Recapturing Millions of Dollars by Leak-Proofing Your Contract Processes

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Hannah Dixon | Manager, Commercial Contracting, DaVita Kidney Care
Tim Cummins | President, IACCM

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Introductions

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Elevate

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Contracts Manager
DaVita

Tim Cummins
President
IACCM
Consideration = $100
Question:
How much value does each party actually get?

A. $94
B. $88
C. $60 (or less)
Average Contract Value Leakage

- All Companies: -9.3%
- Best in Class: -6.2%
- All the Rest: -12.4%
- Bottom quintile: -40.0%

*Numbers include only direct leakage and not consequential losses*

*Sources:* Tim Cummins, *Poor Contract Management Costs Companies 9% – Bottom Line* (IACCM, October 29, 2012); Supporting Local Public Services Through Change, Contract Optimization (Ernst & Young 2016) at 2; KPMG:LLP Strategic Sourcing Point of View: Shared Services, Outsourcing Contracts Can Hinder Business Plans Without Proper Governance (Feb. 23, 2012).
Company A and Company B are competitors who have identical revenues but manage contracts differently.

<table>
<thead>
<tr>
<th></th>
<th>Company A</th>
<th>Company B</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Annual Revenues</strong></td>
<td>$1,000,000,000</td>
<td>$1,000,000,000</td>
</tr>
<tr>
<td><strong>Gross Margin</strong></td>
<td>20%</td>
<td>20%</td>
</tr>
<tr>
<td><em>(excluding contract value leakage)</em></td>
<td>$200,000,000</td>
<td>$200,000,000</td>
</tr>
<tr>
<td><strong>Operational Maturity Level</strong></td>
<td>Top Performer</td>
<td>All the Rest</td>
</tr>
<tr>
<td><strong>Contract Leakage</strong></td>
<td>6.2%</td>
<td>12.4%</td>
</tr>
<tr>
<td><em>(excluding contract value leakage)</em></td>
<td>$62,000,000</td>
<td>$124,000,000</td>
</tr>
<tr>
<td><strong>Gross Margin</strong></td>
<td>13.8%</td>
<td>7.6%</td>
</tr>
<tr>
<td><em>(including contract value leakage)</em></td>
<td>$138,000,000</td>
<td>$76,000,000</td>
</tr>
</tbody>
</table>
Sources of Value Leakage

- Poor contract quality
- Contracting costs
- Inadequate contract management
Nobel Prize in Economics 2016
for their contributions to contract theory

Oliver Hart
Harvard

Bengt Holmström
MIT
Contract Quality

Between 1/2 and 2/3 of leakage traces back to issues of contract quality, mainly incompleteness and ambiguity.

See Tim Cummins, Poor Contract Management Costs Companies 9% – Bottom Line (IACCN, October 20, 2012); Supporting Local Public Services Through Change, Contract Optimisation (Ernst & Young 2016)
Sources of Quality Issues

- Initial Contract Template
- Negotiated Agreements
## Plugging the Quality Leak

Standardization and discipline are the keys to quality contracts

<table>
<thead>
<tr>
<th>Quality Defect</th>
<th>Impact</th>
<th>Solution</th>
</tr>
</thead>
<tbody>
<tr>
<td>Contract is not fit for purpose</td>
<td>Fails to address important elements of relationship, impeding effective contract management</td>
<td>Use tailored agreement templates; avoid generic purchase agreements</td>
</tr>
<tr>
<td>Contract template is ambiguous</td>
<td>Makes contract difficult to manage</td>
<td>Use quality templates</td>
</tr>
<tr>
<td>Negotiations cause strong template to become ambiguous</td>
<td>Makes contract difficult to manage</td>
<td>(1) Use click accepts where possible</td>
</tr>
<tr>
<td></td>
<td></td>
<td>(2) Use playbooks</td>
</tr>
<tr>
<td></td>
<td></td>
<td>(3) Stop needless negotiations</td>
</tr>
<tr>
<td>Unclear remedies</td>
<td>Make contract difficult to manage</td>
<td>Have clear SLAs and remedies</td>
</tr>
</tbody>
</table>
## Contracting Costs and Cycle Times

<table>
<thead>
<tr>
<th></th>
<th>Top Performers</th>
<th>Others</th>
<th>Delta</th>
</tr>
</thead>
<tbody>
<tr>
<td>Transaction Cycle Time</td>
<td>11.5 days</td>
<td>21.2 days</td>
<td>46%</td>
</tr>
<tr>
<td>Cost of Completing Simple Contract</td>
<td>$3,800</td>
<td>$6,900</td>
<td>45%</td>
</tr>
<tr>
<td>Cost of Completing Medium Contract</td>
<td>$14,000</td>
<td>$23,000</td>
<td>39%</td>
</tr>
<tr>
<td>Cost of Completing Complex Contract</td>
<td>$49,000</td>
<td>$100,000+</td>
<td>51%</td>
</tr>
</tbody>
</table>

Contracting Cost and Time Drivers

- Poor quality templates
- Needless negotiations
- Lack of defined process
  - Authority matrix
  - Playbooks/fallbacks
  - Escalation paths
- Lack of tools
  - Repository
  - Workflow
  - Doc assembly
  - eSignature
Extended Impact

• The typical law department’s budget is around 1% of revenues.

