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Contract Management: The Quote-to-Cash Cycle

More Revenue, Less Leakage

December 2006

Executive Summary

Contracts are a dynamic representation of an enterprise's relationship with its customers. In this electronic age, and more importantly, going forward, paper-based records are likely to become a thing of the past. It will become more and more essential for enterprises to have data at their fingertips, such as that within sales contracts. Amongst a range of other things, this sort of data will be used for historical analysis, as well as forecasting and risk assessment and analysis.

According to the 189 participants in our research, the percentage of an enterprise's revenue that is dictated by a contract will increase from 56% to 68% on average over the next two years. The trend is clearly that enterprises increasingly want contracts in place with their customers and vice-versa. Apart from the increased contract data that needs to be monitored there is also the issue of cycle time for contract creation, negotiation and approval, any of which can be bottlenecks.

Key Business Value Findings

One of the major challenges reported by 68% of survey respondents is **the disconnect between the various processes on the sell-side,** i.e., the quote-to-cash cycle. This includes things such as pricing, proposal creation, negotiation, contract management as well as order management and invoicing. To further complicate things, the sales order management process and the entire quote-to-cash cycle has become increasingly complex. This is largely due to rising sales volumes and intricate product pricing and configurations. All of these complexities contribute to the revenue leakage experienced by a number of enterprises.

Forty-three percent of enterprises face challenges with **standardization of the language** used in various documents such as proposals, contracts, service agreements, etc., which surfaces the issue of financial and legal risk. The financial risk of not controlling this activity includes unapproved contract terms and conditions resulting in additional or unknown customer commitments and corporate liability.

Implications and Analysis

What is the impact of these and other challenges? Respondents reported that, on average, their enterprises lose **9%** of their revenues due to regulatory penalties, missed deadlines, lost sales, "maverick" pricing and transactional errors, clearly a substantial amount.

> Aberdeen research shows that, on average, revenue leakage amounts to 9% of an enterprise's revenues.

Additionally, in any enterprise the reduction of **sales cycles** is critical. Through our research we have found that, on average, **18%** of an enterprise's sales cycle is attributed to contract creation, negotiation and approval. It was also reported that for many enterprises a one-day reduction in the sales cycle is worth on a significant amount.

Best in Class enterprises have shown improved performance in terms of process efficiency and well as substantial financial results. For example, these enterprises reported a 21% reduction in Days Sales Outstanding due to better contract management compared to a 13% reduction at other enterprises. We also found that Best in Class enterprises have a higher percentage (82% vs. 33%) of contracts stored in an electronic/searchable repository with approximately 17% of contracts having non-standard language compared to the 35% at all other enterprises.

Overall, participants identified the following areas to have significant opportunity for improvement:

- Proposal creation
- Contract approval workflow
- Pricing compliance
- Contract analysis

Recommendations for Action

- Plan and execute a strategy to migrate contracts from paper and legal systems into a centralized contract repository; standardize contract terms and language
- Streamline and automate the entire quote-to-cash process; integrate the contract management with financial and transactional systems; use the contract management system as a way of reducing errors and delays in invoicing
- Track commitments and obligations to customers as stated in the contract by making contract data available to relevant stakeholders; place risk values on various contract terms, conditions and clauses therefore taking into account not only revenue, but financial and legal risk

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Table of Contents

Figures

Tables

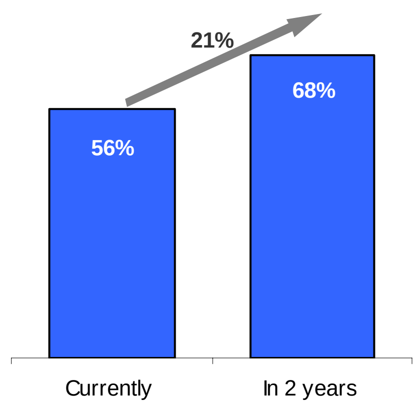
Chapter One: Issue at Hand

Key Takeaways

- The percentage of revenues managed by a contract is expected to increase by on average 21% over the next two years.
- Key factors driving improvements in contract management include:
  - Improvements in management of customer relationships
  - Increasing importance in the management of customers contracts
  - Efforts to reduce sales cycles

Contract lifecycle management (CLM) as a discipline has for the most part grown up on the buy-side, i.e., the management of procurement and supplier contracts. The primary reason for this is clear: contract management allows for improved monitoring of off-contract purchasing, which in effect ensures that a higher percentage of negotiated savings are captured. Furthermore, contract management is a mechanism that makes it easier to bring more spend under management (a key metric in the procurement world).

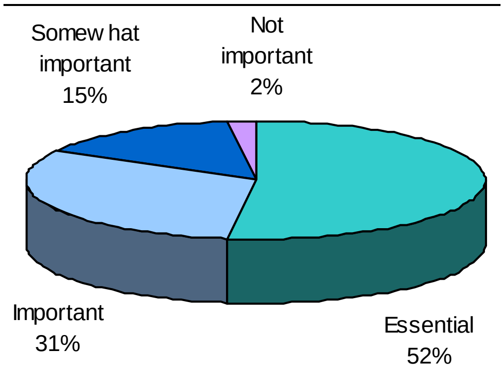
Figure 1: Average Percentage of Revenues Based on Contracts



Source: AberdeenGroup, December 2006

Take these and a number of other uses and flip them around to a customer focused perspective; now, we are talking about contracts that deal with an enterprise's revenue, essential to any organization. Our research has shown that currently an average of 56% of an enterprise's revenues are dictated by a contractual agreement and according to survey respondents this number jumps to approximately 68% in two years (Figure 1).

