



PAY NOW OR PAY LATER

The Case for Investing in Contractor
Qualification & Management



Introduction

Calculating a return on investment (ROI) or proving the “economic value” of a purchase is the foundation of any sound business investment. The return on some purchase decisions is so obvious that when the costs are weighed against the potential benefits, there is a collective exclamation of “*Why didn’t we do this before?*” Other situations, and most purchasing decisions are less clear-cut. To further complicate matters, the exact same costs can have a very different “value” to an organization based on intrinsic factors such as risk tolerance, size, age of the business, and industry.

For example, a multi-national corporation may consider it inconsequential to invest in a new safety compliance program when balanced against the risk of a potential lawsuit or fines that may cost hundreds of millions if there is an incident on a worksite. Conversely, a small operation may see the same investment as a significant portion of their annual operating margins. Their evaluation of such an investment will look much different than the larger organization, despite the fact that they are evaluating the same solution investment and could see the same potential outcomes relative to their business. Fortunately, there are affordable solutions available for businesses of all sizes that are interested in managing their contractor compliance.

So how do you effectively and responsibly evaluate a new investment to derive the best outcome for your organization?

This white paper outlines a process for assessing the economic value of investing in an externally managed contractor compliance management solution. We will outline the business conditions that make compliance management an imperative for many businesses, including the expected costs associated with effective compliance management. Next, we will consider the potential direct and indirect costs of “doing nothing”; that is, deciding against an investment in compliance management. Finally, we explore the process of outsourcing compliance management to a vendor who offers a complete contractor management solution.

The Compliance Imperative

With the disasters of Deepwater Horizon, San Esteban, and Fukushima still looming large, regulatory bodies around the world are scrutinizing workplace health and safety more than ever.

Both the United States and Canada recently increased penalties for workplace safety policy breaches. Countries in the developing world are introducing new legislation to protect workplace safety.¹ In the United States, OSHA requires an employer to assume primary responsibility to ensure that employees have what they need to work safely, are knowledgeable about the hazards of their work, and have the ability to perform needed safety procedures.

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No organization is immune from accidents and it’s only a matter of time before a safety incident occurs at a worksite. A recent study by Conoco Phillips estimates that “for every single workplace fatality there are at least 300,000 at-risk behaviors” taking place.ⁱ

Meanwhile, to save costs and streamline operations, many organizations are turning to contractors to supply them with goods and services they previously kept in-house. Experts predict contingent workers—already 30% of the US workforce—could climb to 40% or more in the next 10 years.ⁱⁱⁱ

Though it might seem cost effective in the beginning, hiring the wrong contractors could turn out to be extremely expensive in the long run, especially for companies in industries that have risk-prone work environments. If a contractor has not received proper screening, or an unqualified contractor is hired without checking their credentials, their inexperienced acts may lead to an accident occurring at the worksite which could lead to a string of problems and uncertain economic consequences.

For Procurement, Environmental, Health and Safety (EH&S), Operations, and other departments, this means even more insurance policies, professional licenses, safety manuals, OSHA/MSHA logs, and other documents to study and retain. To manage employee and contractor compliance, it’s not inconceivable that the staff of an average sized owner/operator could be monitoring 5,000 to 10,000 documents at once.

This burdensome number begs the question: why worry about contractor compliance at all? Do owner/operators bear the responsibility to ensure that contractors are compliant with safety requirements? After all, contractors aren’t really employees.

The answer to each of these questions is a resounding ‘YES’. Not managing contractors effectively could lead to expensive problems such as hefty fines, compensation for damages, and potential litigation.

Let’s examine a few of the reasons why it makes sense to invest in contractor compliance management.

REDUCED RISK If contractors meet all prescribed regulatory and safety requirements the risk to a company of an incident being caused by that contractor is significantly reduced.

UPSTREAM ACCOUNTABILITY Even though you do not employ contractors directly, as the owner/operator you could be potentially liable for fines, medical expenses, workers compensation, and penalties related to incidents that occur at your worksite. It is essential that you prescreen contractors to ensure their compliance and safety-focus.

LITIGATION & LIABILITY In the US, after a safety incident, it’s not inconceivable that the owner/operator will be sued for damages related to the event. Many litigating attorneys have a policy of “sue everyone and see what sticks”. That means that any organization, employer, or any person remotely connected with the incident is likely to be named as a party in a lawsuit.

