national treasury

Department:
National Treasury
REPUBLIC OF SOUTH AFRICA

Quick Reference Guide to Reduce Procurement Spend

Contents

1. Introduction

The purpose of this document is to give guidance to users on the different techniques that can be deployed to reduce procurement spend on goods, services and works. It is not meant to be an all exhaustive list but common techniques that can be deployed in the procurement arena to reduce costs.

2. Background

The Public Sector is the country's single largest service provider. An incremental improvement in public service delivery positively impacts the lives of millions of people. Public procurement spend in South Africa is estimated at R600 Billion. Beyond advancing social objectives, public procurement in South Africa is also being leveraged towards generating employment, enhancing domestic manufacturing capacity, and supporting inclusive growth priorities.

One of the primary objectives of the Office of the Chief Procurement Officer (OCPO), through the Transversal Contracting Unit, is to realise value for money and improve service delivery by ensuring that quality of goods and services are contracted on behalf of User Departments.

With a shrinking revenue stream and rising expenditure levels measures need to be put in place to do more with the lesser financial resources that the State has at its disposal. Centre led procurement enables the User Departments to free their resources in order to focus on their core service delivery mandates. One of the objectives of the OCPO is to also provide guidance to Institutions on leveraging their procurement spend by reducing duplication, inconsistencies, wastage, price differences, and leakages and therefore generate savings for government through economies of scale.

3. Problem Statement

The following challenges were identified in procurement across the State during the 2016/17 FY:

i. Fragmented procurement system across the State that is resulting in duplication of effort and different pricing models
ii. Lengthy tender processes (6 months to a year to finalize a tender)
iii. Huge price variations between procuring entities
iv. Poor standardisation in procuring same goods / services / works
v. Interference in the procurement process
vi. Tenderpreneurism (when government employees abuses their political power and influence to secure government tenders and contracts)
vii. Lack of capacity to conduct monitoring and compliance
viii. Shoddy quality in workmanship, products and services
ix. Lack of focus on core service delivery
x. Lack of procurement planning
xi. Over-use of RFQ methods
xii. Inadequate Procurement System
xiii. Lack of Self-Monitoring Culture
xiv. Weak contract management
xv. Unnecessarily appeals and judicial review process

xvi. Duplication of effort – RFx's, Contract creation, Contract Management, Supplier Management, Supplier queries, Litigations, Cancelled tenders and contracts, and Audit queries.

4. Savings Introduction

The OCPO has initiated savings strategies in the 2016/17 financial year which has led to procurement cost reductions that will see the State benefit to the tune of R7 Billion over the medium term expenditure framework.

The quick reference guide provides guidelines on how Institutions can reduce their procurement costs. These are grouped into 6 comprehensive themes of – volume concentration, demand management actions, best price evaluation, global sourcing product specs improvement, joint process improvement and relationships restructuring.

The quick reference guide provides areas that should be probed further to check as to whether we have explored all cost reduction opportunities as well as examples that would further illustrate the technique that could potentially be deployed.

Savings in terms of procurement consists of soft and hard benefits. Soft benefits are indirect or non-tangible which are not measurable and have no impact on the bottom line and cannot be quantifiable. This is when one knows that it is the right thing to do but there is no proof or quantifiers (e.g. safety improvements, environmental changes). Hard benefits are direct or tangible which are measurable and have impact on bottom line. These include cost reduction and cost avoidance strategies.

The OCPO is looking more towards cost reduction and avoidance strategies. Cost reduction includes:

i. Bankable savings – allocated budget vs previous price paid vs tender price.

ii. Renegotiation of prices – reduction in existing price that leads to bankable savings through renegotiation with existing suppliers or appointment of new suppliers.

iii. Operational cost reduction through process efficiencies – the reduction in cost compared to a historical cost derived directly from interventions or proposals made by procurement and/or cross functional commodity teams. Assuming the volumes remains constant a cost reduction will be reflected in a reduction in the current operating costs.

iv. Volume discount – consolidation of quantities creating economies of scale can provide discounts deductible in advance of payments.

v. Rebate – discount that comes as a result of purchase of specified quantity or value of goods within a specified period refunded after the payment of full invoice amounts.

vi. Make vs buy – a strategic choice between producing an item / providing a service internally (in-house) or buying it externally (from an outside supplier). The same business requirements and quality standards are still met.

vii. Early payment rebate – A reduction (rebate or discount) in in price is agreed for early payment or supplier invoices. The cost of capital needs to be accounted for if payment period is moved by more than 1 month. Savings benefits can also be demonstrated if payment terms are extended.