Figure 2: Importance of CLM in the Quote-to-Cash Cycle



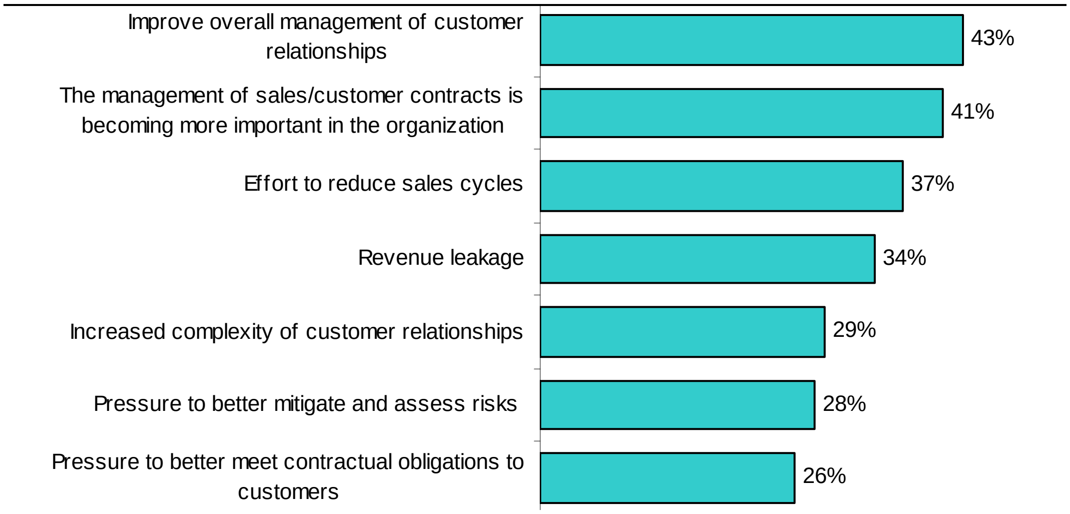
Source: AberdeenGroup, December 2006

When asked how critical contract management is in the entire quote-to-cash cycle, over 50% said that *is* essential, making it clear that this is a critical component of managing customers and revenue (Figure 2). The question is: how many people are doing something about it? Not too many. However, this looks to be changing in the near future.

Driving Factors

Contracts are far from simple documents nowadays; they have evolved into dynamic tools for optimizing business relationships. Despite this, contract management in most organizations usually involves largely manual, labor-intensive and disjointed processes, This results in poor visibility into contracts and compliance, lengthy creation and approval cycles as well as missed revenue and cost-savings opportunities.

Figure 3: Factors Driving Improvements in Contract Management on the Sell-Side



Source: Aberdeen*Group*, December 2006

- **Improving customer relationship management** is something enterprises are constantly trying to do. This is the major driver for improvements in the management of sell-side contracts. Missing or delaying key commitments to a customer does not portray a good relationship. In many cases, this happens because the relevant people do not have access to or visibility into the contract and key milestones that must be met.

- **Increasing importance in the management of sales contracts.** It is clear from Aberdeen's research that the way in which contracts are managed on the sell-side is becoming important within enterprises. Especially with a large volume of contracts, it becomes difficult to determine the total value of contracts that are open or in progress. Although it does seem logical that customer contracts are important, there are cases in which contracts cannot be found, not even in the filing cabinet.

- **Reducing sales cycles** is another reason that enterprises are looking to contract management. The creation, negotiation and approval of contracts in many cases can take a long period of time. This is largely due to manual methods and inability to track approvals and status of various agreements. Being able to reduce this time has a direct impact on the sales cycle, which in most enterprises is extremely valuable. Our research has shown that, on average, 18% of the sales cycle is attributed to creating, negotiating and approving contracts.

- **Revenue leakage** due to penalties, missed deadlines, inconsistent pricing, transactional errors, etc., is something that has the attention of a third of the enterprises. An average of 9% of revenues are being leaked away, this is definitely an issue that deserves significant attention.

Chapter Two:
Key Business Value Findings

Key Takeaways

- One of the major challenges facings enterprises includes the disconnect between the various processes in the quote-to-cash cycle.
- Another challenge is the lack of standardized language used in various contracts and agreements.
- Top areas reported as being ideal for improvement include proposal creation, improved approval workflow and pricing compliance.

Revenue leakage is something facing a number of organizations today. It involves the loss of a significant percentage of revenues due to, amongst other things, regulatory penalties, missed deadlines, lost sales, maverick pricing, transactional errors and unearned discounts.

