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FOUR PITFALLS, FOUR FIXES:

Worst and Best Contract Management Practices

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EXECUTIVE SUMMARY

Effective management of outsourcing contracts is a critical must-have in today's enterprise environments. For one thing, complex, multi-vendor sourcing arrangements are becoming ubiquitous, meaning that businesses have to manage more and more contracts on an ongoing basis. In addition, in an increasingly stringent regulatory environment, contracts are a crucial mechanism to maintain transparency and oversight of third-party relationships. Finally, rapid technology innovations are driving continual changes in service delivery models and metrics, changes that require new approaches to contracting.

While executives responsible for sourcing relationships focus close attention on negotiating contract terms and conditions and pricing and on closing the deal, the day-to-day oversight of details related to service delivery, process efficiency and outcomes often receives limited attention. As a result, operational governance is compromised and business value from outsourcing is sub-optimal.

This Alsbridge white paper examines four common problems related to contract management that arise is sourcing relationships, and four strategies designed to identify and address those problems.

PROBLEM AREAS

Contract Auto-Piloting

After an outsourcing contract is signed, the buy-side team often assumes that the heavy lifting is done with. Subsequently, as the deal moves into a steady state phase, no one on the client side takes ownership for managing the myriad details related to contract deliverables and obligations, reporting requirements and supporting services levels. When new business processes aren't integrated with existing processes, performance suffers, leading to misunderstandings, disagreements and erosion of trust.

In this type of environment, both parties revert to focusing on the current state, rather than on possibilities and the potential to drive positive change. As "fire drill mode" becomes standard operating procedure, progress slows and the critical task of monitoring and managing retained risk falls through the cracks. Ultimately, the relationship is tarnished and the contract may be unworkable.

Transition Gap

Enterprises often underestimate the meticulous planning required when transitioning from in-house service management to outsourcing, leading to a wide range of challenges. Issues with existing personnel often arise, raising implications related to pay, pensions and security. Businesses often fail to communicate clearly, consistently and tactfully, leading to rumors and speculation. If the transition starts to look like a train wreck, key personnel will be tempted to leave, placing the transition in jeopardy. If escalation procedures and documentation aren't a priority, problems will arise not just during the transition but during the course of the contract.

Software License Non-Compliance

Perhaps one of the riskiest contract management shortcomings an enterprise faces is in the area of software agreements. Software contracts contain terms and conditions around licenses, and software programs installed on-site usually have expiration dates. If the expiration date comes and goes, employees often continue to use the products. This leaves the business vulnerable to a software audit from the vendor; indeed, software providers are increasingly aggressive about pursuing audits. In these situations, customers can face enormous fines and penalties. While most clients view a software audit about as favorably as a root canal, the reality is that preparation is imperative.

Watermelon Syndrome

This often-cited metaphor refers to situations where service levels appear as "Green" on reported dashboards, while in reality service delivery – and customer perceptions – inside the environment are bright "Red." In many cases, inadequate contract management contributes to the watermelon syndrome in a death by a thousand cuts manner. Multiple schedule, delivery, cost and other variances arise and go unaddressed, and over time these oversights – even if they concern minor issues – exert a negative impact on the relationship.

WAYS TO IMPROVE CONTRACT MANAGEMENT

Standardized Contract Language

Contract templates with standardized language –including approved alternate language – enforce consistency and manage risk while reducing the need for support by corporate counsel. Keeping it simple is imperative – contract language that relies on plain English rather than legalese, combined with awareness sessions for business-side users on the meaning of specific contract terms and their use, make the templates more user-friendly and relevant. Organizations tend to be more amenable to standard contract language when it is based on shared perspectives of risk tolerance throughout the organization, and when legal, business operations and finance units are involved. The numerous benefits include increased understanding of contractual deliverables and obligations, reduced negotiation cycles and fewer demands on corporate or outside counsel.

Regular Review of Clauses

In and of itself, developing standardized language is insufficient to keeping an organization in the forefront of contract management innovation. The challenge is that terms are regularly renegotiated, so templates with standardized language lose their effectiveness. Forward-thinking organizations routinely analyze contracts to identify clauses that are frequently negotiated, and then revise their "starting point" language to reflect a consistent outcome. Regularly reassessing and evolving key clauses to align them with business practices can reduce the number of negotiation cycles and time between drafts, as well as ease business relations with vendor and internal stakeholders.

Stratified Vendor Portfolio

Stratifying the vendor portfolio annually allows a company to analyze how pricing, risk, key terms and conditions and cycle times are aligned or misaligned. The exercise provides useful information to renegotiate or revise standard language and terms, improve processes or reallocate resources. Criteria to stratify the vendor portfolio may include factors such as overall spend amount, risk factors, new geographic presence and use of non-standard contract terms. For example, contracts with a relatively low total value that involve services with an inordinate amount of risk should be closely monitored and identified for renegotiation at the time of renewal. The stratification analysis can also reveal how much time is spent on managing low-value versus high-value contracts, which might indicate that the low-value contracts should be simplified, streamlined and standardized to reduce the time they require to administer.

Implement a Contract Management System

Multiple solutions are available to automate the contract management process from contract creation and negotiation through approval, compliance, and renewal. Unfortunately, many organizations have a variety of internal contracting processes. In addition, many companies have multiple contract management systems in place within multiple functional units. When organizations treat contract management as an enterprise-wide process, automation can be further leveraged when integrated and unified with other corporate systems. This ensures consistency of information and reduces duplication of effort. Integration with corporate systems can also reduce error rates and unapproved changes to contracts. Corporate systems that manage pricing and margins can also be tied to the contract management system to import relevant data, enabling significant insight into provider performance and delivery of business value.

Benefits

Benefits of effective contract management include increased productivity, as staff spend less time on figuring out how to do things and have more time to actually do the work. Centralized contracts are easily accessible and visible, and the consistency enforced by standard language, contract templates and checklists ensures a standard of quality of output.

Contract management reduces legal fees, eliminates unwanted service renewals and drives spend visibility. Enterprises are equipped to buy from approved vendors at the right times, for the right quantities at agreed-upon prices, thereby reducing shadow spending. Tracking rebates can ensure that negotiated savings in a sourcing cycle are captured accordingly.

Enforcing and managing the latest terms, conditions, controls and policies leads to improved compliance and reduced risk exposure. Proactively demonstrating compliance requires rigorous audit trails and ongoing compliance monitoring. Standardizing processes and procedures decreases maverick buying and vendor risk while improving spend leverage. The net impact is to reduce vendor risk and deliver more sourcing value at lower cost.

Organizations that leverage available data to analyze terms related to pricing, quality guarantees, service levels and warranties are positioned to be more proactive in the negotiations process. Specifically, at the end of a contract term, they can take a more fact-based approach to evaluating the vendor relationship and assessing the financial and business benefit of a given contract.

ABOUT THE AUTHOR

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David has more than 25 years of diversified expertise in vendor management and governance, information technology, strategic sourcing, cloud and mobile computing, vendor rationalization and program/project management. He is recognized as a change agent in designing and implementing business solutions to reduce TCO and deliver a strong ROI for his clients.

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