ZYCUS™
PROCURE PERFORMANCE

We hereby commit to,
BUILDING AN EFFECTIVE CONTRACTING PROCESS

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Building an Effective Contracting Process

Recently Wal-Mart issued a Zero Tolerance policy for suppliers subcontracting work. In another incident, Tesco severed ties with its horsemeat supplier. These events highlight the importance of contract governance at a time when the business is volatile & the supply chain has gone global.

Contract management plays an important role in maintaining an effective and competitive supply chain. More often than not, procurement professionals give more weightage to finding suppliers, and negotiating the terms & conditions as compared to managing contracts. Even though finding and awarding the correct suppliers is crucial, the effort put into it can be undone if the contracts are not managed effectively.

Organizations have long used contracts to conduct business. It provides the framework within which the organization carries out activities and tries to mitigate risks. Today, with a constant battle with the competitors to stay ahead and maintain a sound profit margin companies need to source from across the globe to save on cost and at the same time keep an eye on tight regulatory norms. This further increases the need for a well defined and well managed contracting process.

The need of the hour is to manage contracts across its various stages, right from drafting the contract to implementing it to its renewal. A typical contract life cycle has following stages;

Contract Drafting

Contract Negotiation

CONTRACT LIFE-CYCLE MANAGEMENT

Contract Storing & Repository

Contract Optimization

Contract Renewal

Contract Compliance & Administration

> This white paper will focus on the challenges in managing contracts and how technology can be utilized to address these challenges.

An efficient contract management ensures improved relationship with suppliers, offers competitive advantage to the organization and thus improves shareholder value. However a contract that is kept locked in office drawers may result in something unfortunate like a scandal, or cost the organization millions of dollars if a contract is renewed without evaluating the supplier.

A traditional decentralized paper based approach for maintaining contracts exposes the organizations to risks. It presents challenges like,

1. Lack of visibility

Disparate data spread across the offices of the organizations obstructs the visibility into the following areas:

- **Renewals**
  Evergreen contracts stand the risk of auto renewal. This can be an issue for the organization if there are other players in the market providing the required material at a lower price with the same quality.

- **Key contract terms**
  Every organization follows standard practice for payment terms, publicity etc. However, manual method of maintaining contracts may result in discrepancy in the usage of these terms.
 For instance, an organization follows payment practice of net 20 days. However a newly hired sourcing manager states payment term of net 15 days in the contract. Such instances occurring frequently affect the organization's working capital.

- **Contract ownership**
  There is lack of ownership once the contracts are signed. Sourcing managers negotiate the contract terms and is in charge of it till the contract is finalized. Once the contract is signed it is passed onto the contract manger. The ownership is lost in this transition and the contract signed lies in the office lockers with no one following on it.

- **Contract hierarchies**
  Contracts generally follow the below hierarchy
  - Master contract
    - Sub contract
      - Agreement
        - Sub agreement
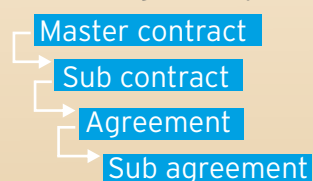
  Contracts/agreements are often revised multiple times before they are finalized. In some cases amendments are made to a signed contract. Due to the multiple versions

there is loss of control, as it is difficult to keep track of it manually. Many a times since the hierarchy is not visible, sub contract can be mistaken as master contract.

2. Issue with compliance

Lack of visibility often makes it difficult to track contract utilization. This results in following compliance issues,

- **Purchase price compliance**
  Many times the price negotiated is different from the price actually paid. This may happen when the person who creates the contract and the one in charge of procuring the items, are different. It may also happen if the procurement professional misplaces the contract.

- **Control maverick spend**
  Maverick spend is one of the big culprits behind organizations spiraling costs. Very often purchases are done outside the scope of agreed contracts from a different vendor. This is especially true for stationery/administrative requirements.

- **Visibility into existing contracts**
  It may so happen that the organization already has a contract for a particular item/service which is half utilized but as the contract is misplaced or lost, procurement function may enter into a new contract thus, rendering the existing contract redundant.

3. Difficulty with standardizing the contract terms

Organizations often face challenges with standardizing contract terms and templates on account of the following reasons;

- **Different categories have different clauses**
  For instance, contracts for categories like administrative, IT, packaging etc. may have different indemnification clauses. Thus, standardizing this with traditional contracting method is a very tedious task. This may result in different clauses being used in different offices.

- **Lack of standardization for spend on services**
  Services are often customized and so there is difficulty in standardizing the templates. Thus, most of the spend is either maverick or off contract.

- **Global spread**
  Organizations spread across the globe often cite problems in standardizing the templates on account of different rules and regulations in different countries.

4. Longer cycle times

- **Approvals**

  When contracts are paper based or dependent on MS word, getting approval from concerned stakeholders on important clauses often consumes time.

