality</li> <li>• Lack of schedule compliance</li> <li>• Cost overruns</li> <li>• Safety violations</li> </ul>
Procurement Process	<ul style="list-style-type: none"> <li>• Poor Scopes of Work</li> <li>• No clear definition of work acceptance criteria</li> <li>• Increased work load</li> </ul>
Daily Control of Work	<ul style="list-style-type: none"> <li>• No process to review daily work performed</li> <li>• No process to review daily cost incurred</li> <li>• No documented history of work performed</li> <li>• No record of changed conditions or Scope</li> </ul>
Manually Receiving Work after Invoice	<ul style="list-style-type: none"> <li>• Delay in visibility of job costs</li> <li>• Receiving document dependant on Vendor Info</li> <li>• Any corrections will be more expensive</li> <li>• Company reduced to a weak defensive position</li> </ul>
Lack of Visibility and Transparency	<ul style="list-style-type: none"> <li>• Cash flow management and accruals</li> <li>• Internal and external audits</li> <li>• Decisions based on incomplete data</li> <li>• Disagreements with vendors</li> <li>• Work stoppage</li> </ul>

### Traditional External Services Management / Pay Process



### Selecting a Service Provider

The phone book or internet is full of service providers offering all the services your company needs. At issue is how your organization determines which provider to use. Has your company established a set of prequalifying guidelines to address performance, experience, insurance levels or health and safety policies? Choosing the right service provider can make or break the job.

### Procurement Process

Procuring services is not the same as buying goods. You can't just go to the catalog and select the item and quantity (unless you use service masters). Before procurement starts the RFQ process the scope of work must be drafted. The scope of work contains the who, what, where, when and how the work is to be performed. It should also contain how the work is measured for payment and what deliverables must be achieved to receive payment. Does your company create a new contract each time they employ a service provider? Does procurement have a process in place for leveraging their buying power?

## Daily Control of the Work

Many companies make the erroneous decision that the External Service Provider has a complete understanding of the work assignment and requires no oversight once the work begins. Companies who fail to perform regular (in most cases daily) work inspections will soon find themselves at a disadvantage in terms of work and cost management. It is expensive to correct deficiencies after the work has been completed. The time to review the work is not after the invoice has been received but as it is being performed.

A key understanding in the relationship between the Company and the Service Provider is that the service provider is in business for themselves. Their goal is to put as much of the Company's money in their pocket as fast as possible... then ask for more. Don't get the wrong impression. Most External Service Providers are not out to rob the Company, but human nature being what it is, if not controls are put in place, the Company is at a higher risk level of not receiving the requested service for the agreed price.

People generally do better work when they know their work output is being watched. This phenomenon is called the Hawthorne Effect. An External Service Provider will soon realize that the Company is paying attention to their work through the routine interactions and accordingly quality, schedule compliance and safety all improve.

Some companies think that the cost of managing their External Service Providers outweighs the risks. The premise ignores the fact that more and more service providers are working in critical areas of the company and capable of disrupting operations or services. The cost of those disruptions can far exceed the basic cost of the service. Additionally, experience shows us that the cost incurred in managing External Service Providers is returned five times over.

## Manually reviewing work after Invoice

In industry, there is a common practice that reviewing a service vendor's work at the end of the job and when their invoice has been received by accounts payable. This practice results in the loss opportunity to actively manage the work to ensure the contracted service being delivered meets the specification. Few individuals have the discipline to maintain sufficient records to accurately review a vendor's invoice that references work performed days, weeks or even months in the past. The lack of accurate job records places the company at a disadvantage when reviewing the invoice. For this reason, many vendor invoices do not receive the level of scrutiny they deserve. The end result is the acceptance of vendor invoices that contain errors that cause overpayments.

## Manual invoice processing

Manually processing paper invoices is a time intensive process. Documents must be scanned then data is manually entered into the system. The supporting documents must be matched against invoice documents. Mismatched invoices must be sent to other departments for price adjustments or reconciliation. Each one of these steps consumes time and money and is frustrating for all involved.

Managing the External Service Provider while the work is being performed reduces the amount of effort expended by accounts payable.

## Lack of Visibility and Transparency

Well run companies understand that access to accurate and timely information is critical to their business's success. Good decisions can not be made using poor data. Waiting for invoices to be received from a service provider before understanding the cost liabilities on a job causes deficits in information. It is paramount that everyone, including External Service Providers, are using the "Same Version of the Truth". Compliance with internal and external audit reviews is dependant on being able to follow the linkage between purchase orders, work performed, work received, invoices for work received and the corresponding payments.

