WHITE PAPER

Contract Performance Management Now: The Foundation for all Procurement Initiatives

Part III: Outsourcing

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Series Introduction

This whitepaper, focusing on outsourcing, is the third 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 will not be able to effectively control costs and 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 two white papers in this series

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Introduction

Outsourcing more and more is becoming an integral part of business these days. With companies outsourcing everything from human resources to procurement to manufacturing, both the ability to outsource and the propensity to outsource are growing faster than ever before. And, the value of outsourcing is becoming more attractive, with categories like IT services and call centers being off-shored to lower-cost countries where wages are significantly lower than in the U.S.

Outsourcing providers are growing at an even faster pace. According to Gartner, the size of the global outsourcing market will be $173 billion by 2007, with $24 billion of that outsourced to offshore contractors. And, according to Aberdeen, 71% of process companies and 39% of consumer companies are planning or discussing outsourcing strategies.

Companies continue to look for more ways to lower costs, shed operations outside of their core competencies, and attempt to gain competitive advantage. Furthermore, the large consulting companies continue to expand their business process outsourcing practices and offerings, providing expertise and improving the ease and effectiveness of outsourcing initiatives.

Clearly, outsourcing is no longer a fringe business strategy. For many large companies, it is an integral part of their day-to-day operations. However, most companies do not have the visibility and control across their extended supply chain necessary to understand, measure, and track the performance of their current contracts, which is necessary to successfully transition to and manage an outsourcing relationship. By creating a solid contract management foundation first, companies can better manage and measure their current business relationships, resulting in a higher degree of success with their outsourcing initiatives, as this paper will explain.

Furthermore, when companies finally decide to outsource, the relationship opens up a host of potential liability issues related to supplier agreements, such as subcontracting hierarchies and the effect on operations. Companies considering outsourcing need to have their existing contracts in order, so that the outsourcing firm has a clear, well-managed, and solid foundation on which to work, thereby ensuring supply chain continuity.

Detail Expected Cost Savings in the Contract

"The most important step of all is to 'nail down in the contract the expectation of cost savings. Businesses get sold on the concept of outsourcing because of promised cost savings, but oftentimes you don't see them anywhere in the contract.' Sometimes a supplier's response is that the cost savings are just an estimate, says John Funk, a partner at Jones, Day, Reavis & Pogue. 'But even then, the contract should reflect a range of committed savings.'"

"Out-sourcery: Myth or Magic?"
Erika Morphy,
Supply and Demand Chain Executive

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Outsourcing Complexities

Given the nature of outsourcing—with sensitive information traded back and forth, the inherent liability of having a third-party Business Process Outsourcer (BPO) perform critical tasks, and the daily interactions between a company's employees and the provider's employees—it is obvious that outsourcing relationships are extremely complex. Therefore, companies need to understand clearly their business, their processes, and their relationships before they enter into any outsourcing agreement.

Sure, BPOs are expected to make changes, improve processes, and cut costs. But companies must completely understand their current state and needs before they make decisions on what to outsource or begin searching for and evaluating BPOs. Visibility into all relationships and agreements prior to the entrance of the BPO will help to better identify the complexities and define the limits of the outsourcing relationship. Some specific questions that need to be answered include the following, which highlights the breadth and depth of issues that must be considered:

- With whom do we have current contractual agreements?
- Will there be any conflicts of interest if we engage a BPO? How will this change by revising the scope of the BPO's role?
- Are their any outstanding liability risks that must be address before outsourcing?
- Do subcontracting relationships exist that may impact the decision to outsource?
- What is the current cost basis for what is to be outsourced, and where will the cost savings be found?
- What legal issues need to be mitigated?
- Can some goals be achieved without a BPO?

Once the details of current relationships and processes are understood, companies have a better mechanism for determining if a BPO is needed, if so in what capacity, and identifying what gains can be made on their own without the help of the BPO.

The Importance of Contracts When Considering Outsourcing

In most outsourcing agreements, the BPO will take over the management of all underlying related contractual relationships. For instance, if facilities management services are outsourced, the BPO will commonly manage all of the related landscaping, maintenance and janitorial agreements. This management can result in the BPO continuing the current relationships, or, more likely, leveraging their own contracts and scale to command better pricing and terms. This can result in contract termination or transfer issues.

Since the contract is the relationship-defining document, it is important to have complete visibility into current agreements prior to entering into any outsourcing relationships. Early in the process, the question of "Who is responsible for this item?" will arise

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again and again. By having standardization of contracts and related processes, complete visibility into those agreements, and control of the contracting process, these questions can be quickly answered and the level of conflict or uncertainty will be lessened.

The specifics of each relationship—the reporting requirements, the measurements and KPIs, the service levels—are contained in the contract. If a BPO is engaged, they shouldn't spend time searching for contracts and contract details, rather, they should be completely focused on the outsourcing goals. As the BPO takes on business responsibility, companies need to have a foundation on which the BPO can operate.

Visibility into the entire portfolio of contracts will ease the BPO's job, which is beneficial to both parties. Having the ability to facilitate complete contract visibility and reporting capabilities and enforcing defined contract processes before the BPO arrives will increase the success of the outsourcing relationship. Also, many processes must be transferred to the BPO's control, so a well-defined contracting process will ease the transition and information transfer.

