

# WHITE PAPER

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## **Contract Performance Management Now: The Foundation for all Procurement Initiatives**

*Part II: Spend Centralization*

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## Series Introduction

This whitepaper is the second in a four-part series designed to explain why Contract Performance Management (CPM) is the critical first step for any broad procurement initiative your organization might be undergoing or have prioritized.

With a focus on spend centralization, this paper presents the benefits of implementing a contract performance management system prior to initiating any spend or procurement centralization project. Two additional whitepapers will follow that will focus on Outsourcing and Globalization.

| Procurement Initiative          | Contracts Enable:   |
|---------------------------------|---|
| Part 1:<br>Spend Management     | <ul style="list-style-type: none"><li>• Complete visibility into enterprise spend</li><li>• A better baseline for sourcing activities</li><li>• More accurate spend classification</li></ul>                    |
| Part 2:<br>Spend Centralization | <ul style="list-style-type: none"><li>• A true picture of centralization opportunities</li><li>• The ability to leverage centralized volumes</li><li>• Instant control of centralized spend</li></ul>           |
| Part 3:<br>Outsourcing          | <ul style="list-style-type: none"><li>• Complete visibility into outsourcing relationships</li><li>• Identification of outsourcing opportunities</li><li>• Smooth transition to outsourced providers</li></ul>  |
| Part 4:<br>Globalization        | <ul style="list-style-type: none"><li>• Control over global agreements</li><li>• Centralization of worldwide enterprise spend</li><li>• Identification of opportunities for Low Cost Country Sourcing</li></ul> |

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.

## Pitfalls

“Before taking the journey down the procurement staffing highway [i.e. centralization] some discussion is needed on potential potholes one may encounter. Some of the more strategic pitfalls that may develop consist of:

- Silo mentality - putting unit objectives over corporate objectives.
- Corporate culture- each business organization involved may have its own beliefs on the way operations should function.
- Lack of vision - each of the procurement organizations may be more transactional than strategic.
- Trust - having the customers and purchasing professionals believe in a new idea or concept that can significantly impact their operations.
- Job security - some (all) of the purchasing professionals may feel that their jobs are in jeopardy.
- Geography - the remote locations of various procurement operations might work against team work and improved customer service.
- The +/- of existing procurement organizations - despite all the potential strategic benefits of a new organization, the existing dispersed organizations probably have contributed some good results in the past.”

Source: *Achieving World Class Purchasing Through Solving the Centralized vs. Decentralized Organizational Dilemma*  
Dr. Peter E. O'Reilly, C.P.M.  
ISM Services Group

## Introduction

It has been proven time and again that consolidating purchasing across the enterprise is an effective means for driving savings. In fact, Purchasing Magazine estimates that centralizing procurement can lead to 15-20% savings on purchased services and materials (“Centralize!,” February 2003). For a \$500 million company with \$200 million in annual spend, this would equate to up to \$40 million.

From aggregating spend in order to negotiate better prices with suppliers to exerting control over and compliance with purchasing practices to sharing supplier and process knowledge across the enterprise, procurement centralization can provide many opportunities for realizing cost savings and making processes more efficient. However, by first implementing a Contract Performance Management (CPM) system to gain control of your contracts, which define all procurement relationships, you can increase the effectiveness and success of any centralization initiative.

In today's profit- and regulation-driven business environment, CPOs and CFOs require immediate access and visibility into up-to-date purchasing data. This requirement leads directly to the need for contract visibility, without which executives cannot adequately fulfill their responsibilities.

This paper discusses why gaining insight into and control of your contracts is an ideal starting point and a critical success factor for any spend centralization initiative. It addresses the benefits you will receive from contract performance management, the pitfalls of ignoring the role of contracts in centralization projects, and how investing in a CPM solution before embarking on these initiatives will help to define your centralization efforts.

