

PUBLIC PROCUREMENT

12 WAYS GOVERNMENTS
CAN UNLOCK BETTER VALUE



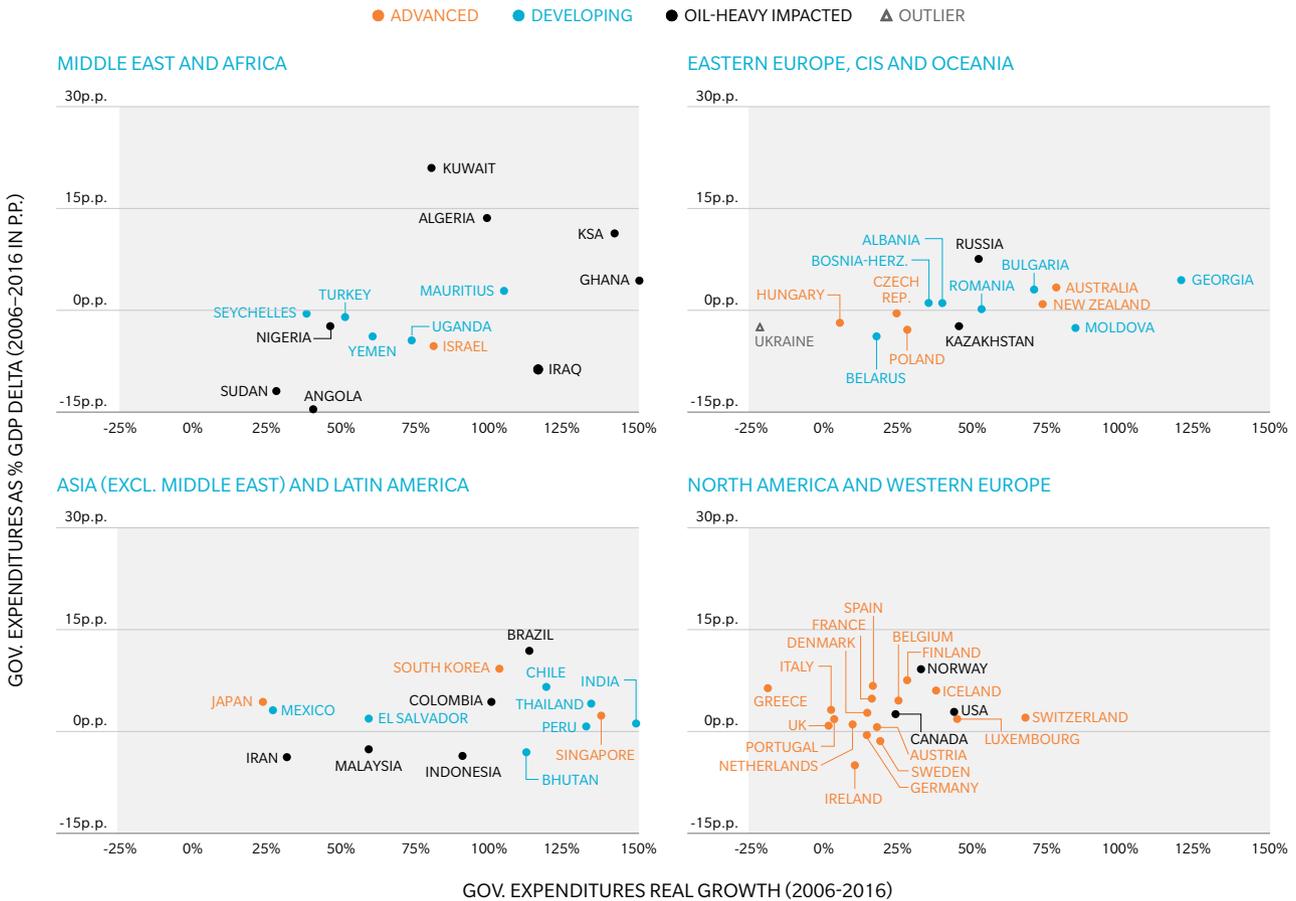
Public Spend is about a US\$28 trillion market globally. Oliver Wyman estimates that out of that figure, procurement public spend corresponds to roughly US\$8.5 trillion. Whether in advanced or developing economies, governments are facing increasing pressure to achieve more with less.

