

## Chapter 1

# Commercial Management in Project-Oriented Organisations

### Learning outcomes

When you have completed this chapter you will be able to:

- Define the terms commercial management and commercial manager
- Identify the common activities undertaken by commercial managers
- Identify the skills and abilities that support these activities
- Identify the theories and concepts that underpin commercial practice
  - legal
  - strategy: value, activity-based theory of the firm, competitive advantage
  - managerial economics: transactional cost economics
  - marketing: make or buy decision
  - organisational behaviour
- Understand the relationship between the purchaser's procurement procedures and the supplier's bid cycle

## Introduction

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### Commercial awareness (acumen)

All members of an organisation should be commercially aware – that is, have a basic understanding of the economics of business: the benefits and realities of an economic exchange from both the supplier's and the buyer's perspectives (UCAS, ND). They should also have an appreciation of the environment within which this transaction occurs. A key aspect is a broad understanding of its clients and/or suppliers:

'... identifying with them, and helping them achieve their commercial objectives - their strategy. It's about understanding their culture and using their language. This requires an interest in, and liking for, business and what it's about.' (Stoakes, 2011)

We talk about people being commercially astute, minded or aware, etc. The implication is that this aspect is more than a generic skill or competency – it is something that is related to the individual's mind-set (approach, attitude, way of thinking, outlook); view point (perspective, standpoint, opinion, belief, ethos, feelings, thought); behaviour (manner, stance, position); and predisposition (inclination, propensity), which is innate (natural, inherent, or intrinsic).

This chapter further explores the nature of commercial practice within project-oriented organisations at the buyer–seller interface. It presents a commercial management framework that illustrates the multiple interactions and connections between the purchaser’s procurement cycle and a supplier’s bidding and implementation cycles. Additionally, it outlines the principal activities undertaken by the commercial function, identifies the skills and abilities that support these activities and reviews the theories and concepts that underpin commercial practice.

### What is commercial management?

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Although an activity (discipline/function) labelled **commercial** clearly exists within many organisations, an elementary search on Google for commercial manager/director positions will generate numerous hits. However, a similar search within the academic domain will be somewhat less successful. It seems sensible, therefore, to start with a definition of the subject of this text – **commercial management** – however, the endeavour is fraught with potential difficulties.

The *Oxford Online Dictionaries*<sup>1</sup> define **commercial** as:

‘... concerned with or engaged in **commerce** [... the activity of **buying and selling**, especially on a large scale]... making or intended to make a **profit**: having profit rather than artistic or other value as a primary aim.’

The word ‘commercial’ is derived from the French *commerce* or Latin *commercium* (of trade, trading) a compound of *com-* (together) plus *mercium* (from *merx*, *merc-* merchandise), the root of merchant. The term is, therefore, directly related to trade: the action of buying and selling goods (assets, items or products) and services, involving an exchange of one commodity for another, which is generally referred to as a commercial transaction. Similarly, a transaction *is an instance of buying or selling something: the action of conducting business* – hence a commercial transaction.

Commercial is often used interchangeably with **business**. However, the word business, which concerns an individual’s *regular occupation, profession, or trade*, has a different etymology, originating from the Old English *bisignis* meaning anxiety. Initially used to convey a *state of being busy*, its current usage denoting an *appointed task* dates from late Middle English. Likewise, trade can also be used in the sense of a person’s *habitual practice of an occupation* (although historically, this was often used in a pejorative sense) or to describe a skilled artisan (tradesman). Business also relates to the activity undertaken by an individual or organisation.<sup>2</sup>

Etymologically, therefore, commercial is clearly associated with the activity of **buying and selling**; commercial actors supporting the associated commercial transaction (interaction, agreement [contract] and exchange process) between the parties: the buyer and seller. The term transactor, a derivative of transact, either with or without the prefix commercial, is a useful descriptor for the commercial actor; interestingly, it is rarely used. The exception to this is, within the UK public sector, where it is used to describe an individual appointed to advise procuring bodies on the commercial and contractual implications of procuring goods and services using the Public Finance Initiative (PFI) approach.

The principal participants in the exchange are generally referred to as the **buyer** and **seller**.

### Buyer

A buyer is an organisation, function or individual employed within an organisation to select and purchase goods, facilities, products and/or services<sup>3</sup> on behalf of the organisation from suppliers and contractors. The term can be used in relation to individuals who merely requisition products and services from pre-established contracts, through to senior executives responsible for making key **value-for-money** decisions regarding major procurement projects, which are then implemented by dedicated procurement personnel (VGPB, 2011). The designations **client**, initially applied in respect to the users of professional services, **customer** and **purchaser** are frequently used interchangeably with buyer to denote an actual or prospective buying organisation (OGC, 2002) or group/individual assigned to make the purchasing

decision (less frequently, the term **vendee** is also used). Although, the PRINCE2 glossary of terms defines a customer as:

'... the person or group who commissioned the work and will benefit from the end results.' (PRINCE2, 2009)

The term **buying centre** is often used to describe the group of individuals (decision-makers), directly involved in the purchase of products or services, whereas **procuring party** refers to the division of an organisation responsible for purchasing products and/or services, frequently possessing delegated authority to sign any resulting contracts on completion of the process on behalf of the organisation (CBI, 2006). Allied terms include:

- **Intelligent customer:** a competency (capability, skills, knowledge and experience) within a buying organisation relating to an understanding of both its own and its suppliers' business aims, needs and capabilities, with the objective of facilitating a successful trading relationship and contract (OGC, 2002)

- **Sponsor:** the principal motivating influence of a project or programme, defined by (APM, 2010) as:

'The individual or body for whom the project is undertaken and who is the primary risk taker. The sponsor owns the business case and is ultimately responsible for the project and for delivering the benefits.' (APM, 2010)

- **User(s)/end users:** are the intended beneficiaries (an individual or group) of the purchased product and/or services: those who will actually use or exploit the output of these products and/or services

A client, customer and user can be external or internal to the organisation.

## Seller

A **seller** is a person or organisation that sells something – that is, provides or transfers something in exchange for money (or some other tangible benefit). In a b2b context, sellers are generally called suppliers, contractors or service providers. The term supplier, for example, refers to an entity (an individual, organisation, company or consortium) that provides or could provide resources (products and/or services) to a purchaser or project. The term, however, also embraces contractors, consultants and service providers:

- A **contractor** is an entity that enters into a contract to provide resources to perform a service or undertake work, either directly or through subcontractors
- A **consultant** is an entity that provides professional expert advice or services
- A **service provider** is an entity responsible for providing any required service

Additionally, the terms vendor, broker, merchant and trader can be used.

In order to respond to specific project opportunity or opportunities, individual suppliers may form joint-venture companies, consortia or alliances with other organisations:

- **Joint-venture companies:** a commercial enterprise entered into by two or more parties, while retaining their individual identities
- **Consortia:** a commercial enterprise created by two or more parties to combine complementary services or to jointly develop new products and services
- **Alliances:** involve the purchaser and their principal suppliers forming a joint organisation to implement a particular project, often becoming shareholders in a co-owned company. Personnel from the constituent organisations are then seconded to the alliance to work in an integrated team. Alliances generally have their own organisational and financial structures, with risk and reward allocated between the participants (shareholders)

In relationship to a specific project or programme, the various suppliers can be categorised in tiers; for example, a tier-1 supplier is an entity that has a direct, contractual relationship with the initial purchaser, whereas a tier-2 supplier is a supplier that has a contractual relationship with a tier-1 supplier.

The commercial activity of buying and selling products and services is termed a **market**, as in market forces. Additionally, the term is used as a collective noun for purchasers who buy goods and services.

In the following text the terms **purchaser** and **supplier** are predominantly used.

## Purpose of the commercial function

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### Commercial activities

The commercial function is engaged in and/or undertakes an amalgam of activities that support and deliver an organisation's, business unit's and project's strategic aims and objectives and in particular their commercial objectives. Examples of these wide-ranging activities, tasks and areas of interest are provided in Table 1.1.

The value of the role is derived from this mix of activities, its integrating features, focus on value creation (profit orientation and maximisation) and the protection of an organisation's position contractually. In particular the purpose of the commercial role is one of developing and delivering innovative commercial solutions that:

- Maximise and deliver **profit** and **value** for the organisation
- Protect and enhance the organisation's **commercial and reputational interests**
- Deliver and acquire **competitive advantage**: *'The product, proposition or benefit that puts a company ahead of its competitors'* (CIM, 2011)
- Drive **growth**, improve **market penetration**, increase **market share**: by supporting the development, expansion and exploitation of the organisation's activities, products and or service offerings

**Table 1.1** Examples of commercial activities, tasks and areas of interest.

- |   |                             |
|---|-----------------------------|
| ● Accounts/accounting                                 | ● Contract administration   |
| ● Acquisitions  | ● Contract award            |
| ● Analysis of suppliers' cost structures              | ● Contract compliance       |
| ● Analysis of cost budgets                            | ● Contract cost modelling   |
| ● Annual sales, profit and overhead budgets           | ● Contract drafting         |
| ● Assessing costs of a venture/project                | ● Contract negotiation      |
| ● Assessing financial viability of projects/contracts | ● Contract pricing          |
| ● Bidding   | ● Contract requirements     |
| ● Budget monitoring and control                       | ● Contract review           |
| ● Budget planning                                     | ● Contract selection        |
| ● Budgeting   | ● Contract strategy         |
| ● Business case generation                            | ● Contracting               |
| ● Business development                                | ● Contractual matters       |
| ● Business planning                                   | ● Controlling prime costs   |
| ● Business process outsourcing (BPO)                  | ● Copyright issues          |
| ● Business proposals                                  | ● Cost advice               |
| ● Calculating service management costs                | ● Cost analysis             |
| ● Cash flow   | ● Cost budgets              |
| ● Cash flow forecasting                               | ● Cost control              |
| ● Claims  | ● Cost engineering          |
| ● Communications                                      | ● Cost forecasting/planning |
| ● Compliance  | ● Cost modelling            |
| ● Continuous improvement                              | ● Cost reporting            |
|   | ● Cost value reconciliation |

(Continued)

Table 1.1 (Continued).

- Costing
- Design and build
- Development of strategic partnerships
- Dispute resolution
- Due diligence
- E-procurement
- Estimating
- Ethics
- European procurement law/directives
- Final accounts
- Financial appraisal
- Financial engineering
- Financial forecasting
- Financial payments
- Financial planning
- Financial principles
- Financial processes
- Financial reporting
- Financial risk
- Financing
- Fixed price contracts
- Gainshare/painshare allocation
- Generating new clients
- Global outsourcing
- Governance (corporate and project)
- Government procurement policy, guidance and legal frameworks
- Guaranteed or agreed maximum price contracts
- Incentive pricing
- Incentivised contracts
- Insolvency
- Insurance
- Intellectual property rights (IPR)
- IT outsourcing
- Legal issues
- Life cycle costing
- Management contracting
- Market analysis
- Marketing
- Measured term/serial contracting
- Model/standard contracts
- Negotiating
- New market opportunities
- New product/service development
- Offers – preparation and submission
- Opportunity development and exploitation
- Outsourcing
- Partnering
- Performance monitoring
- Post contract financial reporting
- Price analysis
- Price benchmarking
- Price increase negotiation
- Price modelling
- Pricing policies
- Pricing proposals
- Procurement
- Procurement cycle/life cycle
- Procurement legislation and regulations
- Procurement methodologies
- Procurement routes
- Procurement strategy/policy
- Profit generation, maximisation, etc.
- Profit and loss (P&L) accounts
- Project cost management
- Project final costs
- Project finance
- Project Finance Initiative (PFI)
- Projects
- Proposals
- Public–Private Partnerships (PPP)
- Purchasing
- Quotations
- Regulatory issues
- Resource allocation
- Risk
- Route(s) to contract
- Sales
- Serial contracting
- Sourcing
- Sourcing strategy
- Strategic sourcing
- Subcontract procurement
- Subcontracts
- Supplier cost driver analysis
- Supply issues
- Sustainable procurement
- Target costs
- Tendering
- Value
- Value and cost reporting
- Variations
- Whole-life costing

Source: Analysis of 90 commercial functional frameworks/job specifications

## Profit and value

Predominantly, the commercial function seeks to maximise, generate, deliver, or optimise profit, margins, and/or return on investment. These terms are all interrelated. For example, **profit** is the financial gain obtained by supplying (selling) a product and or service – that is, what remains once the costs incurred in

producing, supplying, purchasing or operating something are deducted from the price obtained by selling it (the difference between the proceeds generated and the amount spent). This is also referred to as a **margin**. A **profit margin**, therefore, is this difference expressed as a percentage; for example, the gross profit margin is obtained by dividing an organisation's gross (total) income by its net sales (its operating revenues). Alternatively, their objective is to increase income or revenue. **Income** is what an organisation obtains through the sale of its products and or services to customers. Associated financial indicators include: return on investment (ROI), or the rate of return, is the value (profit) derived by an organisation from investing in an opportunity or project, expressed as a percentage; return on assets (ROA), the net income generated by assets divided by their total value (or cost); and return on capital employed (ROCE), the value gained by an organisation from investing in an asset, opportunity or project: a comparison of the revenues obtained with the funds invested.

A further aim of the function is to obtain, create, achieve and add value. In general usage, **value** is the regard (importance, usefulness, or worth) in which something is held, for example, its monetary, material or economic worth – *'the amount buyers are willing to pay for what a firm provides them'* (Porter, 1985) – and its benefit to an individual or organisation (both purchaser and supplier). Benefit is the profit or advantage gained by buying or selling the product and or service. According to Porter:

'Value is measured by total revenue, a reflection of the price a firm's product [or service] commands and the units it can sell. A firm is profitable if the value it commands exceeds the costs involved in creating the product [or providing the service offered]. Creating value for buyers that which exceeds the cost of doing so is the goal of any generic strategy.' (Porter, 1985, p. 38)

In relation to projects, a venture is worth undertaking if its value, expressed as benefits, can be quantified and justified in business terms (OGC, 2007a). For example, the Association for Project Management (APM) defines value as:

'A standard, principle or quality considered worthwhile or desirable. The size of a benefit associated with a requirement. In value management terms value is defined as the ratio of "satisfaction of needs" over "use of resources."' (APM, 2010)

They, define benefit as:

'The quantifiable and measurable improvement resulting from completion of project deliverables that is perceived as positive by a stakeholder. It will normally have a tangible value, expressed in monetary terms, that will justify the investment.' (APM, 2010)

Alternatively, according to BS EN 1325-1: 1997, value is:

'The relationship between the contribution of the function (or VA [Value Analysis] subject) to the satisfaction of the need and the cost of the function...' (BSI, 1997)

Additionally, value is also used when non-monetary features such as availability, speed of implementation, reliability and longevity are taken into account. Value, therefore, is a subjective construct, which varies between the different stakeholders in a project.

Value management provides:

'... a structured approach to defining what value means to the organisation and the project. It is a framework that allows needs, problems or opportunities to be defined and then enables review of whether the initial project objectives can be improved to determine the optimal approach and solution.' (APM, 2006)

Applicable throughout the project (contract) life cycle, value management seeks to maximise the overall performance of an organisation, ensuring that decisions taken optimise the balance of benefits with regard to cost and risk (OGC, 2007a). Its processes, methods and tools can be applied at the corporate level, encompassing stakeholder and customer value, and at the operational level to address project-oriented activities, in order to enhance the likelihood of delivering the project's objectives in terms of value for money (BSI, 2000b; OGC, 2007a).

**Value for money** is realised when **whole-life cost** ('*enhancing whole-life value*' or '*total cost of ownership*') and **quality** are optimally combined to meet the purchaser's/user's requirements (NAO, 2003, 2007; OGC, 2007c) and is derived from '*the effective, efficient and economic*' employment of resources:

- **Effectiveness:** a measure of the degree of success in meeting these requirements (aims, objectives, goals, etc.), occasionally labelled as '*doing the right things*'
- **Efficiency:** a comparison of the output derived with the elements of production, occasionally labelled '*doing things right*'
- **Economy:** the ability or option of acquiring comparative products and/or services at a lower cost to the organisation (price paid) (OGC, 2002)

Further, **value added** relates to the amount, excluding costs incurred, by which the value of a product or service is increased at each phase of its production or delivery. It can also be used in relation to an organisation offering enhanced, supplementary or specialised services.

Interestingly, the associated concept of **utility** – *the state of being useful, profitable, or beneficial* – and in particular its specific economic application as a measure of that which is sought to be maximised in any situation involving a choice, was not mentioned in any of the job specifications or commercial frameworks reviewed.

Generally, all projects undertaken by an organisation should be aligned to its strategy, aim and objectives, at the very least obliquely – that is, seen as a means to an end. A business may carry out a suboptimal project, for example, if it believes that by doing so it will lead to other more aligned and lucrative activity or more pertinent work with a 'key' client, increased market share or facilitate entry to a particular market sector.

