

STRATEGIC PROCUREMENT

CALCULATING VFM SAVINGS

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EXECUTIVE SUMMARY

1. The Central Procurement Directorate (CPD), Department of Finance and Personnel, Northern Ireland is designated as a Centre of Procurement Expertise (CoPE) in the NI Public Procurement Policy¹. It develops and manages procurement projects for the acquisition of strategic assets and services on behalf of Northern Ireland Central Government Departments. Following contract award the projects are 'handed over' to the commissioning client who is responsible for the implementation, steady state operational service delivery and first line contract management.
2. CPD wished to consider how it could identify Value For Money (VFM) savings achieved through the application of professional procurement practices to innovative, strategic procurement projects where there was a lack of available data against which to determine the level of VFM savings achieved by its involvement in the procurement process. Representatives from other public sector organisations were invited to participate in a one-day workshop to seek to identify principles upon which these VFM savings could be measured.
3. VFM savings can be defined as any quantifiable economic benefit (cashable or non-cashable) which is generated by identifiable initiatives by those involved in the procurement process e.g. customers and procurement staff, and which are achieved through a programme of activity beyond that arising from mechanistic order placement. They are achieved through 'procurement influence' and are separate from 'efficiency savings' which can arise e.g. from policy decisions to do something differently, such as to outsource a service.
4. This paper presents principles and concepts which will assist CPD to baseline and measure these one-off, strategic procurements where the project is innovative and there is no appropriate, or comparable, data readily available upon which to base VFM calculations. In practice, the individual procurement body must determine if these principles are appropriate to its procurement evaluation or whether other measurement methodologies should be applied.

Agreed Principles

5. Based upon the discussions, the following principles were identified and agreed:
 - (a) The baseline and comparators must be realistic, prudent and robust. They should also be conservative.
 - (b) It is the impact of the procurement process on that project's component costs as appropriate that will be measured.
 - (c) Savings must be sustainable; if the contractual payment profile is changed any VFM savings should be recalibrated.
 - (d) The VFM savings should be reported as a stand alone measure for each individual Strategic Procurement Project.

¹ Department of Finance and Personnel, Public Procurement Policy, May 2002.
http://www.cpdni.gov.uk/pdf-public_procurement_policy.pdf

6. This means that VFM savings can be aggregated and included in reports regarding the organisation's overall VFM or efficiency targets; the purpose of reporting against individual procurement projects is to ensure the impact of professional procurement practice on the project is effectively assessed and reported.
7. The baseline should be set at the stage at which the procurement professional staff become involved in the project as part of its multi-functional team, this should be, but is not always, at the Outline Business Case (OBC) stage.
8. The identification of the baseline should be made following the award of the contract using the benefit of hindsight to determine which is the most realistic position to use to give a reasonable assessment of the VFM savings achieved from the application of professional procurement processes
 - (a) The OBC (and approved budget) is a realistic baseline, however
 - i. Where the first Most Economically Advantageous Tender (MEAT) is significantly lower than the OBC it will be necessary to identify the reasons for the difference and
 1. if appropriate, update the OBC and use the new valuation (first MEAT) as the baseline, or
 2. if not, use the first Most Economically Advantageous Tender where subsequent tendering cycles are used.
 - ii. Most Economically Advantageous Tenders should only be used as a baseline where there is a measure which underpins their robustness e.g. where a tenderer may be eliminated if the tender is uncompetitive.
 - iii. Where the final contract price is significantly different from the OBC or first Most Economically Advantageous Tender the Project Team should review their robustness, determine a reasonable value to use as the baseline and, having identified the reasons for the variations, ensure that these are prepared as a 'lessons learnt' information document and communicated to others to help to improve future OBC and tendering work
9. Where the procurement process results in a higher initial tender being reduced and brought closer to or under the budget, report the reduction
 - (a) as a cost avoidance down to the budget figure, and
 - (b) as a VFM procurement gain achieved below budget.
10. In a situation where the baseline differs markedly from an available comparator, it will be prudent to analyse the reasons for the difference. In instances where the VFM savings are due to a significant shift in the supply market, the VFM savings should be reported with a commentary explaining the variation from the original OBC. The VFM savings are, however, real even though it is the shift in the market that has reduced the original budget requirement and released the funds for other uses. If the procurement body can demonstrate that changes in market conditions were attributable to the procurement strategy or tactics employed VFM savings arising can be claimed. In circumstances where changing market conditions are a result of

external economic factors the VFM savings may not be attributable to the efforts of the procurement team and the organisation should carefully consider the proportion of savings it should report as being down to its efforts.

11. A simple template should be used when reporting achieved VFM savings. The template will provide a list of the project's available baselines, the reasons why a particular baseline was selected and the value of the gain(s) claimed.

Background

12. The Central Procurement Directorate (CPD), Department of Finance and Personnel, Northern Ireland is designated as a Centre of Procurement Expertise (CoPE) in the NI Public Procurement Policy.² It develops and manages procurement projects for the acquisition of strategic assets and services on behalf of Northern Ireland Central Government Departments. Following contract award the projects are 'handed over' to the commissioning client who is responsible for the implementation, steady state operational service delivery and first line contract management.
13. This approach reflects what happens, on a smaller scale, within organisations where departments with relative autonomy, operate devolved budgets and are supported by a professional, central, procurement structure. Procurement activity is usually viewed as a whole process and any VFM savings and efficiencies are considered on an organisational basis. For the purpose of this workshop we considered the benefits accruing from identification of need, through the procurement process to contract signing for stand-alone scrutiny as this reflected CPD's role and reporting requirements.
14. The CPD wished to consider how it could identify VFM savings achieved through the application of professional procurement practices to innovative, strategic procurement projects where there was a lack of available data against which to determine the level of VFM savings achieved by its involvement in the procurement process.
15. This paper represents the output from a workshop hosted by CPD in Belfast on Wednesday 6th June 2007. The organisations represented by delegates are presented in Appendix A.
16. The principles developed in this paper are intended to assist CPD report on VFM savings arising from strategic procurement projects; it is hoped the paper will be of use to other public sector procurement organisations, particularly other CoPEs in Northern Ireland.

