In this issue of Premium Procurement Bulletin…

[Case Study] PetroSA: What Went Wrong?

PetroSA, South Africa's national oil company, has fallen under investigation by its parent company, Central Security Fund and South Africa's department of energy for a series of ongoing inappropriate procurement procedures. Though a full investigation is underway and few details have been released to date about the indiscretions, here's what's clear from the information known.

What Executives of PetroSA Did

Image via Flickr by Rubber Dragon

The heart of PetroSA's problems lies in senior executives who inappropriately overrode the internal control systems. Chief financial officer Nkosemntu Nita and vice president of operations

Michael Nene were suspended in May 2012, and in early 2013 chief executive officer Sipho Mkhize was fired immediately following an investigation by Gobodo Forensic and Investigative Accounting.

The improper procedures by executives were related to how they handled tenders and contracts. Their actions involved rigging of tenders and mismanagement of the company's finances. Apparently, there are some former executives of the company who are also under investigation.

What It Cost

Of PetroSA's R7.1 billion annual revenue, the indiscretions cost the company a reported R5 million. CEO Mkhize lost his job, and the allegations might hinder the company's future abilities to secure contracts with the government. As of now, the South African government wants PetroSA to provide 30 percent of the company's needs for crude oil, in addition to increasing their refining capabilities and investing in more liquid fuels logistical infrastructure.

PetroSA is trying to meet government requests by building a new oil refinery in Coega, which is expected to produce 400,000 barrels of oil per day. In light of the Oilgate scandal in December 2003, Mkhize and his fellow senior executives were already under suspicion. At the time, money that was supposed to be paid to a supplier, Glencore International, actually went to the African National Congress. Mkhize was eventually cleared of wrongdoing in the Oilgate scandal because he was apparently on leave when the transaction took place.

What Could Have Been Done?

Is there any way PetroSA's parent company, Central Security Fund, could have prevented what ended up being a costly series of malpractices by its executives? There are several ways to help stop executives from abusing their authority and putting the company in legal or financial jeopardy.

- Checks and balances: people at all levels need to be able to sound the alarm if the company's policies and procedures aren't being followed.
- Accountability: people directly responsible for high level decisions need to be held personally responsible for their actions, whether it be ill intent or simple indifference to the regulations.
- Integrity: companies should never assume that a high level of authority constitutes a high degree of integrity. People at all levels of business are susceptible to temptations when it comes to wrongdoing.
- Frequent audits: companies should invest in regular audits by third party organizations to detect any discrepancies, malpractices, negligence, or wrongdoing before the issue gets out of hand.

While the latest scandal at PetroSA may not mean a death sentence to the company, there's no disputing the scandals have marred their reputation and could hurt their abilities to garner new contracts in the future. Taking care to avoid these malpractices before they become an international issue is the only way to protect a company's finances and reputation.

Key Terminology: Procurement

There are tons of terms related to procurement, many of which are so commonplace or self-explanatory most people don't need a glossary to understand them. Here is a list of key procurement terms, especially acronyms, that can be confusing without a definition.

Image via Flickr by GovernmentZA

Abstracting

The process of listing all the bidding contractors and their prices in order to identify the most qualified contractor offering the best value for goods or services.

Alternate Bid

A bid to supply a product that differs in some way from the product originally specified in the request for a bid.

ARO

After Receipt of Order; the period of time after the goods are delivered from the supplier to the purchaser.

Bill of Lading

The contract or receipt provided by the carrier of the goods (transporter) listing the goods it received to be transported.

Blanket Order

Establishes a length of time during which the vendor agrees to provide goods or services on demand. This is a purchase on demand contract.

Bond

This is a measure of protection, assuring some degree of payment in the event the terms of the contract are not fully met.

Compliance

The extent to which the supplier conforms to the terms of the contract.

Consideration

Something of value, usually money, paid by the seller to the buyer for goods or services delivered which are not in compliance with the contract.

Demurrage

The payment required and paid due to a delay in loading or unloading of goods. This term applies to goods loaded or unloaded from a train, ship, truck, or other automobile.

