Risk Management throughout the Procurement Cycle

MAXIMIZING YOUR YIELD

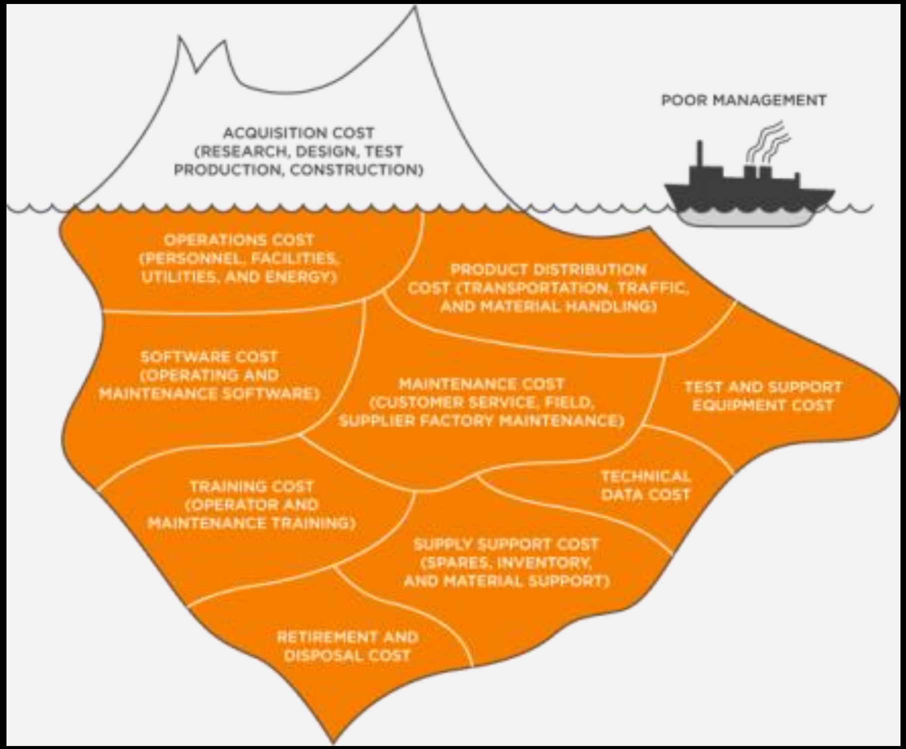
Procurement has traditionally placed a primary focus on pricing and cost.

As strategic sourcing, category management, contract management, and supplier relationship management have emerged:

- TCO and VfM have overtaken the traditional “three bids and a buy” approach
- Greater opportunities for **value generation** have arisen from focusing on **risk management**

Some of the most common items to include in a TCO analysis include:

- Design and development costs
- Hard costs (e.g., labor and assets)
- Operating costs (e.g., energy and maintenance)
- Soft costs (e.g., overhead, corporate allocations, training)
- Installation and commissioning costs
- Governance costs (e.g., cost to manage the relationship)
- Software costs
- Supply chain support costs
- Disposal costs or residual value
- Opportunity costs, including reduced downtime, increased production yield, or sales value or increased sales or margin for developing a better product
- Transaction costs, including cost of switching suppliers and costs associated with a competitive bid and contracting process
- Environmental or sustainability costs or savings



From: University of Tennessee / Vested Outsourcing, Inc

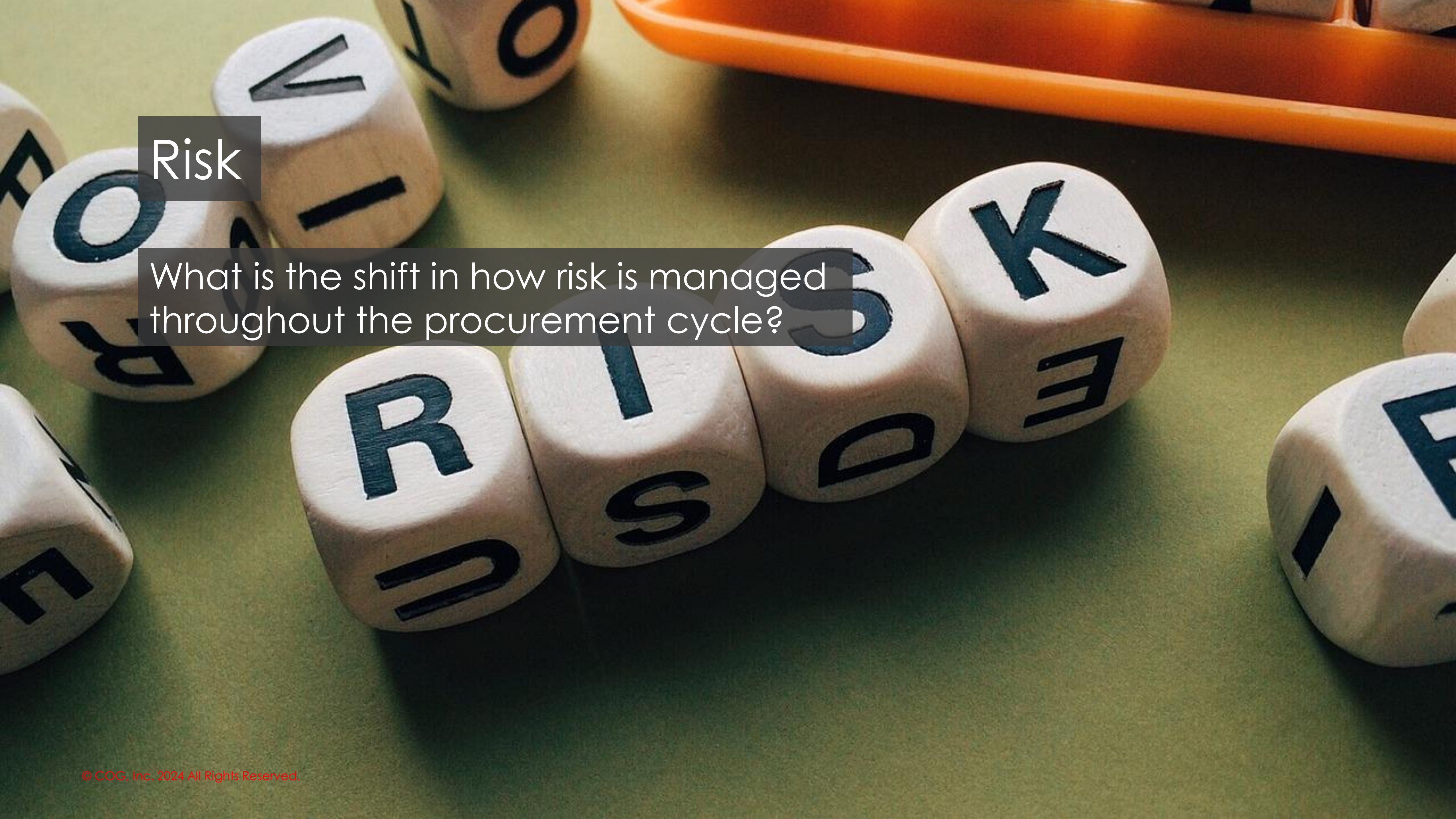
Risk is not to be merely allocated but **proactively** managed through collaboration and **mitigative** approaches.

