national treasury
Department:
National Treasury
REPUBLIC OF SOUTH AFRICA

Quick Reference Guide to Tracking Savings and Benefits of Procurement Activities

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1 TRACKING THE BENEFITS OF A SOURCING STRATEGY

Accurate benefits tracking (reporting of savings and improved efficiencies) will be increasingly beneficial as there is a growing requirement to fully understand the significant part to be played by procurement in supporting the delivery of services at a time when resources are clearly constrained.

This guide aims to help government departments to identify, measure and report on the savings and benefits of procurement activities. It:

- Describes typical procurement savings and benefits
- Outlines the factors you need to consider when measuring savings and benefits
- Provides a five-step process you can use to measure your procurement savings and benefits.

2 WHEN SHOULD WE USE IT?

The five-step process is particularly suited to measuring the savings and benefits of tactical procurement activities with a lower risk and lower expenditure. It may also be appropriate to use this methodology for more complex and high value procurements.

It also responds to the need for a consistent approach across all government departments, particularly in transversal contracts. By using the process, departments will be able collectively to quantify and track their contracts' financial savings and wider benefits.

If your department chooses to use another measurement process for highly strategic and/or complex procurements, you should make sure that the terms you use are consistent with those in this guide.

3 BENEFITS TRACKING IN PROCUREMENT

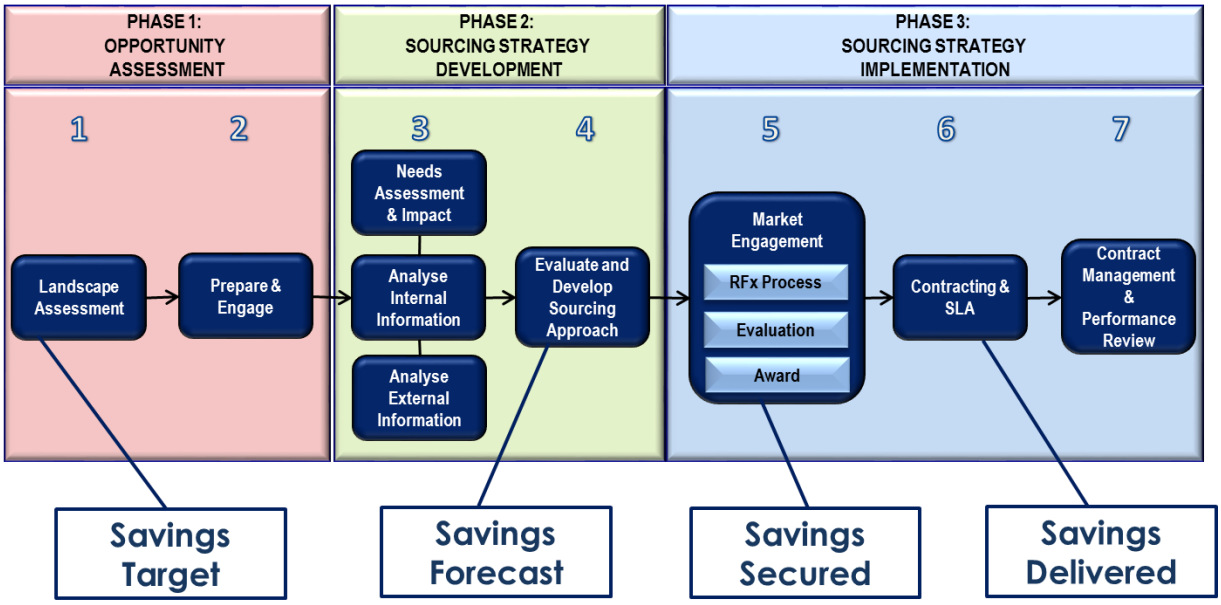
At the very start of the procurement process there may be a **Target** that applies to the procurement project – this will be applicable normally only in the higher

value tenders where detailed market analysis has taken place. This may be imposed (a department may have to maintain the same levels of service with a 5% drop in budget), or aspirational (aiming to achieve a 2% improvement on the current delivery cost).

As the procurement proceeds, market research and strategy development will give a more realistic overview of what savings and benefits may be achievable, enabling the tender process to begin with a fairly robust **Forecast** of the expected benefits.

When tenders are considered the decision to award a contract is based on a value judgement that indicates that the agreed contract will deliver certain benefits – once the contract is awarded, those benefits/savings are **Secured** – that is, the contract will deliver them if it is used and performs as expected.

