

CONTRACT MANAGEMENT: KEY ATTRIBUTES AND BEST-IN-CLASS RESULTS

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This report examines the critical attributes that a robust contract management system should have and how these attributes can impact contract management performance. Best-in-Class companies have achieved strong performance results in managing their contracts, by leveraging their capabilities and technology enablers compared to their competition.

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Maximizing organizational effectiveness is an absolute necessity, and management of trading partners and suppliers is at the heart of that improvement effort

Contract Management has come a long way — from files in boxes, to online searchable repositories and analytic support to leverage the information. This report reviews the key attributes required for a robust contract management solution and overviews what Best-in-Class contract management performance looks like.

Contract Management: Key Elements

To compete effectively in today's global markets, maximizing organizational effectiveness is an absolute necessity. Management of trading partners and suppliers is at the heart of that improvement effort. No longer are cost savings and revenue generation the only priorities, although they have not diminished. The scope has expanded beyond supplier and customer management to include more of a governance role when it comes to risk management, regulatory compliance, and performance. Productivity and efficiency have become paramount in light of taking on these incremental requirements,

with little or no increase in headcount. Risk and regulatory compliance exposure can surface from any point in global supply chains or trading partner networks; managing that exposure within the trade, sourcing and supplier management functions, while maintaining or exceeding performance and efficiency, is now a requirement.

The critical importance of these added requirements, in addition to increasing performance demands driven by competitive pressures, has heightened the need for robust governance of third party relationships, which are determined and driven by a contract. From a contract management perspective that equates to maximizing your contract's potential by realizing the targeted savings, revenue, deadlines, plus managing the elements of regulatory compliance and risk as well. A robust contract management solution is the key enabler to managing and controlling all facets of contract specifications. The following key elements define the requirements for a robust contract management solution.

Productivity/Efficiency

Moving from paper to electronic contracts are table stakes to improving efficiency and effectively covering the breadth of contract management requirements. That's not to say that many companies still find themselves in a manual or partially automated environment. However, with a robust solution, gone are the boxes and files of contracts that procurement and trade organizations have dealt with in the past. Electronic contract records drive standardization and automation opportunities that drastically cut the cycle time of creation processes. Templates and electronic workflows enable efficient creation, approval, escalation and exception management processes. Consistency and standardization are also keys to improved compliance and risk mitigation. The speed of contract

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generation and renewal, plus the increased consistency, is the basis for the following elements.

Visibility

Once the conversion to electronic contract records is made, the contracts are saved in a searchable electronic repository. Standardizing the contract structure and templates with the end in mind, to enable access to and leverage the information contained within each contract, is an important step that may simplify search and reporting capabilities. Visibility increases in many ways and is opened up to several possibilities with a searchable repository:

- Visibility into all contracts, as well as their value and spend under management, are readily available.
- Visibility into synergies across the organization, such as multiple contracts executed with the same third party, facilitates the opportunity for leverage and rationalization; previously unseen and unknown.
- Visibility to the contract lifecycle, and the savings and revenue realization, improves performance by highlighting underperforming contracts or leveraging discounts and potential bonuses or rebates available based on performance.
- Visibility is the key to risk and compliance management by enabling views by location, third party, regulatory requirement, product, or some other condition that might create a risk exposure.
- The overall ability to see and assess contract information quickly cannot be underestimated in an environment where the speed of business continues to escalate.

Performance

Performance can be measured against several variables but for this discussion, the focus is on realization of contract execution targets such as savings, revenue or time-based elements, such as service level agreements (SLA's). Again, visibility plays a key role in being able to provide alerts against under performance, as an early warning, that might trigger a corrective action to get back on track. Similarly, taking advantages of over performance might trigger discounts, rebates or some other form of bonus that can be captured.

Construction projects are excellent examples of services where performance is measured and monitored in detail, but there are many types of other services provided with a service level agreement (SLA) that outline status conditions. These include usage, time of operation, down time, etc. that when achieved may trigger a bonus, or a penalty when missed. Visibility to these elements can certainly enhance performance by recognizing the potential opportunity on the upside or risk on the downside.

