

Date: 22 June 2022

Item: Enterprise Risk Update - Supply Chain Disruption (ER5)

This paper will be considered in public

1 Summary

- 1.1 This paper describes TfL's current position on supply chain disruption following the impact of global supply chain disruptors, including Brexit, the coronavirus pandemic and the Russia-Ukraine conflict. It is an update to the Enterprise Risk Supply Chain Disruption (ER5) papers submitted to Committee on 23 June 2021.
- 1.2 This paper outlines the preventative controls and mitigating actions Procurement & Commercial (P&C) have undertaken to actively manage our supply chain disruption and appropriately reduce risk.
- 1.3 A paper is included on Part 2 of the agenda, which contains exempt supplementary information. The information is exempt by virtue of paragraph 3 of Schedule 12A of the Local Government Act 1972 in that it contains information relating to the business affairs of TfL. Any discussion of that exempt information must take place after the press and public have been excluded from this meeting.

2 Recommendation

- 2.1 **The Committee is asked to note the paper and supplementary information on Part 2 of the agenda.**

3 Background and Causes

- 3.1 TfL heavily relies on contracted goods, works and services to enable safe and reliable journeys. These goods, works and services are provided by our Tier 1 suppliers and their sub-contractors (the supply chain), many of whom are key to TfL's operations.
- 3.2 Failure to sufficiently identify and appropriately manage supply chain disruption due to global supply chain disruptors could result in an increase in TfL's costs, delays to project delivery and interruption to operational services.
- 3.3 Although our supply chain risks have been identified and are being actively managed, global disruptors still have the potential to cause lasting adverse impact on TfL in the medium to long term (between six and 24 months).
- 3.4 As a result of the coronavirus pandemic, the following factors have caused disruption to the supply chain over the past 12 months:

- (a) a reduction in TfL's cash-flow due to reduced passenger demand has had a disruptive impact on some suppliers;
- (b) staff illness and absence;
- (c) unavailability of materials;
- (d) labour shortages;
- (e) transportation and logistics disruption;
- (f) delays to scheduled maintenance; and
- (g) legislation and guidance introduced by the Government in response to the coronavirus pandemic.

3.5 The completion of a Brexit agreement by the Government on 24 December 2020 provided greater assurance on the cost impact and availability of goods and materials. However, some supply chain disruptions remain, including:

- (a) border delays for goods and services from the EU, either directly contracted or part of the supply chain;
- (b) post-Brexit import arrangements, customs charges and terms;
- (c) quotas and tariff charges on materials imported to the UK;
- (d) shortage of non-UK labour sourced from the EU;
- (e) unavailability of materials;
- (f) HGV driver shortages;
- (g) fuel shortages; and
- (h) energy price increases.

3.6 The implementation of full customs controls on 1 January 2022 has worsened disruption from the EU, including increased congestion at ports and has further exacerbated disruption caused by other ongoing global issues.

3.7 As a result of the ongoing Russia-Ukraine conflict, the following factors have caused disruption to the supply chain:

- (a) unavailability of materials;
- (b) transportation and logistics issues;
- (c) energy price increases;
- (d) fuel shortages;
- (e) commodity price increases;

- (f) sanctions on companies with ties to Russia or Belarus; and
- (g) suppliers cutting ties with Russia and Belarus.

3.8 Outside Brexit, coronavirus and the Russia-Ukraine conflict, further key supply chain risks have been identified, including:

- (a) increases in insurance premiums leading to higher pricing, changes to policies and coverage restrictions and cyber security;
- (b) global logistics pressures, including a lack of empty shipping containers, capacity limits and congestion in shipping ports, record high ocean freight rates and disruption to rail freight shipping routes leading to the disruption of goods and raw materials;
- (c) climate change increasing the risk of climate related hazards leading to global manufacturing disruptions, increased sourcing costs and fuel stability issues;
- (d) the impact on the UK economy from high rates of inflation, rises to interest rates, corporate insolvencies, and the possibility of a recession in 2022/23 leading to the increased prices; and
- (e) TfL's continued short term funding arrangements leading to a negative impact on our suppliers and their sub-contractors.