During the lifetime of the contract it is key to ensure that the contract actually delivers the anticipated savings and benefits. This **Delivered** savings are the most important savings as they are based on actual, bottom line savings that have impacted on an organisation so even if there are challenges to recording the savings before this stage, it is essential that this saving is recorded.



4 TYPES OF PROCUREMENT

Savings and benefits typically result from three broad types of procurement:

- **Renewal** – where the term of a contract (or agreement) has ended and it is renewed through a procurement activity. A renewal activity often has a strong historic baseline that can be used to compare and quantify the savings/benefits the activity creates. However, any specification change should be identified and considered in the comparison. For example, in a contract for new vehicles there might be different safety specifications from the original.
- **New** – for procuring products/services for the first time, contracting out existing services or undertaking a one-off procurement activity. New procurement also requires an appropriate baseline for comparison, such as the budget in the original business case (as long as it's realistic).
- **Renegotiation or improvement of terms** – an interaction with an existing supplier that results in savings to the business through negotiating current terms and conditions. The savings/benefits might be simple to quantify, such as those that result from reduced delivery costs, or bulk ordering that leads to supplier discounts or rebates.

How you go about measuring the savings/benefits of a particular procurement activity will be influenced by the type of procurement you use.

5 SOURCES AND IMPACTS OF SAVINGS AND BENEFITS

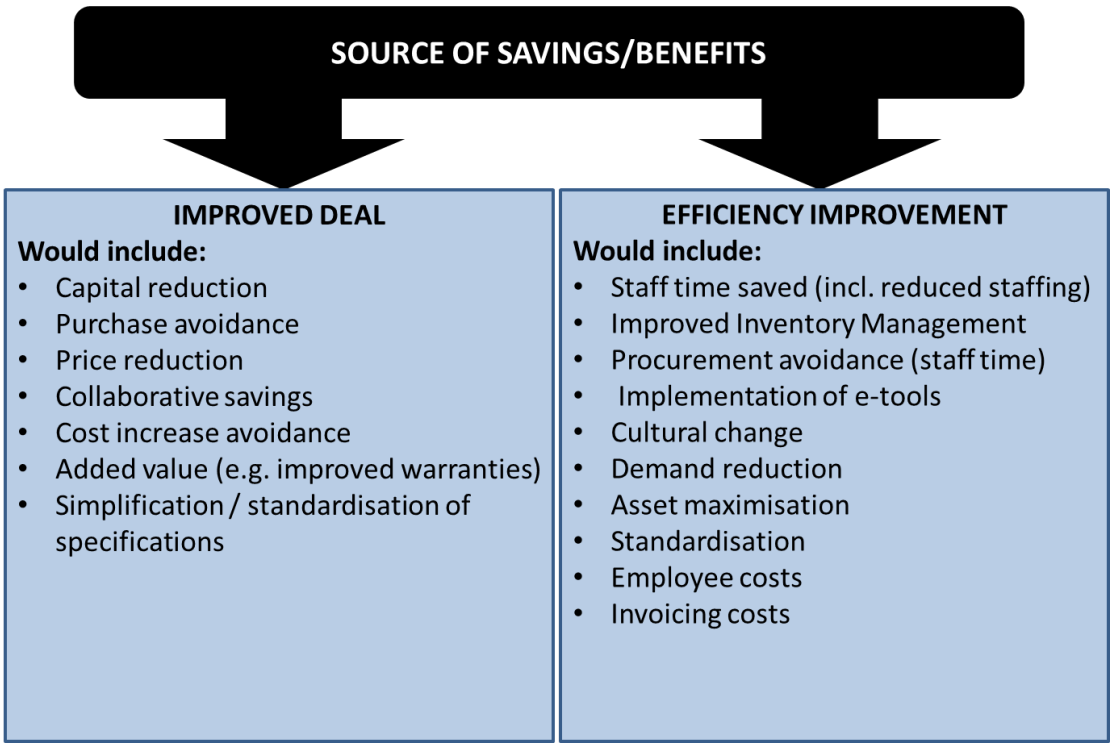
When measuring the savings/benefits of a procurement activity, it's important to differentiate between their **sources** and their **impacts**.

5.1 Sources of savings and benefits

The savings/benefits that result from a procurement activity are generally the result of an improved deal, efficiency improvements, or a combination of the two.