Context

17. Public sector bodies are tasked with delivering VFM savings; methodologies^{3,4} have been published enabling savings to be calculated and reported in respect of operational procurement activity. In these publications Procurement Efficiency Gains and VFM Savings are represented as follows (see Fig 1).
18. VFM savings can be defined as any quantifiable economic benefit (cashable or non-cashable) which is generated by identifiable initiatives by those involved in the procurement process e.g. customers and procurement staff, and which are achieved through a programme of activity beyond that arising from mechanistic order placement⁵. They are achieved through 'procurement influence' and are separate from 'efficiency savings' which can arise e.g. from policy decisions to do something differently, such as to outsource a service.

² Department of Finance and Personnel, Public Procurement Policy, May 2002.

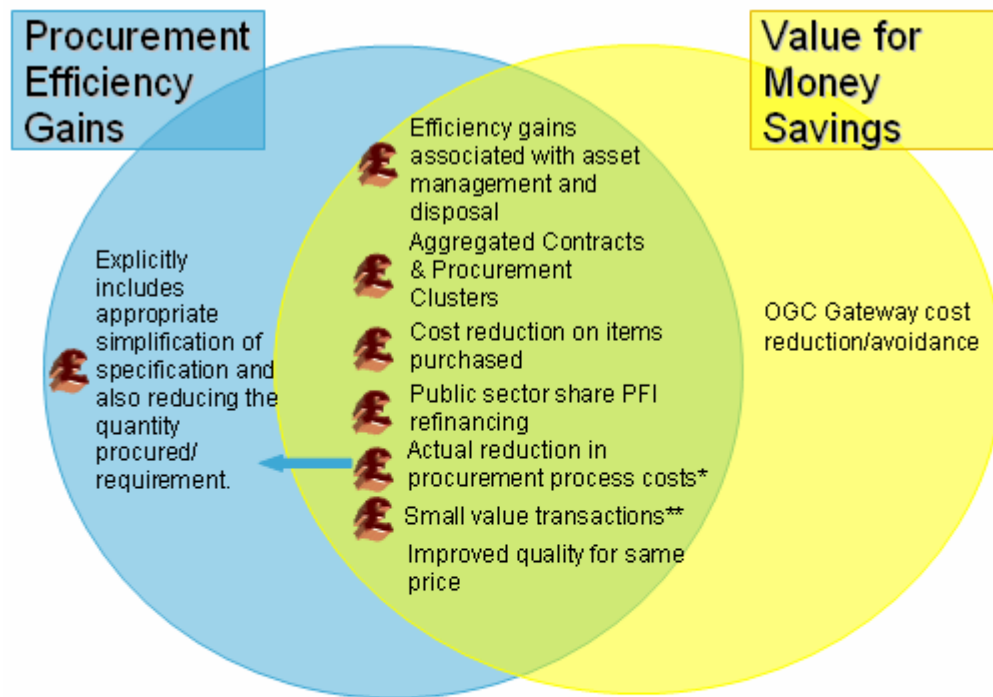
http://www.cpdni.gov.uk/pdf-public_procurement_policy.pdf

³ Procurement Efficiency and Value for Money Measurement, Office of Government Commerce, 2005

⁴ Procurement Value for Money and Efficiency Measurement, Central Procurement Directorate, 2005

⁵ eProcurementScotl@nd www.eprocurementscotland.com/toolkit/Documents/Value%20for%20money.pdf

Figure 1: Representation of VFM and Efficiency Savings and Gains Categories⁶



£ = cashable savings

* part of this gain might be attributed to the Efficiency Programme

** procured collaboratively or calculated using the Low Value Calculator where gains make up no more than 20% of total expenditure

19. Within the published methodologies, the measurement of VFM savings against total project costs is split into three components:

- (a) the investment cost – consisting of the capital cost of the asset or service;
- (b) the process management cost – this includes all the in-house and external costs of the procurement processes;
- (c) the lifetime operating or servicing costs – the costs of running, maintaining and disposing of the asset where appropriate⁷.

20. Where recurring procurements are concerned there is an expectation that suitable baseline data can be found and used to provide robust comparators. The most appropriate baseline will often be determined by the type of purchase and the procurement strategy being used. However, experience has

⁶ Procurement Efficiency and Value for Money Measurement, Office of Government Commerce, 2005 Page 4

⁷ Procurement Efficiency and Value for Money Measurement, Office of Government Commerce, 2005 S 5.7; Procurement Value for Money and Efficiency Measurement, Central Procurement Directorate, 2005 S 4.7

shown that there is a need to determine an approach that can be applied in situations where suitable comparative data is not available, in particular, for high value, innovative projects.

21. The concepts and principles discussed in this document are applied to the three components above to generate a reasonable assessment of VFM savings at the point the contract is executed.
22. Saving declared must be sustainable, after contract award as year-on-year comparative data becomes available, other operational procurement activity methodologies for efficiency and VFM measurement can be applied to verify and, if necessary, recalibrate the assessment of VFM savings reported. These relate to the actual and projected expenditure data and can be applied to reflect variations to the components during transition and steady state service delivery; the variations may then lead to the revision of the VFM or efficiency gains reported.

