Mitigating Risk through Better Decision Making: Contractor Management Best Practices

Brian Callahan, BS, MBA
Vice President
ISNetworld

Dag Yemenu, BS, MS, MBA
Director
ISNetworld

Introduction

Risk is a normal part of doing business. The risk is compounded when outsourcing work to third-party contractors to perform work rather than using permanent employees. The risk can be increased even more by not having a standard, well planned way to evaluate each contractor's health, safety, and procurement information against their past history as well as against their peers in the industry.

Mitigating Risk

Managing this risk is the most important task in evaluating the safety and viability of a contractor. The amount of data available to perform this evaluation is enormous. Companies must ensure they are able to gather all appropriate data, synthesize the data into information that is usable, and make a decision based on that information.
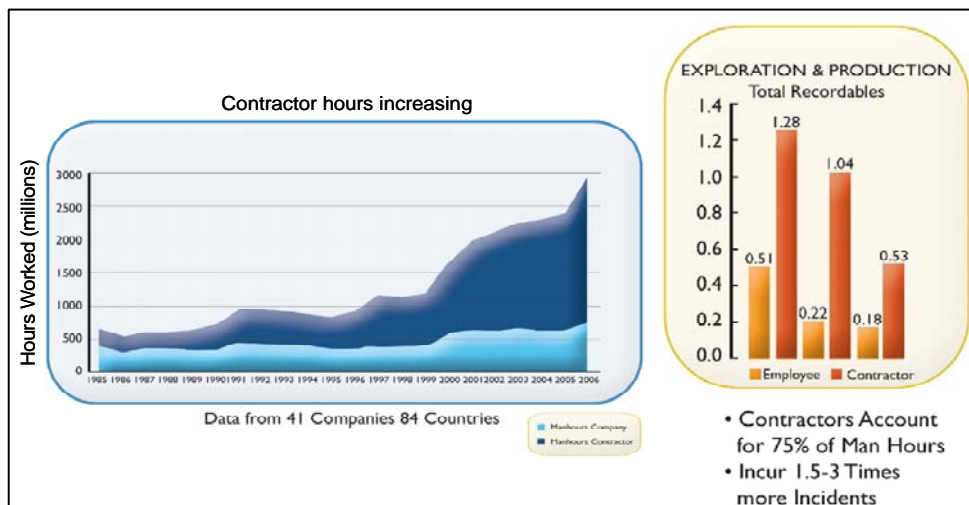

Exhibit 1. Outsourcing trends are based on contractor man hours and incidents.

Analysis has shown health and safety factors are impacted by outsourcing work. As seen in Exhibit 1[1], contractors (companies performing outsourced work for a firm) have a higher rate of safety incidents per hours worked than employees performing work for the firm.

Contractor Management Best Practice Model

A Contractor Mangement best practice model, as seen in Exhibit 2, incorporates the following four elements:

1. Communication
2. Prequalification and Selection
3. Compliance and Performance Monitoring
4. Continual Improvement
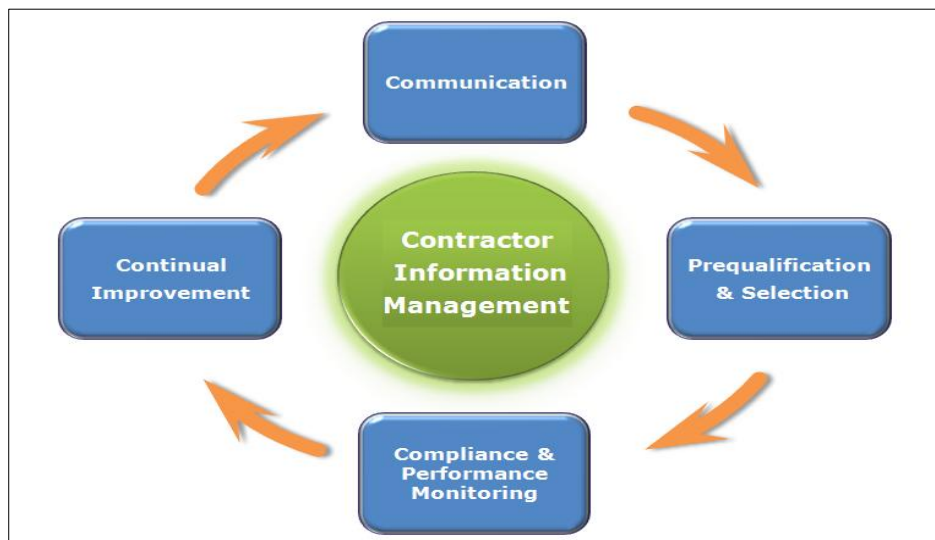
Exhibit 2: The Four Elements of a Contractor Management Best Practice Model.