3.9 A number of factors span each of TfL's main supply chain disruptors, exacerbating the risk and requiring significant action to manage these. They include:

- (a) unavailability of materials: Material shortages have been the most disruptive factor of the past year. Analysis of TfL's supply chain indicated significant issues relating to materials shortages or increases in material costs in 2021, which has been exacerbated by the Russia-Ukraine conflict. P&C have managed these issues by working with suppliers to better forecast requirements and increase lead times on impacted materials; However, with costs continuing to rise, TfL is having to work with suppliers to actively manage these cost increases as a result of these material shortages;
- (b) labour shortages: Many sectors across the UK have experienced labour shortages in the past year with job vacancies reaching a record high of 1.3m in January 2022. Factors such as pandemic related restrictions and post-Brexit changes to immigration rules have exacerbated problems leading to challenges in sourcing staff across TfL's cleaning, security, and call centre contracts. In addition, P&C have also experienced problems in sourcing skilled commercial construction resource; and
- (c) logistics and transportation: Global logistics have seen unprecedented disruption over the past year. Shipping costs have increased dramatically, stemming from a global shortage in capacity, closure of

ports, congestion and shortage of workers due to coronavirus. With rail and air trade routes significantly impacted by the Russia Ukraine conflict, shipping lead times are unlikely to reduce in the coming months and rates are predicted to remain high in 2022.

- 3.10 TfL currently monitors the financial health of 258 suppliers who are critical to TfL's operations.
- 3.11 Forty-nine of the 258 monitored suppliers (19 per cent) are currently considered to be at high financial risk, decreasing from 22 per cent at the time of the last update.
- 3.12 Substantial government support provided to suppliers throughout the coronavirus pandemic masked the total impact on the financial health of TfL's suppliers following Brexit and the coronavirus pandemic. As government support reduced, TfL saw some disruption arising from Supplier financial difficulties in TfL's Tier one suppliers, however it is assumed that greater impact has been experienced by the wider supply chain (Tiers two and three).
- 3.13 All government coronavirus related financial protections were removed with effect from 1 April 2022, leading to a rise in businesses facing financial distress.
- 3.14 Across the UK the number of voluntary liquidations has doubled in the past year, suggesting that organisations are choosing to close in the face of rising costs. As interest rates rise, this may put even more pressure on indebted businesses.
- 3.15 Failure to identify and respond appropriately to poor Tier 1 supplier financial health could also result in significant disruption to TfL, including further increase to our costs, wider supply chain disruption, project delivery delays and interruption to operational services.
- 3.16 Therefore, TfL's P&C directorate have preventative and corrective controls in place to manage supply chain risk (see section 5 and 6).

4 Consequences

- 4.1 Without preventative controls and processes to effectively manage supply chain risk, TfL would be at risk of adverse operational and financial implications:
 - (a) Increased costs: Increased cost of materials, commodities, finished products, contracted services, customs and tariff costs, labour, energy, shipping, increased insurance premiums, interest rates, inflation and wage growth;
 - (b) Project delivery delays: Project delays due to the unavailability of materials, commodities, finished products and contracted services, shortages of skilled and unskilled labour, transportation and logistics

issues, fuel shortages and border delays on imported goods and materials; and

- (c) Operational services disruption: Disruption to operational services due to the unavailability of materials, commodities, finished products and contracted services, shortages of skilled and unskilled labour, transportation and logistics issues and increased lead times.

5 Preventative Controls

5.1 The following controls and processes have been implemented across all business areas to increase TfL's understanding and management of supply chain risks, issues and financial exposure:

- (a) supply chain risks and issues register with mitigation plans: P&C's risk and issues register continues to be used to capture and manage supply chain risks, issues and mitigation plans. A central view of supply chain risks and issues across the whole organisation allows TfL to gain an understanding of the relative actions required, and the appropriate prioritisation needed to manage these action plans to effectively mitigate risks and issues. The risks and issues register is used in each of the P&C's teams to provide an accurate understanding of supply chain risks and issues in each business area. It is a fundamentally important tool for liaising with business stakeholders to help with the planning and control of mitigating actions being undertaken;
- (b) a supplier financial health monitoring process which includes a ratio to measure a Supplier's financial dependency on TfL (exposure rating): TfL's financial monitoring process continues to be used to proactively highlight high risk suppliers. Alerts are given and contingency plans are being developed where appropriate;
- (c) reporting and executive review: Regular reporting cycles have been established for supply chain risks and issues and supplier financial health. Regular reports are provided to the Chief Procurement Officer and P&C Senior Leadership Team;
- (d) centralised management of supply chain risks within P&C: P&C's approach to monitoring and managing risks is being actively managed by the central Governance and Assurance team, allowing for a consistent approach to risk management and providing guidance and support across the P&C teams;
- (e) commercial lessons learned: P&C undertook a lessons-learned process to identify opportunities to improve the capture, monitoring and management of supply chain risks following Brexit and the coronavirus pandemic and is using those lessons to implement improvements to our wider risk management process;

