

Integrating social and economic impact assessment into local procurement strategy

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ABSTRACT

Leading companies operating in the extractive industries sector have adopted policies and standards aimed explicitly at increasing 'local procurement' in their supply chains, recognising that local economic participation has benefits for companies and communities alike. As this practice has spread through the resources sector, a common assumption has developed that local sourcing is a 'positive' to be maximised and an effective instrument for gaining community and government support for resource development. This assumption, however, is one that does not withstand rigorous scrutiny. Previous research by the authors indicates that the extent to which the local community will actually benefit from local procurement initiatives is dependent on its capacity to supply goods and services to large-scale resource projects and, even more importantly, on its ability to adapt to the inevitable changes that accompany major resource development. The central argument of this paper is that that planning for local procurement can be enhanced by the adoption of an integrated social and economic impact assessment (SEcIA) methodology. This paper adopts a cross-disciplinary approach, drawing on the impact assessment literature and on supply chain management theory to suggest how the negative social and economic impacts that may be the unintended consequences of a local procurement strategy can be avoided or mitigated.

INTRODUCTION

There is growing interest globally in enhancing the opportunities for locally-based businesses to participate in the supply chains of major resource projects. Several companies, especially in the mining, oil and gas sectors, have adopted policies and standards aimed explicitly at increasing 'local procurement' or 'community content', recognising that local economic participation has benefits for companies and communities alike. From a corporate perspective, local economic participation is seen as one means of maintaining a social licence to operate, by giving communities a stake in the project, as well as of ensuring reliability of supply by having a supplier located nearby. From a community perspective, the participation of local businesses in the resource project is a means by which the benefits of resource development can flow into their communities. The benefits of supply chain participation have become particularly apparent in Indigenous communities where there are now a number of agreements between companies and Indigenous groups that are aimed at enabling greater Indigenous economic participation and which include commitments to support the development of Indigenous-owned enterprises.

This paper draws on the research undertaken by the authors in developing a good practice local procurement guide for the Australian mining, oil and gas sectors (Esteves et al. 2010). The research for this project included a comprehensive research methodology. First, an extensive review of procurement practices around the world was undertaken. Next, 49 interviews were conducted with key stakeholders operating in the mining, oil and gas sectors throughout Australia. The purpose of these interviews was to identify the key challenges in incorporating local small-to-medium enterprises (SMEs) into the supply chains of major mining, oil and gas companies and to identify successful strategies for their incorporation. Finally, the researchers looked at 23 companies in the mining, oil and gas sectors to consider how their supply chain practices can contribute to the social and economic development of local communities. This research strategy resulted in the development of a number of 'mini case studies', drawn from both Australian and international contexts, that identified the corporate practices involved in successful local SME participation.

This paper has focused in particular on the mining, oil and gas sectors. Because of the huge global demand for oil, gas and metals to fuel economic development, and the desire of developing nations to exploit their natural resources to lift themselves out of poverty, the resources sector is enormously powerful. The sector's impacts, both positive and negative, affect us all. Therefore, the lessons that can be learned from its good practices and efforts to mitigate its negative impacts are important to everyone, in particular, those marginalised communities who would benefit most from more corporate practices that contribute to employment and business development opportunities. These learnings are also relevant to other sectors that have the potential to draw on community assets, such as manufacturing, forestry and agribusiness supply chains.

General stories about the success of local procurement strategies have led many in the impact assessment community to embrace local procurement initiatives as a means of enabling local economic development. A cursory review of the social impact statements submitted as part of the approvals process for new resource developments reveals that there is a common assumption among assessors that local sourcing is a 'positive' to be maximised and an effective instrument for gaining community and government support for resource development. Economic impact assessment reports submitted to permitting authorities also reveal a range of persuasive arguments in favour of the multiplier effects of project spend.

