Project Procurement: Problem Area or Value Creator?

2nd Global EPC Project & Contract Management

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Common Mistakes in Project Procurement

- Imagine a project where:
  - Cost are exceeding the budget
  - Work is occasionally interrupted due to missing materials
  - Deadlines are slipping
  - Some of the delivered materials are rejected due to quality problems
  - Customer is complaining
  - Profitability is going down
- Does it look familiar?
- What is going wrong? Is procurement messing up the Project?

Common Mistakes in Project Procurement

- Procurement stepping in at the last moment / very limited role left for Procurement
- Limited interaction with Suppliers / their potential not utilized
- Tail spend not properly managed
- Commercial risks not mitigated

Early Procurement Involvement

- When is Procurement function typically involved in a Project?
- Usually Procurement is involved when Purchase requisitions are issued and they are asked to compensate the accumulated delays
- In many cases suppliers are already selected, technical details are discussed with the suppliers. It is not unusual that suppliers know that they will be awarded the business
- This leaves very little role and leverage to Procurement function. Rush purchases never give good results

Early Procurement Involvement

- And when should Procurement function be involved in a Project?
- Ideally at tender stage from bid / no bid decision
- Normally there is a long period between bidding / awarding of the project / actual site work
- This time can be utilized to identify and qualify new suppliers, work interactively with suppliers to develop better technical solutions
- Sometimes it would be possible to conclude firm deals with suppliers at tender stage

Suppliers as Consortium Partners

Any critical supplier which delivers more than 10% of the project cost could be considered as a consortium partner. This decision has to be made at tender stage and can be facilitated by Procurement

- Advantages:

1. Supplier will have a direct stake in winning the project. This will force the supplier to be more competitive
2. Similarly, the supplier will have a more direct stake in successful project execution
3. The supplier will not be available as an option to other bidders

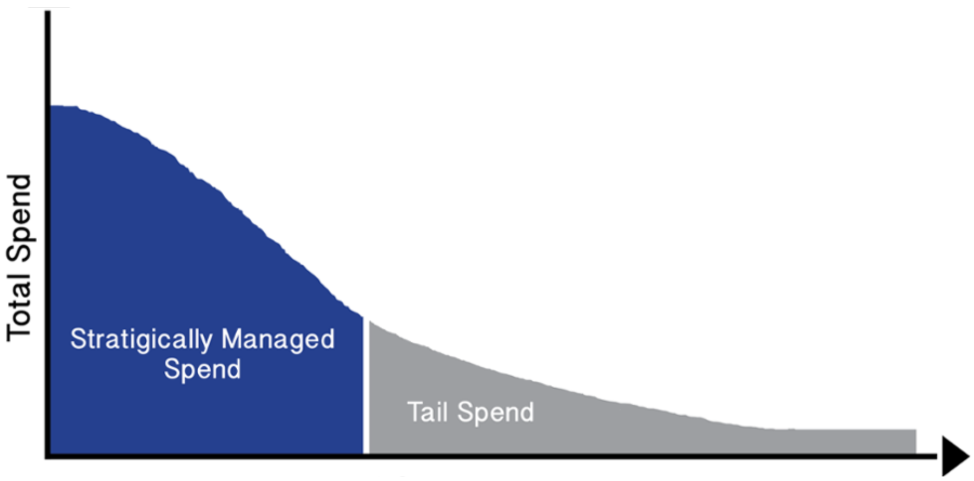
- Disadvantages/risks:

1. Revenues will be split between consortium partners
2. Will not work well if there is not good relations/confidence between the parties

Engineering Specs vs Functional Specs

- The usual practice is to provide fully detailed engineering / manufacturing specifications to the suppliers
- In this case, supplier has no choice other than delivering what is specified
- Functional specifications, where the required function is specified , and the supplier is left free to develop their own solution which satisfies the required functionality is another option, which is rarely used
- This approach requires long working relations/history with the supplier and selection of competent suppliers
- It allows room for creativity and improved solutions

How to Manage Tail Spend?



- Typically in a project, tail spend amounts to 20% of the value, but 80% of the transaction volume
- Usually this spend is not managed and handled in fire-fighting mode

Challenges for Tail Spend

- Low attention from stake-holders
- Can absorb un-proportional amount of resources and time
- Can divert attention from high value items
- High compliance risks, maverick buying
- High risk of slipping out of control
- Non-transparent spending pattern

Solutions for Tail Spend

- P-Card
- Consolidation / categorization
- Purchase catalogues
- Outsourcing / using traders
- Dedicated buyers
- Spot buying desk
- Simplified authorization processes

Mitigating risks of Price Fluctuations

- For most projects, there is a long period between bidding and actual purchases
- This exposes us to the risks of market price fluctuations and can contribute to cost overruns
- Potential methods for risk mitigation:

1. Escalation clauses in the contracts
2. Hedging (Most raw materials can be hedged)
3. Concluding firm deals with suppliers at tender stage

Conclusion

- Procurement can easily be a “Problem Area” for Projects
- However it can also be a value creator by:

1. Increasing competitiveness at tender stage
2. Finding the best suppliers in the market and bringing their competence and strengths on board to support the business
3. Avoiding cost overruns during project execution, on the contrary finding ways to improve the costs and creating positive deviations
4. Assuring on-time and on-spec deliveries
5. Mitigating the commercial risks using the appropriate methodologies
6. Improving the cash flow

Questions?

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