There are a variety of ways a contractor can be evaluated. The use of historical and future trend information is often used to evaluate a single contractor. These lagging and leading indicators can be useful in determining the appropriateness of offering a job to a contractor or even keeping them on a job they are already working.

Lagging Safety Performance Indicators

Historical data is used to determine how well the contractor has performed in the past. This information is useful in evaluating the contractor because the past safety performance is assumed to be indicative of how they will continue to perform in the future.

The major key performance indicators (KPIs) used by many companies to evaluate the performance of contractors include health and safety KPIs (TRIR/TRF and DART) as well as insurance claim indicators (EMR).

---

[1] *OGP Report 391* – Retrieved May 7, 2008. Web sites: *www.ogp.org.uk/pubs/391.pdf* and *http://www.hess.com/downloads/reports/EHS/US/2006/safety2A.html*

- The Total Recordable Incident Rate (TRIR) can be used to determine the rate of incidents that occurred per 100 employees annually. The goal is to achieve a TRIR rate of 0.
- The Days Away From Work and Restricted/Job Transfer (DART) incident rate is a measure of how often an incident occurred that required the employee to stay away from work, work at a diminished capacity, or required a transfer to a different position requiring a lesser capacity.
- The Experience Modification Rate (EMR) measures how many claims were made for Workers' Compensation during the previous year.

Leading Safety Performance Indicators
Improving the safety indicators is what the evaluation and ongoing monitoring of a contractor's safety data is all about. An organization can also take into account leading indicators as part of their evaluation of a contractor. Leading indicators include safety & training programs, job evaluations, and audits.

- Safety programs are an indicator of the processes and procedures used by a contractor to protect themselves and their employees when exposed to safety, health, and environmental hazards. Having a safety program covering all potential hazards and protection processes is invaluable in determining a contractor's dedication to safe work practices and a safe environment.
- Training programs indicate commitment to implementing safety practices and educating employees on the valuable information contained in their safety programs.
- Post Job Evaluations & On-The-Job (OTJ) Inspections - ongoing inspections of safe work practices and evaluations of both good and bad practices that occurred during a job to help organizations and contractors evaluate how safe a job site is. Ongoing OTJ inspections ensure employees do not become lax in their application of the safety manual procedures and safe work practices. Post Job Evaluations provide a learning opportunity to evaluate what factors caused specific unsafe events as well as learn best practices on how best to deal with safety, health, and environmental hazards.
- Audits provide organizations the opportunity to evaluate as many or as few aspects of a contractor's operations as they deem necessary. This can include evaluating practices at a contractor's site, evaluating the same at an organization's job site, and performing desktop audits of safety manuals and safety logs. Evaluating these data provides information to the organization to determine the amount of risk that may be acquired when hiring a contractor to perform a specific job.

Due Diligence Levels
There are several levels to conducting contractor due diligence. The contractor due diligence process starts with the gathering of data and information. Commonly used tools for this purpose include a comprehensive health and safety questionnaire to gather historical information regarding the operational safety of a contractor.

The next step in the due diligence process is to review and verify the data. This requires actual verification of the data that was self reported or provided in the data gathering stage by the contractor. Verification includes a desktop review of the contractor's HSE programs, statistical information such as OSHA logs or EMR rates, citations incurred, and overall verification of any data points that can be done using a neutral third party. Using verified information in the due diligence process ensures the contractor selection process is based on information that has been proven to be accurate and true as compared to the information provided directly by the contractor.

The final step in this process is making a decision based on the synthesized data as well as additional information that may be available. The additional information can include field audits performed by personnel going onsite to ensure the validity of a contractor's reported information. Making this decision can be a complicated process if these steps have not been performed. Making the decision based on synthesized and verified information makes the process easier.

Benchmarking

Benchmarking is a method for evaluating decisions and performance. Benchmarks can compare contractors against a baseline number. Benchmarks can evaluate internal data that compare an organization's contractors to those that do not work for the organization in the same industry to better understand how contractors compare to one another. A benchmark can compare a contractor (or set of contractors) to an external source. This can be from competitors in the same industry, or come from government or other external agencies that have performed vast surveys and compiled a large amount of benchmarking data.