Previous research by the authors, however, revealed that the extent to which the local community will actually benefit from local procurement initiatives is dependent on the capacity of the community to supply goods and services to the project, the extent to which there is a local multiplier effect and, even more importantly, on the ability of communities to adapt to the inevitable changes that accompany large-scale resource development. The central argument of this paper is that planning for local procurement can be enhanced by the adoption of an integrated social and economic impact assessment (SEcIA) approach, where SEcIA is the process of managing the social and economic issues associated with local procurement. The intent of this paper, therefore, is to provide guidance to supply chain managers within the extractives industry, and impact assessment practitioners, with a view to maximising the long-term socioeconomic development benefits for communities and regions, while considering commercial interests. The paper begins with a brief review of current frameworks and methods applied to develop procurement strategy and identify weaknesses in relation to planning for local procurement follows. Next, consideration is given to the potential contribution of SEcIA to local procurement strategies. The paper concludes with some observations on applying the SEcIA process to local procurement management planning, to provide lasting socio-economic benefits to local communities and reduce social risk to the business.

FRAMEWORKS FOR LOCAL PROCUREMENT STRATEGIES

Considering local procurement during the development of procurement strategies involves (Warner, 2011): 1) understanding the business case and the level of priority the business should give to local procurement when compared to price, time, quality and schedule; 2) identifying the future demand for goods and services, and the capacity of local suppliers to meet this demand (while also considering the demand of other companies competing in the same supplier markets); and 3) selecting appropriate procurement strategies, including the packaging of work, selection process, extent of client control and contract terms. These activities are guided by management theories, which are briefly reviewed in this section.

Supply Chain Management

Supply chain management (SCM) has emerged over the last three decades as an increasingly important area to both business practitioners and academics. The concept is defined by the Council of Supply Chain Management Professionals (CSCMP, 2011) as follows:

“Supply Chain Management encompasses the planning and management of all activities involved in sourcing and procurement, conversion, and all logistics management activities. Importantly, it also includes coordination and collaboration with channel partners, which can be suppliers, intermediaries, third-party service providers, and customers. In essence, supply chain management integrates supply and demand management within and across companies”.

A dominant model applied in SCM practice is the Kraljic Purchasing Portfolio Management Model, which seeks to minimise supply risk and make the most of buying power (Kraljic, 1983). The model includes the construction of a portfolio matrix that classifies products according to two dimensions: profit impact and supply risk (‘low’ vs ‘high’). The result is a classification of procurement demand in four categories: bottleneck, non-critical, leverage and strategic items (refer to Figure 1).

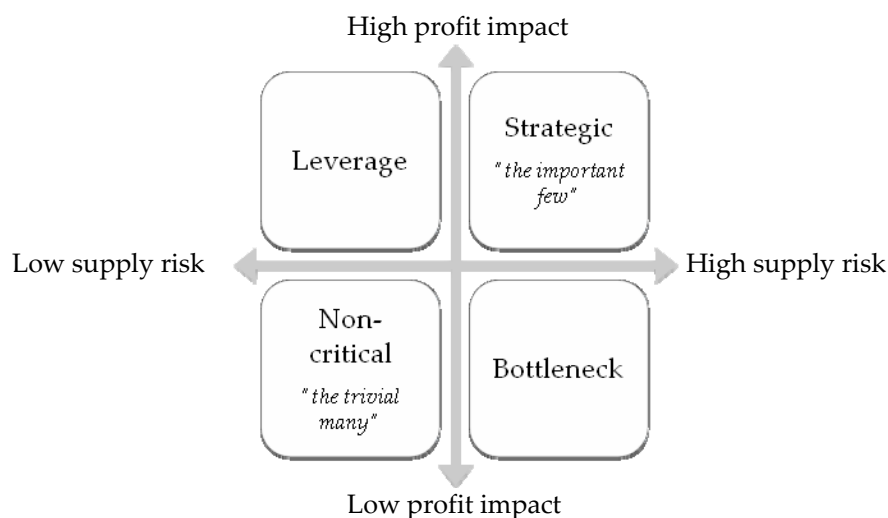


Figure 1 Purchasing Portfolio Management model adapted from Kraljic (1983)

Each of the four categories calls for a specific strategy towards suppliers. Non-critical items (low profit impact, low risk) require efficient processing, standardisation, order volume and inventory optimisation. Leverage items (high profit impact, low risk) allow the buying company to exploit its full purchasing power, such as through competitive tendering. Bottleneck items (low profit impact, high risk) cause significant problems and risks which should be handled by insurances, controls, security of inventories and backup plans. Strategic items (high profit impact, high risk) require development of long-term supply relationships, careful analysis and management of risks, and contingency planning.