Purpose of this paper

23. The aim of the workshop was to determine how to measure the VFM savings achieved in relation to the three components through the use of professional procurement expertise and practices with a particular emphasis on innovative, strategic projects where there is little or no data against which to baseline the procurement process. The focus of measurement is the VFM saving; sustainability, positive social and environmental impacts or efficiency gains are the subject of separate guidance and are not considered within the scope of this document.
24. The purpose of this paper is, therefore, to present principles and concepts which will assist public sector procurement bodies baseline and measure these one-off, strategic procurements where the project is innovative and there is no appropriate, or comparable, data readily available upon which to base VFM calculations.
25. The individual procurement body must determine if the principles in this paper are appropriate to the procurement evaluation or whether other measurement methodologies should be applied.

What is a Strategic Procurement Project?

26. One definition of strategic procurement is 'the purchase of high value, high risk, strategically important and complex goods, services or works.'⁸
27. This definition may encompass certain recurring procurement projects which can be measured by existing mechanisms; the key words that apply to a procurement within the scope of this document are 'new', 'innovative', 'unique', 'never been done by the organisation before'. There is an expectation that these projects will be of relatively high value and often are the result of major policy decisions. It will also be difficult or impossible to find suitable comparative data within the sector to use as a baseline against which to

⁸ Procurement Guidance Note 07/04: Strategic Procurement, Central Procurement Directorate.

measure any VFM savings. Examples of the type of projects that would fall within the definition might include:

- (a) The acquisition of new enterprise wide software
- (b) The external sourcing of activities previously delivered by the public sector where employees are redeployed within the public sector and/or made redundant
- (c) The outsourcing of a function where the staff delivering the service transfer to the contractor
- (d) Capital equipment projects
- (e) Infrastructure projects

Public Procurement Legislation

28. The award of public contracts is underpinned by the European Public Procurement Directive⁹ as implemented into the UK legislation¹⁰. The legislation sets out the basic standards for the award of public contracts. These are derived directly from the rules and principles of the EC Treaty, namely the free movement of goods, the right of establishment, the freedom to provide services, non-discrimination and equal treatment, transparency, proportionality and mutual recognition. These standards apply not only to works, supplies and service contracts where the values exceed the published thresholds, but also to the award of service concessions, to contracts below the thresholds, for the services listed in Annex II B to Directive 2004/18/EC and areas of spend that are deemed exempt from the prescribed procedures.
29. The purpose of the legislation is to open up public sector spending to competition from potential suppliers throughout the EU, and for central government bodies under the World Trade Organisation, throughout the world.
30. The legislation seeks to enable Contracting Authorities to award contracts to either the lowest price tender or the Most Economically Advantageous Tender (MEAT) which balances qualitative and quantitative elements in the award process. VFM can be achieved when procurement professionals facilitate and influence a strategic approach to the procurement to ensure the Most Economically Advantageous Tender maximises the qualitative and quantitative returns from the public investment.

What is to be measured?

31. In terms of strategic procurement projects, the desire is to identify the VFM achieved by the procurement professionals applying commercial skills whilst working within the statutory and administrative frameworks as members of the multi-functional project team.

⁹ Directive 2004/18/EC of the European Parliament and of the Council on the Coordination of Procedures for the Award of Public Works Contracts, Public Supply Contracts and Public Service Contracts

¹⁰ 2006 No. 5 The Public Contracts Regulations 2006 [England, Wales and Northern Ireland]
2006 No. 1 The Public Contracts (Scotland) Regulations 2006

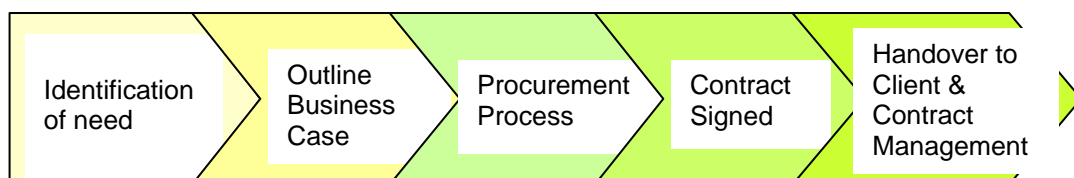
32. What is to be measured is the VFM savings achieved through the application of appropriate strategies and tactics, derived from best procurement practice, to identify and achieve the most economically advantageous tendered solution for the identified business need. The challenge is to determine how to identify an appropriate baseline against which the outcome of the procurement process can be measured where this type of comparative data is not readily available.
33. To ensure there is no double counting in respect of existing VFM and efficiency measurement practices, it was agreed that the reporting of procurement process VFM savings should be a stand-alone assessment based upon the individual project and the savings reported using the methodology outlined within this paper, identified by the project and its Team members.

Procurement Team Members

34. Part of the initiation stage of a strategic project is the formation of governance and delivery structures for the programme or project. These structures may be configured to PRINCE2 standards and the project or programme may be subject to peer, or Gateway, review. A multi-functional Project Team drawing on users, stakeholders, finance and procurement functions will report to a Board led by a Project Executive or Senior Responsible Owner (SRO).
35. Within the context of VFM savings assessment, it is the input from the whole multi-functional team, of which the procurement team members are a part, that will ensure the optimal solution is developed and selected. Therefore the assessment of savings achieved is attributable to the team rather than individual elements.
36. This multi-functional aspect is another reason for the VFM savings reporting process to be focused on the individual Strategic Project.

The Procurement Cycle

37. For the purpose of this paper a simplified procurement process is used to demonstrate the activity that is under consideration i.e. up until the contract is signed with the selected contractor(s).
38. The process may be managed under PRINCE2 and may be subject to peer, or Gateway, review at the stage boundaries.



39. After the contract has been formally awarded and signed, the implementation, operation and contract management rests with the client. In many organisations, the 'handover to client' stage is notional as the procurement staff involved in the competitive tendering process continue to be involved in

the implementation and operation of the project. However, this separation of stages is useful when determining the impact of the procurement process on the VFM savings achieved up to that stage.