A benchmark baseline can be used to measure how much a contractor has improved in those areas the organization determines are important. Without this baseline data, the organization will have no basis to know if the program they have developed is helping their contractors have a safer operation or if no change is occurring.

Exhibit 3 shows benchmarking information across a time frame of three years. This data analyzes the Total Recordable Incident Rate (TRIR) of contractors participating in a health and safety database management system from 2005 to 2007. The results are indicative of many that participate in a management system and show a steady decline across the three year time frame.


Exhibit 3. TRIR Comparison over time with a Safety Management System in place.

A more effective way of comparing the effectiveness of the programs an organization has implemented is to compare internal data against external data. This can be from competitors in the same industry, or more likely will come from government or other external agencies that have performed vast surveys and compiled a large amount of benchmarking data.

In the United States this type of safety information can be commonly compared to the statistics compiled and released by the Department of Labor's Bureau of Labor Statics (BLS). BLS statics cover a variety of incident rates for industries as broken out by North American Industry Classification System (NAICS) code. The statistics are complied and released on an annual basis, and can be used as the baseline for a comparison as they are the average of all incidents and hours within that specific industry sector.

Comparisons between internal data and that compiled by the BLS can provide an important picture regarding where an organization's contractors stand in relation to their peers in the industry. Exhibit 4 shows that contractors who participate in a health and safety database management system have an up to 60% lower Total Recordable Incident rate (TRIR) than peers in the same NAICS code[2].
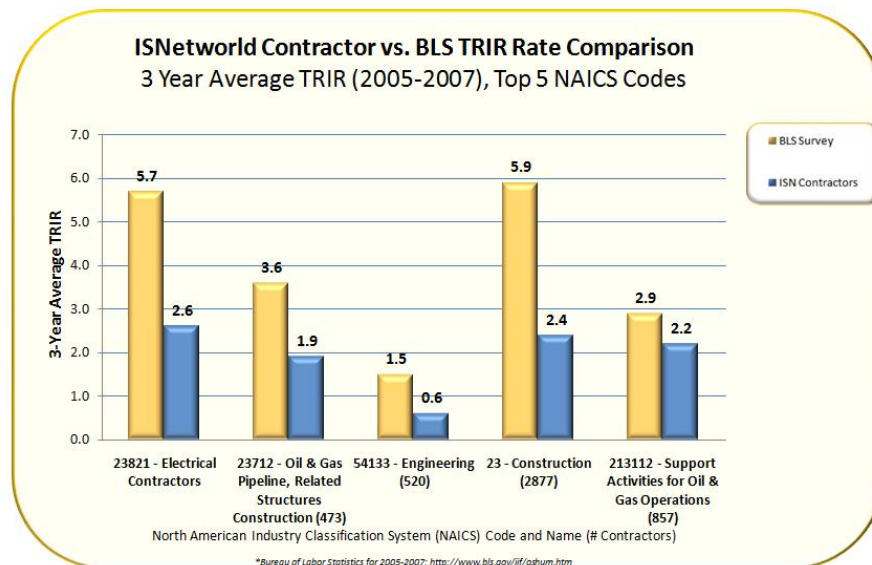
Exhibit 4. Comparison of a contractor's TRIR who is apart of a Safety Management System versus the Industry Average by NAICS.

The information presented is based on the top five NAICS codes used in the Oil & Gas industries, including downstream, midstream, and upstream segments. By using this benchmark data, an organization can compare the effectiveness of their programs to identify and retain contractors with high health and safety standards. It also allows comparison of contractors to their peers in the industry with grading (or other tools). This lets the organization see whether a specific contractor is performing above or below their peers.

Results
Utilizing available tools like ISNetworld allows an organization to put processes in place to meet their goals of reducing outsourcing risk and the associated costs. It is important to use clean and verifiable data when evaluating contractors. This allows an organization to choose only those contractors that are aligned with the organization's health and safety criteria and meet their

---

[2] Chart based on verified data for 3,274 unique contractors averaged across 2004 – 2006 by NAICS code. BLS data obtained from 2004 – 2006 TRIR statistics located at http://www.bls.gov/iif

procurement requirements. In turn, this process leads to continued improvement for compliance and health and safety.

Bibliography

ISNetworld. 2008. (www.isnetworld.com).