The sales order management process and the entire quote-to-cash cycle have become increasingly complex, due to rising sales volumes and intricate product pricing and configurations. Fragmented across disparate systems, applications and organizational boundaries, the quote-to-cash cycle and associated processes have become areas that often spur losses in the various forms mentioned earlier (e.g., providing free shipping when the contract does not call for it or approving ineligible discounts). Such errors that add up and if continuously repeated can be the source of significant revenue leakage.

Competitive Framework Key

The Aberdeen Competitive Framework defines enterprises as falling into one of the three following levels of practices and performance:

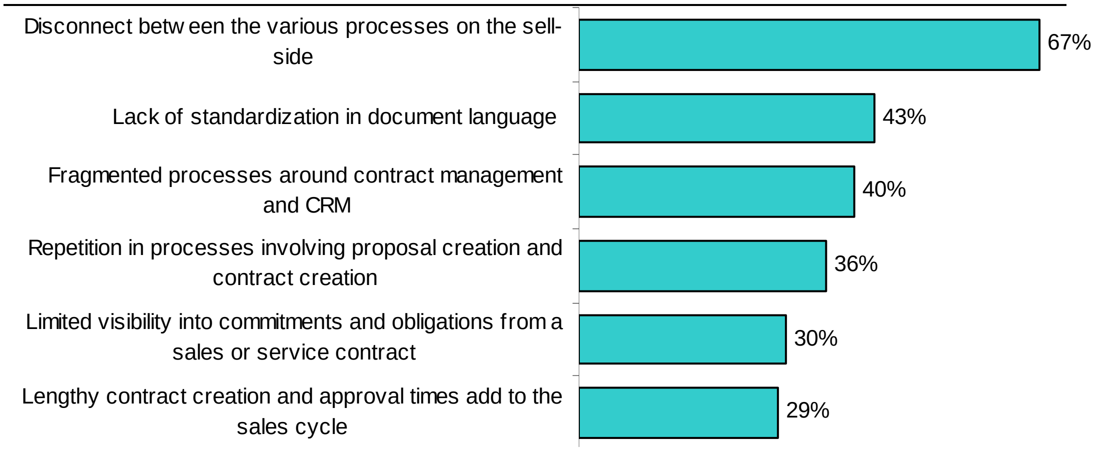
Laggards (30%) — practices that are significantly behind the average of the industry

Industry Average (50%) — practices that represent the average or norm

Best in Class (20%) — practices that are the best currently being employed and significantly superior to the industry norm

Challenges and Strategic Actions

Figure 4: Major Challenges for Contract Management on the Sell-Side

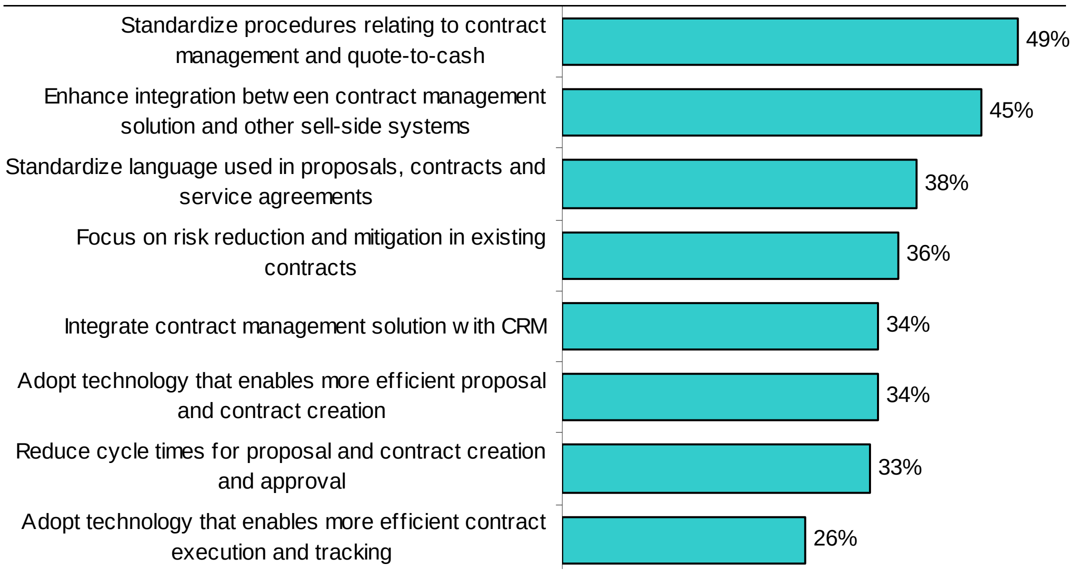


Source: Aberdeen*Group*, December 2006

One of the major challenges reported by 67% of survey respondents is **the disconnect between the various processes on the sell-side** (i.e., the quote-to-cash cycle). This includes things such as pricing, proposal creation, negotiation, contract management as well as order management and invoicing. These fragmented and disjointed processes in many cases are further complicated by manual and/or disparate systems. Such inconsistencies and inefficiencies can be the cause of lengthy sales cycles and high Days Sales Outstanding (DSO).

