

WHITE PAPER

Contract Performance Management Now:

The Foundation of all Procurement Initiatives

Part I: Spend Management

By Jason Rushin, Senior Product Marketing Manager, Nextance



NEXTANCE®

Table of Contents

Series Introduction	Page 1
Introduction: Your Contracts are the Foundation for All Spend Management Activities	Page 2
Contracts: The Critical Foundation of Your Supplier Relationships	Page 3
Contracts Are Integral to Spend Analysis	Page 4
Contracts Are Integral to Supplier Rationalization.	Page 5
Contracts Are Integral to Maverick Spend Reduction	Page 6
Contracts Are Integral to Strategic Sourcing	Page 7
Improving ongoing data integrity for better future analysis.	Page 8
Contract Performance Management – A Low Risk, High ROI Initiative	Page 9
What to look for in a contract performance management system	Page 11
Conclusion	Page 12
About the Author	Page 13
About Nextance	Page 13

Series Introduction

This whitepaper is the first in a four-part series designed to explain why contract performance management is the critical first step for any broad procurement initiative your organization might be undergoing or have prioritized.

With a focus on spend management, this document will discuss the benefits of implementing a contract performance management system prior to initiating other spend management projects. Additional whitepapers in this series will focus on three areas of procurement – spend centralization, outsourcing, and globalization – and how contract performance management systems, when implemented first, will ensure and improve the resulting benefits of these initiatives.

Procurement Initiative	Contracts Enable:
Spend Management	<ul style="list-style-type: none">• Complete visibility into enterprise spend• A better baseline for sourcing activities• More accurate spend classification
Spend Centralization	<ul style="list-style-type: none">• A true picture of centralization opportunities• The ability to leverage centralized volumes• Instant control of centralized spend
Outsourcing	<ul style="list-style-type: none">• Complete visibility into outsourcing relationships• Identification of outsourcing opportunities• Ease of transition to outsourced providers
Globalization	<ul style="list-style-type: none">• Control over global agreements• Centralization of enterprise spend• Identification of opportunities for Low Cost Country Sourcing

Companies that do not implement contract performance management systems prior to initiating projects in these areas will lack the proper foundation to achieve their desired goals and effectively control costs throughout the life of the negotiated agreements.

Introduction: Your Contracts are the Foundation for All Spend Management Activities

Spend management is an objective on every procurement professionals' desk and can encompass any initiative designed to leverage and act upon spend data. Spend management includes, among other things, spend analysis and opportunity identification, supplier rationalization, maverick spend reduction, and strategic sourcing.

Any step taken to establish or maintain a spend management initiative will involve understanding, analyzing and managing contracts with your suppliers, whether a consultant sifts through them manually or they are consolidated into a spreadsheet. Contracts provide insight into a supply base, define the relationship with suppliers, act as the basis for nearly all procurement transactions, and maintain fundamental information related to each transaction.

This paper discusses why gaining insight into and control of your contracts is the starting point and the critical success factor for any spend management initiative. It details the benefits to be received by investing in contract performance management before spending money on expensive consultants or more e-procurement software, the benefits you will receive from contract performance management, and the pitfalls of ignoring the role of contracts in spend management projects.

The cornerstone of any spend management initiative, be it new or an ongoing effort, is good, reliable data on suppliers, expected and actual spend, and spend categorization. Transaction data alone does not give a complete picture of purchases, suppliers or business trends. **Contract data, however, with its complete view of the relationship and "what should have been," completes the picture and helps you make the right decisions based upon complete information.**

Any good spend management program requires tight control over both buyers and suppliers to realize negotiated savings, drive supplier compliance and avoid maverick spend. And, this control must be available both before and after the process, to ensure that the new found savings are fully realized. e-Procurement and supplier relationship management systems cannot do this alone. **Until complete control is gained over contracts and the information that they contain, it will be impossible to have complete control over purchasing costs and purchasing behavior and set the stage for better spend analysis in the future.**

This paper will discuss in detail how contract data and contract performance management processes impact the success of the following four spend management initiatives:

- ▶ Spend analysis and opportunity identification
- ▶ Supplier rationalization
- ▶ Maverick spend reduction
- ▶ Strategic sourcing

Contracts: The Critical Foundation of Your Supplier Relationships

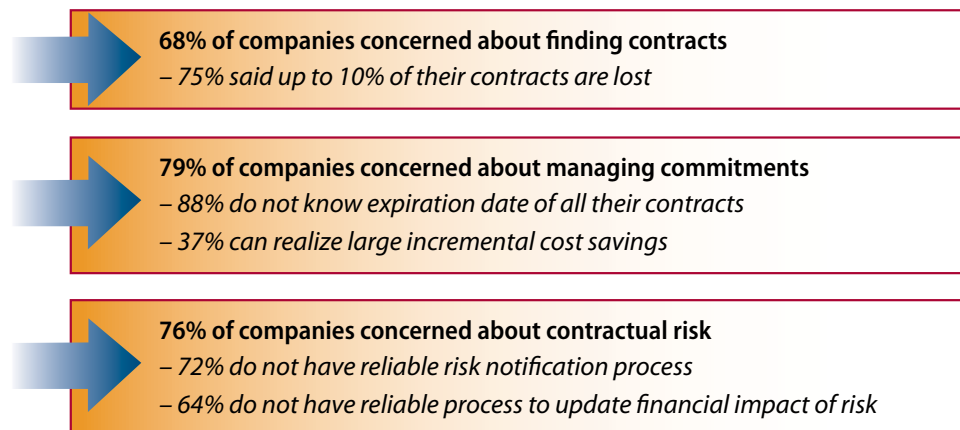
A rapidly deployed contract performance management system will help a company take control over all of their contracts and procurement spend. By creating a centralized, searchable, reportable repository of all active contracts, procurement groups quickly can build the right foundation for all other procurement initiatives. Companies will gain visibility into their contracts, allowing them to identify cost savings opportunities, enforce compliance and manage risk.

What's in a contract? Back office systems, such as ERP, Accounts Payable, and Supplier Relationship Management only capture the basics of a transaction, such as price, quantity, delivery dates, etc. **Without a contract performance management system, companies fail to capture, consolidate, and leverage the deeper data contained within a contract, such as:**

- ▶ Complex pricing matrices
- ▶ Service Level Agreements
- ▶ Quality requirements
- ▶ Milestones and milestone-based payments
- ▶ Specifications
- ▶ Supplier KPIs and metrics
- ▶ Insurance requirements
- ▶ Shipping and delivery requirements
- ▶ Reporting schedules and requirements
- ▶ Termination issues
- ▶ Disclosure requirements
- ▶ Safety, health, environmental requirements

Having control over and visibility into this information leaves companies better equipped to succeed in all other strategic purchasing initiatives. However, most companies do not even have a fundamental control over their contracts, as shown in Figure 1. If the ability to even locate contracts is lacking, then any procurement initiative will leave money on the table.

Figure 1: Most companies lack even fundamental control of their contracts. Source: Nextance/IACCM/NCMA Benchmarking Survey, Journal of Contract Management, April, 2003



Bad Data – How Much is it Costing You?

According to a recent study by consultant A.T. Kearney, incorrect data is costing companies billions each year in excess costs and lost productivity:

- ▶ Companies lose approximately \$40 billion, or 3.5% of sales, each year because of supply chain information inefficiencies.
- ▶ Nearly 30% of catalog item data is incorrect.
- ▶ Correcting catalog data errors costs between \$60 and \$80 each.
- ▶ Companies spend an average of 25 minutes per SKU per year manually cleansing bad information.
- ▶ Nearly 60% of all invoices generated have errors; each invoice error costs \$40 to \$400 to reconcile.

(Source: "Synchronization: A Cure for Bad Data," Supply Chain Management Review, May 1, 2005)

Companies successfully deploying contract performance management achieve:

- ▶ A centralized repository of procurement contracts and related documents
- ▶ Visibility into contracts, contractual performance and compliance, and supplier performance
- ▶ Control and proactive management of contractual compliance, both from internal processes and external supplier perspectives
- ▶ Cost reductions by providing visibility into savings leakage and unnecessary costs and penalties, and missed rebates and discounts
- ▶ Reduction of contract cycle times

Companies that do not implement contract performance management systems will fall behind from a lack of precision in their supplier relationships and a lack of control over costs, unable to compete on price and unable to win and retain customers. Worse yet, they will continue to throw money away on expensive strategic sourcing consultants and additional e-procurement software, while their contracts remain uncontrolled.