ED

Economically Disadvantaged Area Business; must be 51 percent owned and operated by the U.S. Only the Department of Labor can designate a business as ED.

EPP

Environmentally Preferred Product; a product deemed more environmentally friendly than other products which do the same thing. This includes recycled products, products which save water or power, products which produce less waste, etc.

LTL

Less Than Truckload; an amount of product that does not constitute an entire truckload.

Life Cycle Costing

The entire cost of a product during its lifetime, including how much it takes to acquire, how much it costs to operate and maintain, and how much it costs to dispose of.

Lowest Responsible Vendor

The vendor who offers the lowest price, but is also proven to be reliable in terms of past performance and reputation.

NAICS

North American Industry Classification System; formerly called SIC; business classification system to make statistical data on industries more uniform and easier to compare.

NAPM

National Association of Purchasing Management; a nonprofit organization of public and private buying agencies.

NASPO

National Association of State Purchasing Officials; an organization of procurement representatives working toward making state purchases more efficient; an affiliate of the (CSG) Control of State Governments.

NIGP

National Institute of Governmental Purchasing; a conglomeration of purchasing agents from the federal, state, and local levels offering education and technical assistance.

RFB

Request for Bid; a solicitation for bids listing specifications, terms, and conditions which are not subject to negotiation.

RFP

Request for Proposal; a solicitation for a bid wherein all the details are not set forth. Responses are open for negotiation.

TG

Targeted Group Business; a business owned by a minority, woman, or disabled person providing goods and services.

Some of these terms specifically apply to procurement by the government, but most are encountered by procurement professionals at some point. When dealing with government contracts, be sure to consult the specific branch or entity for their particular rules and regulations, as these vary across federal, state and local agencies.

How Quality QA Reduces Reverse Logistics & Increases the Bottom Line

Proper quality assurance measures are critical to reduce the return of goods and services to companies. When there's an abundance of reverse logistics, it affects a number of facets of the organization, including inventory management, warehousing and storage, financials, and even losses and write-offs when you're dealing with perishable goods.

Thorough QA Helps You Meet Customer Expectations

Image via [Flickr] by David Berkowitz

Reverse logistics are often the result of a [mismatch between client or customer expectations] and what is actually received. Customers—even end consumers—have expectations based on their experiences through the sales funnel. When those expectations aren't met, satisfaction drops.

This can be remedied through more accurate advertising and marketing strategies which create more realistic expectations in the customer's mind. But that won't help you sell more products. Quality assurance measures, on the other hand, enable you to both meet expectations and drive repeat business. Reverse logistics has an impact on word-of-mouth marketing, also—and the ability to cause serious devastation to your company's reputation.

Third-Party QA Improves Transparency and Builds Trust

Image via Flickr by Morgan Solar

Third-party quality assurance isn't always practical or even possible. When it is, however, the objectivity offered through third-party QA can be a powerful tool enhancing consumer trust. It also ensures that your products and services meet or exceed industry standards and regulations. In some cases, third-party QA is a requirement in heavily regulated industries.

Outsourcing the QA process also serves its own purpose in reducing costs. Mundane tasks can often be passed on to third-party entities specializing in a specific area of quality analysis, alleviating the company's own resources from performing repetitive testing which can have biased results.

Thorough Performance Standards Reduce Defective Units

Image via Flickr by NASA Goddard Photo and Video

If you're in an industry dealing with functional parts, such as electric motors, performance is a critical component of QA. In these industries, adequate return policies must be offered for consumer confidence. When you're offering a 10-year warranty on a product, the product should ideally last through its warranty to avoid dramatic losses from reverse logistics.

Moving and functional parts found to have major safety defects can lead to recalls from the Consumer Product Safety Commission (CPSC). Even if the hazard is detected before any serious harm is caused, the process of issuing recall remedies to consumers is a lengthy and costly one.

In these cases, products should undergo continuous and thorough QA to evaluate durability over time. The QA process often leads to discoveries of better methods and processes, which can reduce resource investment as well as drive down reverse logistics.