Leading practice organizations realize that risk requires **both preventive and reactive** measures.

But not every supplier relationship is a candidate - segmentation is key

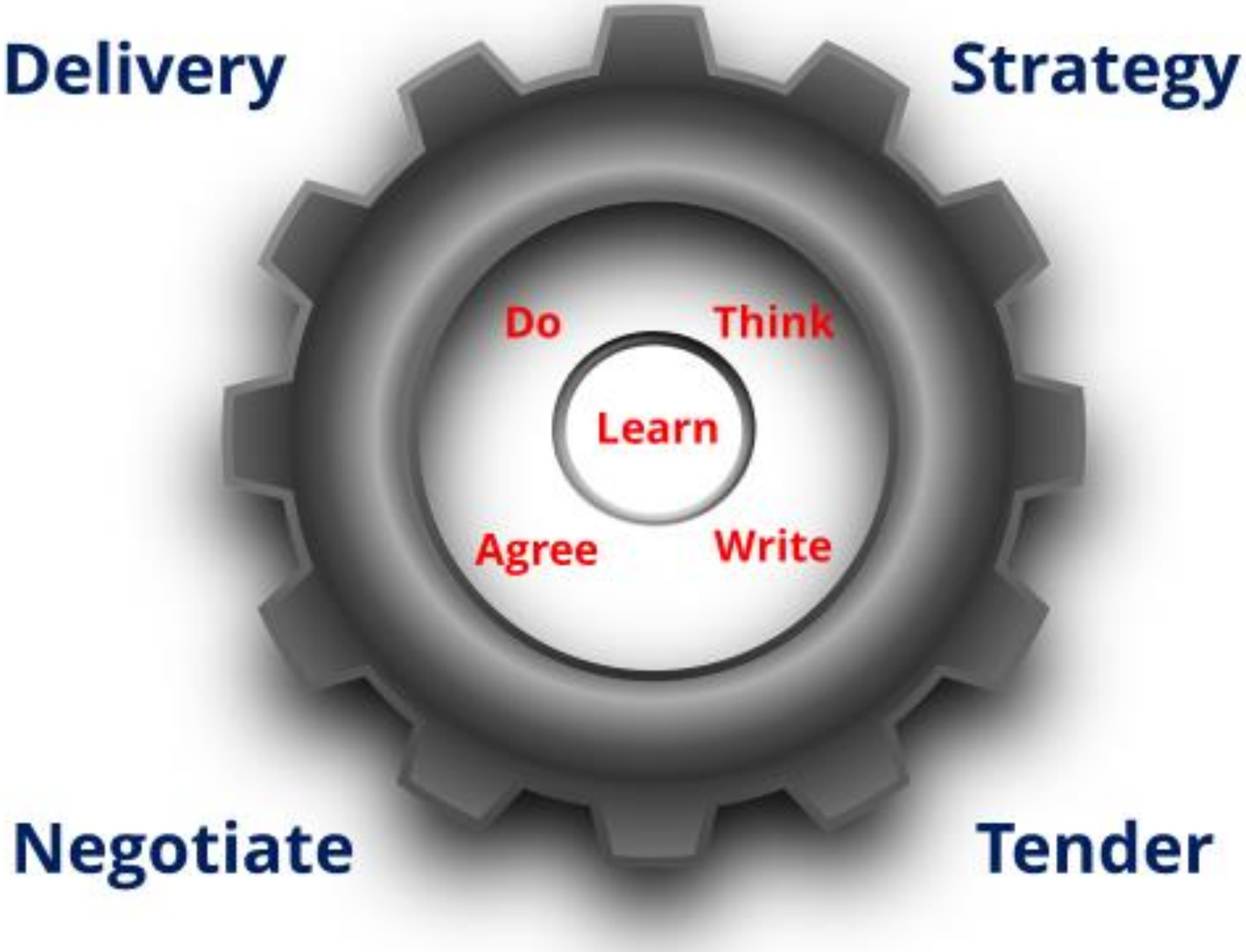
Leading practice organizations realize that risk requires **both preventive and reactive** measures.


