



**national treasury**

Department:  
National Treasury  
REPUBLIC OF SOUTH AFRICA

## **OFFICE OF THE CHIEF PROCUREMENT OFFICER**

### **STRATEGIC PROCUREMENT FRAMEWORK**

Strategic Procurement Document No. : 72/2/1/1

Version : 1.0

Applicable Department : National Treasury

Custodian : Office of the Chief Procurement Officer

Compiled by : Chief Directorate: Strategic Procurement

Issued : May 2016

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### Issue History

Version	Release Date	Description of Issue
1	May 2016	First Issue of the Strategic Procurement Framework

### Amendment History

Version	Release Date	Description of Amendment

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### 1. Introduction

Government spends billions of Rands each year in the provision of goods and services that are needed to deliver public policy and business objectives. Good public service outcomes depend on good procurement. Properly planned and effectively executed procurement is essential for all government organisations.

The Office of the Chief Procurement Officer was established to modernise the state procurement system to be fair, equitable, transparent, competitive and cost-effective. The state procurement system must further enable the efficient, economic, effective and transparent utilisation of financial and other resources; including state assets, for improved service delivery; and to promote, support and enforce the transparent and effective management of state procurement and the sound stewardship of government assets and resources.

One of the functions within the Office of the Chief Procurement Officer is that of Strategic Procurement, whose primary task is to research, develop and implement strategic procurement practices so that cost savings and socio-economic objectives are achieved.

Given the current global economic climate that South Africa has managed to weather thus far, it can be expected to put a huge strain on our fiscal position. Since the crisis has resulted in South Africa's growing budget deficit, slow economic growth, rising inflation, increase in interest rates, slumps in key market sectors, the challenge for procurement in the long term is to ensure that the state's current spend has to be carefully monitored and managed to ensure that value for money is derived. The savings opportunities may provide real opportunities to reduce the cost base and to channel these to much needed areas of critical service delivery and for spending in areas that will start an economic growth trajectory.

This document is a framework for strategic procurement within the public sector that combines the best of private and public sector techniques with

the objective of stabilising procurement over the long term in delivering quality services whilst driving value for money and enhancing socio economic outcomes.

## 2. Strategic Sourcing

Strategic sourcing initiatives have been around since the mid-nineties, and more recently the public sector has begun implementing similar initiatives. There are some differences between private sector and public sector and one key area is that public sector procurement activities are regulated largely through legislation. In general where regulations apply in the public sector, organisations will have to:

- Advertise an intention to procure normally through a competitive bidding process.
- Only exclude a tenderer for justified reasons; the evaluation criteria are normally published in the document pack. Give tenderers the reasons why they were not successful in the tender so that they have the option to appeal the decision.
- Award the contract based on the results of the evaluation process and the rules set out at the outset.

The successful implementation of strategic sourcing may lead to an improved understanding of government spending patterns that will assist in optimising the budgeting and planning process and enable sourcing practitioners and decision makers to make better informed decisions. Furthermore, deployment of strategic sourcing principles will provide alternative methods to improve services and reduce administrative costs.

Strategic sourcing is a collaborative, structured approach to analysing government's spending; using the information from this analysis to acquire commodities and services effectively; and as a result supporting government's service delivery objectives. It helps supply chain managers to plan, manage, and develop the supply base in line with these objectives; and creates an understanding of the categories of goods and services in government's spending portfolio, their intended use and the sources of

supply. This helps to identify the leverage points, develop appropriate sourcing strategies, reduce costs and increase the benefits and value of the service or commodity to government.

Strategic sourcing involves understanding the impact of purchasing decisions on society and therefore needs an alert and informed group of procurement professionals who can apply this flexible, market-aware methodology.

It is worth mentioning at this stage that Strategic Procurement is NOT the purchase of goods and services on a day-to-day, transactional basis. Instead, Strategic Procurement is the opposite: it is a long term and all-encompassing means of achieving procurement and strategic business goals.

It is, furthermore, a process of understanding categories of goods and services, their intended use and their supply markets based on rigorous analysis, in order to identify the leverage points and to develop the appropriate sourcing strategy which reduces the total cost to government and / or increase the benefits / value of the service / commodity to government.

The form and shape of any procurement strategy adopted by public institutions will vary from organisation to organisation and therefore, it is not possible to be prescriptive. Nevertheless, any strategy which is adopted should reflect the requirements of public procurement and achieve value for money, cost-effectiveness, fairness, transparency and equity. The approach followed by government organisations in procuring goods and services should be linked to the overall strategic objectives of the organisation and into the business planning process.

### **3. Public Procurement Challenges in South Africa**

It is important to note that SCM is an integral part of procurement in the South African public sector. Therefore, it is used as a tool for the management of public procurement practices. However, despite the

employment of SCM as a strategic tool, public procurement in South Africa still faces enormous predicaments. These include, among others:

- lack of proper knowledge, skills and capacity;
- non-compliance with SCM policy and regulations;
- inadequate planning and the linking of demand to the budget;
- poor value for money;
- lack of accountability;
- fraud and corruption;
- inadequate monitoring and evaluation of procurement outcomes;
- unethical behaviour;
- too much decentralisation of the procurement system;
- limited/no post contract management and supplier relationship management

#### **4. Achieving a change in Public procurement through Strategic Procurement**

Strategic Procurement is a robust and sustainable solution for use by Government in order to exert much more control over procurement spend. The framework that follows is a tried and tested solution globally which includes private and public sector organisations.