## The Promise of Centralization

Centralization involves consolidating into one department or location all of the processes, management, and control over procurement and sourcing activities for an entire company, worldwide. The following points are common drivers for centralization initiatives, most of which are common sense, yet many “centralized” companies have yet to realize them fully:

- ▶ Volume leverage equals cost savings
- ▶ Complete visibility leads to better decisions
- ▶ Increased control ensures process compliance
- ▶ Knowledge sharing increases success
- ▶ Eliminating inefficiencies reduces costs
- ▶ Consistent strategy increases effectiveness

Nearly all companies have benefited from the effects of spend aggregation to demand better prices from their suppliers. But, as companies grow larger and more decentralized, and contracts spread out across the organization into silos and lose standardization, it becomes more and more difficult to actually identify leveragable spend and take advantage of the spend volumes across the entire enterprise. Additionally, mergers and acquisitions that combine disparate systems, processes, and methodologies add

another layer of complexity and discontinuity. This impaired visibility into corporate spend then leaves money on the table, causing companies to lose the volume leverage or miss process improvement opportunities.

This visibility impairment also leads to ill-informed decisions based on assumptions drawn from unreliable estimates, complex, time-consuming, non-repeatable spend assessments, or from missing the opportunity to tap into the knowledge of the entire procurement team.

## Centralize Procurement Around Your Contracts

Any steps taken to centralize spend will involve understanding current spend at category, department and company-wide levels. Locating, analyzing and leveraging your current contracts is the key to this process. 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 governing each transaction.

Only by first standardizing, gaining control over, and improving visibility into your contracts – with the necessary framework in place on which to standardize – can you be successful with and realize the full potential of your centralization efforts. Once these capabilities are established, then you can analyze your processes and performance, and act upon that analysis to identify cost savings opportunities and define your spend centralization goals. Your improved visibility into your contracts will also enable you to enforce compliance and uncover and manage risk across the entire enterprise.

Establishing control over the principle mechanism for purchasing – the contract – enables companies to enforce established processes and empower Procurement to specify what is purchased, from whom, under what terms, and within which category.

Contract performance management provides a system for sharing procurement best practices, and creates a library of contracts to refer to when developing new agreements. By creating this centralized, searchable, reportable repository of all active contracts, Procurement quickly can build the right foundation for a spend centralization initiative. And by having a CPM infrastructure in place, you can quickly capture more of the total spend within established procurement practices and processes, and therefore more easily measure and manage the effectiveness of the centralization process.

### **This contract performance management framework consists of:**

- ▶ A centralized repository of procurement contracts and related documents
- ▶ Search and reporting that provides visibility into contractual data, contractual performance and compliance, and supplier performance
- ▶ A system to control and proactively manage contractual compliance, both the internal process and external supplier compliance.
- ▶ A mechanism for instituting consistent, standardized processes throughout the enterprise
- ▶ Increased communication and collaboration among dispersed procurement groups and globally-detached supply managers

- ▶ Exposure to cost reduction opportunities from improved visibility into savings leakage and unnecessary costs and penalties, and missed rebates and discounts
- ▶ Reduction of contract cycle times by implementing best-practices Contract Performance Management processes across the enterprise

## The Risk of Waiting

By waiting to implement a Contract Performance Management system until after completing a spend centralization initiative, Procurement will have limited ability to realize all of the benefits of centralization. Companies will founder from a lack of precision in their supplier relationships, a lack of leverageable centralization opportunities, and a lack of control over costs.

Worse yet, they will continue to waste resources – both money and time – on trying to achieve the benefits of spend centralization, while their contracts remain uncontrolled. Contracts will still be paper-based and in file cabinets across the company, offering no means to leverage the valuable data they contain.

Risk identification and mitigation opportunities will remain buried in the contracts, and regulatory compliance will remain an unachievable goal. And perhaps the greatest risk, purchasing processes will remain unenforceable and unmeasurable, casting doubt on any touted centralization benefits.

## Contract Performance Management is Essential to Successful Centralization

Many companies implement a fully centralized procurement organization, with a central command and control structure. Other companies have instituted a hybrid “center-led” procurement model, combining the benefits of centralization with limited autonomy based on geography or business unit differences.

Regardless of the final outcome, whether totally centralized procurement or center-led procurement, any centralization initiative is fraught with challenges and roadblocks. But first having your contracts and the contracting process under control will improve your likelihood of success dramatically.

