Keep Your Contractor Accountable for Results

Fifth article in a series about managing outsourced service providers. Previous articles in this series may be found at our website, clariongp.com/newsletter.

Recently, a Clarion client was greeted with an unpleasant surprise. The new dining service's first year subsidy not only exceeded budget, it exceeded sales.

Obviously, something went radically wrong, not only with operational performance, but with the planning and budgeting that preceded the opening of the service.

That's an extreme and fortunately rare occurrence, but it illustrates the importance of realistic advance planning and the outsourced provider's commitment to meeting the financial and operational goals set for the operation.

Your vendor is responsible for developing the annual budget for its service, but your role as client can't be passive. It's your organization's money that's at stake.

Plan as Well as Budget

It's a good idea to start the budgeting and planning process early, at least three months before the start of your fiscal year. If circumstances change during that period, the budget can be adjusted accordingly before being finalized.

But a budget is meaningless unless you have a plan for its implementation. What changes have occurred over the past year than will affect next year's operation? What changes will occur next year? How will your vendor cope with them?

You should gather all the information you can about your organization's future plans and provide them to the vendor, so he/she can prepare a realistic budget.

Question Assumptions

"Continuous improvement" is a popular mantra that's often chanted but not always observed.

When your vendor presents the budget, you should also receive a detailed plan for the coming year that illustrates how the vendor will improve operations, meet changing circumstances and become more responsive and efficient.

You will be most effective in your organization's interest if you question the plan's and the budget's assumptions.

If the plan is good and the budget realistic, the vendor should have no trouble justifying the assumptions. If not, then the plan and budget needs to be revised. That's why you need to start the process early.

First-year budgets tend to be overly optimistic. Vendors often understates costs and overstate sales in its effort to win the contract. In succeeding years, the tendency is to pad the budget so that it's easier to meet.

If the service is highly variable, like catering and conferences, it's possible to craft a budget that takes this into account.

Variable Budgeting

The budget can be based on an average cost per unit, such as guests served. If activity is higher or lower than budgeted, you can still see how well the vendor is performing compared to the original plan.

A small matter, but one easily remedied: Many vendors prepare budgets and present operating statements according to their company's fiscal year, which may not be the same as yours.

Insist that your budget and statements are presented in accordance with your fiscal calendar. It's easy for the vendor to do and helps you keep track of costs according to your own timetable.

Once the year starts, how do you keep the vendor accountable to achieve the agreed plan and budget?

It's best that the vendor has some "skin in the game." That can be accomplished by tying the vendor's profit or fee to an incentive-based formula.

The next article in this series will discuss the development and administration of incentive-based vendor compensation.

For expert help with the budgeting process, contact Clarion's Tom MacDermott, 603/642-8011 or Angela Phelan, 973/544-6223.