Here are some examples of the savings/benefits that can result from these two sources. (**Annexure 1** has more detail about each example)

It's important to differentiate between the savings/benefits that result from improved deals and those resulting from efficiency improvements.



5.2 Impacts of savings and benefits

The impacts of savings/benefits have two main types:

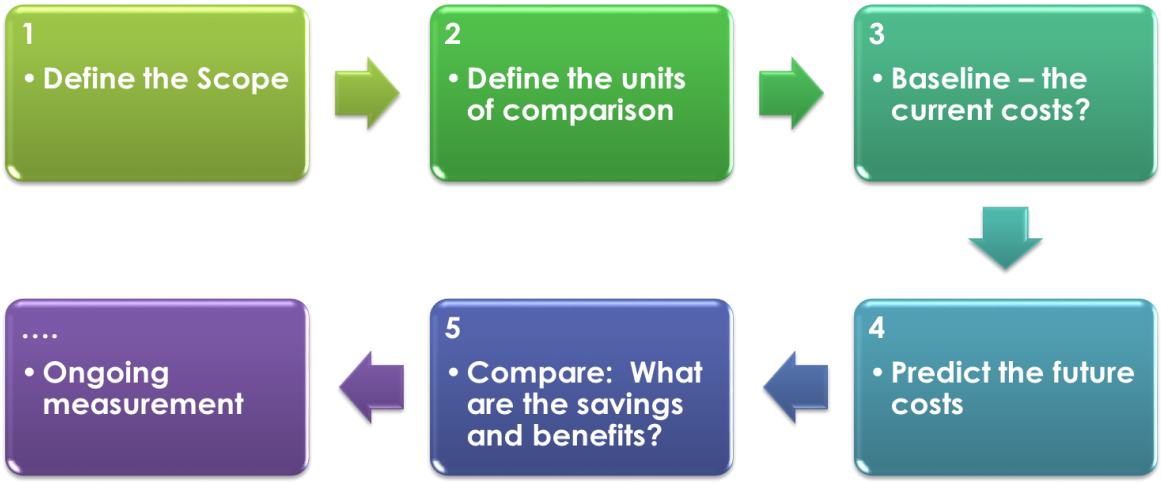
- **Budgetary benefits** (also referred to as 'cashable', 'tangible' or 'hard' benefits), such as price reductions: these generate cash or a budget surplus that you could choose to reallocate.
- **Non-budgetary benefits** (also referred to as 'non-cashable, 'intangible' or 'soft' benefits), such as cost increases avoided: these represent a procurement benefit but don't release cash or budget for reallocation.

While budgetary savings can be redistributed within or across agencies, non-budgetary savings/benefits are less realisable. It's important to differentiate between 'budgetary' and 'non-budgetary' savings/benefits. It's also important

to differentiate how the savings/benefits have been derived: from good procurement practice, or from changes in business practice that the new product/service has enabled.

6 THE SAVINGS & BENEFITS MEASUREMENT PROCESS

The five-step measurement process is simple, robust and auditable. Here is how it works:



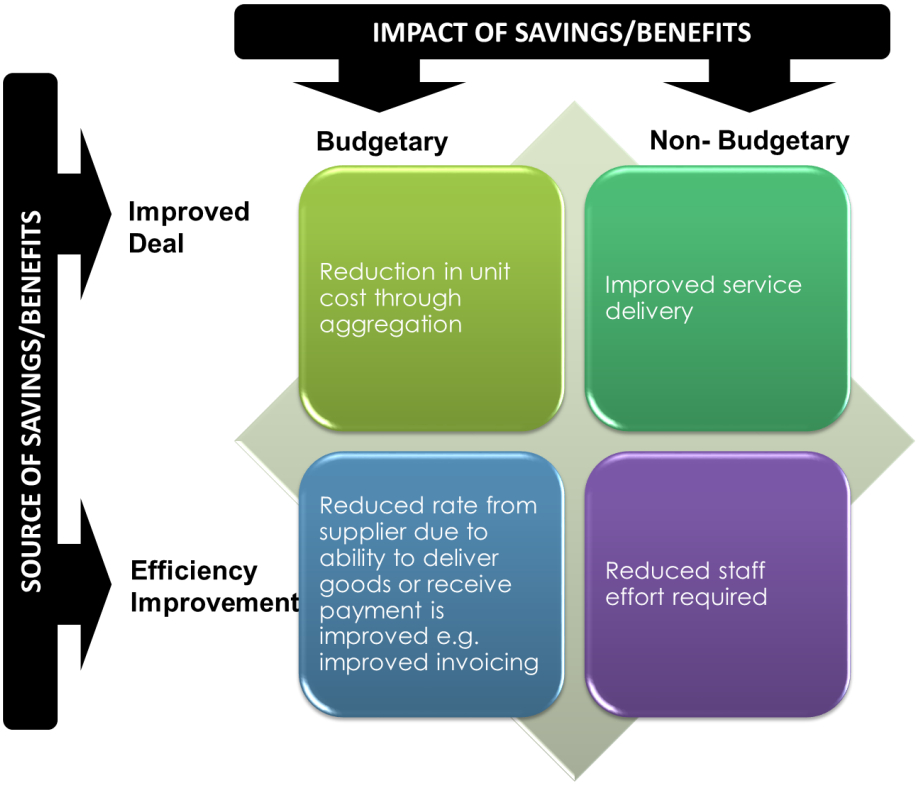
What are we trying to achieve?