### **There are four phases of any successful centralization effort:**

1. Create a contract foundation and develop a baseline of your procurement processes and performance
2. Analyze existing procurement contracts and use the results to identify centralization opportunities
3. Implement the centralization plan
4. Analyze the impact, success and failure, and continuously improve

“Spend analysis technology brings quality, accuracy, and detail to spend analysis, providing the necessary data to size up sourcing opportunities, select and prioritize commodities for sourcing, deliver the spend baselines necessary to drive the sourcing negotiations, and measure the success of the programs. All sourcing efforts are meaningless if companies cannot baseline savings on the front end of the process.”

AMR Research Market Analytix  
Report: Market Sizing Series,  
2005

In each phase, contracts are an integral element of the process. By implementing a contract performance management system prior to the spend centralization effort, companies can be sure of maximizing the improvements realized from centralization and in turn optimizing the impact of the centralization initiative.

The next four sections look more deeply into each of these phases to expose the role that contracts, and CPM systems, can play in improving the overall success of your centralization initiative.

## Create a Contract Foundation and Develop a Baseline of Your Procurement Processes and Performance

First things first – before launching a centralization initiative, you need to get a clear picture of the current state of affairs, your baseline, as well as a system for implementing standardized, centralized processes. In order to accomplish this efficiently and effectively, you must first create the foundation that will provide the infrastructure, information, and visibility essential to establishing a representative baseline of your spend as well as your procurement processes. In other words, you need a system on which to centralize.

A Contract Performance Management system offers a means for instilling a standardized, centralized, enforceable procurement process going forward. Migrating to a CPM system – whether from a manual, paper-based contract management system or from a rudimentary spreadsheet-based system – will offer the opportunity to analyze current processes, determining their strengths and weaknesses, and apply best practices to the preferred processes on which you standardize. These best practice processes will then serve as the basis for procurement process centralization across the enterprise.

For overall centralization success as quickly as possible, it is imperative to have at least the first version of these new processes in place before the centralization begins. Some processes will need to be abandoned, some merged with others, and even other processes to be maintained without change. It is important to define these processes beforehand to understand the strengths and weaknesses of each, and then leverage those strengths and eliminate the weaknesses. Imagine the chaos and lack of workforce enthusiasm during a centralization effort that moves all of the company's contracts onto processes that have long been broken.

Similar to the contracting processes, it is equally important to understand and create a basis for the spend side of the contract as well. A critical area of frustration and shortfall for most companies is the difficulty in accurate spend categorization and analysis (see Part 1 of this white paper series, *Contract Management Now: The Foundation of all Procurement Initiatives: Part 1: Spend Management*). However, by creating a system to categorize spend before each transaction – at the contract – a centralized procurement function can foster a greater level of control over spend.

Once the foundation is in place, it is important to develop a baseline that reflects the current state of affairs, what does and does not work and why, and set a basis from

**“It’s important to drill down to a fine level of granularity in investigating the status quo, since a detailed familiarity with the current practices is essential for the development of an effective change program.”**

**Develop a Governance Model to Transform Procurement Capabilities, Gartner, Inc., August 31, 2005**

which to measure progress towards established goals. This baseline could include data on total spend, categorization of spend, current pricing by supplier, number of contracts with each supplier, renewal rates, etc. This includes process performance and efficiency as well as spend-related performance.

Here, perhaps more than anywhere else, the value of a CPM system becomes clear. Developing a baseline manually would be practically impossible. Even if you could actually find all of your contracts, which most companies can’t, the number of hours needed to organize and review them to pull out necessary data from which the baseline is created would make it completely impractical. But with a CPM system in place, this can be accomplished in a matter of hours if not minutes.

### **Analyze Contracts to Identify Centralization Opportunities**

With contracts centralized, standardized and under control, and a baseline created, Procurement now has a mechanism for analyzing processes and spend, and identifying centralization opportunities. Existing, dispersed groups have undoubtedly provided exceptional results in various categories. For both savings and collaborative reasons, it is important to include field-level best practices during the centralization initiative. Procurement can begin to decide which functions or processes can be managed centrally, which can be eliminated altogether, or which can be decentralized.

