Expert View

Thought Leadership

Building Your Contract Strategy for Bottom Line Benefit

Introduction

In the first of our series of three thought leadership papers on contract management, we discussed the challenges associated with data, reduction of risk and extracting value from the legacy contract portfolio. We believe this risk v opportunity-based approach to legacy contracts is the cornerstone of the ongoing contract management process.

In this second paper, we apply similar techniques to look at how to build a contract strategy and how best to resource it. We will then examine how this can result in tangible gains that will be recognized by the rest of the business.

In our experience of working with numerous large corporates, it's striking that many who look to the resourcing issue of managing contract flow, seek immediately to determine how many resources are needed and how much they would cost. Some corporates embark on an outsourcing strategy without asking some fundamental questions about the overall objectives.

The 'Moneyball' method

For fans of the film Moneyball (a story that studies the inefficiencies and oversights within the game of baseball), there's a famous scene with the scouting team about replacing Giambi (a key player). In the scene the talent scouts want a straight replacement, "one key player for another key player", and discuss who they can afford to buy. The general manager (Brad Pitt) said that it is not the right question to be asking; the real problem is how to get the results that Giambi was achieving.

How does this apply to contracts? The 'problem' is not necessarily that there are too many contracts and an over-stretched legal team. It could be that the approach to assessing how much time and effort is devoted to each type of contract and each clause to deliver the necessary 'home run' is not appropriately weighted. Many teams, swamped with a queue of work and with no framework to decide risk and value, do not apply consistent or statistically sound techniques to prioritize according to the needs of the business. To continue with the Moneyball analogy, the scouts' response to the general manager's statement was "You have a lot of experience and wisdom in this room" – that may be so. But as the movie amply demonstrates, objective analysis beats human intuition more often than not.

What are we trying to achieve?

In building a contract strategy, the starting point is – what are we trying to achieve? The correct answer, in our view, is that the contract team needs to apply the right resources, at the right time to deliver the optimal outcome for the business.

What is the optimal outcome?

In the context of contracts, the optimal outcome is achieving what the business cares about. The main points are:

- It wants to conduct business faster, which means contract turnaround is key to the speed of business.
- It doesn’t want to spend unnecessary money on contract disputes ($100bn annually in the USA alone). In doing so it recognizes that there will always be some contract risk regardless of how well a contract is drafted.
- It wants value from the investment made in negotiating these contracts – call it 'contract obligation management'.

Of course there are other factors the business cares about, but many of them are less important and have little value in the greater business context.

In our recent webinar series, we collected a number of interesting statistics that illustrate the latest trends and perceptions on this topic.

60% – 80%
of all business transactions are governed by commercial contracts

9.2%
the average cost of poor contracts of the firm’s annual revenue

14%
had a fully implemented workflow

Nearly ⅔
see contract portfolio a valuable asset

Less than ⅓
have an effective contract strategy

Not all contracts are equal

The fact is not all contracts are equal as there is always a contract hierarchy. As we discussed when looking at legacy contracts, we use a risk and opportunity matrix to break the contract portfolio into contract types, then apply a weighted scoring methodology to each category of risk. Risk is not analogous and some risk factors are more important than others. Here's an example: in banking, regulatory risk will be more important than settlement risk. Similarly, when working with more complex contract structures, one has more opportunity to claim discount or rebates that are often missed.

Speed up business

Has there ever been a time when the speed of business has been faster? Time is money. An example of this is a mining client who once said: "...if I spend $1bn on buying a site but I can't exploit it because I don't have a single $20,000 digger there, I lose thousands of dollars a day and probably my job shortly thereafter". Just in the same way as contract types, clauses have a hierarchy too in the context of risk and opportunity assessment.

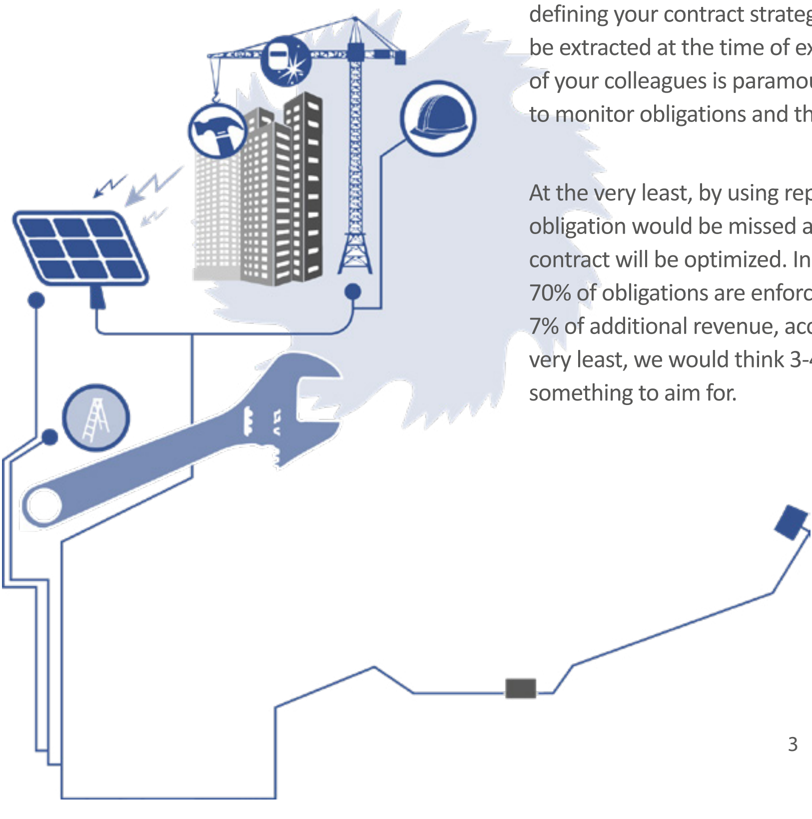
We have developed an objective tool that is backed by in-the-field experience to act as a guide which allows contract managers to focus their efforts effectively. It allows for the optimal allocation of not only the right level of resource but also within the right time frame, all based on your contracts and their individual clauses.

We use a simple to understand cloud-based workflow management tool (Chameleon Efficiency™) for these purposes. This also allows for the tracking of the contract turnaround times and builds a knowledge base of how long tasks really should take.

Getting the 'R' into ROI

All these sources of knowledge create an immensely valuable amount of data. In defining your contract strategy, it's important to think about what information should be extracted at the time of execution of the contract. This is where the collaboration of your colleagues is paramount. At the most basic level, the financial teams will want to monitor obligations and the procurement officers, supplier performance.

At the very least, by using repository-based software, such as Chameleon™, no obligation would be missed and all the hard work applied to a commercially negotiated contract will be optimized. In recent surveys, 55% of respondents believed that less than 70% of obligations are enforced on time and accurately. This alone could generate up to 7% of additional revenue, according to industry studies. That is a staggering figure; at the very least, we would think 3-4% is achievable. That is typically a more realistic value and something to aim for.



Tangible benefits

The key benefits of this approach bring resource planning based upon an opportunity and risk strategy. This is where you can create a hierarchy and effective deployment of resources at the right price point. The additional benefits are:

- Reduced contract risk
- Increased consistency of approach
- Better use of resources – you can now consider the outsourcing option
- A demonstrably efficient and measurable process
- Revenue and profit boost.

Conclusion

We have covered legacy contracts and how to extract value from them in other papers and that there is a demonstrable business benefit to be had. The next in our series of thought leadership papers on contract management focuses on the power of analytics. It is analytics that will bring the insight needed to discover the true hidden value of contracts for the benefit to the business.

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