

A Formula for Success

Procurement effectiveness
in major project delivery



[PROCUREMENT EFFECTIVENESS]

Engagement + Risk management + Contract review
= Delivering Government (Policy)

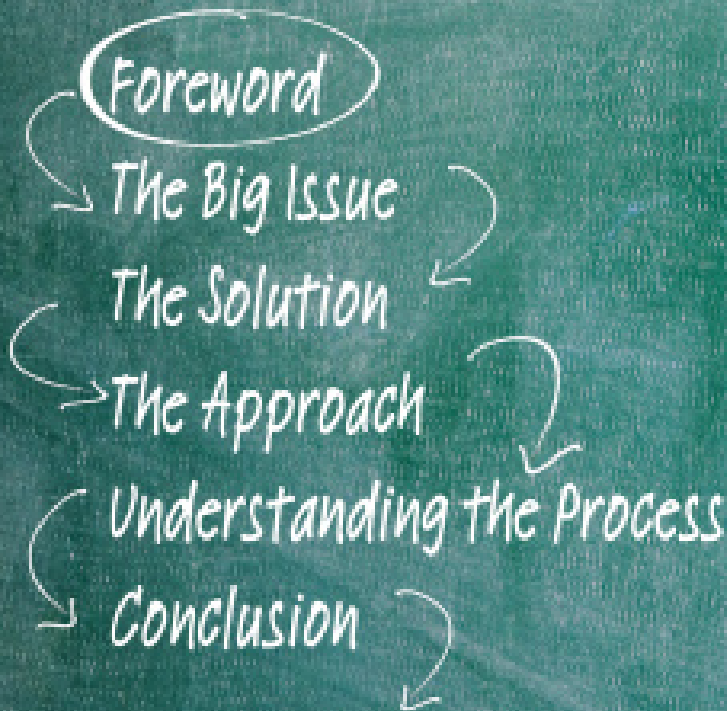
Delivering Government Policy

failure to communicate = (wrong supplier + wrong contract)

lost credibility

[A Formula for Success]

Procurement effectiveness in major project delivery



'...industry has been saying for some time, that the historic approach of arms-length procurement of increasingly large, sophisticated and citizen-centric services is no longer fit for purpose. Recognising and confronting this reality is a bold step, and is to be applauded.'

Keith Wilman
CEO Atos Origin UK

Foreword

The scale and complexity of Government projects is unparalleled. Many major Government projects face issues which may carry a risk to the delivery of their objectives to time and to budget. Although there are a number of initiatives aimed at improvement, there can still be substantial risk to the delivery of our strategic outcomes. Are we doing enough to manage that risk and what role does procurement play?

The successful implementation of Government policy rests on the interdependence of a sound solution, its practical application and effective delivery. Knowledge and experience are essential to all of these; but it is the third that is often the most challenging, requiring support from the private sector, achieved and managed through procurement.

By their very nature, major projects in Government contain uncertainty and risk. Indeed, it is often the case that it is not possible at the outset to state the desired outcome in anything but the broadest terms. Successful delivery is more likely if these, often inevitable, uncertainties are identified and addressed at an early stage.

I believe that effective procurement is central to the management of these risks. To achieve this, however, envisages a role for procurement that is not merely an operational "bolt-on" but a key component in the journey to effective delivery. Through the early engagement of the market comes an understanding of the critical link between the intended outcome and the risk of delivery. Engaging procurement beyond contract award and through the whole of the delivery process ensures that the right supplier, with the right contract, achieves the right result.

This booklet outlines these components in more detail. I would urge you to become personally involved and committed to these principles, and to ensure that your procurement director and function are at the heart of programmes and projects from the outset.

I believe this will make a real difference to the delivery record of Government.

Sir Gus O'Donnell

Cabinet Secretary and Head of the Home Civil Service

[A Formula for Success]

The Big Issue
The Solution
The Approach

It is often best to engage potential suppliers early, to have pre-procurement conversations, which improve the joint understanding of intended outcomes and the cost drivers and risks associated with delivery – some of these risks can only be managed by departments.

Project Success =

(applied skills + outcome focus)

X aligned incentives

To assess whether your department is ready to start the procurement process for a project, OGC recommends using the Pre-Qualification Tool

The Big Issue

Government is becoming more reliant on its suppliers, both for the delivery of services and for the creation of new or improved processes to support service delivery. Procurement is the vehicle through which suppliers are safely engaged and contracts managed to conclusion. A failure in procurement is very likely to put service delivery or service improvement at risk. It is therefore of crucial importance to the Government's delivery agenda.