A major source of savings from procurement centralization, both hard and soft dollar, is spend consolidation. Procurement has long used consolidation as a means to pool spend and drive volume discounts, as well as reduce the number of suppliers and driving process and workforce efficiency gains. So, the benefits are well known. However, the realized benefits have been limited to what Procurement has visibility into either manually or with simple spreadsheet reports. Visibility into all contracted spend, supplier relationships and hierarchies, and supplier overlap made possible by a CPM system will significantly ease the identification of consolidation opportunities and will ensure that all opportunities across the enterprise are identified.

A CPM system will also help to facilitate cross-functional involvement and coordination in defining the centralization plan and identifying the centralization opportunities. The collaboration capabilities of CPM allow multiple stakeholders and departments to have visibility into contractual data, giving greater insight into potential opportunities. CPM also allows for the business units to be involved in the contract definition and negotiation stages, expanding the centralization footprint and allowing for additional layers of control over the end-to-end procurement process.

Across geographies, where some centralization benefits may not apply, centralizing the process and control still can generate significant benefits while continuing to allow local experts to contribute. By doing so, the process becomes standardized, best practices are consistently utilized, and the visibility still is transferred back to central procurement, while the purchasing expertise still drives the localized purchasing. Bypassing centralized processes and relying on completely detached purchasing outposts to provide timely data is a recipe for higher costs.

#### **Additional CPM-related centralization opportunities include:**

- ▶ Full spend accountability, with enterprise-wide inclusion of diversity spend
- ▶ Transfer of supplier recognition and successes across the company
- ▶ Easier processing of the sharp increase in Procurement-managed spend

### **Contribute to Success with Contract Performance Management**

By definition, successful centralization requires inclusion of all stakeholders, far-flung procurement groups, and business units from across the enterprise. A suitable CPM system will leverage all of these stakeholders, include them in the contracting process, and allow procurement processes to be enforceable at the end-user level, regardless of their location or position within the organization. By providing centralization benefits to these users – such as easy, web-based procurement request entry forms, faster procurement response times, and reduced costs of goods and services – buy-in and participation will greatly increase.

Another CPM-driven benefit of centralization is the transfer of procurement expertise across the organization. A proficient CPM system will capture and share localized or siloed procurement expertise to increase contracting success, maximize savings opportunities, and improve procurement processes. Procurement will continuously build a library of contracts and contracting experience, and have visibility into what makes a good contract good and what make a bad contract bad. This information can then be transferred into increasing the usage of best practices and eliminating the usage of high-cost or low-success techniques.

Deploying a CPM system that is intuitive and easy to use will also help to ease compliance with the newly centralized procurement function. With processes predefined and unavoidable through a CPM system, end users will be forced to comply in order to make contracted purchases, reigning in off-contract purchases and maverick spend. However, a difficult, cumbersome, unintuitive CPM system will only hasten the rush of resourceful users who find ways to outmaneuver the CPM system, thereby undermining the centralization effort. Not only will this move purchases off of Procurement's radar, it will quickly undermine the centralization initiative and make success extremely difficult.

### **Analyze Impact and Facilitate Continuous Improvements**

As the centralization initiative expands and takes hold, executives will be increasingly interested in early success and measurable achievements. Additionally, as centralization becomes institutionalized, Procurement should not be content with a few early successes. A progressive procurement organization will leverage centralization to improve processes continuously, lower costs, and drive compliance.

By controlling purchasing through the CPM system, Procurement will have detailed visibility into centralization achievements. CPM will make spend analysis easier thanks to purchasing control and enforced categorization, allowing for greater definition and measurement of key performance indicators. Furthermore, CPM allows for greater contractual control, ensuring supplier compliance with the negotiated terms and conditions of agreements. Newly instituted supplier metrics, changed by the revised scope of centralized agreements and the consolidation of spend and suppliers, will be easier to measure and improve through the increased visibility made possible by CPM.

Finally, one of the main drivers of centralization is the ability for Procurement to apply process control across the enterprise. CPM offers Procurement a vehicle for defining, measuring, and enforcing these newly centralized processes, and exerting influence and control over each and every purchase. Not only for the sake of control, but for the standardization of purchasing practices and the capture of data to measure what is working and what is not.

