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The hidden risks in oil and gas supply chains

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Introduction

With dramatically falling oil prices, reductions in headcount and uncertainty regarding the industry’s future, the global oil and gas industry is currently facing challenging times.

As spend is being closely scrutinized, many firms are understandably focusing on delivering immediate cost reductions. But according to new research, this could mean other issues are being overlooked.

With up to 80 per cent of revenue spent with suppliers, it is vital that oil and gas firms take a long-term approach to managing all risks within their supply chains – particularly those involving contractors.

Yet a lack of standardization in the supplier selection process, insufficient collaboration between buyers and suppliers, and rising labor costs are placing the industry’s productivity levels under increasing pressure and leaving oil and gas companies open to risks associated with their suppliers.

Mike Viator, global director of oil and gas at Achilles, explained: “In the oil and gas industry, there is no longer the headcount there has been in previous years that allowed companies to utilize their staff to carry out proper validation, prequalification and auditing of their suppliers.”

Failure to carry out reviews of suppliers puts main contractors in a significant position of risk, since supply chain problems can affect firms’ financial position and reputation.
What’s happening in the industry?

In January 2015, oil prices dropped to a six-year low1, with the cost of a barrel of North Sea benchmark Brent crude oil decreasing by 5.5 per cent to reach $47.36 (£27.99), which was the largest drop since the beginning of 2009.

Official forecasts for the following months led to many businesses in the sector being forced to cut costs, with a significant number reducing their staff headcount in order to do so.

Mr Viator explained that many of these reductions in workforce numbers are taking place in firms’ purchasing and supply chain departments.

“Companies are putting themselves at huge amounts of risk, as they don’t have the resources to validate and qualify suppliers.”

Mike Viator
Director of Oil and Gas, Achilles

Oil and gas companies share several common supply chain-related pain points, including:

- Improving visibility and managing risk across global, complex and multi-tier supply chains.
- Protecting their brand name and corporate reputation.
- Reducing wasted time, risk and unnecessary costs when sourcing new suppliers.
- Staying compliant in relation to the latest procurement legislation.
- Effectively managing supplier data across multiple systems and locations.

All of these have been exacerbated by the challenges currently affecting the industry.

However, adopting a collaborative approach to business can help to tackle these issues.

A notable example of how collaborative working practices can help deal with the challenges of cost-efficiency, risk reduction and maintaining good ethical standards can be found in the UK North Sea.

As a mature oil basin, the North Sea oil fields have declining output and rising unit production costs. The UK government is determined to significantly prolong the economic life of the North Sea and so commissioned the Maximizing Economic Recovery study by industry veteran, Sir Ian Wood2.

The review makes many practical suggestions on how to reduce costs and collaboration is a recurring theme of the report. In fact, the UK oil and gas industry already has a strong culture of collaboration and this includes initiatives such as vessel sharing, a database of spare parts and a supply chain code of practice that streamlines procurement through the operation of a single shared supplier database. It makes sense that other regions should adopt a similar collaborative approach.

In addition, in April 2015, it was announced that Royal Dutch Shell had acquired the BG group3 in a deal worth $71 billion, indicating that some firms in the sector are beginning to recognize the importance of joining forces to work through the current challenges.

However, new research indicates the majority of firms in the sector still do not work collaboratively to reduce costs. The study was commissioned by Achilles – a global supplier information management company, which works on behalf of 300 oil and gas buying organisations to manage risks associated with 25,000+ suppliers. It was carried out by independent consultancy IFF.

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2 UKCS Maximising Recovery Review Final Report http://www.woodreview.co.uk/
3 Recommended cash and share offer for BG Group by Shell Plc, Shell, April 8th 2015
Organizations often leaving procurement contract decisions to chance

The research looked in detail at the pre-qualification processes being used by buyers in the global oil and gas industry, finding that many are simply leaving procurement contract decisions to chance rather than using a standardized system.

Mr Viator explained that working collaboratively as an industry to gather information and share non-commercial data benefits the sector as a whole because all companies split the associated time and administration between them. This is particularly effective when a neutral third party is tasked with collating the data.

A standardized prequalification system brings a standard to the industry, as well as each supplier involved.”

“By publishing information in a community, suppliers only need to register once to be considered for work by all the buyers in the group.”

Mike Viator
Director of Oil and Gas, Achilles

In the Achilles/IFF survey, 92 per cent of oil and gas companies located within the UK, US, Spain, Brazil and the Nordics stated that they, and their international affiliates, require the same standards from each of their suppliers, in relation to areas including health and safety, the environment, product quality, procurement sustainability and supply chain ethics.

Yet 60 per cent admitted they do not work collaboratively on managing information about suppliers, and instead tackle due diligence tasks such as supplier validation, prequalification and audits on an individual basis – each repeating the same administrative processes on what are often the same suppliers.

There is no competitive advantage in holding mandatory information on compliance so why is the industry still reluctant to work collaboratively on what is essentially an administrative exercise?