RISK



Risk

What is the shift in how risk is managed throughout the procurement cycle?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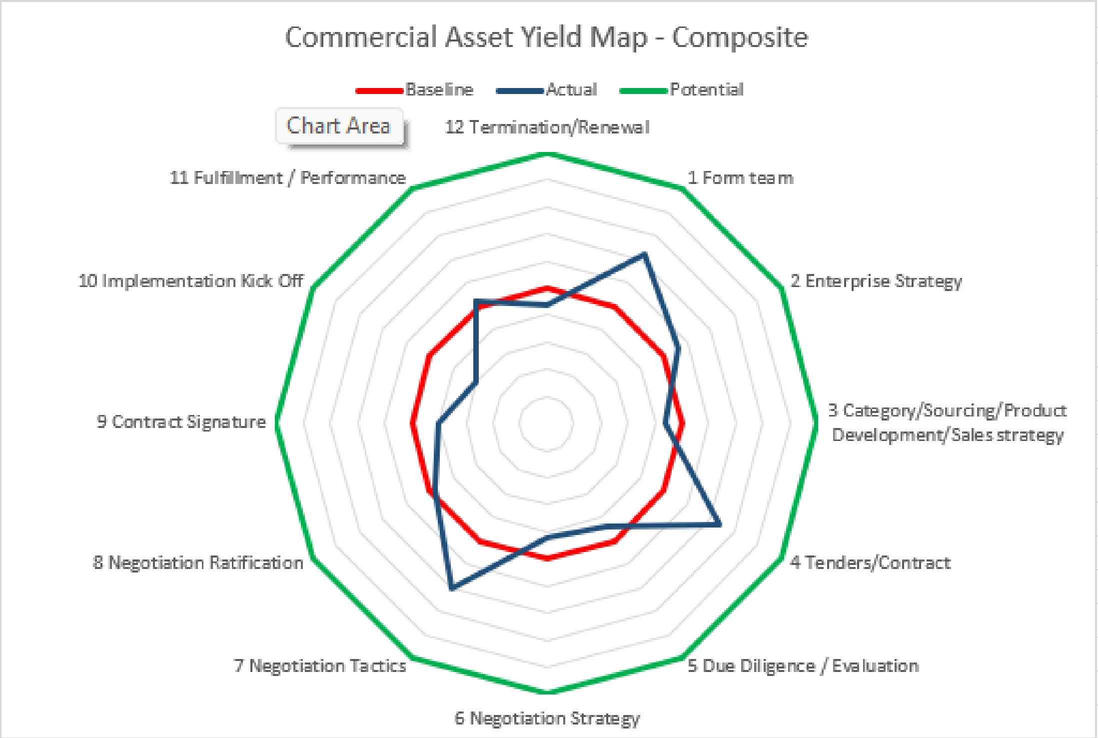
Risk Can Lead to Value Loss

		Baseline	Actual	Potential	Significance	Yield Loss
						Revenue
						$ 1,000,000,000
12	Termination/Renewal	2.5	2.2	5.0	4%	$ 3,360,000
1	Form team	2.5	3.6	5.0	4%	$ 1,680,000
2	Enterprise Strategy	2.5	2.8	5.0	4%	$ 2,640,000
3	Category/Sourcing/Product Developme	2.5	2.2	5.0	4%	$ 3,360,000
4	Tenders/Contract	2.5	3.7	5.0	4%	$ 1,560,000
5	Due Diligence / Evaluation	2.5	2.2	5.0	4%	$ 3,360,000
6	Negotiation Strategy	2.5	2.1	5.0	4%	$ 3,480,000
7	Negotiation Tactics	2.5	3.5	5.0	4%	$ 1,800,000
8	Negotiation Ratification	2.5	2.4	5.0	4%	$ 3,120,000
9	Contract Signature	2.5	2.0	5.0	4%	$ 3,600,000
10	Implementation Kick Off	2.5	1.5	5.0	4%	$ 4,200,000
11	Fulfillment / Performance	2.5	2.6	5.0	56%	$ 40,320,000
			2.6			$ 72,480,000
					100%	7.2%



Risk Exists throughout the Cycle

Risk Can Lead to Value Loss

41. There is structure in place to effectively administer contract changes.
42. The contract is regularly reviewed to ensure it meets evolving business needs.
43. The parties use 'joint working plans' or other shared activities for their mutual benefit, e.g., enterprise process improvement, whenever justified.
44. The parties use supply chain development activities for their mutual benefit, e.g., second/third tier supplier development, whenever justified.
45. The parties use shared management activities to optimize performance, e.g., supplier boards, whenever justified.
46. There are processes are in place with customer to continually evaluate/review any options for delivering services in-house versus outsourcing.

Risk Can Lead to Value Loss

1	2	3	4	5
20%	40%	60%	80%	99.9%
Just Starting	Basic Progress Made	Partially Mature	Very Mature	Nearly Complete

Risk

What is the shift in how risk is managed throughout the procurement cycle?

- Risk mitigation is overcoming risk allocation
- Risk strategies are becoming formalized with governance
- Risk registers – including joint risk registers – are becoming common
- Enterprise risk/insurance towers are evolving – TPRM / Third-Party Risk Management is growing as a discipline
- Risk is more easily quantified through big data and blockchain

Risk Register

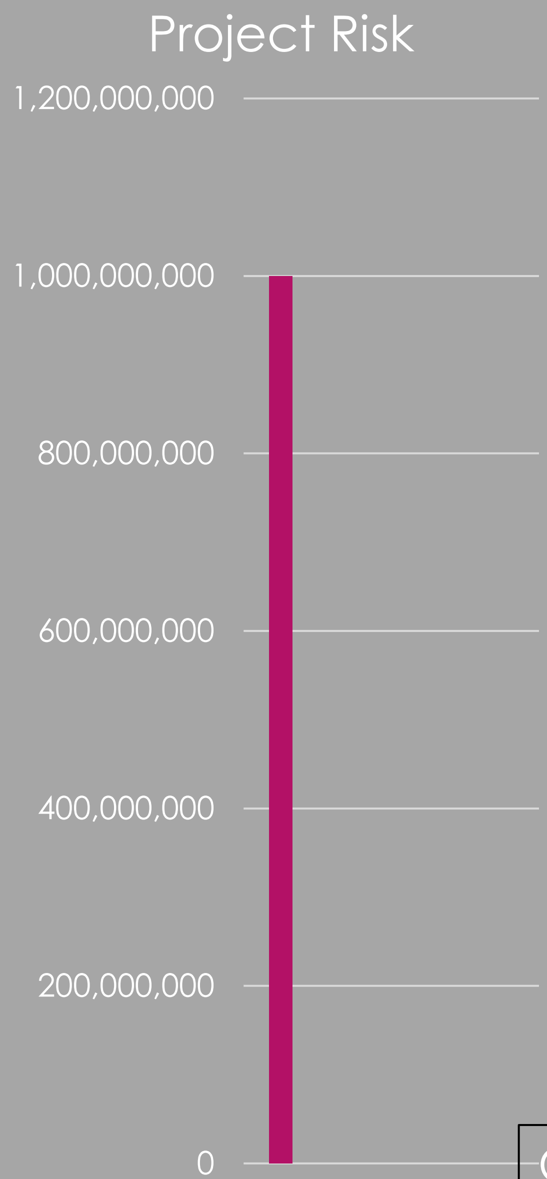
Risk	Probability	Impact	P*I	Tactic	Best Able to Mitigate	Cost to Mitigate	Long- or Short-Term	Insurance?
Late Delivery of Steel Widgets	5%	$50,000	$2,500	Find Alternate Emergency Supply	Customer	$1,000	Short	Not Cost Effective
Steel Price Fluctuation								
Labor Strike at Widget Factory								

