NEW MODELS FOR PROCUREMENT OF PUBLIC SERVICES

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The procurement of public services is not a new concept. However, three elements make the current situation facing governments different:

1. The range of services that governments are looking to procure from external service providers.
2. The drive to purchase outputs, outcomes, and to increase effectiveness.
3. The increasing sophistication of the contracting models being used and the resulting contract management required.

Many government departments are looking to expand the range of services which are competitively tendered and are introducing sophisticated procurement tools such as payment-for-results funding models. This is linked to the gradual shift from the specification of inputs in contracts to the specification of outputs and/or outcomes, with providers being paid on the basis of measurable results. These latter models aim to reward providers not for the activities they perform but for the outcomes (i.e. social impacts) they generate.
The benefits of smarter procurement approaches are argued to be:

» A greater focus on performance objectives.
» Clearer delegation of responsibility for delivery to front-line managers.
» Stronger competition and a more meaningful system of accountability.
» Further, if services are commissioned on the basis of outcomes, it is argued that there will be greater innovation in the design and management of public services.

Procurement involves the purchasing of public services through competitive tendering and contracting. Procurement models can include simple outsourcing models, co-sourcing, establishing managed services, partnering (including PPPs), using social investment or social impact bonds, and a range of other innovative funding models which link payments to successful demonstration of outcomes. The figure below provides an overview of the range of procurement options available to the public sector.

Government contracting options

<table>
<thead>
<tr>
<th>TRADITIONAL MODELS</th>
<th>Contracting</th>
<th>Outsourcing or co-sourcing</th>
<th>Contracting management</th>
<th>Partnering</th>
</tr>
</thead>
<tbody>
<tr>
<td>Operating cost reduction</td>
<td>Look to other organisations to provide the goods or services (make or buy)</td>
<td>Defined output as part of the process</td>
<td>Placing a management layer into the organisation</td>
<td>Different models and ownership structures</td>
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<td>Internally lead efficiency</td>
<td>Could be against in-house team</td>
<td>Clear understanding of desired outcomes</td>
<td>Goals measurable and controllable</td>
<td>Can be a permanent arrangement</td>
</tr>
<tr>
<td>» Process focussed</td>
<td>Lowest cost typically key factor in selecting</td>
<td>Service level driven</td>
<td>Reach back capability as part of the contract to drive improvement in operating costs</td>
<td>Retain a revenue stream and the potential of taxable income</td>
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<tr>
<td>» Limited understanding of costs</td>
<td></td>
<td>Third party takes over delivery either via: • Transfer of resources • Transition to new service</td>
<td>Risk share/results based</td>
<td>» Could involve franchising and/or licensing arrangements where IP is retained with little risk and a revenue stream established</td>
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<tr>
<td>» Supplemented external resources</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>» Cost reduction focused</td>
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</tbody>
</table>
Project delivery process

The figure above provides the outlines of the project delivery process.

A | Pre-procurement

The pre-procurement process is essentially the effective analysis and planning activities carried out prior to when the actual procurement commences. This is typically carried out in the form of a business case.

In the business case several delivery options will be assessed. This is a funnel type process to evaluate a wide range of potential delivery options. The objective of the assessment is to determine the most appropriate investment proposition and procurement option.

A detailed market sounding is a critical, often underestimated step during this phase. The market sounding will provide key input to determine the single investment proposition. It will also provide insight in the capability and capacity of the market to deliver the project and which (contract) structure and associated risk allocation will be considered most feasible. This will ultimately provide confidence that the selected single investment proposition can be successfully tendered.

If a market sounding process is conducted appropriately a project will benefit in a number of ways:

- It is a powerful instrument to understand market dynamics and it will help the public sector to identify and comprehend the service areas that could be delivered / managed by the private or community sectors and the key drivers.

- The market sounding will provide the public sector the opportunity to obtain the private or community sectors' view on issues such as the risk the non-government actors are willing to take, the optimal transaction size to attract investors, procurement routes to be considered and key commercial terms (e.g. project duration, outlines of payment structure).

- A market sounding is the first interaction with the market. A professional market sounding will establish trust with the private sector and stimulate market appetite/level of competition.

- The procurement approach and envisaged timetable can be tested with the market. The timetables should be realistic in order to secure commitment from the private sector to the procurement process.

The outcomes of the market sounding will be invaluable input to select the most appropriate procurement strategy from the wide range of procurement options available. The aim of the business case is to select the preferred procurement route that realises the best value for money, meets policy objectives and warrants the continued delivery of world-class public services. It is also critical that the business case clearly establishes the project requirements and measurable benefits so that the achievement of these can be tested during the procurement and contracting phases.

In some recent New Zealand projects the issues that ideally should have been addressed during market sounding have been attempted to be addressed in the procurement phase. The risks of this approach include unnecessary delays in project progress, uncertainty about the procurement approach that will be used and a lack of appetite from potential market participants.
B | Tender process and contract award

Each procurement option has its own process and requirements and based on the outcomes of the business case the public sector has to organise the tender process accordingly. The tender process should be fair, transparent and secure value for public funds. The private sector input from the market sounding should be adequately addressed in the tender documents and project agreements before procurement commences. This will encourage private sector bidders to participate actively in the tender process, which will increase the level of competition, drive better outcomes and ultimately Value for Money. Furthermore the public sector needs to prepare its own organisation to accommodate the partnership options that will be procured.

C | Contract & supplier management

Contractual relationships play a fundamental role in the delivery of public sector services. Good management of these contracts in the operational phase is essential to ensure successful service delivery. The role the public sector must play will vary depending on the chosen procurement option. In case of traditional procurement the public sector must monitor and manage performance, while in case of a partnership it has to perform a supervisory type role. In general the following three contract management components can be distinguished whereby the relative weighting will differ per procurement route:

» Service delivery management – ensures that the goods or services are being delivered as agreed to the required level of performance and quality, and are supporting the business and operational need for the contract.

» Relationship management – keeps the relationship between the two parties open and constructive, and aims to resolve or ease tensions and identify problems early.

» Contract administration & change management – handles the formal governance of the contract and changes to the contract documents.

KPMG’s smarter procurement services

Smarter procurement of public services plays a paramount role in achieving government’s objectives of better public services and Value for Money. KPMG New Zealand advises clients right across the public sector on leveraging increased value from existing assets, and strategic procurement of new assets and/or services. Our team is in the forefront of creating bespoke solutions to (complex) procurement issues and has been involved in a wide range of smart procurement initiatives in New Zealand and internationally. If you would like to know more about KPMG’s smart procurement services, please contact us at smarterprocurement@kpmg.co.nz.