Contracts Are Integral to Spend Analysis

The first step in any spend management activity, the spend analysis and opportunity identification, is usually a manual, labor-intensive undertaking that frequently begins with a data dump from an ERP or Accounts Payable system, rarely includes 100% of the spend data, and requires a lot of guesswork to complete. According to A.T. Kearney, however, utilizing bad data costs companies the equivalent of 3.5% of sales each year (see sidebar).

Contract performance management can improve spend analysis in two ways:

- 1) For the initial analysis, you will have instant access to all the contracts and terms necessary to create a complete picture of your suppliers and spend.
- 2) For ongoing analysis, you can leverage contract performance management to improve the integrity of your data by reconciling invoices against the contract, ensuring accurate spend categorizations, and enforcing purchasing rules.

Improving the initial analysis. Regardless of the scope of your spend management initiative, whether spend analysis or an enterprise-wide e-procurement rollout, good data is the key to success. Multi-million dollar decisions are based on this data, so companies must do their best to ensure they are looking at all of the right data. Transaction data alone does not provide a complete picture of purchases, suppliers or business trends. However, the contract completes that picture and is required to answer such questions as:

- ▶ Did we receive the correct, negotiated pricing, discounts and rebates?
- ▶ Do the invoiced categorizations match the contract categorizations?
- ▶ Were items improperly classified in order to avoid detection of spend?
- ▶ Do the contract values match the actual spend values?

Contracts Are Integral to Supplier Rationalization

If there are hundreds of unmanaged suppliers in a particular category, then the chances of overspend, receiving incorrect pricing and inadequate service levels is higher. Supplier rationalization is a proven method of reducing the costs and complexities of procurement. However, unless companies begin with accurate and complete data, and have a method to enforce contract compliance at the end, any supplier rationalization initiative is incomplete.

Each day that passes without control over contractual agreements adds to the losses and missed savings opportunities. According to the Journal of Contract Management, 71% of companies cannot locate 10% of their contracts ("Contract Management Is More out of Control Than You Think," April, 2003). If contracts are missing, then suppliers cannot possibly be held to their commitments, whether pricing, performance, quality or service levels. The net result is that money will continue to be lost until complete control over contracts, and the information that they contain, is achieved.

Contract performance management can improve supplier rationalization in two ways:

- 1) Provide visibility into and analysis of your entire contracted supply base and the terms you have with each supplier
- 2) Enable ongoing supplier commitment and compliance management

Visibility into your contracted supply base. By implementing a contract performance management solution prior to a supplier rationalization project, companies can have access to all of the contract data with all of the contracted suppliers. Without this full visibility, the benefits of supplier rationalization will be reduced, and may not be fully realized. Since the language within the contract defines the relationships with the supplier, the contract will provide additional details into whether an agreement with a particular supplier is more attractive than that with another supplier.

The rationalization must be more than just reducing a category's number of suppliers from 100 to 15. It must examine the specific elements of each relationship, then leverage that information in order to ensure that new agreements contain all of the components necessary to create a well-structured relationship going forward.

Companies must also be sure that they have full visibility into the products and services provided by all of their suppliers, both in a specific category and across the entire company. Items may be hidden with suppliers in other categories and lost in agreements with marginal or low-profile suppliers. Or, items may be listed on contracts, but never actually purchased. The foremost benefit here is the ability to leverage 100% of spend and 100% of agreement detail during the rationalization and renegotiation of the category.

Ongoing management of suppliers and supplier compliance. Additionally, as with the other spend management areas, a contract performance management solution is necessary in order to fully enforce the newly rationalized agreements. Again, why spend the time to reduce the supply base and negotiate new agreements only to implement an unenforceable, disconnected contract? Will you have the mechanisms in place to prevent mavericks from purchasing from the same old suppliers?