Risk Tower

Client Insurance
$1,000,000,000
Retention
$500,000,000

Contractor Insurance
$500,000,000
Retention
$200,000,000

Sub-Contractor Insurance $200,000,000,
Retention $20,000



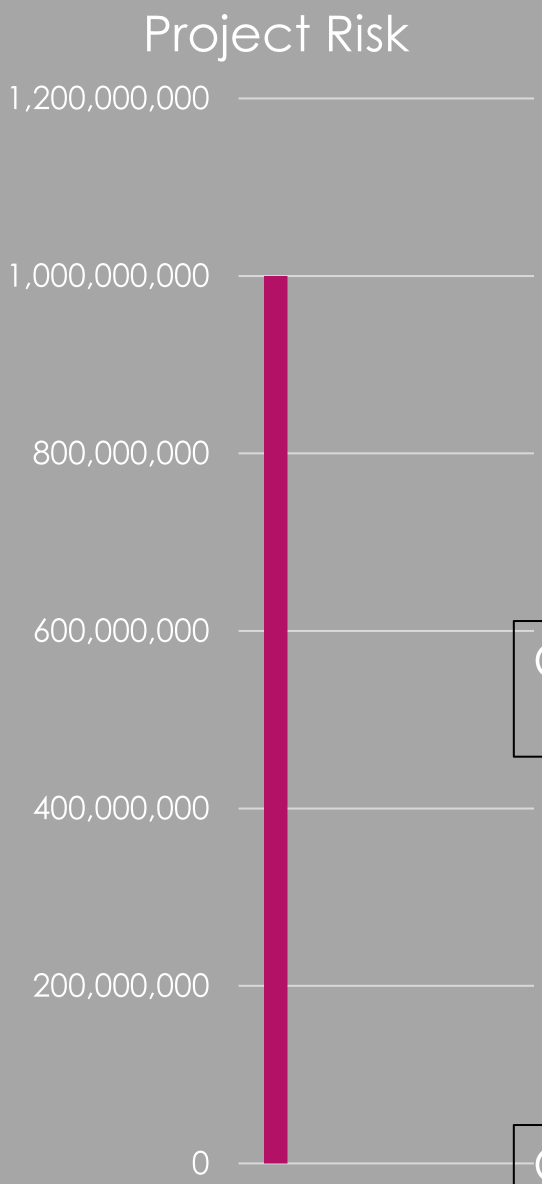
Client Retention $20,000

Risk Tower - Broken

Client Insurance
$1,000,000,000
Retention
$600,000,000

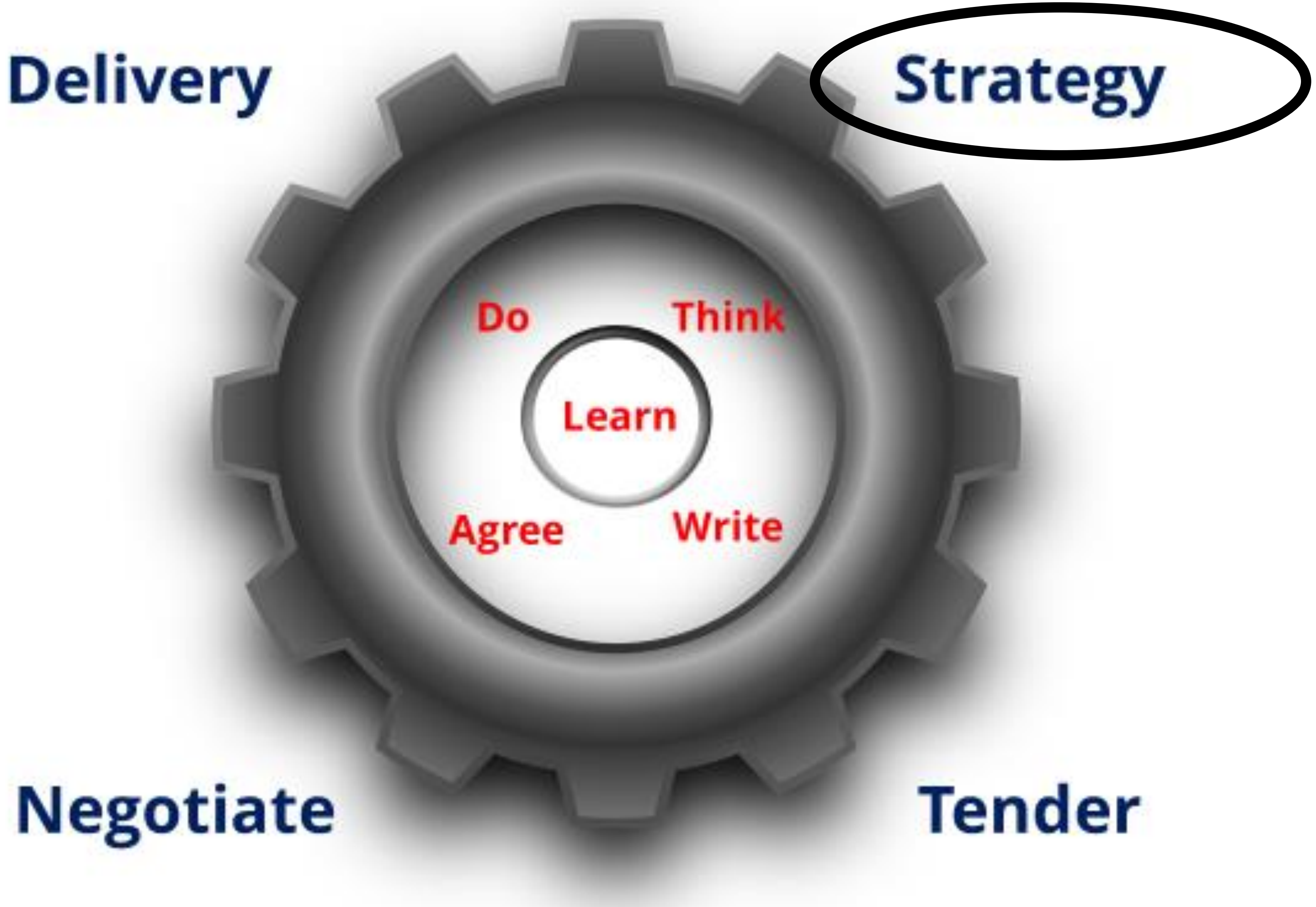
Contractor Insurance
$500,000,000
Retention
$100,000,000

