Can the contracting process improve without an owner?

June 2021

A collaboration between:

KPMG Law

World Commerce & Contracting

Contents

About this report

For any executive wondering how to streamline contracting and extract greater value from their trading relationships, this report is a 'must read'. It is based on input received from an online survey conducted by World Commerce & Contracting and KPMG Law in the period January – March 2021 and a series of round table discussions hosted by World Commerce & Contracting and KPMG Law.

More than 40 executives participated in the round-tables and shared their views on the key trends in commercial and contract management. This was supplemented by input from more than 300 survey respondents, together representing a range of industry and geographic perspectives and sizes of organization. While taking account of all responses, the report focuses primarily on the 200 organizations with annual revenues of more than USD500 million since the complexities being examined are strongly related to the size of the business.

Foreword

Contracting does not work efficiently. It is costly, it creates delay and, too often, it fails to build the trusting, collaborative relationships on which modern business depends. The dominant, widely acknowledged reason for this is simple – no one owns it. There are many who lay claim to portions, but none who accept accountability.

This report tackles the issues head-on. It acknowledges the competing priorities, the political tensions and the legitimate concerns of multiple stakeholders. It recognizes the need for these views to be respected and reconciled within a new collaborative framework. The solution, we believe, is the creation of an Office of Contracting.

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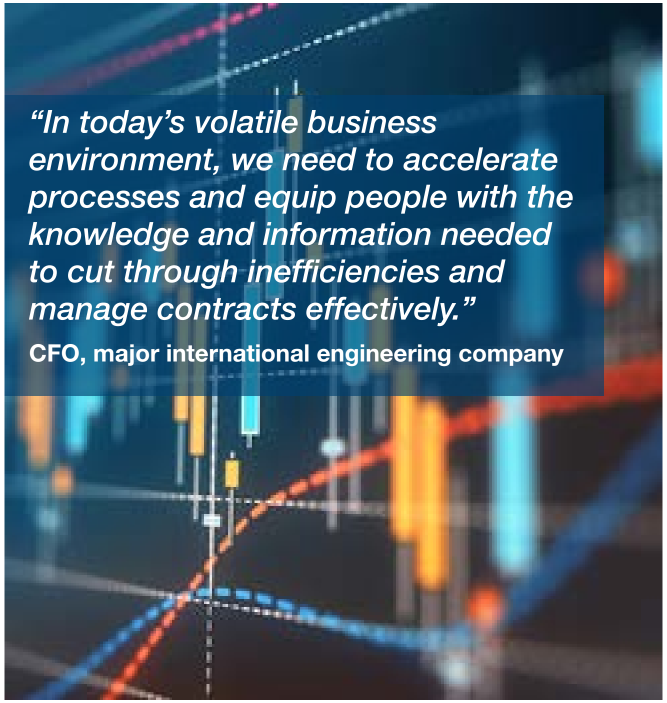
Our point of view

The time has come for organizations to create an Office of Contracting (OoC) with responsibility for the quality and integrity of the contracting process. To be effective and accepted, this office must be independent from any operational stakeholder function, with its purpose to enable those functions to work more efficiently and to deliver greater value.



"In today's volatile business environment, we need to accelerate processes and equip people with the knowledge and information needed to cut through inefficiencies and manage contracts effectively."

CFO, major international engineering company

Why contracting matters

Revenues, risks, reputation, rights and responsibilities – contracts directly impact the health and wealth of every organization. Yet for all their importance, on average, contracts suffer more than 9% value leakage. They generate avoidable resource costs, delays and friction between customers and suppliers. That is not because people don't want to do a good job. It's because they aren't equipped to do better and their current focus is too narrow.

The underlying process and tools through which contracts are designed, negotiated, implemented and managed is inefficient and fragmented.

Currently, the focus of contracts is too narrow, leading, on average, to more than 9% value leakage.

What organizations are doing to improve

This report is just the latest to show that most organizations are optimizing and digitizing their processes. They know that contracts matter and they are focused on reducing cycle times and improving data flows. But in our opinion, most will not succeed. Many have spent millions acquiring or developing software to improve contract performance – and found that it does not work. Real and sustainable improvement will only be achieved by tackling the underlying fragmentation of process ownership.