Contracts Are Integral to Maverick Spend Reduction

Off-contract, or “maverick,” spend is a term often-used when discussing procurement’s potential cost reduction opportunities. Many software providers claim to have the solution to eliminate maverick spend, and many e-procurement and e-catalog systems have been purchased as the silver bullet for maverick spend. However, it is clear that maverick spend is simply an issue of visibility into and enforcement of contracts. If all contracts are totally enforceable, then there will be zero maverick spend.

According to Aberdeen Group, more than 80% of business-to-business transactions are governed by a contract (“The CPO’s Agenda,” March, 2005). The remaining 20% is the target for bringing under procurement’s control and eliminating maverick spend. The cost impact of maverick spend reduction is clear. Any spend brought under the control of procurement and moved to a contractual agreement results in a savings of 5 – 20%, by leveraging procurement’s work in sourcing and negotiating the contract. (And this doesn’t even include the potential compliance, risk and insurance liabilities of off-contract purchases.)

The root of maverick spend is usually either ease-of-purchase or lack of the desired product or service. For example, off-contract purchases of safety equipment may happen because the contracted vendor is across town, while the local home improvement store is across the street. Similarly, off-contract spend for event management services may be caused by the lack of required skills or experience of the contracted service provider.

Contract Performance Management can improve maverick spend initiatives in two ways:

- 1) Provide visibility into current contractual relationships and gaps needed to be filled
- 2) Providing easy access to contracts and contracted items, and contract data to enforce compliance

Visibility into your contracted supply base. Contract visibility is the precursor to an accurate assessment of what is covered by current contracts and what needs to be brought onto a contractual agreement. Having the ability to compare contracts with what is actually purchased is the key to determine the when, where and why of maverick spend, and gives purchasing the ability to quickly target the high-impact opportunities for cost reductions.

Enforce compliance. The ability to enforce contractual compliance internally is the sole solution to maverick spend. If a contract exists for a widget, then employees must be prevented from purchasing the widget from any source other than that which is specified in the contract. By centralizing contracts in a single location, purchasing can more easily identify areas of non-compliance and work to enforce contracts. Furthermore, contract data can be leveraged upstream in the purchasing process, denying off-contract purchase requests before they are ever executed.

A contract performance management system becomes, therefore, the reference point for all purchases, and allows instant identification of maverick spend. Everyone knows that if the item or supplier is not contracted, then it is off-contract spend. However, now purchasing has a single source of truth with which to compare, validate, reconcile and possibly deny purchase requests.

Contracts Are Integral to Strategic Sourcing

Why implement a strategic sourcing program just to realize only a portion of the savings after implementation?

An effective contract performance management system can ensure compliance, both internal and external, with the terms that procurement has spent so many months achieving.

The contract is the result of the strategic sourcing process, and serves as the foundation for the supplier relationship. By giving visibility into and enforcing contractual compliance, purchasing can reduce or eliminate savings leakage from the point of negotiation throughout the life of the contract.

Most strategic sourcing methodologies include a supplier management step after contract implementation. This step is designed to ensure the realization of cost-savings goals and track supplier performance. However, since strategic sourcing initiatives concentrate on process savings as much as, or more than, negotiated savings, the supplier management step runs the risk of turning into a process management exercise.

Over the life of the relationship, teams from procurement, the business units and the supplier are regularly engaged in the management of the process. However, after creating and negotiating a well-defined contractual agreement and the associated SLAs, SOWs, and other related documents, the actual terms of the contract become less important than the meetings and the reports themselves. Companies focus on achieving process improvement goals and tend to push contractual compliance to a lower priority.

This then places a strategically sourced contract in the same predicament as a standard contract, with little or no control over the supplier's compliance, and little or no ability to ensure that the negotiated terms are adhered to over the life of the agreement. However, the time and effort expended during the strategic sourcing process are significantly more involved than with a standard contract. Additionally, sourcing consultants are usually involved in the entire process, adding significant additional costs to procurement.