The relationship between value and **competitive advantage** is explored in Chapter 3 along with the concepts of **value chain** (alternatively, value web and value constellation; Normann and Ramirez, 1993) and **supernormal profit** (Kay, 1993; Augier and Teece, 2008). Finally, value chain management has been defined as the ability:

'... to categorise the generic value adding activities, identifying primary and support activities and analyse these specific activities to maximise value creation while minimising costs.' (MOD, 2009)

## Further reading



### Value management

Kelly, J (2006) Value management of complex projects. In: DJ Lowe (ed.) with R Leiringer, *Commercial Management of Projects: Defining the Discipline*. Blackwell Publishing, Oxford. pp. 298–316

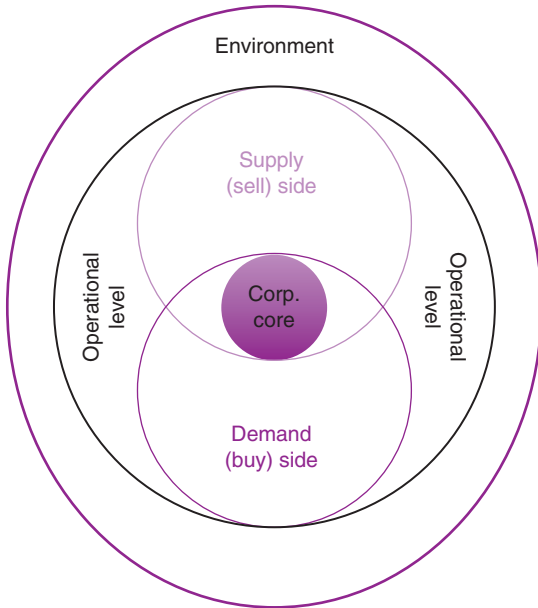


Figure 1.1 Organisational interfaces.

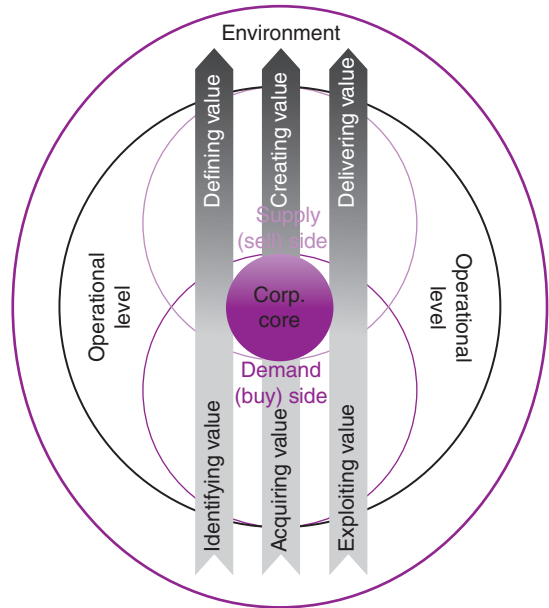


Figure 1.2 Transmission of value through an organisation.

### Transmission of value through an organisation

The transmission of value via the supply-side (customer facing), demand-side (supplier facing) and corporate core of an organisation is represented figuratively in Figures 1.1 and 1.2.

#### *Supply-side (customer-facing) perspective*

Customer-facing supply activities focus upon defining, creating and delivering value:

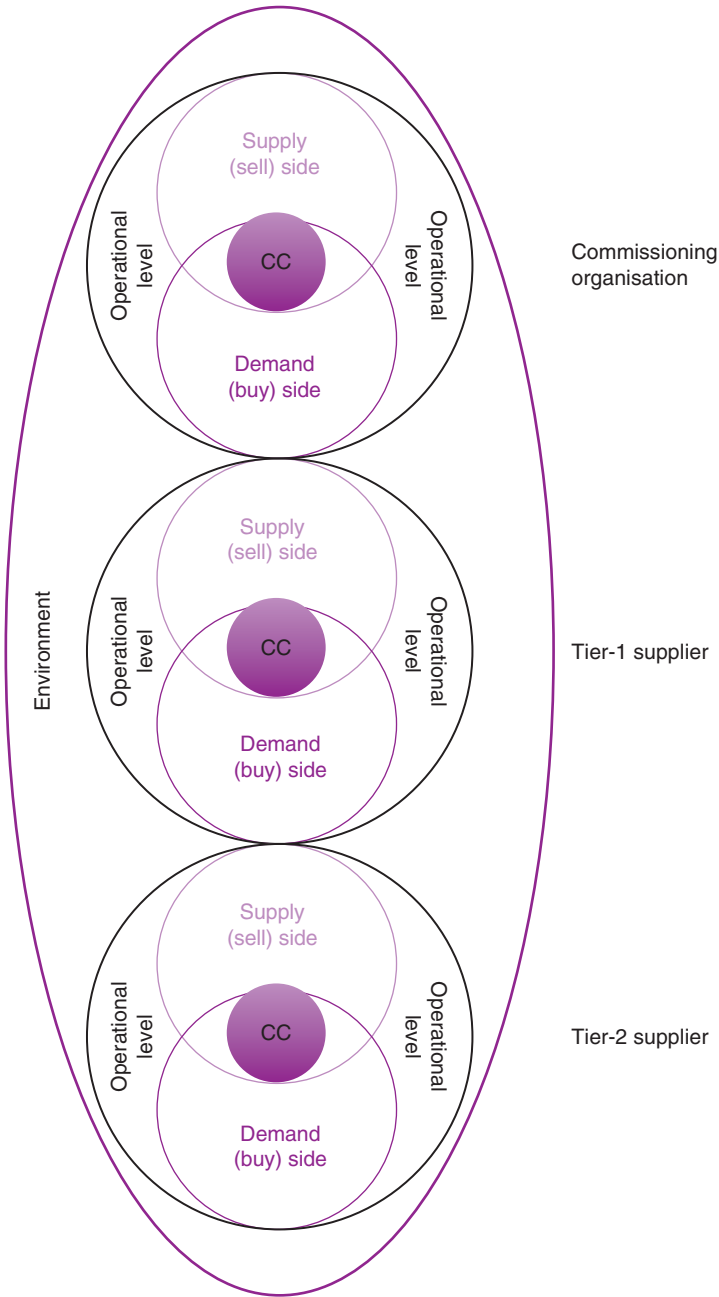
- **Defining value:** stating or describing precisely the scope, nature, or substance of the value to be derived by the purchaser from acquiring the product and/or service offered
- **Creating value:** generating and producing value through the actions of the supply organisation for both itself and its customers
- **Delivering value:** providing and transferring the promised or anticipated value to the purchaser

#### *Demand-side (supplier-facing) perspective*

Alternatively, supplier-facing purchasing activities centre on identifying, capturing and exploiting value:

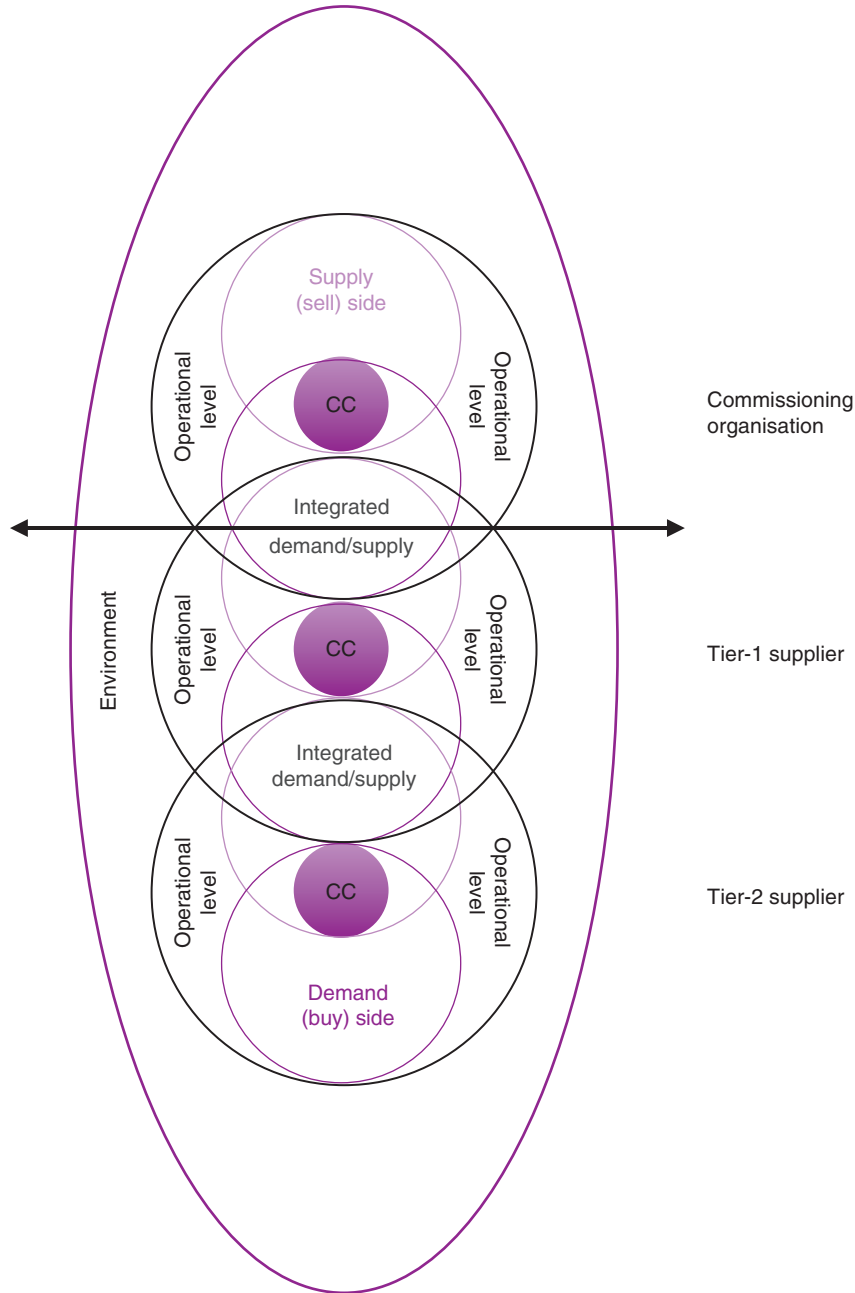
- **Identifying value:** recognising, distinguishing and establishing value in the product and/or service sought by the acquiring organisation or offered by a suitable supplier
- **Acquiring value:** seeking, purchasing or obtaining assets, products and services through which the purchaser can realise value. This aspect could also include the development and acquisition of new skills and abilities
- **Exploiting value:** in the positive sense of deriving benefit from or fully utilising a resource, asset, product or service (as opposed to the term's negative implications, such as, unfair or underhand dealing or unjustly or illegally benefiting from the work of others)

Figure 1.2 illustrates the development and transition of value through a single organisation. However, value is transferred at the point of exchange between organisations and passes 'downstream' through the entire supply/value chain.



**Figure 1.3** Organisational interfaces – traditional arms-length contracting. CC = corporate core.

These points of exchange are illustrated in Figures 1.3 and 1.4. Figure 1.3 represents the traditional ‘arms-length’ approach to contracting, while Figure 1.4 shows a collaborative partnering approach, where, for example, the purchaser’s demand-side activities are often integrated and co-located with those of the principal Tier-1 suppliers’ (supply-side) delivery activities. In relation to this latter arrangement,



**Figure 1.4** Organisational interfaces – integrated contracting (partnering). CC = corporate core.

Figure 1.5 illustrates the complexity of the internal interfaces within an integrated demand/supply team; for simplicity, only four Tier-1 suppliers are shown. However on the T5 project, for example, there were 60 plus suppliers. Similarly, Figure 1.6 illustrates the multiple commercial interfaces across the various tiers of a supply network.

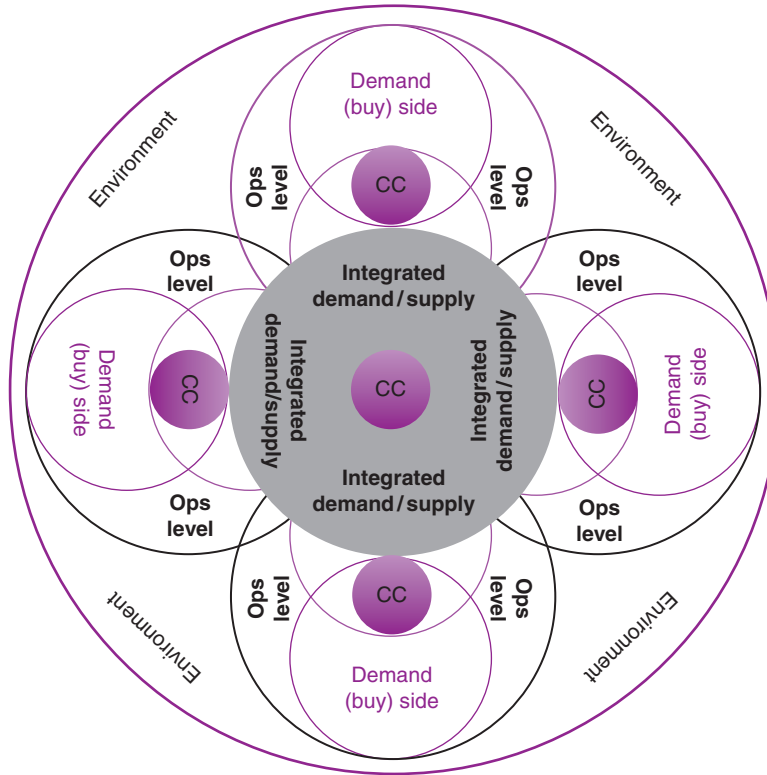


Figure 1.5 Tier-1 commercial interfaces in an integrated demand/supply network.

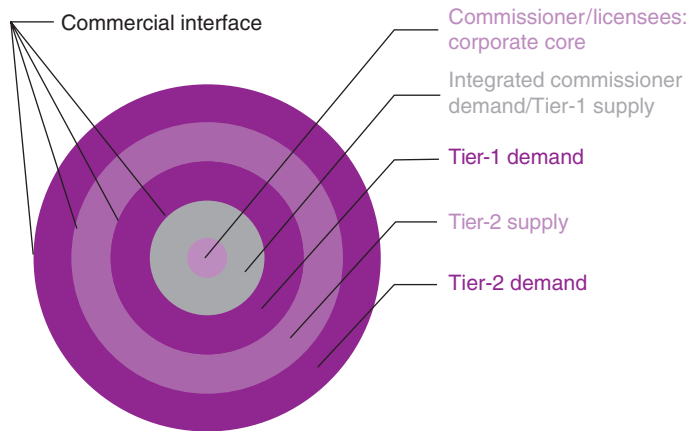


Figure 1.6 Inter-organisational commercial interfaces.

## Commercial management framework

The following commercial management framework (Figure 1.7) exemplifies the multiple interactions and connections between the purchaser’s procurement cycle and a supplier’s bidding and implementation cycles. For simplicity it shows the interface between two organisations, although in reality the connections

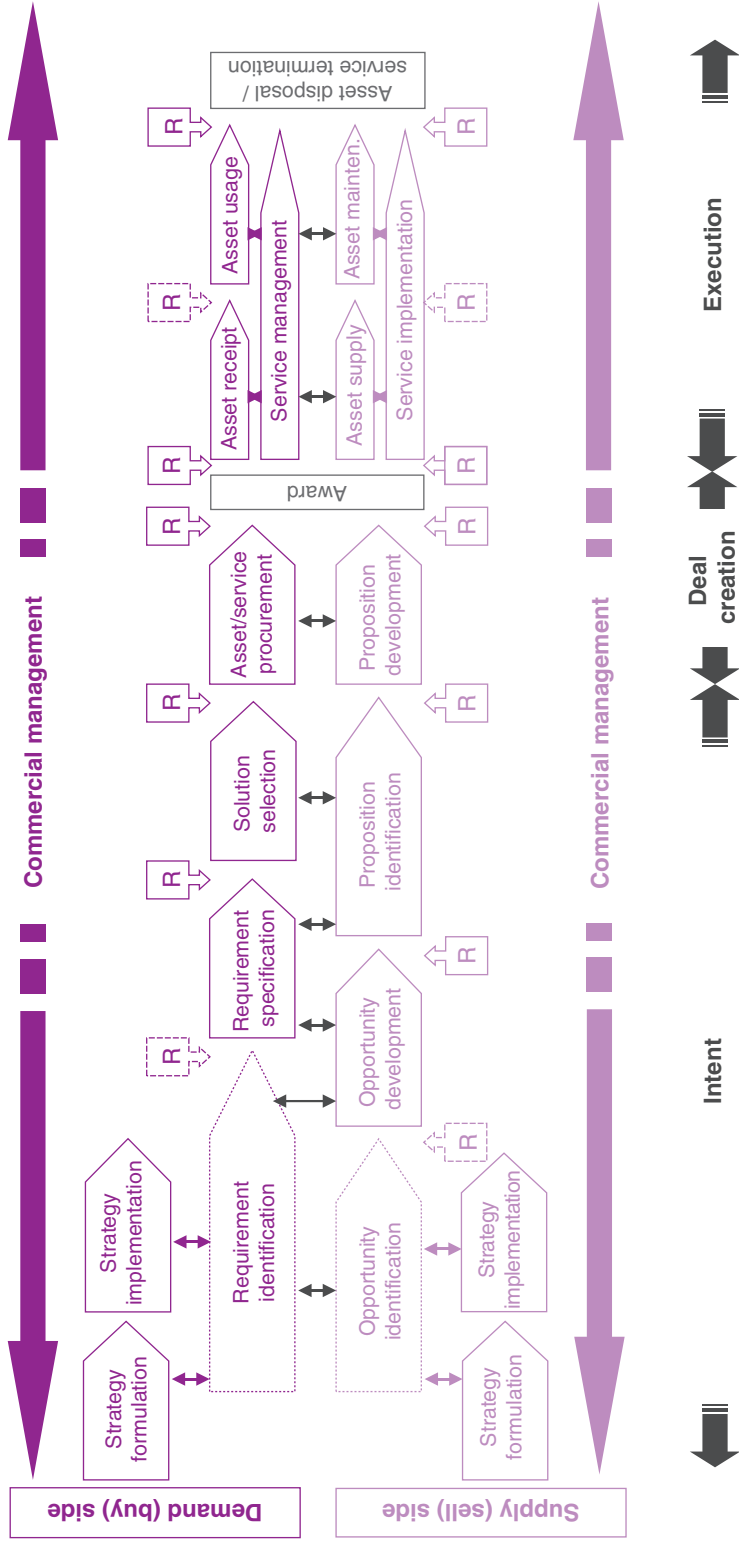


Figure 1.7 Commercial management framework. R = stage review.

are multilayered, the purchaser appointing numerous suppliers sequenced at different points across a project's life cycle. Similarly, suppliers will generally contract with several if not many customers; while in the vertical dimension there will be parallel interfaces between the numerous tiers of the value (supply) network.