The average contracting lifecycle has at least seven different functional owners with competing goals and objectives. When things go wrong, it is always someone else's fault.

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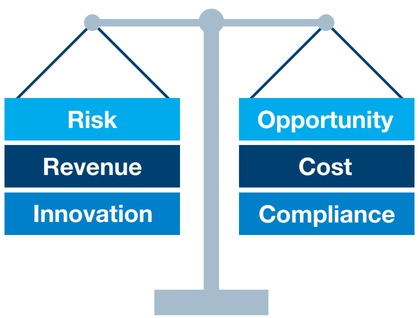
Our point of view *(continued)*

What organizations should be doing

Digitization is an opportunity to develop a holistic view. Transactional responsibility for contract performance will always be scattered across the business. But those transactional owners desperately need an integrated process equipped with the tools, systems and knowledge that support speedy, informed actions.

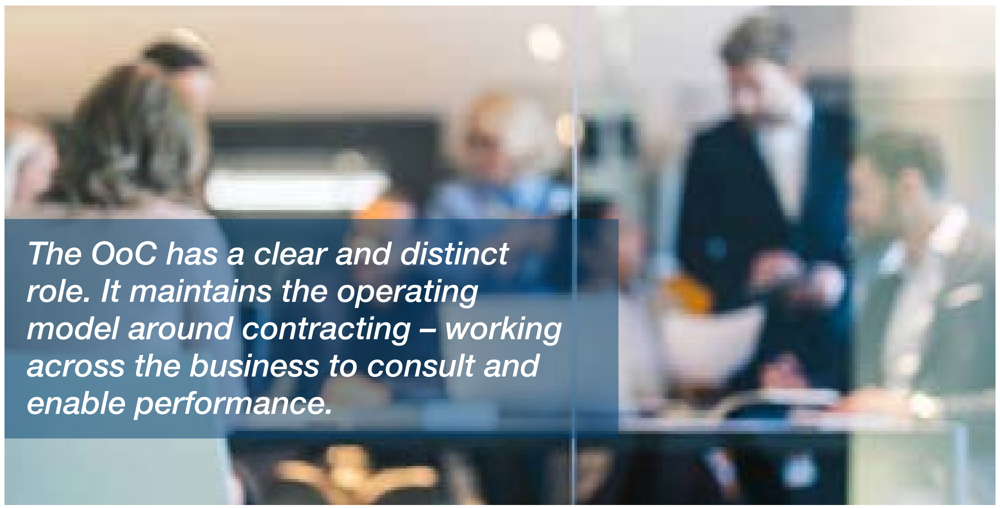
Even when multiple competing stakeholders manage to agree on that process, they face multiple hurdles in establishing and adopting a common set of tools and systems – and then who will maintain them and ensure ongoing integrity and updates? Sustained progress and quality depend on a single point of process ownership – a point of accountability, with the consolidated funding to deliver contracting excellence.



Contracts must represent a balance of views.

Who should that be? Experience tells us that it is risky allocating the role to a core stakeholder. The whole point of contracts is that they must represent a balance of views – risk versus opportunity, revenue versus cost, innovation versus compliance. We therefore recommend that the Office of Contracting must operate with a level of independence to ensure that the contracting process supports the strategic goals and objectives of the business. Ultimately, contracts are about brand image and economic performance. They are our link to the market.

The OoC owns the process and works across the business to ensure a clear service delivery model, with agreed Responsible, Accountable, Consulted and Informed (RACI) definitions in place. It manages core technology for contracting, with responsibility for business-wide data, analytics and reporting, and protecting against contract value erosion. Finally, the OoC ensures that contracting policies and practices both inform and support organizational goals and strategies.



*"Our commercial teams used to interface with 29 different systems. Now, following digitization, they interface with three. The efficiencies this generated, the opportunities it revealed, are generating a bottom-line impact of **£72 million a month – a margin improvement of almost 7.5%.** And there is more to achieve."*

CPO, UK retail business

The background to our research

Markets are dynamic, demanding flexibility and new ideas in contract terms and commercial practices. For almost 85% of organizations and especially in B2B markets, reaching agreement on those terms or practices is frustratingly slow, at both a transactional and strategic level.