SARBANES OXLEY The 2002 Sarbanes Oxley act means that many organizations have now included safety goals as part of their corporate governance. A contractor compliance management program can help to guarantee that all workers are meeting corporate standards.

MEASUREMENT MATTERS When organizations explicitly state their safety and performance expectations contractor performance improves. Measurement drives behavior change and communicating a focus on safety will influence contractors to respond appropriately.

Creating an Environment of Compliance

By now it's apparent that the owner/operator must own the responsibility for ensuring the compliance of contractors at their worksite. This means active programs and policies that monitor compliance. Your supply chain and operations are too critical to have them dependent upon "trusting" contractors to do the right thing. While many contractors are honest and never purposefully non-compliant, it remains your responsibility as the owner/operator to ensure that every contractor working for you adheres to regulator and safety standards. But too often, administrative headaches get in the way of effective contractor screening.


To ensure contractor compliance you need processes in place that will enable you to prequalify, monitor, and re-qualify all contractors who work with your organization. Implementing such a system of contractor compliance management can improve the safety of your workplace and ensure that your organization has a defensible position in the event of a lawsuit or investigation.

Let's take a closer look at each of the critical components of any compliance management program.

PREQUALIFICATION Qualifying contractors before the work begins is a two-phase process. First, your organization must determine and define the criteria for contractor selection that meets your organizational risk profile and safety standards. Second, your compliance management program must incorporate processes to ensure that any and all contractors engaged by your organization meet your defined thresholds, prior to them being allowed to be hired or access your worksite.

MONITORING Compliance is not a static state. Contractors hire new workers. Safety programs are updated. Insurance and licenses expire. Information changes constantly. Your program of contractor compliance management needs to monitor documents and information on an ongoing basis and alert contractors when they have information that is ready to expire. Out-of-date information can be just as detrimental as missing information. Only through ongoing monitoring of contractor information can you ensure that compliance requirements are consistently being met. Further, your program should alert all functional areas of your organization on a regular—or real-time—basis about the specific compliance status of any particular contractor and prohibit contractors who are non-compliant from accessing the work site.

REQUALIFICATION When information changes or is out-of-date your compliance management program should proactively notify contractors about any documentation that is required to remain compliant. Your program should build an auditable trail of notifications and communicate with



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the contractor on a regular basis about upcoming expiration dates. Contractors should also have a prescribed method to submit their updated information and receive notifications when they are once again compliant.

How Much Does Compliance Management Cost?

In January 2011 The Ponemon Institute, LLC released a report called *The True Cost of Compliance*.^{iv} The study surveyed over 46 multinational organizations over a 12-month period about their legal and regulatory compliance management activities. The study found that companies, which increased their compliance spending, also saw a positive correlation in decreased costs associated with non-compliance. In other words, an investment in compliance is one that can yield returns. Further, the Ponemon study concluded that of the money spent on compliance, 60% of costs were expended on administrative overhead and 40% was used to pay consultants, acquire software licenses, and conduct audits, etc. Therefore, it may not be unreasonable to expect the same kind of economic reality when assessing the value of contractor compliance management investments. Spending on compliance appears to be cheaper than the spending that can be expected for non-compliance related costs.

When evaluating a contractor compliance program and calculating the cost of a potential investment, an organization must first decide whether they wish to manage the program in-house or outsource contractor management to a specialized vendor. The costs—and the outcomes—associated with each approach can be dramatically different.

The following list details the common direct costs associated with an in-house contractor compliance program.

- Staff and resources to manage the program.
- Records storage and retrieval systems
- Auditing costs
- Software packages to create and manage processes
- Staff to address contractor questions pertaining to compliance
- Resources to notify contractors of expiring documentation or deficiencies

When managing contractor compliance internally, companies must not overlook the costs associated with adequate staff and resources required to manage compliance documents, monitor documents for expiration, validate appropriate insurance endorsement language and proactively contact contractors to collect updated documentation. Attempting to reduce the costs of internal compliance management is difficult. Utilizing lower skilled or lesser-trained administrative employees without proper knowledge of regulatory requirements, EHS, or insurance standards could leave your business at risk.