## How large is the problem?

In discussion with external auditors and CFO's the majority of companies do not manage their service activities to an acceptable level, and the problem is getting worse. Increasingly, more companies are turning to External Services to augment or replace their existing workforce. Unfortunately, few companies have developed processes or adopted automation to improve their ROI. Some companies have resorted to a risk based process that allows them to blanket pay all service invoices under a certain dollar amount without any verification process at all.

These decisions are predicated on the existing paradigm that the service provider is the expert and no management is required and that the system is not broken so don't fix it. The implementation of a process can reverse the trend. Not addressing the management of External Services is costing companies millions of dollars due to work not meeting specification, inaccurate payments, excessive internal labor costs, missed discounts and litigation.

## What are the benefits of using a cohesive process?

Managing your External Service Providers using an end to end process can reduce a company spend on services on the order of 15%.

The benefits are attributed to:

- Selecting the provider with the right skills and experience
- Reducing the costs during the procurement process by leveraging the providers through long term contracts
- Managing the work while it is being performed, not after the fact
- Verifying the cost of the work is in alignment with the contract rates
- Paying for only work that has been received and approved
- Conduction performance reviews to reinforce the Hawthorne Affect
- Managing cash flow
- Ability to make the correct decisions based on real time data

Implementing an External Services management process can generate savings for the average company between \$2-\$10 million annually.



## The Next Step

External Services Management helps organizations breakdown the traditional silo culture. As mentioned earlier in this paper, the responsibility of managing External Services is different depending on where you work in the organization. A cohesive process ties together the interests of procurement, operations, accounts payable, financial management, human resources and health and safety. The following summary highlights the outcomes in these areas.

Procurement	<ul style="list-style-type: none"> <li>• Prequalifying providers based on guidelines not relationships</li> <li>• Use of Master Service Agreements to leverage rates</li> <li>• Use of past performance ratings</li> </ul>
Operations	<ul style="list-style-type: none"> <li>• Using a common process to eliminate confusion and inconsistencies</li> <li>• Real time review of services rendered and costs</li> <li>• Ability to see variances and forecast costs</li> <li>• Simplified documentation</li> <li>• Manage of change orders or scope changes</li> </ul>
Accounts Payable	<ul style="list-style-type: none"> <li>• Reduce disagreement with vendor over payment amounts</li> <li>• Reduce time spend on price / purchase order adjustments</li> <li>• Take advantage of early payment discounts</li> </ul>
Financial Management	<ul style="list-style-type: none"> <li>• Improved cash management</li> <li>• Real time cost liability</li> <li>• Reduction of accruals for services</li> </ul>
Human Resources	<ul style="list-style-type: none"> <li>• Visibility of service vendor skill usage</li> </ul>
Health and Safety	<ul style="list-style-type: none"> <li>• Visibility of service vendor safety performance</li> <li>• Visibility of service vendor man hours</li> </ul>



## External Services Management

### How it works

The External Services Management methodology encompasses all aspects of the work. The ACCM methodology breaks down the silos that exist between Human Resources, Procurement, Project Management, Health and Safety, Accounts Payable and finance. Each group can see how they contribute to the ultimate success of increasing value and simultaneously reducing costs. The methodology allows for:

**Workforce management:** How the company determines when to use of External Service Providers. Is the decision based on covering peak loading, change is required skills or responding to economic pressures.

**Prequalifying potential service providers:** How to make sure that the service providers being used provide the best skills, performance and HSE program at a competitive price.

**Master Service Agreement:** Optimize the time and skill of the procurement team by negotiating multiple year contracts that leverage the buying power of the company. After you have created a short list of qualified providers, take advantage of the competitive bidding environment to reduce price points. Use the Master Service Agreement across multiple purchase order with the same vendor.

**Manage the service provider work activities:** Don't make the mistake that the service provider understands the scope of work as thoroughly as you do. Taking an active management role can avert mistakes before they happen. It is always easier to have the work done right the first time before potential issues lead to lost productivity. The act of documenting the work as it is being performed provides information that can be used when planning and budgeting related projects plus a basis for contesting vendor overcharges if necessary.