Data Analysis is Difficult Enough Without Having to Worry About Data Integrity

A survey of 400 purchasing managers conducted by Capital Consulting & Management, Inc. found the following:

- ▶ 75% of purchasing groups rely “moderately or extensively” on desktop spreadsheets and databases.
- ▶ 50% rely on their Information Technology (IT) departments to access corporate systems and build customized reports.
- ▶ 30% of respondents cite a lack of analytical tools to identify improvement opportunities and lack of time to devote to spend analysis activities as “significant or major” challenges.
- ▶ Only about 20% of companies report using dedicated spend analysis tools and software today.

(Source: Visibility into Enterprise Spending Most Critical to Improving Strategic Sourcing, as seen on www.cmsiservices.com)

The result is a new contract, potentially with a new supplier or suppliers, a lower price and a new, lower-cost process. However, the new contract required a much higher amount of resources – time, money, and employees – to execute. And, the administration of that relationship is then relegated to the same, manual contract management process as usual, with a high potential for savings leakage and non-compliance.

With a contract performance management system in place, purchasing can be confident that the cost reductions and internal and external compliance will be enforced. Procurement will also have the visibility to ensure that the savings reported to executives will actually be realized. Failing to implement a contract performance management solution prior to a strategic sourcing initiative leaves unmet the ability to ensure that the negotiated cost savings are realized throughout the life of the contract.

Improving ongoing data integrity for better future analysis

While definitely valuable and somewhat enlightening, spend management does nothing to resolve the root of the problem before the transactions are made: categorization, management and enforcement of services, products and purchases at the contractual level. Most companies are relying on inefficient, unrepeatable processes for collecting, consolidating, cleansing and analyzing spend data after the transaction, instead of fixing the problem before the transaction, at the contract.

Without the spend analysis moving to the beginning of the procurement cycle, when the contract is first negotiated and implemented, any spend analysis initiative is outdated the second the data is downloaded. While useful for the current round of strategic sourcing or e-auctions, the data is useless for the next round and the time-intensive, subjective spend analysis cycle must begin anew.

With contract performance management, a mechanism is available to enforce spend controls at the beginning of the relationship, when the contract is signed. The spend analysis will be completely accurate, with spend categorized as it was intended to be when the product or service was sourced. For example, a consultant contracted to provide marketing support will be categorized as “professional services,” not hidden by the marketing department as “temporary labor.”

Data collection is another pitfall in the spend analysis process. For that, procurement must go to the ERP and accounts payable systems that house the transactional data. But, how many systems are present?

Many large companies have packaged or home-grown systems that are unique to a particular division or business unit, and multiple, overlapping systems in rival departments. Add to that the additional systems brought in during mergers and acquisitions and the number grows surprisingly fast.

This then leads to data inconsistencies and the irregularities around business unit identifiers, commodity category names, categorization of individual items, and other categorization schemas. These inconsistencies further hamper any spend analysis exercise, requiring multiple rounds of manual cleansing, setting up the next pitfall: manual, spreadsheet-based analysis with data dumps from back-office systems.

With the intense manual effort required for useful spend analysis, it becomes apparent that the real data integrity problems arise during the manual cleansing and categorization of the transactional line items. Add to that the assignment of spend to specific departments, divisions, cost centers, and the multitude of random items requiring “judgment calls” for spend categorization, and it’s a wonder that companies put any faith into their spend analysis at all.

By instilling enforceable, measurable processes at the contract, companies can significantly reduce, or even eliminate, these data integrity issues. Spend can be classified during the contract negotiation and implementation stages, before any transactions occur. Integrating the contract management application with the transactional system then automates the task of reconciling invoices and transactions against the contract, allowing for complete accuracy in spend categorization.