Instead of simply raising more taxes to harness the public deficit, more efficient procurement spend has become the imperative. In certain cases, countries could rationalize their spend by between 7 percent and 35 percent. This could yield savings of around US\$1.4 trillion globally in a ceteris paribus scenario. To achieve this, governments must radically rethink their approach to procurement.

GOVERNMENT SPEND IN A GLOBAL CONTEXT

Managing public spending is a priority for most governments. In many cases, they are held to the obligation by taxpayers who want to see their taxes spent wisely. Yet, despite the best efforts of governments, our analysis shows that public expenditure continues to rise year after year. In reality, government spend is not only growing in real terms across almost all the countries analyzed, but also is outpacing countries' national GDP levels (see Exhibit 1). Spend levels in many countries will become unsustainable as large budget deficits, steep costs of debt, aging populations, and/or a dependency on commodity prices that are volatile and difficult to predict grow more burdensome. As a result, there exists a compelling need to tackle issues related to government spend in a more structured and systematic way.

Exhibit 1: Government spend real growth 2006-2016 versus government spend as percent GDP (delta 2006-2016)



Source: IFS, IMF, WB, Oliver Wyman Analysis

Countries increasingly face significant budget deficits and high levels of debt, with expenses covering everything from employees' compensation, external procurement spend on goods and services, to social benefits and subsidies, financial costs, and other types of sensitive expenses such as the military. Balancing the books is no easy task, and there are relatively few avenues open to boost the public coffers: taxpayers are unlikely to welcome higher levels of taxation. In a tightening world economy, growth is harder to achieve, and the present situation, with its ever-widening imbalances, is ultimately unsustainable.

Short-term fixes to curb spending, such as reducing employee compensation and social benefits, are typically difficult to implement, not to mention highly charged politically and socially. Prolonged economic hardship and significant pressure from international organizations has forced many countries – such as Greece and Portugal – to take stringent measures to curb their public spending. To some extent, this has been successful. However, for many countries, and particularly those heavily dependent on public spend, the impact will be limited. Governments must now find better ways to introduce new and sustainable reforms to public spending, review their incentives' mechanism, and ensure adequate compliance.

For more advanced or mature markets where costs are already heavily optimized, procurement efficiency is perhaps the only tangible lever remaining, that could offer demonstrable returns. For developing countries and for some commodity-based economies, procurement efficiency will not only support their growth and transformation plans, but also better accommodate variations in revenues and commodities prices.