Sub-Contractor
Insurance
$300,000,000
Retention $20,000



Client Retention $100,000

Client Retention $20,000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Strategy Phase

Five risks to consider in developing sourcing strategies

- Inaccurate, incomplete internal spend data
- Lack of internal cohesion – stakeholder shading
- Lack of segmentation, alignment with strategies
- Market volatility, e.g., inflation, bankruptcies, laws
- Availability
- Bonus: How suppliers view you, Reputation Risk

Strategy Phase

Mitigative measures?

Strategy Phase

Mitigative measures?

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Scrub the data

Strategy Phase

Mitigative measures?

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Invest in Stakeholder Management skills

Strategy Phase

Mitigative measures?

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Conduct segmentation analysis yearly

Strategy Phase

Mitigative measures?

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Track supplier health through D&B, other services

Strategy Phase

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Track material trade reports

Strategy Phase

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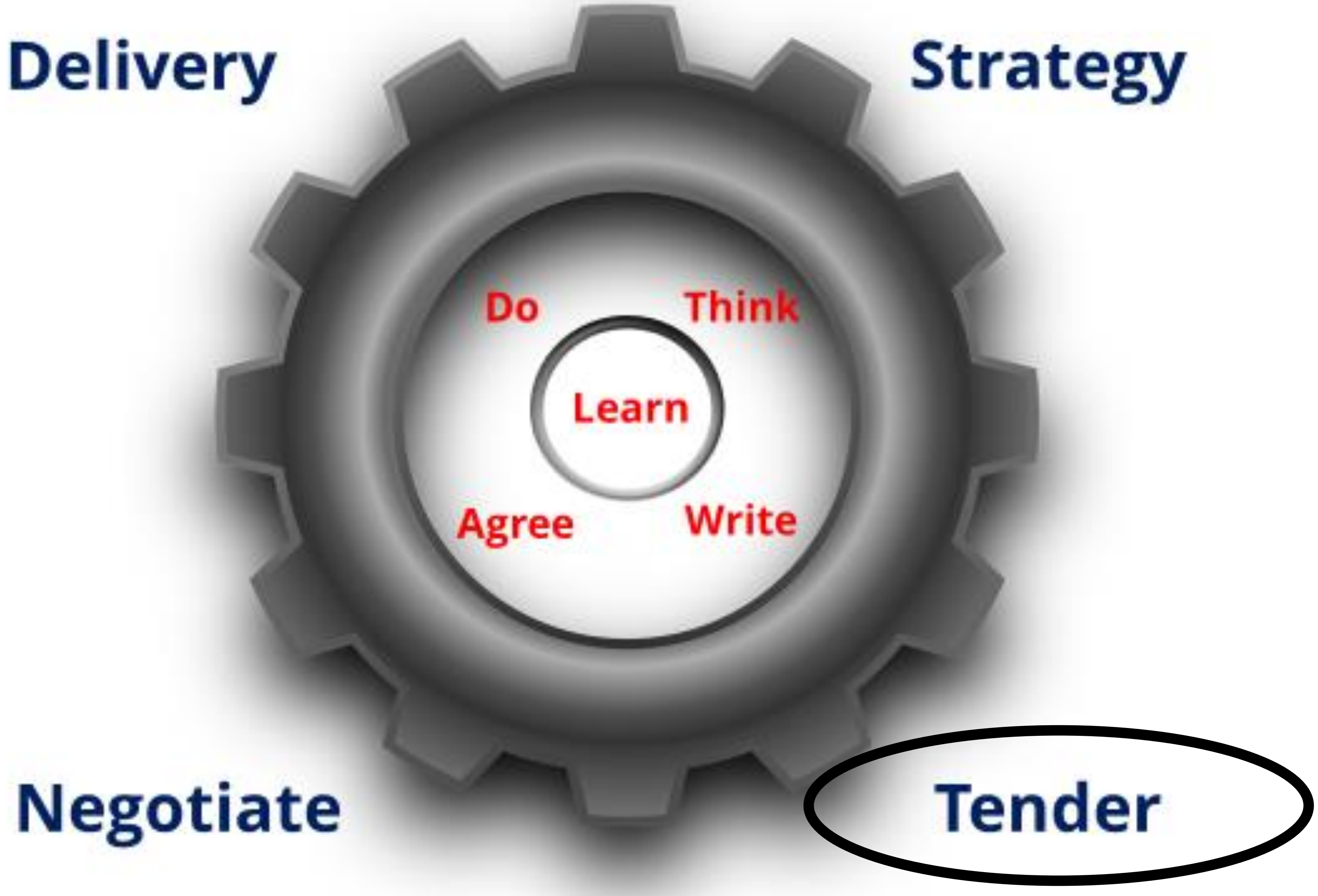
Conduct supplier surveys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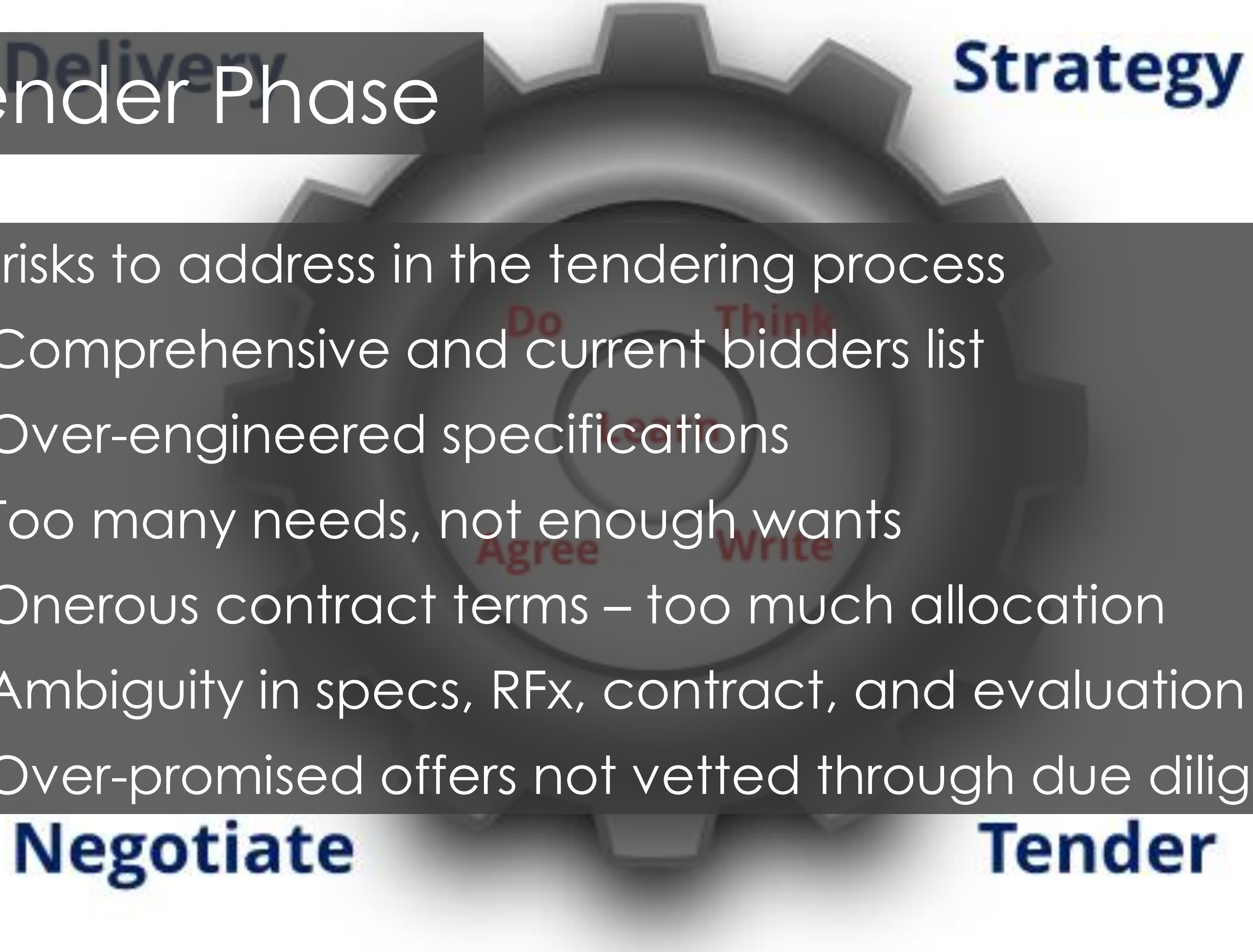
Tender Phase

