Beyond Price: Managing Service Suppliers for Value at the Front Line

Careful management of work scope, enforcement of contract terms and joint cost reduction can help oil and gas companies lower costs while preserving relationships with suppliers.

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Every company in the oil and gas industry is focused on reducing costs. Most start with aggressive negotiations to reduce prices, and some get reductions of up to 40%. But with oil and gas prices so low, that's not enough. Companies must also organize to manage supplier performance, especially in categories where service suppliers make up most of the external spending. This can help them double their savings by carefully managing the scope of what is being procured, ensuring that supplier performance is in line with what has been agreed upon and working with suppliers to reduce costs together.

Four barriers typically diminish the value a company gets from suppliers:

- **Functional silos.** Engineering specifies the requirement, procurement negotiates the contract, and operations works with the supplier—but the three functions don't collaborate closely to get the most out of the relationship and the contract.
- **Lack of clarity about what creates value.** Operations doesn't have a clear view of what creates value in the contract (for example, managing overtime or reducing work volume) or how operations itself may be creating inefficiencies and extra costs for the supplier (for example, onerous permitting processes that can significantly reduce a service suppliers' time on site).
- **Complex contracts.** The front line does not have a simple view of what the contract entails, what to ask for and how they are performing, because it only views the contract as a long legal document designed to protect the company from lawsuits rather than to manage suppliers.
- **Unproductive relationships.** The relationship between the front line and suppliers can either be too cozy or too transactional, rather than a collaborative working relationship that seeks to create value for both.

Oil and gas companies can unlock the full potential of their supplier relationship by improving five key elements.

- **Clear decision roles.** The bedrock of good collaboration between functions is transparency in decision making. Procurement departments manage contracts, but operations teams oversee suppliers' performance and advise on ways to improve the value of the relationship.
- **Fit-for-purpose contracts.** Contracts should spell out not only the services to be provided but also the joint expectations about improvements in key performance indicators (KPIs). One large petrochemicals plant with a variable-pay service contract discovered that costs had escalated in some categories when suppliers were allowed to increase the scope of work. They changed to fixed-resource, fixed-fee contracts, added a mechanism for distributing available capacity across the plant, and saved more than 25%.
- **Shared KPIs that are tracked and improved.** Supply chain, operations and service suppliers should monitor critical indicators focused on value delivery, not just process. Some KPIs might be common across spending categories (for example, adherence to plan or level of overtime), while others will be specific to each category (such as using access methods other than scaffolding).

  To establish indicators, companies need to understand the total cost of ownership for a category, including factors that increase either the supplier's costs (for example, late planning of work that disrupts schedules) or the buyer's (for example, rework due to poor welding). Companies can then use these metrics to manage performance. One industrial company discovered significant costs resulting from scaffolds erected several days before maintenance work began and left standing for days after. By tracking the metric and displaying the data, the front line reduced the costs of these leftover scaffolds by more than 40%.
- **Tools to help the front line decide on work scope, volume and overtime.** Two types of tools that work particularly well are the contract-on-a-page and scoping tools. The contract-on-a-page—sometimes reduced to its main points on a card that can hang on a lanyard—outlines the most important aspects of the contract and tells frontline staff how to reduce service cost *(see Figure 1)*. The scoping tool helps the front line consider the most cost-effective way to do a job. For

instance, one client created a simple chart that described the difference in cost and risk from using scaffolding, rope access, scissor lifts or forklift cages to access key points in the plant. The front line used this on a daily basis to make decisions on the best way to do a job and substantially reduced costs as a result.

- **Ongoing performance discussions with service suppliers** on how to work together to create value, with rigorous follow-up to address any performance gaps. Monthly performance reviews are a good way to complement strong daily management, providing an opportunity to acknowledge successes and identify opportunities for improvement. It is important to plan these reviews carefully, making sure key staff from both sides are in the room and ensuring follow-up. In our experience, these sessions have an immediate effect on performance. In one recent conversation, the supplier offered multiple solutions that reduced the buyer's costs without diluting the supplier's profits.

Companies with strong supplier performance management in place have found that not only do they yield additional near-term value, but they also create tools that empower the front line to keep costs down, improve supplier relationships and release some of the tension between procurement and operations. One client transformed its supplier relationships by piloting these measures in one category and eventually rolling them out across all categories, saving 10% to 15% in less time than contract negotiations would have taken.

With oil priced as low as it is, every dollar counts. Aggressive price renegotiations are one important tactic, but operators and suppliers can create additional value through systematic supplier performance management at the front line. To do this, operators and suppliers will need to break down silos and identify what creates value in the contract. Doing so creates sustainable benefits that will remain even when oil prices and rates eventually recover.

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Figure 1: A contract-on-a-card gives a clear, concise overview of the supplier's and customer's responsibilities

Scope of services contract

Describes the services to be provided, including what elements are and are not included

Key contract features	Select rates and factors
Details the responsibilities of the service and the customer and how to manage change • If scope changes, provider has five days to gain approval • If provider breaches the contract, penalties apply • Cancellation fees apply if the customer cancels the work	**Details of billing, labor rates and cost overruns** • Standard rates are multiplied as follows: – Urgent work (1.15x) – Emergency work (1.2x) – Weekend or holiday work (1.6x) • Equipment left after work is complete can increase the service provider's costs
Contract watch-outs	**Roles and responsibilities**
Key items for customer to oversee to reduce costs associated with service provider's rates • Minimize the use of unnecessarily expensive equipment or services • Minimize the equipment rental time by removing it promptly after work is complete • Reduce the risk of scope change by accurately estimating work	**Description of roles and responsibilities of service provider and customer** • Customer is responsible only for providing water, electricity and 200 meters of working space • Service provider is responsible for providing safe, fit-for-purpose equipment with weekly inspections • Service provider must notify customer as soon as it is aware it cannot meet a production schedule

Source: Bain & Company

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