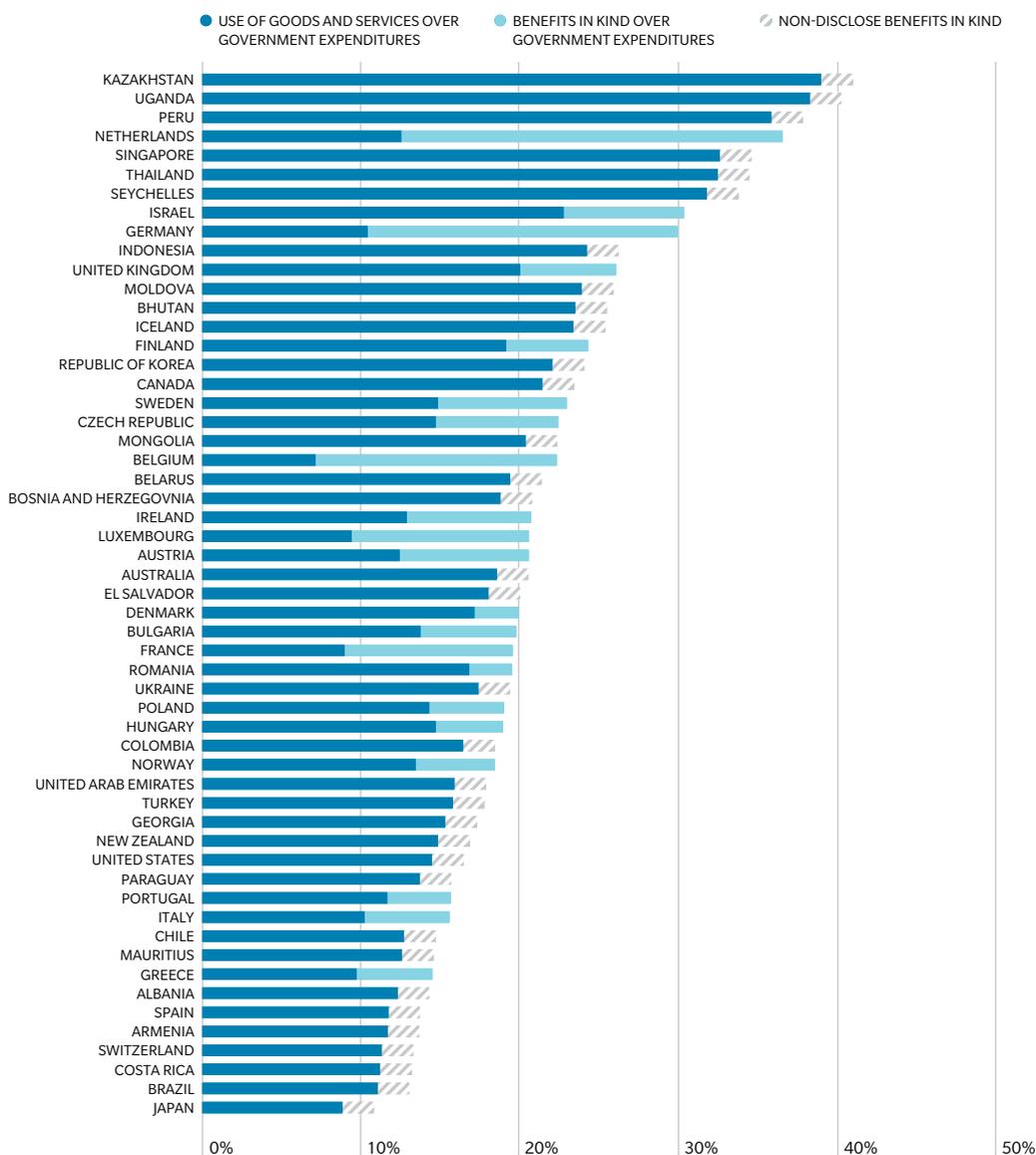
What, therefore, can governments do to make their public procurement spend lean? Unfortunately, there is no quick panacea for governments to address their critical financial situation.

Having supported several governments in optimizing their procurement expenses, Oliver Wyman has undertaken a study to examine and answer this question. There is tangible evidence that improving procurement efficiency can and does work. Research indicates, furthermore, that aside from simply balancing the procurement books, governments can yield results by adopting a bolder and holistic approach to procurement.

THE OPPORTUNITY IN IMPROVING PROCUREMENT SPEND

Public procurement (including goods and service and some social benefits) accounts for approximately one third of government spend, although the figure varies slightly country by country (see as Exhibit 2). This represents a huge market across the globe of approximately \$8.5 trillion spend.

Exhibit 2: Public procurement as a percent of government expenses (2016)



Source: IFS, IMF, WB, Oliver Wyman Analysis

To help governments formulate a plan to enhance the efficiency of their public procurement spend, Oliver Wyman has elaborated a Public Procurement Performance Index (PPPI). The metric is designed to rate the quality of public procurement and assess the potential for improvement across more than 75 countries globally. The PPPI is calculated using different official government indicators drawn from sources such as the IMF, the World Bank, and OECD; the data represents 2016 figures and includes various ratios on public debt, fiscal balance, government expenditures, public procurement efficiency, public procurement maturity, and a corruption index. It has been calibrated based on Oliver Wyman's experiences in recent global procurement projects.

