Avoiding Unpleasant Surprises: Managing Risk in Procurement

CSU Business Conference
March 26 – 28, 2012
Sacramento, California
Would that it be so simple...
This Morning

A. Managing Risk
   - Setting the Stage

B. Procurement Risk Management (PRM)
   - Risks, Strategies & Tactics

C. Risk Identification & Analysis
   - Alterations of Insurance Requirements
   - Insurance Requirements Checklist
Procurement

“Supply and External Service Management”
Managing Risk
Risk Management Elements

• **Risk** (exposure) – Potential for Loss or Gain
• Activity or Event or Ownership or Operation
  – **Loss** – Loss of Value (Care)
  – **Gain** – Gain of Value (Use)
• Financial Loss
  – Direct – Resources, Extra Expenses
  – Indirect – Continuity, Achievement of Goals
Values

- **People** – illness, injury, disability, death
- **Property** – damage, loss of use, destruction
- **Continuity** – interruption of services
- **Finance** – direct & indirect financial expenses
- **Liability** – “Freedom From Liability”
- **Reputation** – Public Trust
Risk Management Process

1. Identify & Analyze
2. Develop Techniques
3. Selection
4. Implementation
5. Monitor

Evaluate & Revise
Risk Identification & Analysis

• What could happen?
• What would be the impact?

• What is the probability that it will happen?
Risk Assessment Chart

<table>
<thead>
<tr>
<th>Severity</th>
<th>Frequency</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>4 (High)</td>
</tr>
<tr>
<td></td>
<td>2 (Low)</td>
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<td>2</td>
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</tbody>
</table>
Risk Management Techniques

• **Avoidance**

• **Control**
  – Prevention
    • Safety
    • Duplication
    • Separation
  – Reduction
    • Acceptable Levels
    • Response

• **Transfer**
  – Contract
    • Release/Acceptance
    • Indemnification
    • Insurance

• **Acceptance**
  – Non-Transferable
  – Insurance Deductibles
  – Residual
    • Direct
    • Indirect
## Risk Register

<table>
<thead>
<tr>
<th>Risk ID #</th>
<th>Risk Description</th>
<th>Risk Value</th>
<th>Techniques</th>
<th>Assigned</th>
<th>Residual Risk Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Late Delivery</td>
<td>2</td>
<td>Contract Penalties, Bill</td>
<td>1</td>
<td>1</td>
</tr>
<tr>
<td>2</td>
<td>Damaged Goods</td>
<td>2</td>
<td>Contract Claims Process, Gail</td>
<td>1</td>
<td>1</td>
</tr>
</tbody>
</table>
Risk Management

• Controls
  – Brakes
  – Acceleration
  – Momentum
  – Steering
B. Procurement Risk Management

• Identify procurement risks
• Prevent risks or reduce them to acceptable levels
• Improve our ability to handle the unexpected in commodity and service acquisition
• Establish procurement as a core function of our campus
Procurement

• Specifying
• Searching
• Soliciting
• Negotiating
• Awarding
• Keeping watch on performance
Procurement Changes

• Increased Outsourcing
• International Supply Chains
• Communication Technology
• Public Scrutiny
• Budgets
• Recession
Procurement Threats

• Supply Chain Disruption
• Supplier Bankruptcies
• Price Increases
• Supply Shortages
• Contract Complexities
• Oversight
• Fraud
Procurement Risk

• Supply Market Behavior & Organization’s dealings with suppliers:

Create outcomes which **harm** company

– Reputation
– Capability
– Operational Integrity
– Financial Viability
Identify

• How could our campus be harmed if procurement threats occurred:
  – Reputation
  – Operational Continuity
  – Financial Viability
  – Target for Litigation

• Divergent Thinking
  – Events/actions of others that could result in:
Analyze Impact

• How Likely /Frequently (#) could occur
  – High, Medium, Low

• What could Severity ($)/ Consequence be
  – High, Medium, Low

• What would it cost to prevent
# Risk Analysis Chart

<table>
<thead>
<tr>
<th>Consequence / Likelihood / Frequency</th>
<th>Almost Certain</th>
<th>Likely</th>
<th>Possible</th>
<th>Unlikely</th>
<th>Remote</th>
</tr>
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<tbody>
<tr>
<td>Catastrophic</td>
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</table>
Develop Techniques

• Immediate Actions

• Contingency Plans
  – Hold Extra Stock (prevention)
  – Hold Supplier Responsible (Indemnity)
    • Seek damages after
      – Reactive
      – Effort
    • Harm Done

• No Mitigation, Monitor
What’s Critical?

