Five Myths of Contract Management

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By Mark Smith (Jan.2003)

For many corporations, it's time to take those contracts out of the filing cabinet and put them to work for the company's bottom line.

For years the corporate contract has been an under-appreciated document in the business world. It was considered critical to have, but, once signed and sealed, employees often filed the contract away, never to view it again.

This habit of taking the contract for granted has led to the development of a number of myths regarding the field of contract management. For corporations, these myths minimize the need for a task-specific contract management system and ultimately lead to increased costs (both actual and opportunity) and decreased profits.

The sections below take a look at the five most common of these myths with the goal of setting the record straight: The contract is a vital business tool, and it is high time it was taken out of the filing cabinet and put to work for the firm.

Myth 1: Firms can manage their contracts with standard desktop applications like Access, Excel or Word.

Standard desktop applications have come a long way since the days of Wordstar v 1.0 and Quattro Pro, but they are still far from being a substitute for a contract management system.

Leading contract management packages leverage the familiar editing capabilities of word processing packages. However, word processing software was not designed for multi-user collaboration or enterprise-wide visibility and it cannot measure operational and financial performance against agreed upon contracts.

Contracts today tend to be highly complex and sophisticated documents that are designed to take into account a wide range of possible eventualities. As such, the system used to manage these documents needs to be specialized, robust and offer the centralized capabilities of an enterprise contract management system. It should effectively break up contracts into their various clauses and then store them based as both a unified document as well as a collection of clauses. For example, such a system should allow a firm to sort for all contracts that could be impacted by a change in a law, regulation or status of a customer or supplier.

Also, a viable enterprise contract management system should be able to link to other systems such as enterprise resource planning (ERP), legal or procurement solutions in a secure manner, permitting role-based access — an issue that is clearly germane to highly confidential documents like contracts.

Myth 2: ERP and customer relationship management (CRM) solutions provide all the contract management capabilities a firm needs.

While ERP and CRM solutions are important business tools and are effective at what they do, they are not always designed to handle the range of tasks associated with an effective contract management system.

In general, ERP solutions focus on transactions related to the product or service of the company, and CRM solutions focus on collecting and utilizing data about the customer. While each of these solutions touch on certain aspects of contract management, only an enterprise contract management system can provide visibility into all of your contracts, validate that the transactions meet the terms and conditions of the contract and ensure compliance. A contract represents a business relationship between parties, and this relationship has a number of distinct phases. A contract management system needs to address each phase.

The three phases that comprise the contract life cycle are as follows:

- **Make** — The Make phase of the enterprise contract management (ECM) lifecycle prepares the organization for contract management and compliance measurement. During the Make phase, ECM uses sourcing technology capabilities that automate and manage the requests for proposal process, reverse auction, supplier scorecarding, and bring the key terms and variables into the contract creation process. Then you can begin contract creation and negotiation and electronic archival processes. Benefits here include reduced legal risk from the use of standardized contract terms and conditions, faster audit preparation, a reduction in maverick contracting, enhanced regulatory compliance and global contract visibility.

- **Manage** — The Manage phase of the ECM lifecycle administers and monitors all aspects of executed contracts, including pricing, rebates, royalties, collections, deductions and both transaction- and event-based compliance. Benefits include increased revenues and decreased expenses from adherence to contract pricing and incentive optimization, a reduction in collections and disputes due to questions involving contract compliance, and elimination of unintended contract lapses. Ensuring integrity and visibility into critical corporate contracts can help ensure compliance with the Sarbanes-Oxley Act of 2002.

- **Maximize** — The Maximize phase of the ECM lifecycle measures operational and financial performance against agreed upon commitments, and examines sales and purchasing activity across the enterprise. It also analyzes contract profitability and notifies senior management of non-compliant events or transactions. Benefits include increased revenue and expense control, enhanced trading partner selection, faster contract renewal and improved business intelligence and management reporting.

Myth 3: The sales force can manage contract milestones and expiration dates.

On the surface it may seem logical that the sales force should be tasked with the responsibility of administering contract expiration dates and milestones. A closer look, however, shows that this policy can be very risky for a company. And this only applies to sales contracts anyway. It does not include the procurement side of the business, nor any other contracts.

While it is true that the sales force's job is to be close to the customer and that they should be familiar with the firm's contracts, this is a relatively small part of contract management. Contracts must be maintained with both customers and suppliers, and the sales force may have no background at all with the latter.

Further, it is more than likely that the sales force is neither trained nor well suited to handle the detailed administrative tasks necessary to effectively monitor multiple contracts. And, even if the sales force is willing to take on this new responsibility, without a centralized, systematic way to monitor contract data, even the most diligent sales person — or any other person charged with managing contracts — can miss a key date, thus costing the firm funds and damaging its reputation.