In addition, 43% face challenges with the **standardization of the language** used in various documents such as proposals, contracts, service agreements, etc. This brings up the issue of both financial and legal risk. It is important for companies to ensure that they are protected by the various terms and conditions of a contract. However, if these are not largely standardized, enterprises are likely to face long contract creation and approval cycles. The financial risk of not controlling this activity is unapproved contract terms and conditions resulting in additional or unknown customer commitments and corporate liability. These include, but are not limited to, unusual order acceptance criteria, extended warranty provisions or commitment to provide free products or services as part of the transaction.

Figure 5: Current or Planned Strategic Actions



Source: AberdeenGroup, December 2006

The chart (Figure 5) above shows some of the actions that enterprises have taken or plan to undertake. A major priority is not only to **standardize procedures** involving contract management and other customer relationship management processes, but also to use standardized language in proposals, contracts and other agreements. Enterprises are also looking to enhance the integration between contract management solutions and other sell-side systems such as pricing, order management and invoicing in order to gain visibility and to prevent revenue leakage and lengthy processes.

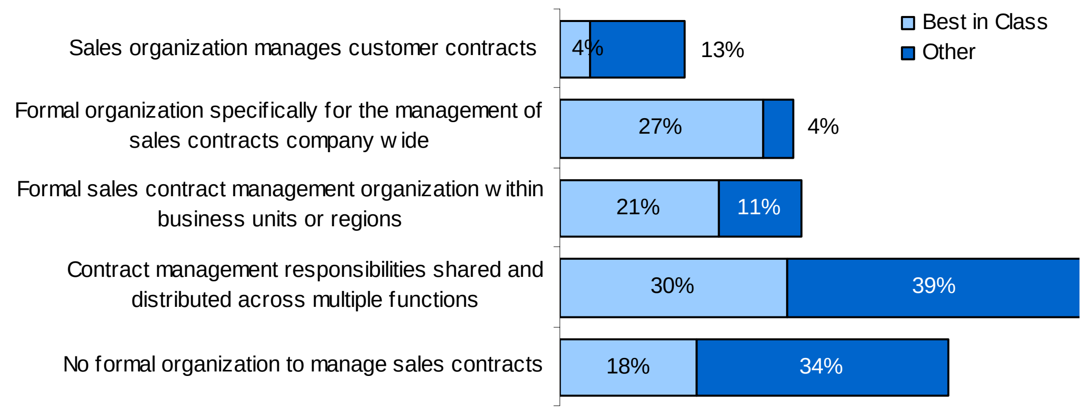
> "It is shocking to realize the amount of risk our contracts carry."
>
> – Senior Executive, Telecom Company

Our data showed that larger enterprises are more focused on **reducing and mitigating risks** within various contracts than their mid-sized counterparts and are also considering technology in order to achieve more efficient contract execution and ongoing tracking.

Processes, Organization and Responsibilities

Many organizations realize the need to better manage customer contracts, as they contain essential data that must be monitored throughout the lifecycle of the contract. However, because of the multiple functions that are involved and the collaborative nature of a contract or an agreement, it is not always clear as to the organizational structure or responsibilities around contracts.

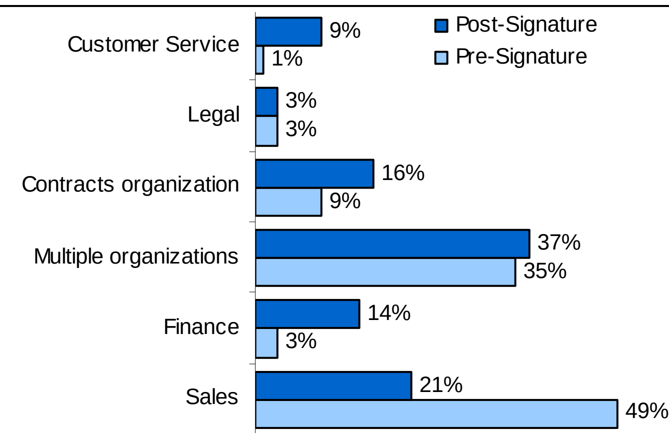
Figure 6: Organizational Structure Around Contract Management



Source: AberdeenGroup, December 2006

In Figure 6, we can see that 48% of Best in Class enterprises have formal organizations specifically for the management of sales contracts either throughout the company or within various business units or regions. However, for the most part responsibilities are shared across multiple functions. In many cases contract management roles and processes are going to involve multiple parties, as shown below (Figure 7). However, for the most part, pre-signature processes are carried out by sales, while post-signature responsibilities are fairly dispersed. For some enterprises it may be finance and in others a central contracts organization is responsible.

