

# Modernising Procurement



Report by the  
Comptroller and Auditor General

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# Modernising Procurement

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Comptroller and Auditor General

National Audit Office  
11 October 1999

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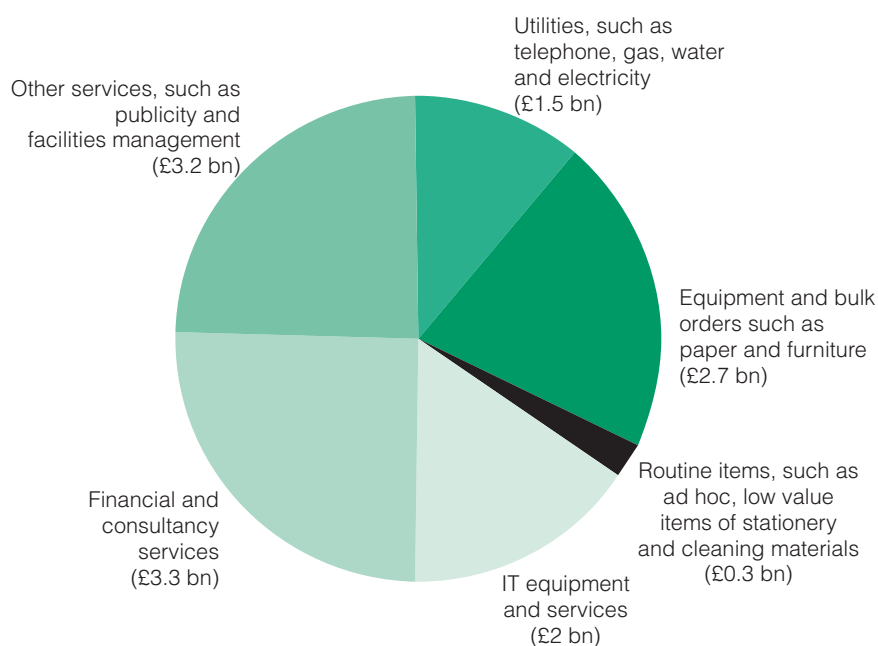
## Executive summary

**1** Procurement by departments and agencies is big business. Some 1,500 procurement staff spend an estimated £13 billion<sup>1</sup> a year on civil procurement – the equivalent of 2 to 3 pence on income tax on a range of goods and services (Figure 1). Procurement covers every aspect of the process of determining the need for goods and services, and buying, delivering and storing them.

Departments and  
agencies spend  
£13 billion a year buying

**Figure 1**

*Figure 1 shows goods and services bought by departments and agencies and their value*



Source: Treasury  
Procurement Group

**2** This report is not about the faults of the past. It is about the opportunities for the future. The examples it uses are examples of successes not failures. The purpose is to stimulate and encourage the development and dissemination of good procurement practice.

<sup>1</sup> Includes civil procurement in central government only; Ministry of Defence expenditure is excluded

**Improving the efficiency  
and cost effectiveness  
of government  
procurement is an  
important part of the  
Modernising  
Government agenda**

**3** Procurement is central to the management of any operation. It is vital to get the necessary goods and services of the right quality, at the right price and at the right time. Failure to do so can put the achievement of a department's or agency's key objectives and outputs, including services to the public, at risk and can result in additional costs. On the other hand stock piling of goods can be wasteful.

**4** The White Paper – Modernising Government published in March 1999 (Cm 4310) emphasised the importance of taxpayers getting best value from public money and to achieve this set out a programme to modernise the way departments and agencies carry out their business. Improving the efficiency and cost effectiveness of government procurement is an important part of the Modernising Government agenda.

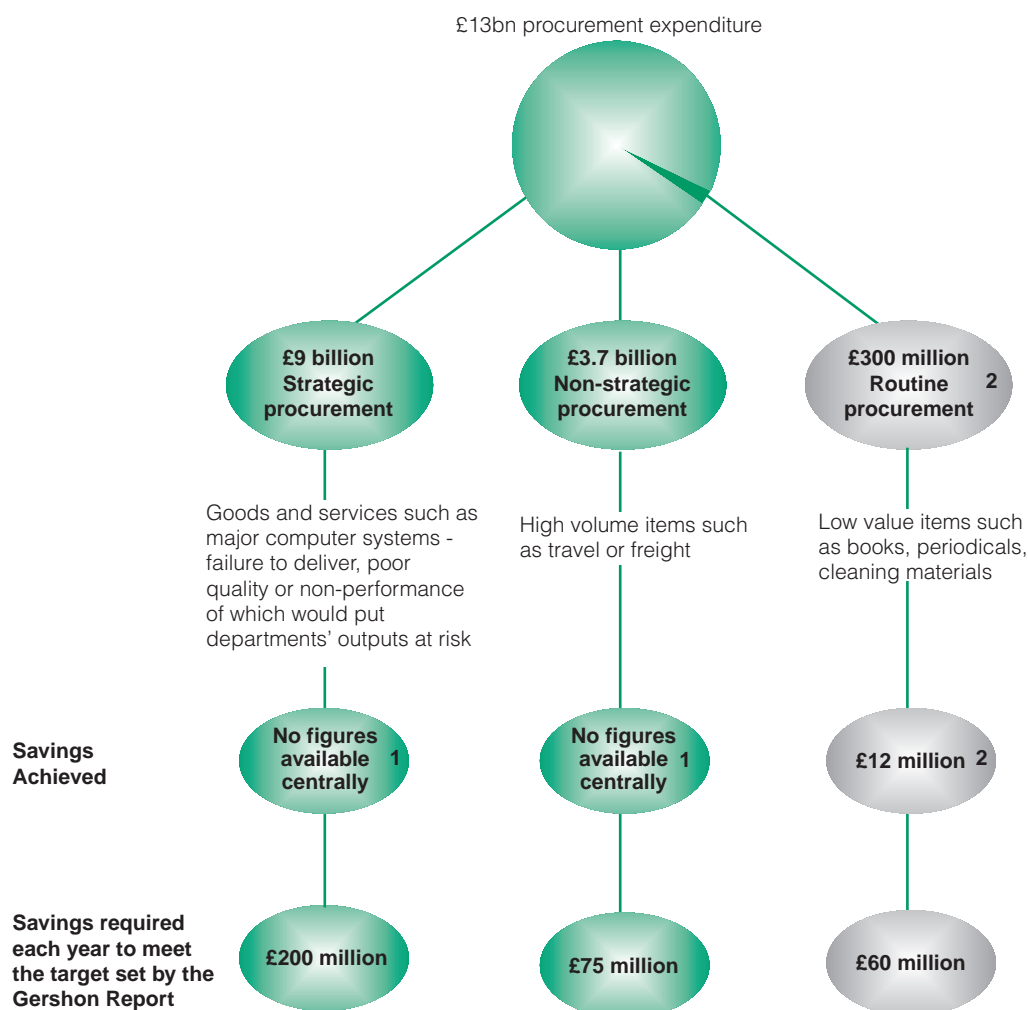
**5** Following an independent review of Civil Procurement in Central Government – the Gershon Report (completed in April 1999), the Government announced in July 1999 its intention to establish an Office of Government Commerce. This will be a single procurement central organisation bringing together many of the central departments and agencies which have a significant involvement in procurement for example, the Procurement Group of the Treasury and the Central Computer and Telecommunications Agency. The Office of Government Commerce will be responsible for formulating an integrated government procurement policy and strategy and will undertake procurement on behalf of departments and agencies where aggregation of purchasing requirements enables significant value for money improvements to be made.

**There is scope for significant price and efficiency savings in procurement**

**6** The Gershon Report concluded that there is scope to achieve significant value for money improvements through structural re-organisation of the centre and reform of departments' and agencies' current procurement arrangements. The Report set an overall value for money improvement target of £1 billion to be achieved through better procurement by the end of 2001-2. Figure 2 indicates the scale of the challenge ahead if these savings are to be achieved by March 2002. For illustration, the figure highlights the savings that might be achieved from routine procurement and it assumes the remaining savings could arise proportionally in the two main categories of procurement expenditure: strategic and non-strategic.

**Figure 2****Scope for annual procurement price and efficiency gains**

Figure 2 shows the broad split in the source of price and procurement efficiency savings that will need to be achieved annually for three years to achieve the savings target of £1 billion recommended by the Gershon Report



Notes: 1. Very few departments and agencies have reliable data on procurement expenditure or savings realised.  
 2. The £300 million routine procurement takes into account the £12 million savings already achieved.

Source: National Audit Office

**7 Strategic items** are those essential to the achievement of departments' key outputs for example, the development of a major computer system to process and pay grants or benefits. Key characteristics of such contracts are that they are high profile; the contract is high value relative to other contracts; and the services or goods cannot be clearly specified up front because of the need for further developmental work involving the contractor, so that choosing the right contractor is likely to be key to the success or failure of the project. The competitive process for strategic items, therefore, needs to allow for negotiation between the procuring

body and bidders about what is to be supplied, how risks are to be shared, a focus throughout the life of the contract on total costs and an incentivised relationship between the department and contractor for delivering the contracted project, to enable the partners to secure mutual benefits as the project develops.

**8** **Non strategic items** are high volume contracts for goods and services that are easier to specify and are not especially critical to the delivery of a department's key output. Examples might include expenditure on travel or bulk orders of stationery. A typical characteristic of such contracts is that they may not provide services directly to an organisation's customers and the organisation would be able to accommodate minor dips in the performance of a supplier for a non strategic item. Many of these items can be specified clearly enough to enable the project to be awarded to the lowest bidder, consistent with the specified quality standards.

**9** **Routine items** refer to the ad hoc purchase of low value items, such as a book, periodical or an item of stationery. Departments place some two to three million low value orders each year, with an average value of £100. But the administrative costs incurred in purchasing a low value item, equivalent to £25 to £100 for each transaction, can often equal or exceed the cost of the items themselves. Treasury advise departments to review periodically their arrangements for low value purchases and consider whether ordering and payment procedures could be streamlined. These are three key approaches to streamlining administrative costs of low value purchases: greater use of electronic commerce – communication by electronic networks; the Government Procurement Card – a corporate card to allow specified employees to buy items directly, to reduce paperwork; and greater use of framework agreements, an agreement to purchase specified items at agreed prices, to minimise contract letting costs by bringing together separate purchases into one contract. Many of the characteristics associated with the procurement of routine items, such as greater collaboration between departments and agencies when letting framework agreements are also applicable to non strategic items.

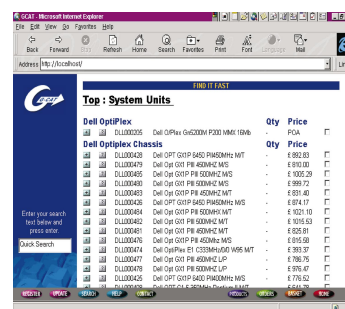
**10** This report (i) examines the initiatives which, prior to the establishment of the Office of Government Commerce, the Treasury has taken to promote improvements in procurement; (ii) looks at a number of examples of good procurement practice implemented by departments and agencies, and through our interviews with 22 heads of procurement in departments and agencies assesses the potential for the wider application of good practice. Electronic commerce, using electronic networks to simplify and speed up all stages of procurement, is essential to securing better value for money. We, therefore, also examined progress in procuring goods and services electronically.



i) **The Treasury has encouraged departments to improve their procurement practices**

**11** The Treasury has taken steps to improve procurement practice by:

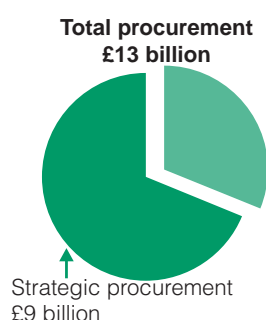
- The creation of the Government Procurement Service in April 1999 to include the 1,500 civil servants responsible for procurement and to enhance their skills and expertise. These staff remain located in their departments and agencies but become members of a recognised specialism within the civil service (paragraphs 2.36 to 2.39).
- Promoting better training, staff development and networking through conferences and seminars (paragraphs 2.37).
- The development of a system for appraising procurement based on the business excellence model developed by the European Foundation for Quality Management and 200 private companies across Europe which sets out a range of criteria for assessing performance (paragraph 2.40 to 2.42).
- The launch of the Achieving Excellence Programme in March 1999 to promote improvements in the performance of departments and agencies as purchasers of construction work (paragraph 2.45).
- The launch of the Government Procurement Card (the equivalent of a charge card) in October 1997 to promote more efficient routine purchasing of low value items such as books, periodicals, small items of equipment and cleaning materials (paragraph 3.6).
- The establishment, in January 1999, of the Government Procurement Website accessible from the Government Secure Intranet and Internet to facilitate better communication and collaboration between departments and agencies so that good practice can be more easily disseminated and opportunities for joint purchasing can be quickly identified (paragraphs 3.17).



## ii) There has been progress in implementing good practice but it needs to be more widely adopted

**12** Good practices developed by some departments and agencies have yet to be adopted fully by all central government organisations. We examined the approaches developed for strategic items and routine purchasing which are also generally applicable to non strategic high volume purchases.

### a) Strategic procurement



**13** The greatest potential for price savings is in the purchase of strategically important, often high value items. Departments and agencies spend some £9 billion annually on such goods and services ranging in value from under £1 million to over £2 billion. These goods and services are often more complex requiring careful risk management. If the savings target of £1 billion recommended by the Gershon Report is to be achieved then the procurement of strategically important goods will have to make the major contribution to this (paragraphs 2.1 and 2.5).

**14** There are a number of procurement routes which departments and agencies can adopt to acquire strategically important goods and services – through the public and private sector working together for example, in Private Finance Initiative (PFI) deals, and by departments and agencies buying goods and services directly themselves. We have examined a number of PFI projects and our report **Examining the value for money of deals under the Private Finance Initiative (HC 739 1998-99)** summarises principles of good practice in managing PFI projects drawing on our earlier studies (paragraph 2.7).

### Actively managing the procurement process can yield benefits

**15** We identified six principles which should be applied to achieve value for money when departments and agencies buy goods and services directly - **(i)** have a procurement strategy; **(ii)** plan early and agree requirements; **(iii)** actively manage contracts (we examined the Driving Standards Agency's initiative to use contractual incentives to ensure high standards in the delivery of the Theory Driving Test-Appendix 2); **(iv)** think about the supply chain (we consulted three private sector companies and examined the Ministry of Defence's Building Down Barriers Initiative to improve the management of supply chains in construction projects -Appendix 3); **(v)** seek continuous improvement; and **(vi)** monitor performance.

**16** We found, however, that departments' Public Service Agreements which are intended to set out how they will use their resources to deliver services cost effectively concentrated mainly on routine low value procurement and only one

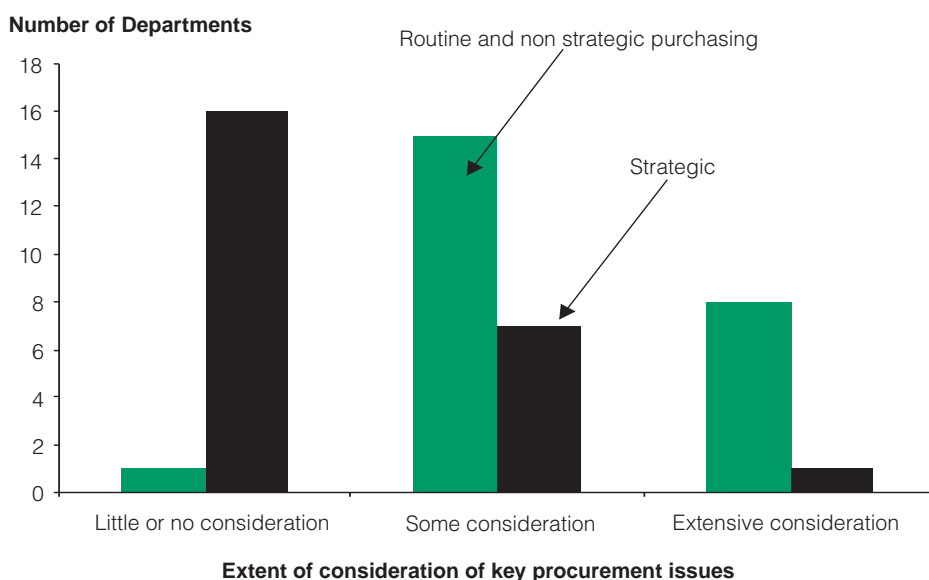
department considered a range of strategic issues, such as working with suppliers to improve product quality (see Figure 3). Heads of procurement are frequently consulted on the awards of contracts too late to have a major influence. There is scope for involving them more at an early stage in drawing up contract specifications which reflected the outputs required from suppliers and in defining criteria to monitor suppliers' performance (paragraphs 2.11 to 2.14).

**17** There is scope to make greater use of incentives in service contracts to improve supplier performance, to work more closely with major suppliers to achieve improvements and drive down costs; and to seek assurance that key suppliers are managing their supply chains and that the benefits that arise from this in terms of better quality and lower costs are being passed on to departments in the prices that they are charged (paragraphs 2.15 to 2.34).

**The extent that  
Departments' Public  
Service Agreements  
for 1999-2002  
Addressed Procurement  
Issues**

**Figure 3**

*Departments' Public Service Agreements tended to concentrate on procurement issues affecting routine items and non strategic procurement rather than strategic purchasing*



Source: National Audit Office  
analysis of Public Service  
Agreements 1999-2002

Note: Figure 11 gives a detailed analysis by department

## b) Routine procurement

**18** Departments place some two to three million low value orders each year averaging £100 each but the processing cost of making these purchases using traditional written orders can range from £25 to £100 per transaction. The Government Procurement Card (Appendix 4), electronic commerce (Appendix 5) and framework agreements can all significantly reduce processing costs (paragraphs 3.1 to 3.3).

**There is scope for further efficiency savings in the region of £70 million to £95 million from wider use of the Government Procurement Card and electronic catalogues**

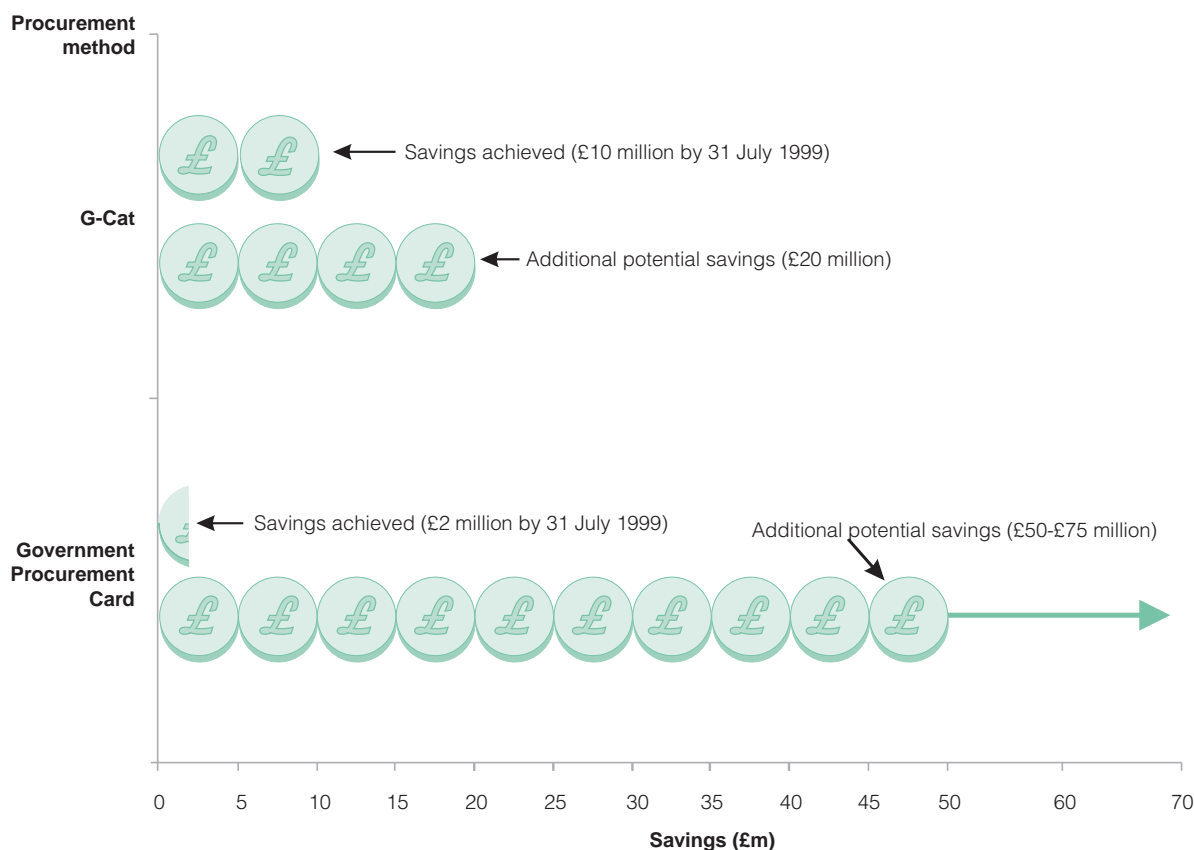
**19** Despite a major promotion campaign by the Treasury, take up of the Government Procurement Card has so far been slow. By June 1999 11 departments and 22 agencies and non-departmental public bodies had introduced it. In 1998-99 the Card was used for 70,600 transactions purchasing goods and services valued at £7.9 million. Since the Government Procurement Card was introduced in October 1997 departments and agencies have saved £2 million in purchasing processing costs. **We estimate that further efficiency savings of between £50 million to £75 million are achievable from wider use of the Card** (paragraphs 3.6 to 3.14).

**20** G-CAT is a catalogue of computer equipment, software programmes and related products managed by the Central Computer Telecommunications Agency. Using G-CAT to purchase computer related products can typically reduce ordering costs from £30 a transaction to 30 pence. Since April 1996 efficiency savings from using G-CAT are estimated to be £10 million. **We estimate that further efficiency savings of £20 million are attainable** (paragraphs 3.20 to 3.24).

**21** On framework agreements, there appears to be scope for further expansion of their use also leading to substantial savings. For example, one department joined with others in aggregating demands for furniture through a framework agreement and saved over £360,000 (11 per cent) on total expenditure of £3 million. While purchasing in bigger quantities can help departments use their buying power to secure price discounts the associated transaction costs, where the procurement is done through a separate buying agency, should be carefully monitored to ensure that they remain competitive and do not outweigh the price discounts achieved and the reduction in in-house processing costs. It is important that departments package their purchasing requirements in a way that allows them to take advantage of potential price discounts and that they have reliable market information to compare suppliers' prices (paragraphs 3.25 to 3.33).

**Figure 4****The scope for further efficiency gains in routine purchasing**

Figure 4 shows that there is scope for greater efficiency gains in routine purchasing



Source: National Audit Office analysis of VISA, Treasury Procurement Group and Central Computer and Telecommunications Agency management information

### Challenging targets have been set for implementing electronic commerce

**The Government has set the target that 90 per cent by volume of routine purchasing should be done electronically**

**22** Electronic commerce involves using electronic networks to simplify and speed up all stages of procurement including tendering, design and production for development projects, ordering, requisitioning, stock management, and monitoring delivery and supplier performance. Electronic commerce should provide better information about products, prices and suppliers to help ensure that departments and agencies get the best deal. It should also facilitate better communication between departments so that they can do more purchasing jointly. The Government has set challenging targets for the introduction of electronic commerce – 90 per cent by volume of routine purchasing should be done

electronically by 2001. But in July 1999, for example, less than one per cent of orders for goods and services on G-CAT, the government catalogue of IT products, were placed electronically (paragraphs 3.15 to 3.17).



**23** It is not clear what will contribute to the achievement of the electronic commerce target – whether it will include the relatively simple process of placing an order by telephone, fax or via an electronic catalogue with invoices paid through the Bank Automated Clearance System (BACS) or whether it should include the more complex process of transacting electronically with suppliers through all stages of procurement – tendering, assessing and monitoring prices and scheduling delivery. The risk is that without clearer definition procurement staff may focus their efforts on the former at the expense of more complex forms of electronic procurement which offer the most return in terms of efficiency and better prices (paragraph 3.18).

### **Better management information is needed if further improvements in value for money are to be achieved**

**24** Reliable management information on procurement performance is required if improvements in value for money are to continue to be made. The Modernising Government White Paper (March 1999) emphasised the importance of sound management information to compare performance against targets, between departments and with the private sector in order to achieve continuous improvement. Such information should typically cover what is bought, at what price, in what quantities and provide data on suppliers' performance in delivering goods to time, cost and quality requirements. Procurement staff need such information to:

- **Adopt a strategic approach** and target their expertise on the goods and services where value for money is most at risk in terms of potential missed opportunities to secure better prices and improve quality.
- **Benchmark prices** to ensure that they are getting the best price for the quality they require and have good market information on the range of prices on offer.
- **Assess the performance of the purchasing function – the procurement overhead** to ensure that internal administrative costs of procurement and external transaction costs, where goods are purchased through central agencies, remain competitive.

## Recommendations

**25** The Treasury has made good progress in promoting a number of initiatives to help departments and agencies improve their procurement. The four cases which we examined (Appendices 2-5) show some of the innovative approaches which departments are adopting, and the procurement staff to whom we spoke are all committed to achieving improvements. There remains, however, considerable potential to secure significant savings in terms of both better prices and more efficient procurement.

**26** In order to build on what has so far been achieved and to realise the significant price and efficiency savings and improvements in quality that are potentially achievable we recommend that the newly established Office of Government Commerce and departments and agencies should.