Cost Avoidance benefits include:

i. Price increase limitation - defined as being representative of the difference between prices for goods and services and the probable increase in price occurring if actions had not been taken to obtain reduced costs for the same goods and services. Tender price vs negotiated price.

ii. Spend avoidance – reduced consumption through better demand management.

5. Savings Tracking Principles

The following principles should be used as guidelines in calculating savings:

i. Savings must be tangible, credible and measurable or can be reasonably estimated. It must have a positive impact on the bottom line of the organization.

ii. The baseline and method of calculation should be agreed with and signed off by delegated authority prior to commencement of the project.

iii. Savings must be calculated inclusive of Vat in local currency (converted to ZAR).

iv. Savings should be calculated from a holistic process view (i.e. Total Cost of Ownership). All aspects must be considered and included in the calculation, including negative aspects. It should be calculated net of incremental cost over the total contract period.

v. The baseline from which the value is calculated must be reasonable. Using a budgeted cost as baseline (e.g. budget for capital expenditure) is not a reasonable baseline unless it can be shown that appropriate rigour was used to determine the budget figure.

vi. Value is not double counted – value reported at the commencement of a contract is not also reported during the term of the contract. Incremental value as a result of additional users to an existing contract may be reported as savings during the term of the contract. However, no additional benefits are recognized if the actual purchase volumes exceed or decreases based on the forecast upon which the initial benefits are based.

6. The Sourcing Gemstone

The OCPO has chosen the sourcing gemstone methodology as a useful tool to determine spend reduction interventions. The gemstone groups the methods into 6 areas as follows - volume concentration, demand management actions, best price evaluation, global sourcing product specs improvement, joint process improvement and relationships restructuring.

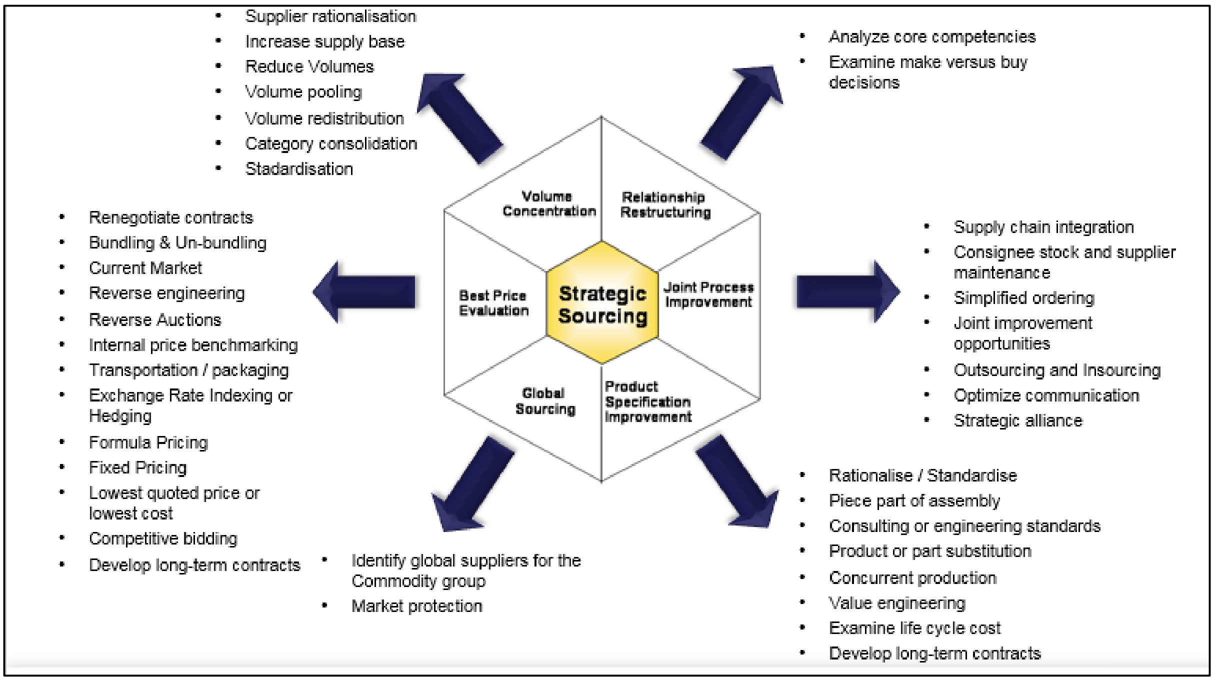

Figure 1: Sourcing Gemstone

Each of these areas are discussed below.

