WHITE PAPER

Contract Performance Management Now: The Foundation for all Procurement Initiatives

Part IV: Globalization

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Series Introduction

This whitepaper, focusing on globalization, is the last in a four-part series designed to explain why contract performance management is the critical first step for any broad procurement initiative.

We have found that companies that do not implement contract performance management systems prior to initiating projects in these areas will have two significant challenges: 1) They will lack the proper foundation to achieve their desired goals, and 2) they be not be able to effectively control costs and effectively manage performance throughout the life of the agreements that are direct outcomes of these initiatives.

The chart below identifies the specific procurement initiatives addressed by this white paper series and the importance that contracts play for each.

Contract Management Now: White Paper Series	
Procurement Initiative	**Contracts Enable:**
Part 1: **Spend Management**	• Complete visibility into enterprise spend • A better baseline for sourcing activities • More accurate spend classification
Part 2: **Spend Centralization**	• A true picture of centralization opportunities • The ability to leverage centralized volumes • Instant control of centralized spend
Part 3: **Outsourcing**	• Complete visibility into outsourcing relationships • Identification of outsourcing opportunities • Smooth transition to outsourced providers
Part 4: **Globalization**	• Control over global agreements • Centralization of worldwide enterprise spend • Identification of opportunities for Low Cost Country Sourcing

Please visit the Nextance website at www.nextance.com to download the first three white papers in this series

Introduction

Globalization is fast becoming a necessary component of doing business. The world is shrinking, new markets – both supply and customer – are popping up on a regular basis, and successful companies are participants in the global economy (see Figure 1). Globalization offers many benefits, such as:

- Access to more customers
- More sourcing options, which increases competition and lowers costs
- Allocation of risk across different regions
- Ability to meet new and changing product or customer needs
- Support the increasingly global presence of an organization
- Faster response to a global customer base

From a procurement perspective, the term "globalization" has dual meanings. On one hand, more and more companies are becoming global entities. Through mergers, acquisitions and simple organic growth, the global reach of a company naturally grows over time. Having facilities in multiple countries is standard operating procedure for most mid-size and larger companies. This then forces procurement organizations to locally source office space, indirect materials, services, energy, and potentially, raw materials. It also breeds stand-alone procurement outposts that follow their own processes and fall out of corporate-wide procurement initiatives.

Figure 1: A recent survey of over 170 US-based companies by Aberdeen Group verifies that "going global" isn't just a fad, it's a standard practice and it's growing.

On the other hand, companies of all sizes, whether with limited locations or a worldwide presence, are globalizing their supply chain. The buzz phrase "Low-Cost Country Sourcing," or LCCS, is used to describe this process, where companies look to areas such as China, India and Eastern Europe to source raw materials, services, manufacturing, and product components at the lowest possible cost. This aspect of globalization is present regardless of the end product or end user – it's purely a way to reduce costs and increase competitiveness. However, this increases the complexity of supply relationships, and calls attention to issues such as currency risks, export laws, and customs issues.

Regardless of whether globalization is viewed of in terms of company presence or supply location, to be successful in a global economy at the most fundamental level, organizations need to begin by gaining control of their contracts and leveraging that control to reduce costs, reduce risks, and better manage their supply chain. Procurement organizations must:

- Standardize their contracts in order to manage and reduce areas of risk and liability, and have a mechanism for ensuring consistency across the globe.
- Have visibility into worldwide contracts and be able to mine contractual data in order to capitalize on volume leverage and supplier consolidation initiatives.
- Control the global contracting process in order to enforce compliance and ensure full adoption of contracting best practices.

Realizing Globalization Benefits Depends on the Contract

Smart companies are competing globally, both for new customers and lower cost suppliers. Those who do not expand run the risk of declining revenues, profits, and market share. To understand why contracts are so critical to the success of a global organization, it is important to understand the goals of globalization.

Purchasing Magazine ("Nine tips for low-cost country sourcing," September 1, 2005), quotes a recent Aberdeen Group study that found that purchasing from low-cost countries can realize an average cost savings of 10-35 percent. The article also references a study by Hackett Group that found global sourcing to lead to part price savings of about 19 percent.