Ongoing QA is Critical for Customer-Facing Service Providers

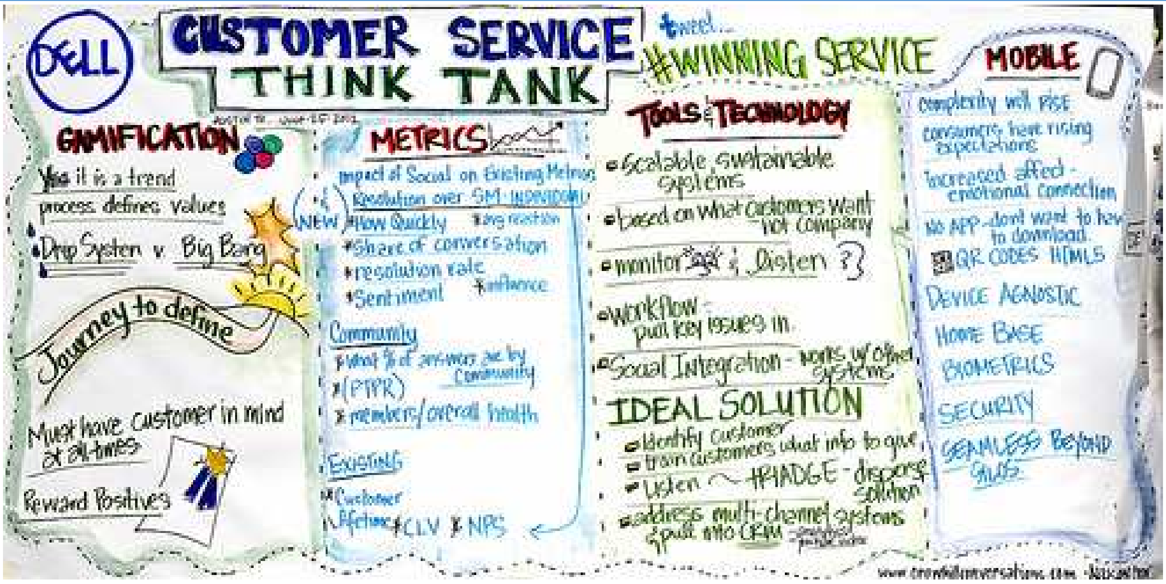

Image via [Flickr]() by Dell's Official Flickr Page

The rise of the social web has had an unexpected consequence—consumers are turning to social media to voice their discontent with service providers, sharing the news with thousands of people instead of a single friend. That's why client-facing departments must undergo rigorous and continuous QA to set the foundation for solid customer experiences.

There are so many reasons a quality assurance program is important. But above all, quality is the primary driving force behind reverse logistics.

What Conflict Minerals Law Means for Supply Chain Sustainability

Since the Dodd–Frank Wall Street Reform and Consumer Protection Act passed in July, 2010, procurement professionals have thought more than ever about the various metals within their supply chains, particularly if those metals may contain conflict minerals. The conflict minerals law added to the Dodd-Frank Act could have a widespread effect on supply chains in various industries from component manufacturers to retailers, but the new legislation may also impact supply chain sustainability.

Who's Responsible for Conflict Minerals Disclosure?

Image via Flickr by Nite_Owl

Questions and lobbying from various industries filled the months after the Dodd-Frank enactment. Originally, the rules created by the Securities and Exchange Commission (SEC) were vague in their implications. The 3 Ts - tantalum, tungsten, and tin - along with gold are the metals targeted by the legislation. These minerals are found in all sorts of consumer goods, including automobiles, medical supplies, and most popular electronics.

The Retail Industry Leaders Association petitioned the SEC to exclude retailers from the requirements, even companies that carry private label products that may contain conflict minerals. Tiffany & Co. also asked for exemption, saying that fine jewelers couldn't trace the exact origin of recycled gold bars.

The final SEC ruling, settled in August, 2012, requires publicly traded companies who already file reports with the commission to look at their supply chain for the use of conflict minerals. A company that manufacturers products that need these minerals for functionality or effective production must file Form SD and should begin tracing the origin of the metals.