40. Applicability of Approach

41. Reporting the VFM savings resulting from the procurement process alone is not the approach applied within the majority of the attending organisations which seek to capture a broad range of economic benefits generated by their operations. The approach detailed is necessary within the current reporting regime and does not preclude the reporting of non-cashable economic benefits. It was felt, for example, it would be beneficial in situations where the outcome of a procurement exercise resulted in a VFM procurement gain that the end-user, subsequently, spent on additional goods, services or works. Ultimately there may be no cash remaining as the procuring entity has been able to acquire additional goods, services or works.

42. For this reason, it was felt it was important that

- (a) The unit of assessment should be the individual Strategic Procurement Project.
- (b) The VFM savings identified and reported for the Strategic Procurement Projects should be treated as stand-alone records that informed any assessment of the procurement body's value adding activity.
- (c) The savings identified for all projects, routine or strategic, may be aggregated or may be reported separately to reflect the value of the involvement of the Procurement Unit. Care must be taken, however, to ensure that each project is only reported once.

43. These stand-alone VFM savings, reflecting the procurement process and investment cost component of the strategic project, will also feed into the existing VFM savings data and count, in the Central Procurement Directorate's case, against its Procurement Board's VFM savings target.

Potential Baselines

44. During the life of a strategic project, there are a number of stages at which the potential costs of its implementation are determined with increasing levels of accuracy.

Business Cases

45. At the very beginning, a Strategic Business Programme [SBP] may be developed to help define a number of projects in relation to an overarching strategy to achieve a policy decision. From this, one or more Strategic Outline Cases [SOC] may be developed to help scope the requirement, explore the potential routes, and give a general indication of likely costs.

46. From the SOC one or more potential options will be developed into Outline Business Cases [OBC] which, in turn, should lead to the selection of a preferred option to achieve the desired outcome.
47. As the process continues, projections are fine tuned and as a result the accepted OBC should be more robust and inform the more detailed planning stage of the investment. Its purpose is to check and demonstrate the affordability of the project and should indicate the likely budget that will be required. The OBC should also support the selected procurement strategy and reflect the ultimate implementation of the project. It is therefore one potential baseline against which to evaluate the VFM savings achieved by the procurement process.

Procurement Processes

48. Once the decision has been taken to proceed with the project, the procurement exercise begins. Depending on the project's complexity there are a number of procedures that may be followed – open, restricted, competitive dialogue or negotiated. The procurement professionals will select the most appropriate.
49. Under each procedure the 'first tenders' received will provide the first indication of the remuneration that the market will expect to receive in order to meet the requirement. This first tender stage is therefore a potential baseline.

Open/Restricted Procedures

50. Under the open and restricted procedures, the expectation is that the 'first tender' will be the only submission with the tenderers tasked to submit their most competitive offer. The tender represents the final contract cost; therefore the baseline would be represented by the OBC.
51. Caution must be exercised if the procurement is to be baselined on the OBC as the innovative nature of the project, and lack of comparator data, mitigate against the validity of the OBC. To rely on the OBC it is vital that the organisation is able to demonstrate robust and logical reasoning justifying the use of the OBC as a baseline.
52. Upon receipt, the procurement professional will condition the tenders to ensure that each meets the requirement, can be evaluated on a like-for-like basis and then determine the most economically advantageous tender. Part of this process will involve clarifying any issues prior to the award decision.
53. As the procurements within the scope of this paper will be new, innovative or unique to the procuring entity the expectation is that the requirement, solution, financial and legal structures will need to be discussed or negotiated with tenderers; consequently the Competitive Dialogue, or exceptionally the Negotiated procedure, will be appropriate.

Competitive Dialogue Procedure

54. Under the competitive dialogue procedure, the expectation is that there will be a number of tendering cycles each closed with the submission of tenders. The evaluation of tenders at each stage may be used to reduce the number of

tenderers or solutions until final tenders are received and an award decision made.

55. Competitive tension is maintained throughout the process as tenderers may be eliminated at each cycle if their tender is uncompetitive, consequently tenderers must ensure their tenders are accurate and competitive.
56. The dialogue is closed with the invitation to submit final tenders upon which the award decision is made.
57. The Most Economically Advantageous Tender received to close **each** tendering cycle is a potential baseline.

Negotiated Procedure

58. A structured negotiation process may share a number of characteristics with the Competitive Dialogue procedure e.g. closing periods of negotiation by the submission of tenders.
59. Again competitive tension is maintained by the possible elimination of a tenderer at each cycle. The Most Economically Advantageous Tender received to close **each** tendering cycle is a potential baseline.
60. In both the Negotiated and Competitive Dialogue procedures the Most Economically Advantageous Tender which is taken to contractual close becomes the comparator.
61. A number of potential baselines have been identified above that could be used to determine VFM savings achieved as a result of the applied procurement process:
 - (a) Outline Business Case [OBC]
 - (b) Most Economically Advantageous First Tender
 - (c) The Most Economically Advantageous Tender to close each tender cycle
 - (d) The Most Economically Advantageous Final Tender leading to the award decision (Best and Final Offer [BAFO])
 - (e) Final Contract Price

Which baseline should be used?