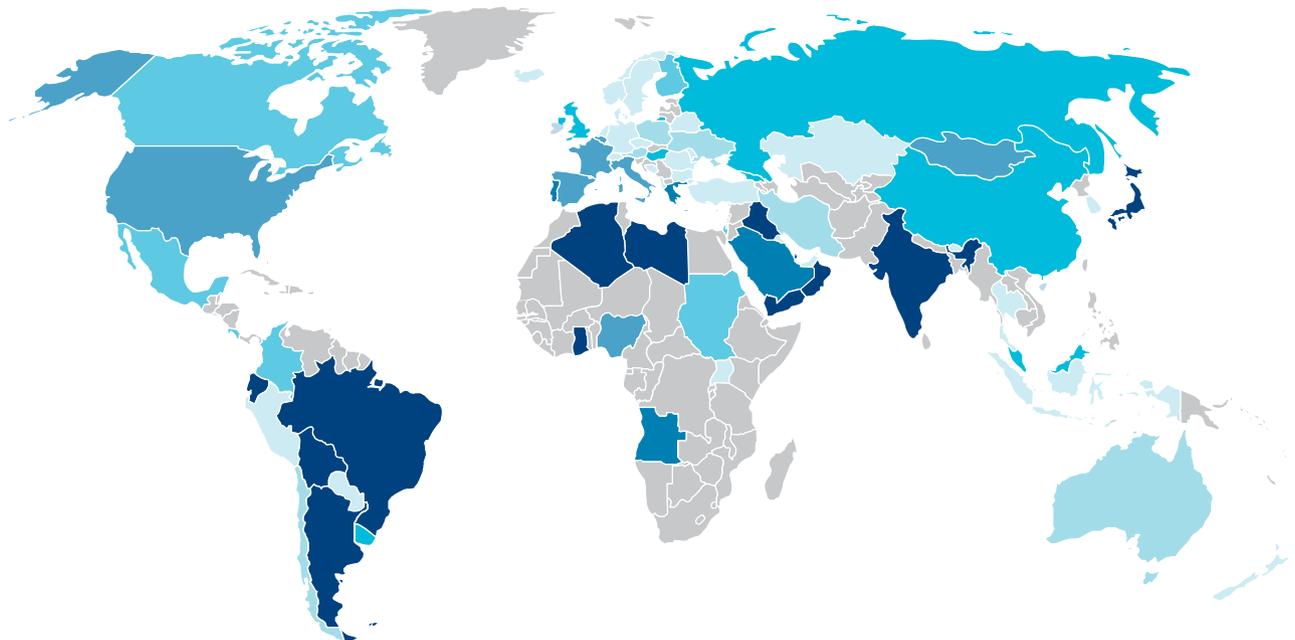
The PPPI shows that highly indebted economies with growing fiscal imbalances and inefficient or immature public procurement systems have considerable scope for improvement. Several best-in-class international practices and macro-procurement levers can unlock value that is currently being wasted; governments can spend less, spend better, and buy cheaper (see Exhibit 3). Importantly, rationalizing public procurement spend could yield savings of approximately US\$ 1.4 trillion (about 17 percent of total procurement spend), ranging between 7% to 35% depending on the country.

The greatest potential for improving public procurement is among emerging markets, where governments have yet to carry out many of the necessary reforms or conduct comprehensive expenditure reviews.