In the same vein, failing to comply with key contractual obligations could lead to an audit of the firm's financials. If the audit reveals that the firmÕs financials are not in compliance with the Sarbanes-Oxley Act of 2002, it could have serious implications, including steep fines, penalties and even jail time. In the event of an audit, it is important that a clear audit trail has been established for each contract — a task that can be performed more efficiently by an automated system rather than members of the sales force. The most effective contract management systems provide automatic notification through the company's e-mail system and incorporate escalation procedures if action is not taken within a predefined period of time.

Myth 4: All of the firm's business transactions are compliant with customer and supplier contracts.

Compliance with a contract is more often assumed than actually verified. While it is easy to simply believe that the company is complying with all of its contracts, the only way to be sure is to maintain a centralized system that stores all contract information in a functional data structure that is then tied to the company's transaction reporting system (ERP) and financial systems. ECM software will allow the firm to see when its transactions are diverging from its agreements so it can take corrective action in a timely fashion.

When one considers the fact that some form of contract governs 80 percent of all B2B transactions and that the average Fortune 1000 company has between 20,000 and 40,000 contracts, the need for structure regarding contract data becomes clear.

By establishing this contract compliance system the firm can achieve several important business benefits, including:

- **Control** — ensures adherence to contracting best practices through a centralized, searchable contract storage repository
- **Security** — protects and archives documents through proven document management technologies and business process workflows
- **Speed** — facilitates internal and external communication through collaboration features
- **Flexibility** — enables companies to define the contract terms and transactions that need to be monitored and set tolerance levels
- **Savings** — reduces labor costs by eliminating the need to manually check and monitor milestones
- **Enterprise Fit** — integrates with transactional systems — including ERP, CRM, supply chain management and other transactional systems
- **Risk Reduction** — contract related audit trails are preserved for future use and thus risks of a regulatory audit are minimized
- **Consistency** — all contracts adhere to the corporate standards and agreements with customers and suppliers are consistent

The achievement of the above tasks will significantly reduce the chance of downstream problems including:

- Financial losses
- Non-compliance with the Sarbanes-Oxley Act of 2002
- Lawsuits and regulatory fines
- Inaccurate revenue and expense forecasting
- Incorrect packaging
- Incorrect product specifications
- Incorrect quantity shipped
- Late shipment
- Invoicing errors
- Billing errors

In today's challenging and competitive business landscape, savings associated with avoiding these problems can make the difference between profit and loss.

Myth 5: Contract management only impacts a few people within the organization.

The basis for this myth is the fact that traditionally only a limited number of individuals had access to the firm's contracts, which created the illusion that only a limited number of people used the contract. Many employees may not know where to look for the information, as a result, or they may not even associate the contract with a source of critical information.

Contracts impact departments and functions throughout the organization and are therefore important to virtually every person in the firm. However, not every element of the contract is equally important to all areas of the company, which makes it is important to have a contract management system that stores the contract in a repository with role-based access. In this way, groups like legal, finance, purchasing and shipping can access those elements of the contract that are relevant to them.

To many it may seem that only major strategy agreements between firms are classified as a contract, but when a broader definition of contracts is used, it becomes apparent that contracts have a wide impact across the enterprise and drive a significant part of an organization's business. Some representative contract types found throughout organizations include:

- Advertising//PR Agreements
- Agency Agreements
- Asset Purchase Agreements
- Broker Agreements
- Bylaws
- Commercial Lease Agreements
- Confidentiality Agreements
- Contract Sales//Research
- Co-promotion
- Distribution Agreements
- General Proxy
- Intellectual Property License
- Joint Marketing Agreements
- Joint Venture
- Leasing Agreements
- Limited Liability Certificate of Formation
- Material Transfer Agreements
- M&A
- Outsource Services
- Partnership and Strategic Partnership Agreements
- Patent Applications
- Power of Attorney
- Research Agreements
- Security Agreements
- Strategic Consulting
- Supplier Agreements
- Termination of Lease Agreements
- Value-added Reseller Agreements

In addition to those contract categories, there are other agreement types that are handled by contract, such as a purchase commitment, returns and replacement, incentives and discounts, payment terms, and duration and expiration. Contracts extend to all corners of a corporation and affect all employees.

The Power of Contracts

Believing these myths surrounding contract management is a common misconception without the proper information. Fortunately, armed with the proper details about what contract management can do, companies can save time and money without risk or loss of opportunity.

In the present market environment, especially with new reporting requirements mandated by the Sarbanes-Oxley Act of 2002, increasing competition and tighter margins, companies must explore every possible opportunity for improving business processes and ensuring the accuracy of their financial transactions. For many companies, unlocking the power of the contract is an excellent place to start.

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