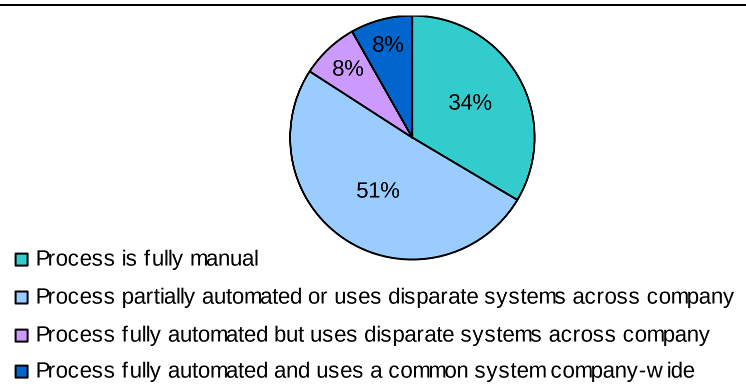
Figure 7: Where Do Contract Management Responsibilities Lie?



Source: AberdeenGroup, December 2006

If we consider the automation of contract lifecycle management, on average, just over half of the survey respondents use a manual process (Figure 8). Of the Best in Class enterprises, however, 30% use an automated process.

Figure 8: Level of Contract Management Process Automation

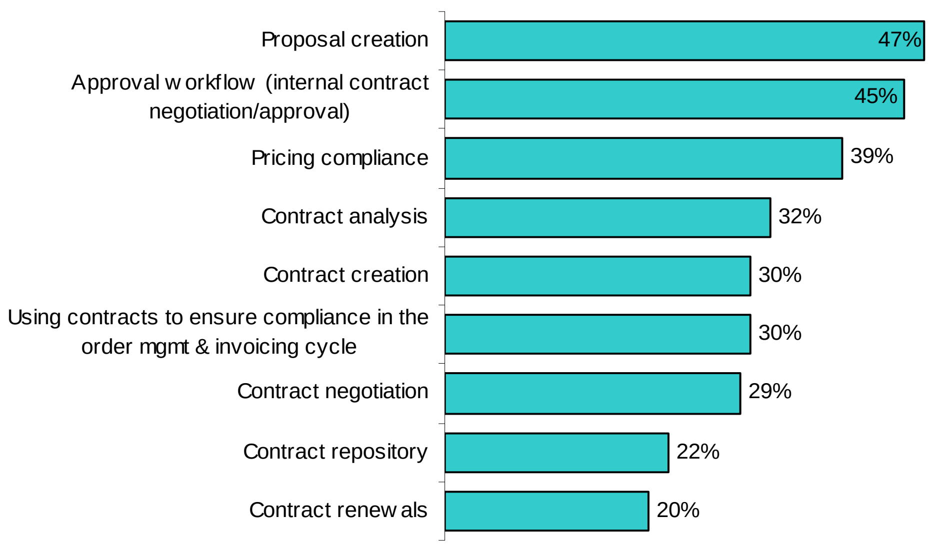


Source: AberdeenGroup, December 2006

Opportunities for Improvement

According to respondents, some of the activities in and around contract management that are ripe for improvement include things like proposal creation, improved approval workflow and pricing compliance. Analysis and reporting on various contract data and the way it is used is also a key area for improvement (Figure 9). Interestingly, proposal creation faces some of the same challenges as contract creation. In many cases, enterprises have to create extremely complex proposals that require input from multiple parties, drawings, spreadsheets, etc., and often end up looking similar to a set of separate documents meshed together rather than one consistent and formatted document.

Figure 9: Processes that Present Opportunities for Improvement



Source: AberdeenGroup, December 2006

Chapter Three: Implications & Analysis

Key Takeaways

- Revenue leakage, on average, amounts to 9% of total revenue.
- There is significant interest in using contract management technology over the next two years.
- Best in Class enterprises outperform their peers in the following:
  - Percentage of contracts actively tracked through a system (post-execution)
  - Percentage of contracts stored in a searchable repository
  - Reduction in Days Sales Outstanding (DSO)

Throughout Aberdeen's recent research it is clear that there is an opportunity for significant improvement in the way sell-side contracts are managed along with other processes in the quote-to-cash cycle. With regards to revenue leakage, survey respondents reported that, on average, their enterprises lose 9% of their revenue due to regulatory penalties, missed deadlines, lost sales, maverick pricing and transactional errors, clearly a substantial amount.

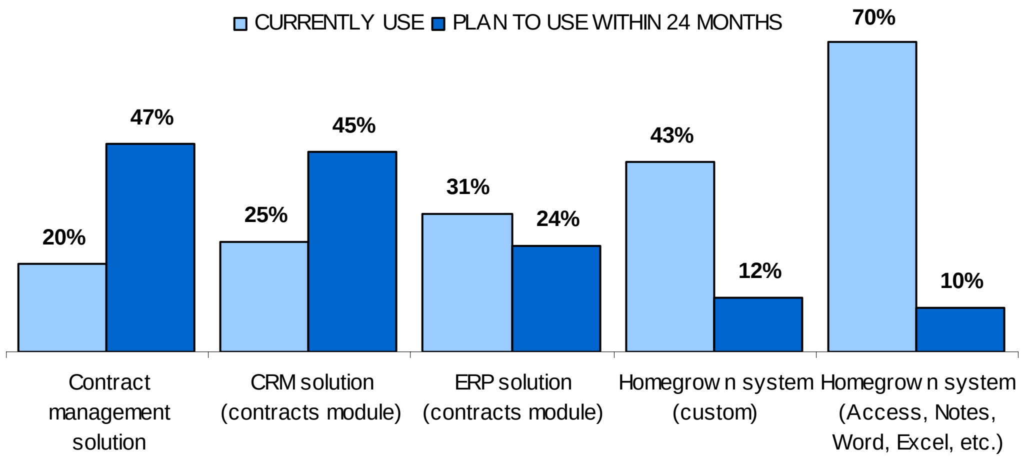
Additionally, in any enterprise the reduction of sales cycles is critical and through our research we have found that, on average, 18% of an enterprise's sales cycle is attributed to contract creation, negotiation and approval, which if reduced can have a significant impact. Exploring this further, we concluded that on average a one day reduction in the sales cycle is worth approximately **$80,000**. For the larger enterprises this is worth over $215,000; in several cases, this number was much larger and the fact is that Best in Class companies have cycle times that are 10 to 15 days shorter than other companies, showing that there is a fairly significant opportunity.