Aside from simple price reductions, Aberdeen Group also found that LCCS can lead to average inventory cost reductions of 12 percent and average logistics cost reductions of over 10 percent. Combine these three areas of savings and LCCS becomes an extremely attractive and proven method for reducing costs. Further add in other benefits, such as sourcing closer to end markets, reaching "local content" requirements, and gaining access to outside innovations, and it's a wonder companies can survive without a global supply chain.

Establishing presence, whether by sourcing from a low-cost country or by opening facilities in a particular region, also contributes to global reach objectives. Lead times within regions can be shortened dramatically by sourcing locally, speeding time-to-market. Global sourcing and manufacturing can also help to fulfill local content requirements, opening opportunities that were unavailable before a presence was established.

However, without a solid contracting foundation, these benefits cannot be fully attained, and a globalization effort will never reach its full potential. Cost savings, for example, cannot be accurately tracked unless the contracts are effectively managed and controlled, searchable and reportable, and integrated into ERP, SCM, eProcurement, and other enterprise systems (see example below). Where local content requirements exist, auditable tracking and measurement of contracts and contract values must be present. Furthermore, there must be an understanding of current-state costs against which to measure the future-state global costs in order to accurately measure and achieve reduction targets.

For example, if the goal is 20 percent cost savings on a particular supply category, how will tracking towards that goal be determined? First, you need to have complete visibility into your current costs. Not invoiced prices, not estimates of logistics costs, but the costs on the contract to which suppliers are held. And not just pricing information, but shipping rates, packaging specifications, taxes, service levels and other critical information that resides only in the contract and comprises the total cost of supply. Simply comparing prices will surely show significant savings, but only by comparing the total cost of purchasing an item will a true savings ever be determined. This data can only be found in the contract.

Considering only the impact to costs, contracts must be constantly managed and tracked to ensure that negotiated terms are honored and goals are being reached. Invoices must be reconciled against the contract to ensure proper pricing, discounts and volumes – all aspects of standard contract management.

However, enter the globalized aspects and further assurances are required, adding significant risk and additional workload to a procurement staff. Are the correct exchange rates being applied? Are the correct tariffs being paid? What is the impact of the taxes and duties? Is the supplier using the correct shipping partner and method? Are the shipping lead times being met and not adversely impacting production? These outcomes of globalization, whether from LCCS or simply extending a global reach, all rely on the contract for reconciliation.

Global Procurement Optimization Begins at the Contract

From an organizational perspective, global procurement groups have many opportunities for spend reductions, process improvement, and supplier consolidation. Regardless of the extent of the global reach, from LCCS to regional sales offices to manufacturing and assembly plants, when an organization has a global presence, many opportunities exist for procurement to leverage the global agreements to reduce costs, reduce risks, and enforce compliance.

However, realization of these benefits begins at the contract. To reduce spend, contracts must be correctly categorized and easily accessible in order to create a baseline and identify opportunities across suppliers. In order to improve processes, there must be a mechanism to manage, measure and enforce compliance back to the contract. In order to consolidate suppliers, visibility into all current spend, suppliers and contracts is required.

Leveraging global spend is arguably the easiest benefit to achieve, particularly if a company has facilities spread across multiple locations. For example, just as a company would realize savings by consolidating desktop computer spend for US locations, a company can achieve similar results by consolidating desktop computer spend worldwide.

However, that requires visibility into global agreements. At most companies, contracts are stored as paper documents located in disparate file cabinets. At progressive companies, the files are electronic, but located in disparate hard drives and network drives, with the local modus operandi dictating the storage scheme. Without complete visibility into contracts across the global organization, significant savings cannot be achieved.

A global procurement group can also easily benefit from standardizing processes to ensure compliance and reduce risk. To realize the benefits of global spend leverage, employees must purchase off of the consolidated contracts. To reduce the risk creation of a global procurement group, companies must enforce contracting processes, standardize contract language, and enable template-driven contract creation.

The benefits of globalization are largely profit-driven – lower cost supply, reduced logistics costs, increased revenue opportunities – and the price component is only a portion of the total cost. To be successful, there must be complete visibility into contracts in order to understand the full impact of all costs, and accurately measure tracking towards goals across all cost components. For most companies that have paper contracts stored locally and providing no visibility, accurate savings measurement will be nearly impossible.