Kraljic (1983) also recommends a further market analysis of the strategic items. The firm’s buying strengths are plotted against the strengths of the supply market, to identify three basic power positions and associated supplier strategies: balance, exploit, and diversify. According to Kraljic (1983), supply managers should develop long-term relationships with their suppliers based on mutual trust and openness under the strategic quadrant, and conversely, in the noncritical quadrant, they should take a short term transactional exchange focus and spread purchase volume among multiple suppliers. Macbeth (2002) refers to the two quadrants respectively as the “important few” and the “trivial many”.

However, recent trends in risk management and stakeholder research raise questions around the appropriateness of the Kraljic model in identifying how supply chain performance can be aligned with social and environmental considerations and be responsive to stakeholder and societal expectations of performance (Frankel, et al. 2008). For instance, Macbeth’s (2002) classification of low complexity/low contribution to profit suppliers as the “trivial many” may be brought into question in areas when where there are weak markets and project-affected local communities have high expectations of participation and the ability to prevent continuity of operations. These trends call for a change in how firms think about their supply chain performance.

Awareness of the limitations in a two-dimensional approach that merely considers business impacts of procurement decisions led the authors to test a multicriteria methodology for ranking and prioritising opportunities. In early 2011, an oil and gas company operating in Australia was seeking to identify potential opportunities for Indigenous businesses to participate in the facilities

management contract. The contract comprised approximately 70 activities, or 'scopes of work'. The set of criteria and relative weightings were reached through consensus amongst procurement decision makers and Indigenous liaison personnel. The criteria were expanded to take into account aspects such as the existing capability and capacity of Indigenous suppliers to deliver the scopes of work, the extent of potential employment benefits, a very rough estimation of the extent of 'cultural fit', as well as the sustainability of the opportunity. Each of the scopes of work was rated by systematic application of the scoring scales in TABLE 1.

Table 1 Criteria used to score, rank and prioritise opportunities for Indigenous-owned businesses in the facilities management contract of an Australian oil and gas company

Criteria	Scoring scale	Weighting
Supply risk	0 = 'show-stopper', 1= high supply risk, 2 = moderate, 3= low	20%
Technical & managerial complexity	1=specialised training required, 2= basic training plus Health, Safety and Environment training, 3= routine task, basic training	10%
Capital outlay	1= heavy machinery required, 2= vehicle, 3= no/minor capital requirements	10%
Consistency of demand/ sustainability	3= daily, 2= at least monthly, 1= less frequent	10%
Cultural fit with Indigenous community	3= activity undertaken outdoors, 2= indoors, in a workshop environment with a group of Indigenous workers, 1=indoors	20%
Existing local business capability gap	1= weak capability, 2= moderate, 3= strong	10%
Potential for direct job creation	1=1 full time equivalent employee, 2= more than 1, 3=at least five employees	20%
Total		100%

The simple 'rate and weight' exercise, followed by ranking the weighted averages for each scope of work, generated a number of opportunities for Indigenous sourcing for further investigation. The decision-makers agreed on a process to engage the Indigenous community to explore their interest in taking up the opportunities, inform of the contract requirements and procurement process, and to determine the nature and scale of supplier development that would be required to ensure Indigenous businesses are able to deliver to company standards and have access to the required capital. In essence, these steps would lead to a local Indigenous procurement strategy for the facilities management contract. The company's intent was to learn from the process and replicate across other contract areas.