Six risks to address in the tendering process

- Comprehensive and current bidders list
- Over-engineered specifications
- Too many needs, not enough wants
- Onerous contract terms – too much allocation
- Ambiguity in specs, RFx, contract, and evaluation matrix
- Over-promised offers not vetted through due diligence



Tender Phase

Conduct web searches

Mitigative measures?

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Tender Phase

Mitigative measures?

Allow suppliers to suggest alternatives

- Comprehensive and curre t
- Over-engineered specifications
- Too many needs, not enough wants
- Onerous contract terms – too much allocation
- Ambiguity in specs, RFx, contract, and evaluation matrix
- Over-promised offers not vetted through due diligence

Tender Phase

Mitigative measures?

- Comprehensive and curre t
- Over-engineered specific

Conduct prioritized objectives exercise

- Too many needs, not enough wants
- Onerous contract terms – too much allocation
- Ambiguity in specs, RFx, contract, and evaluation matrix
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Tender Phase

Mitigative measures?

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- Too many needs, not enough wants
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Conduct a regular terms audit

Tender Phase

Mitigative measures?

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- Over-engineered specifications
- Too many needs, not enough wants
- Onerous contract terms – too much allocation
- Ambiguity in specs, RFx, contract, and evaluation matrix
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Engage more stakeholders for review

Tender Phase

Mitigative measures?