Comprising a series of interrelated processes and actions, the framework is organised into three discrete stages: **intent**, which links the proposed acquisition or opportunity to supply to the strategic objectives of the organisation; **deal creation**, which culminates in the award of a contract; and **execution** – the implementation stage – which concludes with the disposal of an asset or termination of a service agreement. However, it is acknowledged that in practice contract life cycles will contain minor variations depending upon the specific industry sector or even business unit involved. The framework incorporates several stage gates (review points) to ensure that the proposed contract delivers the anticipated benefits (value) for both the purchaser and supplier. The Office of Government Commerce's (OGC) Gateway™ Project Review Process, which is outlined in Chapter 7, provides examples of the types of questions to be asked and techniques to be applied at each point of the process.

Although there is a clear boundary between the pre- and post-contract award stages, the boundaries of other activities are not as precise. Moreover, the constituent processes are likely to be iterative, containing cyclic decision loops, and with some actions being carried out simultaneously.

## Stages of the framework

### *Intent*

The **intent** stage bases and connects the proposed acquisition or identified opportunity to supply with the overall strategy (motivation, purpose, aim or objective: the *raison d'être*) of each organisation and to its implementation. The phase includes the following elements:

- **Strategy formulation:** creating or preparing a plan intended to achieve or deliver a long-term or overall aim (*a purpose or intention; a desired outcome*) of the organisation
- **Strategy implementation:** executing, effecting or enforcing the plan
- **Requirement identification:** identifying and confirming a need or want, a potential opportunity to be exploited or an issue to be resolved
- **Opportunity identification:** identifying potential customer requirements that the organisation is capable of satisfying
- **Requirement specification:** collating and comprehending the internal customer's needs, stating (specifying), invariably in a written form, a detailed description of precisely what is required. The resulting document, the specification, can include: design details, a description of or reference to the materials to be used, service levels or the standard of workmanship to be achieved, and references to acknowledged standards. The phase will also include an evaluation of the viability of the proposed endeavour and the production of a business case
- **Opportunity development:** cultivating a relationship and dialogue with potential customers, and creating, preparing and marketing potential solutions (product/and or services) to them
- **Solution selection:** identifying and deciding upon the most appropriate means of satisfying the acknowledged organisational need, which the market is capable of supplying (preferred solution), and the route to obtaining the selected product(s) or services (sourcing strategy). During the phase the selected solution will be progressed and appraised; concurrently the business case will be reviewed and revised
- **Proposition identification:** identifying and refining a potential solution to a customer's identified and specified requirement

### *Deal creation*

The **deal creation** stage focuses on bringing an agreement (principally a contract) by two or more parties into existence for their mutual advantage. Colloquially referred to as brokering or 'striking' the deal, the phase contains the following elements:

- **Asset/service procurement:** obtaining or procuring property, products and/or services through the implementation of the selected sourcing (procurement) strategy, the tendering process, and negotiating the agreement: the precise terms of the exchange

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- **Proposition development:** creating, preparing and submitting a proposal (an offer, bid or tender) in response to a client's request for proposal, quotation or tender (RFP/RFQ/RFT) in respect of the supply of property, products and/or services

The stage concludes either with a decision not to proceed with the 'purchase' or in the award of a contract:

- **Award:** assigning or granting a contract (or commission) to an individual or organisation. It also marks a transition point: the commencement of the implementation stage, requiring the delivery of the commitments made by the contracting parties during the deal creation phase

### *Execution*

The **execution** stage involves implementing, delivering and fulfilling the commitments made during the deal creation stage and incorporated into the contract, concerning the required asset, products and/or service. The term has been adopted due to its legal connotation: an executed contract is one where the provisions have been fully performed by both parties. Depending upon the nature of the purchase (asset/product or service) and associated sourcing strategy the phase comprises the following alternative components.

The purchase of an asset or product involves the following elements:

- **Asset supply:** designing, manufacturing, constructing, providing and delivering the procured asset or product(s) in accordance with the contract
- **Asset receipt:** receiving and accepting the procured asset or product(s) in accordance with the agreed terms and conditions of the contract
- **Asset usage:** applying or utilising the procured asset or product(s)
- **Asset maintenance:** preserving and maintaining the procured asset or product(s)

The stage concludes with the disposal of the asset:

- **Asset disposal:** divesting of property and assets

Alternatively, the acquisition of a service includes the following elements:

- **Service implementation:** executing, effecting and delivering the procured services in accordance with the agreed terms and conditions of contract
- **Service management:** receiving, utilising, monitoring and management of the procured services in accordance with the agreed terms and conditions of contract

In this instance the stage concludes with the termination of the service:

- **Service termination:** bringing to an end a service contract<sup>4</sup>

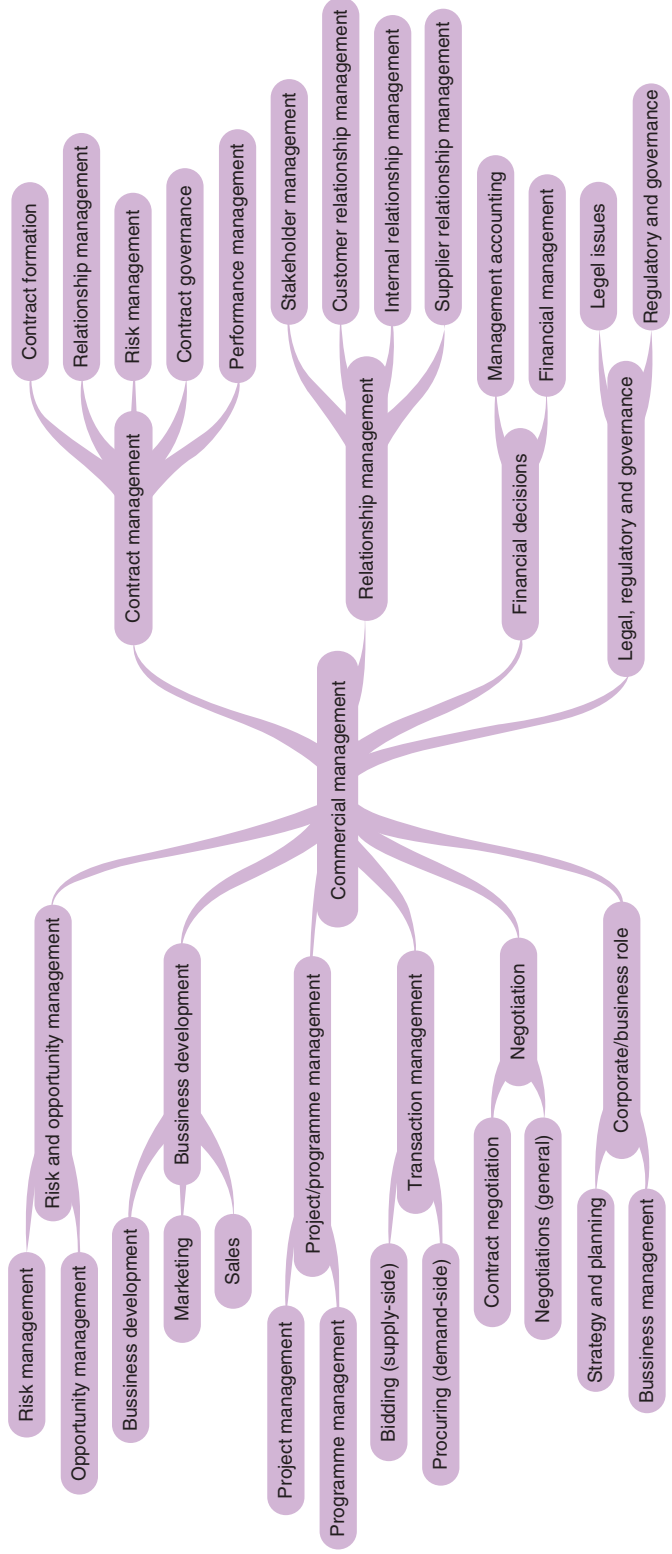
Each of the above elements will involve **contract management:** the monitoring and control of the contract to ensure that the agreement between the purchaser and supplier operates efficiently and effectively, and that all contractual obligations are appropriately discharged. Similarly, each element (usually covered by separate contracts) will conclude with a **closeout** component, involving a final review of the exchange and the conclusion of all contract matters.

Chapter 8 adopts this structure; similarly, the case studies are also presented under the above heading.

## The components of commercial management

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Commercial practitioners perform and contribute to several business processes – management, operational and supporting – each involving an array of interrelated structured activities and tasks (Figure 1.8). Each component will generally be integrated within organisational policies, processes and procedures, and



**Figure 1.8** Processes frequently undertaken by the commercial function. Source: Analysis of 90 commercial functional frameworks/job specifications.

supported by underlying knowledge, theories and concepts. They will also require the practitioner to possess and/or develop specific capabilities.

The processes frequently undertaken by the commercial function are described below, in order of commonality.

### *Contract management*

**Contract management** concerns the application of a variety of processes, activities and procedures aimed at ensuring the agreement (contract) between the purchaser and supplier operates efficiently and effectively, and that all contractual obligations are discharged. Commencing with the identification of the purchaser's need(s) and concluding with the completion of the contract (referred to as the contract life cycle), the dimension is undertaken by both purchasers and suppliers. It has two main characteristics:

- **Relationship management:** establishing and maintaining appropriate relationships and channels of communication between the contracting parties, their agents and suppliers, based wherever possible on openness, trust and respect. The aim is to facilitate the smooth running of the contract/project through proactive intervention: identifying and resolving issues before they turn into disputes
- **Risk management:** identifying, allocating and managing risk – balancing risks with their associated costs. This aspect is closely related to post-contract award performance/ implementation management

Both these aspects are explored in more detail in later in this chapter.

The primary aim of contract management is to deliver the requisite corporate, business and operational/ project level objectives encompassed in the contract, attain value for money (best value), and ensure the individual party's agreed contractual position is safeguarded.

#### *Pre-award*

Preliminary, pre-award components of contract management include:

- **Establishing the contract management team:** deciding upon the structure and composition of the contract management team and when it should be formed
- **Forming the contract:** interpreting the requirement through drafting, negotiating and approving an appropriate agreement (contract). Agreeing an appropriate contract is crucial to the ultimate success of the purchase/project, as it forms the basis on which the trading relationship is shaped and contractual compliance is measured and controlled

This 'transaction focused' aspect of the role is often undertaken by different personnel from those responsible for post-award contract management. However, this segregation of the role needs careful management to ensure that knowledge gain during the procurement process is utilised during the implementation stage.

#### *Post-award*

In addition to relationship and risk management, post award elements of the role include:

- **Contract governance:** administering and implementing contract procedures, including the formal communication and interface between the parties, such as notification of any variations to the contract, certification of any interim payments or the submission of a claim for additional payments
- **Performance/implementation management:** monitoring and ensuring that the asset and or service is delivered in accordance with the contract terms and conditions – to the specified performance and quality standards and to the stipulate programme – and that the allocated risk distribution is upheld. It also involves looking for any detrimental execution or service trends, applying any financial remedies for non-performance, evaluating the effectiveness of any subsequent remedial action, and implementing continuous improvement in performance and functionality over the contract life cycle.<sup>5</sup>

The terms **enterprise contract management (ECM)** and **contract life cycle management (CLM)** are frequently used interchangeably in relation to the provision of organisation-wide contractual services based on current best practice and IT-enabled processes, which efficiently and effectively support the management of a business' contracts and agreements.<sup>6</sup>

Commercial managers are accountable for the commercial acceptability, quality, legality and management of contracts. This involves:

- Acting as the principal interface with customers, partners and suppliers regarding contract management issues, and briefing and providing guidance and advice on contractual issues to senior management and project teams
- Contributing to the financial effectiveness and profitability of the business by developing and implementing organisation-wide 'whole-of-life' commercial and contract management policy, procedures, processes and techniques; developing or aiding the formulation of contractual strategies and contract management frameworks in respect of core business activities; and developing and publishing standard terms and conditions for products and services
- Drafting, evaluating, negotiating, agreeing, reviewing and monitoring/managing contracts and agreements (for example, licensing, service level, confidentiality – non-disclosure, distribution, teaming and partnership agreements and memorandums of understanding) with customers, partners and suppliers; ensuring that contract requirements are clearly specified and in accordance with the organisation's strategy; clarifying customer requirements and ensuring that the resulting contract reflects these needs
- Developing and maintaining a register of contracts and beneficial contractual relationships with customers, partners and suppliers
- Managing contracts and the commercial resources of projects throughout their life cycle, including: developing, implementing and reviewing effective commercial activity; providing support and expertise to ensure that contracts are appropriately administered, monitored, reported on and fulfilled so that all contractual obligations are performed and rights conferred by the agreement are appropriately exploited; realising business plans and project objectives, maximising profit, taking advantage of opportunities and minimising risk; and delivering continuous improvement; compiling, notifying, assessing, approving and reconciling contract variations (change management) and claims for loss and expense; negotiating and agreeing contract disputes and price increases to realise commercially acceptable solutions; agreeing final accounts; and managing contract close-out, extensions or renewals

### Further reading



#### Contract management

Hughes, W (2006) Contract management. In: DJ Lowe (ed.) with R Leiringer, *Commercial Management of Projects: Defining the Discipline*. Blackwell Publishing, Oxford. pp. 344–355

### Relationship management

Relationship management (RM) is a systematic process involving the application of various activities and procedures, plus an ability to proactively develop (establish, build, create, cultivate) contacts, manage appropriate working relationships, including communicating, negotiating, interacting with and influencing significant suppliers, customer, colleagues and stakeholders. The activity includes:

- **Stakeholder management:** the identification, analysis and planning of exchanges with stakeholders aimed at developing and maintaining their committed and active support to the implementation of the contract or project. A stakeholder is any organisation, group or individual that is involved in, affected by (or consider itself to be affected by), has a vested interest in, or can influence change in, a system, an

enterprise (programme, project, activity, change or risk), or an organisation and its sphere of operation. The term includes shareholders, users and decision-makers.<sup>7</sup>

Commercial practitioners develop, manage, maintain and act as the primary interface with key stakeholders forming effective, strong collaborative relationships with colleagues, customers, suppliers and all interested parties. They create a network of contacts with high level influencers to shape the strategic aims of the business, deliver anticipated benefits and fulfil commitments made

- **Customer relationship management (CRM):** the development and management of effective relationships with customers (clients, purchasers, buyers, buying centres and procuring parties, etc.).

The commercial function identifies, develops, maintains, manages, understands, supports and has ownership of/is the prime point of contact with customers forming effective, strong, key 'customers focused' relationships. This entails understanding the business goals of customers, appreciating and clarifying their requirements (establishing the client's brief) and end-user constraints, gaining their trust and respect, and managing their expectations and satisfaction. The principal aims being to improve market share and secure profitable business

- **Internal relationship management:** the development and management effective working relationships with colleagues.

Commercial personnel create, develop, lead and manage close, effective, strategic and collaborative relationships with other functions and teams – for instance, interfacing with colleagues from business development, engineering, finance and accounting (treasury, tax, insurance and business assurance), legal, marketing, sales, communication and information, procurement, project and programme management, operations, service delivery and production at senior management, business unit and project/programme levels. The activity is associated with demand management, the identification and analysis of anticipated future requirements and the selection of appropriate sourcing/procurement approaches to meet this demand. It also entails fostering a positive cross-function organisational culture and effective team working, creating business-wide decision-making frameworks, facilitating the development and implementation of appropriate business development, commercial, product and services strategies in accordance with corporate objectives and achieving social and corporate responsibility aspirations and requirements. The key goals are to improve the quality/efficiency of products and services, develop new offerings, ensure that offerings meet and exceed customer expectations, minimise customer churn, and secure the position of provider of choice, while at the same time delivering the maximum return on investment

- **Supplier Relationship Management (SRM):** understanding, categorising, developing, coordinating and managing relationships with suppliers (contractors, consultants and service providers) with the aim of maximising or optimising value. An alternative term is key supplier management (KSM), which involves the provision of corporate and strategic data on the most important suppliers to the purchasing community. A key feature of the activity is supplier development, which incorporates supplier performance measurement against pre-agreed criteria, benchmarking and the concept of continuous improvement. The activity is a constituent part of supply chain management (SCM) covered later under a separate heading.<sup>8</sup>

Again, the commercial function is involved in developing, managing, maintaining, understanding and coordinating suppliers and partners; forming effective relationships across the supply network. These tasks require a detailed knowledge of the supply network, the implications of working with third parties, and how to incentivise suppliers and their employees. It involves analysing supply networks – reviewing existing relationships with, sourcing, co-ordinating and optimising the performance of external contractors, suppliers and partners to ensure successful delivery, and designing and implementing appropriate SRM, procurement and supply chain strategies. The objective being to provide value for money, improve supply networks and deliver mutual benefits

These activities are frequently facilitated by IT systems; they are not, however, despite the implications of some definitions, totally reliant on them.

