Contracts as a Connector

The case for improved contract management

Facing increased complexity and market volatility, executive management needs new and improved sources of business information and control. A well-designed contracting process offers the solution, as well as unleashing substantial improvements to the bottom-line.

Authored by:
Tim Cummins
tcummins@iaccm.com
This paper briefly describes the forces that are driving 'contracting competence' and provides a summary status of current strengths and weaknesses in contract management process and skills. It is based on a survey undertaken by the International Association for Contract & Commercial Management (IACCM) in October 2014, drawing on input from more than 300 international corporations and public sector organizations.

**Industry Mix of Survey Responses**

**Company Size ($m revenue)**

---

**About the Author -**

Tim Cummins, President & CEO, IACCM; Tim works with leading corporations, public and academic bodies, supporting executive awareness and understanding of the role that procurement, contracting and relationship management increasingly plays in 21st century business performance and public policy.
Introduction

The ability to win and perform contracts lies at the heart of business. Yet in spite of their critical importance to an organization's reputation and survival, many do not have a defined process for the management of their contracts. They rely on a series of fragmented activities, controlled by different groups or functions, which offer limited insight to management.

However, a small (but growing) number of organizations have not only grasped the need for a more holistic approach to contract management, but have made the investments necessary to develop competence. Their reward includes a substantial boost to the bottom line; but more than this, they become a preferred customer or supplier, with resultant benefits including greater loyalty and increased innovation.

Many reports and articles have been written about the need for today's businesses to achieve greater synthesis, for skills that can coordinate and coalesce a growing army of experts. Whether it is IBM writing about the CEO challenge of 'interconnections and interdependencies' or PwC highlighting the importance of 'trust', there is ample evidence that executives are struggling to maintain control and insight over their increasingly complex and volatile markets and organization. With more and more of the business outsourced or reliant on extended supply networks, the problems are getting worse. Add to this the pressures of regulation, of constant cost reduction and increasingly unpredictable geopolitical risk and it is easy to see why management is anxiously seeking new ways to maintain oversight and control.

When managed well, contracts connect the views, opinions and needs of stakeholders, internal and external. They establish the rules and obligations under which performance will occur. The quality of that performance has a high dependency on the quality of the contracting process. Taken together, contracts and the contracting process can act as critical 'connectors' both within the business and to its trading partners.
Factors driving the importance of contracting competence

- Unrelenting pressure on costs
  - New service delivery models and forms of contract

- Growing dependence on third parties
  - Need for increased discipline in governance and performance management

- Increasing regulation
  - Focus on improved transparency and oversight

- Greater 'internationalism'
  - Mechanisms for improved communication, understanding and change management

- Focus on collaboration
  - Growing integration of contract and relationship management

- Realizing contract value
  - Identify and control value leakage, opportunities for growth

Understanding the purpose of contracts

In the highest performing organizations, contracts and the contracting process are seen as instruments of quality control. 'Commercial assurance' - that is, continuous evaluation and testing of organizational capabilities and commitments - is given status equivalent to 'technical assurance'. Just as design drawings or systems roadmaps might be used to ensure technical performance, so is the contract used to ensure commercial performance.

"Senior managers have not taken contract management seriously."

(UK NATIONAL AUDIT OFFICE REPORT ON CONTRACT MANAGEMENT, SEPTEMBER 2014)
This approach is far removed from the more typical view of contracts as primarily legal instruments which are employed as offensive or defensive weapons in the event of dispute. Indeed, senior managers have often abdicated responsibility for contract management to their in-house legal team, little understanding the potential business impact. For those who understand the financial and competitive impact, contracts are seen as critical business instruments in the delivery of economic value. In those organizations (frequently engaged in the delivery of complex projects or services), the contract management process is deployed to give effective management insight and control over the performance of the contracts portfolio.

Recently, senior management in a broad array of industries has started to take an increased interest in contract management. As the table below shows, the trend is worldwide and has resulted in improved capabilities. However, the research suggests that in many cases the focus has been on improved compliance, with less attention paid to the generation of increased value and more collaborative trading relationships. Therefore the major opportunities lie ahead.

### A growth of interest and capability

<table>
<thead>
<tr>
<th></th>
<th>% reporting growth of capability in last 2-3 years</th>
<th>% reporting growth of interest by top management</th>
<th>Gap</th>
</tr>
</thead>
<tbody>
<tr>
<td>Africa</td>
<td>61</td>
<td>46</td>
<td>15</td>
</tr>
<tr>
<td>Australia</td>
<td>67</td>
<td>56</td>
<td>11</td>
</tr>
<tr>
<td>Asia</td>
<td>52</td>
<td>52</td>
<td>0</td>
</tr>
<tr>
<td>Europe</td>
<td>65</td>
<td>60</td>
<td>5</td>
</tr>
<tr>
<td>Middle East</td>
<td>71</td>
<td>74</td>
<td>-3</td>
</tr>
<tr>
<td>India</td>
<td>58</td>
<td>58</td>
<td>0</td>
</tr>
<tr>
<td>North America</td>
<td>64</td>
<td>63</td>
<td>1</td>
</tr>
<tr>
<td>South &amp; Central America</td>
<td>82</td>
<td>55</td>
<td>27</td>
</tr>
</tbody>
</table>

It is important to remember that the costs or benefits of contract competence are cumulative across a supply network. The impact of good or bad performance flows across the links in a supply chain, with each link individually contributing or degrading overall value. Therefore smart organizations are not only focused on internal capabilities, but also test the resilience and commitment of their trading partners. In a world of increasing complexity, weaknesses in contract management are a primary source of risk.