• Direct impact of higher contracting costs is relatively small.

• Indirect impact can be huge as the same things that lead to contracting cost and time increases also impact quality.
Contract Management

Value captured during procurement “Value Promised”

The business case “Value Expected”

Value

Pre-contract award (procurement) Post-contract award (supplier governance) Time

hard leakage

12%

20%

What was delivered “Value Realized”

soft leakage

8%

Sources: Jason Donner & Claude Marais, Redefining CLM to Realize the Power of the Connected Enterprise, slide 11 (presentation to IACCM Americas Conference, October 11–13, 2017).
Examples of Leakage

Hard Leakage
- Invoicing errors
- Unrealized pricing adjustments
- Non-compliant work

Soft Leakage
- Delivery failures
- Poor customer experience
- Lost renewal opportunities
- Lost business
Managing Contracts

Individual Contracts

- Event-based notifications
  - Renewals
  - Pricing adjustments
  - Delivery milestones
- Delivery compliance reviews
- Invoice compliance reviews

Contract Portfolios

- Risk profile reviews
- Negotiated terms review
- Profitability reviews by deal type, business unit, region, etc.
- Transaction cycle times by deal type, business unit, region, etc.
Contracts may be your company’s biggest asset.

- Over 80% of the value of the Fortune 500 is attributable to intangible assets.
- Many of these assets are embodied in contracts.
- A robust contract repository arguably contains more data about the business than the company’s financial systems.
- You cannot harness that data unless you have the systems and processes in place to collect and analyze it.
Optimized Approach to Contracts

<table>
<thead>
<tr>
<th></th>
<th>Traditional Model</th>
<th>Request, Generate and Deliver</th>
<th>Review, Negotiate and Approve</th>
<th>Sign, Store and Search</th>
<th>Contract Management</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Analytics</strong></td>
<td>Event driven manual undertakings</td>
<td>Use data from downstream analytics tools to drive continuous improvement in templates and playbooks</td>
<td>Use management intelligence from workflow to continuously improve process</td>
<td>Advanced analytics tools, including reporting, pattern recognition and predictive analytics</td>
<td>Analyze install base of contracts to manage obligations, manage risk profile, and improve templates/playbooks</td>
</tr>
<tr>
<td><strong>Technology</strong></td>
<td>Microsoft Office</td>
<td>Contract authoring and/or click accept; workflow</td>
<td>Workflow and contract authoring</td>
<td>E-signature and secure, scalable, searchable repository</td>
<td>Event-based notifications, vendor management tools</td>
</tr>
<tr>
<td><strong>People</strong></td>
<td>Lawyers do everything</td>
<td>Self-service model</td>
<td>Right sourcing including contract managers within the business, onshore, offshore</td>
<td>Automated where possible, with right sourced contract admin center support as needed</td>
<td>Automated where possible, with right sourced contract management center support as needed</td>
</tr>
<tr>
<td><strong>Process</strong></td>
<td>Ad hoc</td>
<td>Simplified, standardized templates and playbooks</td>
<td>Defined approval/escalation process with negotiators having authority to use standard fallbacks</td>
<td>Centralized process</td>
<td>Standard obligation and template management processes; mix of centralized and decentralized</td>
</tr>
</tbody>
</table>

Leak-proofing your contract processes requires a holistic approach.
Case Study: DaVita

Leak-proofing contracting processes with a vendor portal.

- One of the largest kidney care providers in the US
- Identified need to improve process to keep up with growth

<table>
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<th>Issue</th>
<th>Solution</th>
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<tbody>
<tr>
<td>De-centralized processes</td>
<td></td>
</tr>
<tr>
<td>Vendors without appropriate terms in place</td>
<td>Vendor Portal</td>
</tr>
<tr>
<td>Lack of process automation</td>
<td></td>
</tr>
<tr>
<td>High risk profile</td>
<td></td>
</tr>
</tbody>
</table>

- Vendor Portal can be foundation for portfolio contract management
**Case Study: DaVita (cont’d)**

DaVita Vendor Portal – Solution

- Implement a vendor registration solution which will formally onboard new vendors.
- This solution will improve compliance, reduce enterprise risk, provide visibility across AP and Legal, and improve process efficiency.

<table>
<thead>
<tr>
<th>Legal</th>
<th>AP</th>
<th>Compliance</th>
</tr>
</thead>
<tbody>
<tr>
<td>- Reduce risk</td>
<td>- Reduce burden via increased process</td>
<td>- Reduce risk of doing business with excluded</td>
</tr>
<tr>
<td>- Lower costs</td>
<td>efficiency</td>
<td>vendors</td>
</tr>
<tr>
<td>- Improve transaction</td>
<td>- Reduce risk of billing fraud</td>
<td></td>
</tr>
<tr>
<td>cycle times</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
Case Study: DaVita (cont’d)

DaVita Vendor Portal – Challenges

- Process change and buy-in
- Platform selection
- Integrating technologies
- Funding source identification
Questions and Discussion