While the multi-criteria approach that encourages participation of both decision makers and communities presents an advancement on traditional procurement planning, the authors' belief is that this still does not go far enough. For every local procurement strategy, there needs to be a rigorous assessment of the impacts on markets and affected communities. For example, small suppliers can be disadvantaged by long-term partnering strategies (relational exchange). Applying resource dependency theory and transaction cost economics (TCE), Barringer (1997) developed a conceptual framework on relational exchange in the small supplier/large-buyer context. The

framework focuses on advantages and disadvantages for small suppliers. Advantages of relational exchange include reduced transaction costs, more certain access to critical resources, reliable customer base, and quality and cost. However, small suppliers can be negatively impacted through loss of autonomy and flexibility, dependence on the buyer, weaker negotiating position, and having to share confidential cost and other information. These disadvantages have led Larson et al., (2005) to hypothesise that relational exchange may be more suitable for large suppliers than smaller ones.

Supply Chain Risk Management

Supply chain risk management (SCRM) is a field within SRM that is also commonly used within the mining, oil and gas sectors and is applicable to all large-scale extractive and manufacturing industries with significant infrastructure costs and lengthy supply chains. SCRM is typically a formal process that involves identifying potential losses, understanding the likelihood of potential losses, and assigning significance to these losses (Giunipero & Eltantawy, 2004). A key argument of this paper is that the ex ante prediction of social impacts (negative and positive) should be incorporated and systematised into existing SCRM processes. SCRM would be enhanced by considering the impacts of the procurement intervention on the entrepreneurs, their employees, households, communities and regions. This crucial information would identify which are those exogenous material considerations which impact the business through value creation or protection.

USING SIA AND SOCIAL RISK AND OPPORTUNITIES ASSESSMENT TO ENHANCE LOCAL PROCUREMENT STRATEGY

The field of impact assessment offers a number of methods to assess systematically each alternative available to project developers intent on making opportunities accessible to local businesses, build local business capacity to meet contract requirements, and improve their competitiveness. Integrating SEcIA into contracting strategy involves the following steps:

- 1) Categorise future demand opportunities using the four Kraljic (1983) categories, each of which calls for a specific strategy towards suppliers.
- 2) Determine and assign relative weightings to criteria for assessing 1) opportunities according to local suppliers' ability and interest to take them up, and 2), potential for community benefit.
- 3) Within each of the four Kraljic categories, rate each opportunity according to criteria, and rank and prioritise opportunities. This will require a basic understanding of local suppliers and of their capability.
- 4) Determine what will be the potential 'community content' component of each priority opportunity, based on a more rigorous supply side analysis. Design a plan to realise the targeted community content by selecting appropriate procurement methods and supplier development strategies. This, in essence, is the local procurement strategy.
- 5) Identify the potential social and economic impacts associated with the local procurement strategy. The objective is to understand the likely responses of affected businesses, their communities and the regional economies to which they belong.
- 6) Assess the potential impacts using a social risk and opportunities assessment.

Figure 2 proposes a comprehensive framework for social risk and opportunities assessment of procurement strategies. The criteria reflect local procurement impact variables compiled from

Esteves et al., forthcoming 2011; Esteves et al., 2010; SEAF, 2007; World Business Council for Sustainable Development (WBSCD), 2009; and WBSCD & IFC, 2008.