Non-Price Components of Global Contracts

Obviously, procurement's primary role is to cut costs, and globalization and LCCS are proven methods for doing so (see Figure 2). However, the non-price costs of sourcing globally can drag down the price savings if companies are not careful. Creating new agreements with a global supply chain requires an entirely new set of skills that a procurement organization most likely does not have.

Figure 2: Consider the impact of poor contract management on globalization.

> "Preliminary results from a Hackett Group study on successful global sourcing show that companies save approximately 19% on parts price savings alone. Add expenses, such as shipping costs, duties, tariffs, IPO operations, inventory and other charges, and the savings dwindles to less than 17%—an important 2% difference when plotting financial targets and presenting results to the CFO."
>
> **"Nine tips for low-cost country sourcing"**
> Wayne Forrest
> Purchasing magazine, 09/01/2005

Language is the most obvious consideration. Normal, day-to-day communication is a hurdle, but interpreters can mitigate that issue fairly quickly. But what about the actual language of the contract itself? Will it be written in English or must it be written in the local language? How will standard clauses be interpreted by another country's legal system?

Sourcing goods and services in foreign countries requires consideration of many issues that are unrelated to sourcing strictly in the US. From the complexities of tariffs and trade agreements to local labor laws and insurance requirements, it is necessary to have the ability to quickly identify areas of risk and impact across many contracts, locations and jurisdictions.

Currency exchange rates and risks are a good example. More often than not, the contract will be negotiated in the local currency. Since exchange rates fluctuate frequently, it is obvious that this consideration be part of the contract. Specifying when payment is to be made, when the exchange rate is to be set, and from what source the exchange rate is acquired are important contractual considerations.

Managing currency exchange risk is then an ongoing process. If there is a political event in a country that causes a significant change in exchange rates, Procurement must be able to quickly measure the impact by determining how many contracts are written with suppliers in that nation, the value of those contracts, and the financial impact of those agreements. This is possible only by having a centralized repository of contracts that offers complete visibility and robust reporting and searching capabilities.

Significant non-financial risk considerations are present in foreign contracts as well. Copyrights and patents are frequently violated in certain markets. If infringement occurs, Procurement and Legal must be able to determine the affected agreements, governing law, jurisdiction, and the course of action. Again, without complete visibility into standardized agreements, this is nearly impossible and definitely time consuming. Sifting through paper agreements scattered across an organization can take weeks or months, instead of minutes when using a contract performance management system.

Figure 3: Global Contracting Considerations.

Global Contracting Considerations		
• Tariffs	• Politics	• Communications
• Duties	• Local Customs	• Labor Laws
• Taxes	• Security	• Copyrights
• Logistics	• Terrorism	• IP Ownership
• Customs	• Language Barriers	• Jurisdiction
• Exchange Rates	• Quality	• Patents
• Treaties	• Lead Times	• Phraseology
• Antitrust	• Service Levels	• Inspections
• Governing Law	• Corruption	• Training
• Regulations	• Infrastructure	• Local Content

The non-price components of global agreements go on and on, from security issues to quality programs to labor law compliance to service level assurance (see Figure 3). All of these issues are addressed in the contract, and require contracts to be properly written with language acceptable and defensible to two legal systems.

Leveraging a contract performance management system that offers template-driven contract creation to ensure use of pre-approved language is critical to ensuring contract compliance. An enforceable process of contract approvals and automated routing and notification will help to avoid implementation of non-standard contracts. And a central repository of agreements provides complete visibility to assist with identifying and reducing contractual risk across a global organization.

Leveraging a Contract Performance Management System

It has been shown above that the information contained within the contract is a critical contributor to the success of a global organization. Therefore, a contract performance management system's standardization, visibility and control are obvious necessities. However, when selecting a solution to support globalization efforts, many other key contract-centric issues must be considered, including:

- The ability to support multiple currencies for items and contract components, such as liability levels and insurance requirements.
- The ability to control the end-to-end contracting process, from initiation, through negotiation, and on through transaction management.

- The ability to support multiple languages, particularly in the contract authoring process, providing pre-approved, country-specific templates and fall-back clauses.
- The ability to easily extend contract templates by allowing local end-users to add new fields at the local level.
- The ability to define process workflows by the supplier's location or governing country, then routing approvals based upon expertise.

