# **Understanding the supply chain - Goods and services procurement guide**

## What is a supply chain?

A supply chain is the effort and resources that contribute to the delivery of goods and services from a supplier to an end user. This could include people, organisations, systems, activities, information and resources.

Supply chain and market analysis go hand in hand. Where market analysis looks at the whole marketplace and the ability of the supply market to meet an organisation’s procurement need, supply chain is a deeper analysis and looks at the risks impacting the supplier to supply to the customer and the individual elements that contribute to the successful delivery of the goods or service.

The supply chain can include research and development, product development, sourcing, production, logistics and the systems to manage these activities.

The depth of supply chain management and analysis will depend on the complexity and criticality of the goods and services to the organisation’s core business.

## What is the purpose of this guide?

The purpose of this guide is to give insight into supply chain analysis and encourage procurers to understand the supply chain to inform the way they procure and to inform the broader organisations procurement framework including Social Procurement plans.

## The importance of knowing the supply chain

Understanding what contributes to the delivery of a good or service can:

* help to achieve optimal value for money;
* assist with managing risks that may impact the successful delivery; and
* help to identify where procurement can be used to meet broader government objectives;
* and identify social procurement opportunities

It depends on the goods and/or services being procured to how elaborate the supply chain may be. The market analysis undertaken as part of the procurement process will contribute to understanding factors impacting the supply chain. Understanding the supply chain should not be isolated to that of the contracted supplier but should also include the sub contracted suppliers and for more complex procurement the broader relationship suppliers have with other organisations in delivering the required goods and/or services.

It is about analysing and mapping out the process for the provision of the goods and/or services and identifying what impacts each element that contributes to the successful delivery of the goods and/or services and where value can be added. These may include, but not limited to:

* raw materials;
* labour;
* research and development;
* logistics (transport, storage, time);
* intellectual property, insurances and other regulatory requirements;
* sales and marketing;
* after sales care;
* systems – information technology, machinery and maintenance; and
* relationships etc.

Generally, the more complex the supply chain, the more important it is to influence the contracted supplier in their management of the supply chain. Also, the more sophisticated the market place, the better understanding the supplier has of the matters impacting their supply chain.

It is recommended that supply chain analysis be undertaken for procurement determined as focused or strategic in complexity. For more information about complexity refer to the [Complexity – Goods and services procurement guide](https://buyingfor.vic.gov.au/complexity-goods-and-services-procurement-guide).

## Understanding the supply chain to achieve optimal value for money

Understanding the supply chain for any goods and services will help a procurer understand what makes up the cost of the good and/or service. Having intimate knowledge of what makes up the cost of delivering a good or service can help with the evaluation, negotiation and selection of a supplier. It can also help a procurer to identify what contributes to their value for money assessment.

A total cost of ownership analysis will look at the costs of acquiring, operating, maintaining and disposing or decommissioning procured goods or services, including revenue from disposal. Understanding the supply chain for each of these elements will help to determine the baseline cost of providing a good or service and identify the value add components which will contribute to the value for money assessment?

For further information relating to the value for money refer to the [Achieving value for money - Goods and services procurement guide](https://buyingfor.vic.gov.au/achieving-value-money-goods-and-services-procurement-guide).

## Understanding the supply chain to mitigate risk

Another benefit of understanding the supply chain is to ensure strategies are in place to mitigate risk and a contingency plan is in place should the risk not be manageable. Knowing the risks that impact the supply chain helps to establish better risk allocation between parties and what contributes to the value for money assessment.

Depending on the complexity of the procurement being undertaken, consideration should be given to identifying supply chain risks and the management of them. Risks should be managed at four stages of the procurement life cycle, the planning stage, through market engagement, the evaluation process and contract management.

Once the supply chain is mapped out, a risk assessment should be undertaken for each element. The process could be as follows:

### Establish and identify the risk

Identify the risks to be managed. Focus on identifying:

* what can happen (events/incidents);
* what are the causes?

e.g. raw materials could be impacted by climate factors, labour could be impacted by industrial relation disputes.

### Analyse the risk

The purpose of risk analysis is to further understand the identified risk:

* what is the likelihood of the risk occurring?
* what are the consequences if the risk eventuates? and
* what controls are currently in place and how effective are they?

e.g. the likeliness of a drought in outback Australia is high, where does the supplier source their raw materials from? Is the raw material readily available? What is the likelihood of the labour content being impacted by industrial disputes?

### Evaluate the risk

The supply chain risk evaluation process should focus on the extent to which a risk is acceptable or unacceptable. A risk is deemed acceptable where existing controls are considered effective and should the risk eventuate the likely impact affecting the successfully delivery of the good and or service is minimal.

If a risk falls into the unacceptable risk category, the risk must be prioritised, and appropriate treatment plans developed and implemented. Prioritisation of risks should be undertaken in consultation with the end user of the good or service. The risk assessment will contribute to the value for money assessment of offers.

e.g. can the raw material be replaced by another raw material? If the provision of the supply is delayed how will this impact the organisations core business?

### Manage the risk

The supply chain risk management is about developing internal controls and management plans.

A control is something that is put in place to reduce the risk impacting the successful delivery of the goods and/or service. Where an event has occurred, it is not because of a lack of controls, usually it’s due to a failure of existing controls. All controls need to be monitored and have appropriate performance measures.

### Risk considerations by procurement stage

**Planning**

In developing a business case and procurement strategy, analyse the market by assessing any supply and/or market risk. What could potentially go wrong? E.g. natural disaster, acts of terrorism, port closures, supplier non-performance, insolvency, damage or faulty goods, political risk, industrial action, reputational risk shortage of raw materials, etc.