7. Techniques for best price evaluation:

No.	Tactic	Description	Questions	Examples
7.1	Renegotiate contracts	Renegotiate price with existing suppliers. Value/supply chain analysis and Purchase Price Cost Analysis are useful tools for challenging individual cost elements	• Can the current contracts be renegotiated with regards to price and contract terms?	• Can we approach the building landlord for reductions on leasing? • Can we negotiate a 2,5% payment term within 30 days settlement?
7.2	Bundling and unbundling	Grouping commodities or de-constructing categories so that maximum price advantage is achieved	• What benefits can be achieved by regrouping and contracting current non-contracted items?	• Can we join cleaning and pest control services together? • Can we have a total facilities management service that includes maintenance and repairs, cleaning and security services?
7.3	Current Market	Lock into traditional old suppliers could potentially lock the buyer into unfavourable escalating costs.	• Can we explore potential new suppliers?	• Intensify market research to identify suppliers for products often where suppliers find it cumbersome to tender for Government requirements
7.4	Reverse engineering	This is a technique, also known as target pricing, which involves giving a supplier a fixed price to manufacture, or supply a service	• Can we give the supplier a fixed price to manufacture/ supply a product or service?	• For RDP houses can we not give suppliers set prices to build houses at?
7.5	Reverse Auctions	This technique sets a fair price and allows bidders to bid against each other on an online platform	• Can we set a price for s commodity and get bidders to bid online against each other for a limited window of time?	• For example where the industry and specifications are highly regulated eg. Pharmaceuticals, suppliers can be pre-qualified upfront and allowed to bid on online reverse auctioneering tools?
7.6	Internal price benchmarking	In some cases commodity comparisons can be made against in-sourcing.	• What is the cost of internal supply/ manufacturing vs external supply?	• Would it be more cost effective for us to appoint our own cleaners and procure own materials?
7.7	Transportation / Packaging	Re-arrange the relationship for the supplier to change the packaging materials used or the mode of transport	• What benefits can be achieved by reviewing the current manner of transportation? • Can benefits be obtained by	• Can the Institution collect the product rather than these being delivered? • Can we get the supplier to change packaging for Government to one that

No.	Tactic	Description	Questions	Examples
			requesting the supplier to use standard packaging material rather than fancy consumer centric materials?	is standard but provides the same quality?
7.8	Exchange Rate Indexing or Hedging	Method of ensuring that prices are protected in the event of volatile currency fluctuations.	• Can we (should we) protect ourselves against exchange rate fluctuations? • If so by whom? Us or the Supplier? • Can we enter into forward cover agreements with suppliers to hold the rate at date of procurement?	• Can we set aside a basket of common currencies for foreign purchases such as medical equipment, for use when the currency markets are not favourable? • Can we request medical equipment suppliers to ensure that they carry exchange rate cover to ensure price stability?
7.9	Formula Pricing	Pricing linked to key input prices or influences such as volume usage	• Can we link prices to indices such as fuel, CPI, PPI?	• Instead of getting suppliers to load pricing, can we link pricing to key indexes where it is known that these indices will be favourable eg. Long term fuel pricing?
7.10	Fixed Pricing	Pricing that is fixed over a period of time	• Can we fix prices where it is known that these commodities are always subjected to volatile market conditions?	• For medical procurements where it is known that we import in excess of 80% can we move to fixed price modelling to ensure that our budgeting process remains intact?
7.11	Lowest quoted price or lowest cost	Supplier base is increased to promote active competition	• Can we obtain multiple quotations on an ongoing basis that is not limited to only 3 traditional suppliers?	• Can we create ongoing tension amongst suppliers to remain competitive and promote ongoing decrease in standard products and services?
7.12	Competitive bidding	Suppliers are invited to formally tender for the business	• Can we increase the use of competitive bidding?	• For high value commodities can we advertise more widely and attract a larger base of suppliers?
7.13	Develop long-term contracts	May provide security of supply for buyer and preferential treatment in short supply situations. Supplier is secured the business for competitive pricing	• Can we enter into a longer term contract with the suppliers to reduce the cost of the item?	• For pharmaceutical products where technology changes can we foster relations where there is ongoing cost reduction and product formulation interventions?

