

SOURCES OF RISK IN TODAY'S BUSINESS

What You Do

Activities, commitments, operations

Who You Do It With

Prospects, customers, vendors, partners, competitors, employees

How You Do It

Processes, rate of growth, appetite for risk, insurance and mitigations

Where It Is Done

Geographies, locations, domains

Risk in Today's Enterprise

Managing risk means different things to different people. Risk management is very mature in some areas, but in most organizations, a global view of risk remains elusive. Risk can bubble up from all areas of an organization: business activity, partners, customers, vendors, regulatory environments, or geography.

Even in companies with risk programs, the identified risks are managed in silos, with limited capability to analyze the impact or cascade responsibility across the organization and supply chain. For example, financial default by a customer in one business unit could be an early alarm for other units dealing with the same customer. Another example: a supply disruption with a vendor for one contract may be indicative of a larger problem developing in that vendor relationship.

While risk can arise from almost any area of a business, all of these areas are defined, governed, or affected by contracts. From employee offer letters to Non-Disclosure Agreements (NDAs), contracts define the boundaries, frontiers, and risk appetite of an organization.

Therefore, a paradigm shift is needed to start treating contracts not just as legal repositories of agreed terms to be referred to for payments and in case of disputes, but as stores of potential risks that an organization may be knowingly or unknowingly exposed to.

From this perspective, properly managing contracts goes well beyond the "contract risk management" view that is common today and instead suggests a platform for grounding risk models to the realities of doing business. This is more than contract management. It's contract intelligence.

TYPES OF RISK HIDDEN IN TODAY'S CONTRACTS

- Risk at Creation
- Financial Risk
- Operational Risk
- Compliance Risk
- Visibility Risk

The Intersection of Risk and Contracts

To better understand how contracts can help organizations assess risk at different levels, let's consider a hypothetical use case.

Say a technology consulting company signs a contract with a new customer in another country. The work specifies milestones, penalty clauses if milestones are not reached in time, payment terms, and optional sharing of intellectual property (IP). The company should be asking the following questions to assess what risk the contract exposes them to.

Risk at Creation

Contract risk begins with the contract language itself. Questions the company needs to ask about this contract include:

- Does the contract use language that is approved by the company's legal department, and does it contain all the clauses required?
- Have the standard clauses changed, and if yes, have the changes been approved by the right people?
- Has the contract deviated from the organization's standard payment terms for this type of business?
- Is the contract approved and signed by the appropriate people?

! FAST FACT

The right contract management system can automatically check contract parties against information from sources such as Dun & Bradstreet and Thomson Reuters to ensure they are safe to work with.

♂ KEY POINT

Contract management shouldn't end at execution. Performance is business-critical."

Financial Risk

The purpose of the contract is to generate income for the company, which starts with the right contract language:

- What is the customer's ability to pay?
- · What are the customer's past payment history and current credit rating?
- Are the payment terms unfavorable in this context?
- Are the milestones and payments structured correctly?
- Are penalties/rewards operationally implementable?
- Do compliance breaches result in financial penalties, and are these penalties passed down to vendors involved in the delivery of those services?

Operational Risk

Many contract management systems only address the authoring of the contract, and not the performance. Yet contract performance is business-critical. A company must answer these questions about the contract throughout its lifecycle:

- Has a milestone slipped, and by how much?
- Will this slippage result in work remaining after the term of the contract?
- Is work being done against an expired contract?
- Are supply disruption risk scenarios sufficiently covered and risks monitored in real time to avoid missed obligations?
- Are the right people as required by the contract working on the project?

ANALYST REPORT

Compliance requirements are exploding. Without a firm grasp of its supply chain and related risks, compliance will be impossible for any organization."

Spend Matters, "The Intersection of Contract 'Invisibility' and Risk Management: Be Afraid (Be Very Afraid)"

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\$1.5 MILLION

A leading technology consulting firm missed revenue recognition of \$1.5 million due to SOW expiry, which they were tracking manually.

Compliance Risk

Contracts can provide a strong bulwark against compliance risk, as they define the terms of work. But they can also become targets of auditors and regulators if not properly authored or managed:

- Can the approval process of the contract be proven to auditors?
- · Does the financial reporting adequately compensate for the terms of the contract?
- Is the contract legally valid in the country the company is doing business in?
- Does the contract sufficiently capture the responsibility of customers/vendors in order for the company to meet regulatory and statutory compliance and reporting requirements?

Visibility Risk

Ultimately, contract risk management comes down to contract visibility, which allows the right people to see the right contracts at the right time:

- Do the right people have visibility into the risks already identified? Does the finance head of the business unit have visibility into unfavorable payment terms, and does the legal head have visibility into changes to the IP clause?
- If contract owners change (due to reorganization, attrition, etc.), will the new people get this visibility automatically?
- Do risks become visible before they are "about to occur" through rightly designed early-warning sensors to prevent the consequential damages?
- Are board-level issues (brand risks, reputational risk, loss of goodwill) made visible to the CxO level?