Continuing the facilities management outsourcing example, consider the breadth of related agreements. Janitorial and landscaping are obvious relationships that can be easily transferred to the BPO. But, having visibility into all contracts may uncover other related agreements that may or may not be readily apparent. Consider a particular supplier that provides vendor managed inventory on highly sensitive electrical components, and that service requires 5,000 square feet of floor space, an allowable temperature range of 65 -75°, and an air quality of half-micron particles per cubic foot of air. Can the BPO handle those requirements? Do they have the capabilities to manage clean rooms? If those requirements are not met, does the BPO work directly with the supplier to resolve, or will the outsourcer's purchasing department need to be involved? If product is damaged, how is responsibility determined?

Contracts First, Then Outsource

The goal of outsourcing is to reduce costs and improve performance. To be successful, however, companies need to define their current state, decide if outsourcing is even required, and if so, set bounds to the outsourcing relationship. Contractual standardization, visibility, and control is critical before outsourcing begins.

A contract performance management (CPM) system will provide the foundation necessary for outsourcing initiatives to be completely effective. A CPM system provides the visibility into agreements, sub-contracting agreements, and agreement details that eliminates ambiguity during the outsourcing relationship. And, the visibility works both ways: it allows the outsourcing company to effectively manage the BPO, while also allowing the BPO more visibility into and control over the processes, vendors, products, and services necessary for their success and the success of the outsourcing initiative overall.

By creating a solid contracting foundation, companies can better manage and measure their current business relationships, resulting in a higher degree of outsourcing success.

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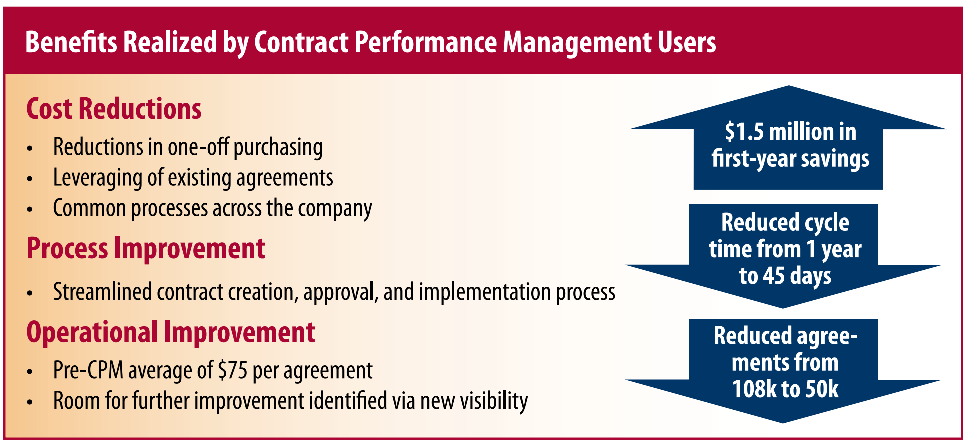
Contract Performance Management—A Low Risk, High ROI Initiative

The concept of consolidating all contracts into a central location will, by itself, offer immediate value beyond outsourcing. Outside of the benefits to support outsourcing initiatives as described in this paper, 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.

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 1 provides examples of the benefits and returns Nextance customers have achieved with their contract performance management implementations.

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



CPM solutions can provide immediate benefits based upon capabilities to provide the following:

- Instant visibility into 100% of contracts and contract data, compliance, and supplier performance, easing outsourcing support
- Control and proactive management of contractual compliance, both from internal processes and external supplier perspectives, facilitating the outsourcing relationship
- Cost reduction opportunities from consolidation, reduction of unnecessary costs and penalties, and collection of missed rebates and discounts, allowing the BPO to be more effective in a shorter amount of time
- Increased productivity and efficiency through the reduction of contract cycle times, allowing for faster realization of outsourcing benefits

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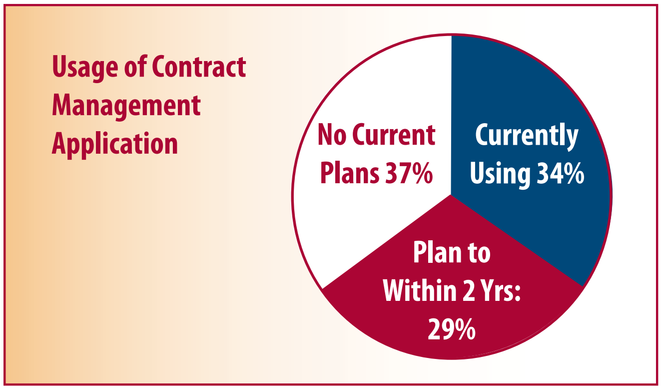

Figure 2: Utilization of contract management applications. Source: Aberdeen Group.

According to Aberdeen Group ("The CPO's Agenda," March, 2005), 34% of companies currently use some form of contract performance management application, 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 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, key initiatives, such as outsourcing plans, may be hampered by the inability to quickly locate key contracts and accurately determine the effect of contracts on these key initiatives.

What to Look For in a Contract Performance Management System

The immediate benefits of a CPM system are clear, and the benefits of implementing CPM prior to an outsourcing initiative 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 Time-to-Value. A fast, well-defined implementation plan, including necessary services, with an expected delivery of the first benefits within 30-45 days.
- Compelling ROI. System offers a total return on investment of 200% or more within one year.
- 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.

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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 increase the chances of success of outsourcing initiatives by determining the impact on current relationships, better understanding current needs, and identifying risks before they become liabilities. By implementing a contract performance management solution prior to launching an outsourcing initiative, purchasing can have complete visibility into contracts necessary to build the foundation for determining outsourcing strategy, and creating a platform for supporting the BPO as they assume control of related relationships. Furthermore, a CPM system will allow faster realization of outsourcing achievements through increased productivity and efficiency.

By using an effective contract management solution as defined in this paper, 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 business process outsourcing relationships.

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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.

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