Building consensus across multiple stakeholders, each with their own unique views and interests, is difficult and time-consuming. This 'breakage' inevitably leads to inefficiencies, which then generate incremental cost and missed opportunities. For example, current studies are suggesting that on average organizations are expending 4.2% of contract value on avoidable post-award management.[1] Ensuring the capability to perform and deliver against commitments is a major source of risk.

Within most organizations, it is not clear who has responsibility for identifying and acting on the need for improvement and change. Many initiatives therefore focus on sub-processes – for example, contract review and approval – without consideration for the upstream or downstream impact. In part, this arises from a lack of consolidated data and the insights needed for holistic management. However, of greater significance is the absence of anyone with authority or accountability for assessing and maintaining the market competitiveness of contracting process and practices, researching and developing aligned industry standards. While a need for new terms or commercial practices may be evident at the level of an individual transaction or relationship, it remains rare to have any specific group or function responsible or equipped to monitor trends at a broader level or to make change happen.

This is reflected in an absence of benchmarks, both internal and external, and standard contract offerings and commercial models which slow down business needs, impeding opportunities and constraining value delivery.

The pandemic revealed the extent of data fragmentation and forced many to operate outside standard commercial procedures. This has led to an upsurge in digitization of contracting, with a strong focus on greater speed and efficiency. In the words of the General Counsel at one of the world's largest consumer goods corporations:

"The pandemic accelerated digitization, putting us 2 or 3 years ahead of plan. It has released resources to focus on long-term relationships and outcomes."

This report confirms that action is being taken in both sales and procurement contracting and it highlights the phases of the process that are being prioritized.

For most, any digitization initiative depends on a clear executive sponsor and an executive lead. While there are major variations in which executives are fulfilling these roles, it is perhaps unsurprising that almost 60% anticipate a continuing consolidation of responsibility when process re-engineering is complete. Without this, contracting will continue to operate as a constraint on business performance.

Figure 1. The contracting process and its digitization

1. Research, soon to be published by World Commerce & Contracting, has explored the cost of post-award contract management, taking account of contract complexity and the extent to which responsible personnel have been equipped with necessary skills and tools.

The contracting process

Many organizations lack an integrated view of contracting. That is because contract-related activities are embedded in many other processes and this leads to fragmentation of roles and underlying data.

Figure 2, below, represents the core activities that occur across the contracting lifecycle at both strategic and operation levels. It shows the flow of transactional activities that lead to the creation and subsequent management of a contract. It also illustrates how these should be guided by overall business and commercial strategies, in turn feeding performance analytics and flowing back into strategic validation and update.

This overall flow is typically disjointed because each phase is led or influenced by a different group or function, with multiple stakeholders or interests that must be reconciled. The extent to which there are checks and balances, areas of contention, ambiguous authorities and responsibilities, combine to create cost, delay and potential value erosion.[2]