Depending on the complexity of the procurement, generally for more complex procurement, a supply chain risk management report may be developed or incorporated into a broader procurement risk management plan. It should include the findings and proposed actions from your supply chain risk assessment and inform the procurement strategy.

The supply chain risk assessment should be used to inform the:

* market approach documentation;
* evaluation plan; and
* contract management plan.

**Market approach**

Supply chain risks can be mitigated through comprehensive specifications and an all-encompassing offer template.

* The specifications can prescribe to regulate quality and standards of the goods and/or services being procured.
* The offer template can seek to ask questions so that the offers can be assessed against the value for money proposition i.e. suppliers can be questioned on their methodology to manage or mitigate known supply chain risks.

The value for money assessment involves a balanced judgement of financial and non-financial factors. Typical factors include fitness for purpose, quality, whole of life costs, risk factors, environmental and sustainability considerations as well as price.

For further information about developing specifications, refer to:

* [Specification writing - Goods and services procurement guide](https://buyingfor.vic.gov.au/specification-writing-goods-and-services-procurement-guide)
* [Building an offer template – Goods and services procurement guide](https://buyingfor.vic.gov.au/develop-offer-template-goods-and-services-procurement-guide)

**Evaluation, negotiation and selection**

In evaluating suppliers, the methodology set out in the planning stage and the market approach documentation must be followed.

Offers should be evaluated to ensure the supplier that is best able to deliver the goods and/or services through offering the best value for money is selected. The evaluation process should include appropriate due diligence to mitigate risks identified through the supply chain risk assessment.

**Contract management**

It will depend on the complexity of the procurement to determine the breadth of activity undertaken during the contract management stage to manage supply chain risks. Contract managers are required to monitor suppliers and should review risk management and mitigation plans through the life of the contract (aligned with procurement complexity).

This may entail regular supplier certifications, reviews and verification. A contract manager should also be continually analysing the market to understand broader risks to the supplier and work with the supplier to understand risks that impact the successful delivery. The monitoring and management of this will be dependent on the risk of the supply to the organisations business.

## Understanding the supply chain to meet broader government objectives

Government traditionally will use policies, conditions within invitations to the market and contractual clauses in procurement to require suppliers to meet specific requirements. Understanding the supply chain will help the procurer to understand where these requirements may also be built into a procurement process and contractual arrangement. This ensures the government’s leadership role in driving change, setting standards, encouraging better practices and meeting broader government objectives is extended not just to direct suppliers, but also to other suppliers through the supply chain.

The core objectives of procurement are to achieve value for money outcomes through making decisions that balance cost and benefits. However, there is opportunity of using procurement as a tool to implement broader government policy and program objectives. Organisations should give consideration to building a broader government objectives analysis into their organisational procurement strategy.

### Social procurement

Social procurement is about the intentional generation of social benefits through the procurement process. Understanding the supply chain and the elements that make up the supply chain can assist government in understanding where there is opportunity to incorporate policy, programs or provisions to drive social benefits.

Building social objectives into the procurement process including the supply chain can be difficult. Organisations will have to make the value judgement of what is value for money when developing their procurement strategy while giving consideration to seeking social benefits through procurement.

Social benefits that can be achieved through procurement include but are not limited to:

* creation of training and employment opportunities;
* promotion of fair and ethical trade;
* engagement of minority groups – Aboriginal, women owned businesses, disability, youth, multi-cultural, Australia and New Zealand small to medium size enterprise (SMEs), [social enterprise groups](http://www.socialtraders.com.au/buy/dsp-default.cfm?loadref=88) etc.;
* environmental management; and
* industry development opportunities.

The Victorian government already has a policy in to ensure that Australia and New Zealand SMEs are given full and fair opportunity to compete for government contracts. The [Victorian industry Participation Policy (VIPP)](http://economicdevelopment.vic.gov.au/about-us/strategies-and-initiatives/victorian-industry-participation-policy/about-the-vipphttp%3A/economicdevelopment.vic.gov.au/about-us/strategies-and-initiatives/victorian-industry-participation-policy/about-the-vipp) requires departments and agencies to consider opportunities for competitive Australia and New Zealand SME’s when awarding contracts above relevant threshold values.

For more information on building social procurement into your procurement activity refer to:

* [Social Procurement – A guide for the Victorian Local Government](http://www.dtpli.vic.gov.au/local-government/strengthening-councils/social-procurement)
* [Industry Capability Network (ICN) Victoria](http://economicdevelopment.vic.gov.au/about-us/strategies-and-initiatives/victorian-industry-participation-policy/industry-capability-network-icn-victoria)

ICN is a non-profit organisation that introduces Australian and New Zealand companies to the supply chains of projects, government procurement and commercial developments.

## Using this guide

This guide accompanies the [goods and services supply policies](https://buyingfor.vic.gov.au/goods-services-supply-policies). There are 5 supplies policies:

* Governance policy
* Complexity and capability assessment policy
* Market analysis and review policy
* Market approach policy
* Contract management and disclosure policy

This guide supports the [Market analysis and review policy](https://buyingfor.vic.gov.au/market-analysis-and-review-goods-and-services-policy-and-guides).

This guide accompanies the:

* [Market analysis and review – Goods and services procurement guide](https://buyingfor.vic.gov.au/market-analysis-and-review-goods-and-services-policy-and-guides)
* [Improving access to government for SMEs – Goods and services procurement guide](https://buyingfor.vic.gov.au/improving-access-government-business-small-and-medium-enterprises-goods-and-services-procurement)
* [Value for money – goods and services procurement guide](https://buyingfor.vic.gov.au/achieving-value-money-goods-and-services-procurement-guide)

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