This component of the commercial function requires highly developed interpersonal, influencing and communication (including presentation and linguistic) skills; plus the ability to account for individual and group cultural, social, economic and political differences and to use constructive feedback to improve relationships.

## Further reading



### Performance measurement

Horner, M (2006) The governance of project coalitions – towards a research agenda In: DJ Lowe (ed.) with R Leiringer, *Commercial Management of Projects: Defining the Discipline*. Blackwell Publishing, Oxford. pp. 270–297

## Financial decisions

The provision of current and accurate financial information is crucial to effective management planning, decision-making and control. This information is predominantly supplied by the **accounting and finance** function within businesses. As Anne Stafford explains in Chapter 5, this entails classifying, measuring and summarising transactions, then analysing and communicating this data. A significant aspect of accounting is the preparation of **financial reports**, for example, **balance sheets**, **income statements** and **cash flow statements**. Although there is some interrelationship, these reports can be classified as either **financial accounting** (data prepared for external consumption) or **management accounting** (information compiled to aid internal planning, evaluation and control).

The financial aspects of the commercial role can primarily be subdivided into management accounting and financial management.

### Management accounting

Management accounting, according to Charles Tilley, Chief Executive of the Chartered Institute of Management Accountants (CIMA, 2011), is:

‘... where finance and business meet and helps corporations build more efficient and effective organisations’.

Within the project environment, the component involves the provision of effective financial control of projects/contracts via:

- **Cost management:** the management of monies to be spent; and
- **Cash management:** the management of monies received by the organisation

This entails analysing, evaluating, planning, estimating, forecasting, budgeting, coordinating, controlling, monitoring, and reporting cost and revenue data, throughout the asset/project/contract life cycle. It also involves the application of techniques, such as value management and cost-value reconciliation, and operating ‘open-book accounting’ on projects, where integrated project teams have access to project cost data.

### Financial management

Financial management, likewise, is a key management activity, organisational function, and decision-support process that seeks to ensure an organisation’s sustainability by efficiently and effectively investigating the availability of, sourcing of and utilising of financial resources (capital funds). Associated management activities include appraising, planning, balancing, controlling, reporting and budgeting/forecasting, enabling an organisation, business unit or project to realise its stated objectives.

Regarding this component, commercial practitioners are responsible for the cash/cost management and profitability of projects and contracts, liaising with and supporting the finance, accounting and tax functions. This involves:

- Contributing to business, financial and tax planning and compliance: ensuring that suitable corporate governance and financial management processes and procedures are adopted and implemented, in particular the efficient and effective operation of appropriate commercial and financial systems and techniques
- Developing and implementing business plans: leading discussions on the establishment of annual sales, profit and overhead budgets; initiating and maintaining measures of sales and financial performance
- Driving revenue growth across the organisation's business activities/projects (including bids and contracts), selecting investment opportunities, and pursuing all opportunities to maximise sales, profit and cash for the business and/or deliver value for money
- Managing funding requirements and financial structuring: ensuring that adequate financial resources are available to support commercial activity, arranging international financing and taking action to mitigate currency fluctuations
- Undertaking budgeting and financial forecasting: generating accurate cost estimates and developing contract/project-related cost models for assets, products or services; and carrying out ad hoc analysis and financial assessment
- Providing pre-award advice and guidance on the financial viability of projects/contracts: evaluating the financial standing of customers (and suppliers) including any funding, budgetary and phasing constraints; assessing capital and revenue expenditure over the whole life of an asset/project/contract; determining the financial risk associated with contractual non-compliance and obtaining appropriate financial sign off
- Providing post-award cost control and financial and management reporting to ensure the financial stability of the project/contracts: preparing project/contract budgets and cash flow forecasts for projects and individual work packages; establishing payment schedules and reviews; tracking payments and financial targets, and providing performance monitoring information; comparing planned spend against costs actually incurred, preparing monthly management accounts and cost value reconciliation reports; valuing work in progress for interim payments; instigating change management, valuing changes and calculating the final project cost (final account); managing loss and expense claims; maximising cash flows; carrying out value engineering and benchmarking exercises; and ensuring the accuracy of monthly financial key performance indicators (KPIs)

The component necessitates numeracy skills and the ability to determine, maintain and communicate apt cost information in respect of projects, products and or services.

### ***Legal, regulatory and governance***

Legal exists as a distinct function within many organisations. Generally headed by a general counsel, the traditional role of legal is to provide legal advice, plus the oversight of **governance** and **compliance management** (relating to organisational regulations and procedures), particularly in respect of reputation and risk management. The role includes aspects of **corporate governance**, the maintenance of a rigorous system of internal control, **project governance**, the internal control of project-related issues and activities, and **performance management**, assessing achievements against goals, targets, performance frameworks and external benchmarks.<sup>9</sup>

In relation to legal, regulatory and governance, the commercial function can be responsible and accountable for:

- Ensuring compliance with the organisation's objectives, guiding principles and systems, and adherence to commercial, contract and procurement law, financial and statutory regulations, and other relevant legal requirements
- Acting as the initial point of contact for any incoming legal-related issues; providing or obtaining legal advice, briefing and managing in-house legal expertise/counsel or interfacing with external lawyers concerning commercial issues and contracting policies that impact upon the organisation's business activities
- Determining the organisation's commercial policy: developing and ensuring that effective commercial procedures, contracting frameworks and contract management protocols are adopted and implemented that are legally sound and beneficial to the organisation, and that protect its commercial and reputational interests

- Interpreting and clarifying contract terms and conditions; ensuring that all contracts and agreements are commercially sound, are negotiated, agreed, executed, implemented and consistent with organisational objectives and policies; recommending the inclusion of terms and conditions that protect the organisation's interests and accurately document the intended business relationships; informing senior management of all legal responsibilities contained within contracts and agreements; and developing the organisation's capability to monitor and report on contract compliance; ensuring contract compliance, i.e. that commitments made by all the parties are met
- Establishing effective monitoring processes: monitoring and assessing the impact of legal issues on the commercial function and responding appropriately; monitoring and reporting on contract compliance, ensuring that the contracting parties deliver on their commitments (obligations) in accordance with the terms of the contractual framework
- Providing commercial direction and support to senior management in meeting all governance and reporting requirements; ensuring that appropriate corporate governance and robust internal and external control systems are in place (in accordance with statutory requirements and professional standards) and adhered to; and promoting standards, codes and practices aligned with corporate governance, values and ethics
- Ensuring that all commercial and financial aspects of projects are managed effectively and efficiently in accordance with business procedures and systems; that all business opportunities, sales proposals, bids/quotations and contracts are prepared in accordance and comply with the organisation's policy and procedures; that risk exposure is appropriately acknowledged, understood, accepted, minimised or mitigated; and signing off or obtaining regulatory and legal sign-off of all commercial aspects of business opportunities, proposals, bids/quotations and contracts in accordance with delegated authority

The capability requires an understanding of business, commercial, competition, contract and environmental law; legislation and legal frameworks, in particular national, EU and international procurement legislation; jurisdiction, government procurement policy and guidance; health and safety and duty of care; intellectual property (IP) and trade mark issues, including: the protection and breach of trademarks, copyright, patents, royalties, licensing, sharing information (identification and apportionment of background, foreground, arising IP); and standard forms of contract, etc.

### Further reading



#### Project governance

Winch, G (2006) The governance of project coalitions – towards a research agenda. In: DJ Lowe (ed.) with R Leiringer, *Commercial Management of Projects: Defining the Discipline*. Blackwell Publishing, Oxford. pp. 344–355

### Corporate/business management role

At senior levels, commercial actors contribute to the overall management of organisations. Having responsibility, in conjunction with other senior colleagues, for the strategic leadership, direction and development of the organisation, they participate in strategy formulation and setting business objectives. Specific activities undertaken may include:

- Driving and providing commercial support to the strategic decision-making processes in the business
- Leading and shaping the organisation's commercial and business planning activities
- Leading and supporting the development of business units, for example, identifying, developing and implementing joint ventures and strategic partnerships
- Contributing to and establishing the organisation's corporate core purpose, vision, mission and values

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At other levels they may contribute to the development of the organisation's strategy and direction at the corporate, business unit, division or function level. This may involve:

- Leading, advising, driving, assisting and providing strategic input and commercial expertise to the development of corporate, commercial and service (delivery) strategy – for example, by providing insights into competitor activity
- Converting strategic corporate aims, business unit objectives and functional policy goals into commercially viable activities
- Developing, implementing and monitoring integrated business and commercial plans, policies, systems and decision-making processes to support the organisation's business objectives and strategies, and communicating these both internally and externally
- Promoting a shared vision of the organisation's values and strategic objectives

Additional responsibilities/accountabilities may include:

- Contributing to and participating in the effective general management and direction of the business; providing advice and support to senior management, business units and other management functions as appropriate; forecasting the probable impact of proposed business decisions including, for example, undertaking scenario analysis, assisting in the preparation of annual budgets, and distilling and generating 'fit for purpose' management information
- Leading, managing and developing commercial business activities and solutions with third parties and ensuring these activities support the organisation's vision, values and objectives
- Delivering operational and economic performance and continuous improvement of the commercial function against predetermined targets and KPIs

The capability requires an understanding of and the ability to analyse the business unit, the corporate debate and the organisation as a whole – its management systems and business processes; the role and responsibilities of the commercial function within the business; and the key drivers and elements of its business plans. In addition, an ability to employ commercial experience, knowledge, expertise and acumen to maximise the organisation's potential, add value and generate competitive advantage.

### Further reading



#### Strategies for solutions

Davies, A and Hobday, M (2006) Strategies for solutions. In: DJ Lowe (ed.) with R Leiringer, *Commercial Management of Projects: Defining the Discipline*. Blackwell Publishing, Oxford. pp. 132–154

## Negotiation

**Negotiation** is a competence, activity and 'bargaining' process, through which two or more entities interact in order to reach an agreement, consensus or compromise. Both formal and informal negotiations are undertaken throughout the project, product and service life cycle.

Negotiating with internal and external stakeholders, customers (clients and commissioners), partners and suppliers, is an integral part of the commercial role, although some commercial practitioners may predominantly focus on either the customer or the supply chain (suppliers, contractors and partners). Depending on the level of the individual within the organisation, they may be responsible for leading, managing or facilitating the process, and either leading or participating in negotiation teams at the strategic, programme or project level. The role can involve:

- Formulating appropriate negotiation processes, assembling negotiation teams, consulting internally and externally from initial enquiry to final settlement, establishing objectives and setting the negotiation strategy and ensuring that it is applied
- Negotiating, within agreed delegated limits, various standard and bespoke contracts (commercial and legal terms and conditions, contractual risks and liabilities) for the supply or purchase of goods and services and for aftermarket support, including formal, short form, and annual contracts; agreements, for example, Teaming Agreements (NDAs), Non Disclosure Agreements (NDAs), Intellectual Property Rights (IPR) and commercial exploitation agreements; tenders, deals and prices; and various opportunities and business plans – providing commercial solutions
- Negotiating and agreeing post-award contract changes, variations (additions or omissions) and price increases; disputes (conflict avoidance, management and dispute resolution); claims, liabilities and implications of changes to contract terms and conditions; high value or complex subcontracts; and final accounts and contract close-out
- Ensuring that the output of the negotiations reflect and are consistent with the corporate/business units/ programme/project's strategic plan, objectives and requirements; protect business needs and interests; are commercially acceptable; generate the optimum return for the business; meet the customer's requirements; identify and mitigate exposure to risk; support and maintain equitable and balanced business relationships; deliver savings or efficiencies; and balance the drive for sales with business risk

The capability requires an understanding of the emotional and psychological aspects of negotiation and of the principal influencing techniques and strategies. It also requires the ability to: communicate and negotiate at a senior level both within the organisation and externally; determine and deploy negotiation strategies; be forthright, tactful, and gain the trust of the other parties; and secure concessions without undermining relationships.

## **Transaction management**

### **Bidding (supply-side)**

The terms 'bidding' and 'tendering' are generally used interchangeably to refer to the process and activities undertaken by suppliers when preparing and submitting an 'offer' to a prospective purchaser. An offer (also termed a bid, quote or tender) is a proposal to meet the purchaser's requirements and can include an economic (price) as well as a commercial and technical element. They are predominantly submitted in response to a formal invitation (invitation to treat), such as, an invitation to tender (ITT), request for proposal (RFP), request for quotation (RFQ) or request for tender (RFT). Under English contract law, an offer to contract:

'... must be made with the intention to create, if accepted, a legal relationship. It must be capable of being accepted (not containing any impossible conditions), must also be complete (not requiring more information to define the offer) and not merely *advertising*.' (Chapman, 2004)

An offer, therefore, must signal a desire to enter into a legally binding contract based on stated terms that requires no further negotiation or forms a further invitation to treat. The formal submitted bid document presenting the offer is also called a tender, while the terms 'bidder', 'tenderer' and sometimes 'respondent' are used in respect of the party (supplier) submitting an offer.

Bid management is an integral part of the commercial role. Generally, the function is responsibility for leading and managing the proposal (bid/tender/offer) development stage, developing and implementing bid strategies, and establishing and managing the bid production and estimating processes. The role also involves bid team management: leading, supporting and liaising with business development, marketing and sales, operations, production and project management colleagues throughout the bid process to coordinate the development and production of proposals and offers. The prime objectives are to ensure that bid opportunities meet the business's strategic objectives – for example, that they drive revenue/sales growth, maximise profit, address potential risks and opportunities, and that all products and services are offered on appropriate, competitive terms and conditions.

Commercial practitioners, therefore, work as part of bid teams to generate proposals, dealing with the commercial aspects of bid (offer/tender) production and submission, and providing commercial solutions and market information. Additionally, they can be involved in:

- Developing, monitoring and implementing processes and procedures to select and process bid opportunities, produce tender documentation and evaluate proposals, in order to comply with internal governance and improve tender success rates
- Identifying, delivering and managing (within delegated powers) the entire bidding process; responding to tenders and proposals, managing the pre-qualification process, and reviewing requests for quotations (RFQs); capturing customers' requirements, screening projects (the bid/no bid decision); formulating win themes; defining and selling the customer proposition, preparing commercial responses to customer invitations to tender (ITTs); developing the commercial shape of deals; establishing pricing and payment policy, obtaining requisite bonds/guarantees/insurance/export control licences; reviewing, drafting, compiling editing, pricing, approving, and submitting proposals; owning and implementing the bid authorisation process and providing commercial authorisation; participating in bid presentations, negotiating with the customer in respect of any offers submitted; and ensuring that effective CRM techniques are applied and maintaining the commercial integrity of relationships and the deal throughout the process
- Providing an assurance function, ensuring that bid proposals are submitted on time, in the correct format, and in accordance with company policy; that the executive commercial director (or bid sponsor) is provided with progress briefings and kept abreast of potential issues; that tenders obtain the appropriate approvals (sign-off) before submission. Commercial is also responsible for evaluating and reporting on the success of bids and the effectiveness of bid processes and procedures

Estimating and **pricing** activities include: leading and managing the estimating function, estimating, analysing and evaluating the costs and risks inherent in bid opportunities, overseeing the pricing process, constructing appropriate pricing strategies, modelling and negotiating prices, and establishing the commercial viability of all quotations. They also include working with the finance function to align pricing, margin, risk, contingency and discount provisions with organisational policy.

This component of the commercial role is underpinned by an ability to analyse customer requirements and analyse, define and plan the proposal, proactively project manage the proposal development stage. It also requires an understanding of the tendering process, bidding and proposal development best practice, the implications of Incoterms, the relationship between commercial competitiveness and profitability, and the financial aspects of bids and contracts.

### Further reading



#### Bidding

Lowe, D and Skitmore, RM (2006) Bidding. In: DJ Lowe (ed.) with R Leiringer, *Commercial Management of Projects: Defining the Discipline*. Blackwell Publishing, Oxford. pp. 356–389

### Procuring (demand-side)

**Supply chain management** (SCM) is a function and set of processes and activities responsible for planning, developing, coordinating, integrating and maintaining upstream and downstream collaborative relationships with customers, suppliers and other channel partners such as contractors, consultants, intermediaries, manufacturers, distributors and service providers, etc. – its supply chain.

A supply chain comprises a network of all the organisations, groups and individuals, plus the various activities, processes, resources and information, both within and external to an organisation, required to

meet a specified need or implement a project. Supply chain activities, both inbound to and outbound from organisations, include the development, production, distribution, and marketing, etc. that transform resources (raw materials, components, and intellectual property) into a final finished product or service. This network, therefore, is responsible for realising and delivering a specific product and or service, including the requisite inputs, outputs and outcomes, to the ultimate customer.