The basic premise to be considered is that the nature and business of Government organisations in South Africa do not change profoundly over time, the service provision remains the same. That being said, the items procured and buying patterns of public sector organisations are stable and predictable, hence, we will need to position ourselves for long term stability within procurement.

The Strategic Procurement Framework (SPF) is a guided process with methods and tools to focus our procurement efforts on projects that would meet the organisation's top strategic priorities for service delivery.

Increasingly applying strategic sourcing across the South African public sector will bring a number of benefits. It will:



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- Use the size and value of spending on commodities commonly purchased across government to *leverage the state's buying power*.
- *Greatly reduce duplication of effort*. Currently, numerous tender processes for similar goods and services take place across departments.
- *Reduce inconsistency in prices* between the private and public sectors and between government departments. In some cases, departments buy the same product or service from the same suppliers at different prices.
- *Encourage common government policy positions* on certain commodities and services. It will, for example, point the relevant authorities towards a common position on broadband or software licensing.
- *Encourage the development and use of standardised specifications* of common commodities. Examples are school furniture, office equipment and IT hardware. This will discourage end-users from over-specifying, insisting on "the best" when a more modest alternative may be adequate for service needs.
- *Increase government efficiency* by providing information on government's spending patterns. This will aid *better and more informed decision making* from the product, quality, cost and socio-economic perspectives. Strategic sourcing provides for a greater understanding of the supplier market and how to involve them in the procurement process.
- *Create expertise* about commodities among purchasing officials and reduce complexity for end users. Government supply chain practitioners generally manage administrative functions such as requests for quotations and competitive bidding; not enough attention is paid to their thoroughly understanding the specialized commodities within their environment.
- *Improve vendor performance*. As the clarity of requirements increases, relationships with suppliers tend to improve and they are encouraged to identify new and innovative solutions. Competition for government

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business increases, and contract-structuring and performance management systems to measure vendor performance improve.

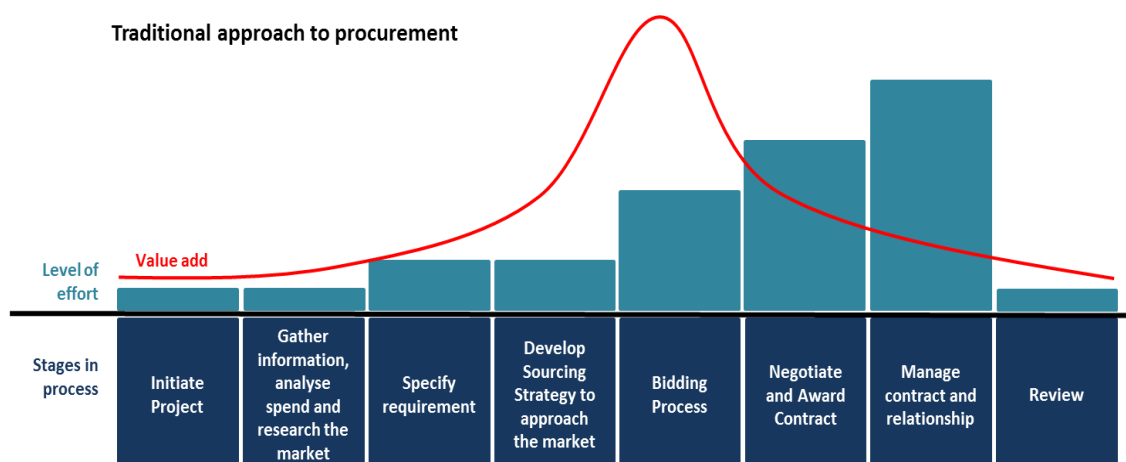
### 5. The differences between strategic sourcing and traditional procurement

The traditional approach to procurement views it as buying goods and services. Irrespective of how critical a transaction may be, government currently uses competitive bidding, a standard method of buying.

A strategic approach involves a combination of understanding the importance of procurement to enable government to achieve its objectives; identifying suppliers and managing relationships with them; and obtaining value for money. There is a need to move from transactional buying to commercial decision-making.

#### 5.1. The traditional approach

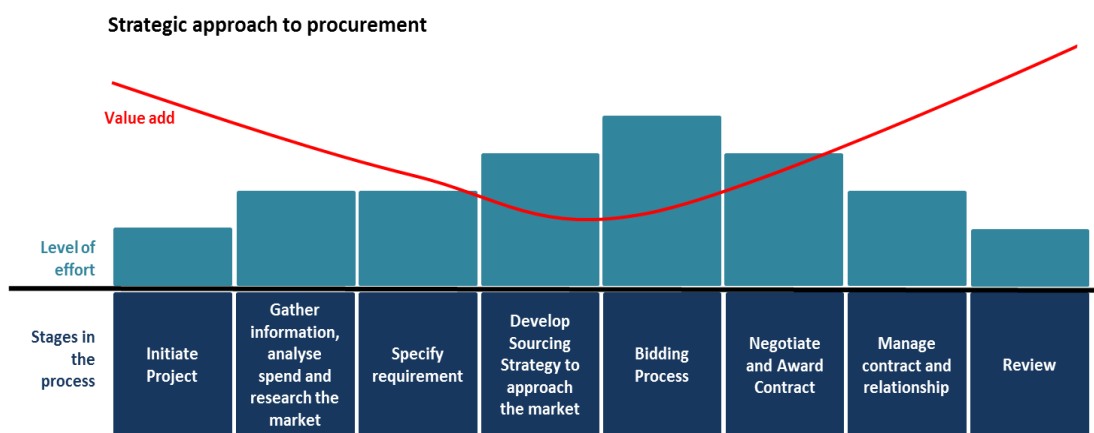
In the traditional approach to procurement, a relatively small percentage of the overall effort goes into the initial planning phase. Due to insufficient analysis in the planning stage, effort tends to increase in the bidding phase. In turn, this results in greater levels of effort in the contract and relationship management phases, where little extra value can be gained.