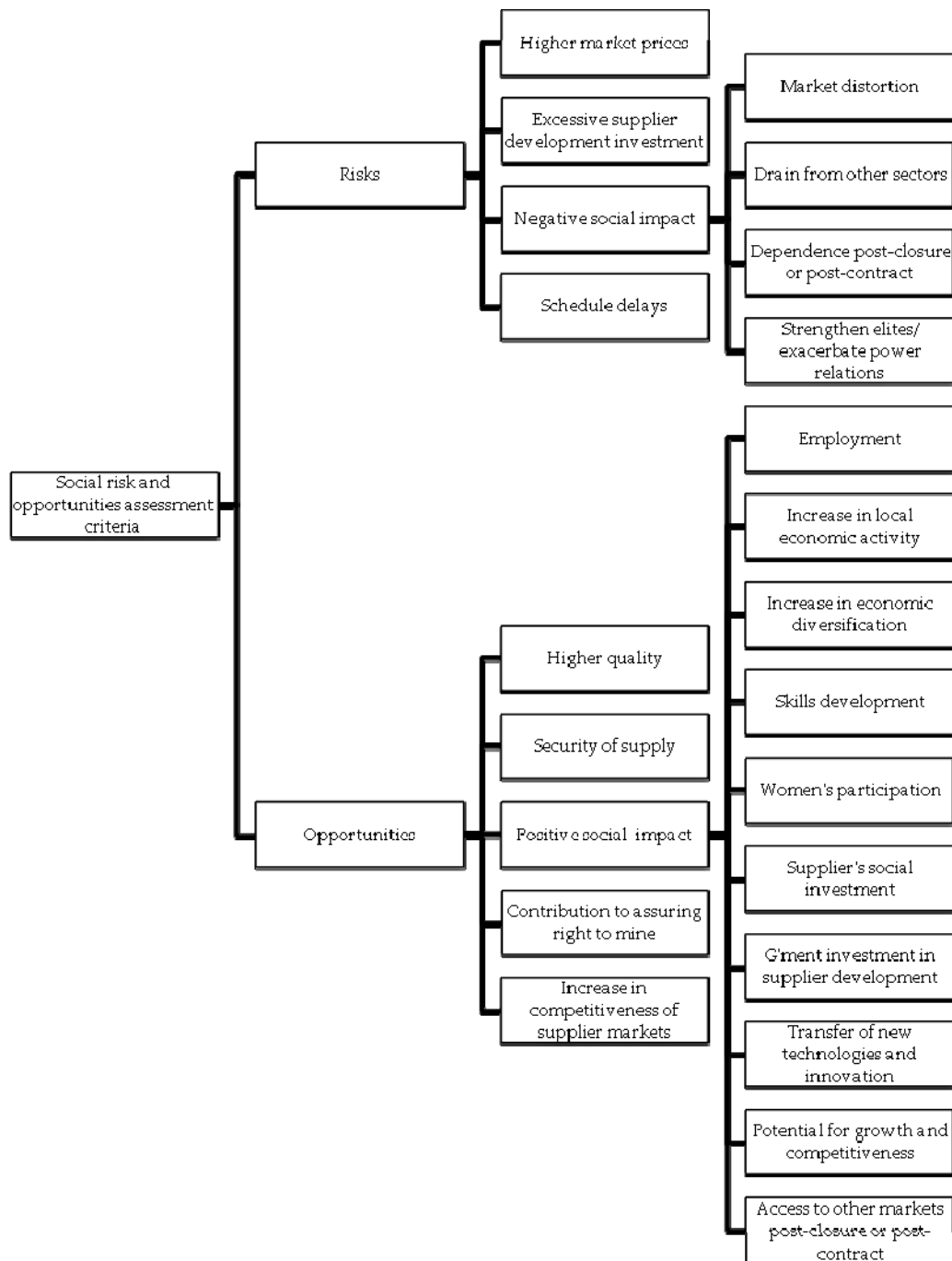


Figure 2 Social risk and opportunities assessment criteria

CONCLUSION

When integrated into contract strategy, SEcIA can be an effective tool to promote collaboration and enable communities to be active agents in their social and economic futures. Local procurement can play a vital role in community's self-determination and wellbeing. However, scholarship is lagging behind practice, and local procurement planning faces the risk of becoming another 'siloed' managerial activity undertaken solely by staff in supply chain management roles and experts from economic disciplines. The interface between procurement practice and the community environment requires interdisciplinary understanding and the emerging area of local procurement practice, both within the extractive industries and in other industry sectors will benefit from further scholarship.

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