### For the Office of Government Commerce

- 1 Actively promote the achievement of the £1 billion procurement improvement target.** If the £1 billion target specified in the Gershon report is to be met by 2001-02, the Office of Government Commerce will need to take an active role in encouraging current procurement practices in departments and agencies to improve. In particular, the Office could examine by department/programme how this target might be broken down between strategic and routine purchasing by department and programme and agree a programme with departments on the timescale for achieving these targeted savings (paragraphs 2.5 and 2.9 to 2.12).
- 2 Develop a centre of expertise for the procurement of high value strategic items.** The Office should consider providing, through careful monitoring and the storing of expertise, up to date advice to departments and agencies on modern procurement practices (paragraphs 2.36 to 2.39).
- 3 Given the significance of electronic commerce to the Modernising Government agenda the Office might take further action to ensure that electronic commerce becomes a standard way of doing business for departments and agencies.** Effort is needed to promote the benefits of electronic commerce to departments and agencies focusing in particular on the use of the Government Procurement Website to facilitate more joined up purchasing; tendering electronically; and monitoring prices and suppliers' performance. Doing business electronically offers the potential of faster purchasing and more reliable up-to-date information to secure better prices (paragraphs 3.18 and 3.19).

- 4 Encourage further the initiatives to reduce the time spent on purchasing routine items.** The Government Procurement Card, electronic procurement and framework agreements can all help to reduce purchasing process costs and release procurement staff's time to target their expertise on higher value more strategically important goods and services. As yet, however, despite a major promotion campaign, there is considerable scope for departments and agencies to adopt these initiatives. The Office of Government Commerce should promote greater take-up of the Government Procurement Card in those agencies and non-departmental public bodies most likely to benefit significantly from using it. (paragraphs 3.13 and 3.14).

**For departments and agencies**

- 5 Better procurement** will depend on a cultural change in departments and agencies to give procurement staff the authority and management backing to influence all purchasing especially that of goods and services critical to the operation of the organisation. The Gershon Review found that, despite having sensible recommendations, previous studies of Government procurement had not fully succeeded because realistic implementation plans were not carried through and the necessary top-level commitment had been lacking. Departments and agencies will need the commitment of all levels of management to achieve better procurement and deliver the three-year savings of £1 billion identified by the Gershon Review.
- 6 Have better management information** about the amount they spend on procurement, on what, and to which suppliers. Such information is essential to benchmark prices to ensure that they remain competitive, to monitor suppliers' performance, and to ensure that the cost of departments' and agencies' purchasing function - the procurement overhead remains reasonable (paragraph 2.12).
- 7 Actively manage contracts.** High value strategic procurements are generally more complex and carry greater risks. Too often procurement staff are brought into the procurement process too late after key decisions have been taken. They need to be involved at an early stage to ensure that they understand market conditions, in particular, cost drivers and the latest technological solutions; to identify the risks and develop risk management strategies; draw up tender specifications which are output based and reflect user needs; and that they plan a contract management strategy with appropriate performance measures (paragraphs 2.15 to 2.18).



**8 Collaborate with suppliers to achieve continuous cost and quality improvements.** Working closely with suppliers can drive costs down and improve the quality of complex, longer-term contracts for services or products. It does not necessarily mean increasing the risk of financial impropriety if appropriate oversight mechanisms are in place, for example clear definition of responsibilities and proper monitoring of supplier performance (paragraph 2.33).

## Part 1: Why procurement matters

**1.1** Procurement covers every aspect of the process of determining the need for goods and services, and buying, delivering and storing them to help achieve departments' or agencies' key objectives and outputs. Excluding military equipment and construction, government departments, agencies and non-departmental public bodies<sup>1</sup> spend in excess of £13 billion a year on a range of goods and services.

**1.2** This part of the report explains why the National Audit Office undertook an examination of procurement practices in departments, agencies and non-departmental public bodies. In particular:

**Why government procurement is important.** There are a wide range of different procurement practices and the need for improvement is a core element of the Modernising Government agenda

**What is value for money in procurement.** The key approaches to achieving efficiency savings.

**Recent developments and the establishment of the Office of Government Commerce.**

**How we examined the progress which departments and agencies are making.** In particular how we identified the key elements of procurement expenditure and the organisations we contacted.

**1.3** This report is not about the faults of the past. It is about the opportunities for the future. The examples it uses are examples of successes not failures. The purpose is to stimulate and encourage the development and dissemination of good procurement practice. In March 1999, the Government published the White Paper - Modernising Government (Cm 4310) which emphasised the importance of taxpayers getting best value from public money and to achieve this set out a programme to modernise the way departments and agencies carry out their business. Improving the efficiency and cost effectiveness of government procurement is a central part of the Modernising Government agenda. The National Audit Office recognises that successful implementation of this agenda will require new methods of working. We will support well thought through risk-taking and innovation in such circumstances.

<sup>1</sup> A body which has a role in the processes of government, but is not a government department, or part of one, and which accordingly operates to a greater or lesser extent at arm's length from Ministers.

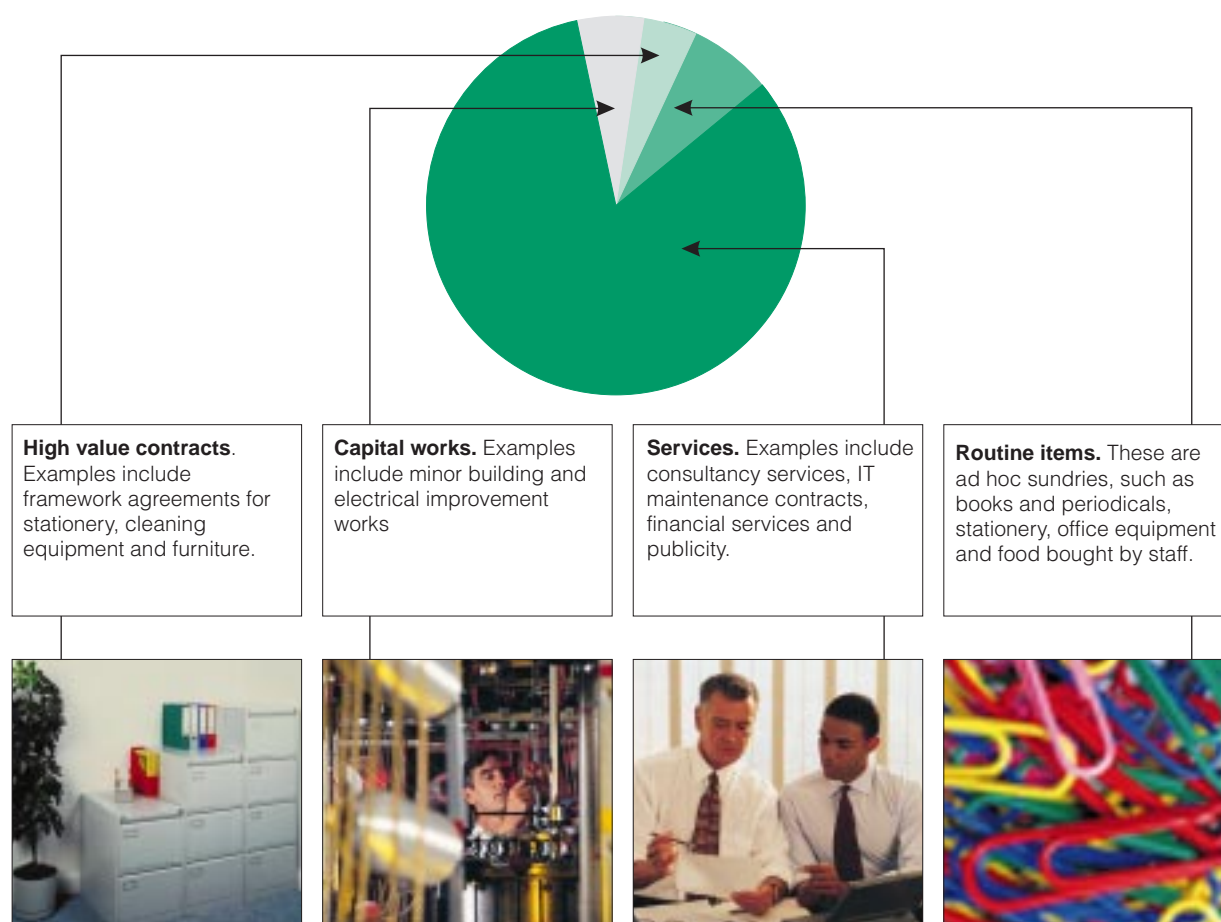
## i) Why Government Procurement is important

**1.4** Purchasing is central to the management of any operation. It is vital to get the necessary goods and services of the right quality, at the right price, and at the right time. Departments, agencies and non-departmental public bodies have to purchase a wide range of goods and services to fulfil their key objectives and deliver their core activities. Figure 5 gives an example of the range of products bought by one department – the Department of Trade and Industry.

**Figure 5**

**Typical goods and service bought by the Department of Trade and Industry in 1998-99**

*This figure shows that Department of Trade and Industry expenditure on procurement is mostly for services (85 per cent), such as IT maintenance, financial services and publicity*



Source: Department of Trade and Industry

**1.5** Departments have a wide range of possible options when making purchasing decisions such as outsourcing an entire activity, awarding individual contracts for goods or services, collaborating with other departments to purchase jointly or purchasing through a central buying agency (Figure 6). Out sourcing and the Private Finance Initiative have meant a shift in focus by departmental managers to think in terms of the purchase of whole services such as the management of prisons, rather than buying the goods necessary for civil servants to deliver or manage the service. This has highlighted opportunities for improvements in quality of service and for cost reductions. It has also emphasised the need for departments and agencies to draw on a range of good practice in buying goods and services to support those operations which they still manage directly.

**The four main approaches to buying goods and services**



Source: National Audit Office

**1.6** Cost-effective procurement depends on specialist skills to ensure that buying requirements are reliably determined; appropriate contract strategies are developed; contracts are well managed; and that opportunities to get the best deal are taken by having good market knowledge and by departments working together to maximise the influence which their considerable buying power gives them to get the best price. There are some 1,500 staff involved in some aspect of procurement who can get advice, guidance and practical assistance from the Treasury and the Cabinet Office and central buying agencies.

**1.7** The amount of money spent by departments and agencies on buying goods and services each year means that just a one per cent procurement efficiency improvement would equate to £130 million. In July 1999 the Government announced their intention to establish the Office of Government commerce which will subsume the activities of the Treasury, Cabinet Office and central buying agencies in developing procurement expertise, promoting better purchasing by departments and encouraging good practice.

## **ii) What is value for money in procurement**

**1.8** Better value for money from procurement can be achieved in many ways, for example:

- Getting an increased level or quality of service at the same cost.
- Avoiding unnecessary purchases.
- Ensuring that user needs are met but not exceeded.
- Specifying the purchasing requirement in output terms enabling suppliers to recommend cost-effective and innovative solutions to that need.
- Optimising the cost of delivering a service or goods over the full life of the contract rather than minimising the initial price.
- Introducing incentives into the contract to ensure continuous cost and quality improvements throughout the period of the contract.
- Aggregating transactions to obtain volume discounts.

- Collaboration with other departments to ensure that the best prices are obtained and better discounts from bulk buying are obtained.
- Reducing the cost of buying goods or services by streamlining procurement and finance processes.
- Reducing the level of stocks held.

**1.9** These improvements in value for money fall into two main categories – (i) those aimed at reducing the cost of purchasing and the time it takes for example, the administrative effort in processing an order, seeking and evaluating tenders, and taking delivery of the goods ordered. This effort is the procurement overhead and can typically add between 10 to 50 per cent to the cost of buying goods and services (ii) the price of the goods and services charged by the supplier and the quality of services provided.

**1.10** Buying goods and services through competition remains the best way of ensuring the best price for the quality of service required. But it is not always appropriate nor cost-effective for low value items, complex goods and services or where no well developed market exists. Increasingly, value for money depends on combining competition with innovative ways of procurement while managing the risks associated with innovation effectively, and drawing on latest advances in electronic commerce and good procurement practice.

### **iii) Recent Developments and the establishment of the Office of Government Commerce**

**1.11** Until the 1990s procurement by departments and agencies relied on traditional purchasing methods --competitive tendering, fixed price contracts, bulk buying and large stock holdings. Contracts rarely contained incentives to promote better supplier performance and working with suppliers prior to letting the contract was usually limited to post-tender negotiations. There was little collaboration with other departments and agencies except through the use of some of the central buying agencies. Since 1993 a number of reviews have attempted to improve government procurement. Figure 7 provides a summary and chronology of the key developments.

## Chronology of Key Events in Procurement

**Figure 7**



H M Treasury

**1984 Government Purchasing: A multi-departmental review of Government contract and procurement procedures.** The main recommendations were that methods of procurement should be improved, there should be changes in the organisation of procurement in departments and that departments should be formally untied from the Crown Suppliers and Central Computer and Telecommunications Agency by April 1987.



H M Treasury

**1993<sup>1</sup> Organisation of Procurement in Government Departments and Agencies.** This Treasury Paper highlighted the fragmentation of the procurement function due to the devolvement of responsibility and operations from departments to agencies. It advocated that each department develop a clear strategy for its procurement.



1991-1995

**Enactment of EC Directives.** Several EC directives were incorporated into UK legislation. The fundamental principles of the Directives are that there should be an equal opportunity to bid for work without discrimination on grounds of nationality, that the award criteria should be stated clearly at the outset, and that there should be transparency in the award decision.



H M Treasury

**1995 Setting New Standards White Paper.** The paper recognised recent developments, such as outsourcing and the Private Finance Initiative and that procurement staff now have to work to a new strategy. The paper set out this strategy by defining procurement and emphasising new standards, in particular: fair competition; whole life costing; a step change in professionalism; benchmarking; and a new statement of best practices.



Procurement Group

**1998 The PX study.** The PX Committee, as part of the Comprehensive Spending Review commissioned a study of how procurement practices might be modernised to generate efficiency savings. The report identified 42 action points. In particular, that:

- electronic procurement will be everyday practice in three years
- joint procurement strategies will be pursued by departments
- procurement performance will be benchmarked
- by 2000, most procurement staff in key posts will have a professional qualification.
- Treasury will monitor progress and report back to the Prime Minister every six months.



H M Treasury

**1998 Modern Public Services for Britain: Investing in Reform.** This White Paper summarises the Comprehensive Spending Review - how public expenditure has been reallocated to match government's priorities. The paper emphasises that efficiency savings are an essential component and it summarises the findings of the PX report.



H M Treasury

**1998 Public Services for the Future: Modernisation, Reform, Accountability.** This White Paper publishes measurable targets for all government services in Public Service Agreements. These agreements specify departmental strategies for achieving efficiency savings from procurement.



H M Treasury

**1998 Tackling the Improvement of Public Sector Procurement.** The Prime Minister commissioned Mr Gershon, managing director of Marconi Electronic Systems, to identify efficiency, modernisation and competitiveness gains in central government procurement. Mr Gershon reported in April 1999.

**1999 The Office of Government Commerce.** In July 1999 the Government decide to establish this new body to promote further improvements in government procurement.

Source: National Audit Office

Note 1: In 1993 the Procurement Group was the Central Unit on Purchasing.

**1.12 The White Paper: Setting New Standards May 1995 (Cm 2840).** This defined a new strategy for procurement emphasising the importance of innovation drawing on proven private sector practices. It recommended that the costs and benefits of a service or product should be considered over the whole of their working life not just the lowest initial procurement price. The White Paper stressed that best practice procurement should be a central element in departments' businesses and that departments should collaborate to achieve value for money.

**1.13 The PX Report.** In January 1998, the Ministerial Cabinet Committee on Public Expenditure (PX) commissioned a study to take forward efficiency issues in procurement arising from the Government's Comprehensive Spending Reviews. The terms of reference were "to work with departments and others to assess how central Government can secure continuous improvement in value for money from civil procurement of all goods and services over the lifetime of this Parliament and beyond". The PX Report was published in July 1998 and made 42 recommendations to take advantage of electronic commerce, collaboration and joint procurement, performance measurement and procurement staff development. The key findings of the PX Report are summarised in Figure 8.

**1.14 Implementing the PX Report.** The Treasury<sup>2</sup> had responsibility for developing procurement expertise in departments and agencies and promulgating good practice and was specifically charged with implementing certain recommendations from the PX Report. In April 1999 the Treasury reported to the Prime Minister on progress in implementing the PX Report. The Treasury found that departments and agencies had responded positively to the Report and that progress in implementing its recommendations was good – progress is covered in more detail in Parts 2 and 3 of this Report. The Treasury identified, however, a number of key factors which had prevented further progress:

- **Loss of skilled procurement staff.** There are some 1,500 designated procurement posts, of which 44 per cent are filled by qualified staff and a further 28 per cent by people studying. Some 250 qualified and experienced staff had left, of whom 72 per cent were within 12 months of qualification; a loss of training investment of £2.7 million.

2 The Treasury Procurement Group consisted of 22 staff drawn from industry and departments who had a range of procurement expertise. The Director of the Procurement Group reported to the Permanent Secretary at the Treasury.



**Key Findings of the  
PX Report on Efficiency in  
Civil Government  
Procurement**

**Figure 8**

*This table shows the key actions required following the PX report and, in particular, those actions which fall to the Treasury to carry out*

Key Findings:	Actions Required:
<i>There is a new agenda for procurement: key developments, such as the Modernising Government Agenda and the information age require change</i>	<ul style="list-style-type: none"> <li>■ Better communication between procurement staff, senior management, and auditors</li> <li>■ Organisations to have a clear strategy for procurement, improved information on performance and better procedures.</li> </ul>
<i>Greater use of electronic commerce</i>	<ul style="list-style-type: none"> <li>■ A phased introduction of electronic commerce. Treasury and CCTA to develop facilities on the Government Secure Intranet (GSI).</li> <li>■ Departments to give staff access to the GSI, to add information to the GSI, to collaborate with framework agreements and to implement the procurement card.</li> </ul>
<i>Government needs to improve its purchasing power</i>	<ul style="list-style-type: none"> <li>■ Departments to collaborate by better networking between procurement staff, and agreeing joint contracts for common goods and services.</li> <li>■ Central procurement agencies to improve their profile within government and to ensure they respond to departments needs.</li> </ul>
<i>Improved performance measurement</i>	<ul style="list-style-type: none"> <li>■ Treasury and the Cabinet Office to develop a model for performance measurement of procurement based on the Business Excellence Model.</li> <li>■ Departments to benchmark performance and share experience.</li> </ul>
<i>Better staff development in procurement</i>	<ul style="list-style-type: none"> <li>■ Treasury to instigate a professional government procurement service and to keep a record of all procurement posts.</li> <li>■ Departments to train managers and all staff in procurement posts in procurement.</li> <li>■ By 2000, three quarters of the members of the Government Procurement Service should be working towards a graduate level procurement qualification.</li> </ul>

Source: HM Treasury/Cabinet  
Office PX Report (July 1998)

- **The paper based procurement process.** Much of procurement is still transacted on paper, including the issue and receipt of tenders and the payment of invoices. This is expensive in terms of both the time and effort required to make purchases. A significant number of departments are still not using the Bankers Automated Clearing System (BACS) or other electronic payment methods to pay invoices.

- **Structure and culture.** Procurement is undertaken by departments and central buying agencies. The Treasury Procurement Group, the Private Finance Initiative Taskforce and others offer advice. The culture is risk averse, rule driven and resistant of change.
- **Poor identification and measurement of procurement expenditure.** Expenditure under procurement control is not measured directly. There is no coherent means of measuring the added value which procurement makes to the business efficiency and effectiveness of departments and agencies.

## **Establishing the Office of Government Commerce**

**1.15 The Gershon Report.** In November 1998 the Government commissioned Peter Gershon, Managing Director of Marconi Electronic Systems to review civil procurement in central Government in the light of the Government's objectives on efficiency, modernisation and competitiveness in the short and medium term. The Review considered six aspects of current procurement arrangements to determine their efficiency and effectiveness and reported in April 1999. The Report recommended the creation of a new body, the Office of Government Commerce to formulate an integrated procurement policy and strategy, to undertake procurement on behalf of departments and agencies where aggregation of requirements enables significant value for money improvements to be made, and to promote a culture that was less risk averse and resistant of change. Figure 9 summarises the findings of the Gershon Report.

**1.16** In July 1999 the Government announced their intention to establish the Office of Government Commerce which will subsume the activities of the Treasury Procurement Group, the Private Finance Initiative Policy Group, the Buying Agency, Property Advisers to the Civil Estate and the Central Computer and Telecommunications Agency.

**Figure 9**

### Gershon Review of Civil Procurement in Central Government Summary of findings and recommendations

Findings	Recommendations
<p><b>1. Policy</b></p> <p>Past decentralisation and delegation to departments has led to wide differences in the approach to procurement and no common framework exists in which departments have to operate. Practice in procurement varies from the best in class to the worst.</p> <p>On gas and electricity, the lowest prices obtained by departments were comparable with the best secured in the private sector but the highest prices exceeded the lowest prices by 140 per cent for gas and 66 per cent for electricity.</p>	<p>Establishment of a common strategic framework:</p> <ul style="list-style-type: none"> <li>■ Standard procurement process</li> <li>■ Common performance measures</li> <li>■ Key standards</li> <li>■ Key values</li> </ul>
<p><b>2. Organisation and structure</b></p> <p>Fragmentation and lack of co-ordination of central activities result in the centre lacking the necessary clout to lead Government procurement into the 21<sup>st</sup> century.</p> <p>There is no single body accountable for the deployment of resources involved in central procurement activities and this results in a sub-optimal use of these resources.</p>	<p>Creation of a new central organisation, the Office of Government Commerce with a Supervisory Board to provide top-level support and strategic direction. The Board would include the Chief Secretary to the Treasury, as chairman, senior officials from Government departments, the Chief Executive and an observer from the National Audit Office.</p>
<p><b>3. Process</b></p> <p>There is no well-defined common process for managing large, complex or novel procurements.</p> <p>No common cross-departmental process exists for the management of the associated supplier base resulting in differential pricing.</p>	<p>Implementation of a common process for the strategic management of large, complex or novel procurements with distinct phases in their life cycle with associated deliverables to be assessed by the Office of Government Commerce before the project could progress.</p> <p>The Office of Government Commerce to develop a common process for the management of the supplier base and define the role of the Office in the management of the overall relationship with suppliers.</p>
<p><b>4. Measurement</b></p> <p>There are no common systems across Government:</p> <ul style="list-style-type: none"> <li>■ To record what is purchased, associated prices and sources of supply;</li> <li>■ To analyse the true cost of procurement transactions;</li> <li>■ To rate the capability and performance of suppliers;</li> <li>■ To target and measure value for money improvements from the procurement function.</li> </ul> <p>Adoption of e-commerce in Government procurement is at risk because of the lack of information about the benefits.</p> <p>If the Department that paid the highest price for electricity had had the benefit of the lowest rate, the saving would have been almost £2.5 million a year.</p>	<p>The Office of Government Commerce should, with departments:</p> <ul style="list-style-type: none"> <li>■ Define common ways of recording what is bought, prices and sources of supply;</li> <li>■ Produce a common system for rating the capability and performance of suppliers;</li> <li>■ Develop a common system for measuring value for money improvements for both cost reduction and avoidance.</li> <li>■ Departments should implement systems to measure the true cost of procurement transactions.</li> </ul>

continued..

**Figure 9**

**Gershon Review of Civil Procurement in Central Government Summary of findings and recommendations *continued***

Findings	Recommendations
<p><b>5. People</b></p> <p>Levels of skill, capability and seniority in the Procurement service need to be raised significantly.</p> <p>There is too much focus on low value procurement and insufficient involvement in critical procurements such as outsourcing or Private Finance Initiative contracts where qualified staff could add the greatest value.</p>	<p>In departments with large procurement expenditure, the Head of Procurement should be a grade 3 reporting direct to the Permanent Secretary and such appointments would require Office of Government Commerce approval.</p> <p>The Office of Government Commerce should identify why it is difficult to recruit and retain professional procurement staff and develop an action plan to remedy the matter.</p>
<p><b>6. Supply base</b></p> <p>Government procurement is seen to be fair and open.</p> <p>Civil Service is risk averse and normally adopts the least initial cost option rather than using value for money criteria to judge proposals.</p> <p>Innovation is not encouraged and requirements are prescriptive rather than describing the required output and performance levels.</p> <p>Tendering to Government is burdensome and costly to suppliers.</p>	<p>Departments need to be more sensitive to the burdens which they place on suppliers.</p> <p>In some sectors, the Office of Government Commerce needs to determine whether the base of suppliers is broad enough to maintain competition and innovation and to take appropriate action to stimulate the interest of potential suppliers.</p>

Source: Review of Civil Procurement in central Government (April 1999)

#### **iv) How we examined the progress which departments and agencies are making**

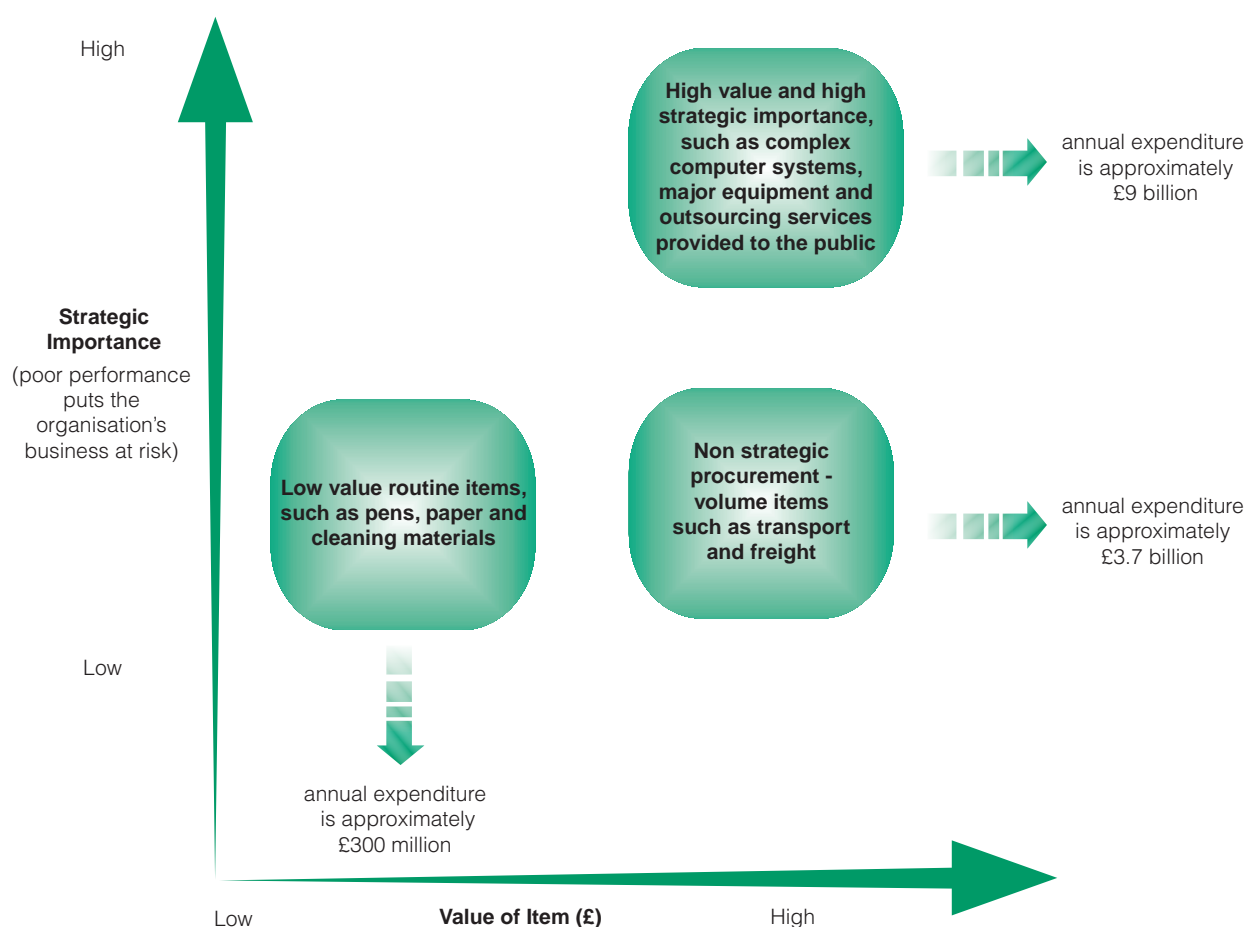
**1.17** In light of the significant amounts of money spent on buying goods and services and the potential for better value for money identified by a number of reviews (Figure 7) we examined the progress which departments and agencies have made in implementing the good practice promoted by the Treasury.

**1.18** Goods and services can be categorised according to their value and their strategic importance to a department or agency (Figure 10). For example, a good is strategically important if its non- performance or late or non delivery would put the achievement of the organisation's key objectives and outputs at risk. The most appropriate and cost effective procurement approach will, therefore, be influenced by the types of goods and services being bought. We reflected this distinction in our examination.

**Figure 10**

**Goods and services typically bought by departments and agencies are usually of two broad types**

Figure 10 shows the categorization of each procurement by strategic importance and value draws out three broad groups: strategic; non strategic and routine procurement







Source: National Audit Office

- **Part 2** considers more strategically important goods and services; and
- **Part 3** examines the approaches most appropriate and cost-effective for routine lower value items.

**1.19** Non-strategic items are contracts for often high volume purchases such as transport, travel tickets and bulk orders of stationery that are not necessarily essential to the delivery of a department's key output. The best procurement approach for high volume non-strategic items will often be similar to that best suited for low value items and sometimes for strategic goods and services. For example, framework agreements<sup>3</sup> can reduce the cost of high volume non-strategic

goods such as stationery but framework agreements can be equally appropriate for low value routine items. We discuss framework agreements in Part 3. The factors determining the best approach for high volume non-strategic goods will be volume of purchases and the degree of risk associated with them.

**1.20** In undertaking the study we:

- Carried out four case study examinations of initiatives to improve procurement:
  - Contractual incentives. How the Driving Standards Agency uses incentives to manage contracts for the theory based driving test (Appendix 2) 
  - Supply chain management. How Defence Estates in the Ministry of Defence has trialled supply chain management techniques to minimise costs and improve quality (Appendix 3). 
  - Procurement Card. How the Forensic Science Service implemented a charge card in 1996 and the benefits it has brought (Appendix 4) 
  - G-CAT. The electronic framework agreement for purchasing computer equipment and software (Appendix 5) 
- Interviewed 22 heads of procurement from departments, agencies and non-departmental public bodies and ran a focus groups of procurement officers.
- Reviewed departments' Public Service Agreements<sup>4</sup> to determine whether they included specific actions to improve procurement.

3 Contracts to provide a range of services usually from a catalogue which sets out the price of each item. Departments may sometime buy on a call off basis when goods are required.

4 Public Service Agreements set out how departments intend to deliver the services they are responsible for to high standards of efficiency and cost effectiveness.

- Commissioned a paper from a leading academic on the applicability of supply chain management to the public sector, and examined good procurement practice in the private sector and internationally.
  - Established an expert panel to advise on the study methodology and findings.
- a) Our case studies were selected to reflect good practice which could be more widely adopted. The sample of procurement officers we interviewed were selected to reflect the range of departments, agencies and non-departmental public bodies and the types of goods and services which they typically bought. Further background to our approach and methodology is given in Appendix 1.

## Part 2: Strategic procurement

*During a number of meetings with Departmental Heads of Procurement it became clear that there is too much focus by procurement staff on low value commodity items and insufficient involvement in business critical procurement, where qualified personnel could add the greatest value.”*

### *The Gershon Report April 1999*



**2.1** All departments and agencies purchase some goods which are essential to the delivery of their core services – computer systems in the case of the Benefits Agency; equipment for major research institutions; and facilities management where delivery of support services – maintenance, catering, security of public offices are contracted out. Such goods are strategically important because failure to deliver when required, poor quality or non performance would put achievement of the department’s key outputs at risk or result in additional costs. No precise figures are available but expenditure on these types of goods and services is in the region of £9 billion a year and the value of contracts typically ranges from less than £1 million (such as the purchase of flora by the Royal Parks Agency) to over £2 billion (such as the PRIME contract – the transfer of the Department of Social Security’s estate to the private sector). It is essential that the procurement of strategically important high value items is done well to ensure that departments and agencies pay the best price for the level of quality and standard of service they require.

**2.2** This part of the report explains what we mean by the term strategic procurement. And what more can be done to improve the quality and reduce the cost of such projects. In particular:

1. **Key features of high value strategically important procurement.**
2. **How departments and agencies are implementing good practice to achieve value for money.** One procurement option is for the public and private sectors to work together, for example through Private Finance Initiative deals. An alternative is for departments and agencies to buy goods directly themselves and our report identifies six principles of good practice:
  - Have a procurement strategy
  - Plan early and clearly agree requirements
  - Actively manage contracts
  - Think about the supply chain
  - Seek continuous improvement
  - Monitor performance
3. **Action which the Treasury have taken to promote good practice.** The Treasury have promoted five key initiatives: establishing public procurement as a career specialism in the civil service; encouraging better performance measurement; examining how to improve supplier management; developing guidance on Private Finance Initiative deals; and the ‘Achieving Excellence’ programme for construction procurement.



## 1. Key features of high value strategically important procurement

**2.3** The terms high value and important are relative; what is large and important in one department or agency may not be so in another. High value procurement usually takes two forms

- **Strategic:** Goods and services that are relatively expensive and fundamental to the success of an organisation. For example, the driver theory test is a core responsibility of the Driving Standards Agency; candidates cannot go on to take their practical test until they have passed the theory test – see Appendix 2. The Agency chose to outsource the operation to a single contractor, and with an overall value of around £50 million, the contract has a major impact on the running costs of the Agency and on whether or not it meets its targets and objectives.
- **Bottleneck:** Goods and services that may not be expensive but are critical to an organisation and where there may be a risk that security of supply could be threatened. For example, Ordnance Survey needs high quality paper for printing. While the cost of each sheet of paper is relatively small, Ordnance Survey's supplier has to maintain a warehouse of stocks to ensure reliability.

**2.4** Key criteria which are likely to indicate whether procurement is strategic or bottleneck include:

Category	Criteria	Definition
<b>Strategic</b>	High profile	Procurement decisions, such as the choice of supplier are likely to be of significant interest to the public and politicians or other stakeholders (such as employees).
	High value	The likely cost is high compared to the cost of other contracts.
	Uncertainty	The product to be bought cannot be clearly specified
	Developmental/leading edge	The procurement is pioneering a new approach or technique
<b>Bottleneck</b>	Impacts on a core activity	The procurement is critical to the achievement of the organisation's core business and where security of supply is threatened

Our examination focused on the approach departments and agencies are adopting to manage the procurement of these types of goods and services.

## **2. How departments and agencies are implementing good practice to achieve value for money**

**2.5** The Gershon Report recommended that an overall procurement efficiency and price savings target of £1 billion should be set for achievement by the end of the financial year 2001-2. Because an estimated £9 billion out of the total £13 billion procurement expenditure is spent on strategically important goods and services they will have to make a significant contribution to the achievement of this target.

**2.6** There are a number of procurement routes which departments and agencies can adopt to acquire strategically important goods and services – **(a)** through the public sector and private sector working together for example, in Private Finance Initiative (PFI) deals; and **(b)** departments and agencies buying goods and services directly themselves.

### **a) The Private Finance Initiative approach to procurement**

**2.7** Since the Private Finance Initiative was launched in 1992 successive governments have continued to negotiate procurement projects founded on the principle of drawing on private sector expertise, including finance raising, to providing services which traditionally would have been provided directly by the public sector. The private finance procurement approach offers the prospect of better value for money in terms of both better prices and better quality of service and should contribute to the achievement of the savings target suggested by the Gershon Report. It is new and more complicated than traditional procurement and requires new skills on the part of the public sector. We have examined a number of PFI projects including for example:

- **Examining the value for money of deals under the Private Finance Initiative (HC 739 1998-99).** This report sets out our approach to examining the value for money of deals which have been entered into using the PFI. It sets out the analytical framework which we have developed to cover comprehensively the key value for money issues to which these projects give rise. The framework sets out that a project should have an overarching aim : to get a good deal for the taxpayer. This overarching aim should be supported by four pillars : clear objectives should be set for the project (which should involve departmental top management), proper procurement processes should be applied, the best available deal should be obtained and departments should ensure, throughout the procurement process, that the deal makes sense (an issue about which top management will wish to be satisfied). We believe that

setting out our approach to examining PFI deals in this way is of value to departments as it highlights principles of good practice which can inform their development of such projects.

- **The PRIME project: The transfer of the Department of Social Security estate to the private sector (HC 370 1998-99).** This study examined the transfer by the Department of Social Security in 1998 of the ownership and management of almost all their estate (the largest civil estate in Government) to a private sector consortium Trillium led by the US investment bank Goldman Sachs. The study focused on whether the contract should deliver the accommodation service the Department sought, whether the Department's conduct of the negotiations was satisfactory and whether the contract should deliver value for money.
- **The Immigration and Nationality Directorate's Casework Programme (HC 277 1998-99).** This study examined the contract which the Home Office Immigration and Nationality Directorate let in 1996 to Siemens Business Services Limited for a privately financed business change initiative which depended heavily on new information technology. As well as examining how the Directorate procured these services and the value for money likely to be obtained from the contract this study examined how the Directorate and Siemens were addressing difficulties in implementing the contract.
- **The Private Finance Initiative: The First Four Design, Build, Finance and Operate Roads Contracts (HC 476 1997-98).** This study examined the first tranche of privately financed road contracts let by the Highways Agency in 1996. Under these contracts, the private sector agreed to build roads which met the Highways Agency's technical requirements and to operate and maintain them and some existing roads for 30 years.
- **The Contract to Develop and Operate the Replacement National Insurance Recording System (HC 12 1997-98).** This study examined the contract let by the Contributions Agency in 1995 to Andersen Consulting to develop a replacement for the existing National Insurance Recording System by February 1997 and to operate it for seven years. In common with all our examinations of PFI deals the study focused on the management of the procurement process and whether the contract was value for money. It also focused on the effectiveness of the arrangements

to ensure compliance with the contract including the impact of the timetable revisions which the Contributions Agency agreed to when delays occurred in introducing the new system.

## **b) Departments and agencies buying goods and services directly**

**2.8** Drawing on our discussions with industry, the advice of our panel of experts (Appendix 1) and review of international experience we identified six principles of good practice which departments and agencies need to follow when they buy goods and services directly to ensure that they can take advantage of efficiency and price savings and ensure appropriate standards of quality:



Have a procurement strategy



Plan early and clearly agree requirements



Actively manage contracts



Think about the supply chain



Seek continuous improvement



Monitor performance

---



### i) Have a procurement strategy

*“There is no well defined cradle to grave process for managing procurements which are large, complex, novel or some combination of these criteria”.*

*The Gershon Report April 1999.*

**2.9** A comprehensive procurement strategy should include an analysis of the key goods and services, and their cost, which the department or agency needs to deliver its outputs; an assessment of the way in which these goods are purchased; the performance of key suppliers; and the scope for price reductions and improvements in quality of service. The strategy should also consider the performance of the department’s purchasing unit and the potential to reduce processing costs through for example, using electronic commerce, procurement cards and framework agreements (discussed in Part 3). The strategy should consider the scope to adopt innovative approaches to improve procurement while reliably managing associated risks. The private sector companies we consulted told us that because procurement can have a significant impact on profits senior managers frequently consider its performance, expect regular reports and will consider strategically important procurement issues such as long term relationships with key suppliers.

**2.10** Until recently procurement has had a low profile in departments and to a lesser extent agencies. The PX Report highlighted that in most departments procurement is only considered by the management board infrequently. There is, however, some evidence of improvement. In reporting progress in April 1999 in implementing the recommendations of the PX Report, all departments and agencies who responded confirmed that they now had a senior manager, usually the Principal Finance Officer, who has overall responsible for procurement. Of the 22 procurement officers whom we interviewed 14 said that they now had a strategy.

**2.11** Nevertheless further progress is needed. Our examination of departments’ Public Service Agreements - which set out what improvements in public services, measured in terms of outcomes, the public should expect plus efficiency and procurement improvements; found that reference to procurement strategies concentrated mainly on routine issues reflecting the main emphasis of procurement officers’ current work. Only one Department (the Department of Social Security) focused on strategic issues and only eight out of 24 departments explicitly referred in their Public Service Agreements to longer term issues such as developing a system to measure procurement performance or encouraging procurement staff to become professionally qualified (Figure 11).

**Figure 11****Procurement Issues Addressed in the Public Service Agreements for 1999-2002**

*For the large majority of departments, their procurement strategies focus on routine procurement rather than strategic purchasing.*

**Key procurement issues covered in Departments' Public Service Agreements**

Department	Routine Purchasing					Strategic Purchasing					Key:
	Efficiency targets	Procurement card	Electronic commerce	Collaboration	Payment in 30 days	Staff development	Performance measurement	Reducing the supplier base	Working with suppliers	Supply chain management	
Department for Education and Employment	-	-			✓	-	✓				<b>Key:</b> ✓ Explicitly mentioned in the procurement strategy - Implicitly referred to in the procurement strategy
Department of Health	✓	✓	✓		✓						
Department for Environment Transport & Regions	✓	✓	✓	✓	✓	✓	✓				
Home Office	-	✓	✓	-	✓	-	✓				
Lord Chancellor's Department	✓	✓	✓		✓		✓				
Law Officers		✓			✓						
Foreign and Commonwealth Office	✓		✓	✓	✓		-				
Department for International Development	-	✓	✓				✓				
Department for Trade and Industry			✓		✓						
Export Credit Guarantee Department		-			✓				-		
Ministry of Agriculture Fisheries and Food	-			-	✓						
Forestry Commission				-	✓						
Department of Culture Media and Sport		✓			✓	✓					
Treasury	-	-	✓	✓	✓	-	-				
Office of National Statistics		-	-	-	✓	-	-				
Government Actuary's Department		-	-	-	✓	-	-				
National Savings		-	-	-	✓	-	-				
Customs and Excise	✓	-	✓	✓	✓	✓	✓				
Inland Revenue	✓	✓			✓	✓	-				
Cabinet Office	-	✓	-		✓	-	-				
Department of Social Security	✓	-	-		✓	✓	✓	✓	✓	✓	
Scottish Office	✓	-	-			-	-				
Welsh Office	-	-	-			-	-				
Northern Ireland Office	-	-	✓			-	-				

Source: NAO analysis of Public Service Agreements 1999-2002

**2.12** As highlighted by the Gershon Report very few departments have reliable data on procurement expenditure and supplier performance. In the absence of common ways of recording what is bought, prices and sources of supply it is difficult for procurement officers to adopt a strategic approach and target their expertise on the goods and services where value for money is most at risk in terms of potential missed opportunities to secure better prices and improve quality.



## ii) Plan early and clearly agree requirements

**2.13** Early planning so that contract specifications for strategically important goods and services are clear and unambiguous is essential. Other benefits of planning early are:

- **The procurement contract can more easily be tailored to customers' needs.** Contracts can be drafted to reflect the outputs to be achieved rather than the services to be delivered. This is particularly important with contracts such as facilities management (catering, maintenance, and site services), transport or research and development. Nissan Motor Manufacturing UK Ltd involve procurement staff, production staff, engineers and design teams to define the outputs they expect from each supplier.
- **Departments' and agencies' bargaining power is increased.** Knowing from the outset the market in which the supplier operates for example, factors influencing the cost of raw materials and labour can help assess whether prices are reasonable. Early consultation with suppliers can also help ensure that the contract reflects latest technological break throughs and innovations. TNT UK Limited, for example know their key suppliers' market sufficiently well to assess the likely impact of changes in component costs on supplier prices.
- **Reliable risk management can be put in place.** Contracts for more complex procurements such as major IT projects require well thought through risk management strategies covering specification through to delivery and successful implementation. More attention can be given to this if it is addressed very early on.

- **More time can be devoted to getting performance monitoring arrangements right.** If value of money is to be achieved, how the performance of suppliers of strategically important services will be assessed needs to be carefully considered. This should not be an afterthought but built into contracts from the outset.

**2.14** The 22 heads of procurement whom we interviewed said that they were frequently consulted on the award of contracts too late to have a major influence. Departments typically value the expertise of their procurement staff on procedural matters such as compliance with European Union Directives. But the PX Report found that middle managers and senior staff in departments were often not consulted on wider procurement issues although they could provide expert advice on contract design and management. Only one of the 22 heads of procurement we interviewed regularly attended their department's management board meetings and knew which contracts were likely to arise over the next 18 months to two years. Only three senior civil servants (grade 3 or above) outside the Ministry of Defence are directly involved in procurement. There is scope for involving procurement officers more at an early stage in drawing up contract specifications and performance review criteria. Information technology contracts are a good example with high incidence of late delivery or poor performance. Sixteen out of 22 of the heads of procurement we interviewed said that such contracts are routinely dealt with solely by information technology staff.



### iii) Actively manage contracts

*“For all contracts departments will appoint contract managers who are the focal point for the intelligent customer role for that contract. They will have a clear responsibility for ensuring that the service contracted for is delivered by the supplier and for maintaining communication for all parties with an interest in it”.*

*The White Paper - Setting New Standards 1995 (Cm 2940).*

**2.15** Ensuring a high level of performance for all types of high value and strategically important procurement requires active contract management by departments and agencies. This involves ensuring that reliable and comprehensive information is available to monitor the performance of the contractor, and taking action quickly when delivery, price and quality is at risk. Contract management also requires a clear understanding of shared responsibilities so that when the client department has agreed to provide facilities, support or other inputs essential for the supplier to meet the terms of the contract



these are provided at the right time. Failure to provide that which was agreed or changes to the original requirement by the client should not be capable of being used by the contractor to justify poor or non performance on their part. If changes to requirements are essential the cost implications of these should be fully assessed by departments and agencies.

**2.16** Our interviews with 22 heads of procurement indicated that they all put much importance on effective contract management and our focus group of heads of procurement established that many of their staff were being trained in contract management.

**2.17** We also carried out a case study (Appendix 2) of one agency, the Driving Standards Agency to find out about their approach to contract management. The Agency have a contract worth around £50 million to manage the Theory Driving Test which is conducted at 158 test centres across Great Britain with over 100,000 tests conducted each month. The current contract is held by Capita Group but from January 2000 Sylvan Prometric Ltd will deliver the theory test. The Driving Standards Agency have a carefully thought through approach to contract management.



**2.18** Contract management can be resource intensive and arrangements need to be clear for it to be cost-effective. One contract manager and five support staff in the Driving Standards Agency spend some 40 per cent of their time on this contract – equivalent to some £45,000 a year. And there are other additional costs. The Agency, through its contract with Capita Group requires that they provide an external audit of the contractor's performance each year and there is an indirect cost associated with requiring the contractor to prepare a performance report each month. In addition:

- *The contract manager has a job description clearly setting what is expected.*
- *All communication with the contractor is through the contract manager.*
- *The contract manager has the necessary 'people skills' to negotiate with the contractor, retain their independence and build a professional close working relationship with the company.*
- *The onus is on the contractor to provide performance data each month.*

- *The contract manager examines and validates the contractor's performance each month – figures are not taken at face value.*

- *Evidence of under performance is quickly raised by the contract manager with the supplier.*



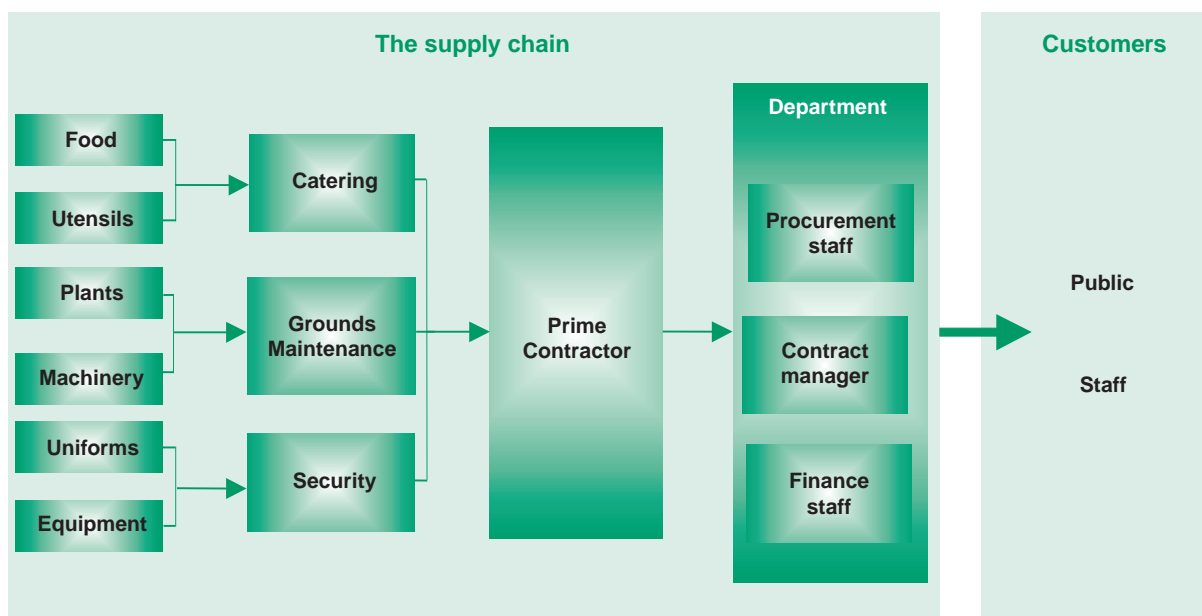
#### iv) Think about the supply chain

**2.19** Suppliers almost inevitably will have their own suppliers. For example, a major computer software company will buy components from a range of suppliers, a transport company may sub-contract the maintenance of its vehicles, and a company providing facilities management may rely on a number of suppliers to provide cleaning, catering and grounds maintenance. This series of mutual interdependencies between suppliers is known as the supply chain (Figure 12 shows the typical supply chain for a facilities management contract). Non performance, poor quality or late delivery by one supplier in the chain can ultimately put the service provided by the main contractor to their client at risk.

**Figure 12**

**An example of a typical supply chain for a department's facilities management contract**

*Figure 12 illustrates the range of suppliers and departmental staff required to deliver a facilities management contract*



Source: National Audit Office

**2.20** The private sector therefore place much emphasis for strategically important contracts on knowing the supply chain of their key suppliers and seek assurance from them that it is well managed and that the risk of non delivery or poor performance at any point in the chain is minimised. Industry also consider effective supply chain management to be key to reducing costs and improving product quality. To become an approved supplier private companies often require suppliers to go through an accreditation process, one aspect of which is obtaining information on their supply chain and how it is managed.

**2.21** Supply chains are particularly important for manufacturing and retail industries such as motor car production and major food outlets. Departments and agencies have, therefore, considered supply chains to be of less or no relevance for the types of goods and services which they buy. But supply chains are important where a company is contracted to deliver complex IT services to a department; with facilities management contracts which are very common now in departments and agencies; with major consultancies and research and development contracts; and with construction projects.

**2.22** Fourteen out of the 22 procurement officers whom we interviewed were either not convinced of supply chain management's relevance to the public sector or confirmed that they had very little understanding of it. We were unable to find any example of a department or agency which expected their main suppliers of strategically important goods and services to provide information on their supply chain and assurance that it was well managed. We therefore, examined an initiative by Defence Estates – Building Down Barriers to use supply chain management techniques for construction projects (Appendix 3) because the lessons are equally applicable to large procurement. We also commissioned Andrew Erridge, Senior Lecturer, School of Public Policy, Economics and Law, University of Ulster to prepare a paper giving an overview of literature on supply chain management in the private sector and its relevance to the public sector (Appendix 6).

**2.23** The Building Down Barriers initiative was established in January 1997, and runs until late 2000. It entails the design and construction of two similar physical and recreational training centres in Aldershot and Wattisham. Work on the construction of the two centres started in May 1999. It is funded by the Department of the Environment, Transport and the Regions and Defence Estates of the Ministry of Defence. The initiative has three objectives:



- To develop a new approach to construction procurement, called Prime Contracting, based on supply chain integration.

- To demonstrate the benefits of the new approach, in terms of improved value for the client and profitability for the supply chain through running two pilot projects.
- To assess the relevance of the approach to the wider UK construction industry.

**2.24** It is too early yet to assess the full benefits and wider applicability of this approach and its relevance to procurement. But drawing on our initial review of this project, the research paper we commissioned, and discussions with industry a number of lessons appear relevant. A supply chain management approach is more likely to be useful for departments and agencies when:

- *The existing supply market is organised in the form of a chain or network for example, major equipment purchases, major service contracts such as cleaning, and construction.*
- *There are significant logistics or distribution aspects to the contract for example delivery of suppliers to dispersed users such as local offices.*
- *The procurement is high profile or sensitive requiring close and active over view by contract managers for example, major equipment, IT and construction projects.*

**2.25** As emphasised by Andrew Erridge in the paper he prepared for us, the costs of adopting supply chain management have to be assessed by departments and agencies in terms of the likely benefits it will deliver. For example, the need for a possibly longer pre tender phase in appraising contractors' approach to managing their supply chain has to be compared to the potential for better product quality and lower costs in the longer term. Our expert advice is that supply chain management is unlikely to be cost effective for procurement contracts less than £100,000 in value. In many cases, as Andrew Erridge's paper highlights it will probably be sufficient for departments and agencies to seek assurance from their key suppliers that they are actively managing their supply chains to reduce costs and improve quality and that this is reflected in the prices they pass on to departments and agencies.

**2.26** We identified, however, two potential obstacles to supply chain management being more widely applied. The 22 heads of procurement whom we spoke to said that (i) they would have some reluctance in adopting this approach

because of the risks which they perceived were associated with it – too close collaboration with suppliers; but this need not lead to impropriety if proper controls are in place such as clear definitions of suppliers' responsibilities and monitoring of suppliers' performance. And (ii) because there were insufficient departmental procurement staff with practical expertise in supply chain management. The Treasury have set up a Supplier Management Action Group to explore the benefits of implementing supplier management techniques.



## v) Seek continuous improvement

**2.27** The companies we spoke to emphasised the importance of seeking continuous improvement from key suppliers. There are two main ways of doing this **(a)** building quality aspects in to contracts and **(b)** closer working with key suppliers.

### a) Building quality into contracts

**2.28** Departments and agencies have traditionally used either fixed or firm price contracts awarded through competition. The advantages of this approach are that costs cannot be exceeded above an agreed threshold without prior agreement of the client, and the service required has to be clearly defined. The disadvantages are that such contracts do not provide an incentive to the supplier to improve performance or reduce costs for the clients' benefit. The White Paper – Setting New Standards 1995 (Cm 2940) advocated the greater use of contractual incentives in departments' contracts. There are two types of contractual incentive: incentives that reward a contract for exceeding targets or delivering before deadlines; and incentives that seek financial compensation when standards are not met. In each case, the benefits in terms of better service delivery should be quantifiable. Discussions with our focus group of procurement officers highlighted the general view that departments were reluctant to use contractual incentives because the contracts were inevitably more complex and took longer to prepare, and there was a concern about compliance with European Union Directives and ensuring propriety. None of these factors need, however, be a real constraint if contracts are drawn up with expert advice.

**2.29** We examined the experience of the Driving Standards Agency (paragraph 2.18 and Appendix 2) who introduced over 20 performance measures into their contract to run the Theory Driving Test covering four main areas:



- **Availability** – providing a service that meets the needs of driving test candidates
- **Responsiveness** – dealing with candidates in a timely and efficient manner
- **Reliability** – providing an accurate and reliable service
- **Service** – paying over test fees and providing accurate information to the Agency on time

**2.30** The Agency in inviting tenders asked interested suppliers to indicate the level of liquidated damages (financial compensation) they would pay the Agency if the service they provided was less than a pre agreed standard measured by a number of performance indicators. The final contract specified a sliding scale of liquidated damages which the supplier would have to pay subject to a maximum of £60,000 a month. In the 37 months of operation to July 1999, the Agency has received a good quality of service overall, but has received liquidated damages of £314,500 excluding VAT – maximum liquidated damages during this period if performance had not met required standards would have been £2.22 million.

**2.31** In this case the Agency opted for liquidated damages because they needed the contractor to deliver the theory test to the same standards of service as the practical test. Achieving standards of performance above the practical test offered minimal benefit to the Agency but less than adequate performance would put delivery of the driving test at risk. Therefore the risk of having to pay financial compensation for less than satisfactory service is a major incentive to the contractor.

**2.32** There is scope for making greater use of incentives, either to reward good performance or to discourage poor performance, in department and agency procurement contracts particularly where a service is provided. Expert procurement advice is needed to define the performance measures and incorporate these into the contract but the advantages are considerable for example:

- *It encourages the department or agency to identify exactly what is wanted from the contract.*

- *The process helps departments and agencies focus on the costs of the service throughout the duration of the contract and the likely reliability and quality of service offered by each tenderer before awarding the contract.*
- *Contractors know exactly what is expected from them.*
- *Poor performance is discouraged.*

#### **b) Close working with key suppliers**

**2.33** The private sector companies which we spoke to placed importance on working closely with key suppliers to improve the quality of the product or service they provide and reduce costs for mutual benefit. They stressed that the emphasis is on partnership not cosy relationships. Nissan Motor Manufacturing UK Ltd, for example, have developed a Supplier Appraisal and Improvement System to monitor performance and to communicate more closely with their key suppliers (Figure 13). Departments and agencies generally do not adopt this approach but for large scale contracts running for several years there would be advantages in terms of improved quality of working more closely with suppliers. With adequate safeguards, such as clear definition of responsibilities, the risk of financial impropriety should not be increased.



#### **v) Monitor performance**

**2.34** If departments and agencies are to have assurance that they are getting the best deal from their procurement of goods and services in terms of price, quality of service and supplier performance they need to have reliable information and systems to assess the performance of all stages of the procurement process. Without such information it is very difficult to benchmark prices to ensure that they remain competitive, to track whether each year the procurement of goods is improving, and that efficiency targets and savings are being realised. The Gershon Report identified the lack of reliable systems to monitor performance as a fundamental weakness. The procurement officers to whom we spoke all agreed that this was an area which needed to be addressed. In terms of supplier performance they seek to benchmark prices when appropriate and when reliable data is available to assess whether prices remain competitive. But there was general recognition that departments as yet lacked reliable systems to assess supplier performance to benchmark the prices and generally to assess overall performance in improving the way goods and services were purchased.

**Nissan Motor  
Manufacturing UK Ltd's  
approach to encouraging  
continuous improvement  
from suppliers**

**Figure 13**

**Briefing on the Supplier Appraisal and Improvement System**



**What is the Supplier Appraisal Improvement System?**

The Supplier Appraisal Improvement System is a management system to monitor the performance of each supplier and to identify areas for improvement.

**Achievements**

- Nissan's approach is to maintain sourcing stability throughout the production life of a particular model of car. As such Nissan works with suppliers to achieve continuous improvement in performance.
- Nissan has reduced the elapsed time for designing and developing a new car from around 4 years to nearly 30 months.
- Defects now occur in less than 50 parts per million.
- Nissan only hold sufficient stocks for 0.7 days of car production. Such low stocks avoid the need to devote plant accommodation to warehousing.
- To achieve year on year cost improvements it is essential to understand the cost breakdown. Open book cost information exchange is a pre-requisite to establishment of cost reduction plans through both engineering and process improvements.

**How does it work?**

The system works by generating quantifiable and consistent performance information on each supplier every month. Nissan identified five key areas to assess the performance of each supplier:

- Quality
- Cost
- Delivery
- Development
- Management

Each category specifies a number of quantifiable performance measures. An evaluation is made monthly and a report is fed back to all suppliers on a quarterly basis. Such a structured approach enables Nissan's management team to compare performance over time and between suppliers. While responsibility for meeting the specified targets rests with suppliers, procurement, production or engineering staff from Nissan Motor Manufacturing Ltd will work alongside the supplier if necessary to resolve any problems.

Source: Nissan Motor  
Manufacturing UK Ltd

### 3. Action taken by the treasury to promote good practice

**2.35** Following the publication of the PX Report the Treasury saw most immediate benefit in focusing on improving the procurement of routine items. This could be done quickly and achieve fairly speedy improvements – the further promotion of the Government Procurement Card and electronic commerce (examined in Part 3) are good examples. Once these were implemented procurement staff would have much more time to focus on strategically important goods and services where the returns in terms of better value for money were potentially greater. The Treasury have promoted four key initiatives which are intended to have most impact in improving the procurement of strategically



important goods and services – **(i)** establishing a professional government procurement service; **(ii)** better performance measurement; **(iii)** better supplier management; and **(iv)** developing guidance and advice on Private Finance Initiative projects.

### **i) Professional Government Procurement Service**

*“Although there are some very talented and capable people within the Government Procurement Service that is now being established I concluded that the overall levels of skill, capability and seniority need to be raised significantly”.*

*The Gershon Report April 1999.*

**2.36** In 1998 the PX Report set a target that by the end of 2000, 75 per cent of departmental procurement staff should be professionally qualified. In April 1999 the Government Procurement Service was set up to provide a professional specialism for the 1,500 civil servants in designated procurement posts. As part of the new arrangements heads of procurement in each department remain responsible for the recruitment and career development of their staff but procurement is now a recognised specialism within the civil service similar to the Government Accountancy Service.

**2.37** The objectives of the Government Procurement Service are:

- To help to improve procurement management in departments by the best use of key procurement staff with skills, experience and qualifications to deliver professional, ethical and legally compliant procurement processes to meet government business objectives.
- To provide departments and members of the Service with information on best practice for procurement and the use of procurement staff in departments, and to help match procurement staff to posts.
- To provide members of the Service with information on employment opportunities and developments in procurement best practice.

**2.38** The 22 heads of procurement to whom we spoke were very positive about the Service. They believed it would help encourage qualified procurement staff to stay with departments – 180 (12 per cent) newly qualified staff left in 1996-97. And

the development of the Certificate and Diploma of Competence in Purchasing and Supply with the Chartered Institute of Purchasing and Supply should help improve the professional skills of purchasing staff.

**2.39** At the 31 March 1997 some 660 procurement staff, 44 per cent of those employed by departments had a professional qualification. To achieve the PX Report target of 75 per cent a further 465 will need to be qualified by 31 December 2000.

## ii) Better performance measurement

*Performance measurement is critical to any core business activity. If the performance of an activity is not measured, it cannot be managed effectively nor can continuous and sustainable improvement be made. This is just as valid for procurement as any activity.*

### *The PX Report April 1998*

**2.40** The Treasury have put emphasis on encouraging departments and agencies to develop a comprehensive framework for assessing procurement performance. Its main features should be:

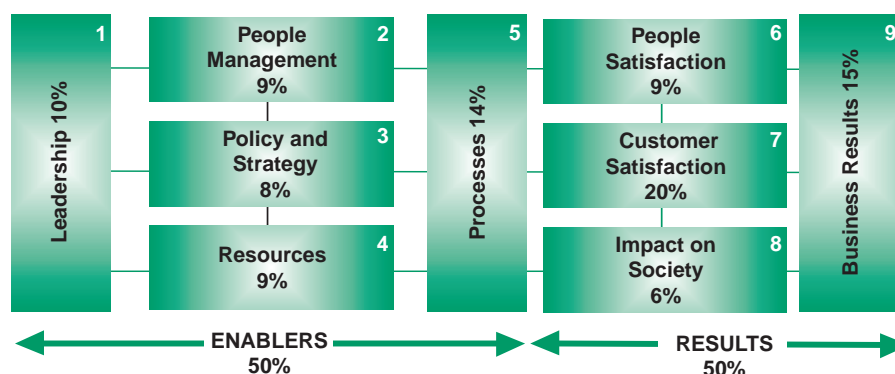
- Forward looking – using retrospective indicators such as cost, number of orders to influence future performance.
- Basis for wider benchmarking of prices and supplier performance.
- Linked to other initiatives to improve quality such as the quality standard ISO 9002
- Capable of promoting continuous improvement.
- Simple and focused – measuring everything is expensive, impractical and unnecessary.

**2.41** The Treasury consider that the Excellence Model developed by the European Foundation for Quality Management and 200 private sector organisations across Europe best meets these characteristics (Figure 14). The model enables an organisation to collect performance data in a consistent method so that results can be quantified and compared with other organisations.

## The Excellence Model

**Figure 14**

*The model enables an organisation to measure performance in a consistent method against nine criteria, weighted to take account of their relative importance.*



**2.42** The model is widely used by private sector companies – at least a third of the Financial Times Stock Exchange 100 companies are said to use the method. Most of the 22 heads of procurement to whom we spoke supported use of the model as a means of measuring procurement performance and making comparisons between departments. The Treasury have actively promoted the adoption of the Excellence Model through, for example, development of a guide and presentations at conferences of government procurement officers. Six departments and agencies, including the Benefits Agency, the Department of Trade and Industry and the Department of Education and Employment began piloting the Excellence Model in April 1999. The Treasury launched the Procurement Excellence Guide in September 1999.

### iii) Better Supplier Management

**2.43** In mid 1997 the Treasury set up a working group of procurement officers to look at how departments managed their suppliers, including the number of suppliers and the scope for rationalisation, and whether collaboration by departments with suppliers would lead to better value for money. The working group ran two pilots looking at supplier management across departments with IBM and the Stationery Office. As a result the group produced guidance on contract management in July 1999 and plan to produce guidance on managing suppliers in 2000.

#### **iv) Developing guidance and advice on Private Finance Initiative projects**

**2.44** The Treasury recognised the significant opportunities which the PFI presents for the delivery of strategically important goods and services. In 1997 they established a Taskforce to provide advice and support to departmental teams engaged in PFI projects (the Taskforce replaced the Private Finance panel Executive which had previously provided advice to departments on PFI matters). The Treasury also formed a PFI Policy Unit which has developed a range of PFI guidance to assist departments. For example, in July 1999 they published guidance on the standardisation of PFI contracts which aims to allow a consistent approach to be taken across departments to the development of PFI contracts. A second review of the PFI carried out by Sir Malcolm Bates was published in July 1999. It sets out various recommendations which were accepted by the Government including an ongoing role for the Treasury Taskforce and the PFI Policy Unit, further skills development and training for public sector staff engaged in PFI deals, additional support on project management and financial matters and close co-ordination with the Government's Wider Markets Initiative.

#### **v) Promoting improvements in the way departments procure construction work**

**2.45** In March 1999 the Treasury Procurement Group launched a programme to improve the government's performance as a purchaser of construction work – "Achieving Excellence". Achieving Excellence provides guidance on how to bring about such improvements by promoting cultural changes in management practices, enhanced measurement of performance, standardisation of practice, and improved working with contractors. By March 2002, the Group aim to achieve, for new contracts, reductions in capital costs, construction times and cost reliability, benchmarking comparators and supplier satisfaction. Achieving Excellence, and the rewards it seeks to achieve by March 2002, is being taken forward within the framework of the wider industry improvements sought by the 1998 Egan Task Force Report "Rethinking Construction" and the Movement for Innovation within Department of Environment, Transport and the Regions.

## Part 3: Routine procurement

*“The review’s recommendations will enable procurement expertise to move from day to day involvement in low value/low strategic procurement towards the higher value/strategic areas where it will have the greatest impact.”*

*The PX Report April 1998*



**3.1** Departments and agencies spend some £300 million a year buying routine items such as stationery, cleaning materials, food and clothing. Purchased as individual items these types of goods usually have a low monetary value but the purchasing costs associated with them – ordering, taking delivery, authorising payment and holding goods in stores can be disproportionately high. For example, departments place some two to three million low value orders each year, averaging £100 each. But the estimated cost of making such purchases using traditional written purchase orders can range from £25 to £100 per transaction.

**3.2** Value for money depends, therefore, on finding ways of minimising the purchasing costs of such low value items and by departments maximising their buying power to secure discounts through for example, aggregating requirements and timing purchasing to place larger scale orders, and by departments and agencies purchasing jointly. Reducing the amount of time purchasing staff have to spend on low value items also allows them to invest more effort and resources in managing the procurement of higher value items or those more essential to the department’s or agency’s core business which usually offer greater potential for improving value for money.

**3.3** This part of the report examines three initiatives to improve value for money in buying routine goods. In particular:

1. **The Government Procurement Card.** How such a corporate card works, what the Treasury has done to promote its use by departments and agencies, and the potential efficiency gains it might generate.
2. **Electronic commerce.** What we mean by the term, Treasury's plans to introduce electronic commerce and our examination of one electronic catalogue (G-Cat) to determine the potential efficiency gains electronic commerce might generate.
3. **Framework Agreements.** How such agreements operate, Treasury's establishment of a Government Procurement Website to promote framework agreements and our estimates of the potential efficiency savings.

Figure 15 summarises when the three approaches are best used.

**When best to use each of these methods for purchasing routine items**

**Figure 15**



#### **Government Procurement Card**

- ◆ The purchase value is low. The average value of purchases using the Card is around £120.
- ◆ The item needs to be bought at short notice.
- ◆ The item is not already covered by a framework agreement. Unless payment for framework agreement can be made by the card.
- ◆ The suppliers will accept the Card.
- ◆ Purchases are in small volumes, where the opportunities for aggregation and obtaining bulk discounts are not available.



#### **The G-CAT Electronic Catalogue**

- ◆ For all IT products, ranging from desktop portable computers to telecom equipment.
- ◆ For computer equipment maintenance contracts.
- ◆ Where the requirement is not immediate, recognising that 84 per cent of G-CAT orders are delivered in 10 days or less.
- ◆ Where purchase would otherwise require the letting of a contract in accordance with European Union procurement directives - thus providing savings of up to £500,000.
- ◆ Where the IT services have not been contracted out under a Private Finance Initiative arrangement.
- ◆ The catalogue can be used in conjunction with the Government Procurement Card for orders less than £5,000.



#### **Framework agreements**

- ◆ Where demand for goods and services can be aggregated to minimise procurement cost and maximise volume discounts.
- ◆ For all high volume requirements.
- ◆ Where goods and services are already available from other department's framework agreements.
- ◆ Where goods and services are required over a fixed period.
- ◆ Where requirements for goods and services can be fixed over an agreed timescale - using a call-off arrangement.
- ◆ Payments can be made using the Government Procurement Card

Source: National Audit Office

## 1. Government Procurement Card



### i) How the Procurement Card works

**3.4** The Government Procurement Card is similar to charge cards operated by most commercial businesses. Designated staff within a department or agency are given a card which they can use to order goods and services by telephone, fax, written purchase order or in person. Cards usually have some restriction limiting the holder to the types of goods they can purchase up to a certain monetary value. The price of the item is charged to the card and at the end of an agreed period the department or agency will receive a statement listing the purchases bought so that they can be verified. A consolidated invoice is sent by the card company to the department or agency which is settled by one payment.

**3.5** The benefits of procurement cards are:

- **Reduced purchasing costs.** Card holders purchase directly from a supplier; they do not have to fill in purchase request forms which have to be processed by purchasing staff. This can save up to 85 per cent on processing costs, an average saving of £15 to £60 per transaction.
- **Speedier delivery.** Card holders can order and receive items much more quickly – often the same day (Figure 16). The need for large stock holdings is consequently reduced.
- **Improved efficiency.** Less time is spent checking and authorising purchases. This becomes a monthly task when the card company issues a statement and consolidated invoice.

**Figure 16** Improvements in processing using the Government Procurement Card

Figure 16 compares a typical purchasing process with a purchasing process using the Government procurement card



Source: Adaptation of a VISA diagram



- **Risk of impropriety is minimised.** With proper safeguards procurement cards are as secure as any other procurement method. The typical controls and safeguards which should be in place are shown below as illustrated by our examination of how the Forensic Science Service uses the Card (Appendix 4).

Risk	Safeguards adopted by the Forensic Science Service
Procurement of goods for personal use by the cardholder	<ul style="list-style-type: none"> <li>■ The cardholder must be a permanent employee and have been with Forensic Science for at least 12 months.</li> <li>■ The cardholder is subject to security and credit checks.</li> <li>■ The cardholder is informed that any misuse will be treated as a disciplinary offence.</li> <li>■ Each cardholder maintains a log of transactions. The cardholder's manager checks the log each month and reconciles the record to the monthly card statement.</li> <li>■ Card use is restricted to transactions below a certain amount and to specific types (for example, cash withdrawals are excluded).</li> </ul>
Use of card by unauthorised staff	<ul style="list-style-type: none"> <li>■ The cardholder is instructed to keep the card and any personal identification number secure. Failure to do so is a disciplinary offence.</li> <li>■ Line managers must authorise cardholders' statement each month</li> </ul>
Collusion between cardholder and supplier	<ul style="list-style-type: none"> <li>■ As with other methods of procurement, this risk is difficult to eliminate. Forensic Science minimise the risk by examining monthly management reports of expenditure by supplier and by item to look for anomalies and trends.</li> <li>■ The cardholder's manager examines the log for evidence of goods received and price paid.</li> </ul>

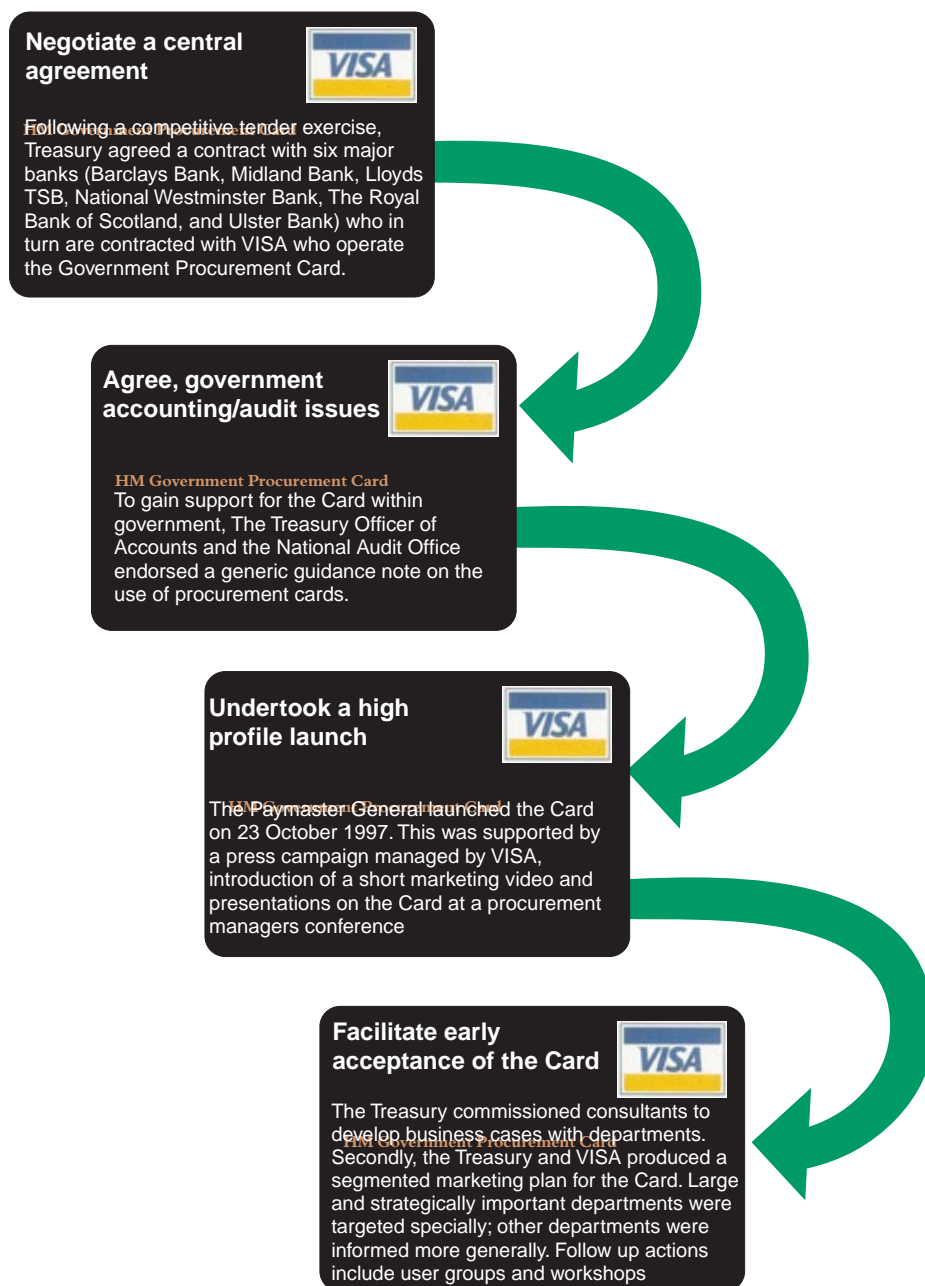
## ii) Action taken by the Treasury to promote the use of procurement cards

**3.6** The Treasury launched the Government Procurement Card in October 1997 when they estimated that efficiency savings to the value of £70 million were achievable on the processing of two to three million low value items. Cards are issued by a consortium of banks who can issue VISA purchase cards and all departments and agencies can use them. The Treasury adopted a four stage approach to encourage departments and agencies to use the card as set out in Figure 17.

**The Treasury four stage approach to introducing the Government Procurement Card**

**Figure 17**

*Figure 17 shows the contract award and marketing approach adopted by Treasury for launching the Government Procurement Card*



Source: Treasury

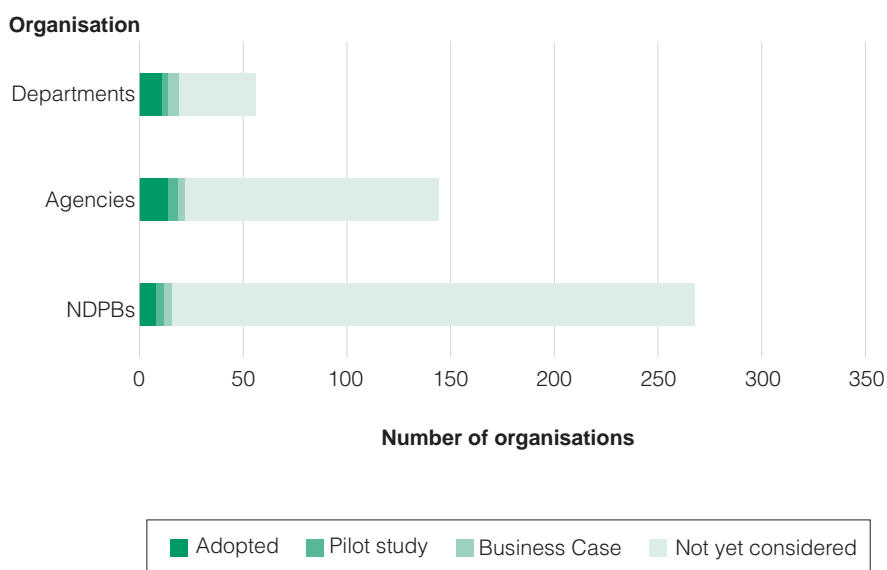
### iii) Efficiency gains so far achieved and the potential for more

**3.7** The Treasury's targeting of larger and more strategically important government organisations has meant that by June 1999, 11 departments and 22 agencies and non-departmental public bodies had adopted the card. Five of these had been using another card before the introduction of the Government Procurement Card. Eleven organisations were piloting the card and a further 11 were assessing the business case – the potential costs and benefits of introducing the card (Figure 18).

#### Take up of the Government Procurement Card

**Figure 18**

*This shows that there is still significant scope for increasing the use of the Government Procurement Card*



Source: Treasury

**3.8** Within those organisations which have adopted the card or are piloting it some 4,700 cards are now in use and in 1998-99 these were used for 70,600 transactions purchasing goods and services valued at £7.9 million. The Environment Agency is the major user of the Government Procurement Card. In 1998-99 its purchases represented 36 per cent of all departments' and agencies' purchases using the card. In May 1999, the Environment Agency's share of total purchases had increased to 58 per cent.

**3.9** We discussed with procurement officers why more departments and agencies were not adopting the card. They gave a number of reasons –the need to ensure that the card could be tied into existing accounting systems to guarantee that budget holders received reliable information, difficulties in recovering VAT on goods purchased with the card, and a general concern that adequate safeguards had to be in place to minimise the risk of impropriety.

**3.10** The card is usually most appropriate for agencies because they are more likely to have an operational or customer service function. This means that they will be more dependent on a range of low value items which have to be purchased quickly. Our discussions with agency procurement staff indicated that they are more likely to await the outcome of their parent or sponsoring department's pilot exercise in using the card before actively considering its use.

### **The experience of the Forensic Science Service in using the Procurement Card**

**3.11** We examined the experience of one agency, the Forensic Science Service in using the card (Appendix 4). The service adopted the Government Procurement Card in June 1999 but previously had operated its own card run by the National Westminster Bank Plc since April 1996.

**3.12** Using a procurement card has enabled the Forensic Science Service's finance section to reduce its bill payment workload by 58 per cent. Finance staff paid suppliers nearly £13.4 million in 1998-99, and this required some 6,000 separate payments. But the additional 3,500 transactions using the card only contributed one invoice a month; without the card, finance staff would have had to make some 9,500 payments. Each monthly invoice requires more checking than an individual transaction, but our discussions with the Agency's Head of Finance confirmed that the net impact had been an efficiency gain of approximately three finance staff (out of a total complement of five) – equivalent to £37,000 a year. The procurement section had reduced its workload by 38 per cent – an efficiency gain of approximately two procurement staff (out of a total complement of six) – equivalent to some £25,000 a year.

### **Scope for considerably more efficiency savings exist if the card is more widely used**

**3.13** As illustrated by Figure 19 significant savings in purchasing processing costs could be realised through greater use of the Card.

**Savings in purchasing  
processing costs  
achievable from wider use  
of the procurement card  
by departments and  
agencies**

**Figure 19**

*Figure 19 shows that considerable efficiency savings from using the Government Procurement Card could still be achieved*

	£ million
Original Treasury Estimate of savings potential	70
Achieved by departments and agencies since October 1997	2
NAO estimate of further savings that could be achieved	50 - 75

Source: Treasury and  
National Audit Office

Note: Our estimate of potential efficiency savings is based on the experience of the Forensic Science Service, the Treasury's original estimates when the Government Procurement Card was introduced in 1997, and discussions with VISA. We assumed that savings in processing costs of between £25 - £50 per transaction are achievable, and that there are between 1.5 million – 3 million low value transactions which could be purchased using the card.

**3.14** It is important that the card is not used when other forms of purchasing are likely to result in better value for money. When a department purchases large volumes of low value commodities for example, in the case of stationery it is better to negotiate a separate contract to secure discounts from bulk buying rather than to purchase from a large number of suppliers using the card. There is no reason why, however, items should not be ordered and purchased under such contracts using the card if the supplier agrees.

## **2. Electronic commerce**

### **i) How electronic commerce works**

**3.15** Electronic commerce involves using electronic networks to simplify and speed up all stages of procurement including tendering, design and production for development projects, ordering, requisitioning, stock management, and monitoring delivery and supplier performance. Electronic commerce should provide better information about suppliers, products and prices to help ensure that departments and agencies get the best deal. It should also facilitate better communication between departments so that they can do more purchasing jointly. With the Internet becoming the fastest growing market place in the world economy the potential benefits of electronic commerce for improving the way departments and agencies buy goods and services are fully recognised by the Government:

- *In October 1997 the Prime Minister set the target that by 2002, 25 per cent of dealings with Government should be capable of being done by the public electronically.*
- *In September 1998 the Secretary of State for Trade and Industry announced the target that 90 per cent by volume of the procurement of low value goods by central government should be conducted electronically.*
- *In March 1999 the Modernising Government White Paper (Cm 4310) set the new targets that 50 per cent of dealings with Government should be capable of electronic delivery by 2005 and 100 per cent by 2008.*

## ii) Action taken by the Treasury to promote electronic commerce

**3.16** The application of electronic commerce to procurement was one of the central themes of the PX Report and in response the Treasury promoted a phased introduction (Figure 20) so that electronic procurement becomes standard for departments by September 2001. This is helped by the establishment of the Government Secure Intranet which allows departments and agencies to exchange non sensitive information electronically between themselves and with suppliers in a secure environment.

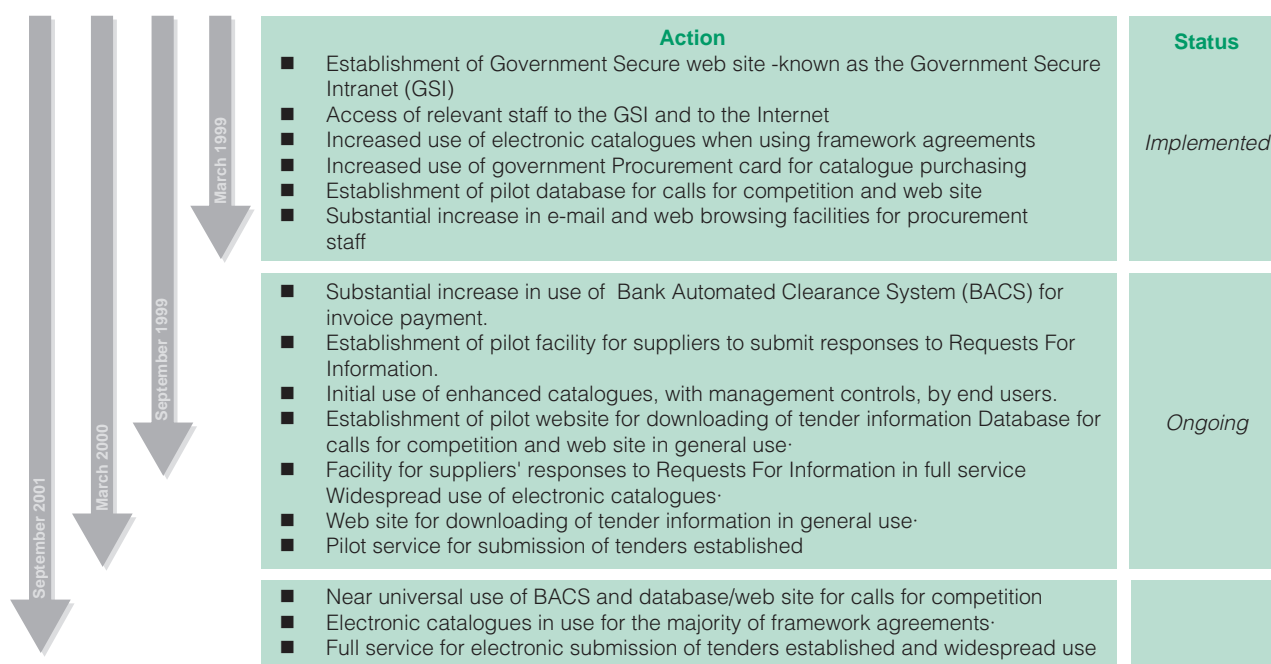


**3.17** Key achievements in introducing electronic commerce to date include:

- The launch of the Government Procurement Website, accessible from the Government Secure Intranet and Internet, in January 1999. This is the main electronic medium for communication and collaboration between departments, agencies and Non-departmental public bodies. It includes: a procurement register of contracts let, or to be let, by individual Departments which other Departments might have access to, or learn from; a discussion forum where procurement staff will be able to seek advice from, or discuss with, their colleagues in other Departments.
- Draft specifications for electronic tendering using the Government Secure Intranet.
- The Government Procurement Card, launched in October 1997, to purchase low value items electronically.

**Figure 20****Treasury Procurement Group's phased Introduction of Electronic Commerce**

Figure 20 shows the key stages in making electronic commerce standard in departments by September 2001



Source: Treasury

**3.18** While progress has been good in some areas much remains to be done before electronic commerce becomes standard for example, encouraging all departments and agencies to use the Government Procurement Website, and convincing them generally of the benefits of electronic commerce. A key issue is how achievement of the target that 90 per cent by volume of routine procurement will be conducted electronically by March 2001 will be measured. It is not clear for example, what will contribute to the target – whether it will include the relatively simple process of placing an order by telephone, fax or via an electronic catalogue with invoices paid through the Bank Automated Clearance System (BACS) or whether it should include the more complex process of transacting electronically with suppliers through all stages of procurement – tendering, assessing and monitoring prices and scheduling delivery. The risk is that without a clearer definition, procurement staff may focus their efforts on the former at the expense of more complex forms of electronic procurement which might offer a better return in terms of efficiency and better prices.

**3.19** As with the development of all new approaches, managers should, when introducing e-commerce, ensure that the appropriate controls and safeguards are in place to minimise the risks of error, fraud and impropriety. Controls should be considered to achieve:

- **confidentiality** - to prevent sensitive information from unauthorised disclosure;
- **authenticity** - to ensure that both parties to a transaction are whom they claim to be, and that the contents of an electronic business transaction have not been tampered with;
- **non-repudiation** - to prevent one party subsequently denying involvement in the transaction.

The use of data encryption, digital signatures and digital certificates will help to meet these objectives.

### Implementing G-CAT

**3.20** A core element of the Treasury's strategy to promote electronic commerce is to encourage more departments and agencies to use electronic catalogues to purchase goods. One of the main catalogues which central government is using is G-CAT, the Government catalogue of IT products. We examined how this is being implemented (Appendix 5 provides more detail).



**3.21** Departments and agencies spent approximately £142 million on IT products from G-CAT in 1998-99 including for example, desk top computers, laptops, software programmes and support equipment. The G-CAT catalogue covers over 20,000 products and is managed by the Central Computer and Telecommunications Agency of the Cabinet Office. Day to day management of the catalogue is contracted to Electronic Data Systems Ltd (EDS) whose sub contractor, Computacenter, is responsible for ordering and supply arrangements. EDS won the contract competitively to operate G-CAT. Figure 21 summarises how G-CAT operates.



## How to make a purchase through G-CAT

**Figure 21**

*Figure 21 shows that it is very easy to purchase using G-CAT*



Source: Central Computer and Telecommunications Agency

### 3.22 The main benefits of G-CAT are:

- **Reduced processing costs.** Placing orders via an electronic catalogue minimises the cost of preparing and processing an order.
- **Benchmarking prices.** The Central Computer and Telecommunications Agency monitor the prices of goods included in G-CAT to ensure that they remain competitive.

- **Price savings through bulk buying.** G-CAT provides small customers with greater purchasing power and additional discounts can be negotiated for bulk purchases. For very large orders, G-CAT will run competitions amongst suppliers.
- **Reduced cost** of complying with European Union (EU) Supplies and Services Directive. As the G-CAT contract was awarded following the EU procurement procedures, there is no need for G-CAT customers to repeat these procedures.

### iii) Efficiency gains achieved so far and the scope for more

**3.23** When G-CAT was first introduced, the Central Computer and Telecommunications Agency estimated that efficiency savings from using the electronic catalogue could be between £5 million and £45 million over a five year period. The wide range is because much depends on the take up of the service by departments and agencies and the level of price savings in the IT products purchased. By June 1999, 67 departments, 63 agencies and 72 non-departmental public bodies were registered to use G-CAT. In a customer survey in 1999, 74 per cent of those who replied considered that G-CAT provided value for money. The value of the purchases made by government departments and agencies through G-CAT in 1998-99 was, however, only some £142 million compared to total annual expenditure on IT products by departments and agencies of approximately £2 billion.

**3.24** There, is therefore, considerable scope for greater use to be made of G-CAT with the potential for significant efficiency savings. Most orders are, however, still placed by fax with less than one per cent being placed electronically. The main reasons given in a June 1999 user survey for not placing orders electronically were that departments' and agencies' existing procedures made it difficult to use or that traditional paper methods were preferred. The potential efficiency savings that are achievable in using G-CAT and other electronic catalogues are shown in Figure 22.

**Efficiency savings  
achievable from wider use  
of the G-CAT electronic  
catalogues by  
departments and agencies**

**Figure 22**

*Figure 22 shows that considerable efficiency savings from purchasing through G-CAT could still be achieved*

	£ million
Original Central Computer and Telecommunications Agency's estimate of savings	5 – 45 (depending on take up)
Estimated savings achieved since 1 April 1996	10
NAO estimate of potential savings that are possible through wider use of the G-CAT	20

Note: Using G-CAT and other electronic catalogues typical ordering costs can be reduced from £30 per transaction to 30 pence. This is because the customer can order direct from a computer terminal with no need for any internal ordering procedures. The Central Computer and Telecommunications Agency estimate that between 20 per cent and 25 per cent of the £2 billion spent annually by central government on IT products could be done electronically. Therefore, by applying the 5 per cent overall efficiency gains typically achieved by G-CAT, we estimated that around a further £20 million.

Source: Central Computer and Telecommunications Agency and National Audit Office

### 3. Framework agreements



#### i) How framework agreements operate

**3.25** Framework Agreements are contracts let competitively for a fixed period, typically three to five years. Such contracts can cover a range of low and high volume goods and services and a most common example is stationery. In such a case a supplier will be contracted to provide all of a department's stationery needs and the department may agree to purchase a minimum amount each year. Prices will be agreed when the contract is awarded possibly with some provision for price increases to cover inflation and the supplier will provide goods in required quantities when needed. The supplier will often provide a catalogue of the goods they can provide and their price in electronic format which staff will order directly from thus reducing purchasing administration costs. G-CAT is an example of an electronic catalogue framework agreement.

**3.26** The benefits of framework agreements are:

- **Price reductions.** Departments can exercise their buying power to secure discounts because suppliers have a guaranteed minimum level of sales.

- **Little or no stockholdings are needed.** Departments need to hold very little stock because the supplier is contracted to provide goods within a set time period, often at short notice or immediately, to meet departments' requirements.
- **Reduced purchasing costs.** As department staff can order directly from the supplier internal purchases processing requirements and time are reduced.
- **Good supplier relationship to improve quality of service.** If managed well, longer term framework agreements can give departments more influence to improve the quality of service which suppliers provide. This is because the supplier has a guaranteed business for a number of years and has more of an incentive to work with the department in improving quality.
- **Reduced cost of contract letting.** Central government contracts for goods and services must comply with European Commission tendering requirements – which can be expensive and time consuming. Framework agreements let by European Commission procedures enable departments to purchase goods and services under that agreement without also having to let a contract in accordance with European Commission requirements.

## **ii) Action taken by the Treasury Procurement Group to promote the use of framework agreements**

**3.27** Over the last ten years large departments and government purchasing organisations such as The Buying Agency have established framework agreements from which goods and services can be purchased on a call off basis when required. More recently departments are increasingly collaborating in their use of such agreements. Typically this can involve one department taking the lead in awarding a contract to a supplier which other departments will purchase from. A good example is the collaborative framework agreement for photocopiers negotiated for all the Research Councils, and available for use by the Higher Education Institutions. Savings from this framework agreement are estimated to be around £340,000 per annum.

**3.28** The main initiative which the Treasury Procurement Group have taken to promote framework agreements and joint purchasing between departments and agencies is the establishment of the Government Procurement Website in January 1999 (paragraph 3.17). Current facilities on the Website cover :

- **The Collaborative Procurement Register.** An on-line register holding details of collaborative contracts and projects. Procurement personnel can use the register to identify potential collaborative procurement opportunities.
- **Government Procurement Agencies.** Pages containing information on the services offered by central procurement agencies such as the Buying Agency, and the role that they can play in helping departments to increase procurement efficiency.
- **Procurement Guidance.** On-line guidance for government procurement personnel.

By July 1999 the collaborative procurement register had entries from 11 departments and procurement agencies with details of 146 collaborative contracts. The Treasury Procurement Group plan to develop the Government Shopping Mall which will feature the 'best' cross-government framework agreements for low value goods and services.

### **iii) Efficiency gains achieved so far and the potential for more**

**3.29** Twenty one of the 22 procurement officers whom we interviewed said that their organisations were part of some framework agreement (Figure 23) but the proportion of their expenditure covered by an agreement varied (Figure 24). The most typical goods and services bought through framework agreements included stationery, photocopiers, IT products, furniture and travel.

Organisations interviewed  
and the type of framework  
agreements they have in  
place

**Figure 23**

Figure 23 shows the range of commodities covered by framework agreements in 21 organisations

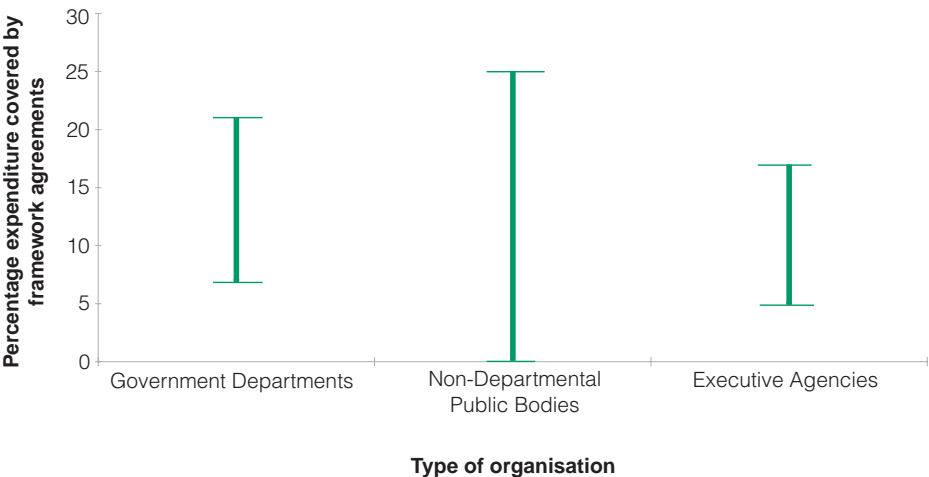
	Organisations interviewed	Examples of commodities purchased
Government Departments	8	<ul style="list-style-type: none"><li>IT equipment</li><li>Stationery</li><li>Photocopiers</li><li>Travel, freight</li></ul>
Non-Departmental Public Bodies	7 (6 have framework agreements)	<ul style="list-style-type: none"><li>Furniture and fittings</li><li>Storage cabinets, shelving, display units</li><li>Micro film readers, maintenance</li></ul>
Executive Agencies	7	<ul style="list-style-type: none"><li>Victorian benches</li><li>Uniforms</li><li>Travel (UK and overseas), hotel bookings</li></ul>

Source: National Audit Office analysis of 22 structured interviews with government organisations

Proportion of  
procurement expenditure  
covered by framework  
agreements

**Figure 24**

Figure 24 shows that the proportion of expenditure covered by framework agreements varied



Source: Twenty-two government organisations interviewed by the National Audit Office

**3.30** No precise information is held centrally of the extent of the efficiency savings and price reductions achieved by departments and agencies through framework agreements. Our interviews with procurement officers identified the following examples which suggest that there is considerable potential to achieve price reductions through departments exercising their buying power.

- *Renegotiation of existing IT framework contracts (saving over £1 million (8 per cent) on total expenditure of £12 million)*
- *Aggregation of demands for furniture through a framework agreement (saving over £360,000 (11 per cent) on total expenditure of £3 million)*
- *Collaborative procurement of office paper by three agencies (saving of between £2,000 and £5,000 (between 9 and 26 per cent) over their original contracts of £20,000 each.*
- *Negotiation of a framework agreement for supplying photocopiers (saving around £190,000 (9 per cent) on total expenditure of £2 million)*

**3.31** We also asked the 22 procurement officers whom we interviewed the price which their department or agency were currently paying for two items most commonly bought by departments and agencies – a box of A4 white paper for photocopying and a standard A4 black and white laser printer. These are typical commodities that are very much suited for purchasing through a framework agreement. We found that the price varied from £1.62 to £4.72 for a box of A4 paper and from £613 to £1,980 for a A4 black and white laser printer. While there may be a number of factors explaining the range such as paper quality and minor variations in printer specifications it does suggest that scope exists for departments and agencies to secure better deals. Departments and agencies would be in a stronger negotiating position with suppliers if there was a greater exchange of information about the prices paid for goods and the quality of service received by other departments and agencies.

**3.32** The Gershon Report included a similar comparison benchmarking electricity and gas prices paid by departments against those paid by a number of large private sector companies. This showed that the lowest prices obtained by departments were comparable to those secured by the best in private sector organisations. But the highest prices paid by departments exceeded the lowest prices paid in the private sector by 60 per cent in the price of electricity and 140 per cent in the case of gas. If the department that paid the highest rate for electricity had the benefit of the lowest rate paid by departments the saving would amount to £2.5 million per annum.



**3.33** The procurement officers to whom we spoke highlighted some potential drawbacks in departments and agencies acting together to establish framework agreements. There was some concern that small departments and agencies might be excluded because their purchasing requirements were too small and that national contracts might not offer such a good deal as local or regional contracts. Our discussions with senior heads of procurement suggested that the best way forward is for some departments to take the lead in negotiating and re competing framework agreements on a co-ordinated basis. Many procurement officers considered that such agreements should be set up on a cluster or regional basis to maximise and enhance regional networking of procurement expertise and purchasing power. In this way smaller agencies were less likely to lose out.



# Appendix 1: Study methodology

- 1** The main aspects of our methodology were:
  - We collected and evaluated information from the Treasury Procurement Group on the progress that they had made with initiatives they are promoting to implement the recommendations of the Comprehensive Spending Review on Efficiency in Civil Government Procurement Expenditure (“the PX Report”).
  - We carried out four case study examinations –
    - i) The Government Procurement Card (Forensic Science Service)
    - ii) Electronic procurement – G-CAT (Central Computer and Telecommunication Agency)
    - iii) Contractual incentives (Driving Standards Agency).
    - iv) Supply chain management (Ministry of Defence – Building down Barriers project).
  - As part of the examination of G-CAT, we analysed the business and technical IT risks to an organisation of procuring items from the G-CAT catalogue.
  - We carried out structured interviews with 22 procurement officers of Departments, Agencies and Non Departmental Public Bodies.
  - We ran a focus group of procurement officers to seek their opinions on how procurement could be improved.
  - We spoke with three companies – TNT UK Ltd, BAA plc and Nissan Motor Manufacturing UK Ltd to discuss procurement practice in the private sector.
  - We commissioned Andrew Erridge, Senior Lecturer, School of Public Policy, Economics and Law, University of Ulster to produce a paper giving an overview of literature on supply chain management and its relevance to the public sector.

- We consulted selected third parties, including government suppliers, who have an interest in procurement:
  - Electronic Data Systems Ltd
  - Computacenter
  - Warwick University
  - Tavistock Institute
  - Capita
  - SAP UK Ltd
- We commissioned RAND Europe to review procurement experience overseas to identify key lessons.
- We constituted an advisory panel to provide us with informed comment on the scope of our study; the audit methodology; our findings and their presentation in this report.

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**The National Audit Office panel**

- Dr Jonathan Cave of Warwick University Business School and RAND Europe.
  - Andrew Erridge, Senior Lecturer, School of Public Policy, Economics and Law, University of Ulster.
  - Peter Hill, Vice President of European Purchasing and Director of Nissan Motor Manufacturing UK Ltd.
-

## Appendix 2: Contractual Incentives - The experience of the Driving Standards Agency

### What are contractual incentives?

- 1** Contractual incentives are terms set within a contract to offer financial inducements to the contractor to improve a specified level or quality of service.
- 2** Incentives are useful in ensuring a high level of performance throughout the contract and for promoting innovative ways of service delivery. We, therefore, examined how contractual incentives were being used in a major government contract – that covering the Driving Theory Test of the Driving Standards Agency.

### What is the Driving Standards Agency?

- 3** The primary aim of the Agency is to promote road safety in Great Britain through the advancement of driving standards and, in particular, by testing drivers, motorcycle riders and driving instructors fairly and efficiently. The Agency is responsible for the theory and practical driving tests.



- 4** While the Agency's headquarters are based in Nottingham, the vast majority of staff are Driving Examiners working from 325 practical driving test centres plus 5 Area Offices where administrative staff book tests and schedule examiners' programmes. The Agency's operating costs are around £70 million a year.

### What is the Driving Theory Test?

- 5** The Theory Test is a multiple choice based examination introduced on 1 July 1996 to meet the requirements of the European Union Second Directive on Driver Licensing. In the past, the driving examiner would ask candidates six questions after the practical test. But the European Union require a more rigorous test: the theory test is separate to the practical test; it requires a formal examination paper, and a record of results to be retained.

**6** Theory Testing is conducted at 158 test centres across Great Britain. The current theory test fee is £15.50 and around 100,000 tests are conducted each month. Candidates have 40 minutes to answer 35 questions and 60 per cent passed in 1998-99.

## **Who Operates the Driving Theory Test?**

**7** The Agency contracted out the service delivery of the Theory Test to Drivesafe Services Ltd, a specially formed joint venture company between Capita Group and JHP Training Ltd. Following a buyout in 1997, the company is now wholly owned by The Capita Group plc. This contract is due to finish at the end of December 1999 and the next contract, with Sylvan Prometric Ltd will deliver a computer based theory test from January 2000.

## **Why did the Driving Standards Agency use Contractual Incentives?**

**8** The Driving Standards Agency opted to contract out the delivery of the Theory Test to one company. The Agency did not have the existing resources to provide the test themselves, and one company providing national coverage would ensure consistency.

**9** The theory test is a main part of the core business of the Agency. Candidates cannot take the practical test until they have passed the theory test. The Agency recognised that high reliability and good quality of service were essential. Any delays would have a knock on effect on the practical test and a consequent drop in revenue. And a poor quality of service on the theory test would reflect badly on the Agency's reputation. The Driving Standards Agency wanted to define the contract, therefore, in terms of what outputs the contractor had to deliver. The Agency evaluated each tender against a range of criteria, including cost, quality, experience and financial status.

## **What Contractual Incentives Do the Agency Use?**

**10** To ensure value for money throughout the three years of the contract, the terms and conditions also specified over twenty output measures. The measures can be classified into four main areas:

- Availability – providing a service that meets the needs of candidates.
- Responsiveness – dealing with candidates in a timely and efficient manner.

- Reliability - providing an accurate and reliable service.
- Service to the Driving Standards Agency – paying over test fees and providing accurate information to the Agency on time.

**11** The Agency monitors performance monthly. While the contractor is responsible for collecting the data and reporting results against each output measure each month, the Agency has a contract manager to examine performance and deal with issues as they arise. Contract management includes spot checks to validate that the contractor's performance reports are accurate plus an annual external validation by commercial auditors.

**12** Failure to achieve a target incurs one or more performance points. For example, in 1998 each 2 per cent below the target of 95 per cent of telephone calls to be answered within 10 seconds incurred one performance point. Total performance points each month trigger liquidated damages (compensation paid by the contractor) according to a sliding scale – see Figure 25. The scale ranges from £500 per point initially up to £2000 per point and subject to an overall maximum of £60,000 liquidated damages each month.

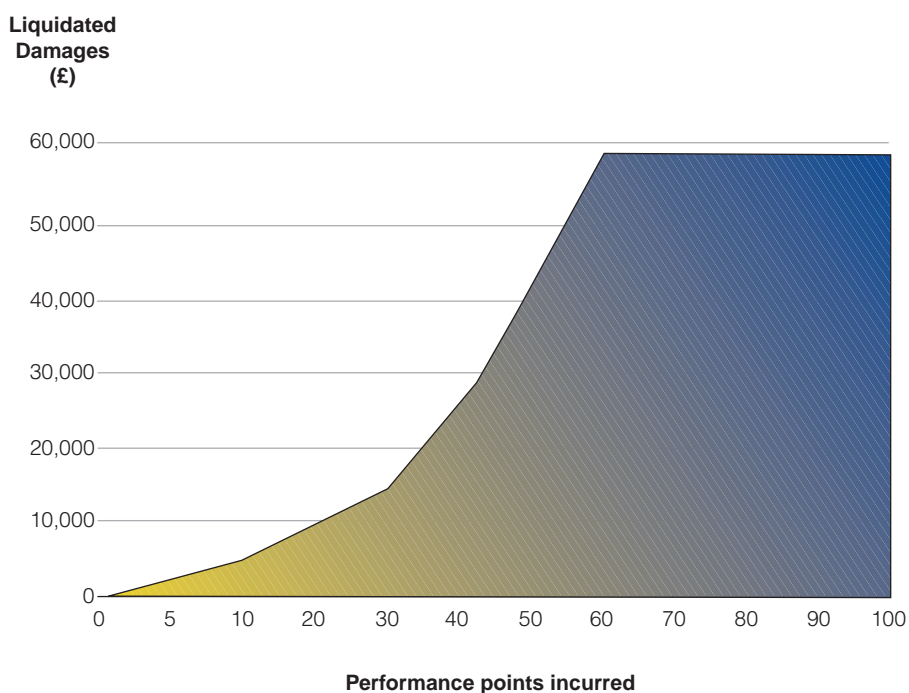
## How Successful are Contractual Incentives?

**13** Despite initial problems (there were 272 performance points incurred in the first two months), the contract with Drivesafe has run well. Some 1.2 million theory tests are conducted each year. And only 3 per cent of the respondents to the customer service questionnaire Drivesafe are required to send to a sample of candidates each month were dissatisfied with the overall level of service in 1998-99 - even though 40 per cent of candidates fail the test each month. Total liquidated damages paid by the contractor to the Agency over a 37 month period amounted to £314,500 excluding VAT.

## The rising scale for liquidated damages

**Figure 25**

Figure 25 shows that as more performance points are incurred the compensation (liquidated damages) which the contractor has to pay the agency increases.



Source: Driving Standards Agency

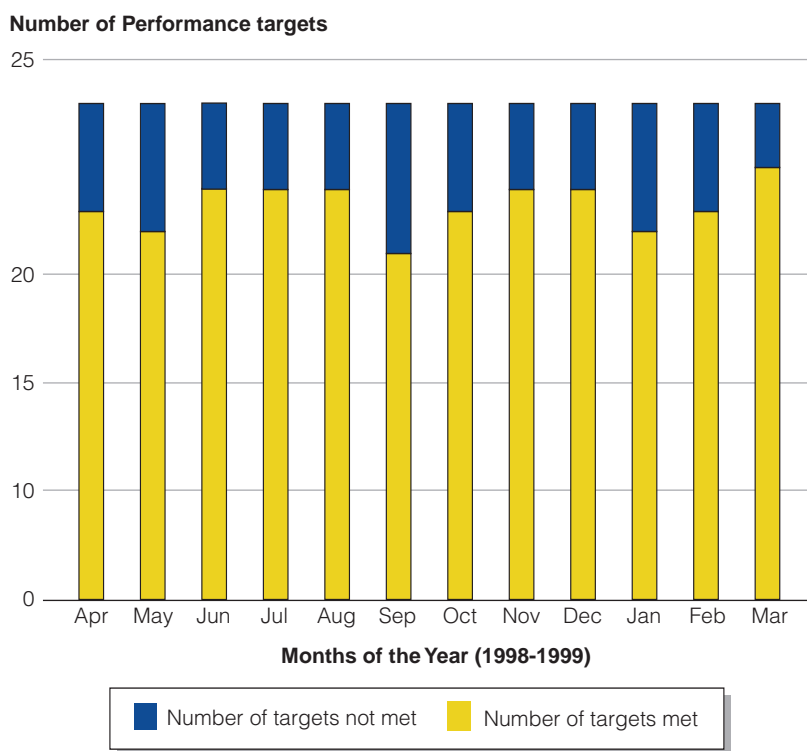
**14** A satisfactory performance, however, does not mean that every target is met each month. At least three targets were missed each month in 1998-99 and seven targets were missed in September 1998 – see Figure 26.

**15** Drivesafe worked closely with the Driving Standard Agency to deliver the driving theory test and the company and the Agency consider that its high quality service (evidenced by the ISO 9002 quality standard) contributed to the Agency regaining its Charter mark in December 1997.

## Performance in meeting targets

**Figure 26**

Figure 26 shows the number of performance targets which were not met each month in 1998-99



Source: Driving Standard Agency

## What are the wider lessons?

**16** The Driving Standards Agency experience with the Driving Theory Test suggest four main lessons:

- 1 All substantial contracts might incorporate contractual incentives.** Specifying and agreeing performance measures, targets and levels of liquidated damages requires considerable up front work. The Chief Executive and other senior staff from the agency were involved in post tender negotiations with Drivesafe for nearly 3 months. Such effort might only be cost-effective for larger contracts. Major benefits from having contractual incentives are:
  - It encourages the organisation to identify exactly what is wanted from the contract.
  - The process helped the Agency concentrate on the likely whole life cost, reliability and quality offered by each tenderer before letting the contract.

- The contractor's staff know exactly what levels of service are expected from them.
- Poor performance is penalised. It is in Drivesafe's interest, both financial and in terms of reputation, to maintain the standards specified.

**2 Contract management arrangements need to be clear.** Contract management should not be resource intensive and arrangements need to be clear for it to be cost-effective. One contract manager and five staff in the Driving Standards Agency spend some forty per cent of their time on this contract – equivalent to some £45,000 a year. And there are other additional costs. As part of the specifications Drivesafe is required to appoint external auditors to audit annually the system which reports their monthly achieved targets. The cost of this is factored into the overall contract costs. It is important, therefore, that:

- The contract manager has a well defined job description and understands the role.
- The contract manager has the financial and operational authority to make decisions on the contract.
- All communication with the contractor goes via the contract manager.
- The contract manager has the necessary 'people skills' to negotiate with the contractor, retain their independence and build a professional close working relationship with the company.
- The onus should be on the contractor to report on performance each month.

**3 Contract management requires good practice principles to be applied consistently.** The contract is a working document to underpin a close working relationship. Key principles include:

- The contract manager requires independence and professionalism to refute any unsubstantiated requests for mitigation by the contractor. Poor performance should incur performance points unless the contractor can demonstrate they were not responsible for the lapse.



- The contract manager should recognise and deal with necessary contract variations.
- The contract manager should examine and validate performance each month – figures should not be taken at face value.

**4 Choose between liquidated damages (provision for financial compensation) and incentives.** The Driving Standards Agency opted to use performance points that incurred liquidated damages above a specified level for their theory test contract with Drivesafe. The Chief Executive recognised that the contractor had to deliver the theory test to the same standards of service as the practical test. Performance above the practical test offered minimal additional benefit to the Agency but less than adequate performance would put delivery of the Driving Theory Test at risk. The risk of liquidated damages (financial compensation) was considered by the Agency to be the best incentive to ensure a reliable standard of service.

## Appendix 3: Defence Estates: Building Down Barriers – supply chain management

### What is supply chain management?

**1** Supply chain management is the process by which every stage of the procurement of goods or services is managed from beginning to end. It can extend from the end customer to second or third tier sub-contractors. The aim of supply chain management is to improve the quality of the product or service being bought, to eliminate waste and excessive costs and to improve delivery times.

**2** To examine the potential benefits of good supply chain management in the public sector, we looked at the experience of Defence Estates in managing the initiative – Building Down Barriers. While this project is concerned with construction, supply chain management is used widely by industry in buying goods and services we, therefore, explored its wider applicability for the types of non construction purchasing undertaken by departments and agencies.

### What is Defence Estates?

**3** The Defence Estates was first launched in March 1997. Its mission is “to deliver estate solutions to defence needs since, ultimately, Defence Estates exists solely to support the delivery of defence capability and for no other purpose. The primary objectives of the Agency are:



- To ensure that the defence estate is of the appropriate size and quality for the delivery of defence capability.
- To ensure that the defence estate is managed and developed cost-effectively, in line with acknowledged best practice.
- To ensure that the defence estate is managed in line with government policy on the environment.

## What is Building Down Barriers?

**4** The Building Down Barriers initiative was established in January 1997, and runs until late 2000. It entails the design and construction of two similar physical and recreational training centres in Aldershot and Wattisham. Work on the construction of the two centres started in May 1999. It is funded by the Department of the Environment, Transport and the Regions and by Defence Estates of the Ministry of Defence. The initiative has three objectives:

- To develop a supply chain management tool set to support the introduction of a new approach to construction procurement, called Prime Contracting.
- To demonstrate the benefits of the new approach, in terms of improved value for the client and profitability for the supply chain through running two pilot projects.
- To assess the relevance of the new approach to the wider UK industry.

## What is the Building Down Barriers approach to supply chain management?

**5** Defence Estates decided to pilot this novel approach on the design and construction of two similar training centres containing gyms and swimming pools. It wanted to contract with one party in each case – Prime Contractor - and work with them to design in maximum functional performance and design out waste and inefficiency in the construction process and the subsequent management and maintenance of the facilities. This systematic approach to the procurement and maintenance of buildings draws on the best available tools, techniques and practices, including through-life costing, supply chain management, value engineering and risk management. It aims to achieve significant improvements in value for money, profitability and the functional efficiency of the completed buildings. Prime contracting should replace short-term and adversarial supplier relationships with long-term ones based on trust and co-operation. Key features of the approach include:

- strategic alliances between the prime contractor and its suppliers;
- continuous improvement targets to reduce costs and enhance quality;

- the use of a systematic analysis of the weaknesses and strengths in the existing design and construction process; and
- a focus on the through-life cost and functional performance of the building.

## **Why did Defence Estates start the experiment?**

**6** In 1996, Defence Estates reviewed the performance of construction industry firms dealing with its £1.7 billion works procurement programme. It concluded that excellent performance was rare and, in common with other organisations, was paying unnecessarily high costs for an inefficient and wasteful process which all too often delivered functionally inefficient buildings and facilities. The Latham Report had also estimated that potential savings of 30 per cent were possible on construction projects. Defence Estates identified that there was tremendous potential for standardisation between buildings based on the commonality between processes, components and materials. It saw that multiple benefits would arise if the experiment worked. For owners and users, buildings would have cheaper capital and running costs and would better serve the functional needs of the users and there would be more accurate forecasts of maintenance and energy costs.

## **What did they do?**

**7** Defence Estates decided to fund a major research initiative to develop the necessary supply chain management process and to test out the process on real projects. The initiative has two stands: the two pilot projects; and the research and development to support those projects, to develop the approach and associated tool-kit and to evaluate the initiative. The pilot projects chosen were the design and building of two army physical and recreational training centres at Aldershot and Wattisham.

**8** The Tavistock Institute and the Warwick Manufacturing Group, Warwick University were appointed to the Research Group to act as evaluators and facilitators of the initiative. In early 1997, Defence Estates, the Research Group and two construction firms AMEC and Laing devised a satisfactory supply chain process to begin the two projects. Initial contracts were awarded to Laing and AMEC in June 1997. Second-stage contracts for detailed design, construction and maintenance of the training centres were issued in January and February 1999.

**9** Laing and AMEC organised their projects on the basis of “supply clusters”, each slightly different but both based round aspects of the work such as the frame and envelopes or mechanical and electrical services. This allows all those involved in a particular area to participate in the design development, breaking down barriers between those who design, who bid prices and who deliver.

**10** Building Down Barriers identified five specific phases in the life of a prime contracting construction project: inception; definition and appointment of prime contractor; concept design; detailed design and construction; and post hand-over. This latter stage is very important and involves the prime contractor maintaining the building until he has proved the accuracy of his cost prediction of running costs.

## **What lessons have been learnt so far?**

**11** The Tavistock Institute and the Warwick Manufacturing Group carried out an interim evaluation of the initial phases of Building Down Barriers. The research costs of the initiative have been some £1.6 million to date. The Group reported on the interim evaluation under the seven underlying principles of the initiative in March 1999. A summary of the results is given below.

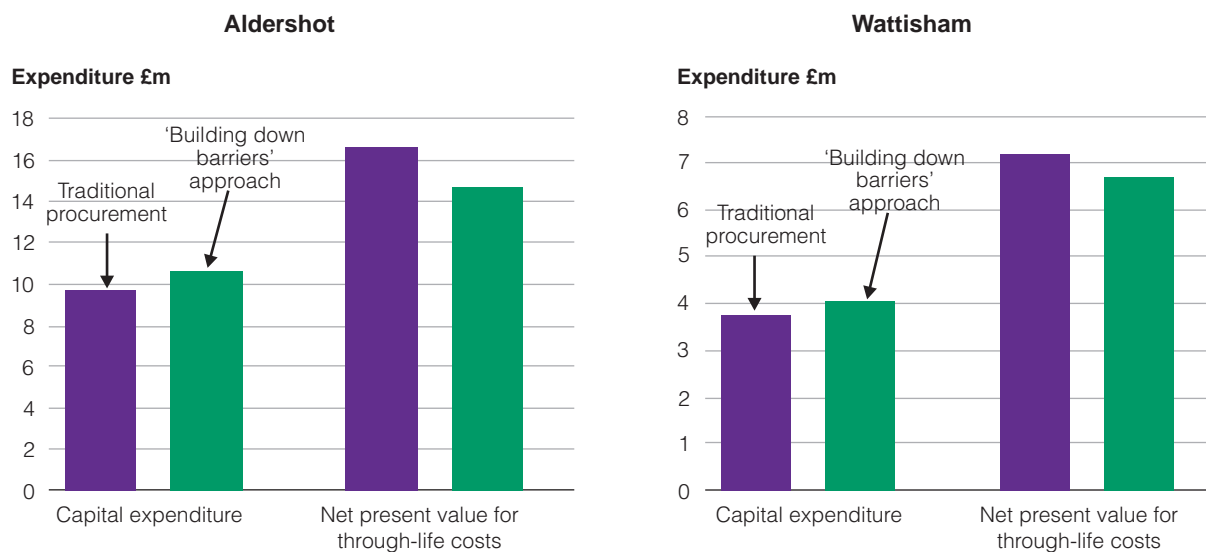
### **Compete through delivering superior underlying value rather than lower margins**

- The designs produced for the pilot projects met the output based functional specification to a very high standard.
- Predicted through-life costs compare very favourably (seven or eleven per cent below) with the benchmark cost for a similar building procured using the Ministry of Defence’s established design and build method although capital costs alone are higher (Figure 27). Calculating the benchmark costs was difficult and contractors regard them as too low.
- Capital costs are higher due to the use of high quality and durability components and materials in order to reduce running costs, such as the investment in a combined heat and power installation at Aldershot.

**Figure 27**

**Comparisons of predicted costs**

Figure 27 shows that supply chain management has resulted in lower predicted through-life costs of 7 per cent (Wattisham) and 11 per cent (Aldershot)



Source: Building Down Barriers: Interim Evaluation Report March 1999

- AMEC and the Ministry of Defence have agreed that the further savings made during the building of the Aldershot centre will be shared between themselves. At Wattisham, Laing has built in a four per cent saving on capital expenditure into its guaranteed maximum price although evidence from the early works suggests that the saving will be greater.
- The process has worked by removing costs not by squeezing profit margins.

### **Establish long-term relations with key suppliers**

- Prime contractors have laid the foundations of some long term supplier relations. However, the incorporation of targets for rigorous performance improvement remains a challenge.

### **Manage the supply chain through supply clusters**

- Contracting and key elements of responsibility for design were initially centralised as prime contractors have had difficulty passing authority to the supply clusters.

### **Make “value” explicit: design to meet a functional requirement for a through-life cost**

- Both projects have made considerable progress in implementing a rigorous approach to value management in developing designs and costing them.

### **Involve the supply chain in design and cost development**

- Costing of design options was considerably slower and more difficult than anticipated. There is scope for improving the efficiency of this procedure and for generating more reliable cost data. During the detailed design and construction stages, the supply clusters have become more involved and the process improvement teams have cut the cost of some elements by up to 60 per cent.

### **Develop continuous improvement within the supply chain**

- Both projects have set up systems for achieving continuous improvement. Application of these systems during the construction phase has proved to be crucial.

### **Promote collaboration through leadership, facilitation, training and incentives**

- Most participants reported that they had learnt a lot from this process.
- Learning and facilitating change on these projects has consumed a great deal of time and resources.
- The Building Down Barriers approach has required change at the corporate level of the prime contractors and suppliers as well as at project level.

## **What departments and agencies need to consider before they adopt a similar approach?**

**12** Supply chain management is neither appropriate nor cost effective for all types of contract. For government departments, in addition to construction contracts, it is likely to be best suited for facilities management contracts, where one company is contracted to supply a range of services required by a building or establishment such as catering, cleaning, security, maintenance and utilities, for major consultancy type contracts and for equipment and other large scale contracts with potential environmental impacts.

**13** Using supply chain management in the Building Down Barriers way requires commitment from the client and the suppliers involved and this commitment must come from the top of those organisations. Departments and agencies need to be aware of the following before undertaking this approach:

- The cost of the exercise in resources and management time will be considerable. Any project using this approach should be important. It must be demonstrably cost-effective to devote resources to getting the performance and quality right.
- The project should be specifiable in terms of the output required to enable suppliers to offer innovative ways of delivery.
- Similar contracting opportunities should be available in the near future. Cost reductions, especially on capital expenditure, are more likely to accrue on subsequent projects.
- There should be evidence of waste and inefficiency in the current supply arrangements which can be addressed by better “design” and “deliver” collaboration.
- The initial use of the process should be independently evaluated when it is on-going and at the end.
- There should be scope for continued cost and quality improvements.



## Appendix 4: Procurement Cards in the Forensic Science Service

### What is a procurement card?

**1** A procurement card is similar to a corporate card and allows specified employees to purchase low value goods and services such as small items of equipment, training courses, and publications on behalf of their organisation. Cardholders can place their orders for goods and services by telephone, fax, purchase order or in person. At the end of each month, each cardholder receives a statement to verify their transactions and a consolidated statement from the provider is sent to the finance section for payment. In October 1997, the Treasury Procurement Group introduced the Government Procurement card run by VISA which all departments and agencies can use.

**2** Procurement cards can significantly reduce purchase processing costs and we, therefore, examined how procurement cards are used by one agency, the Forensic Science Service who adopted the Government Procurement Card in June 1999. Previously the Service had operated its own procurement card - run by National Westminster Bank Plc – since April 1996.

### What is the Forensic Science Service?

**3** The Forensic Science Service is an executive agency that undertakes scientific examination of evidence to support police investigations. The agency merged with the former Metropolitan Police Forensic Science Laboratory in 1996 and staff numbers increased from 847 to 1,800 in 1999. The Forensic Science Service has six laboratories and a head office in Birmingham; operating costs are some £73 million a year.



### What are the benefits of procurement cards?

**4** The purpose of procurement cards is to improve the method of purchasing and payment for low value transactions which often attract disproportionately high processing costs. There are significant financial benefits from procurement cards. Procurement cards reduce paper work and the amount of time procurement and finance staff have to spend in processing requests to purchase. The introduction of procurement cards in the Forensic Science Service has enabled the agency to meet an increasing workload after its merger without having to employ

additional finance and procurement staff. The agency had 73 procurement cards at the end of 1998-99. Over the year, cardholders used their cards nearly 3,500 times, with an average transaction value of £158. The main benefits are:



**Improvements in finance staff efficiency.** The procurement card has enabled the finance section to absorb the increase in volume without increasing staff. Finance staff paid suppliers nearly £13.4 million in 1998-99, and this required some 6,000 separate payments. But the additional 3,500 transactions bought using the cards only contributed one invoice a month; without the card, finance staff would have had to make some 7,000 payments. Each monthly invoice requires more checking than an individual transaction, but our discussions with the Head of Finance confirmed that the net impact had been an extra cost of £12,000 a year.



**Improvements in procurement staff efficiency.** The procurement card has enabled the procurement section to reduce the number of requisitions handled on small value transactions by 38 per cent. It removes the need for the completion of a requisition by the originator and order processing by the procurement section and allows the originator to purchase the item direct. The procurement card reduced the workload by nearly 3,500 requisitions, leaving procurement staff to deal with 5,300 requisitions in 1998-99. Discussions with the Head of Procurement confirmed that the net impact of the card had been an efficiency gain of approximately two procurement staff – equivalent to some £25,000 a year.

- **Quicker procurement.** Forensic Science staff often require items at short notice in order to complete a specific scientific test. Before the procurement card, it would usually take 3 to 4 days for processing requisitions and generating orders. The procurement card enables staff to purchase an item immediately and receive it much more quickly.
- **Useful management information.** The monthly statements from the provider provide detailed information on the types and values of transactions made by the Forensic Science Service. Typical management reports include:
  - Individual transactions by cardholder.
  - A breakdown of expenditure by item.
  - A breakdown of expenditure by supplier.

- Exceptions reports – details of any transactions that appear unusual.

**5** Finance and procurement staff use these reports to check the cards are used properly and to identify patterns and trends – such as whether there is sufficient business with one supplier to merit negotiating better prices through a framework agreement.

## What are the risks?

**6** As with any method of payment, there are risks that the procurement card might be used fraudulently. We have established, however, that with proper safeguards, the procurement card is as secure as any other procurement method. The three main risks and how the Forensic Science Service have addressed them are:

Risk	Safeguard
Procurement of goods for personal use by the cardholder	<ul style="list-style-type: none"> <li>◆ The cardholder must be a permanent employee and have been with Forensic Science for at least 12 months.</li> <li>◆ The cardholder is subject to security and credit checks.</li> <li>◆ The cardholder is informed that any misuse will be treated as a disciplinary offence</li> <li>◆ Each cardholder maintains a log of transactions. The cardholder's manager checks the log each month and reconciles the record to the monthly card statement.</li> <li>◆ Card use is restricted to transactions below a certain amount and to specific types (for example, cash withdrawals are excluded).</li> </ul>
Use of card by unauthorised staff	<ul style="list-style-type: none"> <li>◆ The cardholder is instructed to keep the card and any personal identification number secure. Failure to do so is a disciplinary offence.</li> <li>◆ Line managers must authorise cardholders' statements each month.</li> </ul>
Collusion between cardholder and supplier	<ul style="list-style-type: none"> <li>◆ As with other methods of procurement, this risk is difficult to eliminate. Forensic Science minimise the risk by examining monthly management reports of expenditure by supplier and by item to look for anomalies and trends.</li> <li>◆ The cardholder's manager examines the log for evidence of goods received and price paid.</li> </ul>

## What are the wider lessons?

**7** The Forensic Science Service's experience with procurement cards suggests four main lessons:

**1 Procurement cards are better suited to some types of organisation.** The card is likely to be of greater benefit to those organisations (or parts of an organisation) with similar characteristics as the Forensic Science Service, where:

- Routine procurement is devolved to operational staff – employees delivering the organisation's core work.
- It is not cost-effective or practical to keep stores.
- Items are needed at short notice, staff cannot wait several days for goods to be ordered.
- Sufficient numbers of routine transactions are not already covered by framework agreements.

**2 The card is best suited to particular types of transaction.** In particular:

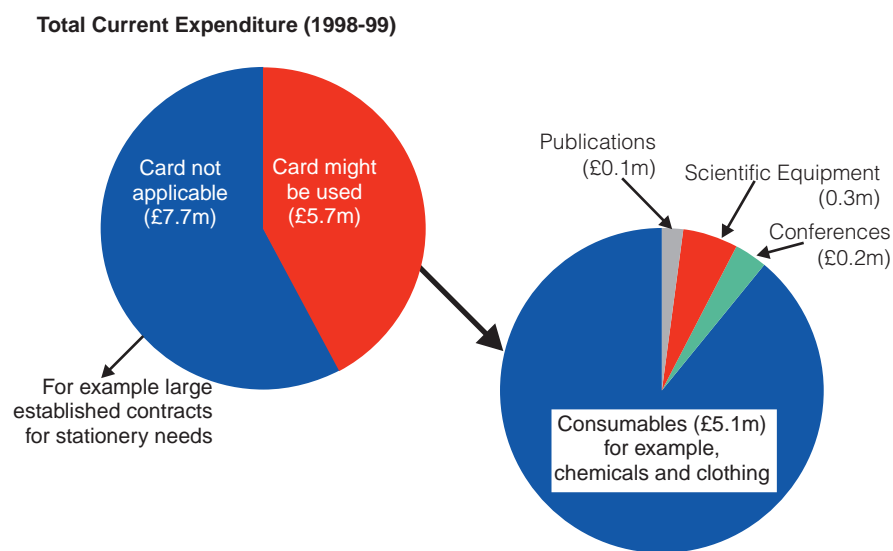
- Items not already covered by framework agreements.
- Items that need to be bought at short notice.
- Items where the main supplier accepts the procurement card. Some organisations, such as small local suppliers, might not accept the card.

Forensic Science typically use the card for four main categories of expenditure (see Figure 28)

## Types of goods and services bought by the Forensic Science Service

**Figure 28**

*Types of goods and services bought by the Forensic Science Service*



Source: Forensic Science Service

### **3 Implementation.** Issues to consider include:

- **The procurement card requires considerable up front work.** The Forensic Science Service had to revise its disciplinary procedures, training programme, finance and procurement systems in order to accommodate the card. Accounting codes, for example, had to be changed to reflect the expenditure categories used on the monthly statements for the procurement card.
- **Provide clear guidance** to staff on how to use the card, security precautions and how to keep a log of all transactions made.
- **Issue cards to the right people.** Cards should be issued to operational staff competent enough to maintain proper control over their use.

- **Train staff how to check card use.** Minimising the risk of abuse relies on cardholders knowing that someone might check what they have bought. Staff responsible for such checking need advice on what to look out for and how to deal with anomalies – especially when the cardholder is a senior member of staff.
  - **Restrict usage to avoid VAT problems.** Purchasing VAT exempt or non-refundable VAT items alongside VAT refundable items on one card causes administrative problems for finance staff. Where possible, use category restrictions on each card to minimise such risk. For example, library staff might have their cards restricted to buying books and periodicals only.
- 4 Day to day management. The procurement card system requires regular management input. Key tasks include:**
- **Checking levels of usage.** Issuing a card does not mean it will be used. Management should check monthly usage and, where usage is low, either withdraw the card (if it is unlikely to be used) or encourage the cardholder to make purchases on the card rather than through the in-house requisitioning system.
  - **Be seen to monitor use of the card.** All cardholders should expect a selection of their transactions to be checked regularly. Too much checking is not cost-effective, too little increases the risk of card abuse.

## Appendix 5: Electronic Commerce using G-CAT

### What is Electronic Commerce?

**1** Electronic commerce involves using electronic networks to simplify and speed up all stages of the procurement process, from design and production for developmental projects, to buying, selling and delivery for all other goods and services. A core element of the Treasury's phased introduction of electronic commerce is to encourage more departments to use electronic catalogues to order and purchase goods. We examined progress in using G-CAT as it is one of the major electronic catalogues available to government departments and agencies.

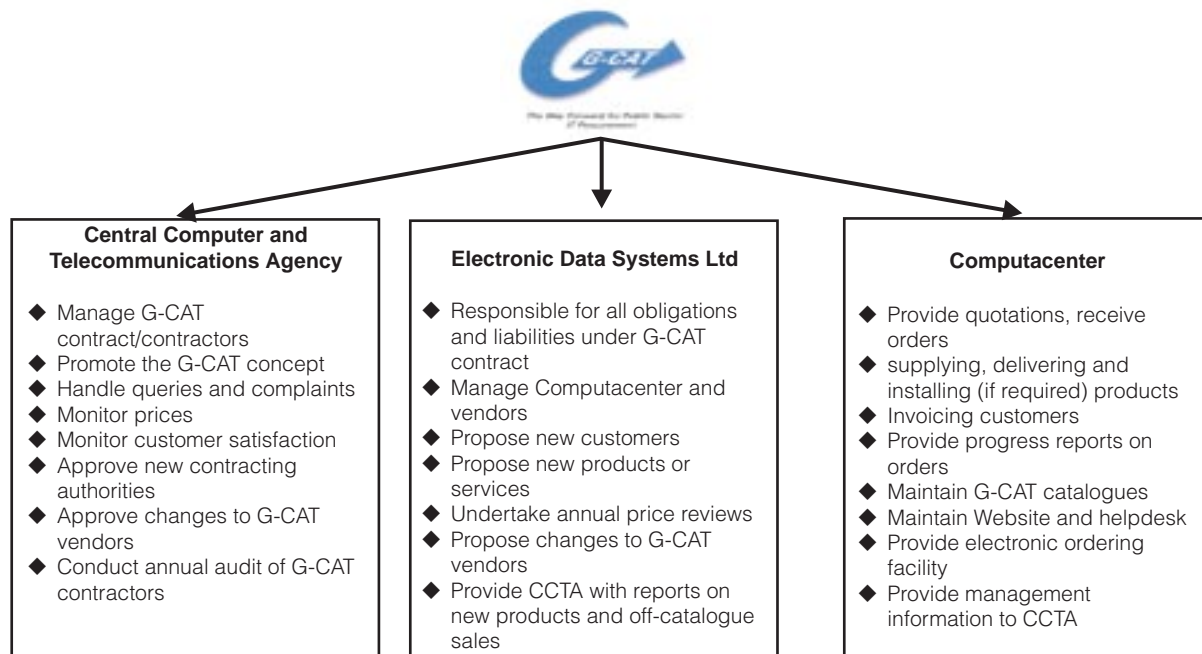
### What is G-CAT?

**2** G-CAT is the Government catalogue of IT products. Departments and agencies and other users can buy a range of IT products through the catalogue including for example, software programmes, hardware and support equipment. The catalogue is managed by the Central Computer and Telecommunication Agency (CCTA), operated by Electronic Data Systems Ltd (EDS), with responsibility for the ordering and supply arrangements sub-contracted to another company Computacenter. Figure 29 shows the responsibilities of these three organisations. EDS won the contract to operate G-CAT competitively in 1996. The G-CAT catalogue covers over 20,000 products.



**Figure 29**

**Responsibilities and relationships between G-Cat partners**



This shows the various responsibilities of the three parties to the G-CAT agreement

Source: Central Computer and Telecommunications Agency

## Who uses G-CAT?

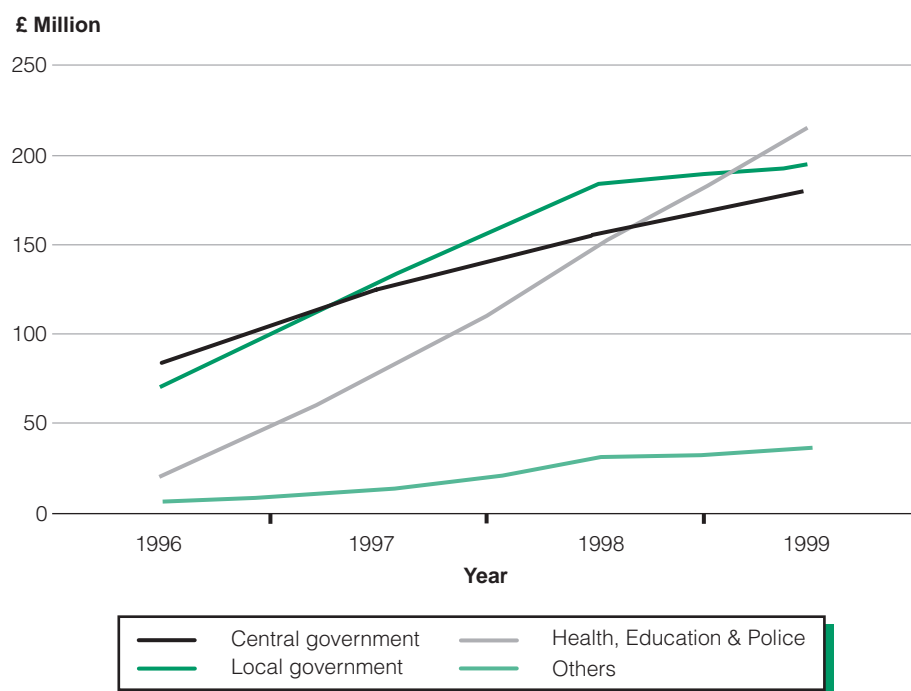
- Since the end of 1996 the number of registered users of G-CAT – central government departments, local government, health, education and police authorities has increased from 175 to 616 in March 1999, a 350 per cent increase (Figure 30). The number of registered users who actually made a purchase through G-CAT was, however, around 370 in 1998-99.
- The number of suppliers included on the G-CAT catalogue has increased from 101 in 1997-98 to 230 in 1998-99.
- The value of purchases through G-CAT has increased from £35 million in 1996-97 to £142 million in 1998-99 (Figure 31). This is relatively small when compared to annual expenditure by Central and Local government on IT products and systems of £4 billion.
- Forty-eight per cent of purchases by value through G-CAT was attributable to only 15 customers.



## Registered users of G-CAT

**Figure 30**

*The number of registered users of G-CAT has more than trebled since 1996*



Source: National Audit Office  
analysis of Computacenter  
user information

Figure 30 shows how the number of registered users of G-CAT has increased since 1996

## How does G-CAT operate?

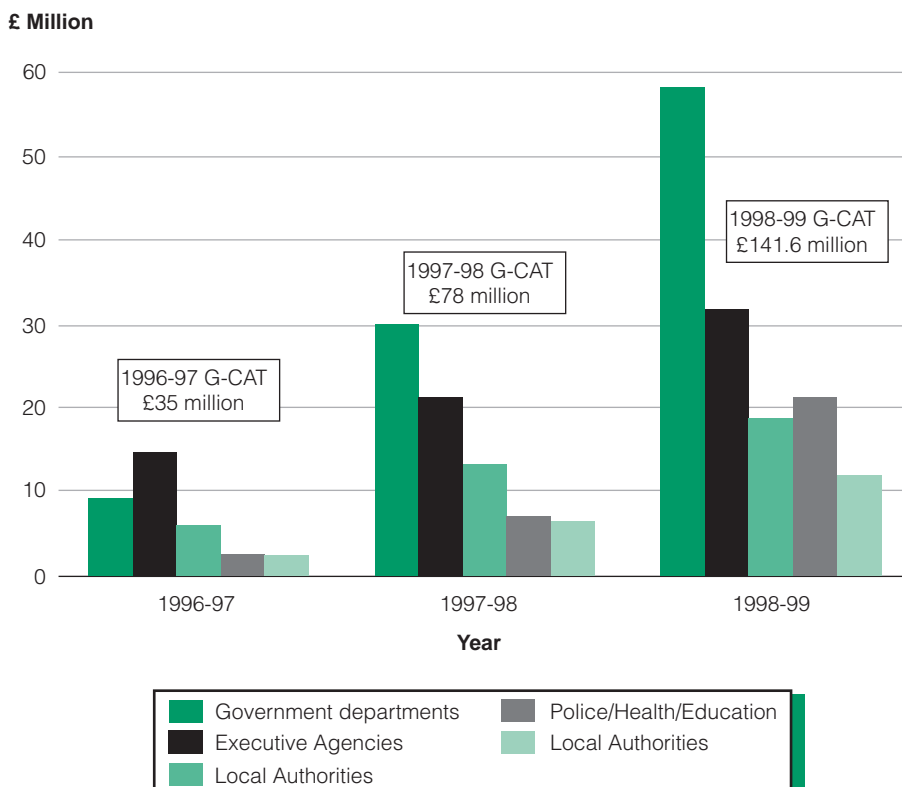
**3** G-CAT operates on an open website – any one can view it, although access to the full catalogue and ordering facility is restricted to pre-registered customers who use a password to gain access. The G-CAT catalogue is also available on a CD-ROM or as a paper catalogue containing a subset of 6,000 items. Products can be ordered electronically from the website, via a dial up facility incorporated in the CD ROM, by fax, or by telephone.

**4** Most orders are placed by fax with less than one per cent being placed electronically. The main reasons given in a June 1999 customer user survey for not placing orders electronically were that the organisations' procedures made it difficult to use or that the traditional paper methods were preferred.

**Value of purchases  
through G-CAT sales -  
1996-97 to 1998-99**

**Figure 31**

*Figure 31 shows how the value of purchases made through G-CAT increased between 1996-97 to 1998-99*



Source: Central Computer and Telecommunications Agency

## How good is the quality of service?

**5** The Central Computer and Telecommunications Agency carry out a customer user survey each year to obtain feedback on the quality of service provided by G-CAT. Feedback from these surveys has been fairly positive, although there have been some criticism of the price of products included in the catalogue, and the speed in providing a quotation and delivery. The 1999 customer survey showed an overall satisfaction level of service of 70 per cent.

## Are the security controls adequate?

**6** The Central Computer and Telecommunications Agency have not undertaken a formal risk assessment of purchasing electronically through G-CAT. The Agency's view is that the electronic ordering arrangements, which incorporate UserID and password security and utilise standard internet

encryption technology, are at least as secure as fax and no additional risks exist. We found that the system is adequately controlled except for a small risk that a customer dispute might be difficult to resolve in the absence of a written signed order. Many of the heads of procurement whom we interviewed considered that departments and agencies need to develop greater confidence and familiarity with E-commerce and that agreed public sector standards setting out the procedures that need to be in place to minimise the risk of impropriety with electronic commerce would promote greater use.

## What are the costs and benefits of G-CAT?

**7** The main benefits of G-CAT are:



- **Reducing processing costs.** Placing orders via an electronic catalogue minimises the administrative costs of preparing and processing an order. Typically, ordering costs can be reduced from £30 per transaction to 30 pence. The Central Computer and Telecommunication Agency originally estimated that G-CAT could achieve efficiency savings of between £5 million to £45 million over a five year period depending on the number of contracts let and the volume of purchases.



- **Benchmarking prices.** The Central Computer and Telecommunications Agency monitor the price of goods included in G-CAT. 8 of the 22 procurement officers we interviewed said that they used the G-CAT catalogue to benchmark prices to ensure that they were getting value for money. In the Agency's 1999 customer survey 74 per cent of those who replied considered that G-CAT prices were competitive. The price of some products for example, telecommunication equipment was, however, considered to be high.



- **Efficiency savings through bulk buying.** G-CAT provides small customers with bigger buying power and additional discounts can be negotiated for bulk purchases. For very large requirements, where customers are prepared to consider offerings from different manufacturers, G-CAT will run internal competition amongst its suppliers. The G-CAT mark up is not normally disclosed to customers, but a degree of transparency has been negotiated by some large customers, particularly those which have been using G-CAT strategically. A few larger customers have also negotiated a retrospective discount based on the value of purchases transacted through G-CAT during the year.



■ **Reducing the cost of complying with European Union (EU) Supplies and Services Directive.** As the G-CAT contract was awarded following the EU procurement directive procedures, there is no need for G-CAT customers to conduct separate EU procurement exercises for large scale specific IT products, bought through the catalogue. Letting a contract in accordance with EU procurement directives can cost in excess of £50,000 and for a major framework contract can be as high as £500,000 to administer.

■ **Improved management information and control.** The data provided by Computacenter on quotations together with invoices is generally comprehensive with reliable information for audit purposes. 8 of the 22 procurement officers we interviewed considered, however, that better data was required to monitor expenditure against budgets. G-CAT will shortly offer their customers on-line access to their purchase records.

8 Since 1996 the Agency estimate the efficiency improvements achieved have been of the order of £10 million. They estimate that further efficiency improvements of some £17 million will be achieved over the next two years.

## **What is needed to promote wider use of electronic catalogues?**

9 There is considerable potential for G-CAT to be used more widely by departments and agencies to achieve significant improvements in the way IT goods and services are purchased in terms of both quicker elapsed times and reduced processing costs. To do so the Central Computer and Telecommunications Agency should

1 **Arrange more publicity** to encourage more departments and agencies to use G-CAT.

2 **Disseminate more widely** the efficiency savings which can be achieved from using G-CAT and other electronic catalogues.

3 **Set out the control procedures** which need to be in place in using electronic catalogues to minimise the risk of impropriety. This should give departments and agencies more confidence to use electronic catalogues.

4 **Provide periodic feedback** to customers in the form of price comparisons to demonstrate the advantages of using the G-CAT.

# **Appendix 6: Supply Chain Management and Public Procurement - paper by Andrew Erridge, Senior Lecturer, School of Public Policy, Economics and Law, University of Ulster**

## **1. Introduction**

The purpose of this paper is:

- to provide an overview of supply chain management literature with reference to organising frameworks suggested by various authors
- to relate supply chain management approaches to the public sector
- to examine the relevance of partnership or closer relationships with suppliers to the public sector
- to propose means by which supply chain management thinking may be incorporated into the contractual process at an early stage.

## **2. Supply Chain/Network Models**

There is an extensive body of literature on how customer-buyer-supplier relationships may be conceptualised. Three summarising reviews of this literature are discussed briefly here, not in any sense as a comprehensive introduction to the body of knowledge in this area, but to provide mental models (please see Appendix, Tables 2-4). Harland (1996), whose empirical work was based on the NHS, categorised supply chain models as: Internal (integration of business functions); Management of supply relationships (mainly between a single supplier and a single customer); Management of inter-business chains ('pipeline management', where position in the chain will affect demand volatility and distortion of logistics information); and Strategic Management of inter-business networks (effective harnessing of the resource potential of the network) (see Table 2).

According to Harland, effectiveness of supply can be enhanced through analysis of network performance (single/multi-sourcing; variability of structure), chain performance (reducing distortion; improving speed and cost performance) and relationship performance (sharing information; measuring performance of relationship, incorporating customer perceptions).

McIlroy (1999) divides the literature into four groups: the early innovators from whom supply chain ideas such as value chains and portfolio analysis emerged; the supply chain co-ordination approach with a focus on improved logistics and chain or 'pipeline' management; the network approach which examined structures eg Japanese network sourcing and the complex interactions of customers and suppliers in search of reduced costs and better value; and the collaboration/partnership approach focussing on relationships based upon trust, shared responsibility, risks and rewards (Table 3).

Croom et al (1999) provides a similar categorisation in relation to the 'extent of analysis' ie how far up and down or across the supply chain or network analysis should extend. They distinguish dyadic (eg one customer to one supplier or distributor), chain (supplier - customer – distributor) and network (upstream to suppliers, downstream to customers, and the whole network) as levels of analysis (Table 4).

The main conclusion which can be drawn about supply chain management from this brief overview is that no single model can be applied in all cases. There is however some agreement on aspects of supply management which are necessary (Cox and Lamming 1997):

- a focus on effective management of the total supply chain;
- careful selection of suppliers who can assist in cost reduction, quality improvement and innovation transfer;
- active development of supplier capabilities and joint assessment of relationships;
- Board level representation and cross-functional operational relationships.

The overarching frameworks presented in Table 2-4 and these agreed aspects of supply management provide the basis for developing practical ways of adopting supply chain management approaches appropriate to the public sector.

### 3. Public Procurement

In the private sector business goals which have led to the adoption of supply chain management approaches are overwhelmingly commercial, usually reduced costs, but also increased quality and the development of innovative products or processes to achieve competitive advantage. In the public sector the commercial aspect is still a key goal related to more effective public expenditure control (Treasury/Cabinet Office 1998) and ultimately better value for taxpayers. In addition, though, two further aspects need to be considered, those of Regulation and Social Responsibility. Regulation embraces audit, accountability and compliance with national (Treasury 1988) and international rules ensuring competition for supply and transparency in the award of contracts (eg European Directives on Public Procurement, WTO Government Procurement Agreement). A third priority which may conflict with both commercial and regulatory approaches is the social responsibility of government. For example, can government use public procurement to support local economic development while at the same time taking advantage of efficiency savings through open competition or complying with regulations on transparency? Table 1 suggests where a supply chain management approach may be beneficial under each of these strands.

**Competing strands of public procurement and supply chain management (adapted from McIlroy 1999)**

**Table 1**

Strand	Key themes	Achieved through	Benefits of Supply Chain Management Approach
<i>Commercial</i>	<ul style="list-style-type: none"> <li>■ value for money</li> <li>■ economy</li> <li>■ efficiency</li> <li>■ effectiveness</li> </ul>	<ul style="list-style-type: none"> <li>■ competitive supply</li> <li>■ closer relationships with suppliers</li> <li>■ longer contracts</li> <li>■ facilities management</li> </ul>	<ul style="list-style-type: none"> <li>■ reduced costs</li> <li>■ improved quality</li> <li>■ lower transaction costs</li> <li>■ improved relationships</li> <li>■ improved logistics upstream from suppliers and downstream to customers</li> </ul>
<i>Regulatory</i>	<ul style="list-style-type: none"> <li>■ competition</li> <li>■ transparency</li> <li>■ equality</li> <li>■ compliance</li> </ul>	<ul style="list-style-type: none"> <li>■ EU Public Procurement Directives</li> <li>■ public purchasing guidelines</li> <li>■ competitive tendering</li> </ul>	<ul style="list-style-type: none"> <li>■ extends regulatory control to sub-contractors eg construction</li> <li>■ facilitates audit</li> </ul>
<i>Social</i>	<ul style="list-style-type: none"> <li>■ public interest</li> <li>■ employment concerns</li> <li>■ social exclusion</li> <li>■ economic development</li> <li>■ environmental policy</li> </ul>	<ul style="list-style-type: none"> <li>■ Best Value</li> <li>■ Contract compliance</li> <li>■ TUPE</li> <li>■ Green buying guides</li> </ul>	<ul style="list-style-type: none"> <li>■ involves all stakeholders including suppliers and 'customers'</li> <li>■ achieves wider social goals efficiently eg equal opportunities</li> <li>■ achieves wider economic goals efficiently eg SMEs</li> </ul>

Table 1 outlines potential benefits of adopting supply chain management approaches. However, as research into supply chain management in the public sector is in its infancy, these can only be asserted at this stage. Conversely there will be substantial costs associated with supply chain management, requiring caution in terms of selecting only those contracts or customer-supplier relationships where the potential benefits are likely to outweigh the costs. Costs may take the form of: time (longer pre-tender phase to allow consideration of potential costs and benefits and mechanisms for adopting supply chain management approaches); financial (increased direct costs of managing a chain or network of suppliers by government procurement staff or increased indirect costs by imposing the requirement on the prime contractor or supplier resulting in an increased bid price); risk (greater potential risk of impropriety, irregularity or non-compliance from closer relationships with suppliers); expertise (training and development to ensure that procurement staff are equipped with the skills and achieve the credibility to be perceived as adding value by suppliers and customers through supply chain management); research skills (mapping and analysing actual or future supply chain relationships). These categories of costs are by no means exhaustive.