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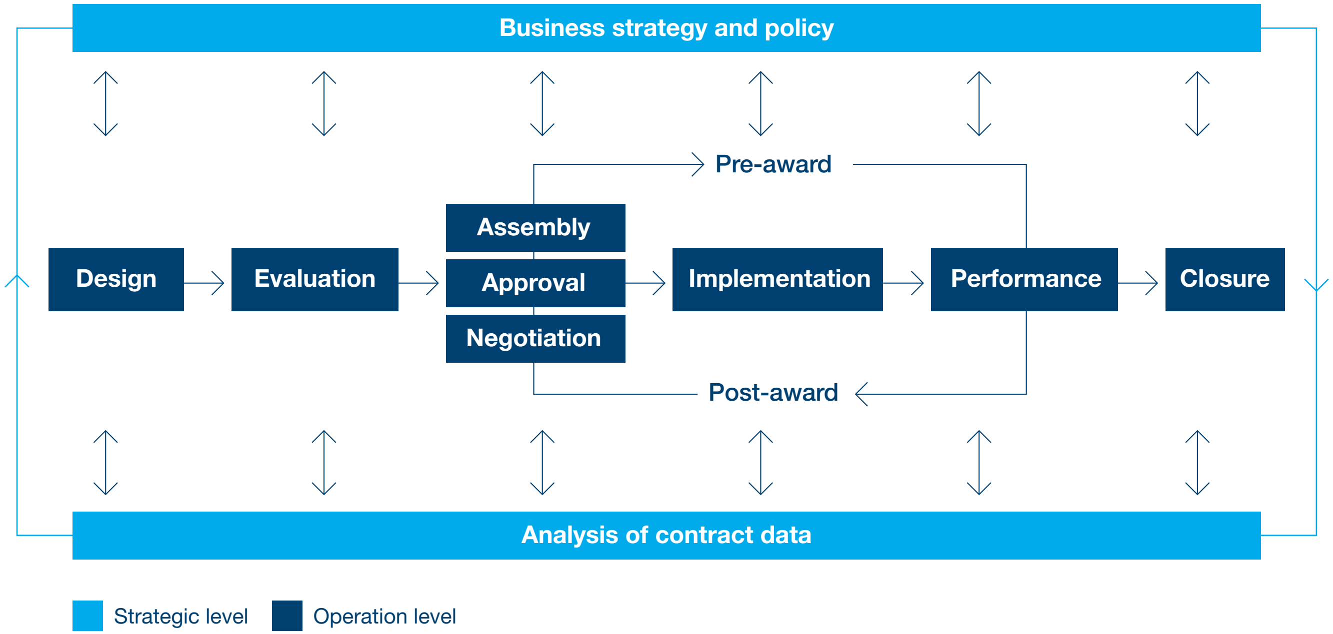
Figure 2. The contracting lifecycle



2. A recent World Commerce & Contracting report identified approximately 40 distinct 'friction points' within the typical contracting process. (See *Better Contracts, Faster Contracts. Friction Points in the Contracting Process,* December 2020).

The contracting process *(continued)*

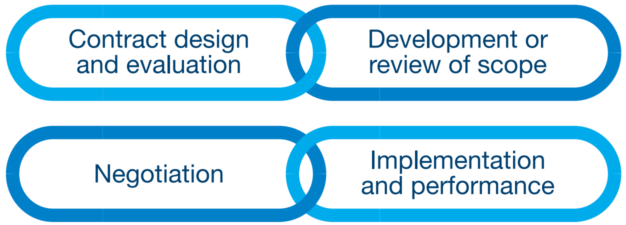
Process ownership

Figure 3, below, illustrates the issue of ownership, showing how different groups or functions are typically responsible for defining and maintaining elements of the overall process. The data shows the comparative positions for sales and procurement.

In each element, survey respondents were asked: 'What is the state of ownership for the contracting process in your organization today?' The charts identify, for each process phase, who is responsible for documenting and maintaining the process.

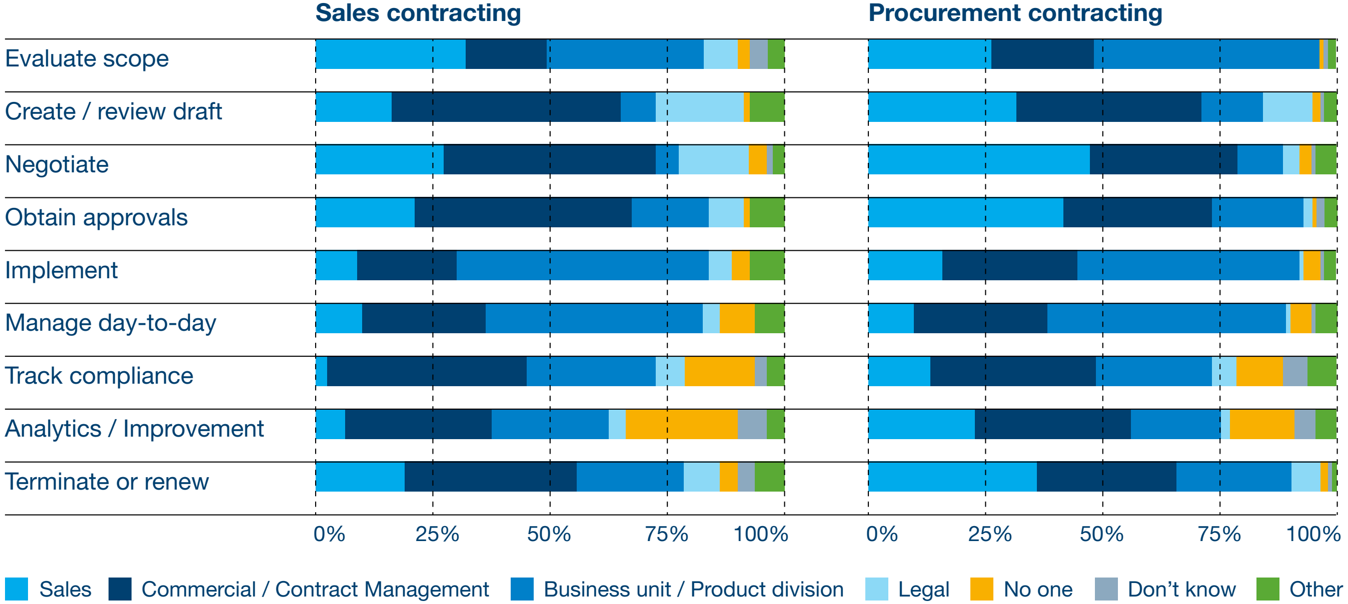
Separately, respondents were asked about responsibility for operational performance and management of contracts, and these results showed similar disparities.

