



# Why Is Contract Management an Imperative?

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As a manager, I make decisions every day about what is worthy of my attention and what is not. So as technology investment opportunities cross our desks on a regular basis, why should we stop to consider contract management? There are two indicators that suggest it's time to stop and take notice of Contract Management systems.

First, contract management is a fast growing application software category, not only in oil and gas, but across industries. According to research conducted by Goldman Sachs, the global contract management software business is expected to reach \$3.1 billion by 2005. This is largely being driven by a desire to "computerize" the relationship between buyers and suppliers in all lines of business.

Second, the ROI on this class of software is compelling. PriceWaterhouseCoopers suggests companies could realize savings that equate to 2% of total annual spend by eliminating inaccuracies and non-compliance through contract automation. So, an oil and gas company spending \$1 billion per year could save up to \$20 million per year annually.

The ROI is delivered by a number of key value drivers: process automation of the contracts lifecycle, contracts administration, contracts archive access across the enterprise, risk mitigation, enhanced performance management, and contracts compliance monitoring.

## The Challenges

The Institute for Supply Management reports that the typical Fortune 1000 company maintains 20,000 to 40,000 active contracts. Depending on size, oil and gas companies are managing from thousands to tens of thousands of contracts every year. These contracts represent the legal relationship between the operating company and its suppliers. But they also represent the potential for significant risk, as well as the opportunity for significant cost savings.

We spoke with a cross-section of operating companies, and found that most procurement, contract administration, and operations professionals face a number of challenges related to contract management:

### Poor Contract Visibility

In most companies, contracts are scattered across the corporation. Even though global or regional contracts and service agreements may be in place, the professionals responsible for managing the contracted work and deliverables often don't have access to the terms and conditions of the agreement, or even the most recent copy of the contract.

## **Insufficient Corporate Controls**

Even when a company has a documented contract approval process, often the chain of approval or audit trail associated with contract decisions is incomplete, or perhaps even non-existent. This not only exposes the company to “maverick” contracting, but also to increased risk and expense. This is of particular concern in light of the new corporate governance regulations contained in the Sarbanes-Oxley Act.

## **Lack of Corporate Negotiating Leverage**

When evaluating supplier performance, historical data about the supplier relationship is often ad hoc, anecdotal, and limited to recent memory. Without access to critical contract, corporate spend, and supplier performance information from across the enterprise, contract professionals are not able to ensure that they are negotiating the best possible deal for the company.

## **Inability to Ensure Contract Obligations Are Met**

Many oil and gas company contracts have complex terms and conditions, with varying “triggers” for obligations on the part of the supplier and the operating company. As a result, many companies suffer from the “Sign and Forget” syndrome, because they have no practical mechanism for ensuring obligation delivery and sign-off. Even items that seem straight forward, such as pricing, are not communicated and verified because the process is complex and manpower intensive, and the volume of transactions is huge.

## **Onerous Renewals Process**

The cumbersome manual processes for identifying contract renewals result in missed deadlines, and significantly increased risk for both parties when operations continue under a lapsed contract.

## **Unique Oil and Gas Industry Requirements**

The oil and gas industry is unique. As such, it represents not only unique challenges, but also unique opportunities for value recovery with respect to contracts management. Highlighted below are a few of the key areas where the uniqueness of our industry presents an interesting opportunity for improved returns.

## **High Percentage of Complex Services**

More than 60% of an operating company’s annual spend consists of complex services – drilling, completions, well services, field operations, plant and facilities maintenance. The purchase of these complex services cannot be automated through a purchase-order process, but only through a contract-to-invoice reconciliation process. Line-item price reconciliation for complex services therefore becomes a high value ROI opportunity within a contracts management initiative.

## Oil and Gas – a Highly Outsourced Business

The oil and gas business is dramatically different from health care, technology and manufacturing industries – where contracts with suppliers cover the purchasing of high volumes of specified products delivered to static locations. Oil and gas suppliers are required to deliver service throughout the globe to an ever-changing number of mobile locations. This results in two unique characteristics that contracts management solutions must provide.

First, it is common for global oil and gas companies to have upwards of 50 or 100 contracts with a single supplier. A contracts management system must manage multiple pricing scenarios.

Second, and perhaps more importantly, global service companies provide critical personnel and equipment working as agents for operating companies in hazardous and difficult working conditions. Third party compliance to required safety and training certification becomes an important part of any contracts management initiative that measures supplier performance. This also drives an important ROI for electronic contract management – risk mitigation.

## What are the key ROI categories for Contract Management?

The following categories comprise the key ROI calculation categories for contracts management:

**Process Automation:** Automation of the manual processes in each phase of the contracts management lifecycle as shown below:

**Collaborative Compliance and Administration:** For certain steps in the contract management process, it is beneficial for the supplier to have electronic access to components of the contract system. For example, when a supplier has an obligation or delivery requirement specified in a contract, ideally the supplier would be able to electronically notify/signify that the obligation is complete. In addition, messaging and warnings in the case of upcoming deadlines or trigger points should include the supplier, as well as the operating company.

