

Best Practices in Contract Management



Introduction

Every organization has contracts, but not every organization adequately manages its contracts. And while the nature and complexity of these agreements can vary widely, careful governance enables organizations to maximize their value and limit their exposure. On the other hand, contracts that are administered poorly—or not at all—tend to leak revenue, drive costs upward and become cautionary tales of unfettered legal and compliance risks.

Enter the need for contract lifecycle management (CLM): the proactive, methodical management of contracts from initiation through award, compliance and renewal. Generally, large corporations aspire to have fairly sophisticated CLM programs, but all too often, they fall short of the mark because their contract processes are decentralized and dispersed across multiple departments, including sales, procurement and legal. Meanwhile, law firms—though themselves partnership hubs, given their relationships with clients, managed services providers and other vendors, and despite their expertise in drafting contractual terms—tend to lag even further behind the corporate world in their contract management practices. Perhaps this is because individual lawyers tend to feel protective of their contracting processes and are reluctant to relinquish their power to others; law firms do tend to lack a formal hierarchy, stymieing decision-making.

To the extent contract management practices, or even technology, exists in these organizations and firms, it is often addressed in a siloed way. With different departments tracking different information, buy-side and sell-side contract solutions may seem impossible to merge. But as technology has improved, so has its ability to capture information across departmental lines, unlocking strategic value for all lines of business. And organizations of all sizes, including law firms, that fail to use these tools to corral contracts across their departments are missing out on the benefits of centralized contract management.

HBR Consulting experts have helped clients of all sizes, and on both sides of the negotiating table, create end-to-end CLM processes and protocols to address these seemingly impossible challenges and reap the rewards of contract management. Based on this experience, here are six best practices that can help corporations and law firms alike optimize the contract management lifecycle.

View Contract Management as an Overarching Program

If you were asked to count the number of active contracts in your organization right now, could you come up with an exact number, or at least a reasonable guess? How about contracts being negotiated? Or contracts that are about to expire?

If you are like most people at organizations without mature CLM processes, you probably cannot answer these or other probing questions about the volume or nature of your organization's contracts. That knowledge deficit occurs when organizations lack a single system where they store and manage contracts. And most organizations do not feel an impetus to form a centralized repository, as many people do not spend time revisiting contractual terms until a controversy about them arises.

Adding to the difficulty of tracking contracts, most organizations have a wide variety of contract types. For example, businesses may have contracts establishing purchase orders for goods or services, partnership agreements with suppliers, property or equipment leases, employment contracts for executives—and the list goes on and on. Given the variety of purposes of these contracts and the departments responsible for forming them, and due to the siloed nature of some businesses, contracts may be scattered around an organization, stored in separate file systems on hard drives or, in the worst-case scenario, in hard copy in any number of file cabinets. The lack of organization may be particularly rampant where businesses have grown by mergers and acquisitions. In these circumstances, it may be impossible to reconcile or integrate any of the existing contracting systems. And, as an organization's contract portfolio grows, managing the various stages of contract development and administration only becomes more complex.

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Law firms are often similarly disjointed in their contracting, with the originating attorneys responsible for managing each client relationship and its related contracts. Diverse viewpoints and client pushback can lead to considerable inconsistencies in the contracts themselves as well as in the contracting process. And, unless the firm is large enough to have a procurement department with firmwide oversight, policies governing contracts may go unenforced.

Rather than taking a piecemeal approach, a better solution is to view contract management as a holistic program spanning the entire organization. Treating contracts as an enterprise endeavor can achieve two goals that are important to lawyers and nonlawyers alike: improving efficiency and reducing risk. Viewed more simply, all of an organization's contracts have the same overarching objective—to further the company's goals—even if each contract achieves that objective in a different way. These contractual projects should therefore all be subject to the same governing principles, eliminating as much inconsistency as possible and ensuring that the organization's goals are better met.

The first step in starting a contract management program is to take an inventory of all the organization's existing agreements. Once you have gathered and catalogued them, you should make storing them in a single place a top priority—preferably, as discussed below, in an electronic, searchable repository. To take the organization to the next level, it is important to categorize each contract, capturing data that will be useful for searching as well as for creating a repository of standard terms and conditions, monitoring milestones and tracking renewal timelines and expiration dates, among other criteria.

After gaining an understanding of the organization's overall contracting landscape, it is time to define the organization's goals regarding contract management. Does the company need to speed up the contracting process to avoid losing out on lucrative deals? Reduce the specter of regulatory risk? Monitor contract noncompliance more closely?