Contract Performance Management – A Low Risk, High ROI Initiative

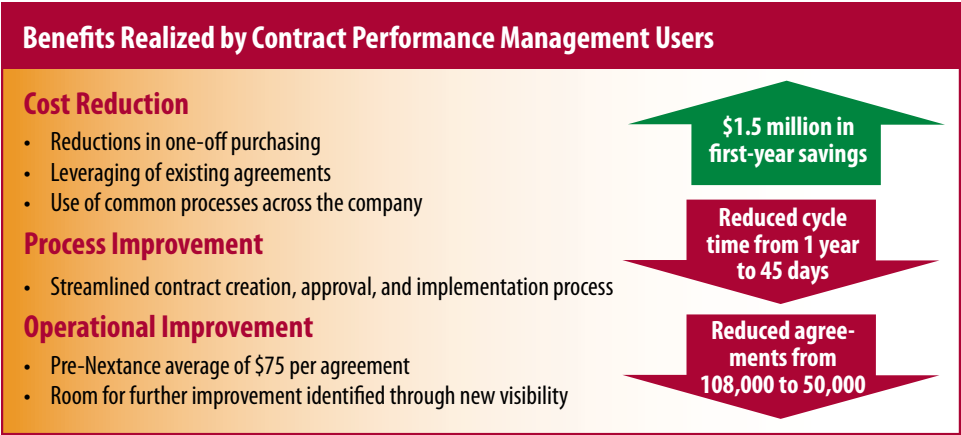
The concept of consolidating all contracts into a central location will, by itself, offer immediate value. Outside of the additional benefits to spend management initiatives, just the process and productivity savings from the ability to find any contract at any time is reason enough to implement a contract performance management system today.

Contract performance management solutions can provide immediate benefits based upon their ability to provide the following:

- ▶ Instant visibility into 100% of contracts and contract data
- ▶ Fast and accurate spend analysis and categorization
- ▶ Immediate identification of off-contract spend
- ▶ Full realization of cost savings achievements
- ▶ Increased procurement productivity and efficiency

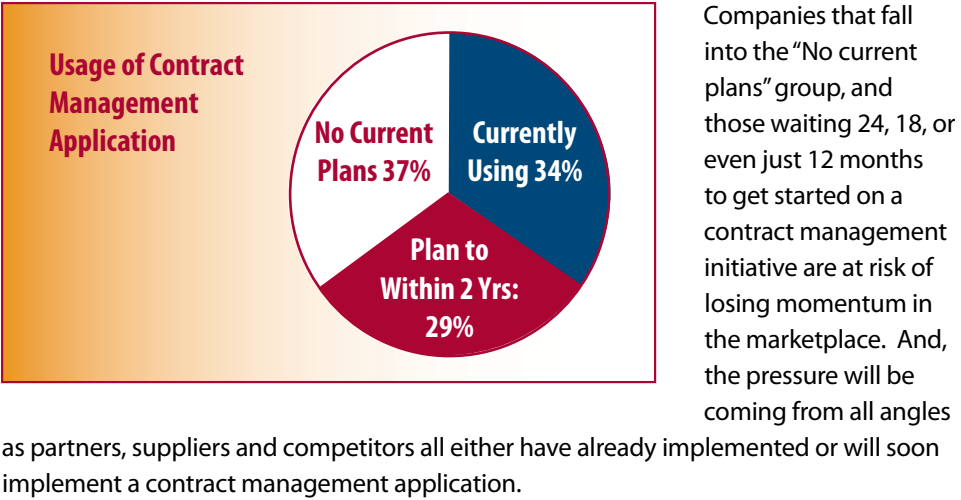
The hard dollar savings associated with a contract performance management solution are significant and can be achieved quickly, in less than one year. Figure 2 provides examples of the benefits and returns Nextance customers have achieved with their contract performance management implementations.

Figure 2: Nextance customers have realized significant, impactful savings in only a few months.



According to Aberdeen Group (“The CPO’s Agenda,” March, 2005), 34% of companies currently use some form of contract performance management application, and another 29% plan to implement one within the next 2 years (see Figure 3).

Figure 3: Utilization of contract management applications. Source: Aberdeen Group.



What to look for in a contract performance management system

The immediate benefits of a contract performance management system are clear. However, companies must ensure that the system that they choose can meet all of the necessary requirements. By choosing the wrong solution, many of the benefits outlined above will not be realized in an acceptable timeframe, and may never be fully realized.

The requirements of an effective contract management solution can be split into two areas: overall solution and functionality.