Adapted from: New Zealand Ministry of Business, Innovation and Employment 2011, *Mastering Procurement: A Structured Approach to Strategic Procurement*, available at <http://www.business.govt.nz/procurement/for-agencies/strategic-procurement/mastering-procurement-the-guide>

### 5.2. The strategic approach

The strategic approach to procurement works methodically through each stage in the process. The initial effort spent on planning, research and analysis helps significantly in identifying solutions that meet the needs. The focus on developing and managing relationships with suppliers after awards have been made means that less time is spent resolving issues and more on assessing the quality of delivery and on identifying opportunities for cost savings and benefit gains. A strategic approach delivers greater value.

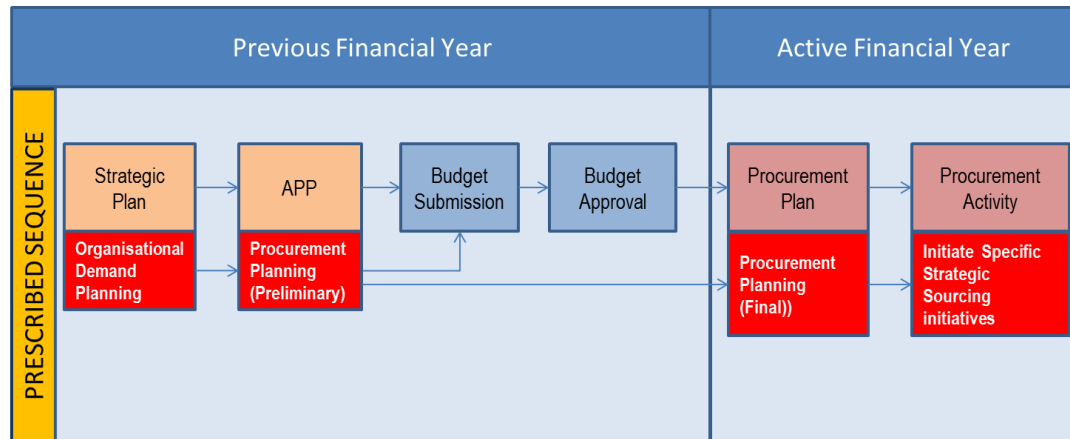


*Adapted from: New Zealand Ministry of Business, Innovation and Employment 2011, Mastering Procurement: A Structured Approach to Strategic Procurement, available at <http://www.business.govt.nz/procurement/for-agencies/strategic-procurement/mastering-procurement-the-guide>*

## 6. Strategic Procurement link to the planning framework

When developing Strategic Plans and Annual Procurement Plans it is useful to conduct situational analyses on the sectors or spheres of responsibility that fall within the organisation's mandate, the present delivery environment and the state of the organisation itself, taking into account relevant government policies and long term plans. At this point it will be useful to introduce strategic sourcing principles to assist the strategic planning process especially with regards to demand and procurement planning.

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Strategic Plans and Annual Procurement Plans should include, amongst others, a description of how the organisation will give effect to their service delivery mandate through procurement, starting with demand planning.

"Demand management forms an intrinsic part of the whole planning process of the institution. During the planning process demand management has to continuously verify resources required to give effect to the goals and objectives of both the strategic and annual performance plans, cost these resource requirements and provide feedback to management accounting in the budget office. The cost of these requirements is weighed against funds available and plans amended until a balance is reached between resource requirements in terms of the plans and the availability of funds in the budget."<sup>1</sup>

Demand management, include principles and activities that are typically found in Strategic Sourcing processes. Examples include:

- spend analysis
- categorising procurement spend
- commodity/category analysis
- industry analysis
- determining specifications, etc.