The variations in responsibility are understandable. They reflect the need for different competencies and accountabilities. Where issues arise, these are typically because the interfaces within and between phases lack coherence. For example, contract design and evaluation should be closely tied to the development or review of scope, and the negotiation phase should have a strong link to implementation and performance.



Stronger links between certain contracting phases will increase coherence and avoid issues.

Figure 3: Who is responsible for documenting and maintaining the process?



Why does this matter?

As previously observed, markets are dynamic, demanding flexibility and new ideas in contract terms and commercial practices. Building consensus across multiple stakeholders is difficult and time-consuming.

The delay associated with forming or negotiating contracts is often the most evident reason for executive frustration with the process, and this is reflected in the priorities for digitization indicated in Figure 4, right.

Identifying the appropriate form of agreement and then streamlining stakeholder review and approval are obvious candidates when it comes to speed and ease of doing business. Research shows wide variations in the time it takes different organizations to reach agreement with their customers or suppliers. For example, for simple agreements, 'world-class' performance yields an average cycle time from bid to contract of just under 2 weeks. This compares with an average of more than 10 weeks for the worst performers and a median of 5.8.[3] As complexity increases, those weeks stretch into months, creating tensions and delays to key programs, projects and relationships. Inevitably, those same inefficiencies are reflected in the organizational costs of contract production.

"Getting a contract is like having a root canal."
Former Head of Sales
Global software and services provider

For example, the average cost of reviewing and processing a low-complexity negotiated agreement is USD6,900 – but the range of cost is from around USD2,000 for the most streamlined, and more than USD10,000 for the least efficient.

While the cycle time leading to contract signature may be the most obvious source of frustration, the reality is that equivalent and often greater value is lost during other phases of contract performance. Research by World Commerce & Contracting, supported by the findings of KPMG Law, has identified multiple sources of value erosion and missed opportunities that result from a lack of process coherence. For example, the transition of agreements from pre-signature to post-signature implementation and performance is often poorly defined. In many cases, the resources applied to contract performance are untrained and lack appropriate tools or systems. This has a major impact on the efficiency and resulting cost of contract management – according to a World Commerce & Contracting study,[4] the average organization could improve margins by almost 3% through reductions in the operational costs associated with managing its contracts.