62. The approach to selecting the most appropriate baseline is founded on a number of simple rules ie the baseline should be
 - (a) Realistic
 - (b) Prudent
 - (c) Take a conservative approach , and
 - (d) Give recognition to the benefits achieved through the application of best procurement practice within the public procurement legislative framework
63. The Pros and Cons of the four identified baselines are presented in Table 1

Possible Baseline	In Support of	Against
Outline Business Case	<p>Tests and affirms the affordability of the project and option selected</p> <p>Stage at which the approval for the project to proceed is given</p> <p>Budget identified and funding allocated on basis of OBC projections</p>	<p>Costs are based on best information available which may be inaccurate.</p> <p>Market not yet tested</p> <p>Market conditions changing between OBC and going to tender may lessen the OBC's accuracy</p> <p>Refinements to the scope of the requirement and tenderers input may alter the accuracy of the OBC</p>
Most Economically Advantageous First Tender	<p>First opportunity to gain insight to level of remuneration that market will need to meet the defined requirement</p> <p>The accuracy of the baseline is enhanced if tenderers can be eliminated from subsequent cycles</p>	<p>The first tender cycle may be based on an immature requirement, financial model or draft contract. The baseline may be insufficiently robust.</p> <p>Tenderers will anticipate subsequent tendering cycles and may inflate first tenders for negotiation purposes.</p>
Most Economically Advantageous Tender at interim tendering cycles	<p>The baseline becomes more robust as the requirement, financial model and contract evolve towards final form.</p> <p>The procuring entity will have had the opportunity to update the financial business case ensuring tenderers remain within the affordability envelope.</p>	<p>Reportable VFM savings arising from professional procurement activities may be reduced.</p> <p>Tenders may remain inflated for negotiation purposes.</p>
Final Most Economically Advantageous Tender (Best and Final Offer)	<p>BAFO follows from tender conditioning, tender clarification and value engineering where action should improve overall VFM</p> <p>This is the actual market value of the solution.</p>	<p>VFM savings achieved by the work of the project team and structures are not recognised.</p> <p>If expected by the tenderers, earlier tenders may not be as competitive as possible to enable the tenderer to improve later</p>

	Earlier tenders may not be as robust.	submissions
Final contract price	Contract awarded with full information based on agreed specification and solution	There should be no difference between the final MEA Tender and the contract price. No recognition of benefit of professional procurement expertise and application of prescribed procedures

Table 1: Pros and Cons of Potential Baselines

Consideration of Potential Baselines

64. The applicability of each potential baseline is considered using a number of Case Studies. These are based on real-life examples. Their presentation has been simplified to demonstrate six potential scenarios. For each, the attendees considered the five potential baselines identified in Table 1.
65. Each project was considered to be strategic, was as a result of a policy decision and where it was difficult or impossible to find suitable comparative data to be used as a baseline against which to measure any VFM savings.

Case Study 1

Re-structuring of Bought-in Service

An investigation of the procurement profile of a sector's individual organisational units highlighted that significant funds, over £400m, were spent annually on the use of temporary staff. The sector took a strategic policy decision to move from a fragmented, unit-based, contracting approach to a prime-contractor service provision model under a national, coordinated, framework agreement.

The OBC identified that there was an expectation that the development of a co-ordinated national procurement strategy could lead to VFM savings through the aggregation of need and leverage of volume.

The central body completed an in-depth review of the type, grade and associated hourly rates paid by a number of the sector's organisational units and extrapolated this data to generate a baseline against which the future benefits of the proposed co-ordinated procurement could be measured.

The availability of a representative quantity of quality data, even though its collection and analysis was difficult and time consuming, did enable the sector to create a baseline that could be extrapolated to provide a robust, representative, baseline upon which to measure future activity.

Proposed reporting

Reported VFM savings could be identified against the baseline data identified from the historical research and actual VFM savings could be reported.

Only in a situation where there was a significant change in the volume and/or grade profile of staff engaged under the framework agreement would there be a need to revisit the identified baseline.

Commentary

66. This Case Study provided an example of a strategic procurement project where, with significant work, it was possible to identify source data and create a robust baseline against which the completed project could be measured. The major challenge here is not so much identifying the baseline but, over time, ensuring that that baseline remains relevant during the life of the project.
67. In the real life case, there was a significant change in how some categories of staff were employed / hired and, unusually, a decision taken to realign the baseline to better reflect the emerging usage of temporary staff.

Case Study 2

68. In most cases, the developed OBC indicates the anticipated costs of the project and budgets are allocated based on this information. The completion of the procurement, under the prescribed procedures, may lead to a lower

purchase price that, in turn, leads to a VFM procurement gain that is used for other purposes (buying additional or alternative goods, services or works).

Major piece of equipment

The procurement was for a new item of cutting edge equipment. The OBC and agreed, ring-fenced, budget was £3m.

Following the procurement exercise, the most economically advantageous tender resulted in a contract price of £2½m. Thus, the procurement exercise released a VFM procurement gain of £500k, which the organisation was then able to spend on other items.

Proposed reporting

The end result for the client organisation was increased purchasing leverage that was facilitated by the procurement process.

The difference of a £500k VFM procurement gain, between the OBC price and that finally paid, would be reported as a VFM saving for the Strategic Project.

Commentary

69. In this example, depending up the type of the equipment and its anticipated location, there may be occasions when similar equipment will have been purchased, installed and commissioned by another public or private sector organisation(s) giving comparable data that can be used as the baseline.
70. Where a comparator is not available, however, it was agreed that the baseline could be the OBC as it is the value that will be used to obtain budgetary approval; however there must be objective and robust justification underpinning its use otherwise the integrity of the assessment of savings may be undermined.

Case Study 3

71. There will be instances, however, where the most economically advantageous tender comes in above the budget figure indicated in the OBC. This situation can lead to a number of possible options, the extremes being that either additional funds are sought to meet the increased costs or the project does not proceed because it is deemed unaffordable.
72. Rather than rejecting the project, the procurement approach may be to review the specification and attempt to value engineer the requirement with the aim of developing a more cost effective solution that is acceptable to the end-user, meets the core needs of the requirement and comes in closer to the budget figure.

A new road.

The OBC and the agreed budget was £85m. The Invitation to Negotiate, most economically advantageous tender submission was £103m ie £18m over the available budget.

The Procurement Team (working closely with the key stakeholders) embarked on a major value re-engineering exercise and re-scoped

the requirement, bringing the project value down to the budget figure of £85m. The outputs remained the same, with costs saved e.g. by re-routing sections of the road which significantly reduced the amount of landfill and soil movements required.

