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Realizing ROI from CONTRACT MANAGEMENT TECHNOLOGY

INTRODUCTION

While there is no doubt about the many benefits implementing a Contract Lifecycle Management (CLM) solution brings, quantifying its returns is the tricky part.

This whitepaper presents six methods of determining CLM's Return on Investment (ROI) for your organization. For most companies, summing up the values generated in over three of these methods, as applicable, yields the closest ROI estimate.

CLM's ROI is determined based on the following parameters:

a. Reduction in legal employee costs
b. Prevention of financial losses
c. Reduction in sales operation costs
d. Management of renewable contracts
e. Penalty avoidance and/or recapture
f. Identification of consolidation opportunities

ROI CALCULATION METHODS

REDUCTION IN LEGAL EMPLOYEE COSTS

With an automated CLM system, organizations can accelerate every stage of their contract cycle—be it contract drafting, negotiation, approval, or post-award contract management. Shorter contract cycle directly translates into productivity gain for the legal team and enables them to allocate more time on higher value work. Since legal costs associated with each stage of contract management constitute a significant amount, organizations realize great cost savings on implementing a CLM solution.

According to a report by Goldman Sachs, using a CLM reduces the average number of hours spent on contracts by 20%.

Organizations can estimate the amount of legal cost savings based on the number of members in the legal department (attorneys and non-attorneys), average of the number of their work hours, and the average loaded hourly rate.

Below is a simplified example wherein there are 6 non-attorneys who, on an average, spend 96 hours per month on contracts. Their average loaded labor rate is $100 per hour. We also have 3 attorneys on board who spend 32 hours on contracts on an average, and their average loaded labor rate is $200 per hour. Using the above Goldman Sachs data, we can calculate the amount of annual cost savings for this scenario.

Note: For simplicity, we have clubbed together outside and inside counsels under attorneys.

LEGAL EMPLOYEE COSTS	
No. of non-attorney legal employees working in contracts	6
No. of man hours spent in managing contracts per non-attorney legal employee per month	96
Average loaded hourly rate	$100
No. of attorneys working in contracts	3
No. of man hours spent in managing contracts per attorney per month	32
Average loaded hourly rate	$200
Annual manpower reallocation	**$184,320**

(No. of non-attorney legal employees working in contracts

* No. of man hours spent in managing contracts per non-attorney legal employee per month

* Average loaded hourly rate

* 20%

* 12)

+

(No. of attorneys working in contracts

* No. of man hours spent in managing contracts per attorney per month

* Average loaded hourly rate

* 20%

* 12)

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Annual legal manpower reallocation

Hence, the organization in this example will be able to manage around 12% more contracts with the same number of legal team members.

PREVENTION OF FINANCIAL LOSSES

Often, once a contract is signed off, it is simply stored among thousands of other contracts and never looked at again. This leads to missed opportunities and lost revenue due to inadequate or non-existent contract tracking and enforcement. A cutting edge CLM solution empowers you to use your contracts to generate intelligence for taking better business decisions. For organizations with thousands of contracts, post-award management is critical since multiple instances of inefficient obligation management, erroneous overpayments, and revenue leakage can result in huge financial losses.

A recent research by IACCM (International Association for Contract and Commercial Management), reported that organizations lose 9.2% of revenue every year due to poor contract management.

In the example below, we have a company with annual revenue of $1,000,000,000. Using the IACCM data, we can calculate ROI of CLM based on the savings incurred due to reduction in annual revenue loss. Let us assume a 50% recapture / reduction in loss to annual revenue since CLM wouldn't be able to prevent all the losses to annual savings immediately in the first year of its implementation.

Note: After 18-24 months of implementation, a next-generation CLM would be able to recapture the remaining value as well.

PREVENTION OF FINANCIAL LOSSES	
Annual revenue	$1,000,000,000
Potential loss based on IACCM research (9.2%)	$92,000,000
Recapture / Reduction in loss to annual revenue	50%
Reduction in loss to annual revenue	**$46,000,000**

Potential loss based on IACCM research

* Recapture / Reduction in loss to annual revenue

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Reduction in loss to annual revenue

REDUCTION IN SALES OPERATION COSTS

An organization's sales cycle is directly affected by embedded inefficiencies in contract management which, in turn, translates into wasted resources. With shorter sales cycles, organizations can get more business done with the same sales team size in the same amount of time. This cuts down on the sales operation costs.

As per a research conducted by the Aberdeen Group, CLM usage results in 24% reduction in sales cycle.

That is, with CLM implementation, the members in sales teams can recoup 24% of their day. Before, if it took 4 weeks to close a quarter; with CLM implementation, they will be able to do that in 3 weeks!

Let us take the example of a smaller organization—20 salespeople working 40 hours per week, with average loaded labor rate of $80 per hour. Assuming that this reduction in sales cycle boosts sales team's performance by 20%, i.e., 20% less man hours for the same sales, we can calculate CLM's ROI as:

SALES OPERATION COSTS	
No. of salespeople	20
Average loaded hourly rate	$80
Average no. of hours worked per week per employee	40
Annual savings	**$640,000**

No. of salespeople

* Average loaded hourly rate

* Average no. of hours worked per week per employee

* 50

* 20%

=

Annual reduction in sales operation costs

MANAGEMENT OF RENEWABLE CONTRACTS

One of the main problems organizations face is not having sufficient notice about when a contract renewal / expiry is due. Inefficient expiry / renewal management causes contracts to expire / renew without any performance evaluation. Knowing when a contract is up for renewal well in advance helps you prepare for it adequately. With enough time on your hands, you can evaluate the contract performance and hence, renegotiate better.