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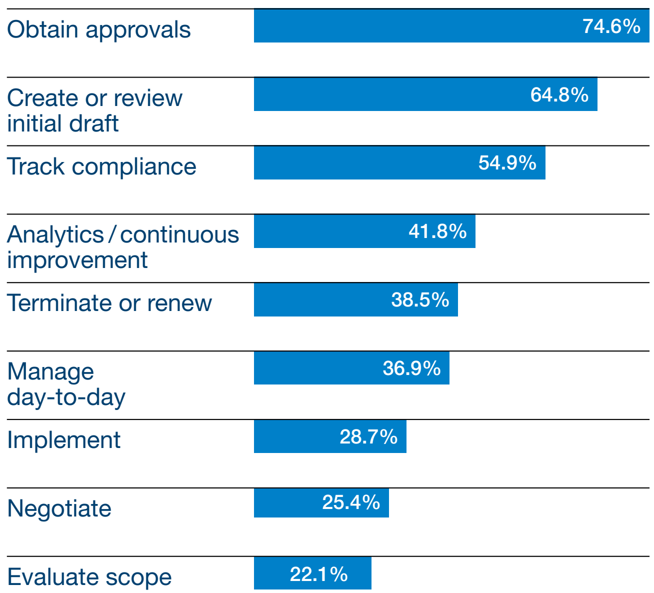
Figure 4: Priorities for digitization



3. World Commerce & Contracting, *2019 Benchmarking Report.*
4. *Value erosion index,* May 2021.

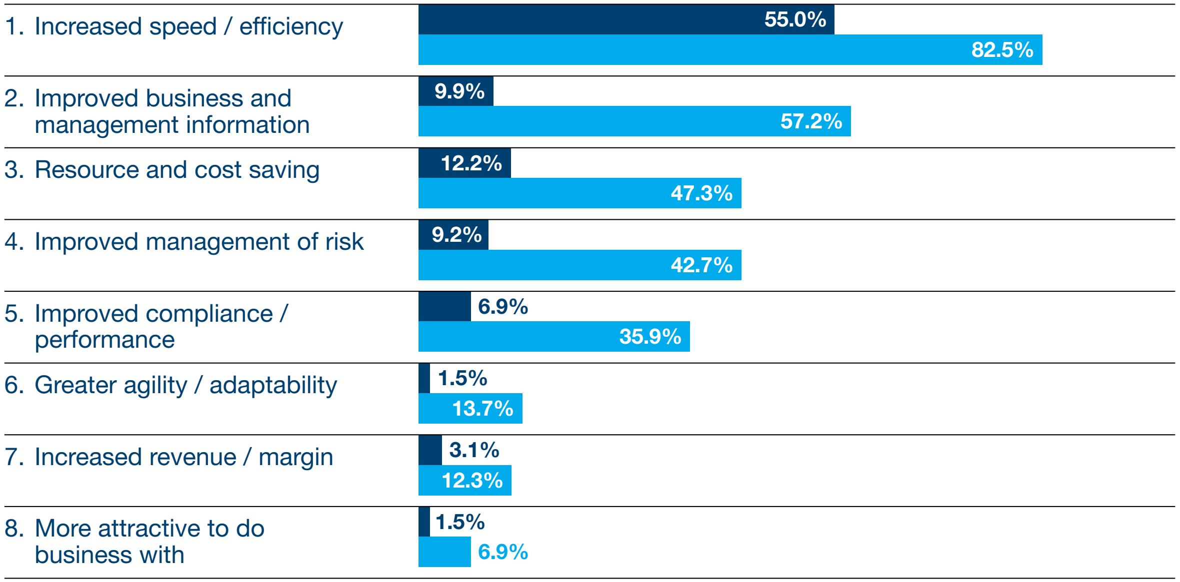
Why does this matter? *(continued)*

Figure 5, below right, shows the primary targets and the expectations of the benefits from digitization. The scale of difference between these factors is surprising – for example, 55% place 'Increased speed and efficiency' in first place and only one other, 'Resource and cost saving', was selected as the top driver by more than 10%.

Looking at the cumulative percentage for the top three drivers/benefits 'Improved business and management information' ranks second (57.2%) after the 'Increased speed and efficiency' (82.5%) and before 'Resource and cost saving' (47.3%). Conversely, only 3.1% selected 'Increased revenue /margin' as the highest rank and 12.3% among the top three.

Although there are some variations between buy-side and sell-side, these are not of great significance. Far more notable are the differences in priority created by the executive sponsor (See page 10 for 'Who's leading improvement?')

Figure 5: Drivers and expected benefits



Participants were asked to rank the eight options in order of importance for their organization.

Percentage of people selecting that driver at rank 1.

Cumulative percentage for the highest three rank positions for each driver.

Who's leading improvement?

