Open Book Contracts

In an open-book contract, the customer and the service provider agree which costs are remunerable and the mark-up that the contractor can apply to them. The customer is then invoiced for the work based on the actual costs incurred plus the agreed margin.

This form of contract is a practical mechanism to ensure that a competitive price is obtained in cases where the complexity of service makes a fully detailed tender competition impractical. It is also useful if the work is difficult to specify precisely up front, or if the buyer wishes to avoid the risk-premium that sellers typically add when giving fixed prices.

This open accounting approach requires a good deal of trust as stories abound of contractors hiding additional profit elsewhere in the bill or outside of the contract through volume discount or centrally returned rebates from their supply chain.

In some contracts the margin achieved this way exceeds the profit that would be made by the contractor delivering the service with their own staff, thus incentivising the service provider to sub-contract more and more without regard to the impact on the client.

Sadly many of these stories are true. The contractor cannot lose under such a deal. If its costs rise then it simply passes the increase on to the customer while pocketing an increased profit.

While the benefits of open book contracts are achievable they require robust management controls and appropriate incentive mechanisms to deliver a sustainable return. Where Open Book is held to have failed it is often where these have not been designed in to the contract.

However in successful cases, an incentive is usually included for the supplier to give a realistic price and to minimise or reduce costs during the contract. Typically, the mechanism for such an incentive is that the supplier gets a bonus or penalty calculated as a percentage of whatever saving is achieved.

Some contracts include a provision whereby the contractor provides profit and loss accounts relating to that area of the business for examination by the client's representative. Most contracts contain limits on what that information will cover. The supplier will not disclose information about unrelated areas of its business or other customers.

The Office of Government Commerce www.ogc.gov.uk has many resources available for free download on alternative procurement models including open book contracting