Good procurement produces value for money: the Efficiency Programme has amply demonstrated the value that procurement can bring through the reduction in cost of goods and services. Procurement should, however, be valued equally for its ability to assure the strategic delivery of complex projects, and through them, policy outcomes.

The Solution

To bring more certainty of success to the delivery of Government policy, there must be greater business engagement of suppliers at senior level with delivery risk addressed much earlier in the procurement process.

The Approach

Proposition 1: Talk first...

In all strategic projects, senior stakeholders will find considerable advantage in developing their policy and strategic thinking through business-to-business engagement of their potential suppliers; developing a stronger understanding of the art of the possible and preparing better to manage uncertainty. This does not have to compromise the procurement process.

Early engagement with the market helps to create joint understanding and clarity of purpose. For the customer this involves understanding the issues that might be faced in delivery; for the supplier it is clarity of the intended outcome. Competition rules do not preclude such engagement, but they do require that all potential competitors be given the same opportunity.

Engagement with suppliers should not be left solely to procurement staff, nor should it be carried out without their guidance. Clear and visible business support, including that from the Senior Responsible Owner (SRO), demonstrates departmental commitment which further increases supplier confidence whilst ensuring discussions remain at a high level, focusing on the business outcome rather than any intermediate output. Early engagement also allows the greatest range of potential solutions to be explored, and due consideration to be given to those risks which might cost-effectively be transferred, as well as those which could be best managed in-house.

However there should not be a rush to start the procurement process. The competitive phase in the procurement process is often started too early, principally in an effort to make, or to be seen to make, progress. But this is a false economy. Using the competitive process to resolve issues, which could have been dealt with before the start, is likely to be more difficult and more costly. Bid teams carried

by the supplier are a limited resource which feed back into the cost of business and, in the longer term, to the supplier's customers, including Government.

The unplanned extension of the procurement process is one of the key factors that make Government business unattractive for suppliers. This is particularly the case for smaller companies which have lower capacity to commit. Aside from the impact on the costs of doing business with Government, unplanned extensions can cause companies to withdraw from the process and make them circumspect about competing in the future. The result is a restricted marketplace, decreased competition and increased cost of delivery.

Suppliers will always weigh up the risks of entry to competitions and will use a formal process to decide whether to engage in a procurement opportunity. A procurement that is not well prepared will be less attractive than one with a high certainty of timely completion, regardless of the potential prize in terms of financial reward. They will evaluate their many opportunities in order to maximise the return from their investment in bid teams.

Pre-Qualification Tool: OGC, CIO Council and Intellect have jointly developed a tool which helps to assess the preparedness of a department to start the procurement process. It uses four measures: the preparedness of the customer, its business leadership, the market and of the procurement itself. Failure in any one of these measures indicates that the planned procurement will fail to deliver the intended outcome; at best causing delay in the procurement.

[A Formula for Success]

The Approach

[Simple Procurement]

$$\text{Price} = (\text{cost} + \text{margin}) / \text{volume}$$

[Complex Procurement]

$$\text{Price} = (\text{Cost} \times \text{Uncertainty}) + (\text{Margin} \times \text{Risk})$$

The Approach

...Act later

Procurement is not well understood. Too often the focus is on the process, which is seen as overly formal and lengthy. It leads to the perception of a function which merely 'protects' customers from legal challenge and which calls suppliers to account when problems arise. Instead, procurement should be seen as an opportunity to agree clear, joint objectives in a commercial arrangement aligned with a supplier's capability to drive successful delivery. This should happen at an early stage in the process in order to better assure delivery.

When it comes to Government contracting, there is little to invent. Even PFI existed in Elizabethan times – some say Egyptian – and the entire process, with its strengths and weaknesses, has been honed over many years to meet evolving needs. The latest challenge is to adapt procurement to match the increasingly complex needs of Government.

These include where:

- customer choice makes demand unpredictable
- commercial arrangements need to be innovative and flexible
- there is an inability to define fully the requirement, or significant elements of it
- there is difficulty in determining, at the outset, the best model for delivery
- there is a likely impact of future events.