8. Techniques for Volume Concentration:

No.	Tactic	Description	Question	Examples
8.1	Supplier rationalisation	Reducing the number of suppliers is a common technique to maximise the volume on offer and allows resources to be focused on the few preferred suppliers	• Can we reduce the number of suppliers	• Can we consolidate who provides catering services to a Departments to reduce costs and ensure a successful business venture
8.2	Increase supply base	Increasing the number of suppliers to improve market competitiveness	• Can we Increase the number of suppliers	• For billion rand contracts can we engage with more suppliers to make industry more competitive especially in the downstream and upstream supply chain activities?
8.3	Reduce Volumes	Reducing demand for a product can reduce costs.	• Can volumes be reduced for the product or service?	• Can we reduce the amount of paper that we utilise? Have we encouraged reduction in printing and copying or even moved to double sided printing or even re-using paper?
8.4	Volume pooling	Pulling together the volume of business on offer through supplier rationalisation or consolidation of group wide expenditure can leverage lower prices	• Can we work together with other regions or districts or Departments to bring volumes?	• Can small Departments pool their stationery procurement to save due to more attractive volumes
8.5	Volume redistribution	Re-allocating business from one supplier (or constantly switching) to another can maintain competitive conflict amongst the supply base.	• Have we considered multiple awards of the contract?	• Awarding of regional suppliers for example courier services
8.6	Category consolidation	Identifying supplier synergies in the category base can allow greater volumes of business to be offered for tender. This approach will tend to support larger vertically, horizontally and laterally integrated organisations.	• Have we considered that certain suppliers can offer multiple products?	• Awarding business to a supplier that has synergies in different products such as - vehicle financing, maintenance, insurance, repairs and services
8.7	Standardisation	Is a tailored/customised product/service necessary? Standardisation opens up competition	• Can we create a common standard for the product or service?	• Can we create standards for laptops and computers for the different types of users?

9. Techniques for Global Sourcing:

No.	Tactic	Description	Question	Examples
9.1	Identifying global suppliers for the Commodity Group	Increasing the potential population of suppliers will often ensure suppliers with the lowest cost structure, advanced technologies and high quality standards.	Have we considered procurement of products from abroad?	Where South Africa does not have a local manufacturing advantage have we considered approaching low cost manufactures internationally?
9.2	Market protection	Dealing internationally exposes the buying organisation directly to currency markets and their inherent volatility. It is therefore preferable to purchase in the buyer's currency. This offers a level of insurance.	Have we considered factors that affect pricing due to international market factors?	Have we considered techniques such as: • Insisting on buying in local currency hence fixing the price? • Exchange rate price indexing. This entails linking purchase prices to a currency range i.e. £1 : DM 2.3 +/- 5%. Within this range the price cannot change, once outside, the price will be re-negotiated. • Exchange rate hedging. To eradicate concerns it is possible to buy foreign currency ahead at pre-determined rates

10. Techniques for Product Specification Improvement

No.	Tactic	Description	Questions	Example
10.1	Rationalise / Standardise	• Evaluation of the complexity and diversity of products and services. • To what extent can they be merged, simplified or standardised?	• To what extent can the current specifications be simplified, standardised or merged?	• Can we have a common design for RDP housing and schools or clinics? • Can we simplify the product formulae for agricultural and veterinary products?
10.2	Piece part of assembly	• Savings can be achieved by assessing the costs of differing levels of assembly.	• To what extent can the current product and service requirement be re-configured to reduce costs?	• Can we buy the product internationally and conduct service, maintenance and repairs in-house or