Any materials sourced from the Democratic Republic of Congo (DRC) or any neighboring countries require additional disclosure forms. The SEC estimates that about 6,000 companies will need to file Form SD and about three-quarters of those businesses will need other disclosure statements.

The Cost of Disclosure

Many products use small amounts of conflict minerals in various components. An average laptop, for instance, may contain 10 grams of tin, a little over half a gram of tantalum, less than half a gram of gold, and a small trace of tungsten, spread over various capacitors, circuit boards, and similar components.

Considering how complex most manufacturing supply chains are, an electronics company may need to investigate more than 1,000 suppliers to find the origin of their raw materials. $2 to $3 billion is what the SEC estimates companies will spend on initial compliance, with another $200 to $600 million to stay compliant each year.

Conflict Minerals and Supply Chain Sustainability

Several organizations were pushing for transparency and accountability in the use of conflict minerals before the US enacted the latest regulations. The Electronic Industry Citizenship Coalition (EICC), the Global e-Sustainability Initiative (GeSI), and the Enough Project are among a few of the NGOs involved in protecting the Congo from harmful practices.

The consumer public also expects the brands and companies they do business with to support environmentally and socially responsible standards. Nearly three-quarters of a company's carbon footprint occurs long before the end product is available to the consumer, so it's important for manufacturers and retailers to learn more about their suppliers.

Complying with conflict minerals law is a costly initiative for those required to file with the SEC, but is a big step toward a more sustainable supply chain that every company could benefit from. The downside to this sort of legislature is that it could affect the supply of conflict-free minerals from the Congo region as well, which could have a detrimental impact on the economy and people of central Africa.

Why You Should Always Be Looking for New Procurement Sources

The best procurement experts are continuously seeking out the most cost-effective procurement sources. Even when the supply chain runs seamlessly and achieves best costs, there are always alternatives that could offer better benefits to your overall operations and profits.

If It's Not Broke...

Image via Flickr by Mike Poresky

Why would you actively search for new vendors and suppliers when there's nothing wrong with the procurement sources you're using? Because there's always room for improvement. The most competitive players in your industry are constantly updating and adapting their strategies. At the same time, suppliers are improving products, pricing, and other features to stay ahead of their competition.

A new procurement source may offer:

- Lower prices, particularly in regards to total cost
- More reliability and fewer supply chain disruptions
- Better compliance with best practices
- Reduced shipping costs based on the supplier's site
- Improved service or more opportunities for collaboration
- Socially and environmentally responsible policies that suit company goals

Add a New Vendor or Replace One?

There are always risks when you take on a new supplier. Jeopardizing an established vendor partnership is usually not worth that chance, even if a new supplier offers better value. Having too many procurement sources results in an increased workload for supply chain managers and often decreases the end product's quality.

What do you do when you find a new source that could potentially improve your bottom line?

- Place small initial orders, offsetting any necessary cuts equally among existing suppliers
- Arrange a short 'trial' contract with the new vendor
- Communicate your plans with existing suppliers; some may renegotiate their own terms

Before You Sign

Think about more than the purchase price before you decide to take on a new supplier, even if you have a supply chain opening to fill. Suppliers should fit into your long-term strategies and be able to meet your expectations. Take the time to talk with potential vendors and consider the following:

- Corporate missions, goals, and values of the supplier
- Product innovation and plans for improvement
- The vendor's response to industry trends
- Supplier reputation and contract history

Know When to Let Go

An established, collaborative partnership should never be sacrificed unless the supplier is repeatedly failing to meet the terms of your agreement or another problem arises. However, vendors who don't fulfill your expectations will slow down your supply chain processes and decrease profits. Evaluate your vendors regularly and openly communicate any concerns you may have.

Letting go of suppliers that fit one or more of the following descriptions could increase the overall efficiency and profitability of your supply chain.

- Consistently unreliable with shipments, quality, prices, etc.
- Refuses to share data about their company or operating procedures
- Has complex rules that need extra resources to manage
- Excessive pricing or terms compared to competitors

Your supply chain is constantly in motion. Your procurement sources have to keep up if they want to stay ahead. It's up to you to seek out the best values.