Proposed reporting

Reported VFM savings would be £18m as the value engineering brought the procurement within the agreed OBC budget while maintaining the stated objectives of the project.

Had value engineering techniques not been applied and costs brought within budget it is understood that this particular project may not have proceeded.

Commentary

73. In such instances, it may not be reasonable to claim VFM procurement gains as a result of the value engineering, however, it was agreed that recognition should be given to the work of the Project Team in reducing the investment cost of the project.
74. The reduction in the need for all, or a proportion, of the additional cost should be reported as cost avoidance – if the project proceeds. The contention being that had the costs not been reduced and/or additional funds secured the project would not have proceeded. The need for any additional funds would, ultimately, be to the detriment of other planned project(s). The project generated wider economic benefits for the region additional to the VFM savings noted above; the VFM savings became a component of the overall benefit reported.

Case Study 4

Building Project

An OBC was prepared for the procurement of an innovative building that would be built, traditionally, using bricks and mortar. A budget figure of £3m was identified and the budget approved.

A restricted procedure was used and when tenders were received, the tenders ranged from £2.6m to £2.95m and there was one abnormally low tender of £1.45m. The procurement staff checked this submission and identified that it was for a pre-fabricated structure which would significantly reduce the resources needed to construct the building and would have a much earlier completion date. The pre-fabricated solution, however, did not meet the design specification.

The procurement decision was to stop the tender process and re-tender with an output based specification, seeking building solutions to provide the required accommodation rather than using a more prescriptive specification based on the building's actual construction.

The re-tendering exercise generated a number of different solutions and the most economically advantageous tender was selected with a

purchase price of £950k.

Proposed reporting

If the OBC is used as the baseline the reported VFM savings would be a VFM procurement gain of £2.05m (£3m OBC budget - £0.95m final cost) which would be unrealistic as the final solution selected was not comparable to that evaluated in the OBC.

The re-drafting of the specification and re-tender did result in an expectation of a significantly more cost effective solution, releasing in the region of £1.5m (£3m - £1.45m = £1.55m ie £1.5 approx.) from the budget at that stage. This could be reported as a VFM saving as a result of the re-tender.

It was felt that, in terms of the final solution, the use of the original OBC figure would lead to an over-statement of the VFM savings as it no longer reflected the ultimate solution selected. The VFM gain that could be reported is £500k (the difference between the original abnormally low tender of £1.45m and £950k).

Commentary

75. In this scenario, there are three options when determining the appropriate baseline, either

76. Use the original OBC

- (a) The danger here is that it no longer reflects the market conditions and while reflecting the basis of the allocated budget, prudence would indicate that where the costs appear to have dropped significantly, that action should be taken at this time to review the requirement, lower the budget figure and release the funds to other projects.

77. Re-work the OBC (in this Case Study, one based on a pre-fabricated solution)

- (a) A decision to re-work an OBC will not be taken lightly and is probably less likely to be considered necessary where the OBC has significantly higher value than the 'first tenders'.
- (b) Where the OBC has a significantly lower value, there will be a much stronger argument to re-visit it to re-assess the affordability of the project taking the tendered data into consideration in the OBC costings.
- (c) If the OBC is re-worked then it is this new valuation that would be used as the baseline against which the VFM savings will be measured.

78. Use a 'first tender' from the initial tender exercise as the baseline ie £1.45m if a pre-fabricated or £2.6m if a traditionally built solution was finally selected.

79. This Case Study illustrates the benefits of determining the baseline at the time the contract is signed. With hindsight, it is possible to select a baseline that is prudent, conservative, robust and reflects the economic benefits (which may be cashable or non-cashable) achieved through the procurement process.

Case Study 5

Software procurement

The procurement was for the development and implementation of new, innovative software throughout the sector's region. The aim of project was to reduce the waiting times of providing services to its client base by improving the utilisation of its finite resources.

The OBC identified a cost of £5.6m, this budget allocation was approved and the decision taken to proceed.

The requirement was tendered through the OGC S-CAT framework agreement, the project board intended to award the contract after one tender cycle i.e. Best And Final Offers were not contemplated.

Five tenders were received; all exceeded the affordability envelope, the Most Economically Advantageous Tender by £600k more at £6.2m. The project had the option of seeking additional resource as the project had strategic importance to service delivery and was an important component within an ICT investment programme.

Analysis of the tenders revealed that clarification was required in respect of certain terms, payment provisions and the service level regimes proposed. Although the specification was comprehensive and informed by business and market engagement, the procurement team identified a previously unforeseen opportunity to add value prior to award through the reduction of bidder risk premiums.

The project board decided to clarify these issues and invite Best and Final Offers from three tenderers who were advised their tenders had to fall within the affordability envelope which was disclosed.

Evaluation of the Best and Final Offers identified the Most Economically Advantageous Final Tender with a cost of £5.2m.

Proposed reporting

The reported VFM savings would be a VFM procurement gain of £400k as this was the difference between the OBC (and identified budget) and the final price. This £400k was released for use on other projects.

In addition, a cost avoidance value of £600k could be reported on the basis of the difference between the original tender submissions and the OBC. Had the tendering process not been robust and no clarification nor BAFO sought either additional funds would have had to been found (to the detriment of other potential projects) or the software procurement and implementation would not have proceeded.

Commentary

80. In this project, the procurement team had investigated and sought representation on all aspects of the client business impacted by the new application. The requirement and procurement strategy was informed by

substantial market engagement to ensure there was sufficient competitive interest to permit the award. However, on evaluation of the initial tenders, careful analysis by the procurement team showed there was an opportunity, which only became visible at that stage, to improve the service and reduce costs.

