

WHITE PAPER

Contractor Procurement

Successful implementation of an industry standard



– Bruce Stevenson

Introduction

In the early twentieth century, accepted businesses practice generally involved problems being handled exclusively 'in-house'. If something needed to be built, repaired, maintained or replaced there was typically sufficient capability and capacity on hand to perform the task. Industry competition steadily increased over time, and by the 1970s and '80s, with an eye to reducing costs, organisations looked to outsource non-core activities and those

with sporadic workloads. This approach continues today as companies re-evaluate what is considered core to their business, and divest themselves of the increasingly untenable and unjustifiable costs of non-core activities. These outsourced activities, both core and non-core, are now delivered by Contractors and sub-Contractors. However, procedural efficacy in the procurement of Contractor services remains an ongoing source of stress and

frustration for company procurement teams as they struggle to reconcile the complexities of their businesses requirements with the availability of reliable Contractor services whilst simultaneously attempting to garner support from operational personnel who are generally reluctant to embrace any change to the status quo.

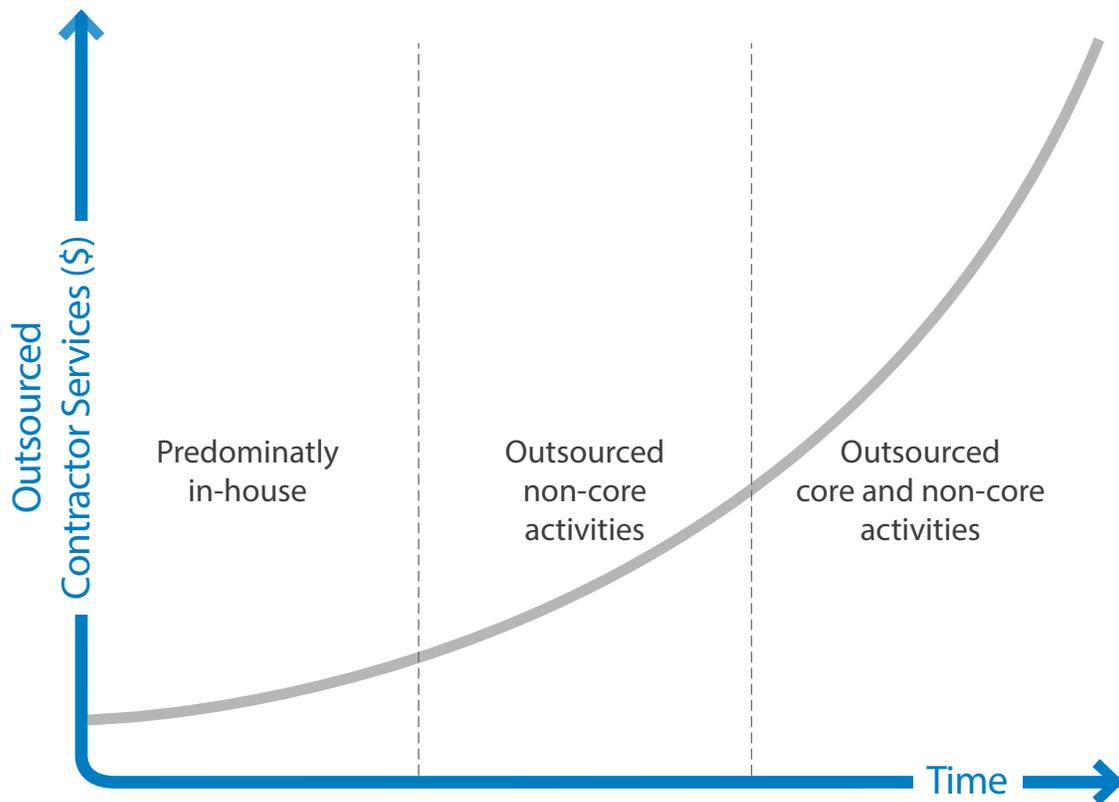


Figure 1: Growth in Contractor Services Market



Expediency, information and expertise: the key challenges to contractor procurement

Traditionally the procurement of contractor services is conducted by site based personnel; usually with limited procurement expertise, with limited documented processes and with minimal collaboration across the business. Typically, these fragmented buying practices result in supplier proliferation and a reliance on site based relationships to ensure maximum productivity. The strong relationships forged between site personnel and contractors, while generally beneficial for delivery, can lead to poor commercial outcomes, particularly when the buyer is focussed on project delivery or plant up-time, rather than cost.

It is important to acknowledge that Contractor procurement is far removed from the purchase of straight materials that have traditionally been the domain or specialisation of the procurement professional. With materials purchasing, future volumes are typically known, and unit pricing can be established through a simple sourcing exercise, and locked in for the duration of the contract.