Not all contract performance management systems are created equal, and not all are designed to scale to a global level. A global supply chain adds layers of complexity that must be addressed, managed, and tracked in order to be successful. Contracts contain the bulk of this complexity, and a contract performance management system will reduce the risk and increase the chances for success.

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 to any organization, not just a global one. Outside of the obvious benefits to support initiatives through global visibility, the process and productivity enhancements from the ability to find any contract at any time is reason enough to implement a contract performance management system today.

Benefits Realized by Contract Performance Management Users

Cost Reductions

- Reductions in one-off purchasing
- Leveraging of existing agreements
- Common processes across the company

Process Improvement

- Streamlined contract creation, approval, and implementation process

Operational Improvement

- Pre-Nextance average of $75 per agreement
- Room for further improvement identified via new visibility

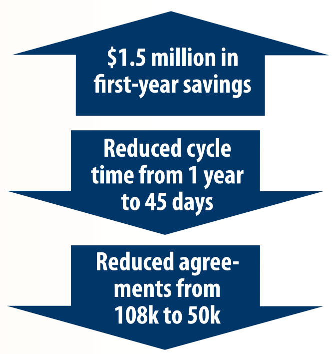


Figure 4: Nextance customers have realized significant, impactful savings in only a few months.

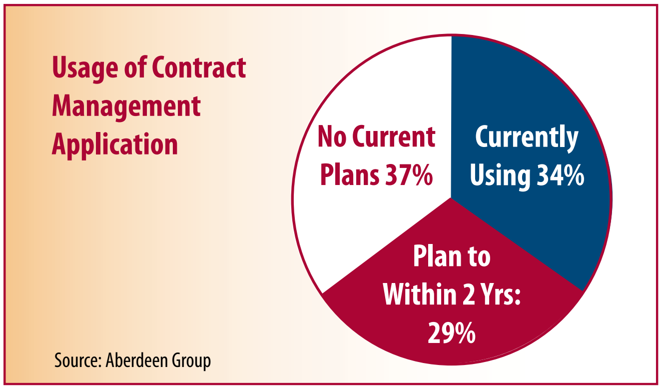
Contract performance management solutions can provide immediate benefits based upon their ability to provide the following:

- Instant visibility into 100% of global contracts, contract data, compliance, and supplier performance, regardless of the supplier's country
- Control and proactive management of contractual compliance, both from internal processes and external supplier perspectives, allowing more control over global relationships

- Cost reduction opportunities from consolidation, reduction of unnecessary logistical costs, and assurance of supply chain continuity, increasing the success of globalization
- Increased productivity and efficiency through the reduction of contract cycle times, allowing for faster realization of globalization or LCCS benefits

The hard dollar savings associated with a contract performance management solution are significant and can be achieved quickly, in less than one year, allowing companies to then focus efforts on other initiatives, such as outsourcing. Figure 4 provides examples of the benefits and returns Nextance customers have achieved with their contract performance management implementations.

Figure 5: Utilization of contract management applications.



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 5).

Companies that fall into the "No current plans" group, and those waiting 24, 18, or even just 12 months to get started on a contract management initiative are at risk of losing momentum in the marketplace. And, the pressure will be coming from all angles as partners, suppliers and competitors all either have implemented already or will soon implement a contract management application. Plus, global effectiveness may be hampered by the inability to quickly locate key contracts and accurately determine the effect of contracts on key initiatives.

What to Look For in a Contract Performance Management System

The immediate benefits of a contract performance management system are clear, and the benefits of implementing CPM for a global organization have been demonstrated. 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 realized within 1 year can reasonably exceed 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, or from region to region over time. 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 alone can offer immediate benefits to any procurement organization. However, CPM can greatly benefit global organizations by providing visibility across the globe, quickly identifying risks before they become liabilities, easing the impact of globalization issues, and ensuring promised cost reductions are realized. By implementing a contract performance management solution prior to facilitating a global organization, procurement can have complete visibility into contracts necessary to build the foundation for determining a global strategy, and creating a platform for supporting global initiatives as they arise. Furthermore, a CPM system will allow faster realization of LCCS achievements through increased productivity and efficiency, and a quicker time-to-value.

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, and can realize more successful global success and global relationships.

About the Author

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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.

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About Nextance

Nextance is setting the standard for Contract Performance Management (CPM) solutions with innovative software and best-practices professional services. With more Global 2000 customers than any other CPM 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**.