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POSITION PAPER

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TOPIC:

THE STRATEGIC VALUE OF PROCUREMENT IN PUBLIC ENTITIES

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THE STRATEGIC VALUE OF PROCUREMENT IN PUBLIC ENTITIES

A position paper from NIGP: The Institute for Public Procurement

INTRODUCTION

Public procurement processes facilitate the purchase of services, supplies and construction in support of essential public functions.¹ While high importance is placed on spending taxpayer dollars responsibly in a manner that is transparent, efficient, accountable and fair, the strategic value of procurement in public entities is not always apparent.

The strategic value of procurement is realized when an organization shifts its focus from reactive, transactional purchases to proactive, value-based procurement actions. While not attempting to cover all of the areas that procurement adds strategic value, this paper addresses: procurement authority; procurement's place in the organization; procurement strategy; use of technology; spend management; strategic sourcing; supplier relationship management; supply chain management; contract management; and risk mitigation. The paper also describes the opportunity, and the responsibility, of the procurement professional to deliver strategic value in their public entity every day.

POSITION STATEMENT

NIGP: The Institute for Public Procurement supports the proactive use of procurement to achieve strategic value in public entities. The strategic value of procurement is best realized by organizations that directly involve procurement professionals in the overall strategic planning process. With a seat at the planning table, these professionals can ensure procurement strategies are aligned with overall strategies and in support of organizational goals. The strategic value of procurement flows from the creation of opportunities for advance planning, obtaining best value, reducing risk and maintaining the integrity of the use of public funds.

PROCUREMENT AUTHORITY

Procurement authority is the power to award, or to approve the award of, legally binding procurement agreements (that is, contracts and purchases) on behalf of the public entity.² Procurement authority holds strategic value for the entity. The allocation of this authority in an organization, therefore, is an important matter and should be done thoughtfully in the best interests of the agency, and the public it serves. Through this authority, the choice of sourcing

¹ NIGP Position Paper –“Procurement Authority in Public Entities”, August 2014

² NIGP Position Paper –“ Procurement Authority in Public Entities”, August 2014

methods is determined, sourcing activities are managed, and contract negotiations are conducted. In addition, contracts and other procurement instruments are developed, modified and administered. Public entities should empower a highly qualified, professional Chief Procurement Officer with the authority to ensure procurement is conducted in a manner that is fair, transparent, responsible, ethical and strategic.

PROCUREMENT'S PLACE IN THE ORGANIZATION

Structured, centralized and narrow delegation of procurement authority to a professional procurement department provides the benefit of establishing a business unit that has specialized knowledge of public procurement principles, processes and best practices. For over 25 years, NIGP: The Institute for Public Procurement has strongly recommended “the adoption of centralized purchasing as the standard government organization” (NIGP Resolution 1002 in 1989). The optimal organizational model is one in which the professional procurement department holds procurement authority and guides and monitors the procurement processes that take place throughout the public entity. When skilled, professional procurement is buried within an organization and disconnected from the decision making process, key business opportunities, efficiencies and full value for money may be lost.

We witness in the private sector the growing recognition of the importance of procurement in support of business strategy and its impact on the bottom line. An increasing number of companies have the chief procurement officer (CPO) reporting directly to the chief executive officer (CEO).³ Procurement's inclusion on a public entity's leadership team ensures procurement strategies are aligned with organizational goals and enables procurement to proactively identify and capitalize on opportunities that improve operational and financial outcomes.

PROCUREMENT STRATEGY

“Strategic procurement planning is the transformation of an organization's mission, goals, and objectives into measurable activities to be used to plan, budget and manage the procurement function within the organization. The ultimate goal is to bring about positive change in organization culture, systems and operational processes.”⁴

In a public entity, procurement strategies should be aligned with the vision, mission, values and goals of the organization. These strategies should further support the needs of the community and key stakeholders, and be designed proactively with the involvement of all levels and units of

³ Bartolini, Andrew. *State of the CPO – Reporting Structure*, August 11, 2011, <http://cporising.com/2011/08/11/state-of-the-cpo-reporting-structure/>

⁴ NIGP Online Dictionary of Procurement Terms, *Strategic Procurement Planning*

the public entity.⁵ Through a holistic procurement strategy planning process, the organization is better positioned to balance and align resources against the current and future requirements of the community and improve positive outcomes for the organization.