> "Our sales cycle is approximately 45 days; a one day reduction is worth well over $250,000"
>
> - VP of Finance, Large Brand Name Electronics Manufacturer

Technology Perspective

With regards to the actual technology being used for contract management on the sell-side, for the most part companies are currently using homegrown systems (Figure 10). This includes Access databases or various other Microsoft products; however, the future outlook for such systems is not very promising. Instead, companies are looking to specific **contract management solutions** or contract management modules within **CRM systems**; both are showing a significantly increasing interest over the next two years. It is important to note that those interested in a contract management solution are likely to be looking for enhanced functionality that caters to the needs of more complex and detailed contracts. Interestingly, if we look at Best in Class companies, 48% reported that they are currently using a contract management solution, whereas only 15% of the remainder are using such a solution.

Figure 10: Contract Management Technology Usage on the Sell-Side



Source: AberdeenGroup, December 2006

"The internal document management system we use to manage our contracts does not allow us to gain any intelligence from the information on contracts."

– Sales Director , Mid-size Enterprise

Key Performance Indicators

It is interesting to see the one difference in what Best in Class enterprises measure in terms of KPI's versus other enterprises. As Table 1 shows, the KPIs mentioned are used almost equally, except for one. Fifty-six percent of the Best in Class measure the percentage of contracts actively being tracked through a system after execution, whereas only 27% of all other enterprises do the same.

Table 1: KPI's Measured (Best in Class vs. Others)

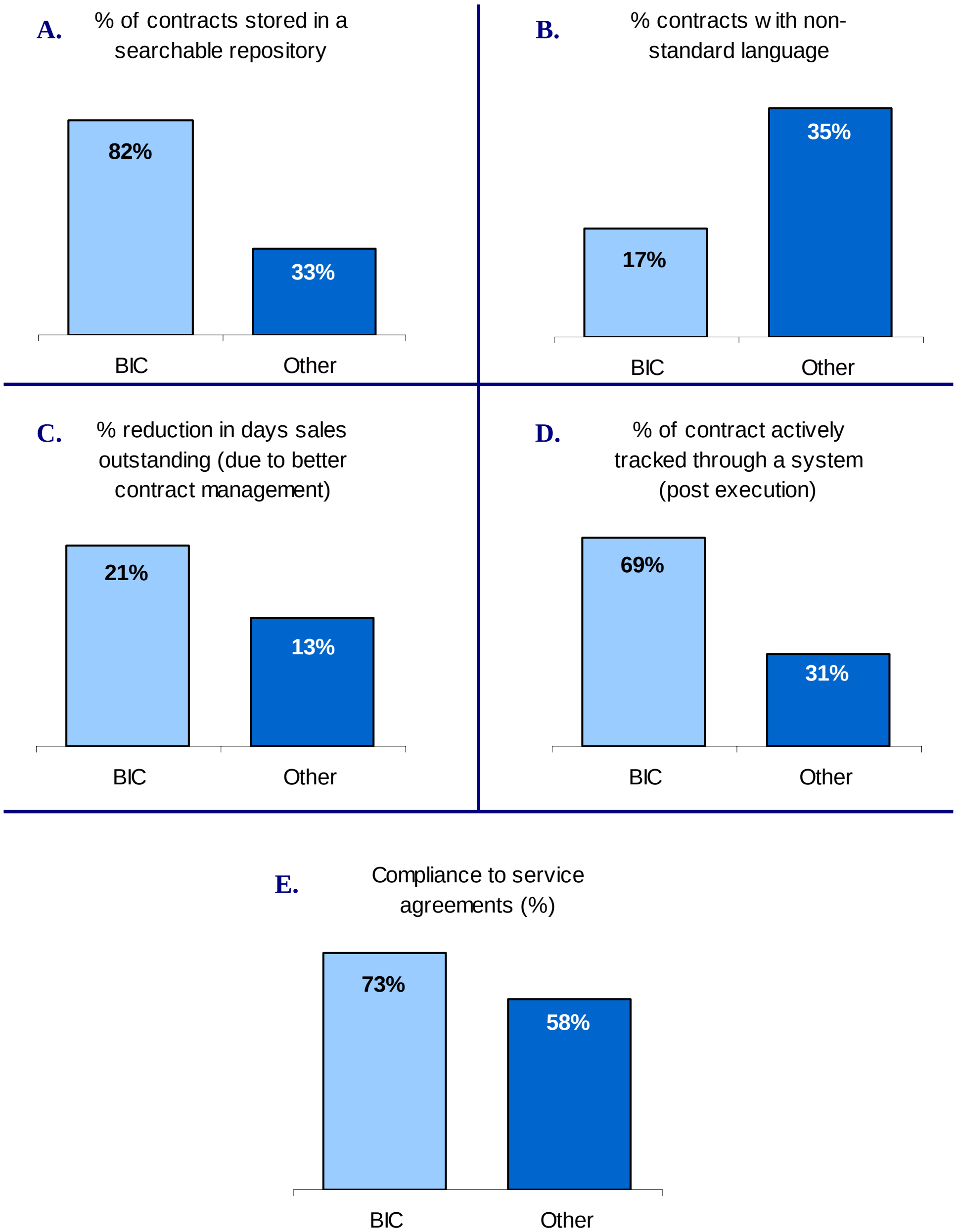
	Best in Class	Others
Contract creation and approval cycle time (days)	58%	56%
% of contracts actively tracked through a system (post execution)	**56%**	**27%**
Compliance to service agreements (%)	55%	54%
% reduction in days sales outstanding (due to better contract management)	35%	40%
% of contracts stored in a searchable repository	30%	27%

