Managing contractual obligations

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Each day enterprises spend thousands of hours and millions of dollars negotiating deals with other enterprises. Whether on the buy or sell side of the equation, the output of all that time and effort are the terms and conditions held in the contract. However, what happens after the contract is signed? For many organizations the contract, once in place, stops being a living part of the deal's lifecycle. This is because many companies spend considerable time and resources executing contracts to their liking and then, once executed, fail to properly monitor and oversee these contracts.

"I have signed a lot of contracts in my time, and at sometime I probably knew what the contracts meant, but six months later everything had grown dim and I could be certain of only two things, to wit: One, I didn't sign any contract. Two, the contract means the opposite of what it says." [1]

– Mark Twain

Contract Lifecycle Management is well known at most companies now, but the definition of what this means varies greatly. Many companies focus on controlling the creation and execution of their contracts, but neglect to put into place virtually any controls for the active contract. This makes the "Lifecycle" portion of the name a misnomer since in many cases the post execution phase of the contract is being ignored. In short, many companies are failing to manage the contractual obligations agreed to during the negotiation phase.

So what is the definition of a contractual obligation? The general purpose of contracts is to define the business relationship between parties and to set the parameters for how the parties will conduct business. The permutations of these relationships is endless and varies based on industry vertical, geography, regulatory environment, and virtually any number of individual business requirements. There is no one-size-fits-all definition for any of them. Contents of the contract might include delivery terms, insurance parameters, milestone dates, service levels, discounts, penalties, warranties or virtually anything else the parties feel is relevant to their relationship or specific transaction. From an impact perspective, failure to meet these obligations can result in missed savings, heavy fines, costly litigation, broken relationships, supply chain gaps and lost customers, just to name a few. Based on the possible consequences of not managing contractual obligations, both made by your suppliers and that you have made to your customers, it is shocking how few companies proactively manage their contracts. Therefore, companies that want to help maximize savings, increase revenue, mitigate risk and maintain positive relationships with their business partners realize the importance of obligation management.

In concept, obligation management is simple: proactively manage the terms of a contract over its lifetime. Execution, however, is much more difficult. This is due to the decentralized nature of contracting and the long lengths of contracts. Until the last decade, obligation management was typically done by individuals just "knowing" what is in a contract or with spreadsheets, notes or some other manual process. However; with the advent of the internet and the evolution of software, obligation tracking no longer has to be manual or time consuming. IBM has recognized this and can help with obligation management.

How IBM manages obligations

- **Alerts can be triggered** based on contractual conditions. These alerts can:
  - Send notifications by e-mail on a recurring basis to individuals and/or groups
  - Trigger actions in the application meaning that a task can appear in a users Contracts Dashboard requiring them to perform a review of a contract at virtually any point in the lifecycle
  - Generate pre-populated forms for more strategic, periodic account reviews that require their own process
  - Trigger amendments to be created automatically as events occur

- **Associate alerts to both contract templates** as well as individual clauses to verify a consistent process without requiring manual setup for each occurrence. When a clause is added, virtually all the associated alerts will automatically be added to the contract record
- **Provide robust amendment management** to facilitate not only the creation of amendments, but also provide a single view of the amendment's impact on the original agreement
- **Create folders** for organization of contract portfolio
- **Perform mass operations** for changing active agreements more quickly and accurately. For example, if political or economic unrest occurs or is likely to occur in a region, a company can quickly identify all contracts, regardless of whether supplier or customer, that might be affected, evaluate the risk and potential impact of the unrest and amend all agreements in mere minutes as opposed to weeks or longer

Case example

Problem: The following business case is based on a large $17 billion global manufacturing company which creates hundreds of highly complex, multi-million dollar contracts per year. These contracts dictate the sales of six figure medical devices and are scrutinized carefully during the contracting process. More importantly, once the contract is executed the obligations detailed in each agreement need to be reviewed actively in order to verify they are met. Was the first payment of $10,000 received on Monday as expected? Was Product X delivered to the customer at the end of the month as agreed on? These are types of contractual obligations that must be reviewed periodically by the company. There can be several negative impacts to the business if the obligations of a contract are not met. There can be ptential loss of revenue, relationships between the company and customers can be damaged, and so on.

Previously, the manufacturing company used two in-house developed systems to manage its contracting and obligation management process. There was one system to handle the contracting portion of the process. A second system handled the periodic reviews of obligations that needed to be completed. Since two systems were involved in managing the process, tasks associated with obligation management had to be set up manually in the monitoring system for each contract. Even then there was no guarantee that the correct sets of reviews were listed for a particular contract. To create and maintain such a structure required a very big manual effort. As a result of the complexity of the contracts, each contract created might need hundreds of monitoring actions triggered over the life of the contract. In the past these actions required a number of different employees to review the contract's obligations at varying intervals.

How it was fixed: To improve management of these contracts, IBM® Emptoris® Contract Management was implemented with its obligation management functionality. For these highly complex sales agreements, proactive monitoring tasks were configured to automatically trigger at given intervals. These monitoring tasks were tied to specific sections of the contract language. For example, the "Pricing" section might require John Smith's review 180 days after the contract had been executed. This review will only be necessary should the "Pricing" section be included in the contract. The review tasks and e-mail messages which trigger as a result of these monitoring tasks are automatically added to the contract if those particular sections of language are included in the contract. This helps ensure that the contract will only have relevant monitoring tasks associated with it and therefore monitoring is conditionally applied only when the elements in the agreement require them. After the contract has become active, the system will notify the relevant reviewer to check a specific section of the contract to verify the obligations set in the contract are met. Additional related forms are also generated to track obligations against the contract. These forms allow a potentially easier way to note which obligations have been met and which have not. If obligations have not been met, the system requires reasons to be detailed in the form which detail how to resolve the issue.

Perceived benefits: With IBM Emptoris Contract Management, the client improves their efficiency in monitoring customers' obligations to the terms and conditions of a contract by:

- Standardizing the post-execution review process for contract terms and conditions
- Providing quarterly alerts indicating the clauses in a contract requiring review
- Automating the creation of monitoring forms to facilitate tracking
- Verifying the necessary reviews and approvals are completed post execution
- Decreasing the cost of monitoring contracts
- Improving the accuracy with which the terms and conditions of a contract are monitored
- Improving the ability to verify the terms of a contract are met
- Increasing compliance with internal monitoring policies
- Allowing a collection of payments on a timely bases
- Improving the tracking of payments and revenues

Finally, the client benefits by reducing the overhead costs associated with customizations required to maintain its home grown contracting application system.

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1 Mark Twain Notebooks

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