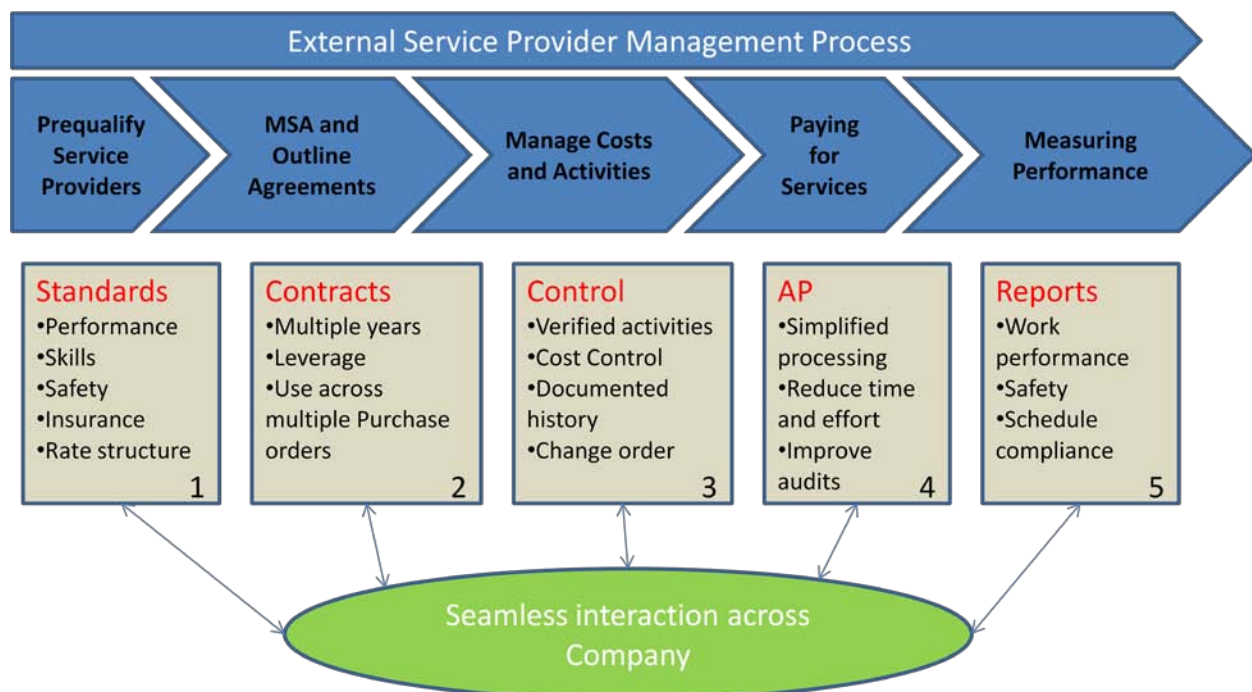
**Managing the service provider's costs:** The ability to understanding costs as they are incurred allows the Company to make critical financial decision based on accurate information. Knowing if a job is under or over budget and the cash flow demands are key to managing the work.

**Paying for Services:** The process of reviewing and paying External Service Provider's invoices is important in managing the company's financial stability. Without sufficient documentation on the work performed the potential exists for erroneous payments and protracted time consuming arguments with the vendors.

**Measuring Service Provider performance:** Significant effort will have been extended to select and manage any External Service Provider used. Establishing metrics to measure the service provider's performance should be part of the overall management system. Including the results of the performance metrics in the project documentation is

useful for both the short and long term. In the short term, documentation is needed to terminate poor performing vendors. In the long term, the information is used in future prequalification exercises.

## External Service Provider Management Process Overview



1. The list of potential service providers can be lengthy. Each company needs a method to filter the list using prequalification standards. Limiting the list of service providers to engage in RFX saves time and money.
2. The company exercises its greatest price leverage during contract negotiations. Increase that leverage by extending contract terms a longer duration. Contract language can be reference across multiple purchase orders to improve efficiency and reduce costs.
3. External Service Providers do not manage themselves. Active engagement in the process will result in high quality work output at the anticipated costs. Failure to manage the process will result in cost overruns and time consuming conflicts.
4. An output of managing the External Service Provider is vendor invoices which are accurate and timely. Waiting to manage the work until the Vendor invoice is received by

Accounts Payable will guarantee invoices that contain errors which on average consume 300% more effort to process.

5. A significant amount of effort is put into selecting and managing External Service Providers. Retaining feedback on these vendors' performance is crucial in managing the current work and in retaining that information to be used in future selection exercises.

## Key Benefits

- Provides a common platform to manage External Service Providers across Company
- Remove the silo mentality towards managing external services
- Clear assignment of responsibilities and accountabilities
- Promotes real time management of the external services to ensure the work is performed correctly the first time
- Reduces downtime costs associated with service provider poor performance
- Provides the Company with a standard process to track and manage service provider costs verse output.
- Significantly reduces confusion generated from everyone doing their own thing
- Real time visibility of external Services cost improves management decisions
- Provides improved audit trail details
- Ensure External Service Providers work efforts are documented for future reference

## About AccM

AccM is a company dedicated to the efficient and cost effective method of managing company's external services. AccM is an established SAP Software Solution Partner. Our methodology is based on years of hands on experience in procurement, contract and contractor management, and cost accounting. Our team is constantly interacting with the business community to ascertain requirements for new and additional functionality with the primary focus to provide our customer with the best service possible.

