

Procurement pretensions prevent proper partnerships

Professor Michael Mainelli, Executive Chairman, Z/Yen Group Limited investigates mutual insurance procurement

Procurement processes in many sectors throughout the UK have frustrated Z/Yen, the City of London's leading commercial think tank. Professional procurement is an important and useful process that should lead to better purchasing decisions, value for money and cleaner, i.e. less corrupt, practices. Yet, sadly, procurement processes are often bureaucratic nightmares of Kafkaesque terror and Catch-22 absurdities.

Some recent work with UK Higher Education Institutions (HEIs) on greater efficiency made us wonder if they were wilfully obstinate about mutual insurance procurement. Mutual insurance is a venerable and widely-used form of risk management, constituting for example the vast bulk of marine P&I insurance. Starting a mutual insurer can be problematic, but there are already two significant mutuals among UK HEIs, UMAL (University Mutual Association Limited – general risks) and UMSR (University Mutual Special Risks – terrorism).

At first glance, mutual insurance is alive and well in HEIs. Of 149 HEIs (excluding private and NI institutions), 34 belong to UMAL (23 per cent) and 98 belong to UMSR (66 per cent). Oddly though, HEIs that belong to procurement clubs such as LUPC (London Universities Purchasing Consortium) or APUC (Advanced Procurement for Universities and Colleges, Scotland) are far less likely to be members of a mutual, UMAL in particular.

	APUC- 18 HEIs	LUPC - 45 HEIs
UMAL members	0	5 (11%)
UMSR members	6 (33%)	28 (62%)

UMSR membership shows that procurement club HEI members can and do use mutual insurers,

EVALUATION CRITERIA	INSURANCE COMPANY/BROKER	MUTUAL
Is data released by brokers?	Insurers buy information	Information held by the mutual for members' benefit only
Where do profits go?	Commercial shareholders	Members
Who owns the reserves?	Commercial shareholders	Members
Who gets commission?	Purchasing consortia often take a percentage of premiums payable	Institutions join mutuals directly without commission or joining fees
How do we learn about risk management?	Little evidence of shared learning	Mutuals are incentivised to raise membership knowledge and standards
Is there discretionary cover?	Claims not covered by the policy can be declined	Claims not included in the cover wording can be adjudicated by the Board and are often paid
What is included in the price, e.g. risk surveys or claims handling?	Additional charges payable	Such services included in price

but UMSR current membership strength is largely due to historic reasons after 9/11; UMSR stood out for providing terrorism cover HEIs couldn't get elsewhere. Of the 86 HEIs that do not belong to a procurement club, membership of UMAL is 29 (34 per cent), while procurement club membership is either 0 per cent or 11 per cent. Is there a paradox here that mutual insurance is fine if you have no choice, but otherwise commercial insurance procurement is better?

If commercial insurance procurement is better, that's a bit strange. For organisations that stay in the same business over long periods of time, mutual insurance is normally a better choice. First, mutual insurance provides much more information sharing leading to better risk management. Second, mutual insurance provides smoother charges and lower charges over the long term. To take

some real numbers, let's look at a not-so-mythical HEI in 2005–2006 with an average claims record. Its declared property value might be £250m; its wage roll might be some £45m. Its mutual contribution might be some £250,000 (0.1 per cent of property or 0.6 per cent of wages). By 2010–2011 its property value might be 80 per cent higher at £450m while its wage roll might be about 30 per cent higher at about £60m. Its mutual contribution would be about £400,000 (less than 0.1 per cent of property or about 0.7 per cent of wages). This looks wonderfully stable but, third, when there is a surplus, over the same period a mutual typically returns that surplus, in this case about £225,000 over the five years, i.e. enough to drop the annual headline rate by about 15 per cent. And in this particular case, the reserve surplus was an additional £500,000 still undistributed, or just over a year's



Mutuals provide the vast bulk of Marine Protection and Indemnity (P&I) insurance

worth of contribution in reserve. So how can savvy procurement clubs be avoiding UMAL?

Sadly, procurement processes seem to be part of the problem rather than the solution. In Z/Yen's work we emphasise that good procurement should, "set criteria for procurement, but in most cases 'window shop up front' so that valid criteria can evolve and emerge." [Harris, Mainelli & Jones, 2008] The HEI procurement clubs we've seen in action do the opposite. Aware that there are brokers and underwriters, they tender for insurance brokers and underwriters, rather than look at risk management. Let's look (panel opposite) at seven criteria they miss by issuing invitations to tender without 'shopping'.

There are numerous other ways in which procurement clubs unthinkingly discriminate against mutuals, for instance insisting on a local office or asking for the pricing of separate lots as part of tendering and failing to look at the aggregate value for money, but three particular problems are worth noting. First, invitations to tender often insist that applicants be authorised by the Financial Services Authority in accordance with the provisions of the

Insurance Companies Act – sounds great, but not necessary for mutuals. Second, applicants must have a credit agency rating – leaving aside cheap shots about the value of these ratings in the first place, it's not the mutual that matters, but the underwriters they in turn use for the catastrophe losses. Third, mutuality is about long-term partnership, collegiality, things that HEIs should treasure. But in reality these values, sharing information and learning, are not valued in scoring criteria.

Procurement needs to be well-run, providing value-for-money through above-board processes. Poor thinking turns any process into one that drives out innovation and learning – procurement is no different. The challenge is for HEIs to look more critically at why their own procurement processes let them down, and start to learn through shopping rather than buying. Why not start with a critical look at discrimination against the mutual solution? ●



About the Author

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Making metal theft more of a challenge for criminals

Every week in the UK there are around 1,000 cases of non-ferrous metal theft, costing the country more than £1bn a year. Universities in particular are finding themselves targeted...

Thieves are well-known for helping themselves to lead on roofs and rainwater goods, bronze sculptures, aluminium items including manhole covers, power cables including theft of cable from construction sites on campus, and copper lightning protection systems.

Many of these thefts are opportunistic. Thieves will make use of onsite scaffolding or external fire escapes to access roofs. They will also take advantage of vulnerable areas where there is no CCTV, including the locations of external sculptures that may not be properly secured in place.

There are, however, a number of precautions that can be taken to minimise the risk of metals being taken illegally. Invisible forensic security sprays such as 'Smartwater' and 'SelectaDNA' are commonly used, with their presence being advertised on site to deter thieves. It is also prudent where possible to substitute non-ferrous metal products with ferrous, plastic or synthetic products as a very good way to prevent theft.

At present non-ferrous metal is often sold for cash but in the future such cash transactions will be banned using the proposed Legal Aid Bill that should become law by April 2012, with the result of increasing traceability. This, coupled with the increase in penalties for offenders, should make non-ferrous metal a less attractive choice for thieves.

Other areas of vulnerability which attract opportunistic criminals are the theft of Apple Mac computers. To deter walk-in theft substantial padlocks can be used to secure the computers to the desks, with metal enclosures for the older machines having separate hard drives. This can be supplemented by monitored CCTV cameras in the rooms. For break-in theft intruder alarm movement detectors should be placed in all such cluster rooms.

In areas such as metal or computer theft, risk assessment can make a valuable contribution to protecting an institution's assets. By identifying the vulnerable areas, building owners can make what is seen as an "easy win" for thieves into a difficult challenge. Members should be making full use of UMAL's risk management guidance to do this. ●