Exhibit 3: Oliver Wyman Public Procurement Performance Index (PPPI)

PUBLIC PROCUREMENT SPEND OPTIMIZATION POTENTIAL BASED ON PPPI ASSESSMENT (2017)

Very low Low Medium-low Medium Medium-high High Very high No data

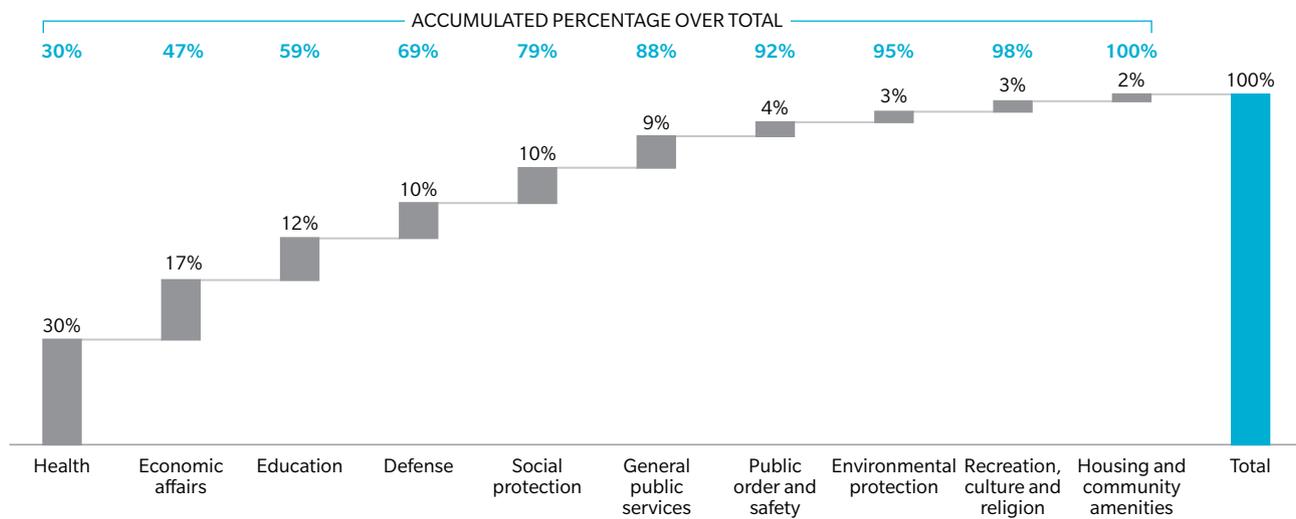


Source: IFS, IMF, WB, OECD, Oliver Wyman analysis

If the answer is so clear-cut, then what has held up governments until now? One reason is that the underlying issues in procurement are more complex than might appear at first glance. Governments have frequently tried to improve the efficiency of their procurement process. This, however, has largely been done on an ad hoc basis – tackling some problems but not others.

Public procurement spend has a variable composition, depending on the type of goods and services provided by the government (see Exhibit 4). In analyzing OECD countries, for example, one can see the average breakdown of procurement spend by public entities and ministries, with health, economic affairs, education, defense, and social protection representing almost 80 percent of total public procurement spending.

Exhibit 4: Public procurement components and breakdown, OECD average



Source: OECD, Oliver Wyman Analysis

However, when we analyzed the procurement spend by cost nature in terms of cost categories across different countries, we identified three main types of procurement spend:

- Vertical spend: cost categories relating to specific public entities such as city cleaning, road maintenance, medical supplies, and power plants construction. This spend generally accounts for approximately 30 percent of total procurement spend.
- Semi-horizontal spend: cost categories that exist across different entities with a high level of similarity, but that somehow might slightly vary depending on the entity, region, and supplier market (such as operations and maintenance). This tends to be the largest type of procurement spend across governments, often exceeding 50 percent of the total procurement spend.
- Fully horizontal and commodity spend: typically, standard products that exist across all entities, such as office supplies, personal computers, cars, and furniture. This spend is often below 20 percent of the total procurement spend, as government spend tends to be mainly focused on services rather than products.

The complexity of the challenge is apparent when looking at the range of different cost categories and issues that governments need to face while tackling public procurement. These can be characterized in four main areas (see Exhibit 5).