At its simplest level, the savings/benefit from a procurement activity can be calculated as:

Baseline Spend – Spend after procurement = Savings/Benefits
(Volume x Price) (Volume x Price)

Before you start

Before you start using the measurement process, you need to determine whether the savings/benefits from your procurement activity are budgetary or non-budgetary.



6.1 Step 1: Define the scope of the procurement activity

Step 1 involves defining the scope of the procurement activity and the related savings/benefits that you're measuring.

Remember to:

- Collate any sub-categories or divisions of the savings/benefits categories into 'baskets' of related items.
- Include any cost component that could be influenced by the product/service selection i.e. if additional services are involved, it's essential to ensure that their cost doesn't offset any agreed cost reductions.
- Beware of 'leakage' – that is, spend that should be within the contract's scope but has been defined as a 'special purchase' and therefore excluded from the scope. This can lead to lower potential savings as a result of not using aggregated contracts, or through reduced asset standardisation.

Step 1 in action….

Case study

Dept XYZ and ABC currently source temporary call centre staff on an ad-hoc and fragmented way from several providers. They believe that a co-ordinated strategy, across the departments and using a panel of two providers, could produce benefits through volume discounts, standardised requirements and an agreement by the providers to only provide candidates who are already trained and familiar with the environment.

Defining the scope

This procurement activity involves sourcing temporary call centre staff through two suppliers instead of a multitude of companies. The contract is set for three years. The hourly rate includes recruitment agency fees and is inclusive of VAT

6.2 Step 2: Define the comparison units

Calculating the savings/benefits of your procurement activity involves comparing its current (baseline) and predicted costs. It's important to define these costs (units of comparison) clearly, so you can compare 'apples with apples'.

Your baseline costs could include one or more of:

- The outline business case
- The total cost of ownership
- The cost per employee
- The cost per unit area (e.g. per square metre)
- The final contract price
- The first price from the successful bidder
- The allocated budget
- The previous cost
- The previous cost of a representative basket of items
- The final negotiated cost with the supplier
- The average of the bids received.

Annexure 2 discusses these measures in more detail, including the pros and cons of using each.

Step 2 in action….

Case study : defining the comparison units

Because the temps' experience and skills are key cost drivers, the departments decide to:

- use the cost per hour for a person meeting their experience/skill requirements (trainee/intermediate/senior) as the unit for comparing procurement costs and calculating the savings
- compare candidate quality by measuring the average training time for each candidate. This is currently captured through each call centre's roster system, with a candidate only considered trained when call monitoring qualifies them to be. Until temps are cleared as 'trained', they are allocated a fewer number of calls each day than are fully trained staff. This affects customer service in each call centre.

6.3 Step 3: Baseline the current costs

Using the units of comparison from Step 3, it's time to quantify the current situation. As this will have a major influence on the result, it's a critically important step.

Remember to:

- Split your capital and operational costs when assessing your baseline spend
- Start collecting information about the 'non-budgetary' benefits, which you'll need in Step 5. This could include, for example, information about staff productivity or time to answer a call under the old and current arrangements.

Step 3 in action….

Case study: baselining the current costs

The department's call centre staff purchases totalled R252,450 in the previous financial year. The hourly rate ranged from R25 to R40, with an average of R33 per hour. The current average training time is half a day per temp. Training is done by staff members, which creates a service 'hole' that doesn't get filled until half-way through the day.