81. The reporting approach is conservative and prudent, the baseline has been set looking back at the end of the procurement process. VFM savings are being assessed as the difference between the final cost and the OBC rather than the difference between the final cost and first Most Economically Advantageous tender. The situation that arose where the first Most Economically Advantageous tender exceeded the budget (allocated on the basis of the OBC) also needs to be considered and recognised.
82. In a situation where the 'first tenders' all exceed the OBC there is the need for the procurement professionals to enable the Project Team members to make an informed decision on the likelihood of improving the initial tenders by clarification, value engineering or, if the procedure permits, negotiation.
83. A key element assuring the robustness of the tenders at the first stage was the intention to award with no further tendering cycles. Revising the procurement strategy to clarify and invite BAFOs was not envisaged at the start of the project and subsequently tenderers were required to submit BAFOs upon which the award decision was made.
84. If a BAFO is sought and the cost of the most economically advantageous tender at each stage improves then, depending on the cost of the final contract the VFM procurement gains may be cashable (as with the £400k in Case Study 5); or may be reported as cost avoidance reflecting the reduction in the amount of additional funds that would have been required had the professional procurement influence not been exerted; or may reflect wider (non-cashable) economic benefits generated.
85. Where the expectation is that there is little scope for improvement through value engineering then it will be necessary to either seek the additional funds if the project is to proceed or a decision taken not to proceed with the project.

Case Study 6

Broadband Provision

An OBC for the roll-out of broadband provision to the region indicated that costs would be approximately £18m. The OBC was based on substantial market intelligence and research on the number and service provision capabilities of providers and a budget was allocated.

The Procurement Team developed an innovative strategy and process, targeting the global telecommunications market with the intention of creating interest and generating competition. They conditioned potential participants to an aggressive process and, as a consequence, the number of tenderers and active competition was markedly increased.

The first Most Economically Advantageous tender submission was £17m i.e. a reduction of £1m compared to the OBC.

In accordance with the procurement strategy, a number of tenderers were eliminated at this point and a structured negotiation process conducted with the remainder, the intention being to invite a Best And Final Offer (BAFO) following intense negotiations.

Due to the negotiation strategy and tactics adopted by the Procurement Team, the process resulted in significantly improved commercial terms and lower costs than had been envisaged.

The result was that, following the submission of BAFOs, the contract award value was £9m. In addition the terms of the contract included provisions enabling the Procurement Team's client to share in increased revenues generated by the Contractor.

Post-award monitoring now indicates that the final contract value will be £7m.

Proposed reporting

The baseline chosen was the first Most Economically Advantageous Tender, rather than the OBC budget figure, as it was the commercial value placed on the contract by the tenderers. Further, they were aware that uncompetitive offers would lead to their elimination from the process. This first tender value was then compared against the final contract award value to determine a prudent and realistic reflection of the VFM savings gain achieved by the procurement process.

Had the procurement strategy and activities not been aggressive, creative and robust, the final contract cost would have been higher. Consequently, £8m was initially recorded (£17m - £9m) and this was later re-adjusted to £10m (£8m + £2m post award gain share).

Commentary

86. The savings reported are substantial and baselined using the first most economically advantageous tender as a true reflection of the requirement's commercial value. Had the Procurement Team not adopted its aggressive strategy, initially by proactively encouraging participation by global service providers and then, during the procurement process itself, generating and maintaining competitive tension; the contract costs would have been substantially higher and closer to the original OBC value.
87. Where the potential baselines e.g. the OBC (£18m) and first Most Economically Advantageous Tender (£17m) differ from BAFO (£9m) and the final contract value (£7m) there is a need to understand why this has happened. In this case, the significant reduction on the original OBC, and budgeted figure was due to the procurement strategy of aggressive market sounding and the conditioning of potential participants on a global basis. The outturn from these activities was the attraction of international competitors to challenge the local service providers.

88. In situations where the tenders differ substantially from the OBC and then reduce substantially the Procurement Team should identify the reasons for the differential. Where appropriate, the lessons learnt should be recorded and disseminated to others to help improve future project costings.
89. Savings arising from increased competition, which is a feature of the market and not generated by the procurement strategy or team's activities should not be claimed. A prudent approach may be to report a proportion of the VFM savings gain. This would reflect that the procurement project delivered VFM procurement gains, releasing the budgeted funds to use on other projects. However, it does not claim that the procurement exercise was the only reason for the achievement.

AGREED PRINCIPLES

90. Based upon the discussions, the following principles were identified and agreed:
- (a) The baseline and comparators must be realistic, prudent and robust. They should also be conservative.
 - (b) It is the impact of the procurement process on that project's component costs as appropriate that will be measured.
 - (c) Savings must be sustainable; if the contractual payment profile is changed any VFM savings should be recalibrated.
 - (d) The VFM savings should be reported as a stand alone measure for each individual Strategic Procurement Project.
91. This means that VFM savings can be aggregated and included in reports regarding the organisation's overall VFM or efficiency targets; the purpose of reporting against individual procurement projects is to ensure the impact of professional procurement practice on the project is effectively assessed and reported.
92. The baseline should be set at the stage at which the procurement professional staff become involved in the project as part of its multi-functional team
- (a) This should be, but is not always, at the OBC stage
93. The identification of the baseline should be made following the award of the contract using the benefit of hindsight to determine which is the most realistic position to use to give a reasonable assessment of the VFM savings achieved from the application of professional procurement processes.
- (a) The OBC (and approved budget) is a realistic baseline; however
 - i. Where the first Most Economically Advantageous Tender (MEAT) is significantly lower than the OBC it will be necessary to identify the reasons for the difference; and
 - ii. if appropriate, update the OBC and use the new valuation (first MEAT) as the baseline; or
 - iii. if not, use the first Most Economically Advantageous Tender where subsequent tendering cycles are used.