Exhibit 5: Public procurement challenges

DIMENSION	LIMITATION/CHALLENGE
 PROCUREMENT STRATEGY AND APPROACH	
Lack of clear strategic direction or unfavorable procurement policies	<ul style="list-style-type: none"> • Different views and regulations on how to incentivize local economy and suppliers through Public Procurement • International agreements • Focus on transactional part of procurement (tendering) rather than the strategic part (deep understanding of what is needed, sourcing of best suppliers, supplier panel management, etc.)
Challenging spend characteristics	<ul style="list-style-type: none"> • Higher share of services, making it trickier than purchasing products • Politically sensitive topics, many of them directly or visibly impacting citizens (e.g. sanitation, education, roads maintenance, etc.) • Use of non-contracted spend • Significant adjustments on procurement spend tend to be harmful for the national economy and supplier market and depending on the cost category have different types of impacts on the local suppliers (e.g. if the category tends to rely more on imported goods or services vs. nationally provided goods or services) • Poor data environment: scarcity of critical operational and financial data and metrics
 CATEGORY MANAGEMENT	
Inadequate application of advanced procurement techniques	<ul style="list-style-type: none"> • Lack of category management and strategy • Limited usage of framework agreements, catalogues and volume pooling • Limited emphasis on total cost of ownership (TCO) • Limited cross-entity purchasing synergies (minimal leverage of bargaining power and scale)
 MANAGEMENT OF THE PROCUREMENT PROCESS	
Poor operating model or governance	<ul style="list-style-type: none"> • Decentralized spending (and authority/power) along Government structure where is not always easy to pool the volumes and centralize the decisions (e.g. equal power among Ministries, Local Government/Municipalities power and eligibility, etc.) • Inadequate spend control, visibility and monitoring • Stringent regulation that limits best practices • Mismatches with Government budget and/or poor budget integration/consolidation • Limited spend ownership and accountability • Lack of commitment on certain decisions and/or on budget objectives with limit downsides/penalties of not making the change happen (versus more normal and straightforward approaches on the private sector)
Poor contracting	<ul style="list-style-type: none"> • Best-practice need analysis not implemented • RfPs often missing basic technical specifications • Limited involvement of experts on technical evaluation
 ABILITY TO ENSURE CONTINUOUS IMPROVEMENT	
Capability gaps	<ul style="list-style-type: none"> • Limited procurement experience • Outdated training curriculum • Limited emphasis on quality hiring and employee retention • Lack of incentive to upgrade procurement skills • Limited use of digital procurement tools and analytics
Unfavorable supplier market	<ul style="list-style-type: none"> • Large and low maturity supplier pool • Low visibility on supplier cost structure

Tackling all the different areas calls for a coordinated and prolonged effort, strong political support, and significant top-down pressure and commitment. Attacking one area and not another can have some short-term positive impact; equally, however, it can hamper overall progress and limit the effectiveness of outcomes in the medium to long term.



DEMONSTRATING SUCCESS IN IMPROVED PUBLIC PROCUREMENT SPEND

According to our research, some countries have made significant steps to reduce their public procurement spend, across a wide variety of initiatives particularly in specific periods where they faced difficult economic conditions:

OBJECTIVE	INITIATIVES ON PUBLIC PROCUREMENT	PROGRAM IMPACT
UNITED KINGDOM		
Improve fiscal balance through rationalization of public-procurement spend	<p>Launched e-procurement platform (10% savings)</p> <p>OpEx initiatives:</p> <ul style="list-style-type: none"> Set up strict Cabinet Office approval controls Set up Crown Commercial Service Introduced new procurement regulations 	Fiscal deficit reduced from 10% (2009) to 8% (2012) during crisis period
PORTUGAL		
Improve fiscal balance through rationalization of public procurement spend	<p>OpEx initiatives:</p> <ul style="list-style-type: none"> Closed underutilized schools (40% savings) Launched new e-procurement platform Introduced new IT technologies, e.g. cloud, open software (US\$0.6 billion savings) <p>CapEx initiatives:</p> <ul style="list-style-type: none"> Cancelled low-yield CapEx projects (US\$9.3BN savings) Changed CapEx financing approach (US\$4.7BN savings) Launched initiatives to optimize CapEx deployment and generate additional savings 	Fiscal deficit reduced from 10% (2009) to 6% (2012) during crisis period
GERMANY		
Improve fiscal balance through rationalization of public-procurement spend	<p>OpEx initiatives:</p> <ul style="list-style-type: none"> Rationalized spend across ministries (US\$18.7BN; 0.5% GDP) Introduced new pricing for drugs (US\$1.2BN savings) Introduced new procurement law Cut back public subsidies by reducing feed-in tariffs for solar panels (23% savings) and readjusting parental and housing benefits 	Fiscal deficit reduced from 3% (2009) to achieving balanced budget (0% deficit) in 2012
ITALY		
Optimization of national budget	Initiatives identified across specific areas including consolidating procurement of goods and services across government departments (e.g. merging police forces, reducing the government vehicle fleet by half)	US\$28BN savings initiatives identified in 2016
DENMARK		
Continuous improvement in public-procurement spend efficiency	Focus has been on non-core activities including facility management and overhead costs for different public entities	~10% budget optimization identified in 5-year spending review cycles
SAUDI ARABIA		
Improve fiscal balance through rationalization of public-procurement spend	<p>OpEx initiatives:</p> <ul style="list-style-type: none"> Established Bureau of Spend Rationalization to oversee public spending optimization across topics and entities and review top contracts Implemented Strategic Procurement Unit to coordinate and align cross-Ministries spend Update Procurement Law (ongoing) <p>CapEx initiatives:</p> <ul style="list-style-type: none"> CapEx projects review initiated (9,600+ contracts) Set up new rules for new CapEx projects based on strict capacity demand studies 	External OpEx (pure public procurement) decreased from US\$40BN (2016 actual) to US\$36BN (2017 actual) vs. US\$41 billion budget (2017)

Source: Individual Ministry of Finance, European Union and OECD reports, Oliver Wyman Analysis

Currently, no government has perfected its procurement approach to achieve optimal efficiency across the board. There is, however, sufficient evidence of consistent success to show how governments can benefit from these types of initiatives.



INNOVATION IN PUBLIC PROCUREMENT

Government spend is fraught with complexities, including scattered spend, decentralized decisions, budget versus efficiency mindset, simple and complex services, and outdated legacy IT systems. To help governments take a definitive stance to rein in excess expenditure, Oliver Wyman has compiled a list of the 12 most important golden rules, derived from best global practices:

CATEGORY MANAGEMENT AND PROCUREMENT STRATEGY	1	Conducting spending review to have a clear view on the spend for the various public procurement categories, based on operational metrics and a cost per unit logic to better assess the spend efficiency
	2	Category review, strategy setting, and opportunity identification across three types of macro levers: spend less, spend better, and buy cheaper
	3	Savings target sizing and defining top-down budget targets for entities to promote efficiency and alignment on the underlying operational and financial unit metrics. This should be done considering national strategies to promote certain industries and local content when relevant.
	4	Develop a supplier view to balance the purchasing performance impact versus local content and supplier market development and broader impact on the national economy, suppliers and SMEs
	5	Use of advanced procurement techniques, such as combinatorial tendering, RFP itemization, and e-auctions to promote more competition and break large contracts
CENTRALIZE PROCUREMENT PROCESS AND UPGRADE OPERATING MODEL	6	Defining standards, specifications, and national price lists (e.g. operational and efficiency standards such as number of FTEs required per SQM and cost and financial standards as price per hour)
	7	Establish centers of excellence within the central government as well as in the regions to promote standards alignment and greater convergence
	8	Introduction of umbrella contracts and catalogues, and volume discount mechanisms
	9	Adjust vendor evaluation process, mechanism, and criteria; moving away from a pure price-based vendor selection to a scoring mechanism that properly evaluates both technical and commercial dimensions when relevant
	10	Set up centralized procurement agency to promote cross-entity purchasing synergies, volume pooling, and supplier consolidations
	11	Implement and standardize the usage of eProcurement, including digital procurement and automation, automated RFP analysis and tools, performance monitoring and compliance tools
ACCELERATED CASH FLOW ACTIVATION	12	Conducting reviews of the largest OpEx and CapEx contracts and upcoming projects for accelerated savings activation through gate stage reviews and better capacity demand initiatives