Conversely, contractor workload is often uncertain and the contractor market is subject to capacity and capability

constraints – meaning that a contractor's competitiveness will vary depending on the number of contracts they hold at any given time. The amount of work a contractor has on the books can also impact upon service quality. – while a contractor's 'A-Team' will deliver an excellent result, a high workload may mean that you get a lesser skilled team, or worse still, a Subcontractor of unknown capability, and the quality of the work and cost may be adversely affected.

Next, there is the information barrier. Most Contractor procurement is conducted by disparate site personnel and as such there are few common approaches and information sharing is poor at best. The common result of these practices is that most contractor information ends up residing in local directories, filing cabinets or even the minds of site based procurement personnel. When vital information like this is unaccounted for, just understanding the quantum of spend and the types of services purchased can turn into a significant task requiring considerable resources. As a result of the manifest lack of available data in most businesses, many attempts to improve

contractor procurement simply cannot get past their preliminary stages.

Finally, although organisations have been procuring contractor services for decades, procurement practices have not seen the level of progression that we have seen in the procurement of materials. There is a clear lack of exemplary companies that people can point out as an example of industry best practice in contractor procurement. As such, procurement teams often place contractor procurement in the proverbial 'too hard basket'; accepting that current practices are as good as they can be and moving on to alternate spend categories. It is this general lack of conspicuous contractor procurement expertise that has led to inefficient and ineffectual contractor procurement methodologies becoming endemic industry wide.

It can be roundly assumed that the above mentioned lack of best practice guidelines combined with an over reliance on a narrow pool of contractors at any given site will adversely impact upon companywide efficacy in contractor procurement.

Common mistakes in contractor procurement reform

Historically, sourcing and managing contractors has been the responsibility of decentralised site based personnel; however as the role of central procurement teams has expanded they have gradually assumed responsibility for contractor procurement. One of the most egregious errors made during this centralisation process is the assumption that 'the site guys' are doing a poor job of managing contractors. This assumption can and will put centralised procurement staff and site based personnel at loggerheads from the outset and undermine the implementation of a considered and balanced approach to contractor procurement.

Arbitrary full centralisation is problematic; the centralised procurement team must immediately deal with a highly fragmented buying group, a highly fragmented supply market and intrinsically sporadic buying patterns. Central procurement teams are invariably overwhelmed by the complexity and the volume of transactions and site based personnel become frustrated by reduced autonomy and increased cycle time. As a result, everything either grinds to a halt, or site based buyers find 'creative' means to bypass the system. This makes arbitrary centralisation of contractor procurement an expensive and ultimately counterproductive endeavour

The second mistake that central teams are prone to making is in thinking that strategic sourcing is going to deliver all the value required and once it has been executed, the operations team can be left to go about their business. In simple materials procurement categories where a fixed price card is all that is required this approach may be entirely acceptable. However, for many contractor services the sourcing process will only establish a capped rate card, discounts, disbursements and an agreed engagement model. These initial strategic sourcing procedures are necessary, however they only establish the platform for the ongoing spot-buying



process, which is typically where most of the ongoing value is derived.

The extent to which strategic sourcing or the ongoing spot buy process is the primary value driver is dependent on the nature of the services being purchased, broadly categorised as either 'Known Services' or 'Unknown Services'.

Known Services are services clearly understood at the time of the strategic sourcing event. This allows procurement teams to establish either a fixed schedule of rates or a lump sum price with a particular contractor to perform the services. Examples of such services are lump sum pricing for maintaining plant and equipment, or unit rates for frequently purchased services – e.g.: call out fees, diagnostic checks, standard motor changeover fees, waste removal per cubic metre fees and so on. For these types of well-defined services, strategic sourcing will typically be the primary procurement value driver.

Conversely, in the case of 'Unknown Services', the business requirements are not actually known at the time of sourcing.

This presents a far greater challenge for procurement teams as it is difficult to identify the lowest cost and most capable contractor before the exact nature of the job in question is known. Examples of Unknown Services include sporadic minor capital works that require the development of a job-specific statement of work. In these circumstances, strategic sourcing is required to establish a panel of possible contractors. However, real value will only be delivered by implementing a robust and competitive spot buying process with panel contractors and then engaging thorough ongoing supplier performance management procedures to ensure high performing suppliers are utilised and recognised.

In practice, contractors usually provide a combination of Known and Unknown services to the same client organisations; as such a holistic procurement strategy must be developed to leverage the full value out of contractor to client relationships whilst maintaining competitive and comprehensive contractor procurement procedures.

Implementing positive contractor procurement reform

Unfortunately there is no silver bullet to the contractor management challenge; success is dependent upon the implementation of a full suite of procurement capability reforms. These reforms include but are not limited to a marked increase in stake holder engagement, systematic data collection, advanced technological enabling and a dynamic approach to supplier performance management.

