



Leveraging Automation to
Enhance your Risk Management

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Leveraging Automation to Enhance your Risk Management

Main Points

- Contract management software has the ability to scan contracts for elements of risk, track the items, report on them and send appropriate alerts to all relevant parties.
- Risk elements can exist at the contract level, the clause level and even at the supplier level, or be tied to specific clauses, so that when a clause is used in a contract, the associated risks are automatically attached to that contract — and whatever workflow and notification was tied to that risk will be automatically a part of the contract process.
- Risk elements should be regulated within the organization so that those risks that are deemed material and significant can be automatically associated with suppliers, contract language and even the purchase or sale of commodities.
- Organizations can now allocate points to risk, as well as pricing, vendor stability and all the other parameters that define good value.

We go through life, personally and in business, either trying to avoid risk or coming up with sound principles for understanding and mitigating risks. However, in most cases, risk management is handled manually — which actually adds a layer of risk — because we are human and, as they say, ‘to err is to be human’.

Automation can be used to accurately capture and forecast risk early on the process, meaning less time spent in managing risk and, more importantly, the adverse effects of poor risk management.

This article will explore in detail the available functionality in contract management software, and how an organization can go about implementing it.

Risks Hide in Contract Language

There are several clauses within a contract that have various elements of risk associated with them. Typically, the ‘deliverables’ section has a large number of risks for the supplier and/or the customer. An example would be when a major computer chip manufacturer is buying a large majority of their silicon wafers from a supplier who makes 100 percent of its wafers in a plant that sits on a known fault line in India. So, if a clause exists that indicates the supplier will provide 1 million silicon wafers per month upon two weeks’ notice, the obvious risks are:

- What are the odds of an earthquake occurring at the supplier’s plant and, if it were to occur, what would be the delay in getting a shipment?
- The supplier only has one plant and no backup or contingency in place.
- What would be an acceptable time delay before missed shipments affect the customer’s ability to meet their market demands?

These are just three of the over 30 risk elements that reside in this one clause.

Organizations need to assess risks and assign the probability factors of each risk element, as well as the impact in monetary terms and time. Risks can have contributing factors (for example,

natural disasters, and raw materials shortage) and probabilities need to be assigned for these elements as well. Once a risk element has been identified, appropriate workflow needs to be established to indicate at what percentage level notification emails need to be sent and to which parties? When the alert levels are escalated (for example, green to yellow to red), what process steps need to be followed and are there any material impacts? (This needs to be reported under the US Sarbanes-Oxley Act 2002 for companies listed on US stock exchanges).

The risk elements in a contract can have devastating effects on an organization if they are not assessed and, worse, not tracked and reported on. By being proactive, organizations can often alleviate risks and apply contingency plans (in the silicon wafer example, a contingent supplier would be part of the resolution process and would get the order if a specific risk element was escalated for the original supplier).

Some CM software packages have a risk management component that allows for scenarios, like the one shown above, to be reported, tracked, governed and acted upon. Risk elements can exist at a contract level, a clause level and even at the supplier level. When tied to specific clauses, the associated risks are automatically attached to that contract, and whatever workflow and notification was tied to that risk will automatically be a part of the contract process. It is important that the risks you want to track are reported on, just as you would want to know when contracts are coming to expiry.

Regulating and Managing Risk

Risk elements should be regulated within the organization so that those risks that are deemed material and significant can be automatically associated with suppliers, contract language and even commodities (goods and/or services) being bought or sold. Management should meet with the appropriate departments (for example, sourcing, accounting, risk, audit and legal) to brainstorm on all the risk elements that could have an unacceptable level of disruption, then document and assign thresholds for notification (for example, at what percentage level should a director, vice president or a 'C' level be notified?). The departments responsible for creating contracts and templates should then ensure that the risks can automatically be associated when a new contract is being created.

It is important to evaluate the CM software to ensure that the risk elements can be completely managed by the organization and that it has the flexibility to add new risk elements, assign probabilities, indicate risk cause potentials and, most importantly, have the ability to indicate specific workflow and notification when a risk element reaches a certain threshold. Within the CM software, risks can be managed and reported based on the impact on either monetary values or time (for example, time lost). Some CM software also allows for the tracking of risk at the supplier level as well as the contract level. This is important, as an organization should know what the risks are of a supplier going bankrupt and, if it were to go bankrupt, what impacts that would have on the organization.

Integrating Risk into your Strategic Sourcing

Typically, strategic sourcing within organizations is limited to reviewing pricing or values offered by suppliers across commodity or spend codes. However, there is a growing trend to include risk and performance records as a key part of deciding which suppliers are deemed able to supply a specific product and/or service.

Organizations can now allocate scoring points to risk, as well as pricing, vendor stability and all the other parameters that define good value. Some CM software packages allow for calculations that can derive scoring based on pricing, past records of performance and risks as well as other criteria as defined by the customer. This enables companies to run reports on a scheduled basis

that shows their top suppliers by category and decide if they want to limit any future buying to a list of accredited suppliers for a given commodity.

Happy Auditors, Risk Jockeys and the Good Folks in Sourcing

The ability to manage risk with CM software provides certainty and makes for happy auditors, risk management and sourcing professionals. The task of managing risk is complex and time-consuming, so using software will not only assist in the overall creation and management of contracts, but also for an automated risk management process. This lightens the burden on the organization, allowing its professionals to focus on the strategic and forward-thinking elements of their jobs.

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Upside Software is the '2007 Supply & Demand Chain Executive Top 100 Company & 2006 Deloitte Fast 50 Company'. Ashif was named the Entrepreneur Year by the Business Development Bank of Canada in 2007 and also the 2002 Ernst & Young Entrepreneur of the Year® recipient (Prairies Region – Young Entrepreneur), recognized as the 2008 Supply & Demand Chain Executive Pro to know, ranked as Canada's Top 40 under 40TM (2004), a member of the Financial Executives International and was recently awarded the Queen's Golden Jubilee Medal.



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