Once you've undertaken this admittedly daunting first step, you'll be able to draft a set of policies and procedures, as outlined below, to minimize potential exposure without creating new bottlenecks that can slow down the contracting process.

Clarify the Roles of Various Departments or Functions with Respect to Contracts

Where should the responsibility for contracting rest within your organization? Of course, the answer is that it depends on the structure of your staff and leadership, but there is one constant: legal must always play a role in the process. In a corporation, the ultimate responsibility may lie with the law department, the procurement team, the sales team, or individual business units. For example, procurement can own the contracts and any associated processes and technologies so long as legal is involved in the oversight of contractual terms, ensuring that clauses remain consistent with company policy and other contracts. In short, it is less important where the core responsibility lands than it is that legal has a seat at the table.

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In a law firm, should contract management fall to the procurement team, or should it be dispersed, given the level of contracting talent likely to exist across the firm? Typically, procurement should spearhead the contracting process. Again, though, other stakeholders should be represented to ensure that all contracts align with the firm's risk parameters.

Delineating clear roles and ownership in the contracting process enables better control and

management of the resulting contracts. It also consolidates transacting power in the hands of those most experienced in, and knowledgeable of, the organization's procedures and existing contractual obligations.

Determine the Acceptable Risk Parameters

Organizations typically sell products and services to and obtain a variety of goods and services from a number of purchasers, vendors and suppliers. Some of these relationships can be risky, but for different reasons. For example, companies may operate in an emerging or developing sector, leaving no way for those who do business with them to examine their track record of performance or payment. Some vendors may have access to the organization's or the law firm's sensitive data. These vendors may need to perform services on-site or may have a strategic location in a heavily regulated country, such as a nation governed by the stringent data privacy rules of the General Data Protection Regulation (GDPR). Some contracts may give rise to more substantial risks: for example, a service agreement typically poses a greater threat than, say, a nondisclosure agreement or purchase order. Certain departments may feel empowered, given their transacting history, to go beyond preapproved terms or amounts in their agreements.

No matter the source or magnitude of the risk, failing to acknowledge and manage the risk of contracting with third parties can lead to dire consequences, whether in the form of higher costs, reputational harm, legal or compliance violations or even criminal and civil penalties. Therefore, risk assessments are a critical element of contract management.

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The keys in assessing the risk of a particular contract are to understand the relative risk of each relationship, based on the materiality and criticality of the relationship to the business, and to determine just how rigorous an assessment of the potential risks is necessary. To determine materiality and criticality, consider how much money the organization spends with the supplier or vendor or how much it stands to gain from the business relationship. On the sell side, organizations should monitor contract performance well ahead of renewal or expiry dates so they can make smart decisions without deadline pressure and put tools in place to ensure that pricing structures and future contract terms align with sales and overall company objectives. To quantify and compare risks, you might create a scorecard to systematically assess the potential threats for all third-party relationships. Such a scorecard might include a standardized scale ranking the risk from 0 to 100, considering the extent of the third party's access to protected information, the length of the relationship or the third party's industry reputation. Bear in mind that it can be difficult to create an objective, consistent risk profile and rating system, so it may make sense to seek outside advice in developing a strategy for assessing contractual provisions and risk parameters.

The final step in assessing risk is to determine how closely each contract's terms match your organization's contracting standards. The further the terms deviate from your organization's idealized standards, the greater the risk, and the more intense your scrutiny should be.

Establish Control Parameters and Decide How to Enforce those Policies

Not all organizations have sound policies in place governing the formation and maintenance of contracts; those that do may have different, or even conflicting, policies that apply only to certain departments or to certain contracts. Others may have a battery of policies that go woefully unenforced. No matter which category the organization or law firm falls into, too often no one is assigned to shepherd the contract compliance process. When contracts are maintained individually or departmentally, it becomes onerous to effectively police the contracting process.

At a minimum, organizations must enact—and administer—an enterprise-wide contracting program designed to support the organization's contracting goal. The contracting program, and the policies within it, should be internally consistent, yet they can set forth repeatable workflows tailored to departmental or team needs. For example, a program can establish parameters that address the following concerns:

- At what point is a contract needed to do business with someone?
- When does legal need to be involved in the contracting process? (For example, a policy might provide that anyone can sign a mutual nondisclosure agreement, but a one-way agreement must undergo legal review. Similarly, you might specify that a master service agreement for a term of five years or greater must be sent to the legal department.)
- Who has the authority to negotiate contracts?
- Who has the authority to sign and enter into contracts?
- Can the negotiating or signing authority be delegated, and if so, to whom?
- When is a risk assessment required? Is this determined by spend level or another criterion?
- Who is responsible for monitoring contract performance and third-party relationships?
- What is the records retention policy for contracts?