“" In a world of increasing complexity, weaknesses in contract management are a primary source of risk ""
The state of the market

The research results show that current contract management performance is on average mediocre. On a scale of 1 - 100, the norm is 52 (see table below). While aspirations have improved, reality lags some way behind. For example, an area such as ‘Managing Relationships’ scores well in terms of management engagement, but is undermined by issues such as lack of data and the fact that few contracts contain performance incentives. At an operational level, contract management remains very inward-looking and often lacks the tools or systems to support internal visibility and collaboration. This means there are inevitable inefficiencies and that opportunities to increase value are often missed.

The IACCM survey explored eight aspects of the contracting process; they are listed here in order of performance, with the strongest areas first:

<table>
<thead>
<tr>
<th>Performance Category</th>
<th>Average Score (out of 100)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Administration</td>
<td>60</td>
</tr>
<tr>
<td>Planning and Governance</td>
<td>59</td>
</tr>
<tr>
<td>Managing Relationships</td>
<td>54</td>
</tr>
<tr>
<td>Managing Performance</td>
<td>50</td>
</tr>
<tr>
<td>People and Skills</td>
<td>50</td>
</tr>
<tr>
<td>Identifying and Managing Risk</td>
<td>49</td>
</tr>
<tr>
<td>Contract Development</td>
<td>49</td>
</tr>
<tr>
<td>Payment and Incentives</td>
<td>45</td>
</tr>
</tbody>
</table>

A story of contrasts: opportunities for improvement

Analysis of the survey results indicates relative strengths and weaknesses and points to a number of areas where immediate action could bring benefit.

- While 63% say that contract management operates as a multi-function discipline, 61% acknowledge that they ‘do not have systems that reliably maintain up-to-date versions of the contract or allow access to users’. This inevitably results in longer cycle times and increases risks of non-compliance, as well as undermining central visibility and reporting.
- 54% say that senior management engages with customers and suppliers on a regular and planned basis to review contract performance, but 73% do not have contracts that incent innovation or shared approaches to problem solving and improvement. Not only is this percentage of engagement surprisingly low, but the failure to establish formal mechanisms for problem solving and innovation reduces the value of management focus.
- 58% say that there is visibility of major contract performance and ownership at board level, but 60% rely largely on supplier-provided performance data. Leading organizations operate with shared data, which reduces contention and provides support for continuous improvement.
50% say that their organization has a strategic approach to managing customer / supplier relationships, but 70% admit that they do not share risk registers and work together with their customers / suppliers on mitigation. Without this transparency and collaborative approach to risk management, performance and value inevitably suffer.

51% say that their organization has the right people in place to undertake contract management; 71% do not have sufficient skilled staff to ensure effective oversight and governance of their contracts. These obviously contradictory statements reflect the failure in many organizations to develop overall competence, as opposed to functional capability. Forward-looking organizations work on disseminating knowledge to the point of need, not retaining it within central bureaucracies.

Call to action

Achieving greater value from contracts depends on viewing contract management as a holistic life-cycle process. For the many organizations that have not yet defined their ‘connected’ process, this must be the first step.

Once the process is in place, continued actions flow naturally, but here are three suggested priorities (which should also guide process design);

- **Integration of contract and relationship.** Mature organizations have grasped the point that ‘the contract’ and ‘the relationship’ are not separate or alternative items. Their integration is fundamental to trust, to the management of ‘interconnections and interdependencies’ and to having effective collaboration.

- **Contract management as an enabler of the business.** Contracts are economic assets and tools for operational management. Therefore its development as a true ‘connector’ between stakeholders – internal and external – is critical to realizing value.

- **Contracts and process designed for users and to support the brand.** The commitments contained in contracts must be accurately communicated to those with a need to know; issues of interpretation and change should be simplified, not only to safeguard performance but also to reduce non-compliance. Contract terms should align with the marketing message and brand image; too often, they are in conflict and drive the wrong behaviors.

Moving to an environment where contracts and the contracting process truly act as ‘connectors’ may not be simple. The number of stakeholders that it involves means that there must be strong senior management support. However, the dividends from taking this approach are substantial – and the cost of not doing so is rapidly increasing.

“Organizations are like islands. Some build a harbor and allow their trading partners a safe mooring. Others force them to sail around the outside and weather whatever storms may occur.”

*Peter Allen, former Worldwide President of Sales, CSC*
About Zycus

Zycus is a leading global provider of complete Source-to-Pay suite of procurement performance solutions. Our comprehensive product portfolio includes applications for both the strategic and the operational aspects of procurement - eProcurement, eInvoicing, Spend Analysis, eSourcing, Contract Management, Supplier Management and Financial Savings Management. Our spirit of innovation and our passion to help procurement create greater business impact are reflected among the hundreds of procurement solution deployments that we have undertaken over the years. We are proud to have as our clients, some of the best-of-breed companies across verticals like Manufacturing, Automotives, Banking and Finance, Oil and Gas, Food Processing, Electronics, Telecommunications, Chemicals, Health and Pharma, Education and more.