Contract Management Risks: How To Manage and Mitigate

As companies rushed to grow, they often find themselves dealing with more contracts. It's a growing pain that's a good sign but without proper management, it can become a major issue.

If there are any weaknesses in a company's contract management process, additional contracts mean additional chances for those weaknesses to create an issue.

Some issues and maybe minor inconveniences, but others can become major crises.

For instance, in 2013, Facebook was not able to detect a violation of its contract with Cambridge Analytica, and the resulting publicity significantly damaged its stock value, eliminating 150 billion dollars of market value within 90 minutes of the earnings call.

Sometimes, it takes a crisis like this for company executives to appreciate the risks of operating without a contract lifecycle management system.

Compliance failures, missed deadlines, ineffective reporting, poor access control, and inefficient approval workflows can create devastating consequences. Subpar

CLM may also lead to a subtle, but steady decline in profitability.

Research from the International Association for Contract and Commercial Management (IACCM) indicates the average company loses about 10% of its annual revenue due to poor contract management practices.

Since typical profit margins hover around 10%, even halving this loss can increase profit margins by 50%.

Implementing proper contract management practices alongside contract management software helps keep a company safe through improved risk management.

Common Risk Types

Financial Risk

Financial risks are contract risks associated with money loss, regardless of how it impacts your top or bottom line. In terms of contract management, it could be a result of missing a key contract date and losing business or inadvertently continuing the contract term as a result of an automatic rollover clause.

It could also be contract termination or compensation associated with missed Milestones, claims, warranty problems, or missed delivery dates.

Security Risk

Security risks can be associated with some of the most severe and highest-profile consequences for your company.

Security breaches with your contract generally result in additional Legal, Financial, and brand issues.

When managing your contracts, security risks exist by storing your contracts in insecure locations. It is also a problem when everyone with contract access has the same level of access to sensitive contract information which leaves confidential contract data unencrypted. Using email to communicate sensitive information is also a problem.

With a digital contract management solution, there's no need to rely on filing cabinets full of contracts. Paper copies can easily be misplaced, or leave the organization courtesy of a rogue employee.

Legal Risk

Legal issues happen when you have a breach of contract with the potential for litigation or legal accountability. Legal risks include compliance, dispute, and regulatory issues.

Your legal risk could result from missing contract obligations, and compliance requirements such as OSHA, HIPAA, and HITECH. It may also result from intellectual property infringement causes, lack of using the right legal clauses, confidentiality disclosures, and other contract disputes.

Brand Risk

Brand risk is the risk associated with negative consumer and public opinion, and low employee morale. It remains an issue after security, legal, and financial issues.

Mitigating your brand is more important now than ever before because bad news travels quickly and today's digital world which can quickly impact your brand reputation. When your brand's reputation suffers, you can see a negative impact on your financial performance and the cycle perpetuates.

Identifying Risks in Your Contracts

Before you can assess and mitigate contract management risks, you have to know how to identify the risk in your processes by determining where it exists. Ask questions such as:

- Which contracts have higher risk exposure? This could involve looking at the edge of the contract, financial terms, privacy requirements, the use of certain clauses, or additional data points.
- Are there parts of your contract management process that introduced risk?
- Are there specific regulatory compliance risks that you have to manage in

your contracts, like OSHA, PCI, or HIPAA?
  - Do you have any geographic regulatory compliance risks that must be managed as parties are located in different states, countries, or legal jurisdictions?

Ideally, to find and document as many risk factors as possible, build a cross-functional team that includes representation from every department involved in the contract lifecycle, from procurement to IT – not just the legal team. Stakeholders may also wish to be involved.

Assessing Risk in your Contracts

After you've identified risks, you must assess what that risk means to your company and assign it a score based on the level of the risk identified for each contract.

The more comprehensive the risk assessment, the more accurate your results will be.

Consider two main factors: the risk probability and the risk consequence. What is the likelihood that this risk will occur and if it does, what will the impact be?

You may also wish to consider a third dimension – the time factor. How do the risk probability and consequence of a contract change over time?

For instance, your consequence may be high or early in the agreement and then lower over time.

The probability, however, may be moderate in the beginning and increase over time.

If you have a contract with the financial term that isn't favorable in the beginning stages of the agreement, as time passes in milestones are met the consequences of not meeting the financial term diminish.

> *In today's business climate, you need more than a legal team that includes indemnification clauses in your contractual terms. CLM goes above and beyond to protect your company.*

Mitigating Contract Risks

Use Encryption to Protect Contract Data

Use encryption to protect your contracts from unauthorized access risk. that information should be encrypted at rest and during transit with the latest encryption standards.

Any data stored within your contract management system is at rest and in transit is any data that is sent externally to or from users or applications.

Eliminate Missed Milestones and Obligations Using Notifications and Alerts

Missing conditions activated by reaching certain milestones or automatic contract renewals may result in significant financial consequences.

With the right contact management solution, they are completely avoidable because you can set up automated alerts and reminders link to the contract data record to stay apprised of critical contract milestones.

Control Access with Role-Based Security

Control who has access to contract information was role-based permissions. This ensures that only the necessary employees can read or write certain documents or contract types.

By preventing unauthorized users from seeing or editing contract details, you mitigate the security risk of having confidential and proprietary information make its way into the wrong hands.

Use Clause and Template Libraries to Increase Compliance

one of the biggest sources of risk is non-compliance and one of the most common reasons businesses run into compliance issues is the use of the wrong language in a contract.

By creating a contract clause and template library, anyone creating contracts can rest assured that they are using the latest pre-approved language from the legal team and general counsel.

This mitigates contract risk inherent in the language that hasn't been properly vetted. You can also apply your company's business rules around the closet and templates to use under certain circumstances, such as when to include a cybersecurity clause.

Maintain Control Over Contract Versions

If you have multiple parties going through the same document, it's crucial to maintain contract version control throughout the negotiation process.

You must track changes by user and allow them to simultaneously review and edit documents directly in the contract management system.

This way, you avoid duplicating, missing, or using inaccurate data that results from emailing back and forth out of the documents. It's also necessary to easily track and manage any contract amendments, addendums, and terminations.

Use Automated Workflows to Enforce Business Processes

Every stage of your contract lifecycle needs to have documented contract workflows based on business rules that anyone who was involved in the contract process has to follow.

This ensures compliance with your processes to mitigate contract and risk associated with missed approvals or missed steps.

It also helps to provide evidence of contract compliance if you are ever audited.

Building and triggering workflows eliminates the need to manually track and facilitate each step in the contract lifecycle, creating a smoother approval process.

Use E-Signatures to Secure Approvals

Electronic signatures get documents signed faster and are more secure than paper signatures.

Legally binding, thanks to the E-Sign act of 2002, e-signatures provide a digital record about who, when, and where a document was signed to ensure authentication and assist with audit trails.

E-signatures prohibit tampering with contract approvals and the possibility of misplacing a hard copy of a contract.

They improve the approver's experience by supporting mobility, as contracts can be signed anywhere on nearly any device.

Contract risk management and mitigation is an important part of keeping business running smoothly. Risk is present throughout the supply chain, and contract managers can only do so much without the right tools.

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