In the face of such uncertainty, suppliers will judge the potential impact of these risks on cost and take account of this in the price they offer. Competitive pressure will go some way to constrain such increases; but suppliers may, under such pressure, simply ignore the potential impact, to win the business.

Their assessment will be heavily influenced by the procurement process adopted and the proposed form of contract. Put simply, the supplier's reward must exceed the likely cost of delivery, including their estimate of the impact that risk might have on those costs.

Unintelligent competition runs the risk of engaging the wrong supplier, operating at unnecessary levels of risk, and failing to deliver overall value for money. In extreme cases, this can lead to failure in delivering the required outcome at all.

Proposition 2: Address delivery and risk much earlier in the procurement process.

Risk is an intrinsic element of complex procurement. Any approach to engage suppliers to support the delivery of complex projects should be based on a clear understanding of the risks involved, as well as how and by whom they might be managed and owned. Early engagement with potential suppliers provides the opportunity to explore their understanding of possible risks and their ability to manage them.

Too often, risk is said to be 'transferred' to suppliers without full understanding of the consequences of doing so. Merely transferring it does not eliminate the risk. A responsible supplier will make provision to manage transferred risk and this will be reflected in their pricing but other suppliers may take a gamble. Without careful analysis by the procurer, the latter may appear to offer better value. The consequence of such an inappropriate judgement is that the risk flows back to the customer unresolved.

So why transfer risk at all? For the same reason as the delivery is, itself, transferred; the supplier can more economically manage some risks, reducing the costs of delivery of the overall project.

It is unsurprising, then, that the risks which are the most readily transferable are those where their management is wholly in the hands of the supplier (eg technical risk, supply chain risk etc.). Risks which are more difficult to transfer include those that rely upon the actions of the customer or of stakeholders outside the supplier's control.

[A Formula for Success]

Understanding the Process

Complex procurements deal with fundamental levels of uncertainty (or risk). It is unlikely that there will be a clear ability to state the outcome to be achieved in anything but the broadest sense.

A well-prepared procurement will take much less time and deliver a more certain result.

The job starts at contract award – not ends!!

'...in reality, long-term contracts should be seen as the baseline for a relationship and the platform for constructive dialogue to handle ever changing circumstances.'

Keith Wilman
CEO Atos Origin UK

Understanding the Process

Competition: Competition facilitates, at a given point in time, the comparison of solutions in terms of the best mix of quality and effectiveness at the most economic advantage.

But for it to be really successful it is also necessary to assess the likelihood of the suppliers achieving the intended outcome and to be confident that the right boundary has been set between the public sector customer and the private sector supplier to manage delivery risk. Get these wrong and there will be a direct impact on the ability of the supplier to cost, and thereby put a price on, delivery and hence the confidence that can be placed in the decision being made through the competitive process.

To ensure value for money, there is a need to understand fully (but not necessarily contractually define¹) how suppliers intend to deliver the contract. This, coupled to a clear statement of the risk to be borne by the supplier, will help to assure the integrity of the proposal. It also allows the payment regime to be constructed in such a way as to drive appropriate behaviour (eg continuous improvement in value for money delivery).

The quality of information supplied by the customer directly influences the supplier's assessment of risk and hence price. Where there is a high level of uncertainty, it may be better to agree a set of assumptions, against which suppliers then bid. The resultant cost uncertainty might then be managed through a process which agrees a pricing variation once the actual position becomes clear, recognising this may be some considerable time after contract award.

Uncertainty: Where uncertainty dominates, a competition based primarily on price is unlikely to identify the best supplier. Consideration should therefore be given to other forms of supplier evaluation in order to assess, and capture within the contract, behaviours which support the continued delivery of value for money post-award.

The Contract: Once the preferred supplier has been selected, it is necessary to establish a contract which protects the customer if things go wrong. However of equal importance is the need to plan maintenance of the contract to ensure that these rights are preserved throughout the period of delivery and that the contract holds true to the original value for money judgements.

The final chance to double check that core elements are in place, and that they are understood and accepted by both parties, is before the contract is awarded.

Key considerations might include:

- agreement, at a senior level, of what is likely to drive successful delivery
- what success will look like for both customer and supplier
- the creation of an environment which allows for the resolution of issues during delivery
- the obligations the contract places upon the customer particularly where such actions have the potential to prevent the supplier from undertaking their contracted duties
- recognition of the work that will be required from the point of contract award onwards.