While no country has yet to adopt all 12 rules, numerous countries have introduced one or more. Successful programs require long-term commitment during the procurement transformation, implementing recommendations with strong accountability, risk-taking attitudes, and a results-driven mindset across the government. Simply implementing a few initiatives in a piecemeal way will not be enough; it will neither drive the necessary momentum nor achieve tangible results. To make a difference, procurement programs must take a holistic approach across multiple areas and a long-term commitment to implement all of this within a three- to six-year period.

FINAL THOUGHTS

The pressure on governments to achieve more with less will only increase. With social, economic, and political factors continuously shaping the requirements of public spend, improved public procurement is the one lever open for harnessing spiraling public spend. However, reducing procurement costs will require a radical and holistic rethinking of procurement policy, avoiding the temptation to undertake short-term quick fixes.

Changes to procurement policy need to be in tune with changing times. Governments must also avoid the temptation to abandon initiatives implemented during difficult economic times as soon as the economic outlook improves. If cost reduction initiatives are to be sustainable, governments need to establish comprehensive, long-term programs complemented by clear and strong support of the country's leadership.

.

DISCLAIMER

Numbers used on this Point of View were based in public available information from official international data sources to ensure consistency and comparability. However, we observed in a few cases minor inconsistencies in some numbers versus other national data sources, but we decided to keep the numbers as published by official international data sources.

Oliver Wyman is a global leader in management consulting that combines deep industry knowledge with specialized expertise in strategy, operations, risk management, and organization transformation.

Oliver Wyman's global Operations Practice specializes in end-to-end operations transformation capabilities to address costs, risks, efficiency, and effectiveness. Our global team offers a comprehensive and expert set of functional capabilities and high-impact solutions to address the key issues faced by Chief Operating Officers and Chief Procurement Officers across industries.

AUTHORS

LAURENT GUERRY
Partner
laurent.guerry@oliverwyman.com

ANDRÉ MARTINS
Principal
andre.martins@oliverwyman.com

PRATEEK SACHDEVA
Engagement Manager
prateek.sachdeva@oliverwyman.com

ANGEL MAYORAL
Senior Consultant
angel.mayoral@oliverwyman.com

CONTACTS

LARS STOLZ
Global Head of Operations
lars.stolz@oliverwyman.com

GREG KOCHERSPERGER
Europe, Middle East and Asia Head of Operations
greg.kochersperger@oliverwyman.com

JOHN SEELIGER
America Head of Operations
john.seeliger@oliverwyman.com

XAVIER NOUGUÈS
Head of Value Sourcing
xavier.nougues@oliverwyman.com

www.oliverwyman.com

Copyright © 2018 Oliver Wyman

All rights reserved. This report may not be reproduced or redistributed, in whole or in part, without the written permission of Oliver Wyman and Oliver Wyman accepts no liability whatsoever for the actions of third parties in this respect.

The information and opinions in this report were prepared by Oliver Wyman. This report is not investment advice and should not be relied on for such advice or as a substitute for consultation with professional accountants, tax, legal or financial advisors. Oliver Wyman has made every effort to use reliable, up-to-date and comprehensive information and analysis, but all information is provided without warranty of any kind, express or implied. Oliver Wyman disclaims any responsibility to update the information or conclusions in this report. Oliver Wyman accepts no liability for any loss arising from any action taken or refrained from as a result of information contained in this report or any reports or sources of information referred to herein, or for any consequential, special or similar damages even if advised of the possibility of such damages. The report is not an offer to buy or sell securities or a solicitation of an offer to buy or sell securities. This report may not be sold without the written consent of Oliver Wyman.