6.4 Step 4: Predict the future costs

This step involves using the units in Step 3 to determine the revised spend under the new or proposed procurement arrangement.

Remember to:

- Consider any changes under the new arrangement, such as:
  - New components or categories
  - Higher or lower service levels
  - Different consumption levels (any change in consumption shouldn't be included in the savings)
  - A different product/service (costs should be for the 'same' product/service)
- Consider which costs are capital and which are operational
- Keep collecting information about the 'non-budgetary' benefits, which you'll need in Step 5
- Adjust for inflation if appropriate. If a contractual term is longer than a year, you could use CPI or another relevant index adjustment to calculate the out-years, offset by any inflationary price increases agreed during the contract's term. If the contract simply specifies adjustments aligned to CPI, the inflationary distortion is zero
- Factor in products/services that are supplied at no charge and used in the normal course of business, such as those used for evaluation or trial, or provided through a supplier's promotional activity. The budgetary savings are the equivalent value of the item(s) being substituted.

Step 4 in action….

Case study: quantifying the predicted costs

The new contract arrangement reduces the average hourly rate to R30 because:

- The agencies will use common job descriptions and bands to source staff
- A co-ordinated approach to sourcing call centre staff can be maintained
- The fees will be transparent and consistent.

Under this new arrangement, the average training time per temp is expected to take no longer than an hour.

6.5 Step 5: Compare: What are the savings and other benefits?

Step 5 involves calculating the predicted savings by considering the 'before and after' difference in spend, and evaluating the other benefits of the procurement activity.

Excluding volume changes from savings reporting?

It is important to ensure at this stage that you are comparing the same volume of units being procured even if there will be a change between the baseline and predicted activity. Changes in volume should be recorded but not attributed to the procurement activity itself.

At its simplest, the saving from a procurement activity can be calculated as:

	Current baseline spend	*(Volume x unit cost)*
Minus	Predicted spend following procurement	*(Volume x unit cost)*
	= DELIVERED SAVINGS	

Your analysis should include:

- An analysis of budgetary savings:
  - Operational expenditure savings
  - Capital expenditure savings (and associated capital interest savings)
  - A clear differentiation between savings resulting from an improved deal and those resulting from efficiency improvements

- An analysis of non-budgetary savings resulting from:
    - An improved deal
    - Efficiency improvements delivered through the new arrangement

Remember to consider:

- Whether the new arrangement includes any new components or categories
- Whether the new arrangement has higher or lower service levels
- Any supplier-imposed volume commitments that could limit your potential savings (for example, if your supplier has quoted a discounted rate if you commit to a specific number of items)
- The savings timeframe. This measurement process assumes that savings will be identified and reported upfront for the entire life of a contract, agreement or procurement activity. If your procurement activity creates a saving that's not associated with any term, a full-year (12-month) effect should be reported unless otherwise agreed
- Currency fluctuations if a product/service has been negotiated in a foreign currency. Any fluctuations will be a gain/loss, not a procurement benefit/increase
- The 'time value of money'. If you're comparing current and predicted costs/savings over multiple years, and depending on the expenditure amount, your finance team might require you to define each year's cash flows in terms of their 'present value', using what's known as Present Value analysis. If you're unsure, talk to your finance team.

Step 5 in action….

Case study: calculating the budgetary saving

For the current year, the agencies predict they will need 38,250 person hours of call centre staff (approximately 20 staff for a calendar year).

	Baseline Spend	**Predicted Spend**
Hourly rate	R33 p/h	R30 p/h
No. of person hours	38,250	38,250
Total	R1,262,250	R1,147,500

So the **predicted budgetary savings** are R115,000 for the current year and R345,000 for the life of the three-year contract.

The activity has also resulted in **non-budgetary savings and wider benefits**:

- By reducing the contracted providers to two, the departments have been able to reduce the number of invoices from 1020 to 24, which has saved processing time for the accounts team.
- The predicted reduction in training time (from half a day to one hour) will:
  - Enable the call centre to cover staff absences easily
  - Free up the department'd training capacity without increasing the number of trainers required.

6.6 Ongoing measurement

The savings from a procurement activity are generally predictive if you're using a baseline of historic practices, pricing and volumes – and for some departments, that's enough to report the forecast savings. However, it's also good practice to report on the savings achieved throughout the contract and at its closure.