• Strategic Supplier/Service Provider
  – Performance is key to achieving campus goals
  – Few if any alternative sources
  – Long term relationships

• Commodities and Services
  – Amounts
  – Values
  – Frequency
THE KRALJIC PORTFOLIO PURCHASING MODEL

Supply risk/criticality

<table>
<thead>
<tr>
<th>HIGH</th>
<th>LOW</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Bottleneck products</strong></td>
<td><strong>Routine products</strong></td>
</tr>
<tr>
<td>Low profit impact</td>
<td>Low profit impact</td>
</tr>
<tr>
<td>High supply risk</td>
<td>Low supply risk</td>
</tr>
<tr>
<td>High sourcing difficulty</td>
<td>Low sourcing difficulty</td>
</tr>
<tr>
<td></td>
<td>Low visibility</td>
</tr>
<tr>
<td></td>
<td>Transactional focus</td>
</tr>
<tr>
<td><strong>Strategic products</strong></td>
<td><strong>Leverage products</strong></td>
</tr>
<tr>
<td>High profit impact</td>
<td>High profit impact</td>
</tr>
<tr>
<td>High supply risk</td>
<td>Low supply risk</td>
</tr>
<tr>
<td>High sourcing difficulty</td>
<td>Medium level visibility</td>
</tr>
<tr>
<td>Long-term contracts</td>
<td>Focus on price</td>
</tr>
<tr>
<td>Executive visibility</td>
<td>Competitiveness</td>
</tr>
</tbody>
</table>

Profit impact
Procurement Risk

- External Dependence
- Handling Unexpected
- Management Controls
- Procurement Process
- Market Conditions & Behaviors
1. External Dependence

Supplier

Supply Chain
Risks of External Dependence

• Poor Supplier Performance
  – Pre-Occupation (projects, takeovers, bankruptcy)
  – Long Term Agreement
  – Importance of Our Business

• Poor Supply Chain Performance
  – Multiple entities
  – Damage & Losses
  – Claims & Recoveries

• Limited Sources
Prevention of Losses
External Dependence

• Assess suppliers & service providers capability
• Map supply chains - Vulnerabilities
• Specifications – commodities vs. services
  – Component parts
• Long Term Agreements & % of Business
• “How Do We Improve Their Performance?”
  – Preventing our “loss” – interruption of service
• Limitation of Business, Second Source
External Dependence Principles

• Know the Supplier/Service Provider
  – Company, Account Manager & Representative
  – Accountability
  – Importance as customer

• Know the Supply Chain
  – What could go wrong, duration & impact
  – Corrective actions

• Collaborate to achieve your goal
PRM Questions
External Dependence

• How do we distinguish between strategic and non-critical suppliers/providers?
• Do we have flow charts for our critical supply chains with weakest links identified?
• Do we assess supplier/provider performance ability?
• How do supplier/providers assess our performance?
2. Market Conditions & Behaviors
Markets Risks

• Composition of the market
  – # of sources available
  – Companies ownership and relatedness
  – Emerging/declining technologies

• Competitiveness of supply markets
  – Mergers and acquisitions

• Price trends
  – Sudden changes, volatility,

• Supply availability (capacity)
  – Demand chasing supply or vice versa
  – Volatility
  – Competitor demands
  – Global events or natural disasters

• Regulatory context
  – Unexpected change
Principles and Risk Prevention
Market Risks

