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Perspective
Supply Chain Research

Contract Management: What's Holding You Back?

Issue@Hand

Despite the benefits that effective contract management offers, many enterprises are resistant to moving forward. This is not due to a simple lack of desire. Here, Aberdeen identifies the four hurdles in the path to contract optimization.

Aberdeen Perspective

Aberdeen estimates that 80% of business-to-business transactions are governed by contractual agreements. However, according to our research, the majority of enterprises are dissatisfied with their current contract management procedures. These findings are not surprising. At most companies, contracts have increase both in number and complexity, involving thousands of products and intricate terms and legal clauses that govern a myriad of factors, including price, service level, requirements, warranties, payments, incentives and penalties.

Synopsis

Companies are annually losing billions of dollars because of contract leakage, unredeemed rebates, inefficient processes and suboptimal contract terms. Aberdeen suggests that the quickest and most effective method for achieving contract optimization is through the use of a Web-based contract management solution that can automate the contract life cycle, provide an active repository for all contracts, integrate with other business systems, and deliver tools for monitoring and analysis of contract performance.

Unfortunately, Aberdeen research suggests that most companies are ill equipped to effectively create, execute, or manage contracts in an optimal manner. In fact, contract management remains a largely fragmented activity at most companies. Aberdeen has identified four barriers that trip up enterprise on the path to effective contract management.

Lack of formalized contract management procedures

Few companies have sufficient processes and controls for creating and managing corporate trade agreements across the complete contract life cycle. Instead, most companies continue to rely on an ad-hoc mix of procedures and tools for creating, executing, and analyzing customer and supply contracts. The result is insufficient intra- and inter-enterprise collaboration during the contract-creation process and limited visibility to active contracts.

Inefficient, labor-intensive processes

The typical company takes 20 to 30 days, on average to create, negotiate, and finalize a contract. It is important to note that these activities typically occur after the initial sourcing or sales cycle is closed.

Chief reasons for lengthy contracting cycles include the number of people involved in the process, labor-intensive contracting procedures, and the use of inadequate contracting "technologies." Negotiation and management of customer contracts requires collaboration between sales, marketing, finance, legal, operations, customer service, and contract administration. Internal stakeholders involved in creating and executing supplier contracts often include sourcing/procurement, finance, operations/ manufacturing, and legal.

An overwhelming majority of companies continue to manage the contracting process by shuffling a series of draft proposals, counteroffers, amendments, and other changes between contracting stakeholders using a myriad of online and offline technologies.

The use of such rudimentary tools lengthens contract finalization cycles, limits collaboration, and introduces the high risk of errors by requiring companies to aggregate and re-key information. The disconnected nature of the contracting process also introduces increased risks into trading relationships, by limiting a company's ability to use standard contract clauses, amendments, and terms. Such fragmented procedures are also in direct opposition to the "controls environment" that CFOs will be required to certify is in place under the Sarbanes-Oxley Act.

Using standard contracting language can help companies ensure that all agreements are both in compliance with company and regulatory policies and do not expose the company to undue risks, such as agreeing to a non-profitable deal.

Limited visibility into corporate contracts

Only about a third of enterprises currently have a central contract repository that allows them to search for contract information by partner name or product/part number. Even fewer companies can locate contracts by product category or contract attributes. Furthermore, many customer and supplier contracts remain locked away in filing cabinets or stored on the hard drives of individual (and often inaccessible) PCs across the enterprise.

Certain subsets of contract information - such as pricing, sales, purchase orders (PO), or payment data - are located in various business systems within and outside the enterprise, from internal ERP systems to the accounting systems of various trading partners. The segregation of contract information makes it difficult to drive compliance, maximize contract usage and fulfillment, and conduct thorough analyses of contract performance.

Ineffective monitoring and management of contract compliance

If the contract is the foundation of business, then the most successful companies will best utilize and comply with corporate trade agreements. Specifically, companies must enforce the following three chief types of contract compliance:

- *Operational compliance* — an enterprise must meet (and, hopefully, exceed) pricing and service level terms of both customer and supplier agreements. Enterprises must also ensure that employees comply with internal policies and business objectives in order to minimize both costs and risks.
- *Supplier compliance* — in order to minimize supply costs and risks and to maximize performance, a company must effectively monitor and manage the pricing and service-level agreements of its supply contracts.

- *Regulatory compliance* — the tragedy of September 11, 2001 and a series of accounting and business scandals have sparked new government regulations. Both federal and industry-specific regulations seek to mandate fiscal disclosure and accountability, consumer protection, and security. These regulations require companies to be more diligent in both documenting and executing procedures that are used to manage customer and supplier contracts.

Unfortunately, the lack of standard procedures for creating and managing contracts provides strong evidence that companies lack the visibility and controls necessary to ensure contract compliance. In fact, the large majority of companies take a "rear-view mirror" approach to contract compliance, measuring compliance and performance on a monthly, quarterly, or ad hoc basis. Such passive reviews put companies at high risk of cost overruns, performance glitches, and regulatory violations.

Conclusion

Aberdeen evidence demonstrates that companies are losing billions of dollars each year because of contract leakage, unredeemed rebates, inefficient processes and suboptimal contract terms. Aberdeen suggests that the quickest and most effective method for achieving contract optimization is through the use of a Web-based contract management solution that can automate the contract life cycle, provide an active repository for all contracts, integrate with other business systems, and deliver tools for monitoring and analysis of contract performance.

Related Research

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