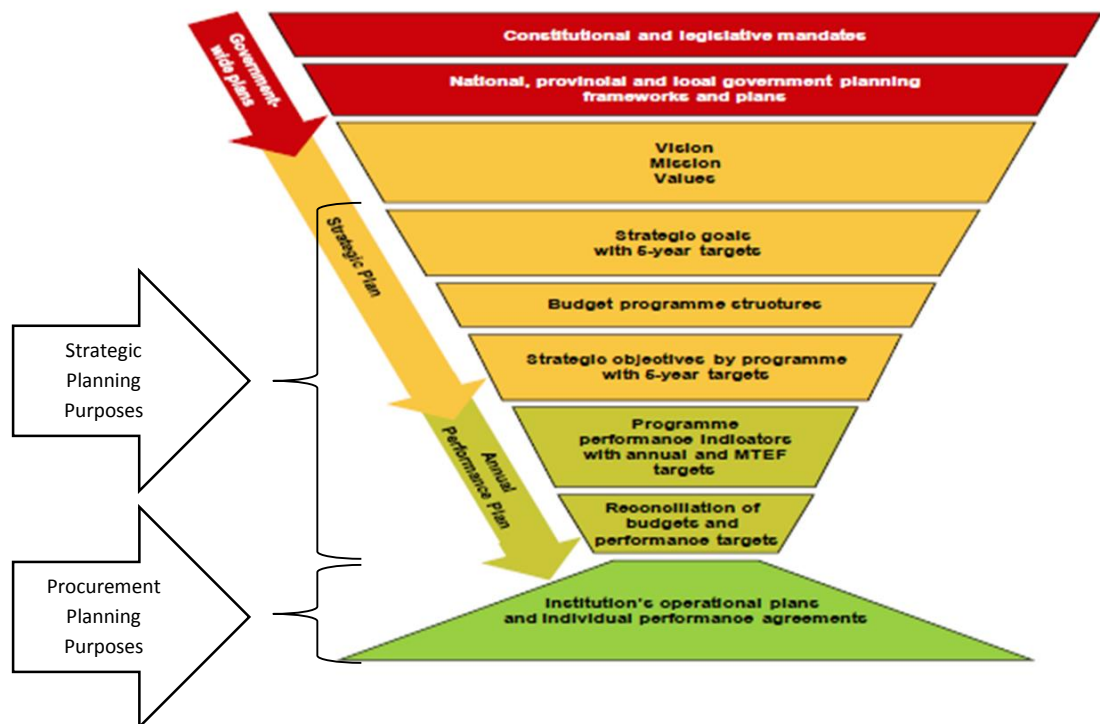
<sup>1</sup> Demand Management SOP – March 2015

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These analyses, in the context of government's planning framework, can be done at two levels of detail.

- i. For **strategic planning** purposes
  - The organisation's total spend profile
  - This initial diagnostic is required to be only around 80 per cent accurate to have relevance and to offer valuable insight.
- ii. For **procurement planning** purposes
  - The organisation's spend by category/commodity group
  - When sourcing teams refine spend data for each category for the purposes of developing sourcing strategies.

In this regard the hierarchy of the planning framework should be noted.



## 7. The need for a differentiated approach to government procurement

Strategic sourcing requires that government adopts a differentiated approach to procurement of the various commodity groups.

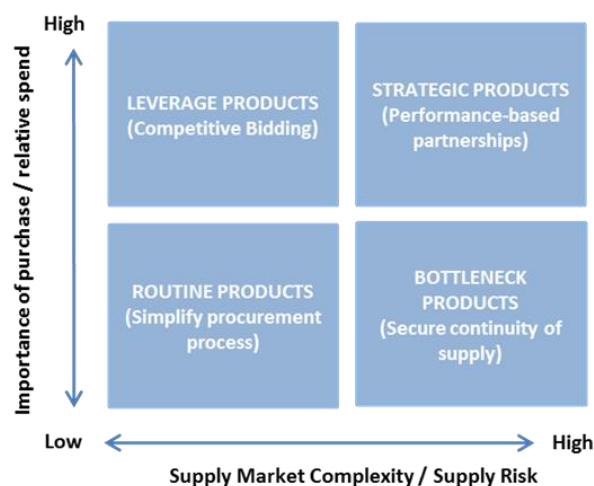
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Households do not procure their monthly goods in the same way as they buy property, which is a strategic decision. In the same way, government should not procure catering services in the same way as specialised and expensive medical or agricultural equipment. Using the principles of strategic sourcing means distinguishing between the various categories of commodities and developing appropriate sourcing approaches for each.

Deciding how to differentiate depends on two factors (adapted from Kraljic, Peter, "Purchasing Must Become Supply Management," Harvard Business Review, September-October 1983):

- i. the **strategic importance** of the goods or services being purchased, either in terms of value for money and service delivery or of the cost. The more expensive, the more important it is to think strategically about how to purchase.
- ii. **the complexity of the supply market**, measured in terms of factors such as how scarce the supply is, how quickly the technology is changing and any barriers to supplier entry to the market.

Using these two criteria, purchasing executives should be able to develop sourcing strategies for the following four commodity types:



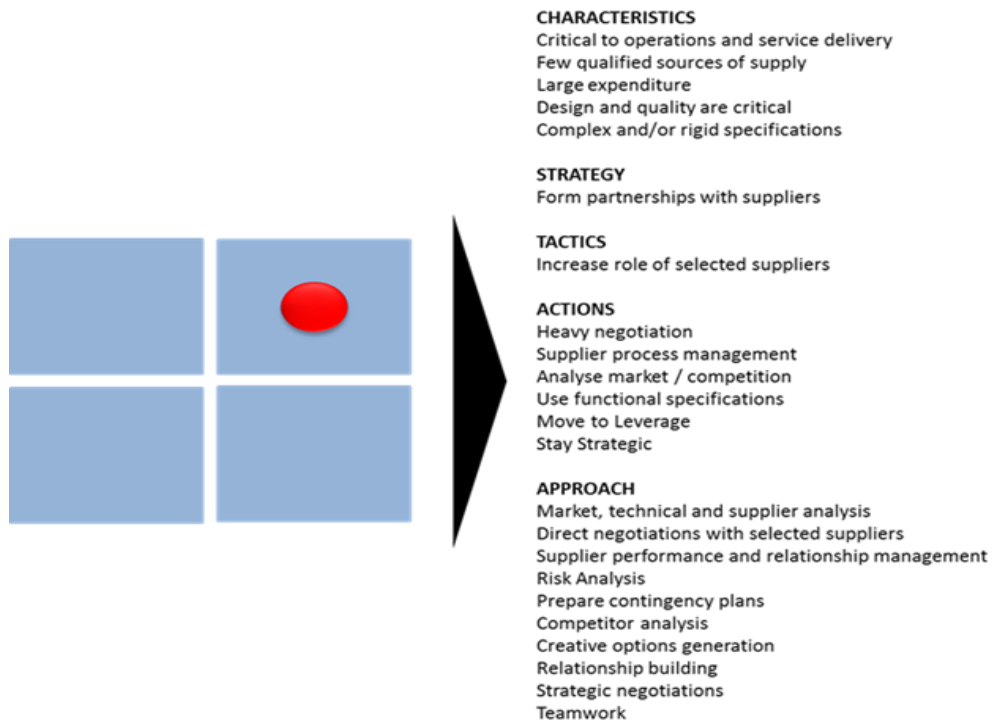
### 7.1. Strategic commodities:

These are high value goods which are critical to service delivery, have complex and/or rigid specifications and for which there are few qualified

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suppliers. The strategy would be to form long term partnerships with suppliers.

The diagram below illustrates the typical characteristics, strategy, tactics and actions to be considered when dealing with strategic commodities.

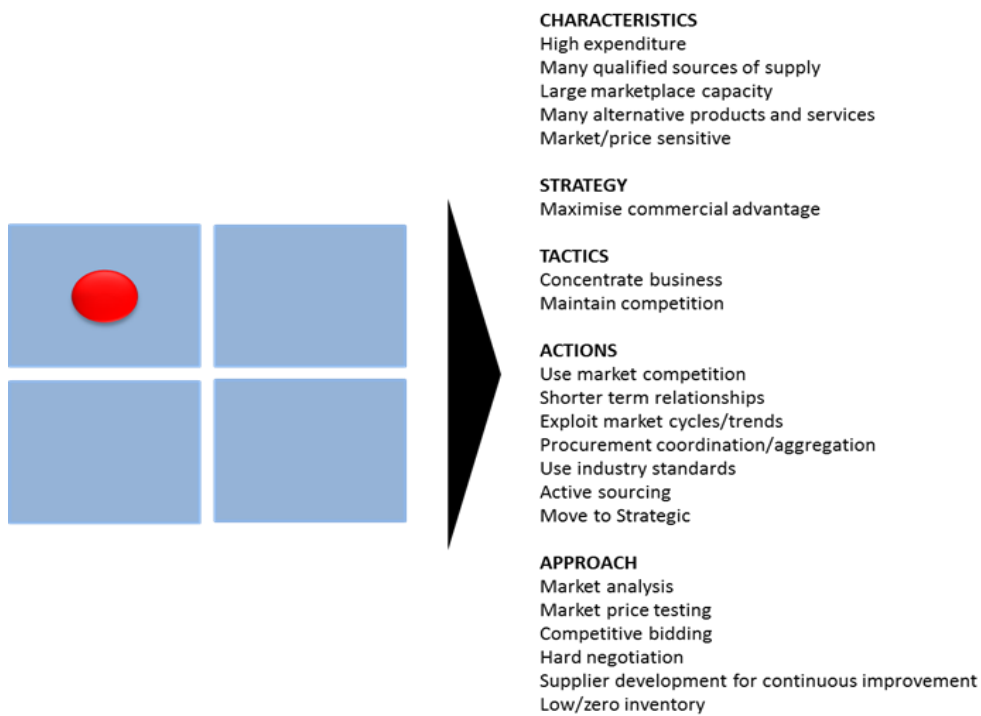


### 7.2. Leverage commodities:

These are high value goods which are market- or price-sensitive because of competition in the market; there are many suppliers and many product and service choices. The strategy would be to maximize government's buying power and maintain market competition.

The diagram below illustrates the typical characteristics, strategy, tactics and actions to be considered when dealing with leverage commodities.

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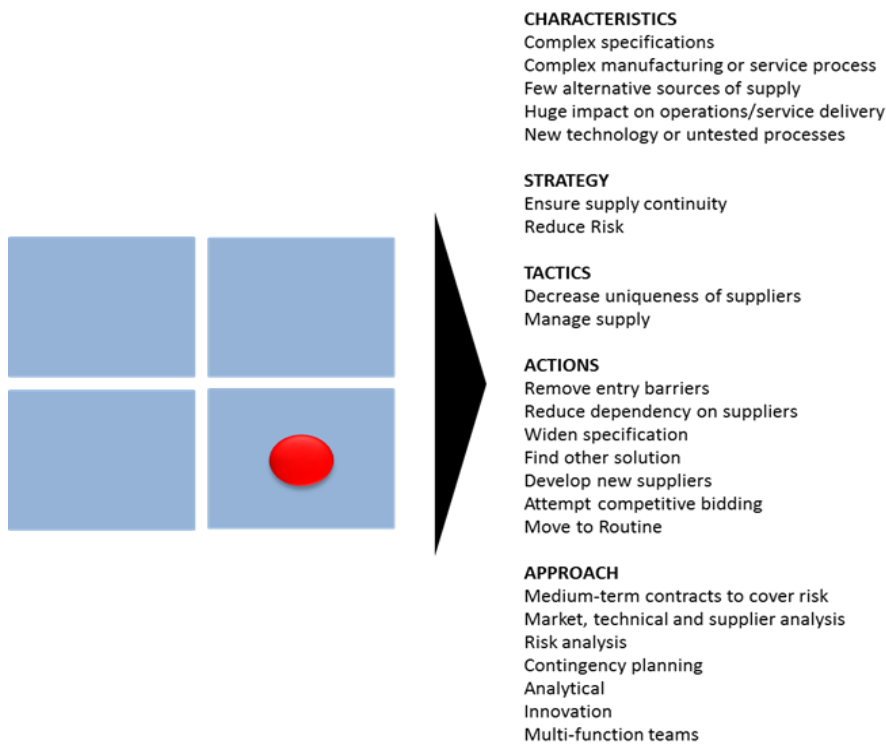
### 7.3. Bottleneck commodities:

These are lower value goods with complex specifications that have a substantial impact on service delivery, have few qualified sources of supply and not many alternatives. The strategy in this case would be to manage the supply risk by ensuring the continuity of supply through firm and longer term contracts.