• Strategic Procurement
  – Exerting Control in Supply Markets
    • Setting Targets
    • Changing Markets
  – Mitigate Risk rather than respond to losses
    • Price Stability & Predictability
    • Supply Chain Security
    • Sources and Availability
    • Cost Levels
  – Contingency Plans
Key Markets Strategy Planning

• Identify:
  – Available Sources
  – Volume to be obtained this year & Costs
  – Volume next year & Cost Targets
  – Splits between Resources
  – Campus Objectives
  – Key Actions Needed NOW
PRM Questions
Market Conditions & Behaviors

- What regional, national, global events are scheduled in the next four years which may affect resources vital to the campus?
- Do we have best suppliers in the industry as our partners?
- How are leveraging our campus size in our partnerships with suppliers/providers?
- Do we have a procurement strategy?
3. Procurement Process
Procurement Process

• How people work together in decision making and behaviors affecting customer’s dealings with suppliers
• Not just to deliver savings
• Process to achieve goals of the business through providing the material resources and external services
Procurement Process Risks

- Reduced negotiating power
- Poor specifications
- Insufficient standardization
- Late involvement in Procurement process
- Inadequate assessment of supplier
- Over focus on price
Prevention
Procurement Process Risk

Procurement Development
• Cost Savings
  – Combine, standardize, use competition
• Cost Management
  – Improve specifications, contract and risk management, supply strategies
• Sustained Value Acquisition
  – Increase commercial awareness, collaborative supply relationships, sustained viability of campus
PRM Questions
Procurement Process

- Are we doing procurement intelligently?
- Do we have a policy regarding supplier visitors on campus? (commercial unawareness)
- Can we improve our procurement process?
- Can we develop collaborative supply and service relationships
- Do our supply and service strategies support the campus goals?
4. Management Controls

• Proper use of authority
• Framework by which it is delegated
• Principles expected to be employed
Risks In Management Controls

- Unworkable procedures
- Biased selection of bid invitees
- Overreliance on favored suppliers
- Unofficial/unauthorized commitments to contract
- Unchecked price increases
- Failure to benefit from volume price breaks
Prevention Management Control Risks

• What to do and why it is important to the business
• Creating a “procurement” culture based upon core principles and policies
• Supplier and Service Provider performance management
PRM Questions
Management Controls

• Do procurement policies and controls apply to all campus personnel?
• When and how were our campus procurement policies last reviewed?
• Do our procurement policies and controls reflect current supply market conditions and behaviors?
• Do we invite supplier and service provider offers in a consistent manner?
5. Handling the Unexpected

- Surviving disruptions and resuming progress toward desired goals
- Luck is where preparation meets opportunity
  - Creating and noticing chance opportunities
  - Listening to intuition
  - Imagining success – self fulfilling
  - Resilient and positive in adversity
Risk

• Failure to anticipate potential events
• Over-reliance on predictive tools
• No strategy or master plan to provide frame of reference for dealing with unexpected events
• Ad hoc reactions to events that diminish public confidence
Preparation
Handling Unexpected

• Make the unexpected smaller
• Look outside the edges of “Past Events”

• BUSINESS INTERRUPTION PLANS
PRM Questions
Handling Unexpected

• Do we have a reporting system for classifying and learning from supplier, service provider and supply chain failures we have experienced?

• Are we creatively identifying potential disruptions in supply chain, supplier and service provider performance?

• Do we have Supplier Relationship Management plans in place with key partners?
Procurement Risk Management

1. Gather data about current expenditures
2. Prioritize categories to examine
3. Involve cross functional team, identify disruptive events
4. Assess impact of events and probability
5. Develop actions & contingency plans for the likely and harmful
6. Develop long term strategies to reduce risk
7. Monitor internal and external events
Bob, the Roofer

- Leaking roof in golf clubhouse
- Just a minor repair
- Bob’s worked for us a lot over the years
- He’s quick and doesn’t charge a lot
- We’ve got his paperwork from last year
Drying off the roofing
Club House Burned to the Ground!