Even contract lifecycle monitoring can enhance performance by triggering actions that might have been overlooked, such as generating an extra purchase or shipment, which could maximize the realization of savings within the contract or create a bonus condition that might have been missed. On the sell side, contract lifecycle management can shorten the contract renewal process and accelerate revenue recognition.

Compliance

Compliance is top of mind for many companies that deal with specific industry or country regulations. The challenge for buying, selling or trading organizations is having the knowledge and breadth of intelligence to cover all regulatory responsibilities that might exist for a particular product or service, which virtually all organizations fall short of. Contract

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Collaboration”

management can offset some of these issues by incorporating all known conditions at every creation, update or contract renewal, however, they are not a substitute for knowledge experts.

Well defined contract terms and conditions that address the known potential legal and regulatory issues are always a sound approach in governing the relationship. Other forms of compliance may also be involved such as audit, which may require actions to be taken within the contract to secure or provide documentation on a timely basis, or make scheduled payments, fees, taxes etc. within a specified timeframe. Regulatory issues alone might trigger certain actions similar to audit as far as documentation, fees, or periodic monitoring/recording of status versus target levels.

When it comes to product compliance, one of the most common contract requirements is the acceptance criteria for “quality,” which is often a matter of documentation, but can also go back to traceability of the material origin. The topic of conflict minerals is a special case that comes to mind. In the realm of quality compliance, consistent and standardized contract language across all enterprise contracts may also create a protective shield. The documentation of compliance showing all requirements were met along the way in completion of a product or project, can be used in defense, so that if misuse or “out of spec” conditions are encountered and failure occurs, warranties can be voided and/or there is no liability.

The attitude on compliance in general should be one of proactive contract management that incorporates the learning over time into the standard contract language, encouraging consistency to ensure compliance across the board.

Risk

As supply chains become more extended in the quest to source the lowest cost producers, the level of *unknowns* also increases. When dealing with known commerce channels, the question of risk becomes more of a compliance issue, but as companies establish new channels or suppliers, even though those channels or suppliers may be known or used by other well established companies, there are still unknowns to be concerned with.

Supply base risk ranges from disruption in supply to less visible risk factors which include financial stability, geopolitical climate, or conflicts of interest which could impact contract fulfillment. Risk assessment is necessary to ferret out the unknowns, or at least drive inclusion of additional terms to the contract. This puts the responsibility on the supplier or customer to actively provide any change of conditions that might affect performance against a contract. Unapproved and unreported material substitutions are examples that should be covered with protective language. Strong contract management can greatly assist in this risk mitigation by providing consistent and updated language at every turn of the creation, approval, renewal, or exception process.

Risk and compliance are very much top of mind for all organizations. No company wants to be the next headline for a disaster or renegade supplier who created a problem. Strong contract management, consistency and standardization can go a long way in minimizing risk.

Best-in-Class Performance in Contract Management

Figure 1 compares Best-in-Class companies versus All Others on their contract management performance (see sidebar for Best-in-Class definition). Given the importance of effective contract

Best-in-Class Definition

- *Best-in-Class* is the top 20%
- *Industry Average* is the middle 50%
- *Laggards* are the bottom 30%
- *All Others* are the sum of the Industry Average and Laggards - 80%