The diagram below illustrates the typical characteristics, strategy, tactics and actions to be considered when dealing with bottle-neck commodities.



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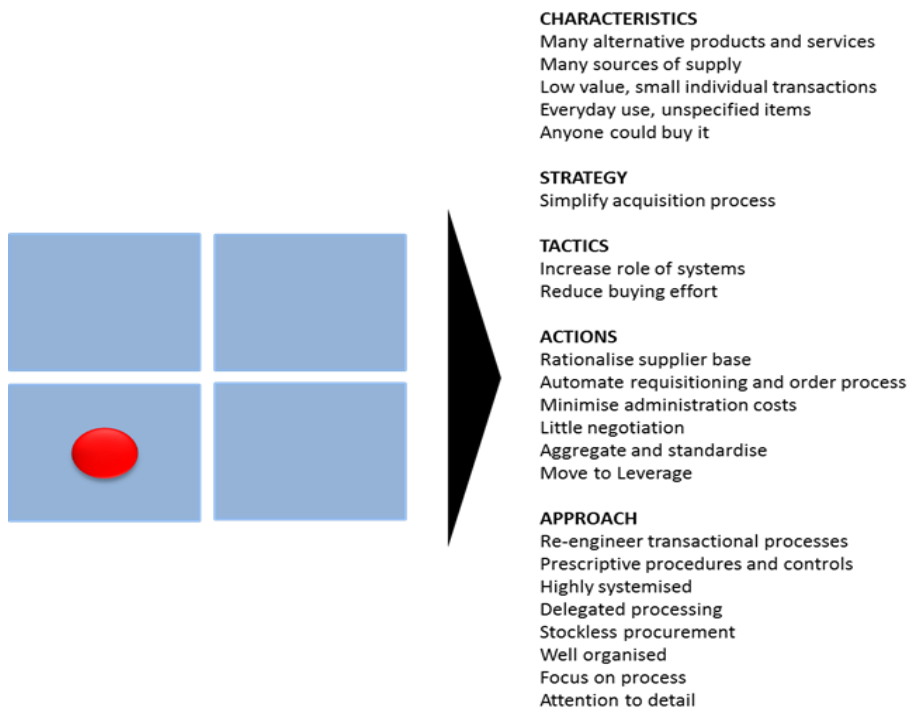


### 7.4. Routine/non-critical commodities:

These are small, low value individual transactions and everyday products and services. There are many suppliers and many alternative products. The strategy here would be to simplify the acquisition process, and reduce the administration of transactions, by as far as possible automating the purchasing process.

The diagram below illustrates the typical characteristics, strategy, tactics and actions to be considered when dealing with routine commodities.

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## 8. Three types of strategic sourcing initiatives available to government

When a government department considers applying strategic sourcing in their environment, there are three types of strategic sourcing initiatives that may be applicable in the environment.

### 8.1. Universal strategic sourcing

This applies particularly where economies of scale are possible through aggregating volumes or quantities from all government institutions. Cost benefits come from leveraging government's buying power and using the savings achieved for other important programmes. As well as giving more control over supply and demand, administrative efficiencies lead to indirect cost savings.

As an example of this approach is a strategy to source goods and services that are common across government. These include travel and accommodation, mobile communication and subscription services, banking services and motor vehicles.

### 8.2. Department-specific strategic sourcing

This relates to procurement of goods and services that are central to a government department's key service delivery objectives, and typically include goods and services above a certain rand value which are considered complex and/or high risk.

There are numerous examples. They typically include commodities such as pharmaceuticals for the Department of Health, textbooks for the Department of Basic Education, prison catering for the Department of Correctional Services and many others equally important.

Achieving value for money means that the department must define its requirements clearly and explain these to the market in order to create certainty, and competitive tension, among competing bidders.

It is departments' responsibility to judge the best way to achieve value for money. Robust business case reviews can help with managing the high-risk nature of some procurement in this category.