Contracting processes are frequently subject to major tensions between the forces of creativity and those of control. In fast-moving markets, those tensions may represent a source of unresolved risk, often requiring determined executive intervention to break down the resistance to change and the barriers to new opportunities.

Figures 6 and 7, right, identify the variety of executive sponsors and executive leads for current digitization initiatives. This once again illustrates the inconsistency in responsibility for contracting.

Figure 7 shows where day-to-day responsibility for project execution has been allocated and at this operational level we observe a significant shift to the Commercial / Contract Management Executive (CCM).

Figure 6: Executive sponsors for digitization

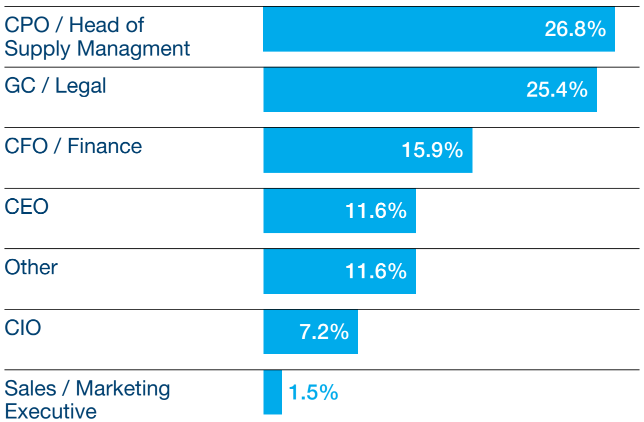
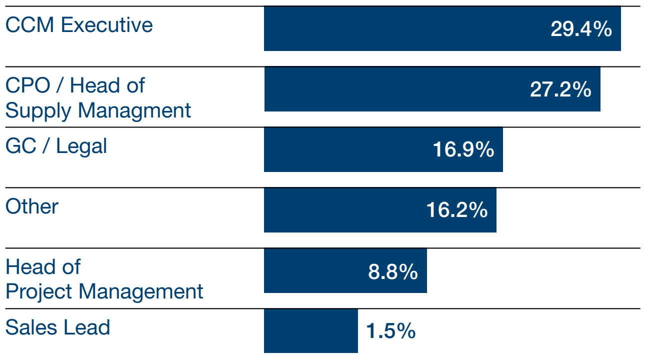


Figure 7: Executive leads for digitization



Further analysis leads to a range of interesting findings:

1. One in nine organizations require the personal sponsorship of the CEO to make change happen. This is indicative of the issues highlighted elsewhere in this report – in particular, the absence of established process ownership, the fragmentation of activities, and competing stakeholder objectives.
2. There is little evidence that initiatives are being viewed holistically to address both buy-side and sell-side contracting.
3. The General Counsel is the sponsor for 44% of sell-side digitization projects, but only 12% on the buy-side (where 41% are led by the Chief Procurement Officer / Head of Supply Management).
4. The Chief Financial Officer is driving 21% of buy-side projects and only 9% sell-side.
5. All sponsors view increased speed and efficiency as the top priority, but there are notable variations in other drivers. For example, the CEO, CFO and GC community view improved business and management information as an important goal (second place), whereas CPOs and CIOs consider resource and cost savings to be more important.

Conclusions

This research points to two big conclusions

1

It is time to find a better approach, to develop a defined capability and accountability for the coherence of contracts and commercial practices. Organizations need 'an owner' of the contracting process – an Office of Contracting that is independent of functional stakeholders.

The contracting process needs an owner – an independent Office of Contracting.

In making this statement, it is important to distinguish between operational responsibility for performing the multiple activities undertaken during the life of a contract, versus a responsibility for overseeing the process that guides and supports those activities.

It is our view, supported by a majority of survey respondents, that process integrity and maintenance depend on a single point of accountability.

Contracts are dynamic instruments, driven by changes in business strategy, markets, competition, regulation and a host of other influences. Without clear responsibilities for process oversight, efforts to simplify, streamline and increase business value will inevitably be temporary.

Where should that responsibility sit? Almost 30 years ago, Lou Gerstner – the man who saved the IBM Corporation – faced this dilemma. He took the view that contracts are about brand image and ease of doing business, so they naturally belong in Marketing.