'The supply chain conceptually covers the entire physical process from obtaining the raw materials through all process steps until the finished product reaches the end consumer. Most supply chains consist of many separate companies, each linked by virtue of their part in satisfying the specific need of the end consumer.' Chartered Institute of Purchasing and Supply (CIPS, 2012)

In the context of realising complex projects, the supply network can incorporate several specialist supply chains that coalesce into an integrated supply team (integrated project team). Although generally used to joint working, the constituent members, such as those in a construction setting, often move from project to project.

Functionally, SCM interacts with commercial, design, finance, IT, operations, marketing and sales, both within the organisation and across its supply chain, while its constituent activities include the sourcing and procurement, transformation and logistics management of capabilities and resources to meet an organisational need. Principally, SCM combines inter- and intra-organisational supply and demand management, with the aim of delivering enhanced customer value at a lower cost to the entire supply chain.<sup>10</sup>

Similarly, **procurement** is an organisational function and a set of business processes centred on the acquisition of assets (products, goods, resources and works) and or commissioning services from both external third-party suppliers and internal providers in response to a specific need or requirement. It encompasses the whole life cycle, commencing with the identification of a requirement and concluding either with the disposal of an uneconomic or unwanted asset or the completion of a service contract. The term **sourcing** (and in particular strategic sourcing) is also used in relation to the processes, approaches and strategies involved in engaging with the supply market to address current and potential business requirements. Procurement is generally undertaken by a purchase and supply team, either as business-wide activity or as a constituent part of a project or programme.

The terms 'procurement', 'purchasing' and 'commissioning' are frequently used interchangeably. Murray (2009), however, is of the opinion that this is a misuse of the terms, which causes some confusion as they mean 'different things to different people'. Further, he maintains that commissioning and procurement are discrete activities arguing that procurement is a subfunction of commissioning, which is driven by the commissioning cycle, whereas procurement is a broader activity than the purchasing cycle.

Commercial practitioners can be responsible for providing strategic leadership to the procurement function in organisations having accountability for establishing and directing procurement processes and procedures, developing and monitoring performance frameworks, and overseeing, directing and coordinating multi-functional procurement and acquisitions teams. Elsewhere, they may be responsible for coordinating the 'commercial' input, interfacing with and providing specialist expertise and support to a separate procurement department, and ensuring appropriate governance procedures are in place and applied.

They generally act as the organisation's lead interface and advisor on all commercial matters relating to external suppliers, partners and integrated project teams (IPTs). Aspects of the role include: collating and interpreting internal demand information, benchmarking and assessing market-wide supplier capability and performance data (supply network mapping, analysis and planning), evaluating alternative procurement methodologies, and utilising the results to inform the development of an appropriate corporate, business unit or programme specific procurement, sourcing and supplier relationship strategies that support the organisation's strategic objectives. The predominant aims are to achieve best value (value for money), ensure continuity of supply/service, deliver optimal commercial outcomes and create opportunities to leverage competitive advantage.

Specific buying (purchasing and strategic sourcing) activities undertaken include:

- Identifying, capturing, collating and appreciating internal customer and user needs (requirement capture), evaluating various solutions and options to address and meet these needs (developing

specifications to meet organisational requirements), applying value analysis, generating make or buy plans, establishing appropriate output and performance requirements to define them, selecting the preferred solution and determining the optimal procurement route to source the solution, including the development of specific supplier selection criteria based on both hard and soft issues

- Leading or liaising closely with and supporting the procurement function in the pre-qualification, tender, evaluation, selection, and award processes relating to supply, subcontract, outsourcing and work package contracts, etc:
  - pre-qualification (pre-qualifying bidders): recommending preferred suppliers and establishing framework agreements following the assessment, selection and accreditation of potential third-party organisations
  - tendering: initiating and managing the tender process in accordance with organisational procedures and applicable legislation and regulations. This can involve choosing an appropriate commercial approach, issuing invitations to tender, defining the obligations of each party, preparing tender documentation and ensuring conformity with procurement legislation
  - evaluating: assessing, reviewing and analysing the resulting bid submissions (supplier proposals), identifying potential commercial risks and compiling tender evaluation reports
  - negotiating: negotiating directly with suppliers (a key dimension of the procurement role), includes the negotiation of agreements and resolution of any subsequent disputes
  - awarding: recommending the preferred bidder, making recommendations on the contract award and concluding the 'deal'
  - administering: managing the resulting supplier contract

The role may also encompass broader aspects of supply chain management and logistics: inventory control, transportation – 'just in time' delivery, materials management – receipt and storage).

Commercial practitioners, therefore, require knowledge and experience of supply chain management, the procurement cycle (category management cycle), the various procurement options, such as, prime contracting, the Private Finance Initiative (PFI), project and strategic partnering, public-private partnerships (PPP), and tendering processes and procedures available to the organisation, and relevant procurement legislation and regulations. They also need an understanding of best value, contingency planning, cost planning, incentivised pricing, KPIs, performance-based outputs, reverse auctions, supplier pricing policies, sustainable procurement and whole-life costing.

The ability is needed to apply relevant sourcing tools and techniques, compile tender documents and reports, identify the potential risks associated with the proposed solution, to balance cost and quality, and manage and control costs during the pre-award stage factors, develop incentive pricing models, analyse complex and innovative commercial arrangements, manage and control costs during the pre-award stage, analyse supplier's proposals (the underlying costs of labour, materials, overheads and profit), and evaluate the suitability of bids.<sup>11</sup>

### Further reading



#### Procurement, strategic purchasing and supply chain management

Langford, D and Murray, M (2006) Procurement in the context of commercial management. In: DJ Lowe (ed.) with R Leiringer, *Commercial Management of Projects: Defining the Discipline*. Blackwell Publishing, Oxford. pp. 71–92

Cox, A and Ireland, P (2006) Strategic purchasing and supply chain management in the project environment – theory and practice. In: DJ Lowe (ed.) with R Leiringer, *Commercial Management of Projects: Defining the Discipline*. Blackwell Publishing, Oxford. pp. 390–416

## *Project and/programme management*

### *Project management*

**Project management** is the process and activity of planning, controlling, monitoring, managing, organising, coordinating, defining, delegating, delivering and directing all aspects of a project. It includes the management of resources (materials, suppliers, contractors, consultants, etc.) and the motivation and leadership of the individuals involved throughout the project life cycle. Its aim is to achieve the project objectives safely, on time, within agreed cost, scope, performance/quality and risk criteria, deliver value and satisfy the aspirations of the stakeholder. Moreover, project management is widely acknowledged as the most efficient way of bringing about change.<sup>12</sup>

### *Programme management*

**Programme management** is a structured and coordinated approach to the management of interrelated projects, involving the application of various processes, activities and procedures. It provides a framework for the implementation of proposals, strategy, and change, and for monitoring and evaluating whether or not a programme delivers its intended benefit to stakeholders. While the precise interpretation of what represent a programme varies between businesses and industry sectors, fundamental programme management practice exists along with an associated ability to establish and manage a programme or programmes. The underlying principles, procedures, techniques and activities are closely linked to those that support project management.<sup>13</sup>

Within the context of projects and programmes, the commercial function may have the responsibility for managing projects or delivering a portfolio of projects (from their inception to completion), including the oversight of their associated project teams. More often, however, commercial practitioners ‘project manage’ the proposition development and bid submission, solution selection and asset/service procurement, and award stages of the project life cycle. Post-award, they generally have the responsibility for the commercial (contractual, financial and possibly procurement) aspects of projects and programmes, supporting individual projects, interfacing with project implementation teams, and supporting and liaising with the project’s commercial director, project manager/director and programme manager/directors. As mentioned earlier, the commercial function often has dual accountability, reporting to both the commercial executive and project/programme director or manager. Additionally, at the programme and project level the commercial role can involve:

- Managing the commercial input to programmes and individual projects under their control (in accordance with organisational systems and procedures) and having responsibility for their commercial success. As discussed earlier, commercial success is generally measured in terms of profitability and achieving value for money. Specific activities include:
  - developing strategies to support a project execution programme and the creation of an appropriate commercial strategy to help deliver a project’s objectives
  - establishing and implementing project commercial operating systems and the project management office
  - ensuring that each project is commercially viable and appropriately monitored and evaluated during its implementation stage, generating and managing financial and performance monitoring information, securing due monies and fees, identifying issues and opportunities to improve profit margins and preparing business cases for board approval to ensure a return on investment and value for money
  - maintaining contractual records and documentation, reviewing and monitoring contract compliance, resolving disputes and managing conflict, and identifying, analysing and managing risk and opportunities
  - reporting on all commercial matters relating to assigned projects and on the success of individual projects to the commercial executive
- Providing commercial services to individual projects and programmes: this may include, for instance:
  - supplying commercial and contractual advice, support, guidance and expertise to project managers when preparing proposals; briefing project teams on the application of relevant contracts, agreements

and associated documentation, particularly on the organisation's key liabilities and obligations, and the implications of non-compliance; promoting project activities in accordance with the strategic plan. They can also become involved in training inexperienced project managers and team members in contracting procedures

The capability requires an awareness of the economic, legal, technological, political and environmental backdrop against which projects are executed and of the roles and responsibilities of all those involved. Specifically, it entails an understanding of the numerous project and programme management approaches, issues, principles, processes, techniques and tools. These include, for example, establishing and managing multifunctional teams, opportunity mapping, project handbook, project execution plans (PEPs), project planning, project programming, multiproject programming, activity schedules, flow diagrams, Gant charts, critical path, key milestones, progress monitoring, issue logs, cash flows, commissioning and handover procedures, and close-out reports. It also requires the ability to successfully manage commercial/procurement projects and programmes, identify and create programmes, coordinate resources within time, quality and budget constraints, track commercial activities and benefits, control performance against established targets, and identify and manage key project commercial and procurement risks.

### *Business development*

**Business development** is a strategy-focused business activity associated with establishing strategic relationships and enduring partnerships with both customers and suppliers. Centred on realising new business opportunities, creating deals and delivering sustainable organisational success and increased sales, its processes and practices include designing business models, products and services, marketing and sales.

Again, depending on the structure of specific organisations, the commercial function can be responsible for overseeing business development activities. Generally, however, their involvement in this area involves leading commercial discussions with third parties and working in conjunction with and providing commercial support and expertise to colleagues in other functions, such as, business, marketing, sales, operations and programme management, and the senior management team. The objective is to ensure that robust business development, marketing and sales strategies are generated and that commercial issues are considered in associated business development, marketing and sales processes. Further, the role incorporates the identifying and exploiting of new markets and capitalising on business development opportunities to achieve business objectives, such as securing new customers and contracts, extending offerings to existing customers, expanding product and service capability, increasing market share/penetration, becoming the provider of choice in a chosen market, and delivering sales and margin targets.

Specific activities may include: leading and supporting **business development** initiatives and activities – targeting, initiating and developing business relationships; formulating and implementing corporate and business unit business development strategies and plans, and ensuring they are adhered to in order to leverage opportunities, deliver efficiencies and drive sustainable growth.

Further tasks undertaken include:

- Identifying, initiating, evaluating, advising the board on, cultivating, implementing, managing and exploiting **business opportunities** (including: acquisitions, business, commercial, development, joint venture, market, new product, partnership and service opportunities) and generating new customers; plus obtaining regulatory and legal sign-off for undertaking new business opportunities, ensuring that all potential opportunities meet the organisation's strategic objectives and investment criteria, and maximise the financial return
- Analysing, evaluating, and generating **business cases** and **proposals** (or providing commercial input to their development); particularly, generating and managing appropriate input data, for example, assessing the likely costs and risks involved in a particular venture, and ensuring that a robust review process is in place and followed, so that the organisation can make sound investment decisions

### *Marketing and sales*

Marketing and sales, either individually or combined into a single department, are management functions, processes and activities centred on promoting and selling an organisation's products and/or services.

**Marketing** is responsible for anticipating, identifying and satisfying customer needs by defining, creating, communicating and delivering proposals (offerings) that possess or generate value for customers and partners profitably. Activities include maintaining key relationships and generating publicity and interest in an organisation at a reputational and corporate level.

Marketing activities carried out by commercial practitioners include: designing, developing, implementing, reviewing and updating marketing strategies; overseeing, directing or contributing to the preparation of marketing plans; providing advice, support and management to marketing campaigns, brand management and new product development; developing customer markets and cultivating customer relationships that are aligned with the organisation's overall strategic plan, maintain and enhance its reputation and contribute to its overall strategic vision. Further marketing tasks may include:

- Establishing a customer demand-focused organisational culture, identifying customers and unmet customer needs, developing appropriate product and service solutions, and ensuring that effective marketing resources, policies, protocols and procedures are in place to promote the organisation's products and services effectively
- Undertaking market research, analysis and benchmarking: developing and maintaining market intelligence systems to maintain knowledge of the market, review and analyse competitors, identify opportunities, mitigate commercial risk, inform strategy development and business and financial planning, and test the viability of new product and service offerings.

Alternatively, commercial practitioners may provide support services to a discrete marketing function, for example, in relation to possible legal and commercial risks inherent in new marketing activities and product/services.

**Sales** is the activity of selling (the organisation's products and/or services); it is a systematic process, focused on the exchange of value between the buyer and seller. Key aspects include cultivating relationships, seeking out, nurturing and securing opportunities then converting these prospects into actual transactions.<sup>14</sup>

The commercial involvement in sales may entail leading, managing and developing, or providing commercial support and expertise to, the sale function and sales teams, ensuring that commercial issues are accounted for in sales activities and that sales proposals are issued in line with company policy. This can involve contributing to and shaping the development of sales/campaign strategies and promotional plans, identifying and analysing new sales opportunities, generating and communicating strategic vision and sales stories, evaluating risks and opportunities in individual campaigns, balancing the drive for sales with business risks, defining and selling customer propositions, developing proposals and offers, and overseeing the implementation of sales plans.

This area of commercial activity requires knowledge and understanding of the various business environments/market sectors in which the organisation engages, the strengths and weakness of competitors' products and services, the capabilities and capacity of suppliers and partners, and the strength of the business's brand and reputation. Further, an ability to engage with and research the market, interpret market research, identify key decision makers in customer organisations, understand the customer's business objectives and end user needs, translate customer requirements into output specifications and apply appropriate business development tools are important requirements.

### *Risk and opportunity management*

In some project-oriented organisations **risk management** is a discrete business function, either in its own right or in association with legal, regulatory or governance. Generally, however, it is viewed as a systematic, iterative process or group of management policies, processes or procedures – a defining feature of the culture of the organisation, which is associated with its internal control, governance and strategic

management. The term also encompasses a coordinated set of activities, approaches, practices, principles, and structures that are applied to risk at the corporate, business and project level and underpin many if not all management activity. At the project level risk management occurs throughout the project/contract life cycle.

There are numerous definitions of risk and risk management. Eunice Maytorena in Chapter 4 of this book reviews and comments on several of these definitions and provides an introduction to risk, uncertainty and the process of risk management. She also outlines relevant underlying theory and provides an overview of some of the available risk management tools and techniques.

Risk is linked to an event (a decision, activity, function, or process) or series of events, the circumstances or environment in which it (they) occurs, and is bounded within a time frame. Additionally, the event or events have a potential consequence, either a positive opportunity or a negative impact, for which a probability or likelihood of occurrence can be established together with an estimation of the magnitude of its potential impact. In a business environment, this impact is commonly expressed as the sum of money the organisation may directly lose, or the adverse influence its occurrence may have both monetarily and reputationally on the business. As Eunice Maytorena discusses in Chapter 4, while some sources see risk incorporating both a positive (opportunity) and negative dimensions, the term is predominantly viewed as having only negative consequences. This view is also supported by the review of commercial job roles and frameworks with risk generally seen as a negative factor – something to be mitigated, reduced, and avoided. The commercial function, however, is engaged in risk and opportunity management.

Risk (and opportunity) management enables an organisation to identify, contextualise, analyse/assess/evaluate, quantify, understand, prioritise and communicate potential risks and opportunities. These risks, in turn, may be accepted or transferred to another party (a supplier or purchaser). Within a b2b context a degree of risk taking is expected, and is clearly associated with value (profit) creation (an opportunity): an organisation may agree to accept a specified level of risk, at a premium. A general commercial principle is that risk should be borne by the party best able, economically, to control, manage or insure against its consequences (Wearne, 1999). On identifying or accepting a potential risk, an organisation will seek to mitigate and reduce its likely impact by developing, justifying and implementing a risk response that can be coordinated, monitored and controlled.

Risk management is, therefore, a decision-support activity, which allows decision makers to make informed, proactive management decisions, striking a suitable balance between opportunity maximisation and the minimisation of potential threats and losses for each aspect of a project or for an entire project.

Specifically, the commercial function is involved in identifying, responding to and managing potential commercial, contractual and procurement risks related to satisfying an acknowledged requirement or responding to an identified opportunity. In particular, this involves drafting, negotiating, agreeing, managing and fulfilling any associated contractual commitment, with the aim of supporting the definition, creation and delivery of sustainable value (supply-side) or the identification, capture and exploitation of value (demand-side).<sup>15</sup>

### Further reading



#### Risk management

Kähkönen, K (2006) Management of Uncertainty. In: DJ Lowe (ed.) with R Leiringer, *Commercial Management of Projects: Defining the Discipline*. Blackwell Publishing, Oxford. pp. 211–233

### ***Combinations of these common components***

Commercial roles across industry sectors and even within organisations can comprise different combinations of these common components. Different prominence is given to aspects of the role due in part to the

dominance of other functions within the business (for example, marketing and sales, finance and accounting, legal, procurement/supply chain management and project management) and to the different 'histories' (backgrounds) of individual commercial practitioners. The role has been described as the accidental 'profession' as there is no designated entry route, unlike other more established business functions. Moreover, the function recruits from all the aforementioned areas.

## Management, leadership and communityship

### Management

The label '**manager**' is frequently given to commercial practitioners, irrespective of whether or not they have a line-management position, in order to confer status. However, the job descriptor commercial specialist is becoming more common, conferring equal status to those commercial actors who do not have line-management responsibilities.

Similarly, the terms '**managing**' and '**management**' occurred throughout the earlier overview of the processes undertaken by the commercial function. In fact, all the job specifications/functional frameworks included elements of managing and management. Table 1.2 lists the most frequently occurring management aspects of the commercial role.

The most common definitions of management have as their origin the description of managing provided by Henri Fayol (1916), who described managing as '*planning, organising, commanding, coordinating, and controlling.*' Latterly, **leading** is usually used in lieu of commanding. There is, however, less agreement over

**Table 1.2** Aspects of management undertaken by commercial practitioners.

- |                                      |   |
|--------------------------------------|---|
| ● Bid team management                | ● Marketing and communications management |
| ● Brand management                   | ● Opportunity management                  |
| ● Budget management                  | ● Performance management                  |
| ● Business management                | ● Portfolio management                    |
| ● Category management                | ● Prepare management accounts             |
| ● Change management                  | ● Production management                   |
| ● Claims management                  | ● Programme management                    |
| ● Commercial management              | ● Project management                      |
| ● Commercial relationship management | ● Quality management                      |
| ● Compliance management              | ● Relationship management                 |
| ● Conflict management                | ● Reputation management                   |
| ● Contract/contractual management    | ● Requirements management                 |
| ● Cost/cash management               | ● Resource management                     |
| ● Customer relationship management   | ● Risk management                         |
| ● Data management                    | ● Sales management                        |
| ● Demand management                  | ● Service management                      |
| ● Dispute management                 | ● Stakeholder management                  |
| ● Facilities management              | ● Strategic management                    |
| ● Financial management               | ● Sub-contract management                 |
| ● Global account management          | ● Supplier management                     |
| ● Knowledge management               | ● Supplier relationship management        |
| ● Life cycle management              | ● Supply (chain/network) management       |
| ● Line management                    | ● Team (people) management                |
| ● Management accounting              | ● Tender management                       |
| ● Management contracting             | ● Time management                         |
| ● Management of due diligence        | ● Value chain management                  |
| ● Managing advisers                  | ● Workload management                     |

Source: Analysis of 90 commercial functional frameworks/job specifications

what is meant by the terms **leader** and **leadership**, although numerous definitions have been proposed; for example:

‘A leader shapes and shares a vision which gives point to the work of others.’ Handy (1992)

‘Leaders are individuals who establish direction for a working group of individuals who gain commitment from these group of members to this direction and who then motivate these members to achieve the direction’s outcomes.’ Conger (1992, p. 18)

One area of literature differentiates between leadership and management, as illustrated by Kotter (2011):

- **Leadership:** is responsible for generating the systems that managers manage and revising these processes and structures in order to respond to risks and opportunities and allow the organisation to grow and evolve. Leadership involves:
  - creating the organisation’s vision and formulating its strategy
  - establishing and communicating its direction
  - motivating action
  - aligning individuals
- **Management:** ensuring that these systems, which integrate technology and people, run consistently, efficiently and effectively. Management involves:
  - planning and budgeting
  - organising and staffing
  - controlling and problem solving

Conversely, another section, exemplified by Mintzberg (2009), argues that leadership should be seen as a component of management, which is itself embedded within what he terms **communityship**: *communities of actors who get on with things naturally*. Mintzberg views management as a combination of:

- **Art:** the expression or application of human creative skill and imagination; a skill at doing a specified thing, typically one acquired through practice
- **Craft:** an activity involving skill in making things by hand – *art and craft*; or the skills in carrying out one’s work
- **Science:** a systematically organised body of knowledge

Analysis of commercial functional frameworks/job specifications revealed that commercial practitioners were predominantly involved in **leading** (including directing, mentoring and overseeing) and **planning** (which included strategy development). Additionally, there were some references to **coordinating** (and administering) and **controlling**; although these were limited. Surprisingly, there were no references to **organising** tasks. Interestingly, there appears to be reluctance in some organisations to use the term administration, particularly in relationship to post-award contract administration/management. The term is unfashionable, infers (inappropriately) subservience, and its lack of use is probably driven by a desire for the commercial contribution not to be seen as a ‘back-room’ technical support role. Having said this, many of the job descriptions included the requirement to provide support and assistance to others, and/or be a source of advice, guidance and expertise: the terms ‘lead consultant’, ‘trusted advisor’ and ‘advisor of choice’ were to be found.

In addition to managing and leading, commercial actors provide an **advisory** role – a source of specialist knowledge (therefore a specialist, an artisan); a **regulatory** (policing, protecting and enforcing) role, having responsible for overseeing, monitoring and ensuring compliance and performance, and sanctioning action; and an **advocacy** role, persuading and influencing others.

Maria-Christina Stafylarakis explores these issues further in Chapter 2 and in particular the importance of personal leadership (mastery) to commercial practitioners.

## Commercial management professional bodies and associations

Commercial practice and commercial practitioners are principally supported by two bodies: the International Association for Contract and Commercial Management (IACCM) and the Royal Institution of Chartered Surveyors (RICS):

- **IACCM:** with members spread across 28 countries and 8804 organisations, the IACCM supports public and private sector professionals and corporations drawn from numerous industry sectors in the area of contracting and relationship management. It is a non-profit membership organisation, offering advisory, research and benchmarking services, together with web-enabled training and certification. Its membership comprises contract and commercial managers, negotiators, legal and supply chain specialists
- **RICS:** established in London in 1868, and granted a Royal Charter in 1881, the RICS is an independent organisation that represents professionals engaged in aspects of land, property and construction, plus associated environmental matters. It has approximately 100 000 qualified members spread across 140 countries. It is divided into several professional groups, which have developed generic statements of competencies required of members. Its Quantity Surveying and Construction group supports approximately 40 000 professionals who have an interest in the cost and procurement of construction projects

However, due to the eclectic nature of the role, as defined earlier in the chapter, there is a certain degree of overlap between the activities undertaken by the commercial function and the areas of interest of other

### Box 1.1 Various professional bodies with an interest in commercial activities

#### Contract management

- **National Contract Management Association (NCMA):** A membership-based, professional society, NCMA, based in Ashburn, Virginia USA, was established in 1959 to advance the professional development of its members. The organisation has developed a Contract Management Body of Knowledge, now in its third edition: [www.ncmahq.org/ProfessionalDevelopment/NCMAProductDetail.cfm?ItemNumber=501](http://www.ncmahq.org/ProfessionalDevelopment/NCMAProductDetail.cfm?ItemNumber=501) (accessed 25 March 2011)

#### Financial decisions

- **The International Federation of Accountants (IFAC):** A global body comprising 163 individual professional accountancy organisations, IFAC represents over 2.5 million accountants in public practice, education, government service, industry and commerce. Separate organisations have developed their own bodies of knowledge
- **American Institute of Certified Public Accountants (AICPA):** Based in New York, AICPA is the world's largest accounting profession association representing 370 000 members in 128 countries. Its members are active in business and industry, public practice, government, education and consulting
- **Chartered Institute of Management Accountants (CIMA):** Active in 168 countries, CIMA is the world's leading and largest professional body of management accountants. Established in 1919, it has 183 000 members working in industry, commerce, the public sector and third-sector organisations
- **Additional UK-based organisations include:** The Institute of Chartered Accountants in England and Wales (ICAEW); The Institute of Chartered Accountants of Scotland (ICAS); The Institute of Chartered Accountants in Ireland (ICAI); The Association of Chartered Certified Accountants (ACCA); and The Chartered Institute of Public Finance and Accountancy (CIPFA)

### Legal

- **The Law Society:** Founded in 1825 as ‘The Society of Attorneys, Solicitors, Proctors and others not being Barristers, practising in the Courts of Law and Equity of the United Kingdom’, the Law Society represents in excess of 145 000 solicitors (qualified in England and Wales) that practice globally. The Law Society Group contains the Solicitors Regulation Authority (SRA), which is responsible for regulatory and disciplinary matters relating to solicitors in England and Wales. It also establishes, oversees and enforces professional standards
- **The Commerce and Industry Group:** An unincorporated association (recognised by the Law Society) established in 2001, to represent lawyers (solicitors, barristers, company secretaries, legal clerks, legal executives and paralegals) working in-house in commerce and industry
- **The International Bar Association (IBA):** With a global membership that includes 197 professional bodies, plus over 40 000 individual members, IBA is the world’s principal organisation of international legal practitioners, bar associations and law societies. Established in 1947 its function is to influence the development of international law and the legal profession globally
- **American Bar Association (ABA):** With a membership approaching 400 000 ABA is the largest (voluntary) legal professional association in the world. Acting for the profession at a national level, it accredits law schools, provides continuing professional education and instigates proposals to improve the US legal system
- Further **International bodies** representing the legal professionals include the Law Council of Australia, the Canadian Bar Association (CBA) and the Law Society of Hong Kong

### Transaction management

- **International Federation of Purchasing and Supply Management (IFPSM):** With a global perspective, IFPSM, based in Switzerland, is a union of 43 National and Regional Purchasing Associations, which have a total membership of approximately 200 000 professionals. The body’s aim is to promote the procurement profession and aid the development and distribution of knowledge
- **Institute for Supply Management™ (ISM):** ISM has a membership of over 40 000 supply management professionals supported by a network of affiliated associations. Founded in 1915, it supports research, promotes education – offering a wide range of educational products and programmes, undertakes promotional activities and develops standards of excellence
- **The Chartered Institute of Purchasing and Supply (CIPS):** An international organisation supporting the purchasing and supply profession, CIPS promotes good practice and high standards of professional skill, ability and integrity. Established in 1932, CIPS assists individuals, organisations and the overall profession. CIPS were awarded a Royal Charter in 1992

### Project/programme management

- **International Project Management Association (IPMA®):** Tracing its roots to 1965, IPMA is an international umbrella organisation for over 50 national project management associations representing over 40 countries. Its aspiration is to lead the promotion, development and recognition of the project management profession. To this end it certifies project managers, publishes a number of project management publications, and provides standards and guidelines for project management personnel via the IPMA Competence Baseline (ICB) version 3. <http://ipma.ch/resources/ipma-publications/ipma-competence-baseline/> (accessed 29 August 2012)

- **The Association for Project Management (APM):** Having more than 18000 individual and 500 corporate members, APM is the largest project management professional body in Europe. In addition, it has a branch in Hong Kong and an international online community. APM's objective is to raise awareness and standards in the profession by developing and promoting project and programme management. Underpinning APM's qualifications, accreditation, research, and publications, the APM Body of Knowledge (fifth edition) is a principal part of APM's 'Five Dimensions of Professionalism'. <http://www.apm.org.uk/APM5Dimensions> (accessed 29 August 2012)
  - representing the UK, APM is the largest member of the IPMA; it is currently seeking a Royal Charter
- **Project Management Institute (PMI):** Based in Newtown Square, PA, USA and with regional offices in EMEA, India, Asia Pacific and China, PMI is a global project management profession association. Formed as a not-for-profit organisation, it has over half a million members and aspiring members across 185 countries. APM promotes project management through its standards and qualifications, and supports research programmes and professional development. Its Project Management Body of Knowledge (PMBOK®) is now in its fourth edition. <http://www.pmi.org/PMBOK-Guide-and-Standards.aspx> (accessed 29 August 2012)

#### Marketing and sales

- **The Chartered Institute of Marketing (CIM):** CIM is the world's largest organisation for professional marketers, with bases in eleven countries beyond the UK. It is involved in training, developing and representing the marketing profession
- **American Marketing Association (AMA):** AMA is a USA-based global professional association for marketers, both individuals and organisations, involved in the training and certification of individuals, and the development of the marketing practice

#### Risk and opportunity management

- **The European Institute of Risk Management (EIRM):** EIRM is a knowledge network, which generates, collates and disseminates risk management information to the private and public sectors
- **The Institute of Risk Management (IRM):** IRM is a global enterprise-wide education institute with members and aspirant members in over 50 countries; an advocate for the risk profession, it supports risk professionals by offering qualifications and development programmes. IRM's membership comes from a variety of risk-related disciplines across variety of industry sectors
- **The Risk Management Institution of Australasia Limited (RMIA):** Within the Asia-Pacific region RMIA is the largest professional association for risk management. Its membership is derived from numerous diverse disciplines, industry and government sectors. RMIA provides networking opportunities for its members through local chapters and special interest groups. It also provides educational programmes, professional accreditation and publications

Sources: IACCM <http://www.iaccm.com>; RICS <http://www.rics.org>; NCMA <http://www.ncmahq.org/>; IFAC <http://www.ifac.org/>; AICPA [www.aicpa.org](http://www.aicpa.org); CIMA <http://www.cimaglobal.com>; <http://www.lawsociety.org.uk/home.law>; <http://www.cigroup.org.uk/>; IBA <http://www.ibanet.org>; ABA <http://www.americanbar.org/aba.html>; CBA <http://www.cba.org/>; <http://www.lawcouncil.asn.au/>; IFPSM <http://www.ifpmm.org>; ISM <http://www.ism.ws>; CIPS <http://www.cips.org>; IPMA® <http://www.ipma.ch>; APM <http://www.apm.org.uk>; PMI <http://www.pmi.org>; CIM <http://www.cim.co.uk>; AMA <http://www.marketingpower.com>; EIRM <http://www.eirm.com>; IRM <http://www.theirm.org>; RMIA <http://www.rmia.org.au> (accessed 29 August 2012)

### Box 1.2 Extract from the APM Body of Knowledge

- |   |  |
|---|--|
| <p>5.0 Business and commercial</p> <ul style="list-style-type: none"> <li>● Business case</li> <li>● Marketing and sales</li> <li>● Project financing and funding</li> <li>● Procurement (includes contract management)</li> <li>● Legal awareness</li> </ul> | <p>2.3 Value management</p> <p>4.3 Estimating</p> <p>4.5 Value engineering</p> <p>7.0 People and profession</p> <ul style="list-style-type: none"> <li>● Communication</li> <li>● Teamwork</li> <li>● Leadership</li> <li>● Conflict management</li> <li>● Negotiation</li> <li>● Behavioural characteristics</li> </ul> |
|---|--|

Source: APM (2006)

business functions. Box 1.1 includes various professional bodies that represent other business functions with a common interest in commercial activities.

Within most businesses there is a certain amount of competition between the various business functions; for example, between project management, supply chain management, and commercial management for the position of 'lead consultant' or 'trusted advisor' within the organisation in respect of managing the exchange interface (transaction management). Similarly, each of the professional organisations listed in Box 1.1 has its own agenda and remit to promote and support the capabilities of its members.

Many of these organisations have developed specific **bodies of knowledge** (BoK), which identifies the underlying principles of the area of its specialisation and guides to practice. They may also include glossaries of common terms, lists of acronyms and suggested readings (see, for example, Morris *et al.*, 2006a, 2006b). An example of a BoK is the APM Body of Knowledge (APM, 2006) developed to support the development and certification of project managers.

A **project manager** is the individual (or entity) given the overall responsibility, authority and accountability for managing a project, administering the contract (or contracts) and leading the project team in facilitating the successful delivery of the project, the required products or the realisation of specific objectives within pre-established constraints.<sup>16</sup>

It is interesting to note that one of APM BoK's seven sections is entitled 'Business and commercial', which includes many of the key activities undertaken by commercial practitioners (see Box 1.2). Other sections of the APM BoK include further activities undertaken by commercial practitioners – these include value engineering and management, and estimating. It is unclear whether the authors of the BoK claim 'ownership' of these activities for the project management function or classify them as a constituent part of the broader and strategic management of projects for which project managers require a working knowledge of commercial awareness.

## Developing the commercial function

In the absence of universally accepted cross-industry sector professional standards, major organisations such as Rolls-Royce, BT and BAE Systems have invested in the development of comprehensive commercial competence matrices, process excellence and functional development programmes, and university award-bearing qualifications. Similarly, many organisations have appointed senior-level function champions and/or established **Centres of Excellence** (CoE) to rationalise the function across business units (divisions) and to provide a focus for supporting and coordinating their commercial function, providing strategic leadership and championing efforts to improve the function's resources and competence by introducing consistent processes, techniques and standards, assurance mechanisms, training and development opportunities, knowledge management capabilities and learning solutions, plus benchmarking functional performance

against comparable organisations. Additionally, this intervention sought to raise the status of the commercial function both within the organisation and externally.

From a public sector, demand-side perspective, various UK government reports have revealed major weaknesses within central government departments in a number of the commercial skills viewed as crucial to the delivery of complex projects. For example, the NAO report: *Commercial Skills for Complex Government Projects* (NAO, 2009) found that departments were not utilising their limited commercial skills and experience to the 'best effect'; areas of weakness included contract management, the commissioning and management of advisers, risk identification and management, and business acumen. The report established that the main obstacles to developing commercial skills were the demands to reduce public spending and the frequent movement of commercial personnel. It also presented a 'Commercial Skills for Complex Projects Framework' comprising a set of key commercial skills and behaviours. As a result several initiatives have been instigated to improve the commercial capability within central government. For example, the MoD has developed the *Defence Commercial Function Skills Framework* (MoD, 2009) and *The Commercial Toolkit* (MoD, 2008). The former provides a set of competences for the defence commercial function, comprising market knowledge, commercial operations, whole supply network management, and regulatory and legal requirements. It also includes a glossary of terms, a set of appropriate skills, a commercial 'road map' and a competence map.

### Commercial capabilities and activities

The core capabilities ('soft' skills: individual and interpersonal processes and behaviours) and activity-based (task-specific) competencies frequently sought by employers in their commercial staff are listed, in order of preference, in Table 1.3.

Although considered to underpin the commercial role, these skills are in the main generic and pertinent to most professional and managerial practice. However, a survey of commercial practitioners (Lowe, 2008a) established the importance attached to various capabilities (Table 1.4) and task-based competencies

**Table 1.3** Top 20 'commercial' capabilities and competencies.

1	Communication and presentation skills	11	Contract management skills
2=	Commercial acumen/awareness	12=	Decision-making skills
	Relationship/people management skills		Staff development skills
4=	Leadership skills	14=	Creative/innovative thinking
	Negotiating skills		IT/IS skills
6	Team/collaborative working skills	16	Strategic thinking
7	Influencing skills	17=	Problem solving skills
8=	Analytical skills		Time management skills
	Project management skills	19=	Change management skills
10	Financial acumen/awareness		Cost management skills

Source: Analysis of 90 commercial functional frameworks/job specifications

**Table 1.4** Individual and interpersonal processes and behaviours.

Primary commercial 'soft' skills		Secondary commercial 'soft' skills	
1	Negotiation	11	Leadership
2	Communication	12	Creativity/ innovation
3	Problem solving	13	Evaluation
4	Commercial acumen	14	Team building
5	Logical thinking	15	Cultural awareness
6	Influencing others	16	Organisational
7	Analytical	17	Financial acumen
8	Broad perspective	18	Numerical
9	Collaborative working	19	Political awareness
10	Team working	20	IT/IS

Source: Lowe (2008a)

**Table 1.5** Activity-based competencies.

Primary commercial task-specific competencies	Secondary commercial task-specific competencies
1 Negotiate contracts	8 Manage workloads
2 Analyse and manage risk	9 Manage knowledge
3 Understand business objectives	10 Manage change
4 Contract management	11 Project management
5 Manage relationships	12 Value management
6 Manage conflict	13 Bidding
7 Draft contracts	14 Performance management
	15 Manage documents
	16 Manage supply chains
	17 Develop new business

Source: Lowe (2008a)

(Table 1.5), subdividing these items into core and secondary skills/competencies. These results are generally consistent with previous IACCM surveys, although the list of potential skills and abilities used in Lowe's survey was considerably more extensive.

The main area of divergence, however, is the relatively low importance given to the abilities to manage documents, subdivide work into packages and manage cash flow, and numerical and IT/IS skills. These skills and abilities had previously been found to be important to commercial managers working within the UK construction sector (Lowe *et al.*, 1997). Further, competencies considered to be of moderate importance included developing new business, the use CM/sourcing software and marketing. Additionally, it is interesting to note that 'leadership' was only rated as a secondary skill, considering commercial managers' aspirations to seek a more strategic role within organisations. In order to achieve this, commercial practitioners need to be seen as 'leaders'. This dichotomy is addressed by Maria-Christina Stafylarakis in Chapter 2.

Lowe found a relatively high degree of homogeneity in the practitioners' responses, irrespective of their regional location, function/type of commercial/contract professional, level of academic qualification, and length of experience. Although, the results indicate that those with the least experience (particularly those with less than five years' experience) consider the skills/abilities associated with bidding, team building, project management, marketing, IT, managing documents, use of CM/sourcing software and thinking logically to be more important than those with longer experience; these tasks being more pertinent, perhaps, to their current commercial role.

#### *Will your company help you acquire the skills for the future?*

A previous IACCM survey (Lowe *et al.*, 2006) established a clear positive relationship for both job satisfaction and career path with support from the organisation in the acquisition of skills and knowledge, and in providing clear and meaningful rewards for high performance. However, it also found that while 42% of the respondents thought that their company would help them acquire the skills they need for the future, a further 42% were unsure that their company would and 16% considered that their company would not help them. Organisations, therefore, should consider introducing (or enhancing existing) mechanisms that recognise and reward high performance and enable commercial staff to acquire new skills and knowledge.

### **Capability maturity model**

According to Ibbs *et al.* (2004), project management maturity (PMM) is an indication of an organisation's present project management sophistication and capability: for example, its managers know which technique to apply, appropriate to a project's requirements. By inference, therefore, commercial management maturity (CMM) is a measure of a firm's commercial management aptitude and erudition.

Several models designed to measure PMM have been developed, these include:

- The Berkeley Project Management Process Maturity Model
- ESI International's Project Framework
- Software Engineering Institute's (SEI) Capability Maturity Model Integration
- Project Management Institute's (PMI) Organisational Project Management Maturity Model (OPM3)
- Office of Government Commerce's (OGC) Project Management Maturity Model

However, relatively little development has been undertaken in respect of CMM. The exception is IACCM's Capability Maturity Model (David *et al.*, 2008; IACCM, ND), which addresses the following nine business dimensions:

1. Leadership
2. Customer/supplier experience
3. Execution and delivery
4. Solution requirements management
5. Financial
6. Information systems/knowledge management
7. Risk management
8. Strategy
9. People development

The tool enables an organisation to evaluate both its demand and supply side process performance against each dimension. Exemplar descriptors are provided for each of the following phases:

- Phase 1: start up
- Phase 2: disciplines under development
- Phase 3: discipline is functional
- Phase 4: continuous development
- Phase 5: world class (best-in-business)

Box 1.3 provides example descriptors for the people development dimension.

Within the project environment, Ibbs *et al.* (2004) illustrate that organisations with developed project management practices exhibit superior project performance. Improvements in PMM, therefore, can result in:

- Improved cost and schedule performance and reliability
- Lower direct project management costs

The fundamental argument they make is that improved project performance is associated with enhanced PMM and capability, and can, as a result, stimulate corporate success. Similarly, IACCM claim that by benchmarking their contracting capability maturity, using the CMM model, an organisation can emulate the success of 'best-in-business' companies: generating additional savings and cost reductions, and thereby becoming more profitable than the market norm.

There are, however, dissenting views. Cooke-Davies (2004), for example, states that the simplistic process perspective inherent within maturity models does not embrace the complexity of project processes. Further, he argues that they are unlikely to be the panacea that some commentators suggest, as they:

- Lack a theoretical underpinning
- They assume there is a single 'ideal' path towards maturity

However, despite these comments, he asserts that project management maturity models make a positive contribution to the domain.

### **Box 1.3 Example descriptors for the people development dimension**

#### **Phase 1: Start up**

- Organisation desires best-in-business competencies to support business
- Skills, abilities and competencies do not exist to support commitment management
- Job family +/- or function does not exist
- People lack leadership, vision and meaning in work lives

#### **Phase 2: Disciplines under development**

- Commitment made to develop right competencies, hire right resources
- Initial assessment of contracting capabilities and limitations completed
- Immediate and irresolvable skills gaps addressed
- A vision for the future is in place and articulated to the entire organisation

#### **Phase 3: Discipline is functional**

- Team is 're-chartered' with new vision and mission upfront
- Behavioural absolutes are clearly defined and accepted
- Change management is given high priority and attention
- Job family and profiles (descriptions) are developed
- New hires reflect a mix in talent and perspective
- Assessment of competencies against standards is completed

#### **Phase 4: Continuous Improvement**

- Team is performing to new expectations and delivering value to the business
- Skills assessment has driven meaningful development plans
- Gaps in performance are aggressively managed
- Performance expectations have been raised significantly
- Both results and process metrics are in place to track performance

#### **Phase 5: World class (best-in-business)**

- Team members viewed as trusted business advisors by the organisation
- Skills gaps have been closed and higher order skills being developed
- Team is performing at high levels with great collaboration; excellence in execution is a given
- Metrics reflect stable, repeatable performance
- Team members being tapped to take on bigger roles in organisation

Source: adapted from IACCM Capability Maturity Model

### **Is commercial management a profession?**

The question centres around the issues of status and the ability of the commercial function to interface on equal terms with other functions within and external to the organisation. For example, the engineering and legal functions have well-established professional status and representation. Similarly, the Chartered Institute of Purchasing and Supply (CIPS), Chartered Institute of Marketing (CIM) and Chartered Institute of

Management Accountants (CIMA) have all recently acquired their Royal Charters, a sign of achieving professional status within the UK. While these bodies originated in the UK they all have global reach.

While there is disagreement over what constitutes a profession, there is generally agreement on the importance of its knowledge base, for example:

'... the power and status of professional personnel is considerably influenced by the degree to which they can lay claim to unique forms of expertise and the value placed on that expertise'. (Eraut, 1994)

Therefore, to appropriate Morris (2004), if there really is a distinct commercial discipline:

'... then there needs to be some knowledge about it that can be articulated with a reasonable degree of robustness'. (Morris, 2004)

However, as is evident from the foregoing discussion of the key activities undertaken by commercial practitioners, the commercial function cannot lay claim to a discrete knowledge base. There is much that they share with other business functions, such as supply chain management and project management. Both these areas have been subject to considerable research. Examples include the theory and practice of supply chain management (see for example, Burgess *et al.*, 2006; Cousins *et al.*, 2006a, 2006b; Giunipero *et al.*, 2006; Harland *et al.*, 2006; Storey *et al.*, 2006) and the development of a conceptual framework for supply chain management (Croom *et al.* 2002; Giannakis and Croom, 2004). Similarly, work within the project management field includes: project contract management and a theory of organisation (Turner and Simister, 2001) and developing a theory of project management (Söderlund, 2004; Turner, 2006a, 2006b, 2006c), although the later has received some criticism (see for example, Morris, 2002; Sauer and Reich, 2007).

Returning to the question – can commercial management be viewed as a profession? The function has elements of codified knowledge derived from the legal, regulatory, governance and financial dimensions of the role. Moreover, a subset of the function – commercial managers within the construction sector in the UK context – are frequently members of the RICS. However, Mintzberg (2009) regards management as an art or craft not a science, and as such cannot be a profession; he considers management to be incompatible with the notion of 'profession'. Similarly, in respect of project management Morris (2002) argues that, while we are able to differentiate good project management practice, '*... there will never be an overall theory of project management*'. In fact, he considers the idea to be mistaken.

One can sympathise with commercial practitioners in their desire to attain professional status. They are widely considered to be subject matter experts – a source of specific knowledge, expertise and advice – and are often responsible for interfacing with externally sourced experts. In addition to the RICS, the IACCM supports commercial, contracting and commitment practitioners, providing a source of communityship (community of practice), a repository of knowledge and best practice, and a potential means by which to raise the status of the commercial (and contract) management function.

## Theoretical background

The commercial function draws on an eclectic mix of theories, concepts and academic disciplines as illustrated by Table 1.6 and Figure 1.9.

Transaction cost economics (TCE) is an interdisciplinary subject that combines aspects of economics, contract law and organisation theory. As a result, it is highly relevant to commercial management, providing both a theoretical framework and common vocabulary by which to explore and explain commercial practice.

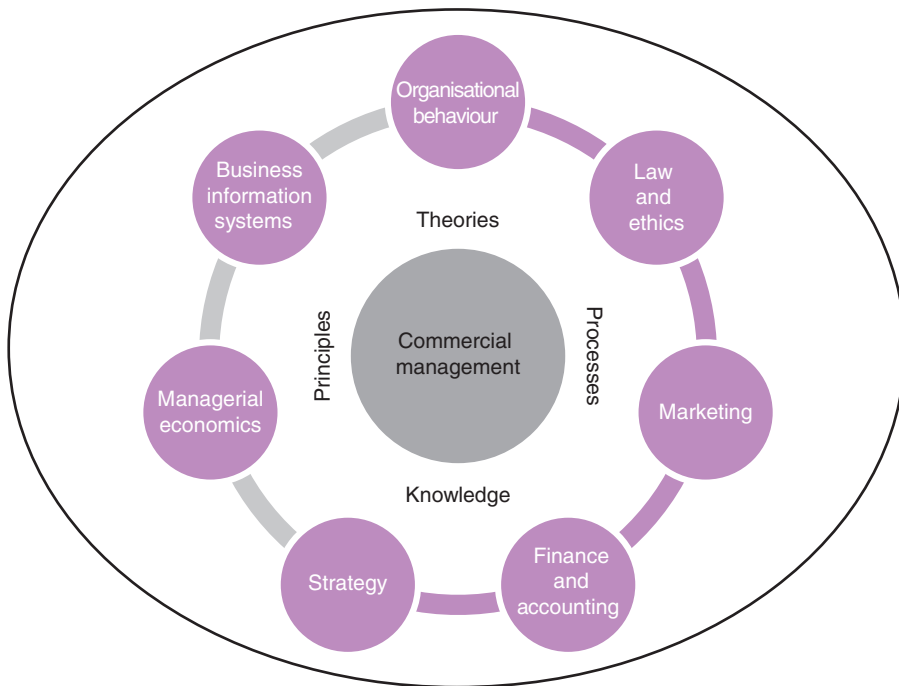
### Transaction cost economics

Oliver Williamson, drawing on the work of Ronald Coase, Chester Barnard and Herbert Simon,<sup>17</sup> is considered to be the key proponent of TCE. His research focuses on economic **governance** and particularly the **boundaries of the firm**.<sup>18</sup> The **governance structure** is the institutional framework within which economic

**Table 1.6** Underlying theoretical concepts and models.

Awareness	
1	Leadership
2	Best value/value for money
3	Competitive advantage
4	Governance
5	Strategy
6	Globalisation
7	Core competence
8	Commitment
9	Creativity
10	Negotiation theory
11	Supply chains
12	Value chain
13	Contract law model
14	Trust
15	Negotiation analysis
16	Decision analysis
17	Corporate control
18	Transaction costs
19	Contract theory
20	Group dynamics
21	Bidding theory
22	Organisational behaviour
23	Problem-solving interest-based negotiation
24	Strategic purchasing
25	Discounted cash flow

Source: Lowe (2008b)



**Figure 1.9** Principal academic disciplines underpinning the commercial function.

exchanges (**transactions**) are conducted. There are principally two choices: **markets** (purchasing products and services external to the organisation) and **hierarchies** (manufacturing the product or supplying the service from within the organisation) the classic '**make or buy**' decision. Although in certain circumstances an alternative **hybrid** approach is appropriate which seeks to combine the advantages of markets and hierarchies.

Employing the **lens of contract**, TCE adopts the **transaction** as its unit of analysis and **governance** as the instrument through which order is introduced to the exchange, consequently mitigating conflict and attaining reciprocal benefit. A **transaction cost** is incurred, according to Williamson (1981), whenever a product

or service is ‘... transferred across a technologically separable interface’, necessitating the development of skills, abilities and the means by which to produce the product or deliver a service. It is, therefore, the cost of acquiring a product or service by means of the market as opposed to producing or supplying them from within the firm: the costs incurred in an exchange. Transaction costs can be categorised under the following activities:

- **Selecting:** for example, the costs involved in collecting and collating information in order to identify and evaluate potential trading partners
- **Contracting:** for example, the costs associated with drafting and negotiating agreements
- **Monitoring:** for example, the costs associated with post-award (**ex post**) contract management in ensuring that the commitments made by both parties are fulfilled
- **Enforcing:** for example, the costs incurred as a result of ex post haggling (negotiation) and implementing sanctions when the other party fails to carry out the terms of the agreement (Williamson, 1985; North, 1990)

These activities, as identified earlier in the chapter, are predominantly undertaken by commercial practitioners: the commercial function is, therefore, essentially a transaction cost.

Although TCE generally assumes a demand-side perspective, transaction costs are incurred by both the purchaser and supplier. While the demand side incurs the direct cost involved in undertaking the activities of selecting, contracting, monitoring and enforcing, they will, more than likely, also pay the costs incurred by suppliers in complying with and responding to these activities. Suppliers usually include these costs as an overhead, which is recovered on contracts undertaken.

In identifying appropriate governance structures (**safeguards**), TCE emphasises the issue of post-award (ex post) **governance**, and in particular the provision of control mechanisms to prevent or moderate the opportunistic behaviour of an exchange partner. Williamson defines opportunism as ‘*self-interest seeking with guile*’ and, while he acknowledges that many trading partners will not behave opportunistically, he highlights the difficulty in determining pre-award (**ex ante**) those who will, although, it is considered that most ‘*have their price*’ – a point at which the rewards for behaving opportunistically are too high to ignore.

The main focus of attention in TCE is the inability to provide appropriate or adequate adjustment (**maladaptation**) during the contract execution phase. For example, in most projects change is inevitable due to unforeseen circumstances and technical advancement. The objective, therefore, is to predict potential contractual hazards during the pre-award phase, identify appropriate control mechanisms and incorporate these into the governance structure (contractual arrangement) adopted.

Williamson notes that Western exchange transactions are predominantly safeguarded by means of legal contracts. These contracts lie on a continuum ranging from simple discrete to complex bespoke; the cost of drafting, negotiating and agreeing these contracts increases significantly as one progresses from simple to complex. Ultimately, a point is reached where the cost of creating appropriate contracts is prohibitive and it becomes more cost-effective to integrate the activity vertically. Additionally, while the identity of the parties is considered relatively unimportant in discrete contracts used to purchase generic goods and services, they are significant in complex contracts (particularly those that are recurrent).

TCE utilises three attributes to describe exchange transactions:

- **Asset specificity:** concerns the extent to which trading parties can redeploy specialised assets acquired to either manufacture a product or deliver a service, and the importance of these assets to the relationship. Williamson identifies the following specific assets: physical, human, site, dedicated, brand name, and temporal. Examples can include the purchase of specialised plant or equipment, undertaking extensive project specific personnel induction activities and the co-location of integrated project teams. Where a party is unable to reutilise these assets or recoup their investment in them bilateral dependency is created, which it is assumed can increase the potential for opportunistic behaviour
- **Uncertainty:** long-term contracts are subject to change and variations due to unforeseen circumstances – for example, as a result of technological change. In order to accommodate these changes contracts

incorporate mechanisms to coordinate and reconcile these adaptations. Uncertainty can give rise to ex ante environmental cost and ex post behavioural costs

- **Frequency:** regular and recurrent transactions encourage the preservation of relationships due to the potential value to be derived from future exchanges. Frequent exchange generates **self-interest trust** and incentivises the parties to invest in specialised governance

Additionally, Williamson identifies two behavioural characteristics associated with these attributes:

- **Opportunism:** as defined above, involves a party going beyond the pursuit of self-interest to include dishonesty, double-dealing, deception and falsifying information in order to achieve its objectives
- **Bounded rationality:** individuals when making decisions are constrained by the availability of information, their cognitive skills to process and analyse this information, and a finite amount of time in which to reach a decision. Bounded rationality, when faced with complex and uncertain environments, will lead (it is theorised) to hierarchy

Winch (2006) has suggested the addition of a third behavioural characteristic:

- **Learning:** linked to the frequency of transactions and the length of the relationship between the parties, the more often and longer two parties transact the more they discover of the other's requirements, aims, processes, etc. and their motivation to transact

Asset specificity is the key feature of TCE. The theory asserts that transaction costs increase as the exchange parties (**transactors**) invest more in specialised assets, due to the need to safeguard themselves against the potential opportunistic behaviour of the other party. According to Williamson (1991), '*asset specificity increases the transaction costs of all forms of governance*'.

- **Market governance (classical contracting):** this is the predominant governance structure for both repeat and one-off contract exchanges, where the product or service is standardised or commoditised. Under this structure the identities of the parties are generally unimportant with minimal effort expended on relationship development and management, as an on-going relationship is not sufficiently valued by either side. Scope and performance is determined by discrete contract terms and conditions, opportunistic behaviour is tempered by the availability of alternatives within the market and litigation is used as the prime dispute resolution mechanism. Features of this approach include: transactional, arms-length and competitive relationships regulated by contracts, standards and rules
- **Trilateral governance (neo-classical contracting):** this is seen as an appropriate governance structure for both mixed and highly idiosyncratic infrequent transactions. The main feature of the structure is the use of third-party intervention (arbitration) to resolve post-award disputes, rather than relying on the legal system (litigation). As both parties are generally motivated to complete the contract, due to their investment in specialised assets and the potentially high switching/termination costs,<sup>19</sup> the focus is on facilitating the maintenance of the relationship. An example is the use of the **Dispute Adjudication Board** under the FIDIC Construction Contract (described in Chapter 6)
- **Transaction-specific governance (relational contracting):** these are specialised governance structures that are frequently utilised on mixed and highly idiosyncratic frequent non-standard transactions. In the case of 'intermediate-production market transactions', Williamson identifies two approaches:
  - **bilateral governance (obligational contracting):** here bespoke governance arrangements are negotiated by the transacting parties to meet the specific circumstances of the exchange. It is a hybrid, networked, third-way approach positioned between markets and hierarchies. Examples include collaborative arrangements, such as, project and strategic partnering, framework arrangements and alliances, which incorporate risk and revenue-sharing mechanisms, and relational approaches based on trust<sup>20</sup>
  - **vertical integration:** here the manufacturer of the product or supplier of the service is brought (directed) within the boundaries 'acquiring' organisation

TCE has been criticised for overemphasising the appropriateness of either the protection afforded by contracts or vertical integration (Poppo and Zenger, 2002), while Ghoshal and Moran (1996) argue that organisations are not direct 'substitutes for structuring efficient transactions when markets fail'. Moreover, they assert that TCE fails to allow for the value creating components of organisations when compared with markets. Nor does it address the limitations of the hierarchies and in particular availability of or the ability to develop the required capabilities (Cousins et al., 2008). Additionally, Zajac and Olsen (1993) suggest that, in certain circumstances, greater value may be generated by adopting an apparently inefficient exchange approach, when viewed from a TCE perspective.

## Case study A

### Football Stadia

The three football stadia projects outlined in case study A (Millenium Stadium, Cardiff, Emirates Stadium, London and Wembley Stadium, London) provide examples of a more traditional arms-length approach to contracting, although the Emirates case illustrates the benefits of a well-established and integrated supply chain.

## Further reading



### Transaction cost economics and project governance

Winch, G (2006) The governance of project coalitions – towards a research agenda. In: DJ Lowe (ed.) with R Leiringer, *Commercial Management of Projects: Defining the Discipline*. Blackwell Publishing, Oxford. pp. 344–355

Müller, R (2011) Project governance. In: PWG Morris, JK Pinto and J Söderlund (eds), *The Oxford Handbook of Project Management*. Oxford University Press, Oxford. pp. 297–320

## Trust

Alternative mechanism to contracts have been identified. These include, for example, the concepts of 'trust' and 'self-enforcing' agreements. Sako (1992), for example, categorises three forms of trust involved in transactions and associated with the development of long-term relationships:

- **Contractual trust:** derived from Western classical contracting
- **Competence trust:** as illustrated by the trust placed in professional advisors
- **Goodwill trust:** the exemplification of established Japanese values of 'open commitment' and 'obligational contractual' relationships

Additionally, Lyons (1995) identifies two further types of trust:

- **Socially orientated trust:** reflecting the connection between experience and past relationships
- **Self-interest trust:** which links the party's assessment of potential future opportunities to social orientation

Formal contracts are widely held to essentially undermine trust and, therefore, promote opportunistic behaviour (Poppo and Zenger, 2002).

## Further reading



### Trust

- Swan W, McDermott P and Khalfan M. (2006) Trust and commercial managers: influences and impacts. In: DJ Lowe (ed.) with R Leiringer, *Commercial Management of Projects: Defining the Discipline*. Blackwell Publishing, Oxford. pp. 172–191
- Gil N, Pinto J and Smyth H (2011) Trust in relational contracting and as a critical organizational attribute. In: PWG Morris, JK Pinto and J Söderlund (eds), *The Oxford Handbook of Project Management*. Oxford University Press, Oxford. pp. 438–460

## Relational contracting

Due to criticism of classic contracting as a means of structuring transactions, Ian Macneil was instrumental in conceiving an alternative field of study, one that emphasises the value of informal mechanisms.<sup>21</sup> Macneil sought to describe behaviour within an exchange, rather than label these exchanges by their governance structure. He advocated that transactions could be placed on a continuum – discrete to relational exchanges, depending on the intensity of the relationship between the parties (Macneil, 1983). Initially adopting the term '**relational contract theory**', he subsequently adopted the designation '**essential contract theory**' to label his approach (Macneil, 2000a,b). Macneil (2000a,b) identified ten common contract behavioural patterns and norms (see Chapter 6), which he asserts exist in all contracts, of which he deems the power norm to have the most influence on exchange relationships.

These relational norms and behavioural patterns are viewed by some as an alternative to explicit, complex contracts or vertical integration.<sup>22</sup> Moreover, relational contracts – '*informal agreements sustained by the value of future relationships*' – are widely used in ongoing, collaborative b2b exchanges (Baker *et al.*, 2002). Examples from the Japanese car manufacturing sector are frequently used to illustrate how relational contracting may be operationalised,<sup>23</sup> while Gil (2009) reports on the introduction of the approach within project-based environments, specifically the Heathrow Terminal 5 project.

Relational contract theory has been criticised for its failure to appreciate the importance of contractual consent (Barnett, 1992), while Eisenberg (2000) asserts that relational contracts are not a distinct class of contract, as all or practically all contracts are relational. Moreover, the findings of Poppo and Zenger (2002) and Arranz *et al.* (2011) support the view that transactional and relational mechanisms are complementary. Although, Poppo and Zenger have established that contractual complexity and relational governance have separate origins and have different roles in fostering transaction performance.

## Case study B

### Heathrow T5

The T5 case study is provided to illustrate the application of the collaborative, relational approach to contracting on a major infrastructure project.

## The power perspective

The central tenet of the power perspective, as outlined by Cox and Ireland (2006), is that operational and commercial outcomes in any exchange transaction are determined by the relative power of the purchaser and supplier. Moreover, it challenges the current received wisdom (best practice) in procurement

and supply management, that is, the championing of long-term collaborative approaches sustained by trust. Cox (2001) asserts that this approach is at odds with the sound logic of economic theory. Further, he suggests:

'... the best defence of the buyer's position, and the one that ensures that suppliers innovate and pass value to buyers, is the maintenance of perfectly competitive (or highly contested) supply markets, with low barriers to entry, low switching costs and limited information asymmetries.' (Cox, 2001)

Cox (1997) refutes the concept of a single 'best practice', suggesting that purchasers' and suppliers' competence is to be found in their ability to make appropriate choices in respect of how they construct and behave in different trading relationships. Superior procurement and supply chain management performance requires an appreciation of the '*power and leverage*' circumstances in which they trade. The Power Matrix developed by Cox *et al.* (2002) provides a mechanism to assess the relative power of buyers and suppliers:

'The matrix is constructed based on the idea that all buyer and supplier relationships are predicated on the relative utility and the relative scarcity of the resources that are exchanged between the two parties'. (Cox *et al.*, 2002)

Buyer and supplier power circumstances can be classified as:

- **Buyer dominance:** where the buyer has relative power over the supplier
- **Interdependence:** where there is '*no relative power imbalance between the parties. Both the buyer and supplier have significant leverage opportunities over the other and they must accept the prevailing price and quality levels*'
- **Independence:** where there is '*no relative power imbalance between the parties. Neither the buyer nor the supplier has significant leverage opportunities over the other because neither party possesses key supply chain resources*'
- **Supplier dominance:** where the supplier has relative power over the buyer (Cox *et al.*, 2000)

Cox and Ireland (2006) illustrate the power perspective by reference to the UK construction sector (see further reading).

### Further reading



#### Power perspective

Cox, A and Ireland, P (2006) Strategic purchasing and supply chain management in the project environment – theory and practice. In: DJ Lowe (ed.) with R Leiringer, *Commercial Management of Projects: Defining the Discipline*. Blackwell Publishing, Oxford. pp. 390–416

### Environment

Exchange transactions take place within a context – the **environment** – which TCE theory and essential contract theory refer to as the concept of 'atmosphere'. The environment includes factors both external to and from within the organisation. Externally, for example, this would incorporate: home and host government systems and intervention; cultural values; legal systems and frameworks, such as, civil codes and precedent based legal models, procurement legislation/directives, competition/anti-trust laws, corporate governance legislation and regulatory obligations; organisation of labour; market structures, and financial system, for example, constraints imposed by the World Bank and other funding agencies. Internally, influences could include the predisposition of senior managers, power and politics, and interfunctional and business unit competition for resources.

Although not covered in detail in this text, **culture** has a significant impact on trading relationships, particularly with the increasing globalisation of markets. For a discussion of the influence of culture on commercial practice see Fellows (2006).

### Further reading



#### Culture

Fellows, R (2006) Culture. In: DJ Lowe (ed.) with R Leiringer, *Commercial Management of Projects: Defining the Discipline*. Blackwell Publishing, Oxford. pp. 172–191

Subsequent chapters will present further theoretical concepts and frameworks including, for example:

- Organisational behaviour and in particular leadership (Chapter 2)
- Competitive advantage and the resource based view of the firm (Chapter 3)
- Risk, uncertainty and opportunity management (Chapter 4)
- Transactional cost economics, relational contracting (essential contract theory), the power balance between parties and negotiation theory (Chapters 6 and 8)

### Summary

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This chapter has explored the nature of commercial practice within project-oriented organisations at the buyer–seller interface. It has presented a commercial management framework, which illustrates the multiple interactions and connections between the purchaser’s procurement cycle and a supplier’s bidding

### Exercise Commercial management in project-oriented organisations

Think about the organisation you work for (or have previously worked for):

- How does your organisation position itself in the supply/value network?
  - illustrate the position of your organisation in its supply/value network and show how it configures its relationships and interacts in order to achieve its stated aims, etc,
- How does your organisation configure itself to support and deliver its aim and strategy?
  - illustrate its organisational structure to include business unit/functional and project programme relationships/interactions
- How does commercial management support and deliver the organisation’s aim and strategy?
  - at the corporate, business unit and function level
- Consider the following, within the organisation:
  - is commercial and contract management considered to be a dynamic capability?
  - is the commercial management function perceived to be a distinctive capability/‘trusted adviser’?
  - where do challenges to the commercial management role come from?
- Do you consider commercial management to be a profession?
- Evaluate the current commercial management maturity of your business unit

and implementation cycles. Additionally, it has outlined the principle activities undertaken by the commercial function and identifies the skills and abilities that support these activities. Areas of commonality of practice with other functions found within project-oriented organisations, sources of potential conflict and misunderstanding are identified. It considers the question: is commercial management a profession? The chapter concludes by viewing the theories and concepts that underpin commercial practice and in particular transaction cost economics.

## Endnotes

- 1 Unless noted all definitions are from the *Oxford Dictionaries Online*, Oxford University Press, Oxford. <http://oxforddictionaries.com/page/contactus/contact-us> (accessed 29 August 2012)
- 2 For a more detailed discussion of the etymology of 'commercial' plus an exposition of the historical context of the job title 'commercial manager' see Stewart (2010)
- 3 Generally referred to as products and services in this text
- 4 Termination also refers to the premature end of a supply contract (*termination of a contract*). It occurs when the contracting parties are released from their contractual obligations due to performance of their duties (an executed contract); agreement of the parties; breach of contract; or frustration.
- 5 See, for example: 4ps (2007); Department of Health (2010a); IPMA (2006); OGC (2002,2007b,2009); VGPB (2011)
- 6 See, for example: Saxena (2008)
- 7 See, for example, glossaries in the following documents: APM (2010); BSI (2000a); BSI (2002); Chapman (2004); MOD (2003); OGC (2006); PMI (2012); PRINCE2 (2009).
- 8 See, for example, glossaries in the following documents: CIM (2011); CIPS (2007), MOD (2003).
- 9 For a more detailed description of the current role of legal within organisations see Nabarro (2010)
- 10 See, for example, glossaries in the following documents: APM (2010); Chapman (2004); Christopher (2005); CIM (2011); CIPS (2007); Council of Supply Chain Management Professionals (CSCMP, ND); Institute for Supply Management (Cavinato, 2010); OGC (2005, 2007b); Rolls-Royce (2000).
- 11 See, for example: APM (2006); Department of Health (2010a, 2010b); IFPSM; Institute for Supply Management (Cavinato, 2010); IPMA (2006); National Procurement Strategy (NPS), Office of the Deputy Prime Minister/Local Government Association (2003); Rolls-Royce (2000); VGPB (2011)
- 12 See, for example: APM (2010); BSI (2000a); Chapman (2004); MOD (2009) PMI (2012); PRINCE2 (2009)
- 13 See, for example, the following definitions: APM (2006); IPMA (2006); MOD (2009)
- 14 See, for example: American Marketing Association (AMA) (2007); APM (2006); Chapman (2004); The Chartered Institute of Marketing (CIM) (2011)
- 15 See, for example, glossaries and definitions in the following documents: APM (2004, 2010); BSI (2000a, 2002); Chapman (2004); CIPS (2007); Institute of Risk Management (2002); IPMA (2006); ISO (2009); MOD (2009); OGC (2002,2007a); Orange, ND; PMI (2012); PRINCE2 (2009); VGPB (2011)
- 16 See for example, definitions in the following documents: APM (2010); BSI (2000a); NHS (2011); PMI (2012); PRINCE2 (2009); VGPB (2011)
- 17 See, for example: Barnard (1938); Coase (1937, 1960); and Simon (1951,1978)
- 18 See, for example: Williamson (1971, 1973, 1975, 1979, 1981, 1983, 1985, 1991, 1993, 2000, 2002, 2005a, 2005b). Also, David and Han (2004); Dixit (2009); Gibbons (2005); Klein *et al.* (1978); Lacity *et al.* (2011); Shelanski and Klein (1995)
- 19 See Monteverde and Teece (1982)
- 20 See Powell (1990)
- 21 See, for example: Macneil (1978, 1983, 2000a, 2000b) and Barnett (1992) and Ivens and Blois (2004)
- 22 See, for example, Arranz *et al.* (2011); Baker *et al.* (2002); Blomqvist *et al.* (2005); Dyer, (1997); Feinman (1990); Eisenberg (2000); Hagedoorn and Heslen (2007); Schwartz and Scott (2003); Zheng *et al.* (2008)
- 23 See, for example, Doornik (2006)

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