**Enterprise Access:** Often overlooked, high value is derived from the simple capability of accessing contracts from anywhere in the global oil and gas organization. Often, business units, field offices, even specific departments such as drilling aren't aware and do not currently have access to existing negotiated contract terms – that have been negotiated in support of a strategic sourcing initiative, or to satisfy specific field requirements. Operations personnel without access to contract terms and deliverables often authorize work and payment in accordance with "price-book" terms and do not take advantage of corporate savings. Enterprise access also exhibits greater compliance and lower risk across an operating company. New contracts can be generated that take advantage of terms negotiated in other business units or departments.

**Line-Item Price Compliance:** Studies have shown that significant percentages of contracted line-items are incorrectly priced due to lack of access to contracting pricing from service personnel at field locations. Internal systems cannot line-item price check against complex services invoices because of complexity and lack of electronic access to contracted pricing. Our research indicates that line-item price compliance can deliver savings as high as 5% of total E&P spend.

**Contract Compliance and Risk Mitigation:** Oil and gas companies operate in harsh and sometimes dangerous environments. As a result, compliance with training and safety certification requirements for both service companies and service company personnel represents an important challenge to contracts administrators. Ensuring that third party contractors, both onshore and offshore maintain current certification is an almost impossible process manually. Electronic contracts management solutions must exhibit the capability for supplier self-service certification against required contractual terms.

**Supplier Performance Management:** Supplier performance is an increasingly important characteristic for the continued business relationship between operating companies and their key suppliers. Electronic contracts management delivers the ability to measure contractor performance through both price and deliverables compliance metrics. Electronic contracts deliverables describe the key results and expectations that the operator has of the supplier, including tangible expectations such as performance reports and end of well or end of project summaries.

## Where should contract management software focus?

In our analysis of procurement and negotiating processes and practices in a number of oil and gas companies, we found many companies were evaluating RFX tools (Request for Information, Request for Proposal, Request for Quote, etc.). Most electronic tools generate value through the automation of repetitive manual processes that involve a high amount of human interaction. In industries where a high number of bids are processed annually for purchases of high volumes of standard components, electronic RFX tools generate substantial ROI. In oil and gas, however, the industry has been moving away from “bidding every job” for some time.

There are several reasons for this. First, substantial consolidation has led to only a few global suppliers of most product and service categories in various regions. So sourcing of new suppliers on a continuous basis isn't required. Secondly, most major oil and gas companies do not consider price as the most important driver in selecting a vendor for key services. Price is always important. However, equally important are considerations regarding safety, the experience of crews and the maintenance of equipment, the level of technological capability, and results/performance. The industry has evolved away from repeated bidding cycles to longer term contracting with negotiated discount structure pricing.

Tools that automate the actual legal clause drafting process have also not delivered value to operating companies. Multiple tools exist in the legal profession and have exhibited real value, especially to firms that are continually drafting contracts that

describe unique business relationships. However, in the global oil and gas business, standard contracts forms exist in most major supplier organizations for the majority of required clauses necessary to enable a working relationship in a variety of business jurisdictions. Other key areas of business are managed through industry organization accepted clause structures such as the IADC Standard Drilling Contract.

So, although there is certainly a place for RFX tools and clause drafting tools in an operating company's suite of software, it is clear that the majority of contracts in upstream companies are handled in a different way. The supplier selection and negotiating processes in most oil and gas companies for complex services seem to be working quite well, as does the use of standardized contracts. So neither of these areas appears to offer "low hanging fruit" for process automation.

Rather, computerization of the negotiating and contracting process should first focus on two areas:

- Where repetitive manual processes are extremely expensive due to high manpower requirements (process automation opportunity)
- Where there are organizational gaps or non-integrated processes that make it difficult and time consuming to execute in an effective manner (process improvement/integration opportunity)

For example, reconciling contract pricing against incoming invoices is so highly labor intensive that most companies can't check all of the invoices against all of the contracts. This process certainly lends itself to computerization, and the prospect of capturing incorrect pricing represents a material cost saving opportunity. Another example of a computerization opportunity is the automation of the mundane task of tracking contract expiry dates. Although not glamorous, this task is extremely important, since a lapsed contract can expose both the operating company and the supplier to increased risk and liability.

Organizational gaps or non-integrated processes (often referred to as organizational "white space") present opportunities for computerization through software that provides automated and standardized workflows as well as connectivity. The opportunity is one of integrating disparate organizations, thus eliminating the "white space" and the inefficiencies in the processes. Clearly, there are organizational gaps between operating companies and their suppliers, and software that brings these organizations together will improve processes and drive out costs. One such example is in the area of obligation tracking and management. Even though obligations may be well thought out and defined prior to signing a contract, the challenge of tracking those obligations and ensuring delivery or compliance is often exacerbated by the fact that the parties are in completely separate organizations. Software that helps close these organizational gaps and improve collaboration can provide not only large cost savings, but also the opportunity to mitigate risk associated with non-compliance.

## **Conclusion**

Contract management is a growing technology category that is being adopted in the oil and gas industry. The benefits exhibit themselves through cost reduction (process automation and price reconciliation), improved corporate controls (standardized processes and auditability), risk mitigation (ensuring contract compliance), and improved supplier performance. The unique challenges of the oil and gas industry in turn present unique opportunities for automation and process improvements that ultimately drive an impressive ROI.