• No contract for services was in place
• Bob had let his insurance expire

• Property loss – Structure
• Personal Property Loss – Member Contents
• Business Property Loss – Restaurant & Pro Shop equipment & supplies
• Revenue Loss – Golf course, Pro Shop, Restaurant
Contractual Risk Transfer

• Responsibility for activity to the entity which can control the activity
  – Other party is Held Harmless and/or Indemnified

• Indemnification is dependent on the financial resources of the responsible entity
  – Insurance is one of their financial resources (contract to pay on their behalf)
  – As an Additional Insured, you also have direct access to that resource for your loss
C. Risk ID & Evaluation

- CSU Technical Letter RM 2011-06
  - Insurance Requirements
  - Hold Harmless Provisions
  - Alteration Process
    - Identify Risks of the activities contemplated
    - Determine Subsequent Losses (Risk Analysis)
    - Consider departure from regular requirements
# Appendix A: Risk Assessment
## Potential High Risk Situations or Special Insurance Required

- Crowd exposures
- Plumbing
- Work involving vehicles
- Work involving watercraft
- Medical services
- Legal services
- Other professional services
- Zoning or planning services
- Use or serving of alcohol
- Work with natural gas
- Work near railroads
- Work near waterways
- Any pollution or environmental exposure
- Maintenance or inspection services
- Use of caustics, flammables explosives
- Work involving utilities/provision of service
- Heavy equipment
- Computer hardware or software
- Work near water, docks, wharves
- Work involving aircraft
- Marine work of any kind
- Construction management
- Handling of funds or assets
- Inspection services
- Electrical work
- Work near roads
- Work near airports
- Underground work or excavation
- Design engineering or architectural services
- Surveys, soil engineering, topographic surveys
- Armed guards, use of armored cars
- Work involving boilers, pressure vessels, turbines
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</table>
Identification and Evaluation of Risk
Goods & Services Procurement

Agreement/Contract: ___________________________  P.O.# ___________________________
Contract Period: ______________ to ______________  Contract Amount: $__________________

Goods or Services Description: ______________________________________________________

Contractor employees: yes/no  Vehicles/Mobile Equipment: yes/no
Activities in public accessible places: yes/no  Hazardous materials or procedures: yes/no

<table>
<thead>
<tr>
<th>Institutional Value</th>
<th>Risk Identification</th>
<th>Yes</th>
<th>No</th>
<th>Severity/Frequency</th>
<th>Hold Harmless/Indemnity</th>
<th>Insurance (Specials)</th>
<th>Limits</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. People</td>
<td>Could ANY persons be injured/killed?</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2. Property</td>
<td>Could ANY property be damaged/destroyed</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>3. Pollution</td>
<td>Are ANY hazardous materials being removed &amp; disposed of, used, installed?</td>
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<td></td>
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</tr>
<tr>
<td>4. Continuity</td>
<td>Could ANY institution functions be interrupted as a consequence of 1, 2, or 3 above?</td>
<td></td>
<td></td>
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</tr>
<tr>
<td>5. Finance</td>
<td>Could there be ANY expenses beyond the contract cost?</td>
<td></td>
<td></td>
<td></td>
<td></td>
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</tr>
<tr>
<td>6. Liability</td>
<td>Could the Institution be liable in ANY way? (1-4 above)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>7. Media</td>
<td>Could ANY of the above interest the MEDIA?</td>
<td></td>
<td></td>
<td></td>
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</tr>
<tr>
<td>8. Reputation</td>
<td>Could the reputation of the institution be decreased or damaged by ANY of the above?</td>
<td></td>
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</tr>
</tbody>
</table>

Identification and Evaluation By: ___________________________ Date: ______________
Reviewed/Approved By: ___________________________ Date: ______________
Insurance Requirements
Commodities & Services

• Certificate of Insurance
  – General Liability Insurance $2M/$5M
  – Automobile Liability Insurance $1M
  – Workers’ Compensation and Employer’s Liability Insurance Statutory & $1M
  – Professional Liability Insurance

• Additional Insured Endorsements –
  – General & Automobile
## Certificate of Insurance