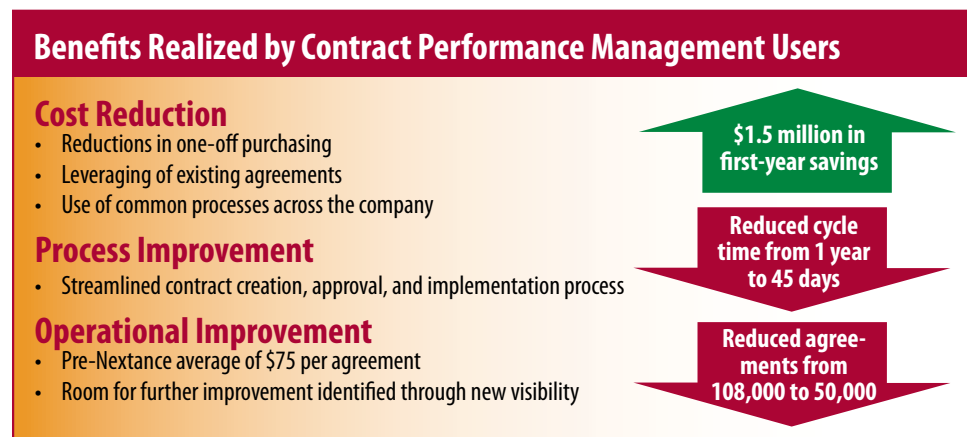
## Contract Performance Management – A Low Risk, High ROI Initiative

The concept of consolidating all contracts into a central location will, by itself, offer immediate value. Outside of the additional benefits of centralization initiatives already mentioned, 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:**

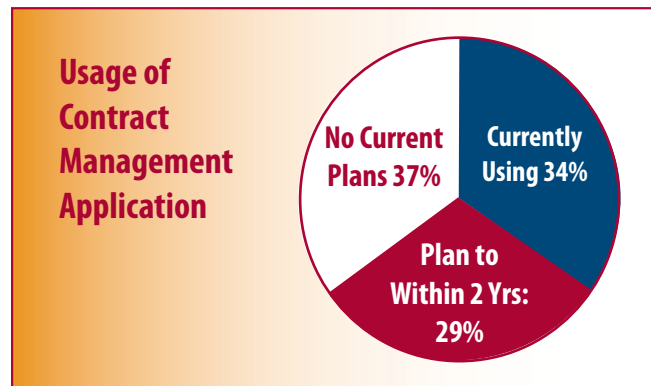
- ▶ Instant visibility into 100% of contracts and contract data, compliance, and supplier performance
- ▶ Control and proactive management of contractual compliance, both from internal processes and external supplier perspectives
- ▶ Cost reduction opportunities from consolidation, reduction of unnecessary costs and penalties, and collection of missed rebates and discounts
- ▶ Increased procurement productivity and efficiency through the reduction of contract cycle times and the implementation of best practices across the enterprise

Figure 1: Nextance customers have realized significant, impactful savings in only a few months.



The hard dollar savings associated with a CPM solution are significant and can be achieved quickly, in less than one year. Figure 1 provides examples of the benefits and returns Nextance customers have achieved with their contract performance management implementations.

Figure 2: Utilization of contract management applications. Source: Aberdeen Group.



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

Companies that fall into the "No current plans" group, and those waiting 24, 18, or even just 12 months to get started on a CPM 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 CPM application.

## What To Look For In A Contract Performance Management System

The immediate benefits of a CPM 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, or may never be fully realized.

The requirements of an effective CPM 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 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. 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. In addition, solutions offer 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 based on milestones, payments due, and terminations dates, according to established business practices.

## Conclusion

Contract Performance Management solutions can offer immediate benefits plus the ability to increase the impact of a procurement centralization initiative. By implementing a CPM solution prior to centralization, purchasing can have complete visibility into contracts necessary to build the foundation for determining purchasing strategy, improving process, and defining purchasing strategy.

CPM will then provide the foundation on which to centralize all purchasing agreements and contracting processes. 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 CPM solution listed in this paper, companies can ensure a quick implementation, fast ROI and time-to-value, and full realization of the opportunities currently hidden in your contractual agreement 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.



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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 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](http://www.nextance.com).

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