Reporting on savings during the contract

Wherever possible, track the 'actual' delivered savings throughout the contract, taking into account any price variances. You should also consider variations in

volume (up or down), but exclude them when calculating your procurement savings.

Using this information, you can benchmark and compare service improvements or time efficiencies within your organisation and with other agencies. This should link to ongoing performance and relationship management in conjunction with relevant supplier information.

Reporting on savings at contract end

Reporting on procurement savings at the end of a contract will help your department to learn from previous practice.

ANNEXURE 1

Examples of improved deals could include…

Capital reducing – where the capital requirement (against budget, business case or forecast) is reduced. The tangible benefit is the difference between the original, agreed budget/forecast and the final cost. It might also be relevant to claim a benefit for eliminating capital equipment lease costs.

Example – Capital reducing
Department AB needs to buy a new machine. The multidisciplinary project team undertakes some initial market research and generates an outline business case with a budget of R550,000. Following a successful tendering exercise, the best-value bid of R475,000 is selected. The capital reduction is therefore R$550,000 – R475,000 = R75,000.

Purchase avoidance – where an intended purchase is cancelled or avoided (fully or partially), for example because the existing equipment still functions adequately or a simpler product meets minimum specifications. The benefit is the difference between the allocated budget and the final price.

Price reduction – the result of a reduction in the price of a product/service that meets the minimum criteria. The (tangible) benefit is the difference between the initial paid price and the new agreed price, multiplied by the volume (actual or predicted).

Collaborative savings (price reduction) – achieved when the price of a specific product/service reduces owing to a 'bulk purchase' order (when multiple departments combine their orders). The saving is the difference between the initial paid price and the new agreed price, multiplied by the volume (actual or predicted).

Cost increase avoidance – where a price increase or above-budget initial tender is reduced so that it's closer to budget, or a cost increase (including the retail price index or above) is reduced or negated. The difference between the agreed and offered prices is the cost increase avoided. If the agreed price goes below the offered price, there is a price-reduction saving in addition to the cost increase avoidance. Note cost increase avoidance is not a tangible cash-releasing benefit.

Added value (e.g. better terms on warranties/guarantees) – where an improvement in terms leads to a more-for-less or more-for-the-same situation. For example, a warranty might be included for the same price as that for which the product alone was historically purchased. This is only a tangible cash-releasing benefit if it can be demonstrated that the warranty or maintenance was being paid for previously.

Example – Added value
Department ABC is buying servers and paying R4000 per server annually for support contracts. Following the procurement activity the supplier agrees to maintain the pricing and include a three-year on-site service support contract. Dept ABC can claim an added-value benefit of R4000 per server per annum for any new servers it purchases. If the supplier also agrees to honour the 'free of charge' support on all existing servers, Dept ABC can claim an added-value benefit of R4000 per number server per annum.

Specification simplification – where the required simplification is made easier to understand or the quantity procured/required is reduced. In some cases this falls into one of the benefit types discussed above, for example a price reduction or purchase avoidance.

Examples of efficiency improvements could include…

Staff time saved – where improvements in process/policy result in improved productivity (reduced staff time). You can claim budgetary savings for the pro-rata reduction in staff time (the value of staff time based on full costs and overheads, or 1.5 x staff members' salaries). Non-budgetary savings would result where you reallocated staff resources to another task or project within your department.

Inventory management – where improvements in inventory management lead to less inventory held. You can claim a one-time cashable saving for the current contracted value of reduced inventory.

Procurement-effort avoidance – where the use of an existing collaborative contract/agreement means you don't need to undertake your own procurement activity. You can claim a cashable saving for the pro-rata reduction in staff time (the value of staff time based on full costs and overheads, or 1.5 x staff members' salaries).

e-tool implementation – an initiative that simplifies the supply chain and generates efficiencies through, for example, reduced staff time or savings (perhaps as a rebate) from the supplier.

Cultural / behaviour change – where a procurement activity leads to a 'step' cultural/behaviour change, which in turn delivers a benefit. For example, it might be possible to link new telecom technology to increased productivity or improved employee retention. This type of benefit might not be quantifiable or might contribute to one or more of the other efficiencies.

Demand reduction – where a procurement activity reduces the demand for a particular product/service. For example, new video-conferencing technology negates the need for travel, fleet and other expenses. If you can demonstrate that there's no detrimental impact on productivity or service, the difference between the cost of the original and new demand levels (e.g. flights) is a tangible saving.