No.	Tactic	Description	Questions	Example
		• Services can be similarly de-constructed.		through local vendors?
10.3	Consulting or Engineering standards	Internal and external standards should be challenged and not considered set in “stone”	• Sometimes standards create unnecessary costs, have we considered changing the standards?	• Have we considered the relevancy of the SABS standards for our products and opt for an international standard which allows suppliers to supply beyond the borders and offer us more favourable pricing?
10.4	Product or part substitution	Technologies are moving at a fast pace, new and different products or parts can be cheaper and more efficient.	• Can we use a different product? • Can we change a part of the product?	• Do we still need landlines? • For ARV’s the most expensive portion is the Active Pharmaceutical Ingredient (API) – can this be replaced with a different API • Can we use synthetic rubber for shoes?
10.5	Concurrent production	Suppliers that will work closely with design engineers, as `guest engineers’ can offer significant competitive advantage in both time to market and cost.	• Can we invite the supplier to assist us with our supply chain?	• Can we get the pharmaceutical giants to assist with problems in the delivery of medication or publishers to assist with textbook deliveries?
10.6	Value engineering	Value engineering involves analysis of function and cost, suppliers can be the key to cost reduction whilst maintaining the market offering.	• Can we invite the supplier to assist us with our production cost?	• Supplier could assist us to understand our total product cost for medicines from manufacture to end user and suggest improvements
10.7	Examine life cycle cost	By examining all the costs associated with purchasing and using the product / service, opportunities for redesign may become apparent. E.g. excessive maintenance and repair costs may signal a need for improved quality standards.	• Have considered all costs – lifespan, maintenance, repairs, service, consumables, disposal	• Have we considered the total cost and lifespan of the machine eg. X ray machine that would last 2 years versus a machine that would last 10 years • Does the road last as long as we require it?

No.	Tactic	Description	Questions	Example
10.8	Develop long-term contracts	• Length of contract will depend on the supply market in question. • Consider length of product life cycle and availability of supply. • Long- term contracts offer the supplier some security and may increase their willingness to enter into redesign /development initiatives.	• Have we determined the optimal contract duration	• Does it make sense to lease a building for 3 years – should we not buy rather than lease? • For ICT wont short term contracts suffice?

11. Techniques for Joint Process Improvement

No.	Tactic	Description	Questions	Example
11.1	Supply chain integration	Utilising information systems such as Electronic Data Interchange (EDI) and the internet / intranet to dramatically improve the flow of information and facilitate efficient order management, delivery and payment.	• How can we capitalise on supplier technology • Can we create enabling technology to monitor deliveries	• Have we considered suppliers systems to be configured to monitor Hospital medicine stock levels and to proactively interact with Health where orders are automatically generated to suppliers? • Government creating enabling technologies to monitor delivery of products to end user sites
11.2	Consignee stock and supplier maintenance	Holding supplier stock on site, paid for on usage, managed by the suppliers/ personnel on site can reduce overhead, and remove an administrative burden.	• What items can Government proactively hold as consignment stock to improve service delivery?	• Institution holds common burst water pipe kits on hand on consignment and paid per usage
11.3	Simplified ordering	Purchases often carry a high overhead burden that is not commensurate with their worth (i.e. low value items). Call-off contracts and purchasing cards help to minimise overhead.	• Are we spending lots of time on low value high volume transactions?	• Identify low value and high volume transactions introduce purchasing cards.
11.4	Joint improvement opportunities	Supplier/buyer team can be engaged to define cost-reduction opportunities. These are then shared 50:50	• How can we team up with suppliers to reduce costs	• Where products require quality assurance testing at both supplier and buyer sites, have we considered

No.	Tactic	Description	Questions	Example
				if this can be done jointly and costs reduced. • Can we contract cost reduction over the period of the contract as a key performance indicator to ensure a reducing cost base?
11.5	Outsourcing and Insourcing	This can be to an outsource agency or by engaging existing suppliers to purchase a wider range of supplies (i.e. some that they do not deal in).	• What services can be outsourced and which insourced to reduce costs?	• Should we doing cleaning services in house or should it be outsourced? • Does every Department need a call centre or switchboard or IT services? • Can we do retainer fee contracts?
11.6	Optimise communication	Having a common message between appropriate people within the organisations will reduce confusion and miss-trust.	• How can we optimise communication using technology between buyers, end users and suppliers	• How can we optimise medical contracts usage to the last mile delivery point's example Musina.
11.7	Strategic alliance	Long term relationships focus on lowering cost and improving quality or creating supply chain innovation.	• How can we work with the market continuously without being contractually bound to reduce costs, improve quality and add innovation to service delivery?	• Have we considered private sector partnerships and collaboration with eg. Discovery Health to improve our pharmaceutical supply chains to improve service delivery to citizens and optimise cost?