A key step in this process is accepting that a simple centralisation of the procurement process is not the answer and that the implementation of new strategies to better manage a decentralised purchasing function, in particular a requirement for ongoing job-by-job quoting, is imperative.

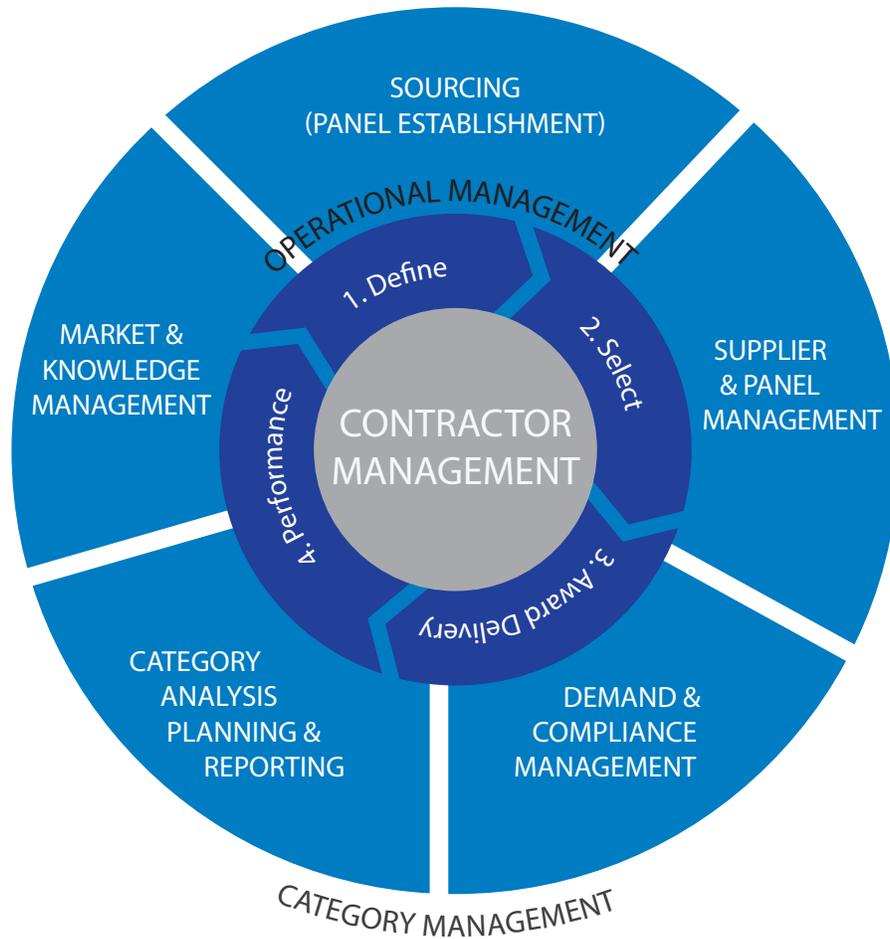


Figure 2: Contractor Management Process

The first, and generally the most difficult, step in this process is information gathering. Due to decentralised purchasing patterns and a lack of effective systems for data capture, developing a comprehensive picture of current requirements can be a significant hurdle. A comprehensive database including ones supplier base, costs, and procurement practices is essential when developing a well-defined contractor procurement strategy.

A simple yet time consuming solution to this problem is to meticulously mine all available data sources; accounts payable data must be compiled, internal and external Requests for Information to buying teams and suppliers must be issued to develop a comprehensive picture of the Contractor category under review. Once a concise and comprehensive picture of where, why and how specific contractors are being utilised is available the review can progress to a more pro-active level.

This level allows the determination of the exact nature of your contractor spend. If it

is predominately Known Services, then a robust strategic sourcing process should deliver an adequate level of value. However if, like many businesses, your contractor spending lists heavily towards Unknown Services then you need to consider the sourcing of supplier panels for various Contractor subcategories combined with the establishment of a robust job-by-job quoting process. Ideally this process will be supported by technology based solutions (transaction engines) to facilitate the process and capture all related information thus assuring greater transparency and expediency in your contractor procurement processes. As procurement of

Unknown Services will be done by a variety of personnel, compliance to process and performance will need to be monitored by a central team allowing easy identification of areas available for streamlining and improvement.

For ongoing engagement of preferred contractor panels, a supplier performance management process is required to drive

contractor performance and reward high-performance contractors. Ongoing monitoring and regular assessment of supplier performance will allow refining of supplier panels over time, with the goal of building stronger relationships with trusted, high performing suppliers.

These procedures, from conception to implementation, must be supported by a comprehensive change management process; this is not an initiative that can be delivered solely from head office – it relies upon the support and interaction of the entire site based buyers and related administrative personnel and so you need to spend adequate time taking them on the journey. Implementing this process will allow for the seamless integration of industry best practise in contractor procurement into your existing business model.

About the Author



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