Answering questions such as these can build the foundation for a robust contract governance program.

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Define the Right Performance Measures Across the Contract Administration Process

So far, we have identified how to manage contracting on the front end by designating responsibilities, setting parameters and creating standardized policies. But remember that a CLM process should continue through the entire lifecycle of a contract. Once the contract is in force and the pendulum swings to the administration phase, different considerations come into play.

The team responsible for contracts at the organization needs to define those metrics that are most meaningful to their unique business needs. These might include the following:

- **Cycle times.** How long does it take from the time a contract is requested until a draft is generated? Do simple contracts take as long to complete as more complicated ones? Studying these metrics can yield a treasure trove of insights about the organization's overall contracting process.
- **Delays in approvals.** Once a contract is generated, how long does it take for a draft to go through the entire approval process? Perhaps there are departmental slowdowns or other bottlenecks in the process that could be resolved with better workflow management. Or it may be that some straightforward contracts are taking too long to wend their way through a labyrinth of approvals that could be simplified.
- **Inappropriate authorizations.** Are managers exceeding their spending authority? Are teams negotiating deals that violate the company's contracting policies?
- **Obligation management.** How much time does the organization spend ensuring that it is adhering to its contract terms? How long does it take to collect any reports or other documentation that the organization is obligated to regularly provide under the contract?
- **Missed milestones.** How many delays occurred during the course of the contract that may impede contract renegotiations?
- **Deviations from standard contract language.** How often do teams fail to follow the strict terms of your contracting policies? What terms are frequently changed? Are particular individuals or teams the culprit behind these variations?
- **Spend.** How much of the organization's spend falls under a firm contract? Are you meeting the spirit of your organization's contracting policy with these spending arrangements?
- **Non-renewals.** How many of your contracts are never renewed? Why are these parties leaving? Was the other party approached about renewal before the contract expired?

This is not a comprehensive list; additional metrics may be meaningful to your organization.

Remember that Technology is a Tool, Not a Complete Solution

While technology is not a magic bullet supplanting sound policies and procedures, it can aid in the facilitation and streamlining of contractual workflows. Don't overlook the usefulness of artificial intelligence and other advanced technologies in, for example, contract self-service: that is, rapidly generating first drafts of standardized, non-negotiable agreements. Automation features can guide the drafting of contracts through a pre-approved library of templates and contractual clauses and workflows. But where technology can be a game-changer is in centralizing documents and improving spend visibility.

Storing contracts in a centralized repository can simplify oversight, shorten the contracting lifecycle and improve compliance. Centralization dramatically reduces the amount of time spent searching for contracts and can also allow more systematic comparison of standardized contractual terms against the terms of individual agreements. This ensures that transactions and invoices remain in line with approved language and that organizations can take advantage of volume-based pricing initiatives. Centralization can also prevent the inadvertent breach of contractual terms that may conflict with each other, such as supplier exclusivity clauses. Additionally, a centralized repository enables teams to readily track milestone dates, such as automatic renewals or termination dates. This consolidation should extend to other documents related to contracts, such as addenda or statements of work, allowing better management of third-party relationships with less effort.

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Insight into spend is also a critical advantage of contract management technology. Spend visibility systems can store all third-party transaction data in a single location, providing a fuller picture of patterns—both good and bad—in the organization's supplier and purchaser base and enabling better understanding of spending and buying relationships. With spend monitoring, reporting and dashboard functions are essential to maximizing the company's ability to make data-driven business decisions and to accelerating cycle times and, in turn, revenue.

Conclusion

Contracts are essential building blocks for the growth and prosperity of every business. But improperly managed contracts can be a source of staggering risk, slowly causing business decline or even death. While implementing a CLM program can be strenuous, both due to limited resources and internal resistance to the change, the stakes are simply too high to justify inaction or the absence of a rigorous contracting framework. Organizations, including law firms, that lack comprehensive or effective CLM programs would be wise to adopt the best practices outlined here. Optimizing a CLM process is no

walk in the park and should not be undertaken lightly. Given the potential risks as well as the advantages that can result, you may prefer to consult an expert with deep industry experience as you optimize your organization's CLM process.

HBR Consulting helps organizations of all types design enterprise CLM solutions that include well-defined processes, carefully aligned resources, clearly defined roles and responsibilities and stringent measurement protocols. HBR also regularly works with law firms on sourcing strategies, managed services and supplier management.

To learn more about how HBR Consulting can create a robust CLM process that proactively manages your organization's contracts and reduces your risks, contact us.

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