Asset maximisation – an initiative that leads to the optimisation of an asset. For example, 'pooling' vehicle fleets and enhancing staff schedules reduces the requirement for vehicles. If you can demonstrate that there's no detrimental impact on productivity or service, the difference between the cost of the original and new asset requirements is a tangible saving.

Standardisation – an initiative that results in a product standardisation and associated benefits, which could then lead to a reduction in demand or unit price, or any number of other savings. For example, standardisation to a single mobile

phone model could generate a price reduction from the supplier, reduced support costs, increased productivity, asset maximisation, etc. The value of each benefit can be quantified (as both tangible and intangible savings) and reported.

Reduced invoicing costs – if a procurement activity leads to a quantifiable reduction in, or consolidation of, invoices, you might be able to claim the associated reduction in invoice processing costs.

ANNEXURE 2

BASELINE UNITS AND MEASURES

When undertaking a formal procurement activity, the RFx's pricing schedule should define the baseline costs and volumes that make up tangible (cash-releasing) benefits. However, it might not be possible to define the more subtle (and potentially considerable) intangible benefits.

A physical (or a comprehensive desk-based) walk-through of the supply chain is a successful way of identifying the existing costs of a particular product/service.

The table below provides a structure you can use to define your units of measurement for both the baseline and the spend (actual or predicted) following the procurement activity. Its considerations include relevance, validity, attribution clarity, accuracy, comparability, consistency, timeliness and cost.

The pros and cons of potential baseline units

Predicted Baseline	Pros	Cons
Outline Business Case	• Tests and affirms the affordability of the project and option selected • The stage at which approval for the project to proceed is given • Budget identified and funding allocated on basis of business case projections	• Based on best information available; could be inaccurate • Market not yet tested • Market conditions changing between business case and going to tender could lessen the business case's accuracy • Refinements to the scope of requirements and tenderers' input might alter
Total Cost of Ownership (TCO)	• Most comprehensive method for generating a baseline of underlying costs • Difference between a before and after TCO represents a 'real' saving • Note: You need to ensure that you model any variation in the specifications between baseline and solution	• The multitude of factors involved in creating a true TCO might make it prohibitive (in this case, use simple models to determine TCO) • Supplier-side costs might be difficult to understand

Cost per employee	• Caters for fluctuations in staff numbers • Simple concept to understand and communicate • Allows for easy benchmarking across organisations and sectors	• Depends upon budgets reflecting fluctuations in staff numbers (to maintain same savings methodology) • Must have a very clear definition of the scope of the product/service that's being considered per employee • Might not be appropriate for some products/services
Cost per unit (e.g. R/m$^{2)}$	• Caters for fluctuations in and variety of organisation sizes • Simple concept to understand and communicate • Enables easier benchmarking across organisations and sectors	• Might not be appropriate for some products/services e.g. price of a widget • The many facets of 'cost' need to be defined
Final Contract Price	• Easily definable • Caters for specification changes during activity	• Doesn't consider budget allocation • Specification/Contract leading to this
First Price from successful bidder	• Easily definable	• Doesn't consider budget allocation • Doesn't cater for specification changes through procurement activity
Allocated budget	• Tests and affirms the affordability of the project and option selected • Stage at which approval for the project to proceed is given	• Costs are based on best information available, which could be inaccurate • Market not yet tested • Market conditions changing between business case and going to tender could lessen the accuracy • Refinements to the scope of the requirement and tenderers input may alter
Previous Cost	• Relatively easy measure to identify • Simple concept to understand and communicate	• Doesn't cater for specification changes • Lack of transparency on total cost, won't identify 'intangible' savings • You need to consider external influences such as RPI (retail price index), foreign exchange, demand change owing to staff, etc

Previous Cost (representative basket of items)	• Easy measure to identify • Simple concept to understand and communicate	• Relevance of basket • Lack of transparency on total cost, won't identify 'intangible' savings • You need to consider external influences such as RPI, foreign exchange, demand change owing to staff, etc • Risk of price fluctuations on non-basket items
Final Negotiated Cost with supplier	• Easily definable • Caters for specification changes during activity	• Doesn't consider budget allocation specifications/contract leading to this
Average of bids received	• Easily definable • Useful when it's difficult to establish previous cost or where the specification is very different under new contract	• Relies on bids received