<table>
<thead>
<tr>
<th>Insured:</th>
<th>Date: (Current Yr)</th>
<th>Approved</th>
</tr>
</thead>
<tbody>
<tr>
<td>(Supplier/Service Provider Company name and address)</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

### Insurers:

<table>
<thead>
<tr>
<th>Ins Ltr</th>
<th>Company Name</th>
<th>Rating</th>
</tr>
</thead>
<tbody>
<tr>
<td>A</td>
<td>(General Liability Insurer)</td>
<td>A:VII</td>
</tr>
<tr>
<td>B</td>
<td>(Automobile Liability Insurer)</td>
<td>A:VII</td>
</tr>
<tr>
<td>C</td>
<td>(Workers’ Comp Insurer)</td>
<td>A:VII</td>
</tr>
<tr>
<td>D</td>
<td>(Professional Liability Insurer)</td>
<td>A:VII</td>
</tr>
</tbody>
</table>

### Insurance:

<table>
<thead>
<tr>
<th>Ins Ltr</th>
<th>Policy #</th>
<th>Limits</th>
</tr>
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<tbody>
<tr>
<td>A</td>
<td>GLI####</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>Limits</td>
</tr>
<tr>
<td></td>
<td>Each Occurrence</td>
<td>($2,000,000)</td>
</tr>
<tr>
<td></td>
<td>General Aggregate</td>
<td>($5,000,000)</td>
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<tr>
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<tbody>
<tr>
<td>AL###</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Limits</td>
</tr>
<tr>
<td></td>
<td>Owned Autos</td>
</tr>
<tr>
<td></td>
<td>Scheduled Autos</td>
</tr>
<tr>
<td></td>
<td>Non Owned Autos</td>
</tr>
<tr>
<td></td>
<td>Hired Autos</td>
</tr>
<tr>
<td></td>
<td>Combined Single Limit (each accident)</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Policy #</th>
<th>Limits</th>
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</thead>
<tbody>
<tr>
<td>WCI#####</td>
<td></td>
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<tr>
<td></td>
<td>Limits</td>
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<tr>
<td></td>
<td>Workers’ Compensation Statutory Limits</td>
</tr>
<tr>
<td></td>
<td>EL Each Accident</td>
</tr>
<tr>
<td></td>
<td>EL Each Disease, Ea Employee</td>
</tr>
<tr>
<td></td>
<td>EL Disease Policy Limit</td>
</tr>
<tr>
<td>Errors &amp; Omissions Liability</td>
<td>(D) Policy # (PLI########)</td>
</tr>
<tr>
<td>------------------------------</td>
<td>----------------------------</td>
</tr>
<tr>
<td>Certificate Holder</td>
<td>(The State of California, The California State University, YOUR CAMPUS NAME &amp; ADDRESS)</td>
</tr>
<tr>
<td>Cancellation</td>
<td>(Should any of the above described policies be cancelled before the expiration thereof, notice will be delivered in accordance with the policy provisions.)</td>
</tr>
<tr>
<td>Authorized Representative</td>
<td>Signature</td>
</tr>
</tbody>
</table>

Additional Insured Endorsement(s) to Insurance Policies

**General Liability Policy**

<table>
<thead>
<tr>
<th>Policy #</th>
<th>(GLI########)</th>
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<tbody>
<tr>
<td>Policy</td>
<td>(Commercial General Liability)</td>
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<table>
<thead>
<tr>
<th>Schedule</th>
<th>Name of Person or Organization (Additional Insured)</th>
<th>(The State of California, The California State University, Your Campus Name, and the officers, employees, volunteers and agents of each of them.)</th>
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**Automobile Liability Policy**

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What will you say when they ask:

“What Happened?”

• Is there a contract?
• Are we held harmless (indemnified)?
• Are we covered (insured)?
• Is it enough?
Questions
References & Resources

• A Short Guide to Procurement Risk. Richard Russill, Gower Publishing. 2010


• To follow up on this presentation: joerisser@gmail.com
Thank You!