- iv. Most Economically Advantageous Tenders should only be used as a baseline where there is a measure which underpins their robustness e.g. where a tenderer may be eliminated if the tender is uncompetitive.
 - v. Where the final contract price is significantly different from the OBC or first Most Economically Advantageous Tender the Project Team should review their robustness, determine a reasonable value to use as the baseline and, having identified the reasons for the variations, ensure that these are prepared as a 'lessons learnt' information document and communicated to others to help to improve future OBC and tendering work.
94. Where the procurement process results in a higher initial tender being reduced and brought closer to or under the budget, report the reduction
- (a) as a cost avoidance down to the budget figure, and
 - (b) as VFM procurement gain if below budget.
95. In a situation where the baseline differs markedly from an available comparator, it will be prudent to analyse the reasons for the difference. In instances where the VFM savings are due to a significant shift in the supply market, the VFM savings should be reported with a commentary explaining the variation from the original OBC. The VFM savings are, however, real even though it is the shift in the market that has reduced the original budget requirement and released the funds for other uses. If the procurement body can demonstrate that changes in market conditions were attributable to the procurement strategy or tactics employed, VFM savings arising can be claimed. In circumstances where changing market conditions are a result of external economic factors the VFM savings may not be attributable to the efforts of the procurement team and the organisation should carefully consider the proportion of savings it should report as being down to its efforts.
96. A simple template e.g. (Appendix B) should be used when reporting achieved VFM savings. The template will provide a list of the project's available baselines, the reasons why a particular baseline was selected and the value of the gain(s) claimed.

Appendix A – List of Delegate Organisations

Northern Ireland Audit Office

Office of Government Commerce

Scottish Executive

Value Wales

Ministry of Defence

Central Services Agency Regional Supplies Service

NHS PASA

DFP Internal Audit

CIPFA

Central Procurement Directorate

Facilitator: figpc ltd

Appendix B – Reporting Template

Project Title:

Date of Report:

Potential Baseline	Value	No of Tenders	Commentary on Procurement activity
OBC	£	n/a	Date: <i>Commentary</i>
First Tender Cycle – MEAT	£	X	Date: <i>Commentary</i>
Second Tender Cycle – MEAT	£	Y	Date: <i>Commentary</i>
Others as appropriate			Date: <i>Commentary</i>
Last Tender Cycle [BAFO] – MEAT	£	Z	Date: <i>Commentary</i>
Final Contract Price	£	1	Date: <i>Commentary</i>

Selected Baseline:

Basis of Selection:

VFM Savings reported:

Signature:

Appendix B – Reporting Template – Worked Examples

Project Title: Case Study 3 – A new road

Date of Report:

Potential Baseline	Value	No of Tenders	Commentary on Procurement activity
OBC	£85m	n/a	Date: July 2003
First Tender Cycle - MEAT	£103m	<i>n</i>	Date: June 2004 The Invitation to Negotiate, most economically advantageous tender received was £18m over budget. A decision was taken to seek to value engineer the project with the hope of bringing it closer to the budgeted figure of £85m
Last Tender Cycle [BAFO] – MEAT	£85m	<i>n</i>	Date: November 2004 Following extensive value re-engineering negotiations, the tenderers were asked to submit BAFO. This included the re-routing of sections of road which significantly reduced the amount of landfill and soil movements required during construction. The most economically advantageous tender had a value of £85m. The contract was awarded on this basis
Final Contract Price	£85m	1	Date: February 2005

Selected Baseline: First Most Economically Advantageous Tender value of £85m

Basis of Selection: This was the available budget figure and no additional funds were available. Failure to provide the road within the allocated budget would have resulted in the road not being built.

VFM Savings reported: Cost avoidance of £18m being the amount by which the First Tender value was reduced to bring the project within budget

Signature:

Project Title: Case Study 5 – Software Procurement

Date of Report:

Potential Baseline	Value	No of Tenders	Commentary on Procurement activity
OBC	£5.6m	n/a	Date: September 2005
First Tender Cycle – MEAT	£6.2m	5	Date: April 2006 The requirement was tendered through the OGC S-CAT framework agreement. The intention was to hold a single tender cycle, however, the most economically advantageous tender received was £600k over the allocated budget. Clarification of the submissions was completed 3 participants were requested to submit a BAFO
Last Tender Cycle [BAFO] – MEAT	£5.2m	3	Date: September 2006 As part of the BAFO, the participants were advised of the available budget (£5.6m). Evaluation of the BAFOs resulted in a most economically advantageous tender of £5.2m
Final Contract Price	£5.2m	1	Date: September 2006

Selected Baseline: First Tender Cycle Most Economically Advantageous Tender of £6.2m

Basis of Selection: This was the first real test of the market

VFM Savings reported: The VFM Savings Gain has been divided into 2 elements
 a cash saving of £400k being the difference between the allocated budget from the OBC and the most economically advantageous BAFO [£5.6m - £5.2m]
 (b) a cost avoidance of £600k being the difference between the First most economically advantageous tender and the allocated budget from the OBC [£6.2m - £5.6m]

Signature:

Project Title: Case Study 6 – Broadband provision

Date of Report:

Potential Baseline	Value	No of Tenders	Commentary on Procurement activity
OBC	£18m	n/a	Date: January 2003 Value derived from benchmarking national market and limited number of regional suppliers.
First Tender Cycle - MEAT	£17m		Date: July 2003 Several tenderers eliminated.
Last Tender Cycle [BAFO] – MEAT	£9m	3	Date: February 2004 Aggressive and comprehensive negotiations with existing suppliers and new entrants attracted by the Procurement Team.
Contract Award Price	£9m	1	Date: April 2004
Post Award Monitoring of Cost and Benefits	£7m	0	Date: January 2006 Authority received £2m share of increased supplier revenue under the terms of the contract.

Selected Baseline: First Tender Cycle Most Economically Advantageous Tender of £17m

Basis of Selection: The value of the contract as determined by the tenderers.

VFM Savings reported: A cash saving of £8m at Contract Award followed by a further £2m savings quantified in post award monitoring.

Signature: