



Towards Tesco – improving public sector procurement

Colin Cram, a public sector procurement specialist, sets out how £25bn per annum of government efficiencies could be made.

UK public sector spending amounts to some 1.5 per cent of global GDP. In 2009-10 it will amount to nearly 50 per cent of UK GDP, approximately £11,000 per man, woman and child in the UK. This is equivalent to a lifetime investment of £850,000 for a person with average life expectancy.

The public therefore has a right to expect that this money is spent efficiently and wisely. However, despite some excellent recent initiatives, the efficiency of the public sector remains too much a legacy of its past and a prisoner of its structures.

This article sets out how the public sector could achieve efficiency savings of some £25bn a year through:

- the fundamental re-structuring of the organisation of procurement – £15bn
- a more radical approach to shared services and outsourcings – £10bn plus.

These savings would represent a large increase to those identified in the Government's Operational Efficiency Programme and could be achieved without cutting services. Devolution means that the proposals apply to England only, but the principles apply equally to the rest of the United Kingdom. The local government share of cash savings would be equivalent to reducing council tax by over 25 per cent.

RESTRUCTURING PUBLIC SECTOR PROCUREMENT

Tesco and the corner shop

Public sector procurement spending amounts to about £225bn per annum, over 0.5 per cent of global GDP. This represents an investment of £3,500 per annum for every man, woman and child in the UK – a lifetime investment per person of over £250,000. It is

SNAPSHOT

- £25bn of annual efficiency savings in the public sector could be realised within three years through a restructuring of public sector procurement and greater use of shared services and outsourcing.

- Public sector procurement is at a multi-Tesco sized level of spending, but much is still organised on a 'corner shop' model. If the public sector were a company, it would have gone out of business long ago.

- HSBC Bank would not be in business if each of its own branches had its own IT, its own finance system, did its own procurement, did its own processing, had its own call-centre and offered its own financial products, albeit to a common theme. Yet that is how much of the public sector behaves.

- There is enormous scope for fewer tenders, better management of contracts and lower costs for taxpayers through integrated public sector procurement.

- The reforms outlined in this chapter could help to reduce the deficit, improve services and make tendering easier for suppliers, especially SMEs.

central to the delivery of public services, has the potential to drive innovation and sustainability and to support employment.

Taxpayers could reasonably expect that spending of this size and importance is coherently managed with a clear structure and a comprehensive understanding of how much is spent on what, by whom and with whom. They would be disappointed.

Four years ago I likened public sector procurement to a multi-Tesco sized spend, but having a corner shop model. Tesco would not have stayed in business if it had operated its procurement on a similar model to that of the public sector. Why then is it acceptable for public sector procurement to remain disjointed? The world has changed, but UK public sector procurement has not kept pace.

The structure of public sector procurement remains too much the legacy of past fragmentation and the independence from the 'Crown' of much of the public sector, eg. local authorities (whose procurement spend is £40bn pa), NHS trusts, higher and further education institutions and the myriad of 'non-departmental public bodies'. Arguably there are several thousand public sector procurement organisations and 40,000 procurement points. There are 40 buying agencies/consortia, some regional, others national or semi-national; some co-exist, others compete. There is a great deal of product overlap.

Reliable data on the impact of public sector purchase spend on the economy does not exist. Without adequate data, it is impossible to set sensible targets for procurement policies and to measure to what extent they have been achieved. Examples include supporting local economies and supporting SMEs, which have been the policy of all governments for the past 25 years. If it isn't measured, it can't be managed. If a suitable procurement structure is not in place, measurement will not help with the management.

The Office of Government Commerce (OGC) has shown first class leadership in the drive for greater collaboration and higher standards in public sector procurement and great improvements to project management. There have also been some excellent individual initiatives, such as the Crescent Purchasing Consortium, which has 573 further education colleges and academies as members. Central government and specialist procurement organisations are developing, several of which are well established, powerful and professional. The OGC has assessed savings through collaborative procurement to be in excess of £1.4bn.

But despite this, UK public sector procurement has neither the overall structure nor the data needed to meet effectively the

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demands of globalisation and global markets, to support innovation and UK industry effectively and to able to deliver value for money overall.

Nationally, collaborative procurement between independent bodies arguably represents under 10 per cent of total public sector procurement spending and its impact is blunted by the lack of a formal supporting structure, good quality data and frequent lack of commitment by public sector bodies to collaboration, which often pay lip service only. The public sector continues to create high costs for itself and suppliers through:

- **indiscipline and disaggregation – failing to make use of existing agreements**
- **constant reinventing of the wheel – varied specifications for what should be identical products/services**
- **a huge variety of contract terms and conditions**
- **different procedures and standing orders**
- **local and different interpretation of EU procurement directives**
- **multiplicity of tendering, contracts and contract managers**
- **multiplicity of attempts to manage suppliers, markets and supply chains**
- **hugely varied expertise of procurement personnel.**

The reality overall is that the public sector should have gone out of business many years ago.

Why is there such a lack of cohesion?

The reasons for the lack of cohesion in the public sector are historical and cultural and include a lack of understanding amongst public sector personnel, including senior managers, budget holders, operational managers, policymakers and those who commission procurements, of:

- **the factors that make up the costs of procurement and how to reduce them**
- **the cost, quality and service implications of 'unique' specifications**
- **the enormous benefits of 'A' class specialist category managers and the large critical mass needed by any procurement organisation that wished to attract and retain them**
- **how independent procurement damages the chances of everyone to secure value for money. When I took over the North West Centre of Excellence at the end of 2004, North West local authorities had over 40 stationery agreements – each one being 'the best'. Stationery represented just 0.04 per cent of total purchase spend, so the cost of letting the agreements was far in excess of any conceivable benefits**

- the potential benefits of and rationale for aggregation and pre-commitment to tenders
- the potential impact of addressing the whole supply chain
- the cost of indiscipline within public sector organisations
- the cost of silo working. Several recent ICT tenders issued by central government departments include the families of organisations for which they are accountable, but do not consider the possibilities of working with other departmental 'families'
- the fact that the world has changed from local to global and that public sector procurement must be organised to reflect this.

Unlike in the private sector, no public sector organisation will go out of business because its procurement is unsatisfactory, so those who are reluctant to change tend to carry the day.

Integrated and collaborative procurement

While *collaborative procurement* brings worthwhile benefits, these tend to fall well short of the potential. There is frequently passive resistance, deadlines get missed, management information can be slow to be provided and agreement on specifications and tender documentation can be difficult to achieve. Lack of discipline within individual member organisations can undermine progress and support for agreements. Progress is frequently made at the pace of the slowest.

Unsurprisingly, collaborative procurement needs expensive structures to facilitate it. The annual cost of the overlay of collaborative structures in the UK public sector will certainly run to tens of millions a year. At the same time, savings from collaborative procurement are often quoted as 'potential', since they depend on the extent to which organisations are prepared to adopt them. Baselines against which savings can be measured are often difficult to determine.

Integrated procurement (or joint procurement), by contrast, is the creation of a coherent procurement structure to do all the



procurement and contracting on behalf of several public sector organisations. It has the authority to take decisions, to deliver, to sort out specification issues, to question the need for procurements, to question solutions proposed by budget holders and to commit. The sponsoring organisations retain their independence, but have chosen to join forces with others for procurement.

The integrated arrangements are managed through service level agreements, with commitments on both sides. The integrated procurement organisations are properly funded but, in return, are expected to provide management information and deliver pre-agreed targets, including pre-agreed service levels at an agreed cost. The overall budget for the joint procurement organisation may be less than the combined costs of the previous organisations, but because matters are so simplified, it should be able to afford the best category expertise.

Examples of savings from integrated procurement

Over the past two decades, there are many and varied examples of where integrated procurement, undertaken by an 'A' class commodity specialist, has saved money. These examples should leave no doubt about what can be achieved:

- **NHS drugs**
The NHS improved its procurement of drugs for hospitals, saving 10 per cent of the £2bn addressed.
- **Office furniture – Benefits Agency**
Through working with suppliers on their manufacturing processes and with customers on their reliability, costs were reduced by 35 per cent (£6m per annum) and quality improved compared to the use of non-commitment framework agreements.
- **Outsourcing facilities management – Benefits Agency**
An integrated approach led to cash savings of up to 35 per cent (£17m per annum) against previously tendered agreements and improved service.
- **Laboratory consumables – research councils**
An integrated approach led by a category expert produced cash savings of up to 90 per cent.
- **Welfare milk – Department of Health**
A category specialist saved 10 per cent (£10m per annum).
- **Postage – Benefits Agency**
A £7m per annum saving on a £70m spend was delivered.
- **Construction**
A joint approach to construction procurement, led by Hampshire County Council, is delivering improvements of 28 per cent on key service and value for money indicators.
- **Prison Service**
Annual savings have risen to over 10 per cent on an annual spend of £450m.

Integrated procurement organisations created from previous disaggregation emphasise the point:

- In its first year, the *Research Councils' Procurement Organisation* reduced the costs of procurement staff by 15 per cent despite an increased workload, and for the first time, expert contracting expertise became available to all.
- The *Benefits Agency Contracts Organisation*, in the mid 1990s, saved 20 per cent (£50m per annum) overall.
- *Buying Solutions* is claiming savings in its most recent full year of over £550m. Pre-commitment to the agreements would have increased this substantially.

Missed opportunities

The evidence for the benefits of integrated procurement is bolstered by examples of missed opportunities:

- Greater Manchester authorities have over 100 specifications for *tarmac*, when seven are adequate – a potential saving of 10 per cent.
- Greater Manchester councils are unable to collaborate on *dust cart procurement* as they cannot agree on the specification and make – a potential saving on total cost of ownership of 10 per cent.
- *Finance systems* in local authorities have inconsistent specifications, even though their functions are often identical, which means that separate finance systems are purchased – potential savings from integrated systems of over 30 per cent appear to be possible, where several authorities work together.
- One financially pressed council rejected a re-design of *street lighting* because the council was situated on “the wrong type of rock” – a wiser council saved 30 per cent.
- *IT licences* for HR and other back office functions are procured separately – potential savings from an integrated approach across the public sector should reach several tens of millions per annum.
- Separate procurement, or only limited collaboration, exists on *accommodation for 'looked after' children*, where the annual costs are hundreds of millions – a potential saving of over 10 per cent and more consistent and higher standards.
- *Laboratory/medical equipment* – only limited progress towards a potential saving of 20 per cent on an annual spend of £150m, while joining forces with the NHS could produce even better results.
- *Indiscipline within organisations and lack of commitment* creates much duplication of contracting, contracts management arrangements and cost for suppliers – a potential saving of up to 35 per cent on total procurement and ownership costs.

- Even the simplest tender costs a bidding organisation about £1,000 if its time is fully costed; so assuming a 10 per cent profit margin and a one in four chance of winning, a potential supplier needs to gain an extra £40,000 of business just to cover its tendering costs. The most complex tenders cost several million pounds. *Complexity and inconsistency of procedures* add to the cost of tendering and hence the cost of the procured goods and services. Integrated procurement reduces the number of tenders and hence the overall cost to all parties.

Towards Tesco: securing the benefits

As these illustrations indicate, the potential benefits of integrated procurement are huge. They should be much greater still for a public sector-wide model. But the Operational Efficiency Programme examined opportunities for collaborative rather than integrated procurement and so underestimated the potential for savings. Integrated procurement points the way to how public sector procurement should be organised and Chart 1 below illustrates an integrated model for the whole of the public sector.

CHART 1

New integrated procurement operating model

| | Central/Major Departments/ Buying Solutions | Industry Specific | Regional P S Hubs/Medium Departments | Local/Med/Small Departments |
|--|---|-------------------|--------------------------------------|-----------------------------|
| Major national contracts/suppliers | * | * | | |
| Common categories | * | * | | |
| Relationship management | * | * | | |
| Market management | * | * | | |
| Industry specific | | * | * | |
| PPIs/major project support | * | * | * | |
| Regional/large local contracts/suppliers | | | * | |
| Small local contracts | | | * | * |
| Discipline/implementation/ compliance | | | * | * |

- Oversight, to ensure that value for money was being secured, that the integrated structure was functioning well and suitable strategies were in place, would logically be provided by the Office of Government Commerce, which should take a lead role in particularly strategic areas or where major international suppliers were involved. It would also take the lead in policy and represent the UK with the EU and in any international

discussions with other countries. Logically, it would provide formal leadership and line-management for such a structure.

- Independent value for money assurance would be provided by the National Audit Office on behalf of Parliament and such oversight would include the degree to which such a structure was delivering other government procurement policies.

Despite its apparent complexity, this model would result in a big reduction in the number of procurement organisations, including those in central government, enable the best expertise to be employed on behalf of all and provide a solid career structure for procurement personnel. It would also:

- be able to attract and develop the best category experts
- eliminate the competition between public sector organisations for such personnel
- eliminate much work that is being done to support collaborative procurement
- have the authority to ensure consistent specifications and question the need for certain procurements
- be capable also of ensuring that procurement and commercial considerations were taken into account in policy making and programme development.

So how would integrated procurement actually work in practice? Government procurement is too big and the range of procurements is too great and complex for a single central procurement unit, but all would be within one overall integrated structure:

- Specialist procurements for specialist organisations need to be handled by specialist procurement teams including defence, security services, NHS drugs and probably ICT (possibly through re-creating the Central Communications and Telecommunications Agency), buildings construction and a specialist team to provide expertise in major and complex contracts.
- Large departments such as Revenue and Customs would need to retain large procurement teams, albeit part of the overall structure, because of the value of procurement, its complexity and the need to ensure that commercial considerations are understood and taken into account at board level. However, the structure would allow for such organisations to provide a service for major procurements, the management of major suppliers and market management for the whole of the public sector and to smaller central government departments.
- Each region would have one procurement hub serving the various customer organisations. Below that level, sub-regional procurement hubs would operate, with functional



or line management from the regional ones. The model would be fully consistent with and supportive of 'Total Place' – the concept of joint delivery of public services in a given area by the respective organisations. It would be able to provide support to those commissioning procurements, for example budget holders and operational personnel, as proposed for the new NHS regional units. Competition between the various buying agencies would be eliminated; indeed, some might form the bases of the proposed regional hubs.

- Local procurement would be restricted largely to small contracts, procurements and call-offs and providing a link between the commissioners and the appropriate contracting teams.

How could such a structure be enforced given that most public sector bodies are independent of the 'Crown'? The answer is it couldn't. However, organisations could be given a choice whether or not to sign up. Those that decided not to would be prevented from signing up for, say, a further three years, thus avoiding fence sitting. Their chief executives could be held to account for any failure to deliver procurement policies, targets or value for money. Few would take this option. Consistency with devolving responsibilities from Whitehall would thus be maintained.

Potential benefits from this approach are difficult to assess precisely, particularly given the limited data, but the examples above suggest that between 15-20 per cent compared to the baseline used for the Government's Operational Efficiency Programme may be feasible overall. The total is unlikely to be less than £15bn per annum. Taking a conservative approach, an assessment might be as follows:

- 20 per cent for non-social care elements of local government procurement, including construction and IT – £6bn per annum saving
- 10 per cent of social care procurement – £1bn per annum saving
- Approaching 10 per cent for much of the rest of the English public sector, including buildings construction and IT, but excluding defence, the NHS hospitals' drugs bill, certain other specialist procurements and other instances where savings have already been achieved or would be less practicable to achieve – £8-9bn per annum.

How long it would take to set up the new arrangements would depend on leadership and drive. However, momentum would be needed and short time-scales concentrate the mind and prevent too many obstacles being raised. Six months should be enough to determine the new structures; one year should be enough to have the new management structures in place and the new organisation to exist. A further year to 18 months would be needed to make it fully effective.



SHARED SERVICES AND OUTSOURCING

What are shared services?

Public sector organisations, for example local authorities (of which there are nearly 400), tend to operate independently, which means that services, both back office and front office, vary in quality and cost. HSBC Bank would not be in business if each of its own branches had its own IT, its own finance system, did its own procurement, did its own processing, had its own call-centre and offered its own financial products, albeit to a common theme. Yet that is how much of the public sector behaves. After all, shared services would reduce the number of jobs.

The high cost of the current approach is evident. It is questionable, for example, whether some of the recent horror stories in children's services might have happened had those services been provided by a single organisation that, through serving several authorities, was big enough to be able to employ the best management, the best people and operate the best procedures. This would be an example of a shared service.

The benefits of shared services

The justifications for shared services are similar to those for integrated procurement, which is a form of shared service:

- Savings due to aggregation
- Standardised and improved processes
- Reduced IT costs
- Bringing together best practice
- Savings due to provision from cheaper parts of the country – due to lower costs and higher productivity, it has been assessed that some parts of the country can have unit costs of 25 per cent less than other parts
- Raising of standards to those of the highest (or better)
- Critical mass to be able to recruit and retain expertise
- Critical mass to be able to deal with peaks and troughs and avoid taking on temporary staff or consultants
- Greatest expertise to be available to all and not just one small organisation in which it resides, which can also help with reducing consultancy usage
- Increased productivity due to employing the best managers, the most efficient processes and performance monitoring
- Greater accountability through the potential for defined service levels and easily monitored costs (which tends to be rare in non-shared services operations).

Shared services are suitable for both back office and front office

activities. Having created and managed several shared services operations, I can confirm that cost savings of at least 20-30 per cent are not unreasonable. There are a number of examples:

- Exceptionally, some local government chief executives now run more than one council and the chief executive at Hammersmith and Fulham Borough Council has also become the chief executive of the local NHS trust. The experience of Ian Lowrie, joint chief executive of Adur and Worthing councils, is that if one combines the management teams, efficiencies follow naturally.
- RCUK's Shared Services Centre, operating on behalf of the research councils, is a limited company providing HR, procurement, IT, finance and grants administration to seven independent bodies, set up to deliver cashable efficiencies of 3.65 per cent per annum across the annual science budget of £6bn and more effective research. The original Research Councils' Procurement Organisation, created in 2001, had reductions in staff costs of 15 per cent and a much increased workload.
- Research sponsored by the North West Centre of Excellence showed that in rural areas joint waste collection could deliver savings of 10 per cent. The implication was that this could be much greater in cities.
- A recent analysis of legal services in West London showed that savings of over 10 per cent could be delivered through a loose collaboration.
- There is huge duplication in IT systems – often bought independently and with different specifications to do the same work. Local government finance and HR systems are examples. Having independent systems keep many people in work. It should be possible to reduce the cost of public sector ICT organisations by 25 per cent through cutting out duplication.
- Construction, particularly that of local government, is ripe for a shared service. The annual spend is £10bn. The expertise varies enormously. This, together with protectionism, leads not only to excessive cost, but also failure to deliver the best outcomes. It can lead to excessive use of consultants. Contracts management is varied. Lack of strategic management has been a direct contributor to the price fixing in local government contracts, which has been highlighted by the Office of Fair Trading. The joint approach led by Hampshire County Council, mentioned earlier, is a huge improvement.

The case for shared services is self-evident. The evidence to support this approach is strong, yet only a small proportion of front and back office services are delivered this way.

Why outsource?

Increasingly public sector organisations are turning to outsourcing to deliver efficiencies and improvements and there are some large outsourcing initiatives in local government. Outsourcing can bring similar benefits to shared services, with the added bonus of investment in new systems, greater attention to costs, a tighter performance regime, regeneration and sharing some of the risk. Implementation tends to be quicker. For example, Pendle Council outsourced a range of services to Liberata, which created a service centre and several hundred local jobs.

In the early 1990s, several operational ‘agencies’ were created in central government, for example the Benefits Agency, with a view to their eventual possible outsourcing. Since then, the structure of the public sector has changed but the cost of such work could well exceed £1bn a year. Whilst certain functions, such as some OFSTED ones, would require a very brave politician to outsource, consideration should be given to outsourcing operational functions that are and used to be undertaken by many of these ‘agencies’.

A simpler approach

The cost of creating shared services and of undertaking outsourcings can be prohibitively high. For large contracts, bidders will often incur costs in excess of £1m, which they can recoup only through higher prices. High costs discourage new players into the market and innovation.

Framework agreements for many services could simplify the tendering process. These would have model specifications and indicative pricing. The cost of any ‘bells and whistles’ would become evident. Even using the traditional approach to creating framework agreements, some outsourcing providers have suggested that tendering costs could be reduced by 30 per cent or more through such an approach.

The framework agreements would in effect be a matrix of services and providers and would look like the following diagram.

CHART 2

Outsourcing matrix

| SERVICES | SERVICE PROVIDERS | | | | |
|-----------------------|-------------------|---|---|---|---|
| | 1 | 2 | 3 | 4 | 5 |
| Roads | | ✓ | ✓ | | |
| Call centres | ✓ | | ✓ | ✓ | |
| HR | ✓ | ✓ | | | |
| Finance | ✓ | ✓ | | ✓ | |
| Construction services | | ✓ | ✓ | | |
| ICT | ✓ | ✓ | ✓ | ✓ | |
| Legal | | | | | ✓ |

There is, however, a new approach, allowed by the recent changes in EU procurement legislation, which applies to ‘commonly used goods, works and services’. This approach would simplify the matrix and would enable the creation, electronically, of what would in effect be a list of approved suppliers. Any supplier who met the criteria would be allowed to join what is called a ‘Dynamic Purchasing System’ (DPS) at any time through its (normally) four-year lifetime. Public sector procurement personnel normally have just 15 working days to decide whether or not to admit a potential supplier to the DPS. Individual suppliers could add services to their portfolio during the course of the DPS.

It could reasonably be argued that the DPS should be considered for many of the services and works that are the subject of shared services and outsourcings.

Potential savings

There is the potential to transform the public sector through facilitating outsourcings and shared services, introducing innovation and new players into the market and opening up the outsourcing market to SMEs. Tendering could be simplified and tendering costs reduced by up to one third. It may not be long before we have the first local government chief executive employed by an outsourcing company.

The Operational Efficiency Programme identified potential savings in back office and IT services of £7.2bn by 2013-14, of which £1.6bn are attributed to procurement. The simplification of the approach to outsourcing and shared services should facilitate this. Extending the principles to front line services and taking into account the potentially high level of savings from shared services and outsourcings should boost this to not less than £10bn per annum and possibly much more. The above model indicates one possible way of driving forward such a programme.

CONCLUSION

There is enormous scope for public sector efficiencies, without reducing the number and quality of services. At a conservative estimate, over £25bn a year should be achievable through a complete re-structuring of public sector procurement and a more comprehensive approach to shared services and outsourcing.

Cashable efficiencies on this scale should enable a large chunk of the government deficit to be eliminated. Taxpayers have a right to expect speedy implementation – it is their investment and their services that will suffer without it. But this will be achieved only with strong leadership from government. **□**

Colin Cram is a Fellow of the Chartered Institute of Purchasing and Supply. He has spent 30 years working on efficiency and procurement initiatives in the public sector, delivering savings of over £1bn. He is now Managing Director of Marcl Ltd, a consultancy and conference-organising company.