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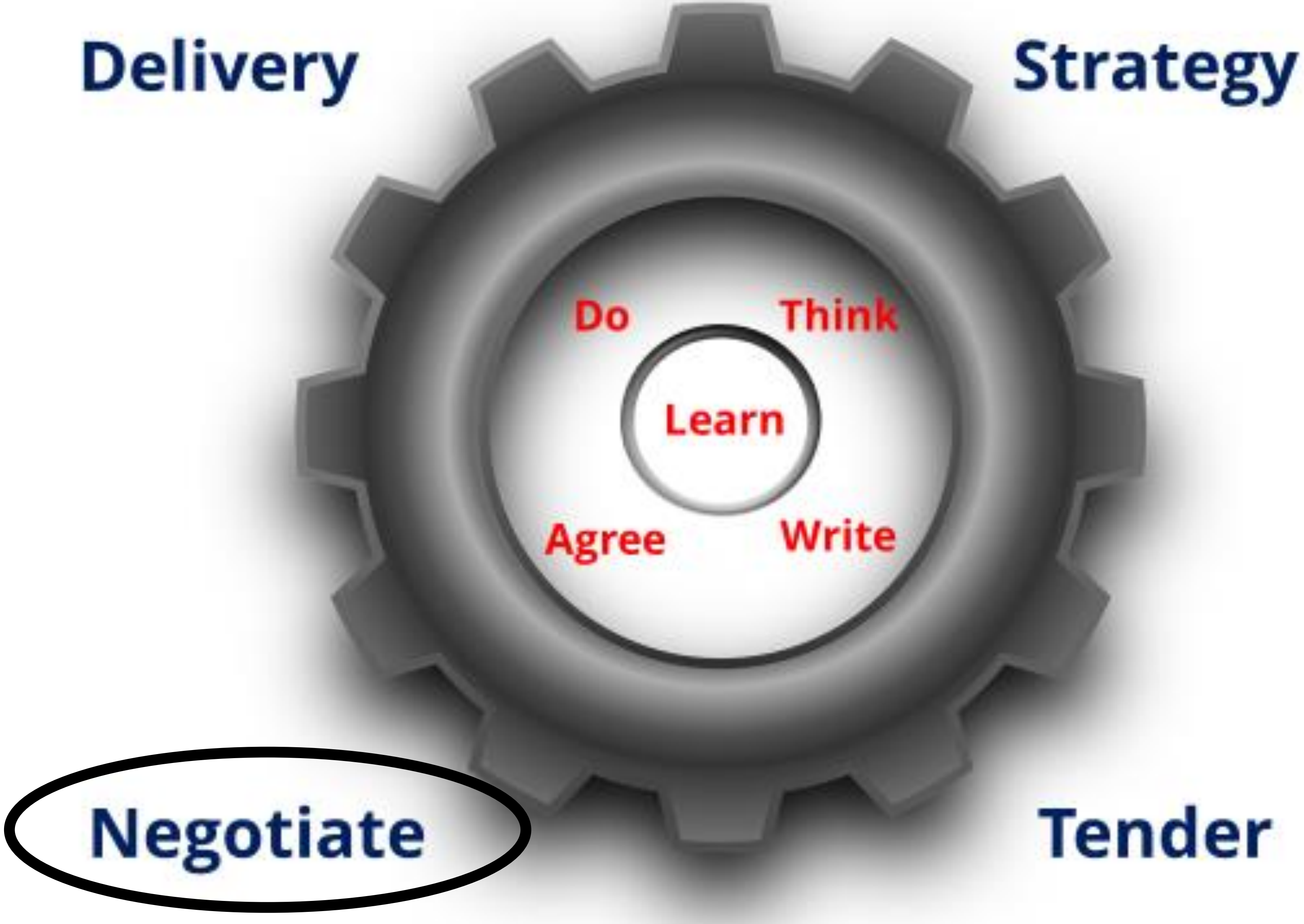
Invest in the due diligence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Negotiation Phase

Three risks to address in negotiation

- Pricing/Cost rather than TCO or Value for Money
- Performance
- Contractual risk calculation and allocation/mitigation
- Bonus: lack of process, teamwork, and negotiation training – positional versus principle-based

Negotiation Phase

All four points - create robust negotiation strategies

Mitigative measures?

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- Performance
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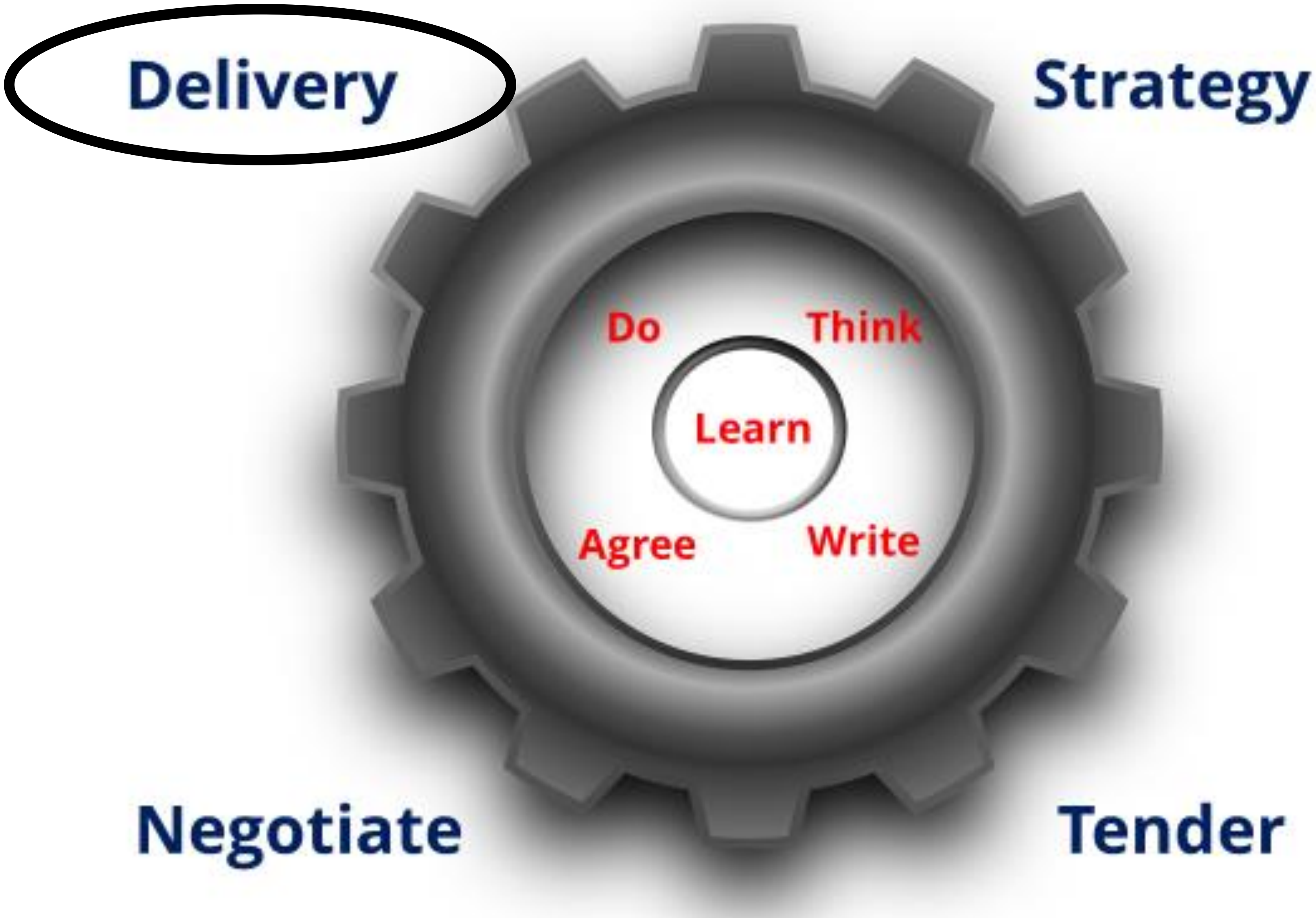