Why aren’t more companies interested in creating a clearer picture of who their suppliers are and where exactly their products are coming from? And what alternative methods are they using to source their suppliers?
In the research, 13 per cent of global oil and gas buyers admitted they do not use either their own judgement or a formal risk model when it comes to choosing suppliers.

This implies that many oil and gas firms do not have clear strategies, processes or scrutiny in place to select the suppliers they work with, which could expose them to a significant amount of risk.

Mr Viator commented: “Without a formal risk model, it is too easy for firms to work from a ‘little black book’ of their favorite companies, casting over other firms that may be able to do the job better.

“Across the globe, oil and gas companies are under pressure to cut costs, rather than risks from the supply chain, but this is a false economy because the cost of doing business with a risky supplier can be astronomical.”

It is not just financial risk that businesses face in this situation, but also potential damage to their brand name and reputation, as well as loss of procurement contracts and possible legal trouble arising due to failure to comply with supply chain legislation.

In addition, the research found that as few as 19 per cent of firms in the industry used only their own judgement to select suppliers rather than an official prequalification process, while just 27 per cent used a formal risk model, but none of their own judgement.

Best practice involves a combination of using a risk matrix and individuals’ own expertise and experience, but only 36 per cent of oil and gas buyers surveyed used this combination to decide who to give supply chain contracts to.
Further research from Achilles and IFF shows that oil and gas companies are not adequately protecting themselves from supply chain risks, with a concerning lack of due diligence and information on suppliers positions in terms of finance, health and safety, anti-bribery and corruption.

We asked businesses: “Before issuing a tender or awarding a contract, do you hold financial information on potential main suppliers?”

Across the globe, 27 per cent of firms said they did not hold such data on their main suppliers.

This is despite our research finding that 36 per cent of firms had experienced some form of disruption due to a supply chain issue over the last 12 months.

This is all the more puzzling because oil and gas companies can protect themselves from these risks by carrying out due diligence on suppliers by collecting critical information on their suppliers, such as their financial performance or compliance with procurement legislation.

Main suppliers – and those in lower tiers – can directly impact the bottom line of buying organisations. Companies that don’t have access to such critical information on their suppliers are putting themselves at risk of legal, financial and reputational damage. This would be difficult to deal with at any time, but particularly so in light of the challenges the industry is currently facing.

As numerous tiers of a supply chain can be affected by issues such as financial collapse or corruption, it is important that industries work together collaboratively to improve supply chain visibility through the sharing of information.

Further, we discovered that one in ten buyers hold no health and safety information on their suppliers, while 11 per cent do not have any data on their suppliers’ anti-bribery or corruption policies, meaning there could be illegal practices taking place in their supply chains that they are not aware of.
In light of the findings of our research, it is clear that improving supply chain transparency and putting to one side any perceived “competition” on managing supplier information in favor of a more collaborative approach could be beneficial for the oil and gas industry.

Achilles manages pre-qualification questionnaires which suppliers must complete to fully join an Achilles oil and gas community. This online form captures a wide range of information on suppliers, including their financial position, health and safety record, carbon footprint, environmental policy, views on climate change, and corporate social responsibility policy.

This data is then put on display in the community, allowing all buyers to view official documents and use the information to make decisions about which companies to add to their supply chains. Suppliers cannot see each others’ data.

Community members can decide how they would like to use the data; either by managing the whole industry’s suppliers in a central location or for sourcing local suppliers for individual projects or contracts, making the model an extremely flexible solution.

There are numerous benefits to signing up to an Achilles community, which presents many new business opportunities for its members, making them visible to organizations they wouldn’t otherwise have connected with in different parts of the world, providing smaller suppliers with access to a larger pool of work.

“Collaboration presents the opportunity for some standard work among the sector, as sharing standards is very important. Today there isn’t a mandatory global standard for prequalification, but we see oil and gas companies across the globe working to devise their own – based on local, regional and global requirements. They recognize that the need to stay on top of supplier risk is constant – even during tight economic times when headcount is reduced.

“This helps share in the cost in tight economic times when headcount costs needs to be reduced, yet the need to stay on top of supplier risk remains.”

Mike Viator
Director of Oil and Gas, Achilles
Conclusion

With the global oil and gas industry facing challenging times and this situation looking unlikely to change significantly in the near future, it is vital that businesses within the sector put perceived ‘competition’ on managing supplier risk to one side and join forces for the benefit of the industry as a whole.

At the beginning of this report, we highlighted several of the most common pain points for oil and gas buyers, and it can now be seen that collaboration is a key part of the solution.

By joining a supplier information community, companies can share the burden of gathering, managing and updating supplier information, while strengthening their supply chains.

Our communities also make the supplier sourcing process more transparent and significantly easier, reducing risk, unnecessary costs and wasted time, alongside helping firms to stay compliant with the most recent procurement laws.

Buyers can join just one central platform, streamlining the process and reiterating the idea that oil and gas businesses should be adopting the mantra ‘work smarter, not harder,’ in light of the current climate of the industry.