### 8.3. Sector-specific strategic sourcing

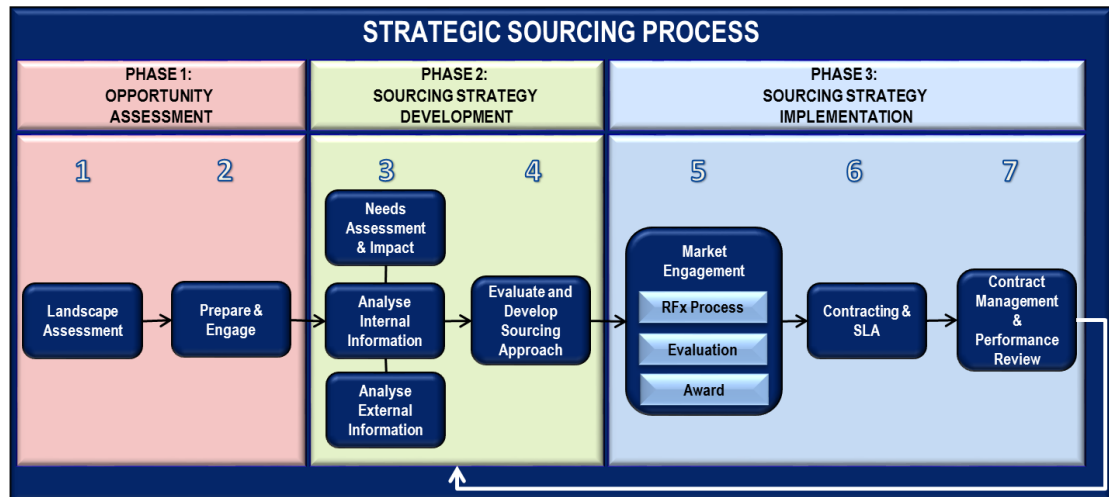
This covers procurement of goods and services purchased by more than one government department and involving an industry sector that government wishes to protect or promote. This includes, for example, commodities in the textile, leather and footwear industry. Because they need to procure items such as uniforms, shoes and boots, a number of government departments (Defense, Correctional Services, Health, Police and others) have an interest in this industry.

Other examples of goods designated by the Department of Trade and Industry for local procurement are buses and steel pylons.

## 9. The strategic sourcing process: an overview

As alluded to earlier in the document, strategic sourcing is not very different from the normal sourcing process except that it requires more effort during planning and analysis phases to gain greater value throughout the process.

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The process consist of three main phases that encompass the complete sourcing process:

1. Phase 1: Opportunity Assessment;
2. Phase 2: Sourcing Strategy Development; and
3. Phase 3: Sourcing Strategy Implementation

The strategic sourcing process requires an organised approach that allows a supply chain function to work systematically and to reduce costs. As with all sourcing models, it has seven main stages. These start with understanding the landscape or spend under your direct control and end with contracting and managing the supplier relationship.

### 9.1. Stage 1: Landscape Assessment:

This involves identifying spend areas where there are opportunities to reduce costs or improve processes. This is usually done at CFO, CEO or CPO level.

Critical to this stage is to prioritise spend areas so that they align with the department's service delivery objectives. Prioritisation can also be based on purchase categories' relative importance, the complexity of the supply market and the extent to which spend areas are common across the organisation.

The objective of the landscape assessment is to obtain an understanding of the organisation's spend profile for strategic planning and procurement planning purposes. It further involves positioning of commodity groups on

the Positioning Matrix, prioritising the waves of sourcing implementation and obtaining approval for initiating specific sourcing projects.

### 9.2. Stage 2: Prepare and engage:

Once priorities have been determined, sourcing can begin. This involves obtaining senior management buy-in and agreement to avoid or reduce possible resistance at operational level where the sourcing strategy must be implemented.

During this phase the project is scoped, stakeholders are identified and a cross-functional team is established. The project team must put in place a governance structure, develop a communication plan, establish timelines and milestones and create a Project Charter.

### 9.3. Stage 3: Gather information:

This step requires the project team to gather information under three headings:

- i. **Needs assessment, and impact of the purchase category.** The team must obtain information on existing sourcing practices, plans and contracts, and find out from stakeholders what they need in terms of functionality, quality, volumes and other issues. Also at this stage, the team must identify opportunities to reduce costs, and carry out an initial risk analysis.

The objective of this exercise is to obtain an overall view of the business impact the commodity has on the organisation. It involves a complete business needs assessment based on previous history and future requirements. It further involves the review of existing specifications or developing new specifications.

- ii. **Analyse internal information.** In this phase, the team collects and analyses information about past purchase trends, price history and overall spend. This is usually collected from internal customers or end-users. The team must analyse prices and costs, review the performance

of current suppliers and analyse the department's risks and vulnerability.

The objective is to obtain a clear understanding of the organisation's spend trends for this commodity in terms of Rand value, quantities, by who, with who and how often. It also involves determining future demand in line with strategic objectives. It may involve deconstructing the price to determine cost elements that will impact on future price adjustments. The analysis of the value chain will assist in identifying the internal process from requisition to payment and where the bottlenecks are.

- iii. **Analyse external information:** During this information gathering and analysis phase, the team typically looks at trends in the supply market, using tools such as Porter's Five Forces Analysis<sup>2</sup>. The team carries out supplier analysis to determine who the major suppliers are, how they are organised in the market and what the item's main cost drivers are. This information is usually collected from suppliers or industry bodies.

The objective to obtain a clear understanding of external factors that influences the purchasing of the commodity. It involves the analysis of the external supply chain, the market dynamics that shape the industry and who the suppliers are in this industry.

#### 9.4. Stage 4: Evaluate and develop a sourcing approach:

In this phase, the project team analyses and interprets all of the information gathered. This is usually grouped under the following headings:

- Supplier characteristics

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<sup>2</sup> The model of the Five Competitive Forces was developed by Michael E. Porter in 1980 and has since that time become an important tool for analyzing an organizations industry structure in strategic processes. Porter has identified five competitive forces that shape every industry and every market. These forces determine the intensity of competition and hence the profitability and attractiveness of an industry. The objective of corporate strategy should be to modify these competitive forces in a way that improves the position of the organization. Porter's model supports analysis of the driving forces in an industry. Based on the information derived from the Five Forces Analysis, management can decide how to influence or to exploit particular characteristics of the industry.