CLM allows you to set up alerts and reminders so that you never miss a contract deadline. CLM constantly tracks contract performance in real time, thus ensuring you renew the right contracts and renegotiate contract terms to your benefits. Further, CLM maintains complete history of the contract—all the metadata, line items, etc. are clearly demarked and available for reporting and analysis, thereby ensuring you make the right business decisions quickly. Such planned expiry / renewal management also allows you to look for opportunities, such as cross sell and up sell, to improve customer relationships. With efficient expiry / renewal management, organizations can realize 5-10% gains on sales agreements.

In an organization, 20-30% of contracts are renewable. If you handle these renewable contracts more effectively, you can renegotiate the revenue with more foresight with a reduced effort.

The following table takes the example of a company wherein the number of contracts is 3000 and the average deal value is $100,000. Let us take a conservative assumption that at renewal, each of these will increase by 5%, on an average. We can now calculate the annual benefit as:

RENEWABLE CONTRACTS	
No. of contracts	3000
Average revenue value	$100,000
Presumed % increase in revenue / Average realized savings on renegotiated contracts	5%
Average net new revenue	$5,000
Annual benefit	**$15,000,000**

No. of contracts

* Average net new revenue

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Annual benefit on renegotiated contracts

PENALTY AVOIDANCE AND/OR RECAPTURE

For organizations with a substantial number of contracts, it is challenging to track and manage deliverables and milestones like payments and deliveries. Penalty clauses in contracts mean that there is a monetary cost associated with these missed milestones.

Modern CLM solutions go past the point of contract signing into the ongoing management and performance of contracts. They tie in with other transactional systems and provide detailed insights to ensure that you effectively enforce the penalties contractually owed to you. Also, they provide granular visibility into contracts to give you the warnings to avoid penalties.

Efficient enforcement and avoidance of penalty clauses (as the case may be) can lead to significant cost savings as demonstrated in the example below. In this scenario, we take the average value of 5 years of historical penalties enforced on an organization. This gives us the amount that the organization will be able to save by not having to pay such penalties anymore. We also have the added benefits that the organization earned by enforcing penalty clauses efficiently.

PENALTY AVOIDANCE AND / OR RECAPTURE	
Avoidance of average of 5 years of historical penalties	$100,000
Added benefits earned by enforcing penalty clauses efficiently	$2,000,000
Annual benefit	**$2,100,000**

Avoidance of average of 5 years of historical penalties

+ Added benefits earned by enforcing penalty clauses efficiently

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Annual benefit

IDENTIFICATION OF CONSOLIDATION OPPORTUNITIES

CLM gives complete visibility into organization-wide contracts thus making it easy to identify the opportunities for supplier consolidation. When it comes to renegotiating services, or doing audits on your service providers, the gains typically range anywhere from 3-9%. There are also opportunities to manage your hard goods suppliers, the suppliers who have deliverables of machinery or consumables for your organization. By running contract analytics across your supply base, you can identify opportunities to consolidate the demand of your internal users. Leveraging this information, you can reduce the number of suppliers and increase the average volume per supplier.

Bringing a supplier pool of 20 down to 5 for a specific commodity or service group can yield significant volume improvement. Organizations can even save a net amount of 14-18% with aggressive supplier normalization and spend visibility tied to the increase in contract knowledge. Suppliers also tend to offer more favorable terms such as a higher credit period, less lead times, etc. for high volume purchasers.

Let us take the example of a company with total procurement contract value of $300,000,000. The table below details ROI calculation using this approach:

CONSOLIDATION OPPORTUNITIES	
Total procurement contract value	$300,000,000
% identified consolidation opportunities through CLM analytics	10%
% average realized savings on consolidations	3%
Estimated hard dollar savings	$900,000
Annual savings	**$900,000**

Total procurement contract value

* % identified consolidation opportunities through CLM analytics

* % average realized savings on consolidations

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Annual savings due to consolidation opportunities

RESULT

ROI estimates for the above examples read:

$184K	– Reduction in legal employee costs
$46 Million	– Prevention of financial losses
$640K	– Reduction in sales operation costs
$15 Million	– Management of renewable contracts
$2.1 Million	– Penalty avoidance and/or recapture
$900K	– Identification of consolidation opportunities

For most companies, combining three or more of these methods gives the closest ROI estimate.

CONCLUSION

CLM solutions not only add value to an organization's bottom line by optimizing resources but also have an impact on the top line by enhancing the sales processes. Organizations that implement the right CLM can thus easily recover investments in a short time.

Contact **info@ultria.com** to get a customized estimate on the ROI of a CLM solution for your organization.

ABOUT ULTRIA

Ultria CLM is built around an intuitive user experience, leveraging a comprehensive knowledge base, robust Artificial Intelligence technology, and encapsulates industry's best-of-breed processes and methodologies. Contract Lifecycle Management software from Ultria centralizes contract storage, tracks compliance across multiple dimensions, and reduces creation cycle time. Ultria can be configured to meet specific enterprise objectives to influence business performance through:

- Accelerated contracting processes and enhanced compliance across multiple legal and government regulatory systems.
- Enhanced stewardship, security, and continuity around important contract documents.

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