However, it is not what our survey respondents expect, nor how things actually turned out at IBM. Of those who believe that digitization will lead to a designated process owner, 60% expect that owner to be the Commercial / Contract Management executive; 23% expect that it will be the Sales or Procurement executive; and just 9% see it being within Legal. However, history tells us that combining strategic and operational responsibility for this complicated and interdependent activity rarely works. That is why we strongly advocate the separation of duties.

When it comes to operational responsibility for contracting, performance will continue to be scattered across the organization. That is how it should be – and it is also why the coordinating role of a process owner is so critical. Their job is to facilitate others, ensuring that they have the tools, knowledge and systems required to optimize contract performance and value.

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"Contracting and commercial capability demands one eye on the market and one on internal capabilities."

General Manager, Commercial
Global telecommunications corporation

Conclusions *(continued)*

2

Digital technologies introduce new value streams from developing and maintaining commercial and contract management capabilities.

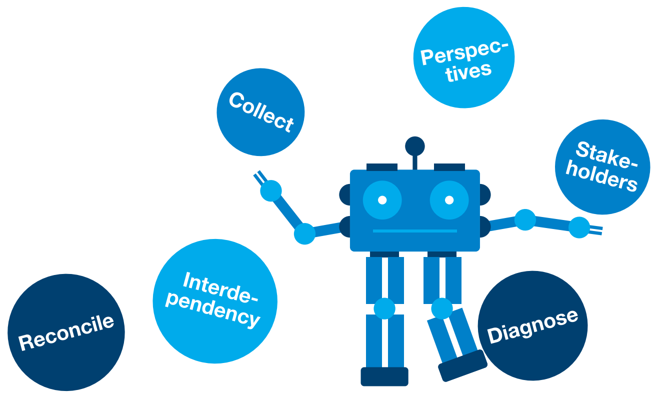
Successful digitization creates a need for better defined standards and for the multiple stakeholders involved in the commercial and contracting process to become both more transparent and more accountable. Artificial intelligence and machine learning are resulting in increased self-service. Together, these technological developments are reducing the frequency with which specialist professionals or coordinators need to engage, for example in transactional review and approval.

But what about:

- The need for exceptions?
- Adjusting terms and policies for shifts in the market?
- Innovation and finding solutions to complicated in-life problems?
- The selection and adoption of new tools or systems to further improve or streamline the process?

This report has confirmed the innate complexity of contracting and commercial practices. That complexity is driven by interdependency, the need to collect, diagnose and reconcile the views and perspectives of multiple stakeholders, both internal and external. Machines won't be performing this integrationist role any time soon, so people continue to matter. Increasingly, equipped with data and facts, those performing commercial and contract management tasks have an opportunity to deliver far greater and more visible value. Advanced technologies will enable a more distributed organizational model, matrixed or center-led rather than centralized.

Empowered by collaborative and intelligent technologies, contracting is entering a new era, providing a dynamic balance between the delivery of value and control. Those who grasp that opportunity and address the fundamental issues of ownership and accountability are establishing commercial and contracting competence as a distinctive capability and source of competitive advantage. But a final word of warning: only 26% of respondents believe that their technology team is well equipped to support their digitization initiative – so will this frustrate many in their progress?



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About World Commerce & Contracting

World Commerce & Contracting is a not-for-profit association dedicated to helping our global members achieve high-performing and trusted trading relationships. Research is at the heart of our work. Relevant, rigorous and high impact, our pioneering insights shape policy and deliver better practice worldwide. With 75,000 members from over 20,000 companies across 180 countries, the association welcomes everyone with an interest in better contracting: business leaders, practitioners, experts and newcomers. We are independent, provocative and disciplined, existing for our members, the contracting community and society at large.

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About KPMG Law

KPMG Law focuses on providing clients with a broad range of legal services and solutions, which goes well beyond traditional legal advice or transactions. Our people are modern legal professionals who are globally connected to a team of over 2,850 lawyers in 81 jurisdictions, and who have deep multidisciplinary expertise, business acumen and strategic experience. We provide our clients with innovative and integrated solutions to help modernize, simplify and digitize their legal function with the support of a global team with experience, real credentials, a mindset for innovation and the power of KPMG's relationships with leading technology providers.

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