Recognizing the need to manage compliance is certainly a step in the right direction, however, too many organizations that keep a program in-house also rely on manual tools to run their program. These businesses manage contractor populations by relying on staff to enter the appropriate data into a spreadsheet, verify its accuracy, and keep hard copies of all documentation in a filing cabinet.

There are a number of problems with this approach. Errors arising from manual data entry are a well-documented occurrence, with research showing that people typically generate one error for every 300 keystrokes.^v The longer the character string (such as insurance policy numbers), the higher the error rate. One study showed that error rate climbed to near 100% when people enter strings of 15-characters or more.^{vi} Therefore, additional costs need to be considered to cover data and quality control processes.

Managing contractors out of filing cabinets and/or spreadsheets is time-consuming, inefficient, and ultimately more costly. Most importantly, companies that rely on outdated, inefficient methods to track and manage this data are taking extremely high risks.

A single error or expired piece of documentation can shut down operations or bring on civil penalties for a company. In rare but real instances, they can also cost lives. In the US, and globally, governments hold prime employers responsible when things go wrong:

Both OSHA and MSHA often assess higher civil penalties against the prime employer, mine operator, or general contractor than against the subordinate company directly involved in the violative action, because the agencies deem the primary employers to have a higher level of culpability or a better understanding of regulatory responsibilities.^{vii}

You Don't Have to Manage Compliance Alone

The costs and issues required to effectively manage contractor compliance in-house can quickly spiral out of control. Luckily, there are specialized vendors who offer solutions that can manage contractor compliance across your entire supply chain. These vendors offer a combination of software and outsourced administrative support to streamline contractor engagement and communications. These vendors can help to define and apply your criteria related to corporate, regulatory and legal compliance and then manage your contractors to those standards.

When considering outsourcing your compliance management program to a vendor the following costs should be considered:

- Consulting fees
- Software licenses
- Administrative costs
- Financial and operational impacts of improved contractor relationships
- Efficiency improvements from customized programs that address unique business needs

Later in this paper we will outline a Roadmap for Success should you wish to engage an external vendor to help with your compliance management program.

Following a recent contractor incident, a Wyoming mine operator was heavily fined by MSHA, a criminal prosecution of the trainer ensued, and a personal injury action resulted in the jury awarding more than \$6 million.

The “Do Nothing” Alternative

Whether by a conscious choice, ignorance of potential consequences, or some other circumstance, there are organizations that opt to passively manage contractors and “hope for the best.” In other words, they do nothing programmatically about contractor compliance management. If the costs of managing compliance seem significant, the potential costs of a workplace safety incident that results from a non-compliant contractor can be positively staggering by comparison.

OSHA has determined that US businesses annually spend more than \$125 billion in total expenses on more than 6 million workers who suffer from fatal and non-fatal workplace injuries and occupational diseases/hazards.

The total settlement cost for the recent West Virginia mine disaster where 29 men were killed cost the owner/operator \$210 million. The settlement was divided into \$46.5 million as compensation to the miners’ families, \$128 million for improving safety, and \$35 million in fines. In addition, those who accepted the payouts are still able to pursue individual civil lawsuits against the company.^{viii}

The February 7, 2010 explosion at a natural gas power plant in Middletown, CT that killed six people resulted in \$16.6 million in penalties. OSHA cited three construction companies and 14 subcontractors for a total of 371 safety violations, 225 of which were considered deliberate violations.^{ix}

In a recent incident, a rail contractor’s employee suffered permanently disabling injuries after failing to follow safe work procedures at a Wyoming metal/non-metal mine. The mine operator was heavily fined by MSHA, a criminal prosecution of the trainer ensued, and a personal injury action resulted in the jury awarding more than \$6 million. The mine operator, the contractor and several individuals employed by the companies were all named as defendants in the tort action.


Potential Direct Costs

The direct costs of an incident related to not managing contractor compliance will differ from situation to situation, but are likely to consist of the following:

FINES AND PENALTIES Fines and penalties make up a substantial chunk of expenditure for companies as a result of incidents tied to improper contractor compliance management. Various local and international organizations (OSHA, MSHA, HSE, EPA, etc.) impose rules and regulations to protect the safety of workers and breaking these rules will lead to citations.