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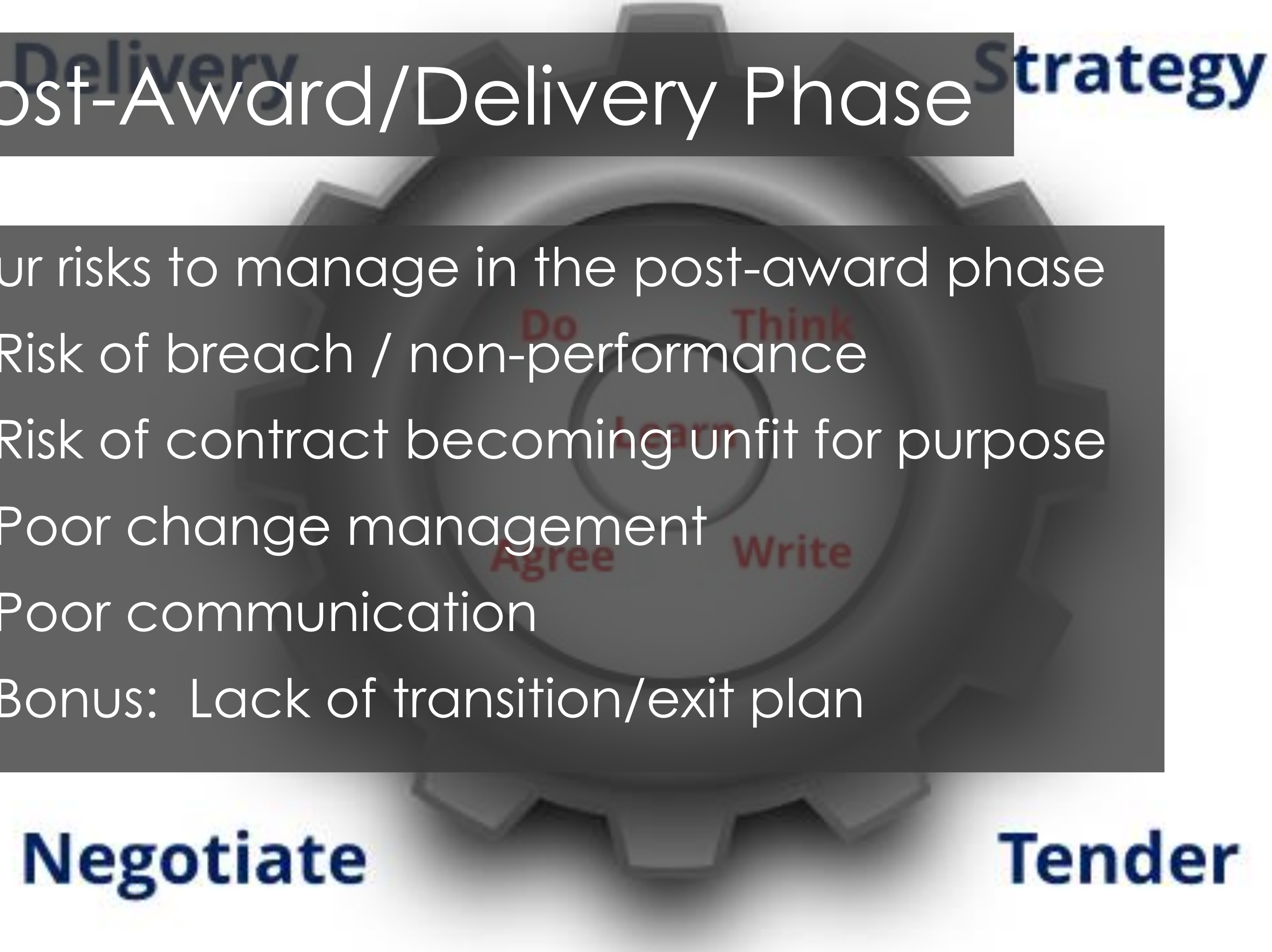
Post-Award/Delivery Phase

Four risks to manage in the post-award phase

- Risk of breach / non-performance
- Risk of contract becoming unfit for purpose
- Poor change management
- Poor communication
- Bonus: Lack of transition/exit plan



Post-Award/Delivery Phase

All five points – create a collaborative contract management governance model and develop training

Mitigative measures?

- Risk of breach / non-performance
- Risk of contract becoming unfit for purpose
- Poor change management
- Poor communication
- Bonus: Lack of transition/exit plan

Project Yield Rates – Risk Mitigation

Capability					
5					96%
4				92%	
3			88%		
2		84%			
1	80%				
	1	2	3	4	5
	Competency				

Key Tools

- RACI
- Risk registers / Insurance towers
- Automation
  - Big Data / Blockchain
  - AI / Analytics
- Revised contract clauses / tender documents

Key Tools – Budget Friendly

- Spreadsheets
- Documentation
- Formulas
  - R = Probability (P) x Impact (I)
  - ROI (Cost to mitigate versus risk avoided)
- Communications

Key Tools – Process – Pick One!

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