Source: AberdeenGroup, December 2006

Overall, Best in Class enterprises were able to perform significantly better than the remainder. For example, (Figure 11a) there is a clear distinction between the percentage of contracts that Best in Class companies store in a searchable repository versus other companies (82% vs. 31%). The top performers also have a lower percentage of contracts containing non-standard language. As for post execution, Best in Class enterprises actively track 63% of their contracts versus the 31% that all others track and monitor.

Getting to the real value of contract management, we can see that Best in Class enterprises have seen a 21% reduction in DSO due to improved contract management, which correlates to the higher compliance they have with service level agreements (Figures 11c and 11e). DSO can certainly be affected by fewer errors due to access to contract data, more-satisfied customers and a more efficient process.

Figure 11: Key Performance Indicators (Best in Class vs. Others)



Source: AberdeenGroup, December 2006

Chapter Four: Recommendations for Action

Key Takeaways

- Review contract management policies and procedures; align them with systems.
- Tighten the entire quote-to-cash process by way of automation and structure.
- Track revenue and commitments by placing risk values on the various terms, conditions and clauses.

Enterprises must start thinking about their revenue-generating contracts and how these can be leveraged to uncover additional process efficiencies and opportunities, as well as the reduction of leakage that too often occurs. The quote-to-cash cycle does not stop at contract execution; to properly manage the process throughout the customer lifecycle, organizations require a system that can link contracts to daily operations in order to enable proactive awareness of deliverables and milestones, even as contracts are amended over time.

Laggard Steps to Success

1. *Review contract management policies and procedures; align them with systems*

   Policies and procedures should be clearly defined, even if execution is still decentralized. Figure out where the disparities are in your organization by mapping the current process in the quote-to-cash cycle. Review policies and procedures with finance and executive management. Involve IT to ensure that policies and procedures are reflected by systems and enforced wherever possible.

2. *Standardize language used in all contracts and agreements*

   It is strongly recommended that enterprises must undertake this suggestion, as it involves financial and legal risks. The more standardized language used in a contract is the less users have the ability to make amendments that potentially have negative impacts to the enterprise.

3. *Move away from paper-based and largely-manual contracting methods*

   As more and more revenue is dictated by a contract it will become essential to keep track of all contracts in the various stages they are in, whether in the pre-execution or post-execution phase.

4. *Create and execute a strategy to deal with legacy contracts*

   One of the biggest challenges with contract management automation is the conversion of legacy contracts into electronic searchable data. Some have chosen only to convert only a certain percentage of contracts others have used third party services to convert all contracts.

Industry Average Steps to Success

1. *Tighten entire quote-to-cash process with more structured processes and automation*

   All the systems being used on the sell-side need to be better-integrated to prevent revenue leakage, repetition and unsatisfied customers. Link contract management to pricing configuration, proposal creation, order management and invoicing to give your company and end-to-end view of the quote-to-cash cycle. This also improves forecasting and planning capabilities.

2. *Track commitments and obligations to customers as stated in the contracts by making contract data available to relevant stakeholders*

   It goes without saying that it is essential to meet all commitments to customers but it is equally important to know when you are providing products or services outside the bounds of any contract. For this to effectively happen, contract data must be accessible to all relevant stakeholders for example, customer service. In the same context, monitoring these commitments allows for more accurate revenue recognition.

3. *Utilize reporting and analytical capabilities regularly to measure contract performance.*

   Measure performance of contracts regularly, using reporting capabilities; for example, contract performance by region, product, or, more specifically, contracts over a certain monetary amount that have been open (created but not signed) for more than 20 days. This type of information allows executives to focus their efforts in the correct places.