#### **4. Partnership/Closer supplier relationships**

In Section 2, there is recognition of an increased emphasis on partnership, or closer supplier relationships, as advocated in Setting New Standards (Treasury 1995) for large service contracts or where requirements are complex or uncertain. Whilst there is considerable debate as to the requirements for and nature of partnership, especially in respect of the inequality and exercise of power in supply relationships, there are clearly situations where the development of supplier partnerships should be considered as part of an overall supply chain management approach. Procedurally, the regulatory framework of public procurement does not proscribe the development of partnerships (see for example Erridge and Nondi (1994), Erridge (1998) on ideas of partnership in competition; and Bouverie-Brine and Ellis (1996) on the selection of potential partners within the Utilities Directive procedure). In recognition of the benefits of a non-competitive approach to supplier selection, the European Commission has advocated the adoption of a 'negotiated competition' procedure within the Public Procurement Directives (Commission 1998). There is also empirical evidence that government departments are developing closer relationships with suppliers of strategic goods and services, with considerable joint activities in terms of planning and forecasting, specification, exchange of technical information, cost reduction and sharing of cost savings (Erridge, unpublished research findings, ESRC research grant no. R000273023).



## 5. Implementing Supply Chain Management

As Table 1 indicates, supply chain management is more likely to be appropriate where:

- there is a significant logistics or distribution aspect to the contractual requirement upstream or downstream eg transport of parts from numerous suppliers for assembly by the main contractor; delivery of supplies directly to dispersed users
- the existing supply market is generally organised in the form of a chain or network eg construction, major equipment purchases, major service contracts
- there is a high political profile for a project requiring close and active overview by contract managers eg major construction projects, major equipment purchases
- government has to ensure compliance with legislation eg Procurement Directives, TUPE, or wishes to promote wider social or economic goals through contract compliance eg employment equality, environment, SMEs etc.

Changes in the nature of the work of procurement staff will be necessary to facilitate the adoption of supply chain management approaches. The ongoing process of reducing clerical and transactional purchasing needs to continue through greater use of: aggregation of requirements across departments; consolidation of contracts eg building cleaning; longer term contracts; electronic procurement eg electronic supplier and contract databases and monitoring, use of the government procurement card. These are necessary to enable an increased focus on 'strategic' procurement (high value/high risk/high complexity/high uncertainty etc), where supply chain management is likely to yield the greatest rewards. Key procurement staff within the Government Procurement Service will need to be qualified to MBA and/or CIPS Professional standard or equivalent. They will be required to act as contract managers as members of teams comprising budget holders, technical experts, users, current and potential future suppliers.

As suggested above, no single supply chain management approach is likely to be appropriate for all government departments or even all supply relationships within a single government department or agency. The business case advocated in

the PX paper (Treasury/Cabinet Office 1998) for contracts over £100,000 could provide the mechanism for determining whether a supply chain management approach and/or partnership should be adopted. This will require review of any current contract and existing supplier performance; analysis of the supply market, particular supply chains or networks and individual suppliers therein; analysis of costs and benefits; selection of the specific supply chain approach (dyad, chain, network; extent of analysis; nature of relationships (see Tables 2-4)); who is to 'manage' the supply chain (internal customer with or without team comprising procurement and other staff; prime contractor or main supplier; facilities management company; outside consultancy). Consideration of the case will need to involve relevant stakeholders and require consultation with potential suppliers. Arrangements for supply chain management will be incorporated in the specification and form part of the evaluation of bids. Suppliers will be selected by the restricted, negotiated or 'competitive negotiated' procedure where appropriate. Once the contract is awarded, the effectiveness of the supply chain management arrangements, including their costs and benefits, will need to be monitored as part of the overall assessment of the performance of the supply relationship.

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## Appendix: Models of Supply Chains, Networks and Relationships

**Supply Chain Models  
(Harland 1996)**

**Table 1a**

Model	Features
Supply chains	<ul style="list-style-type: none"> <li>■ integration of business functions in the internal flow of materials and information</li> </ul>
Management of supply relationships	<ul style="list-style-type: none"> <li>■ business trends eg increased dependence on suppliers; closer, long-term relationships; supplier base reduction</li> </ul>
Management of inter-business chains	<ul style="list-style-type: none"> <li>■ 'pipeline management'</li> <li>■ position in the chain will affect supply eg demand volatility, greater distortion of logistics information upstream than downstream</li> </ul>
Strategic Management of inter-business networks	<ul style="list-style-type: none"> <li>■ competitive position in the network: effective harnessing of the resource potential of the network</li> <li>■ definition of network components: actors, resources, activities; resource dependency</li> <li>■ network structures: Japanese network sourcing; direct/indirect</li> </ul>

Developments in supply thinking (McIlroy 1999)

**Table 2**

**Group 1: Early innovations in supply thinking.**

<i>Date</i>	<i>Author</i>	<i>Principle</i>	<i>important themes</i>
1985	Porter	Value chain	Organisation within the boundaries of the firm.
1985	Hayes & Wheelwright	Commercial chain	Opportunities for vertical integration along the chain.
1983	Kraljic	Supply management	Portfolio of strategic options including closer relations between customer and supplier.

**Group 2: Supply chain co-ordination.**

<i>Date</i>	<i>Author</i>	<i>Principle</i>	<i>Important themes</i>
1989	Stevens	Supply chain management	Located in the firm in a wider system of the chain as a whole.
1991	Ellram		Improved customer service and reduced overall cost.
1992	Christopher	Logistics management	Interdependence and operational integration.
1991	Farmer & Ploos van Amstel	Pipeline management	

**Group 3: Network models**

<i>Date</i>	<i>Author</i>	<i>Principle</i>	<i>Important themes</i>
1988	Johnson & Lawrence	Value adding partnerships	A set of independent companies working closely together to manage the flow of goods.
1994	Hines	Network sourcing	A multitude of interlocking supplier networks/associations sharing information and expertise.
1996	Harland	Inter-business networks	Specific type of relation linking a defined set of persons, objects or events.

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**Group 4: Collaboration models.**

<i>Date</i>	<i>Author</i>	<i>Principle</i>	<i>Important themes</i>
1991	Ellram	Partnership	Agreement involving a commitment over an extended time period sharing information risks and rewards.
1994	Macbeth & Ferguson	Partnership sourcing	Mutual obligation relationships between each link of the supply chain.
1993	Lamming	Lean supply	The sharing of responsibility and benefit as a result of increased confidence and co-operation.

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**Table 3****Framework for classifying Supply Chain Management Literature (Croom et al 1999)**

Extent of analysis		Element of the exchange considered			
		<i>Assets</i>	<i>Information</i>	<i>Knowledge</i>	<i>Relationships</i>
<b>DYADIC</b>	Suppl.	Transaction cost	Information Technology	Collaborative design	Outsourcing
	-	(specificity of assets)	support	Guest engineer	/subcontracting
	Manuf.	Transportation routes	Tools for analysis of	HR development	Trust/Power/Commitment
		rationalisation	Information flow		Supplier development
		Exchange of Technology	Interplant planning and		Transaction cost
		Redesign HR	logistical intergration		approach
<b>CHAIN</b>		organisational incentives	(EDI)		
	Manuf.	Distribution channel	Information Technology	Product teams	Logistic partnership (with
	-	redesign	support		logistic service providers)
	Distr.	Facilities location	Interplant planning and		Trust/Power/Commitment
<b>NETWORK</b>		(warehouses, etc.)	logistical integration (EDI)		Outsourcing/
		Transportation routes	Communication		subcontracting
		rationalisation	processes		
	Suppl.	Quick Response, ECR, etc.	Industrial dynamic	Supply chain councils	Scenarios good for SCM
	-		approach		Opportunism/Trust/Power/
	Manuf.	Industrial dynamic	Information Technology		Commitment
<b>CHAIN</b>	-	approach	support		Positioning in the chain
	Distr.	Reverse supply chain	Structured systems		Influence of product
		management	analysis and design		technology on supply
		Total cost of ownership	method		chain relationships
<b>NETWORK</b>		Value system analysis	Modelling the information		
			flow		
			Communication		
			processes		
	Up	Supply network sourcing	Information Technology	Suppliers meetings	Partnership sourcing
	stream	Transaction routes	support		Lean supply
<b>NETWORK</b>		rationalisation	Supply network		Network sourcing
		Supply network structure	communication		Supply base integration
		Redesign HR	processes		Trust/Power/Commitment
		organisational incentives	Interplant planning and		
			logistical integration (EDI)		
	Down	Transportation routes	Information Technology		Logistic partnership (with
<b>NETWORK</b>	stream	rationalisation	support		logistic service providers)
		Distribution channel	Supply network		Trust/Power/Commitment
		redesign	communication		Outsourcing/
		Facilities location	processes		subcontracting
		(warehouses, etc.)	Interplant planning and		
		Design for supply chain	logistical integration (EDI)		
<b>NETWORK</b>		management			
	Whole	Business network	Information Technology		Value system analysis
		redesign approach	support		Supply network
		Value system analysis	Business network		partnership
		Design for supply chain	redesign approach		Trust/Power/Commitment/
		management	Supply network		Opportunism
<b>NETWORK</b>		Industrial dynamic	communication		
		approach	processes		

Appendix 7 : Comparisons with the private sector

Company - TNT UK Limited

**Expenditure on procurement.** Group purchasing expenditure by TNT UK Ltd in 1998 was some £146 million.



**Types of goods and services.** The main goods and services procured by TNT are commercial vehicles, fuel, engineering spares, mechanical handling equipment, office consumables, packaging, computer equipment, utilities, and office furniture.

**How procurement is organised.** TNT UK Ltd has a centralised purchasing department employing 22 people supplying 271 locations, serving some 14,000 staff in the UK, and supporting the company's stores function. The Group Purchasing Director reports directly to the main Board Director level. The role of the purchasing department is to ensure the effective management of supply chain costs, provide the best tools for the job, and keep TNT competitive. Key to this are maximising economies of scale by combining purchasing power, improving supplier relationships, and setting and achieving specific improvement goals. The purchasing department's role is essentially that of a facilitator.

**Form of contracting.** Some formal contracts are used but the more typical approach is to form strategic alliances with favoured suppliers for which there may be no formal contract. TNT's supplier base consists of approximately 200 companies which they consider is the right number; any larger and managing the supplier base becomes more difficult.

**Electronic procurement.** TNT is moving towards more electronic procurement allowing depots to order directly from suppliers at agreed national prices negotiated centrally. Purchasing cards are now being introduced for low value items but the types of goods and services that can be bought this way are clearly specified.

**Partnerships.** TNT defines each supplier partnership in a framework agreement, not a contract, encompassing the way in which supplier and customer will work together to achieve mutual competitive advantage. It involves the sharing of risks and rewards of technology and innovation. It is a close not a cosy working relationship. To enter into a partnership with TNT a supplier must first be accredited based on seven criteria - quality commitment, trading relationships, technical innovation, reliability of support/administration services and quality of product/service, company culture and environmental policies. Each criteria is given a numerical score. If the company meets these criteria the next stage is product certification after which the company may become an approved supplier. If selected TNT will work with the company to develop a programme to enhance quality of the service or product it provides, always working towards co-operative cost reduction. TNT's approved



Company - BAA plc

**Expenditure on procurement.** Expenditure on Buying operational goods and services and maintenance is some £500 million each year.



**Types of goods and services.** The main goods and services procured by BAA plc are facility management services, equipment, office consumables, utilities, computer equipment and software.

**How procurement is organised.** BAA plc have a centrally organised procurement support function but BAA plc is currently implementing a change management programme. For procurement this means moving to be more product focused rather than supporting a specific geographic location. The aim is to have fully integrated systems encompassing finance, operations and purchasing and other support services. Procurement will be very much a function supporting all airports in the UK. The Group Supply Chain Director reports to a director who sits on the BAA plc Board.

**Form of contracting.** Formal contracts are used for all major procurements. For ad-hoc purchases there will be no contract just a standard purchase order but the instructions accompanying this emphasise to all staff the importance of sound financial control and propriety. For low value items such as paper staff can exercise some choice as to type and quality but within certain parameters. For others such as computer software BAA plc have a number of standards which all staff must comply with to ensure that the software and related equipment are compatible and sustainable. Currently BAA plc have around 7000 suppliers but are seeking to rationalise this to a much smaller number over the coming 12 months.

**Electronic procurement.** BAA plc have number of local electronic systems for small value items together with framework agreements where by suppliers provide their catalogues in electronic format. For this to work, however, it is necessary for first tier suppliers to be linked to BAA plc's computer network so that staff can order directly from the catalogue. The aim is to move to a fully integrated system so that payment to suppliers is linked to the ordering system. BAA plc use procurement cards but encourage staff to use them only in emergencies or where there is no other procurement route to follow. BAA plc prefer staff to purchase through established call off contracts because if BAA plc are buying sizeable quantities from a supplier they have more scope to exercise leverage and influence prices.

**Partnerships.** BAA plc develops partnerships with key suppliers as a matter of course. Partnerships are generally over a number of years so that the supplier can work with BAA plc to secure real improvements in cost and quality. Partnerships tend to be more for complex goods and services - the 80:20 rule applies; 80 per cent of the procurement budget is spent on 20 per cent of the goods and services bought and it is this 20 per cent which BAA plc target to secure continuous improvement.

Company - Nissan Motor Manufacturing (UK) Ltd

**Expenditure on procurement.** Annual spend has increased from £4 million in 1986 to over £1,153 million in 1998. The rise in procurement reflects the increase in car production from 5,100 cars in 1986 to 289,000 cars in 1998.



**Types of goods and services.** The main goods purchased by Nissan are components for cars, plus facilities management and utilities. Components represent eighty per cent of the cost of each car.

**How Procurement is organised.** Nissan's car manufacturing main production facilities are at Sunderland and Barcelona (Spain). The majority of procurement staff are based at the plants in Sunderland and Barcelona, with a small number also based at the European Technology Centre at Cranfield, Bedfordshire. After Sales procurement is in Amsterdam. Some suppliers are located close to the manufacturing plants - mostly to enable synchronous manufacture and delivery - see map.



**Form of contracting.** For production parts Nissan operates on an open order basis rather than formal contracts. Relationships are based on trust and stability and the need for year on year continuous improvement in all aspects of performance.

**Electronic Procurement.** Nissan interface with their suppliers through EDI for ordering their production parts. Payment for production parts and some services is through self billing supported by automatic payment by BACS and EFT. Nissan achieves over 92% on time payment to their suppliers. Initially they have introduced electronic catalogues that allow nominated staff to raise orders.

**Partnerships.** Nissan operate a Supplier Appraisal and Improvement System to encourage continuous improvement of supplier performance. Each function of Nissan, such as design and production control, collate data on the performance of each supplier. Results are brought together into regular management reports and the results shared with the suppliers so that problems can be resolved. As an example of the type of improvement achieved through this programme, Nissan have been able to reduce supplier delivered defective car components to an average less than 50 parts per million.



**Partnerships** - *continued* ...

suppliers include vendors working within national framework agreements to provide consumables and engineering spares, hotel and travel services, computer and software specialists and vehicle hire companies. TNT consider the essential ingredients of a successful partnership to include regular liaison, clear joint objectives, flexibility, mutual respect and commercial confidentiality.

**Supply chain management.** Key to TNT's supply chain management is knowing the suppliers' business for example, the current market cost of key components, such as labour, making up the price charged to TNT. This allows the purchasing department to assess whether the prices they are charged remain competitive. The accreditation process to become an approved supplier focuses very much on how the supplier manages their key suppliers.

**Other initiatives to Improve procurement:** Some key points

- ◆ To make savings, control costs and improve quality it is very important to know what you are spending your money on. "It is obviously inefficient to have 3 or 4 procurement staff targeting pens and pencils when they are not key to the business, expenditure is small and potential savings minimal, and large savings are available from, for example, the purchase of fuel".
- ◆ Proven integrated systems to monitor the performance of key suppliers and the purchasing department are essential to securing continuous improvement.
- ◆ Seeking and winning the European Foundation for Quality Management (EFQM) Award was a major incentive in improving purchasing processes - for example, reducing administration time and improving the quality of service which TNT's operational units receive from the in-house Group Purchasing department.
- ◆ Material price reductions are often achievable through benchmarking suppliers and reassessing existing supply chains.
- ◆ Being innovative and challenging accepted practice is very important.

**Supply chain management.** This is very important and BAA plc give emphasis to knowing their key suppliers' business and market. But supply chains will differ depending on the product or service; they are not all the same and managing supply chains requires recognition of this. A good example is large contracts for cleaning airports worth about £12 million a year for which BAA plc will want to know for example, where the main contractor sources their cleaning materials from, what the market rate for labour costs is, and subcontractor policy. This is important in ensuring that costs remain competitive and having assurance that services will be delivered on time and to acceptable quality standards. Knowing the supply chain is important to ensure that BAA plc has sufficient information with which to negotiate with suppliers and to know the key factors which are likely to influence the supplier's performance.

**Other initiatives to improve procurement:** Some key points




- ◆ Clear senior management involvement and commitment to the purchasing function, recognising the contribution it can make across the whole business.
- ◆ Importance of demonstrating good practice and innovation and showing the added value it provides in terms of improved price and better quality so that others in the organisation are enthused to adopt the same approach.
- ◆ Need to have in place sound and reliable systems to monitor the performance of suppliers and the procurement function.
- ◆ Having strategic partnerships with suppliers to work together to improve quality and reduce costs for mutual benefit.
- ◆ Knowing key suppliers' business and market to have assurance that prices remain competitive and to negotiate effectively with suppliers.

**Supply Chain Management.** Nissan are at the leading edge of supply chain management. The performance of each supplier is carefully monitored to ensure reliability and, as a consequence, the company holds less than one day's stock at the plant. Nissan are able to monitor supplier performance carefully and accurately by limiting their number of suppliers to around 200 companies. The basis of both supplier selection and ongoing performance appraisal is Quality, Cost, Delivery, Development and Management. Selection is made using a Common Supplier Evaluation System and an ongoing performance measurement uses the Supplier Appraisal Improvement System.

**Other Initiatives to improve performance.** Some key points

- ◆ Nissan work closely with the Cranfield University to help suppliers and designers reduce time taken developing new cars -the COGENT project.
- ◆ And the Supplier Appraisal and Improvement Strategy is now being rolled out to other contracts - such as the Staff Medical Contract.

## Appendix 8: International experiences

	<b>Procurement Card</b> 	<b>Electronic Commerce</b> 	<b>Framework Agreements</b> 
<b>Background</b>	<p>The US Government has implemented cards extensively. Three main card programmes have been introduced</p> <ul style="list-style-type: none"> <li>■ <b>Travel charge card</b> - established 1983. Travel sales are estimated to be \$18 billion over 5 years.</li> <li>■ <b>Purchase card</b> - established January 1989. Involving over \$1.5 billion in official purchases. Average purchased is \$340.</li> <li>■ <b>Fleet services card</b> - established 1998. Used to purchase fuels repair and maintenance, and other fleet services for over 150,000 Interagency vehicles and over 200,000 agency vehicles. Sales in 1998 were around \$200 million.</li> </ul> <p>The use of US Government cards has increased 60 fold since 1990 with total sales more than double that increase.</p>	<p>To achieve widespread electronic commerce, a wide range of initiatives have been undertaken:</p> <ul style="list-style-type: none"> <li>■ The Federal Acquisition Computer Network as the standard for communicating with suppliers and contractors. 75 per cent of all eligible government contracts entered via FACNET.</li> <li>■ Supporting an electronic commerce/EDI infrastructure to present "a single face to industry".</li> <li>■ Advantage programme. A government wide electronic catalogue system providing on-line shopping, selecting and ordering facilities.</li> <li>■ Smart Card. The development of a multiple-use Smart Card for all Federal employees to carry by 2001.</li> </ul>	<p>Danish National Procurement Ltd was formed in 1993 to handle the procurement of a wide range of goods and services for various agencies of the Danish government. It operates 85 separate framework agreements with 200 suppliers and serves over 6,000 public organisations on a subscription basis.</p> <p>Danish National Procurement Ltd provides electronic and paper-based catalogue, ordering and payment facilities and advantageous terms on a pre-selected range of goods and services. The service includes an Internet-based catalogue of 200,000 items.</p>
<b>Benefits</b>	<p>The <b>travel charge card</b> contract achieves Government wide savings by:</p> <ul style="list-style-type: none"> <li>■ Improving cash management practices (no need for cash advances or imprests).</li> <li>■ Streamlining the administrative process.</li> <li>■ Providing rebates to Federal agencies of over \$40 million in two years.</li> <li>■ Improving management information enables agencies to manage travel budgets, verify use of Government's discounts and effectively monitor card usage.</li> </ul>	<p>The business case put forward for the Smart Card analysed three different procurement methods for small purchases:</p> <ul style="list-style-type: none"> <li>■ Paper-based procurement estimated to cost \$120 per transaction to process.</li> <li>■ Internet/Credit Card procurement process estimated to cost \$67 per transaction to process.</li> <li>■ Internet/Intranet procurement process estimated to cost \$32 per transaction to process.</li> </ul>	<ul style="list-style-type: none"> <li>■ Aggregation of marketing power and procurement cost economies.</li> <li>■ Avoidance of the need for multiple public tenders - costing up to £170,000 each.</li> <li>■ Avoidance of re-bidding contracts whenever product specification changes.</li> <li>■ Provides characteristics of products, including environmental and energy efficiency data.</li> <li>■ System allows pooling of purchases locally to obtain greater savings.</li> </ul>

*continued ...*

**Benefits -  
continued**

The **purchase card** programme achieves Government wide savings estimated at 14 per cent, or \$700 million over seven years. Card expedites acquisition of essential supplies and services, streamlines payment procedures and reduced administrative costs.

The **fleet card** electronic point of sale transactions speeds fuel purchasing, captures detailed transaction data significantly reducing the paper flow and thereby reduces administrative cost. Processing costs are charged to fuel vendors and users receive one monthly invoice. Inappropriate purchases are easily identified and lost or stolen cards are quickly stopped to prevent further use.

Introduction of the Internet/Intranet procurement process is therefore expected to produce savings of between 52 per cent and 74 per cent, depending on the procurement process currently being employed.

Some costs involved in the paper-based procurement process have not been included, such as the cost of issuing payment, paper holding and filing costs or the cost of the delay in receiving the goods ordered. As such the full savings of the electronic systems have been underestimated.

**Measures to  
promote  
initiatives**

Mechanisms to increase card use involve:

- Shifting authorisation to the lowest levels of the organisation.
- Applying electronic processing.
- Production of purchase card user guides and an Internet-based training programme.
- Comprehensive training and reference manuals on simplified methods of purchasing.
- Issuing formal mandates on the use of the cards.

Improvements in the card programme are also being sought, which will enable agencies to:

- Integrate the use of one card across all three areas.
- Improve security control and user authentication measures.
- Extend the use of the card to include value-added services.

The introduction of E-Commerce in the US Government aims to provide easy, secure access to networks and thereby encourage its use. The measures being introduced aim to:

- Take full advantage of the Internet and other electronic networks to support electronic commerce applications and the US Government information and business needs.
- Have the majority of government business applications, systems, databases directly accessible to employees and public customers through electronic networks.
- Provide easy, secure access to networks to provide employees and public customers with information and services.

Measures to provide knowledge, and encourage use, of e-commerce include:

- Use of interagency agreements and common service requirements.
- A Customer Advisory Board to provide recommendations and advice on the planning and implementation of e-commerce services.

- Encouragement on the use of Electronic Document Interchange (EDI) – although not a formal condition to either suppliers or purchasers.
- Development of an on-line purchase decision support system to enable purchasers to summon product details, rank suppliers according to different criteria, and aggregate orders within framework contracts.
- Organises regular supplier conferences and carries out periodic supplier appraisals.

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# Glossary

<b>Bottleneck items</b>	Goods and services that may not be expensive but are critical to an organisation.
<b>Call off contract</b>	An agreement for a fixed quantity of goods or services at agreed prices with an agreed timescale.
<b>Collaboration</b>	Procurement staff from one organisation sharing information with staff from another organisation. The term includes one department working with another department to improve leverage (see below); and one department sharing information with a long term supplier to improve performance and minimise costs.
<b>Contract management</b>	The process of monitoring the performance of a supplier to ensure it complies with the terms of the contract.
<b>Contractual incentives</b>	Terms set within a contract to offer financial inducements to the contractor to improve a specified level or quality of service.
<b>Electronic commerce</b>	The process of using electronic networks to transact with other departments, the private sector and customers.
<b>Framework agreement</b>	An arrangement to provide goods and services as and when required over a fixed period.
<b>G-Cat</b>	The Government catalogue of information technology products, run by the Central Computer and Telecommunications Agency.
<b>Government Procurement Card</b>	A corporate payment card operated by VISA available to all departments agencies and non departmental public bodies.
<b>Leverage</b>	The aggregation of individual purchases in order to gain the benefits of bulk buying.
<b>Liquidated damages</b>	Quantified levels of financial compensation payable under the terms of a contract.
<b>Procurement</b>	The process of ordering and paying for goods or services.
<b>Routine items</b>	Low value goods and services.
<b>Specification</b>	A detailed explanation of what the client requires from a contractor.
<b>Strategic items</b>	Goods and services that are relatively expensive and fundamental to an organisation.