STUDY ON THE BUSINESS RISK AS A RESULT OF A PERFORMANT CLAIM MANAGEMENT IN MULTINATIONAL COMPANIES

Roxana Maria Gavril[1], Doru-Alexandru Plesea[2], Christian Hell[3] and Ana-Maria Verjel[4]
[1), 2), 3), 4)] *Bucharest University of Economic Studies, Bucharest, Romania*
E-mail[1]: roxana.gavril@gmail.com; E-mail[2]: pleseadoru@gmail.com
E-mail[3]: ch.hell@t-online.de; E-mail[4]: anamariaverjel@yahoo.com

Abstract
This Paper is highlighting a part of the results of a doctoral research regarding business performance improvement through contract management, conducted by author in the Research Centre of Business Administration, Bucharest University of Economic Studies, Romania.
An important part of Contract Management is to handle and process claims. This activity offers a unique context for dealing with one company's weakest performances, giving access to all internal workflows involved in creating the undesired result. Managing claims is most about running back the sequence of events and critically challenging processes and people to identify the root cause of failure; once this achieved, all available methods and conditions are used to negotiate and mitigate the loss or gain the advantage.
If properly managed, it can serve as a strong tool to improve a company's internal structure to raise performance and trust among business collaborators and competitors. Especially nowadays, when the global market is facing a true watershed in outsourcing and mergers, where up to 80% of them fail to reach completion, companies should focus on available tools to recognize its weak links and act proactively to strengthen them. In doing so, it can encounter positive risks which otherwise might have remained lost opportunities.
The goal of this paper is to identify the business risk a company may have to manage after the implementation of the proposed claim management process and risk warning signs.
Our study is based on a thoroughly reviewed existing literature and a case study from the Oil and Gas industry which shows a 180% claim leakage reduction when implementing a performing claim management. This translates itself in a higher rate of successful outsourcing contracts and increased trust among contractual partners.

Keywords: Global Supply-Chain, Claim Management, Risk Management, Business Performance, Process Improvement

JEL Classification: M160; F23

Introduction

Latest studies undertaken by the Big 4 Financial Consultants show that 83% of mergers fail before reaching their scope. Further studies highlight that around 50% of contract value registers significant value erosion before close-out. These alarming numbers contribute to a lower profit, higher rate of insolvency and distressed businesses; all together causing a global instable economic environment.

On such dynamic markets, where profits have a slower growth and the absolute number of competitors is raising (Dobbs & Koller, 2015), business risk as a consequence of supply chain disruptions became CEO's biggest fear. Parts of the causes that create this challenging environment are non-aligned inter-organizational processes and the attempt of responsible employees to cover mistakes and wrongful decisions.

Aiming to lower the hidden risk a company undertakes with each contract, a well-set and transparent claim process is a good solution to face reality and save precious time for safe business decisions. This new reality may unveil opportunities for lasting improvements which otherwise might have remained wasted.

By this Paper, we aim to prove that managing claims in a performant framework has a direct impact on the tangible internal processes, enforcing improvement. This organizational "healing" process can further strengthen one companies' market position and grow control on the overall business risk.

Literature review

Globalization stretches companies over their operational limits and encourages business collaboration. It is our nowadays reality that a product or service is compound of tiles and actions performed by different companies in different areas of the world. This phenomenon has its obvious advantages, yet by the pressure companies' are facing, it tends to raise the risk they would normally undertake. Besides the "safe" inter-collaboration, that takes place between one companies departments or business areas, intra-organizational collaboration (Eisingerich; Bell, 2008) is seeked to be developed on more stable grounds. Due to similar limitations as the operational ones, collaboration is more likely to impact positively the companies' performance and innovation outcomes when it includes a selected few companies, and is not conducted among large numbers of different firms (Eisingerich; Rubera; Seifert; 2009).

Outsourcing represents a business process transfer from a company to an external provider; by this also the correlated responsibility is handed over to the third party expert. (Cooke; Budhwar, 2009). Yet, the aforementioned studies show that a wrongly assigned outsourcing project has a high risk to fail the entire business. Consequently, companies are more and more focusing on global collaboration (MacCormack et. al., 2007) instead of global outsourcing. The difference is the level of invested leadership of all involved companies, shared information transparency and knowledge among stakeholders.

Business collaborations and outsourcings are both legalized the day the agreed working processes of the new collaboration are enclosed into a signed contract.

From business perspective, on one hand this process enforces cost reductions and enables focus on core business and on the other one increass operational risk, both negative and positive, known as risk and opportunities. In the ideal case, all possible risks are identified and mitigated in an early stage of the collaboration (Islam et. al., 2009). However, a study conducted in 2016 by Deloitte & Touche LLP shows a more shadowed reality as 48% of outsourcing agreements fail in achieving their set goal and become terminated before close-out. This is the outcome of ineffectively managed risks that causes value leakages, financial losses and adversary impact on reputation. This percentage is even higher, if we consider that by chance some critical situations never occurred. Following, as long the work is performed as expected, the contract itself remains still and forgotten. Yet if the agreed conditions are not suitable to any of the involved parties' internal processes or given business environment, the signed document became the main tool of negotiation and correction. Therefore, contracts are considered to be legal support in case of any failure of the signing parties and made for the worst case scenario in which something goes wrong and justice has to be done among the business partners.

Whenever a contract is breached by any contractual party, a non-conformity or non-compliance is reported. Whereas non-conformity is a failure and/or deviation from a specific technical requirement, non-compliance is considered to be a deviation (and/or) irregularity from the contractual obligations and/or formal terms and conditions, to which the parties did not have formal prior agreement. Both, if validated lead to Claim, which is a formal demand (and/or) assertion by a Contractual party for compensation from a loss, delay and/or expense caused by the counterparty under the Contract. This work process is mostly unpleasant to many as it presents the lack of performance at organizational and individual level, therefore, it tend to be managed as a last option and rather considered a rigid approach than a problem solving one.

Process improvement is requested when an existing process is not delivering expected results or is bypassed by employees. To perform a process change, companies tend to use Kaizen (Sharp; McDermott, 2009) which came to life in the 1890s. Kaizen is rather a complex of business methodologies, a "umbrella concept" that foster improvement (Imai, 1989; 2012) , where Kai means change and Zen means good. As for Sakichi Toyoda, the main founder of what we know as Lean Manufacturing principles, no process reaches ever a stage from which it can no longer be improved (Liker, 2004).

To start such an initiative in the processes with impact on the company's outsourcing strategy; one company must first possess internal capabilities of process improvement and change management techniques to ensure improvement occurs. Once those available, they have to be developed as suitable capabilities to employ relevant techniques in Business Process Outsourcing (Ronan, 2016). Business Process Management is basically the capability of overseeing how work is performed within a company attempting to ensure consistent outcomes and recognize improvement opportunities (Dumas; La Rosa; Mendling; Reijers, 1998)

Process efficiency can be calculated using the formula:

$$PE = \frac{\sum PTs\ (VA)}{\text{Total } LT}$$

PE = Process Efficiency
PT = Process Time
VA = Value Added
LT = Lead Time

Research methodology

To achieve the objectives, relevant research articles and literature were studied from trustful publishers and world-wide recognized professional associations and organizations. Following, we recognized a common concern on the threat of business instability coming from the supply-chain system. Based on this, we analyzed possible dysfunctionalities of outsourcing contracts and found a correlation between theory and practice. Our empirical research is based on a case study where the claim management process was improved and major operational dysfunctionalities identified based on this change. We interviewed 3 International Contract and Claim Managers, which helped developing a ring-a-bell list for upcoming claims. Based on the literature and empirical research, we propose an efficient claim management process which together with the identified warning signals, it supposes to help professionals to better prepare for critical contractual situations and organizations to improve information transparency.

Empirical research

Within one of Europe's major Oil and gas companies, Claim Management, except of Health, Safety and Environmental incidents, was considered an aggressive approach towards Contractors. The organizational culture was of mitigating contractual breaches and/or deviations in one to one sessions, aiming to reach zero (0) claims for reaching operational performance. It is to mention that the organization used to have a special department within the Business Support function to manage claims, having full control and authority on the process and outcome. Making use of this privileged situation, the project and / or contract responsible offered minimum support and was rather reticent to any involvement as own mistakes may be revealed and / or the personal relationship to Contractor harmed.

However, this approach did nothing else than weakening the Company in any relation to the Contractors and raise the variation of received contractual outcome. This high variation on negotiated solutions raised contractual costs and management decided to improve the existing approach by defining a new process which in time shall support a change in the organizational attitude towards claims. With this occasion, the Contract responsible which is managing the contracts had to take the lead on dispute resolution following a standardized procedure in how to approach a dispute based on a risk guidance.

The Contract Managers which were assigned from different departments within the organization had to start managing disputes and claim cases based not only on their previous experience but concluded a Contract Management Handbook to base guidance.

When the dispute resolution failed to deliver a positive outcome, the contract responsible send an e-mail notification to Claim Department to leverage the problem. At this point in time, the counter-party was already gaining valuable negotiation field and chances of recovery lowered. As only unsuccessful cases reached the centralized Claim Department, no real overview on organizational level was available on where and why an outsourced project failed. It leads to untraceable disputes and claims for the management and reduces the chances of recovering losses caused by Contractors.

Together with the new process, workshops among the entire Business Unit were organized to train and capture valuable information on why and how a claim shall be managed in future. Once the power of negotiating claims was decentralized and restored to the contract responsible and the Claim Department took only the role of experienced consultant, governance and reporting role, the situation changed drastically within only 12 months.

The claim leakage was reduced with 180%, and helped recovering and avoiding 1, 1 % of the overall outsourced value, summing approximately 9 MN Euro. Consequently, major systemic dysfunctions controlling take-over, contract body overall governance and performance reporting were identified. Following the next 12 months, those 3 important control tools were completely reshaped to serve the organizations own interests. Thereby, further contractual value erosions could be prevented and further similar caused losses avoided. The proposed and tested process is visually presented in Figure 1.

Research outcome

As of the above case study the process visualized in Figure 1 shall ensure a functional managerial support in processing claims.

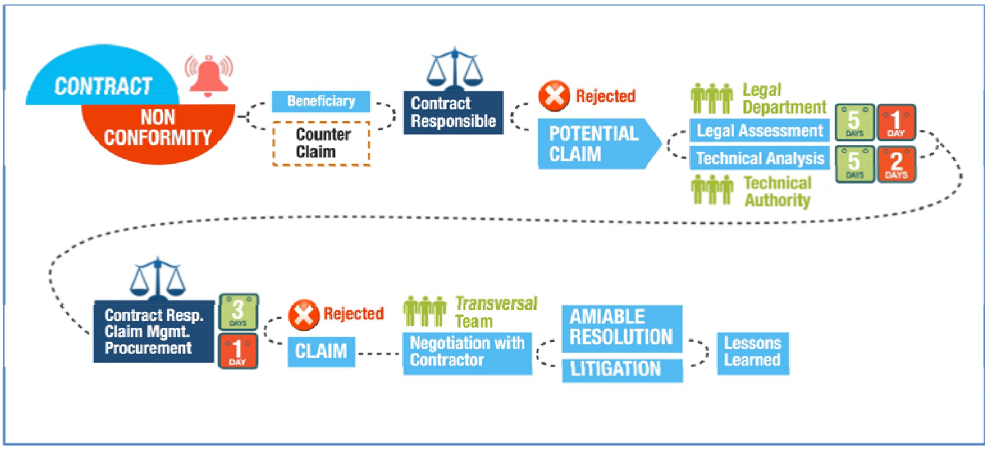

Figure no. 1: Claim management process for Beneficiary companies

Source: authors' contribution

When a Contract breach happens or is alarmed, the event should be registered into a system that offers in time information and transparency among stakeholders on the actual status, pointing clearly where in the process flow which responsible took which decision, based on what arguments. This way, the system is not only tracking the course of the event and decision flow, but supports a thorough understanding of the root cause and management approach on each single case.

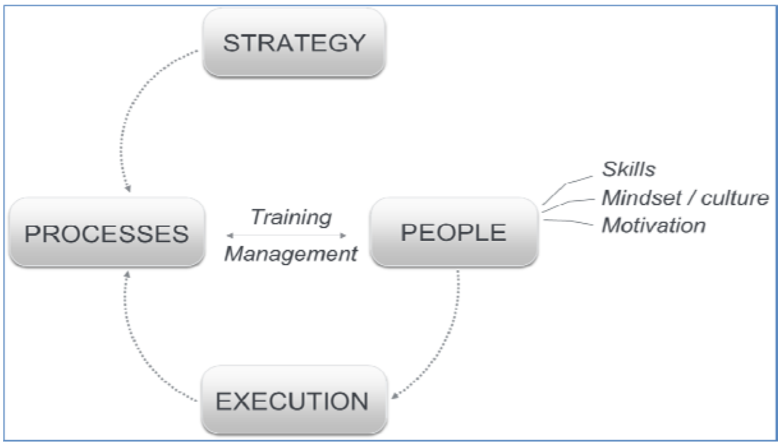

Figure no. 2: Implementation Diagram of a Performant Claim Management Process

Source: authors' contribution

As presented in Figure 2, the company strategy has to be reflected within its internal processes which have to be linked through training, workshops and management to the employees that are going to make use of them. This is the point in time when new skills may be requested, mindset and organizational culture impacted to a better change and tools to motivate people aligned. Once those accomplished, the tasks may be executed within the new framework offering the opportunity to challenge the process and where deviations occur, improvements may be done.

From the experience of the interviewers, such a complex claim management process can be implemented in Multinational Companies within three to nine months, depending on the expertise of those who have to execute it. However, four steps are proposed:

1. Essential for sustainable implementation of the process, the involved employees, especially the involved level of execution shall be exposed gradually to procedural, during training. The aim is to ensure adherence and acceptance thereof, avoiding rejection of concept.
2. Kick-off meeting –present only frame-work and main ideas, not disturbing details;
3. Workshops – organized in 4h sessions for changing mindset and acquiring needed know-how and skills with focus on solving similar, existing cases by using new instruments and process
4. Practical motorization of activity with support and assistance on process risk areas.

Based on the interview held with 3 international Contract and Claim Managers with over 25 years' experience in the field, we concluded a list of early signs which may lead to a claim. To do so, it is recommended to obtain the agreed Baseline schedule very early on in the contract life time and to then select say 10 key milestones in order to monitor performance. These key milestones should be selected by experienced people with direct involvement in the business outcome, as the Project or Business Line Manager or Contracts Manager:

1. Delayed provision of early documents (bonds, insurances, major documents);
2. Notices of claim submitted by contractors;
3. Change Orders or Variation Orders or Requests for Change on agreed schedule;
4. Slippages in applications for milestone payments;
5. Actual Cash-flow lagging projected cash-flow;
6. Failure to manage communication;
7. Changes to approved subcontractors;
8. Health, Safety and Environment incidents;
9. Non-Conformity Reports;
10. Resources below those stated in bidding documents.

Once selected, they should not be changed. When key milestones are missed the responsible persons should be alarmed, an investigation made, and a brief report issued.

Figure no. 3: Major Opportunities and Risks given by an efficient Claim Management
Source: authors' contribution

Conclusions

The management need of having a clear and in time overview of all disputes and claims within the company for a better control of any outsourced service or product, combined with a 360 degree Contractor evaluation supports fast and "healthy" business decision. This can be achieved when the organization is challenging the claim process to deliver information in a transparent mode. It secures diagnosing and recognition of critical situations rather than treating deal-braking events. To aim this, contracts should first define the process for managing a foreseen risk and price it according to the pre-award evaluation. Secondly, contracts shall offer helpful guidance in case of unforeseen events and set clear directions of how those encountered situations shall be best managed.

As claim management does not only reveals the performance leakages of a company, but point out weak decision makers to ensure its complete implementation, the full support of the Board and Top Management is needed. This process is changing organizational culture and challenge old behaviors to break routine. By this continuous improvement cycle, organizations are likely to strengthen valuable collaborations and earn clients recognition.

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