Managing Risk with Contract Intelligence

Now that we've seen where risk exists in contracts, let's explore how contract intelligence can help organizations model their risk and thus better manage it.

Contract intelligence is advanced digital contract management that links the entitlements and obligations in any kind of contract to your critical business processes. Contract intelligence ensures that all agreements are in compliance and commitments are upheld throughout the lifespan of the contract, that changing conditions dynamically trigger the appropriate actions, that high-value insights are available in real time, and that new information makes the whole system increasingly smarter and faster. With contract intelligence, companies connect contracts to the systems and processes they touch, thereby surfacing opportunities for cost optimization and revenue maximization.

The information stored in contracts makes them a superior source of truth with which organizations can model their risk. Risk modeling is both an art and a science. But for the reasons explored above, the most effective way to model risk in an organization starts with the critical business information found in contracts that defines how your business runs.

A very simple example of this is using a contract intelligence platform to set up a survey as part of creating a contract with a potential supplier. A set of risk scores can then be calculated based on the answers to the survey, which can be used as a thermometer to gauge the overall risk for the portfolio of contracts in that category.

This sets the stage for more powerful risk modeling attached to a contract. Much more advanced risk models can be easily plugged in, and based on a contract's metadata (data that is associated with the contract, its counterparties, commitments, financial implications, and legal implications), overall risk can be determined.

The answers to what you do, who you do it with, how you do it, and where it is done can be found across an organization's portfolio of contracts, thus turning a contract repository into the risk thermometer of the organization.

Identify

By contract type

Analyze

By clauses, metadata, and external parameters

Mitigate

By contract and portfolio

Report

On risk, compliance, and exposure

The Icertis Advantage for Managing Risk

Most contractual risks can be measured fairly easily by using mature contract lifecycle management (CLM) tools. A comprehensive clause and template repository and a robust governance process to ensure standard language and appropriate notifications and escalations can mitigate some contract risk.

The Icertis Contract Intelligence (ICI) platform goes beyond that with continuous monitoring and smart rules that automatically ensure compliance and minimize risk.

For example, customer credit-worthiness can be checked periodically, updating risk indices for the organization's contract portfolio. This can happen not just at the time of contract creation, but at any time the contract is in force. Risk models developed in isolation can be plugged into the contract portfolio easily. As the metadata around the contract changes during the contract lifecycle, the risk profile automatically changes. In short, the risk model that is plugged in need not be limited to data that is in the contract system alone. The platform connects contract data to multiple data sources, including external sources like Dun & Bradstreet, Thomson Reuters, and other systems like ERP, CRM, and HRM.

Once a model is applied to the contract portfolio, reporting across that portfolio is simplified. For example, with ICI, the CFO can see financial risk across the contract portfolio for the US or EMEA regions, or world-wide, on his or her personalized dashboard.

Drilling down, this risk can then be isolated by a variety of parameters like customer credit rating, unfavorable payment terms, and milestone slippage. The head of a business unit can see the risk profile of the business unit's portfolio of contracts across vendors and customers and drill down into the operational risks for these contracts. The ICI platform also lets mitigation actions be defined on defined thresholds of risk scores. This makes it a true risk management tool as opposed to a risk monitoring tool.



Conclusion

With the accelerating pace of today's business, companies must be proactive about protecting their business against missed opportunities, damaged business relationships, and regulatory penalties.

Risk modeling, visibility, and mitigation are now integral to the operation of an organization.

ICI allows risk modeling to happen in the context of a contract—the single source of truth for the critical contract data that defines how a business runs. With ICI, you can transform your contract repository into a looking glass of organizational risk.



(i) ABOUT THE AUTHOR

Monish is a cloud-technology pioneer and serial entrepreneur with a 30-year track record in the enterprise software space.

As CTO and Co-Founder of Icertis, Monish has overseen development of the Icertis Contract Intelligence (ICI) platform, the leading contract management solution in the cloud. ICI is used by innovative companies like Airbus, Daimler, Johnson & Johnson, Microsoft, and Sanofi to manage 7.5 million contracts worth more than \$1 trillion. Monish has also led Icertis' successful deployment of cutting-edge AI and blockchain technologies, which have earned Icertis numerous industry accolades including recognition on Forbes' prestigious AI 50 List for two years in a row.

About Icertis

With unmatched technology and category-defining innovation, Icertis pushes the boundaries of what's possible with contract lifecycle management (CLM). The AI-powered, analyst-validated Icertis Contract Intelligence (ICI) platform turns contracts from static documents into strategic advantage by structuring and connecting the critical contract information that defines how an organization runs. Today, the world's most iconic brands and disruptive innovators trust Icertis to fully realize the intent of their combined 7.5 million+ contracts worth more than \$1 trillion, in 40+ languages and 90+ countries.

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