Joint Statement of Intent: O&C, the CIO Council and Intellect have jointly developed a process which leads to a Joint Statement of Intent (JSI). This agreement between senior executives on both the customer and supplier sides becomes a reference point for all those involved in the contract, against which to assess the appropriateness of their response in times of tension. Working towards this non-contractual agreement provides the opportunity for senior-level engagement to provide the clear, visible and joint leadership necessary.

Contract management: The handover from competition to delivery occurs at the point of contract award. Recipients of the delivered service need to understand what has been contracted, to manage expectations and to ensure that key deliverables are appropriately monitored. This should be a specifically resourced activity. Too often customer teams change or are significantly slimmed down at this stage, losing hard-won knowledge of the requirement, the route to delivery and contracted measures gained during the competitive stage of the procurement process. There is growing evidence that this is the point at which projects can start to go wrong, with a clear dip in relationships from which some projects never recover.

Contracts require proactive management. This is not simply a matter of contract administration, but the continuous review of all aspects of performance, by both supplier and customer against the contracted obligations and with reference to the environment in which the contract was originally negotiated. The risks and uncertainties identified in the pre-contract phase will either fall away or mature and their consequences can be assessed against the assumptions made. Where well-managed risks result in cost reduction, consideration should be given to the supplier and customer sharing the benefit. Likewise, where risks have been significantly underestimated, the risk-reward position of the supplier must be open to review.

¹Contracting too tightly for a solution reduces suppliers' opportunities to innovate later.

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Conclusion

senior engagement = joint understanding +
constructive behaviours +
a division of responsibility based on
ability to manage identified risks

SRO TO DO LIST

- Engage supplier regularly
- Incentivise collaborative behaviours
- Commit resource to MANAGE contract through life
- Deliver department obligations
- Create environment in which project will flourish

∴ senior engagement + early consideration of delivery
= more certainty of success

This is a critical area of Government contracting policy. Contracts are placed because suppliers can commit to managing supply chains and risks more cost-effectively than Government. Suppliers accept responsibility for delivery at contract award and their ability to absorb such costs will be balanced by beneficial risk in other parts of the contract or perhaps on other Government contracts. But Government must be prepared to recognise situations where this risk becomes extreme, in such circumstances suppliers may be forced to consider withdrawal from contractual commitments, or to recover the resultant costs from other Government contracts.

For suppliers of strategic importance, broader relationship management is essential. This is of particular value where a supplier is engaged in more

than one contract, maybe across a number of Government departments. Senior level engagement, encompassing the whole of the supplier's activity, provides the opportunity for a wide range of improvement activities which might not be deliverable within the confines of a single contract. It also goes some way to mitigating the risk of cost migration between contracts.

Other areas for consideration include the effects of the supplier's market position and the impact of Mergers and Acquisitions, both of and by the supplier. Does such change affect their delivery risk? What action will they take to protect the customer's position if it increases the risk to delivery? What advantage will they offer the customer if it reduces the risk and how will this be assessed?

Conclusion

Government procurement does work and, in the main, it works well. But there is no getting away from the fact that some projects do fail – and sometimes very publicly. This paper invites challenge of the status quo in an effort to eliminate these failures.

It calls for early senior engagement in major, complex procurements to offer clear, strategic leadership in promoting collaborative relationships with suppliers whilst ensuring the associated risks are

managed and/or transferred appropriately. This is not a matter of going soft on suppliers, but recognising them as an important component of the delivery machine which will increase the chances of success if managed through true understanding.

If these principles are adopted and embedded into Government procurement, there will be greater certainty of success.

Purchasing pays: There is a strong correlation between Purchasing and Supply Management (PSM) health and financial performance.

People matter most: Capabilities and culture have the strongest impact on purchasing performance.

Increase headcount (selectively): High performers invest in 50% more procurement professionals per unit of spend and realize significantly more savings.

Earn a seat at the table: Chief Procurement Officers of high performers are 5 times as often part of the senior management team of the company than those of low performers.

And make the most of it: PSM involvement in corporate strategic decisions can double PSM performance contribution.

*Extract from findings of the Global Procurement Excellence survey carried out by McKinsey & Company and SMI**

*For further detail on the Global Procurement Excellence survey, please contact ukpublicsector@mckinsey.com

*The ultimate risk,
that of failure,
cannot be transferred.*

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