- (f) commercial guidance: Commercial guidance has been developed to advise the P&C teams on TfL's approach to supply chain issues when engaging with suppliers to ensure organisational consistency;
- (g) Supply Chain Management and Risk Management analytics: analytics reporting has been developed to enable live monitoring and management of risks and issues across P&C allowing for increased engagement with business stakeholders around identification and management of their key risks and issues and appropriate mitigation plans;
- (h) commercial cross cutting meetings: Regular commercial cross cutting meetings are used to identify common risks and issues arising across P&C teams and ensure these are being managed consistently;
- (i) the Governance, Risk and Assurance team within P&C: In the recent P&C transformation the Governance, Risk and Assurance team was established with a dedicated team to support the effective management of risk in P&C;
- (j) supplier communication and engagement: P&C staff are in regular communication with their suppliers to identify and understand the scale of risks and issues;
- (k) engagement and collaboration with industry bodies: The Governance, Risk and Assurance team regularly engages with industry bodies and trade associations, of which a number of TfL suppliers are members, to understand the current and future perception of risk in these industries, provide updates and ensure regular engagement;
- (l) Cabinet Office and Department for Transport (DfT) engagement and collaboration: The P&C team regularly engage with the DfT, attending their Strategic Supplier Working Group and working collaboratively to share non-confidential information on suppliers' financial standing and best practice;
- (m) Bus operator engagement and mutual aid: The contracted bus operators and thus their supply chains are managed through their full life cycle by the Bus Operations team. The integrated and continuous tendering process ensures strong oversight of financial stability and performance of the bus operators themselves. Regular TfL / bus operator engagement ensure there are opportunities to flag and share concerns over supply issues. The Bus Operations team have used those forums to effectively manage supply risks ahead of Brexit, during fuel shortages and the pandemic, and where risks and issues are identified, 'mutual aid' is used to minimise the impact of supply chain disruption; and
- (n) Crossrail procurement processes: In order to mitigate delays due to Brexit import issues, Crossrail developed new procurement processes which have helped to speed up the customs imports of plant and materials.

6 Corrective Controls

- 6.1 Supplier insolvency: TfL has noted disruption from the supply chain due to the removal of the government's financial support provided during the Coronavirus pandemic. However, at present this has not been as substantial as originally thought, with only one of TfL's monitored suppliers going into administration. A greater number of suppliers have improved their financial position following end of year results.
- 6.2 Many suppliers are yet to submit accounts that cover the peak of the pandemic and it is too early to observe the financial impact of the Russia-Ukraine conflict.
- 6.3 In order to understand the full financial impact on TfL's supply chain, we must further develop our understanding of both TfL's tier 1 suppliers and in the wider supply chain (tiers 2 and 3).
- 6.4 We continue to monitor its supply chain and where a risk of insolvency is identified, this is communicated to the relevant P&C teams as well as the wider business, and contingency plans are developed and implemented where necessary.
- 6.5 Supply chain risks and issues register: Implementation across all P&C staff has been successfully executed resulting in full visibility of TfL's supply chain risks and issues. These are regularly reviewed along with the assigned mitigation plans.
- 6.6 Crossrail risk management: Crossrail have seen an impact from the supply chain disruptors listed above and have managed these through contracts by agreeing long term realistic end dates via the Workforce Plan and contractor resource schedule rather than numerous incremental extensions in order to give staff greater certainty. However, notwithstanding these effects, the position has been managed successfully to allow the central section of the Elizabeth line to go live to the public on 24 May 2022.

7 Actions

- 7.1 An in depth review of TfL's risk exposure from the Russia-Ukraine conflict is ongoing and outputs will be shared with relevant stakeholders across TfL.
- 7.2 P&C will consider opportunities to prioritise and increase TfL's regional or local supply chains in the medium to long term. Whilst more local supply may not be available for raw materials and commodities, prioritising regional and local supply chains where possible could support the growth of UK industries and reduce the risk from global disruptors including shipping delays and the ongoing impact of the coronavirus pandemic particularly across Asia. Any such prioritisation will be subject to compliance with procurement regulations.
- 7.3 Work is ongoing to develop a process to ensure risks and issues aligned to all commercial contracts are consistently captured and recorded as a standard process in P&C.

- 7.4 Ongoing collaboration continues to take place across P&C with TfL's operational business areas and with professional support from legal and finance teams to develop contingency plans for all financially high risk suppliers.
- 7.5 SAP Ariba, an end to end procurement software solution, is being implemented across P&C including a risk management tool that will support the management of supply chain risks and issues.
- 7.6 A Supplier Relationship Management programme is being implemented by the Capability and Supplier Management team in P&C, developing strong supplier relationships with TfL's key suppliers focusing on collaboration, risk identification and mitigation, cost reduction and strategic value enhancement across core contracts.

List of appendices to this report:

Exempt supplementary information is included in a paper on Part 2 of the agenda.

List of Background Papers:

None

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