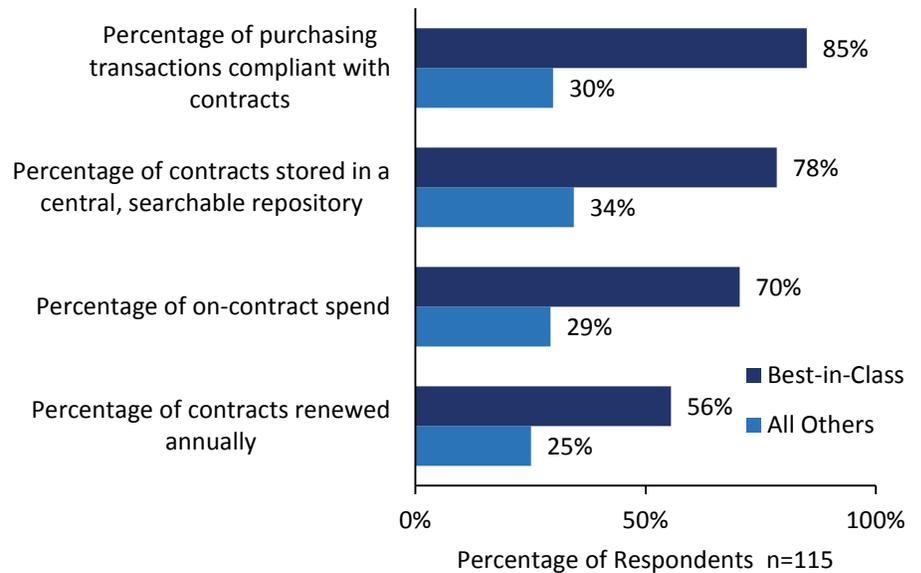
Best-in-Class Performance

- Percentage of spend under management
 - *Best-in-Class* 89%
 - *All Others* 51%
- Average yearly savings realized by sourcing team
 - *Best-in-Class* 12.8%
 - *All Others* 5.6%
- Average cycle time to create, negotiate and approve contracts (in days)
 - *Best-in-Class* 40
 - *All Others* 49

management across all of the critical elements, it is surprising to see the degree of separation between the Best-in-Class compared to the competition. In every measure, the Best-in-Class experience more than twice the percentage of All Others, who have a performance rate of 33% or less in every category.

The concern and call-to-action for All Others is to improve on the fundamentals that stand out, such as the percentage of transactions compliant with contracts. At 30%, it suggests that there is no formal contract management solution in place. The same would hold true for those contracts that are held in a searchable repository. Without this capability in place, visibility to all of the key contract elements that have been discussed is very tough to come by.

Figure 1: Contract Management Performance Measurement



Source: Aberdeen Group, May 2015

Most organizations have some degree of spend that is not under management. At 29% of spend under contract, All Others are quite exposed in many areas that go beyond performance, such as non-compliance and risk management. The cost avoidance alone might justify the investment in a strong contract management solution.

Technology's Role – the Supporting Enabler

After reviewing the performance advantage held by the Best-in-Class compared to All Others, we now consider the degree of automation enablement behind the performance as shown in Table 1.

Table 1: Enabling Process Automation

Contract Management Process	Best-in-Class	All Others
Reporting and analytics (e.g., KPIs, performance management)	91%	49%
Contract creation / authoring	77%	27%
Contract repository	77%	44%
Approval workflow	73%	37%
Electronic signatures	73%	34%

Source: Aberdeen Group, May 2015

At a 91% adoption rate for their reporting and analytics, it is clear that the Best-in-Class know where they stand overall with regard to their contract management. The automation of contract creation, use of a repository, workflows and approvals are also quite high, at least 75% greater compared to All Others, which indicates a commitment and recognition of the value of strong contract management. Investment in technology and automation has paid off in their performance. Conversely, for All Others, the lesser degree of automation is also reflected in their lesser performance as shown in Figure 1.

Key Takeaways

The value of having a robust contract management system is clear. Best-in-Class companies have invested in automation and are much further along in improving their contract management performance. In order to move toward a Best-in-Class contract management performance, the following steps are recommended:

- Build or acquire the ability to create contracts electronically and automate the process. Move away from paper
- Convert active paper contracts to a digital format
- Create and automate the searchable central repository for all contracts
- Improve spend under management to greater than 50%
- Automate the approval workflow process
- Automate the e-signature process
- Build or acquire the analytics tools to search, analyze and create alerts to out-of-contract conditions
- Create visibility views to “contracts by vendors” across all groups within the company, “same products across all vendors,” and a “geographic view” by country and/or region
- Create and provide “performance against contract” views and alerts to end-of-life or out-of-tolerance performance
- Create and provide “compliance to contract” reporting with alerts to out-of-tolerance conditions
- Create a “risk assessment process” for all contracts that deal with new partners and review open contracts that may require an assessment

Start now and do not delay, for the challenge will only continue to grow.

About Aberdeen Group

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