12. Techniques for Relationship Restructuring

No.	Tactic	Description	Questions	Example
12.1	Analyse core competencies	Identify the core competence of the organisation and potential suppliers?	• Which part of the product or service do we do in-house versus via the service provider?	• For grant payments which part of the service do we conduct in-house and which externally to ensure long term protection of intellectual property?
12.2	Examine make versus buy decisions	Consider the current manner of sourcing, it may be more appropriate to buy a managed service rather than manage this in house and vice versa. This may severely change the relationship with a	• Can the product be made internally at a much reduced cost? • Is there products where Government split the materials from the manufacturing?	• For property leasing should we not construct a building for the Institution rather than leasing on a long term basis? • For latex products we can split the

No.	Tactic	Description	Questions	Example
		number of suppliers.		procurement of latex from the manufacturing of gloves and condoms? • For uniforms we can split the fabric procurement from the manufacture of the uniform?

13. Ease of Strategy Implementation

Below is a schematic of the techniques that show quick wins or easy to adopt approaches to the more difficult approaches. Users should be able to identify per product which interventions are required and using the diagram below determine a project plan for the timing of the actions.

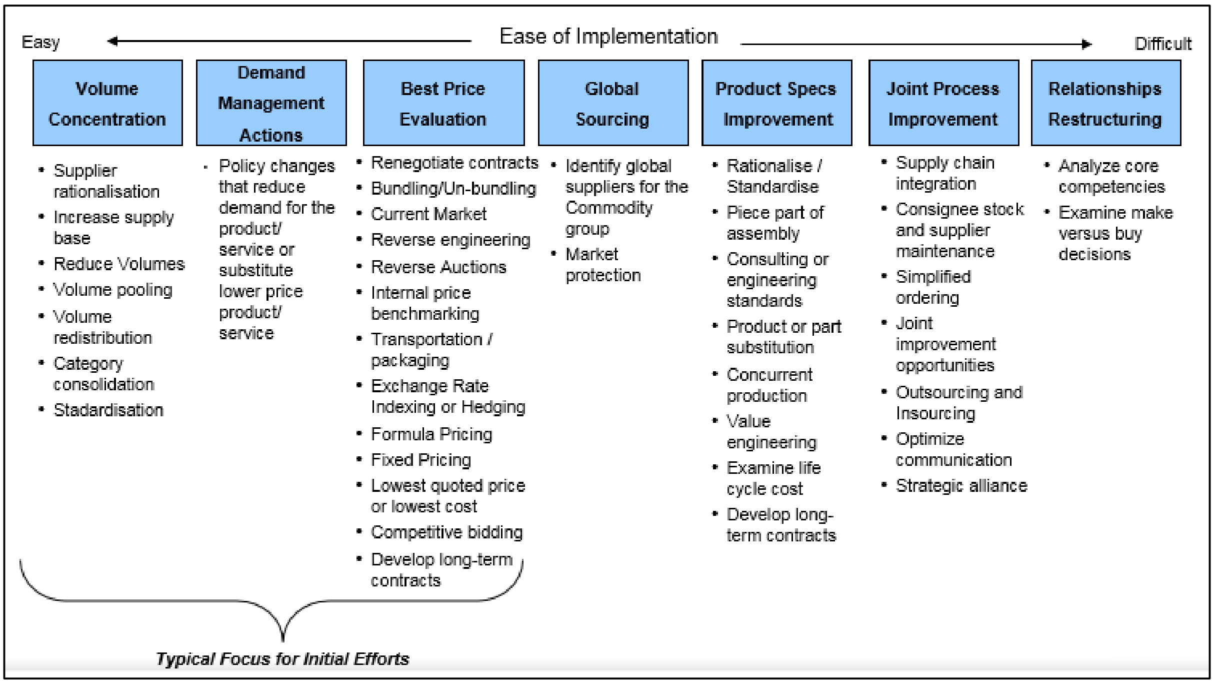

Figure 2: Ease of Implementation of Sourcing Strategy

14. Conclusions

The above quick reference guide illustrates the different approaches that can be undertaken by Institutions for reductions in their procurement spend.