- **Negotiation & redlines**

  Negotiation and changes in the contract terms & conditions involves frequent to and fro amongst the involved parties. This again adds to the contract cycle time.

- **Unclear approval hierarchy**

  Since the approval hierarchy is not defined and stored at a centrally accessible location, very often the contracts get lost, in firstly identifying the approval hierarchy and then following on it.

- **Manual signatures**

  Manual signatures means the documents have to be scanned and mailed, every time a contract is made. This often takes time.

Let us understand this with a case study.

A US based global provider of industrial automation manufacturing equipment had offices across the globe.

It faced following major challenges with its contracting process:

- No standard process for creating new contracts

- Issues with compliance to standard clause language

- SOX compliance risk if contract is not approved by the designated person

- Longer Cycle time for creation of new contracts

- Home grown contract repository provide limited value because of lack of standardization (Multiple versions of the same supplier name, No contract hierarchy)

- Visibility into key contract terms due to lack of reporting

The organization tried to confront these issues by leveraging advanced technology for contract management. This offered them with host of benefits like,

- Standardization of the contract metadata, which enables visibility into existing contracts (For example all contracts with non standard payment terms)

- Reduction in cycle time due to automation of the entire contract creation process

- Automatically routing contracts for approvals based on approval workflow thereby ensuring compliance with regulatory norms like SOX

- Better visibility to all stakeholders. Clause level approval changes are directly sent to legal for review (for example changes in indemnification)

Having seen the challenges let us now explore how technology can help resolve these issues.

1. Resolving the visibility challenge by

- Implementing a central repository to store and manage your contract information. Thus all the contract related information is accessible from a single point

- Identifying key terms which needs to be tracked for key contracts and set alerts on their expiry

- Generating reports to provide detailed information on contract utilization and study the utilization trends. This can help in identifying if the contract terms are being followed or not

- Ensuring all evergreen contracts are reviewed with business owners and identify opportunities for re-negotiation by setting time alert before the contract is due for renewal. This can help avoid renewing contract with a supplier who no longer is a competitive source for the organization

2. Ensuring contract compliance by

- Matching established contracts with actual spend transactions. This will help in identifying if the organization is purchasing from non approved vendors

- Ensuring that organizations track utilization of the contract through detailed analysis of the reports generated

- Matching purchase information with contract. By doing so, organizations can identify purchase price compliance as well as rebates

- Increasing visibility of contracts by integrating with your organization's ERP system

3. Standardizing contract terms by

- Standardizing your organization's terms and clauses by working with different stakeholders to avoid back and forth on the same when a new contract is being made

- Implementing a process which automatically guides sourcing managers to the right template based on a question based survey. Thus avoiding the manual work for searching the correct template

- Tracking what terms are often negotiated and change those terms in the base templates

- Defining a clause hierarchy based on the different regional requirements

- Identifying services which are bought repeatedly and defining your own templates based on third party boilerplate thus, reducing the time spent on writing a contract

4. Reducing contract cycle time by

- Automating the approval process by way of,

  - Pre defined approval hierarchy based on category, spend etc. Thus the written contract will automatically follow the hierarchy for approval and feedback

- Implementing clause level approvals. Sending an entire contract for review is very time consuming. Technology can enable defining clause ownership and automate this process

- Automating the signature process with eSignatures to avoid the hassle of scanning and uploading the documents, which was the case with manual signatures

Conclusion

As quoted by Andy Grove, Intel - "There is at least one point in the history of any company when you have to change dramatically to rise to the next level of performance. Miss that moment - and you start to decline"

With the changing business environment and spurts of supplier related scandals, it has become necessary for the organizations to manage contracts effectively. Traditional methods of governing contracts no longer yield positive results. To actually reap the benefits from the contracts, organizations need to invest in the right technology and develop the right attitude.

Z About Zycus

At Zycus we are 100% dedicated to positioning procurement at the heart of business performance. With our spirit of innovation and a passion to help procurement create even greater business advantages, we have evolved our portfolio to a full suite of Procurement Performance Solutions - Spend Analysis, eSourcing, Contract Management, Supplier Management, Financial Savings Management, and Procure-to-Pay.

We believe our deep, detailed procurement expertise and a sharp focus on being responsive to our customers has reflected in us being positioned as a 'Leader' in the '2013 Gartner Magic Quadrant' for Strategic Sourcing Application Suites. We continue to see each customer as a partner in innovation and no client is too small to deserve our attention.

We are a 600+ company with a physical presence in virtually every major region of the globe. With more than 200 solution deployments among Global 1000 clients, we search the world continually for procurement practices proven to drive competitive business performance. We incorporate these practices into easy-to-use solutions that give procurement teams the power to get moving quickly - from any point of departure - and to continue innovating and pushing business and procurement performance to new heights.