- Commodity characteristics
- Spend information

The objective of this stage is to consolidate all the information gathered, to identify possible risks associated with the project / commodity and to calculate the total cost of ownership. It further involves the identification of improvement opportunities and generating ideas as to where improvement can be achieved. Identify all possible sourcing options, desired supplier relationship and evaluation criteria. A strategy sustainability assessment will identify the sourcing options that will deliver the greatest results and is in line with government procurement and other legislation. The Business case can now be finalised and submitted for approval.

The process now moves towards implementation.

### **9.5. Stage 5: The Market Engagement process:**

This Stage involves deciding an appropriate market engagement approach, the evaluation methodology, effectively structuring the bid and planning a realistic timetable to initiate the implementation and roll-out of the chosen sourcing strategy, in order to select and award the business to the most appropriate supplier(s).

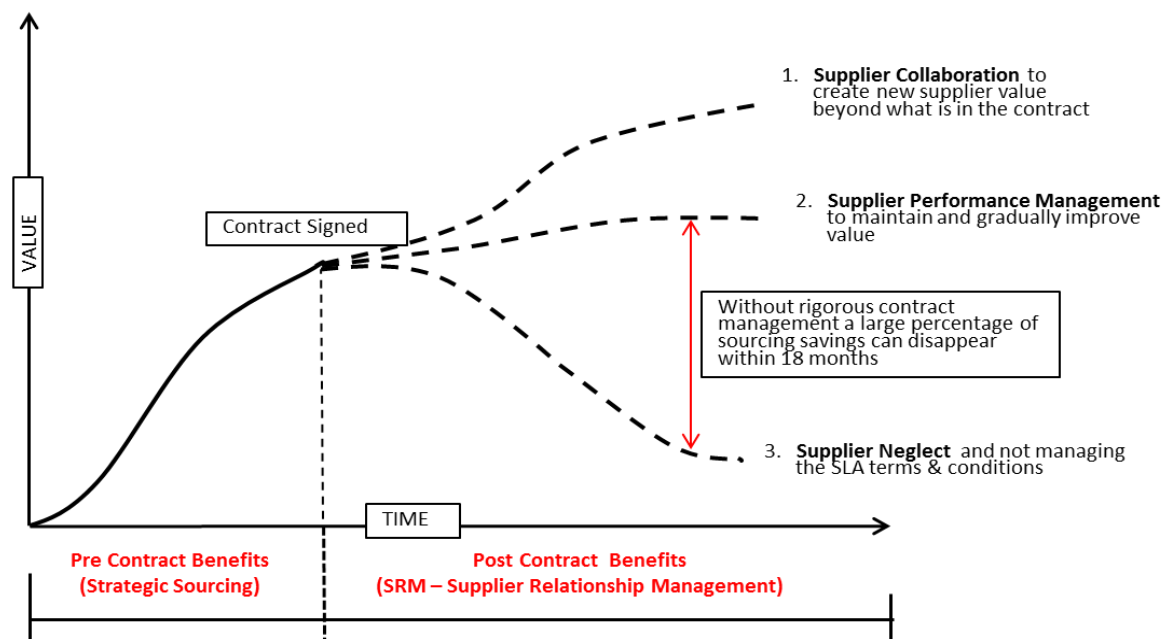
Other activities in this stage are price benchmarking, supplier vetting, implementing a negotiation strategy and calculating potential savings.

### **9.6. Stage 6: Contracting and Service Level Agreements (SLAs):**

This stage formalises the award by putting in place a contract between the department and the chosen supplier(s). It involves the planning for a smooth transition to the new arrangements. Before signing the contract, the parties should agree to performance metrics for both sides; for example on-time payment and on-time delivery. All performance measures, expectations, prices and other important contract obligations should be documented in a SLA and agreed by both parties.

### 9.7. Stage 7: Contract Management and Performance Review:

This step tends to be the most neglected part of the sourcing process. Sourcing is often detailed and laborious, only for this step to fail either because the sourcing team is disbanded or because the relationship between purchaser and supplier is not properly cultivated. The diagram below shows the different ways in which supplier-relationships can be managed in the post-contract phase, and the benefits of managing these relationships well.



This Stage involves contract management activities and various contract administration tasks. This stage includes continuous supplier performance monitoring and the tracking of benefits. This stage concludes the Sourcing Process but not before the sourcing strategy has been reviewed to determine the success and lessons learned.

## 10. Some indicators to consider

- Depending on the commodity or service, a typical sourcing project from inception to developing the sourcing strategy will take from 4-6 months. This excludes the bidding, contracting and monitoring phases.



- Such a sourcing project will require at least 20 per cent of team members' time and thus warrant it to be included on the team member's performance agreement.
- Depending on the commodity or service, a well managed sourcing project can yield savings of between 5 to 15 per cent.
- If a department has not undertaken a sourcing project before, it should not undertake too many projects. It is better to do one or two, get quick wins and establish a process for future teams to replicate.
- The teams, or at least a core part of the team, should stay in place after the award to monitor performance and progress.

### 11. Conclusion

Strategic sourcing is an organised and collaborative approach which takes advantage of the size and nature of government spending to get the best possible service and value from selected suppliers. It is closely linked to transversal contracting, which provides a country-wide framework for maximising government's bargaining power and in this way maximising savings.

Collaboration is vital for strategic sourcing. Rather than working in silos, professional supply chain managers must be members of cross-locational and cross-functional teams.

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