Best in Class Next Steps

1. *Place risk values on the various contract terms, conditions and clauses.*

   Valuing the various terms, conditions and clauses used in a contract allows enterprises to better analyze their contracts and the actual impact they have on the business. This would take into consideration things like payment terms and various clauses that could affect the total amount of revenue actually received from that particular customer, while considering the financial and legal risks.

2. *Integrate the contract management system with the financial and transactional systems.*

   Manage customer agreements into ongoing customer processes, and monitor the sales process from inquiry to completion. Integrate with back-end financial and accounts receivable processes allowing you to do everything from generating invoices to processing payments to crediting returns and processing claims.

3. *Use contract management automation as a way of reducing errors and delays in invoicing.*

   Often invoices are delayed and/or inaccurate in being sent to customers, which ultimately results in questions, changes and further delays. This of course has an impact on Days Sales Outstanding (DSO).

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Vishal Patel focuses on the use of technology in the global supply management arena. With the rise of globalization, outsourcing, and regulations Patel is researching the role software solutions play in making processes such as contract management, strategic sourcing, and overall supply management more efficient and value-adding in this ever-changing environment.

Patel has a manufacturing and operations background, largely in the consumer products industry. He worked previously in an operations and finance role focusing on strategic sourcing and procurement as well as overseeing supplier contracts both locally and internationally. He brings a combination of analytical abilities, hands-on experience, and a global perspective to Aberdeen.

Patel holds an MBA from Babson College and a B.S. in Finance and International Business from Penn State University.

Appendix A: **Research Methodology**

During November and December 2006, Aberdeen Group gathered research data from 189 enterprises across a wide range of industries and other demographics.

Aberdeen supplemented this online survey effort with telephone interviews with select survey respondents, gathering additional information on specific strategies, experiences and results.

The study aimed to identify the goals and initiatives around contract management on the sell-side and present them in a framework that allows for a competitive comparison with other enterprises.

Responding enterprises included the following:

- ***Job function:*** The research sample included respondents with the following job functions: Sales (19%), IT (14%), business process management (16%), finance (14%), marketing (8%), customer service (4%) and other (10%).
- ***Job title:*** The research sample included respondents with the following job titles: Senior management (CEO, COO, President) (21%), CFO (2%), CIO (2%), vice president (10%), director (16%), manager (28%).
- ***Industry:*** The research sample included respondents from High-tech (22%), life sciences and health care (16%), telecom equipment & services (13%), CPG (15%), transportation/logistics (12%), industrial equipment (11%), financial services/banking (10%).
- ***Geography:*** 59% of the research respondents were from North America, 20% were from Europe, and 15% from Asia-Pacific.
- ***Company size:*** 37% of respondents were from large enterprises (annual revenues above US$1 billion); 34% were from midsize enterprises (annual revenues between $50 million and $1 billion); and 29% of respondents were from small businesses (annual revenues of $50 million or less).

Solution providers recognized as sponsors of this report were solicited after the fact and had no substantive influence on the research results. Their sponsorship has made it possible for Aberdeen Group to make these findings available to readers at no charge.

Table 2: PACE framework

PACE Key
Aberdeen applies a methodology to benchmark research that evaluates the business pressures, actions, capabilities, and enablers (PACE) that indicate corporate behavior in specific business processes. These terms are defined as follows: *Pressures* — external forces that impact an organization's market position, competitiveness, or business operations (e.g., economic, political and regulatory, technology, changing customer preferences, competitive) *Actions* — the strategic approaches that an organization takes in response to industry pressures (e.g., align the corporate business model to leverage industry opportunities, such as product/service strategy, target markets, financial strategy, go-to-market, and sales strategy) *Capabilities* — the business process competencies required to execute corporate strategy (e.g., skilled people, brand, market positioning, viable products/services, ecosystem partners, financing) *Enablers* — the key functionality of technology solutions required to support the organization's enabling business practices (e.g., development platform, applications, network connectivity, user interface, training and support, partner interfaces, data cleansing, and management)

Table 3: Relationship between PACE and competitive framework

PACE and Competitive Framework – How They Interact
Aberdeen research indicates that companies that identify the most impactful pressures and take the most transformational and effective actions are most likely to achieve superior performance. The level of competitive performance that a company achieves is strongly determined by the PACE choices that they make and how well they execute.

Table 4: Competitive framework

Competitive Framework Key
The Aberdeen Competitive Framework defines enterprises as falling into one of the three following levels of procurement practices and performance: *Laggards (30%)* — Procurement practices that are significantly behind the average of the industry, and result in below average performance *Industry Average (50%)* — Procurement practices that represent the average or norm, and result in average industry performance. *Best in Class (20%)* — Procurement practices that are the best currently being employed and significantly superior to the industry norm, and result in the top industry performance.

Appendix B:
Related Aberdeen Research & Tools

Related Aberdeen research that forms a companion or reference to this report include:

- The Contract Management Benchmark Report: Sales Contracts, April 2006
- The Contract Management Benchmark Report: Procurement Contracts, March 2006
- Best Practices in Contract Management, September 2004

Information on these and any other Aberdeen publications can be found at www.aberdeen.com.

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