DAMAGES & REPAIR COSTS If a contractor working at your site causes an accident, your organization will be required to make reparations for damages to anyone injured in the incident and for any property destroyed.

LOST TIME Workplace incidents interrupt normal production. It will take time to restore operations after any incident. New workers may require training to replace those who have been injured. That means lost productivity and revenue that may not be recoverable.



LITIGATION COSTS & CIVIL DAMAGES Any incident could lead to a series of lawsuits and the owner/operator could be held liable for the injury claims, damages and fines above and beyond the costs assigned to the contractor.

INCREASED INSURANCE COSTS After an incident an owner/operator will pay more for insurance and workers compensation premiums. These increased costs will be used to offset the cost of likely claims, administrative fees, and the risk of potential future incidents.

Tallying up Indirect Costs

According to the American Society of Safety Engineers (ASSE), the indirect costs of a worksite incident are estimated to be 20x the direct costs of the same incident.* While harder to quantify than direct costs, the indirect costs of a worksite safety incident are no less important and may include:

- Strained employee relations
- Overtime to offset production down time
- Management & supervisory investigative time post-incident
- Reputation damage
- Poor employee morale
- Psychological impacts on affected employees
- Future difficulty hiring new employees

In the end, the decision to actively manage compliance versus “hoping for the best” comes down to the risk tolerance profile of a particular business. However, numerous cross-industry studies have shown that a proactive investment in safety and compliance management will decrease the likelihood of a workplace incident and provide a company with a defensible position in event of an accident. Ultimately, as the owner/operator you must decide; do you want to spend some amount now on contractor compliance or potentially spend much more in the future on damages and fines?

Should you make the choice to invest in contractor compliance management, our next section details a roadmap to assist with your program implementation and the selection of a vendor partner.

A Roadmap for Success

Implementing a formalized contractor compliance management program is a significant initiative that can have an immediate impact on your organization and insulate the business against the risk of potential financial liabilities. For these reasons, it helps to have a solid plan to guide your activities during start-up and implementation.

Since 2002 BROWZ (www.BROWZ.com) has been helping Fortune 500 companies in the mining, chemical, manufacturing, energy, pharmaceutical, and other industries with their contractor compliance management initiatives. Based on experience helping many companies to get started we suggest the following “roadmap for success.”

In the end, the decision to **actively manage compliance** versus “hoping for the best” comes down to the risk tolerance profile of a particular business.

FIND THE RIGHT PARTNER Contractor compliance management is a complex and administratively intense activity. An effective program requires automation that may exceed the scope of your in-house capabilities. Contractor compliance also requires time and attention that your existing staff may not be able to spare. Therefore, it may make sense to work with an external vendor who specializes in contractor compliance management services and solutions. The amount of consultative assistance that you expect to receive will vary from vendor to vendor. Make sure you ask for specifics about the start-up and on boarding process. Ask to speak with client references. Ask the vendors about their client retention. These inquiries will help you to identify which vendor has the “personality” that will best mesh with your organization.

DIG INTO THE SOFTWARE Many vendors base their business on a software package that automates most aspects of contractor compliance management. These tools will form the backbone of your overall program. Therefore, you should conduct an in-depth review and comparison of different vendor tools. At a minimum the software should feature:

- Software-as-a-Service/Web-based delivery
- Uptime guarantees
- Advanced risk assessment tools and functionality
- Hosting in a high quality data center and reliable application availability—legitimate compliance providers should be able to provide credible documentation
- An easy-to-use interface with intuitive compliance icons
- Configuration options that make the solution adaptable for your business
- Multi-lingual capabilities
- Data integration options to work with existing systems like ERP
- Ability to override compliance requirements
- Customization options
- Value added services such as online training courses

GET YOUR HOUSE IN ORDER Assemble your internal team who will work on the compliance management program implementation. Consult with your risk management, safety, and procurement teams to define the thresholds and compliance requirements that will be used for your contractors. Determine the documentation requirements to support qualification. Your requirements should mitigate risk but be reasonable for safe contractor organizations to meet. Remember that not all contractors may have the same level of risk associated with their activities and there may be different compliance models. Work with your compliance solutions provider to define the models that most accurately support your business and fit your risk profile. Qualification criteria may could include:

- Financial Stability
- Environmental Health & Safety
- Quality Systems
- CSR/Sustainability
- Legal
- Insurance
- Business Continuity
- Diversity Status
- And more...