Overall Solution:

- ▶ **Quick, Transparent Time-to-Value.** A fast, well-defined implementation plan, including necessary services, with an expected delivery of the first benefits within 30 – 45 days.
- ▶ **Fast, Measurable ROI.** The total return on investment in the first year typically exceeds 200%.
- ▶ **Address Entire Contract Impact Zone.** Solution offers results in areas of contract control, cost reductions, compliance enforcement and risk mitigation.
- ▶ **Ability to Grow Your Solution Across Procurement and the Enterprise.** Solution offers a phased approach to implementing additional functionality to allow control over the full contract lifecycle as you progress from contract centralization to process control to external enablement to document creation and negotiation. Also the ability to expand utilization of the system to include the revenue and sales side of the business, should the company wish to expand contract performance management across the enterprise.
- ▶ **Understanding of Procurement.** Vendor has a firm grasp of the procurement process and the related needs, pains, and concerns of a procurement organization.

Functionality:

- ▶ **Centralized Repository.** The ability to capture and leverage both structured data (dates, prices, contacts, etc.) and unstructured language (terms, clauses, requirements, schedules, termination liabilities, etc.), as well as house attachments and related documents in an online, electronic library of all contractual agreements.
- ▶ **Reporting and Analysis Tools.** Instant, dynamic visibility into contracts. Uncover savings opportunities through full-text searches of contracts and attachments that are refreshed each time an analysis is requested. The option to integrate with transactional systems to offer a consolidated analysis of spend.

- ▶ **Proven Integrations.** The ability to incorporate data from disparate invoicing, accounts payable and other back-office systems, as well as the ability to present both contractual and transactional data together during analyses.
- ▶ **Business Rules.** Approval routing of pre-filed contracts, in addition to the ability to structure and schedule proactive alerts to milestones, payments due and terminations according to established business practices.

Conclusion

Contract performance management can offer immediate benefits and has the ability to increase the effectiveness of all spend management initiatives. By implementing a contract performance management solution prior to embarking on other initiatives, purchasing can have complete visibility into contracts necessary to build the foundation for determining purchasing strategy and defining purchasing decisions.

This foundation will then provide the basis for fast and accurate spend analysis and categorization, and allow immediate identification of off-contract spend. Furthermore, a successful implementation will allow full realization of cost savings achievements, and lead to increased procurement productivity and efficiency.

By using the requirements of an effective contract management solution listed above, companies can ensure a quick implementation, fast ROI and time-to-value, and full realization of the opportunities currently hidden in paper and scattered throughout the company.

About the Author

Jason Rushin, Senior Product Marketing Manager, Nextance

Jason Rushin brings over 10 years of experience in sourcing and technology as Nextance's senior manager of product marketing. Prior to Nextance, Jason was a consulting manager at Accenture, responsible for strategic sourcing teams at a major energy company with \$1.6B in total spend. He has also developed supply chain opportunities for other large enterprises, sourcing nearly one-half billion dollars in spend. Further, Jason has managed multiple strategic sourcing and e-procurement initiatives as well as led a Transportation sourcing segment at FreeMarkets (now Ariba). At Siebel Systems, he launched new products in key industry sectors, while also leading a change management team to improve company sales performance. Jason earned his BS from University of Pittsburgh and his MBA from Carnegie Mellon University.



1600 Seaport Blvd. 4th Floor
Redwood City, CA 94063

P 650.716.2400

F 650.716.2399

www.nextance.com

E-mail Nextance at:
info@nextance.com

About Nextance

Nextance is setting the standard for Contract Management ("CM") solutions with our Nextance Intelligent Enterprise™ software and best-practices professional services. With more Global 2000 customers than any other CM provider and strategic partnerships with global market leaders, Nextance is helping companies to better run their business by effectively controlling and actively managing their contractual relationships. Countrywide, Covenant Health, Eastman Chemical Company, Fireman's Fund, Genzyme Corporation, Sasol, Sun Microsystems, and others are using Nextance software every day to tap into the value that is written into each of their thousands of revenue, procurement, Intellectual Property licensing, and partners agreements. Nextance is based in Redwood City, CA, and is privately held.

For additional information, visit: www.nextance.com.