Implementing a formalized contractor compliance management program is a **significant initiative that can have an immediate impact** on your organization and insulate the business against the risk of potential financial liabilities.

IMPLEMENT BEST PRACTICES Remember, you are not alone in this endeavor to implement contractor compliance management. Many organizations have gone down this road before you and you can learn from their best practices and successes. Your vendor partner should be able to help you with identifying and defining industry best practices that apply to your business. At a minimum your vendor should be able to offer recommendations about industry and geographic specific thresholds, activities to monitor, and expected program outcomes and measurement.

SOFTWARE ALONE IS NOT ENOUGH To successfully manage compliance; your contractors will need to partner with you. Compliance providers should offer services to minimize the impact on your contractors and ultimately your business relationships. Credible compliance solutions offer proactive support to your contractor population such as data entry support, data validation and proactive compliance assistance with both inbound and outbound call support. Don't settle for traditional call centers, ensure that your compliance provider is willing to assign a single point of contact to every contractor you employ. This will ensure the most efficient process as compliance agents become intimately familiar with your organization and the needs of your contractors.

UNDERSTAND THE PRICING Depending on the complexity of your compliance program, there may be fees assessed to both you and your contractors. Be cautious of compliance providers offering low cost options, claiming to also offer full contractor support. Asking for contractor references is not uncommon, and it will enable you to find out what type of support they truly receive.

BEWARE OF HIDDEN FEES Less credible providers often have hidden fees or charge contractors "minimal fees" but assess those fees for every site you employ the contractor. A \$99 contractor fee can quickly become \$1,000 or more if that contractor works at multiple site locations.

COMMUNICATE WITH CONTRACTORS It's never too early to begin letting your contractors know that your organization will be implementing a new compliance management program. Keeping your contractors "in the loop" can help to alleviate any fears and address any concerns prior to program start-up. As with any change, there are bound to be hiccups but your vendor partner should be able to help you by providing materials and information that can be shared with your contractors. Ideally your vendor will also have a designated customer service team focused on addressing the needs of your contractors. In the end, the implementation of your compliance management program should not negatively impact your relationships with your contractors.

BUILD ORGANIC AND LIVING PROCESSES When implementing your contractor compliance management program remember that what works for your business today may be different tomorrow. Compliance is not a one-time event. Rather, it is a dynamic state that can vary from contractor to contractor and from day-to-day. Flexibility is key, both in the design of your processes and in the software that your vendor uses to support your needs.

Conclusion

Each time a contractor enters your work site your organization is at risk. To manage this risk your business must make the decision whether or not to invest in a contractor compliance management solution. If a contractor has not received proper screening, or an unqualified contractor is hired without checking their credentials, their inexperienced acts may lead to an accident occurring at the work site that could lead to a string of problems and uncertain economic consequences.

Research has shown that an upfront investment in compliance management does correlate to reductions in the long-term costs of non-compliance. Therefore, every organization that employs contractors should weigh the estimated costs of a preventative compliance management solution, as outlined above, versus the uncertainty of potential fines, damages, and other economic impacts.

Next Steps

When your organization is ready to implement a contractor qualification and management program, or improve your existing processes, BROWZ can help. Our team can help you to implement best practices while minimizing the impact on your contractors by offering superior, dedicated support to help with qualification. We also believe in straight-forward pricing that ensures you -and your contractors - won't be surprised by hidden fees or costs after program implementation. Contact BROWZ today to learn more. Call +1 877 392 7699.



About BROWZ

BROWZ assures supply chain compliance through comprehensive assessments and patented, configurable technology, providing confidence of a safer work environment to clients and contractors around the world.

BROWZ is the complete supply chain qualification and management solution addressing your needs related to sourcing and qualifying contractors, identifying risk within your supply chain, managing employee-level data, and conducting safety auditing.

Get a free consultation from BROWZ on best practices in supply chain qualification and management for your industry at www.BROWZ.com.

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CONTACT BROWZ | www.BROWZ.com

Main (US) 877 392 7699

Main (UK) +44 (0) 203 397 1868

Main (AUS) +61 (0) 8 9214 3820

Main (CA) 877 716 9885

Main (DE) +49 (0) 211 5405 7097