USE OF TECHNOLOGY

The strategic value of procurement historically has been overlooked – and difficult to achieve – as procurement-related *processes* grew to define the role of procurement rather than the *outcomes* and added value that it could bring to organizations. Reducing the burden of *process* through the effective use of technology is essential for moving away from a transaction-based mind-set and approach to procurement.

In the public setting, processes are often defined to support greater transparency and formalize practices that ensure ethical, disciplined, professional behaviors across the organization. As these processes are routinized and streamlined through the use of technology, the organization is able realize measurable changes. According to research conducted by the Aberdeen Group, “e-procurement produces cost reductions, higher productivity, and increased spend under management.”⁶ The use of e-procurement significantly reduces requisition-to-order processing costs, cuts transaction cycle time in half⁷ while giving greater visibility and tracking capabilities throughout the process. The posting of bids and quotes on-line, as well as the use of interactive, on-line bidding tools, make it easier for suppliers to do business with government and can lead to increased competition. As the wait time for goods and services falls, customer satisfaction rises.

Thus, through the effective use of technology, the source-to-pay process achieves greater efficiency, effectiveness and transparency; better serves the needs and expectations of the organization and its suppliers; and reclaims time and resource that procurement can refocus on strategic procurement management and more complex organizational initiatives.

SPEND MANAGEMENT

Procurement can use spend management to understand an organization’s buying patterns through a thoughtful, systematic analysis of procurement data, also referred to as spend analysis. Unfortunately, spend management has been neglected by many public entities. This quote from a study conducted by the Office of Administrative Services in the state of Georgia in 2010 is illustrative of the situation:

⁵ NIGP Principals and Practices of Public Procurement, *Strategic Procurement Planning*

⁶ Aberdeen Group, *Best Practices in E-Procurement*, December 2005, published by Ariba

⁷ Selko, Arienne, *E-Procurement Provides Significant Cost Savings*, Industry Week, April 2014,

<http://www.industryweek.com/companies-amp-executives/e-procurement-provides-significant-cost-savings>

State governments spend over \$200 billion in the United States every year. Yet very little of this expenditure is managed in a strategic way. States have little visibility into how agencies spend their money, and there is little knowledge sharing between agencies in optimizing spending. If states can take a more strategic view of spending, they have the potential to harness their budgets to negotiate better contracts while gaining greater procurement efficiency and oversight. It is estimated that state governments can save 5 to 20 percent of expenditures by improving procurement processes. Yet despite the potential benefits, a strategic approach to procurement remains a distant goal for many states.⁸

An ongoing regular analysis of spend data is necessary to support management decisions. “Procurement organizations should use spend analysis to leverage buying power, reduce costs, provide better management and oversight of suppliers and to develop an informed procurement strategy.”⁹

STRATEGIC SOURCING

Spend analysis can provide information to support procurement decisions on strategic sourcing. According to the NIGP Dictionary, Strategic Sourcing is a systematic continuous improvement process that directs supply managers to assess, plan, manage, and develop the supply base in line with the agency’s stated objectives.¹⁰ Procurement organizations that use strategic sourcing are constantly re-evaluating procurement actions to insure alignment with long-term organizational goals. It also facilitates continuous process improvement by measuring the effectiveness of these same procurement actions. Applied effectively, strategic sourcing can significantly lower the costs of goods and services. For example, the General Services Administration (GSA) expects its Federal Strategic Sourcing Initiative to save \$255 million during fiscal years 2014 and 2015.¹¹

SUPPLIER RELATIONSHIP MANAGEMENT

Successful procurement actions rely on effective suppliers. Supplier relationship management is concerned with all of an entity’s potential suppliers, not just suppliers with current contracts. Nurturing a viable pool of potential suppliers can be a valuable procurement strategy. It requires

⁸ Office of Administrative Services, State of Georgia, *Spend Management in Georgia*, July, 2010, published by Microsoft

⁹ NIGP Principals and Practices of Public Procurement, *Spend Analysis*

¹⁰ NIGP Online Dictionary of Procurement Terms, *Strategic Sourcing*

¹¹ Performance.gov, *Generate Savings through Federal Strategic Sourcing Initiative*, <http://www.performance.gov/content/generate-savings-through-federal-strategic-sourcing-initiative#overview>

“planning for, and managing, all interactions with third party organizations that supply goods and/or services to an organization in order to maximize the value of those interactions.”¹²

Supplier relationship management seeks to improve outcomes by getting past the traditional “arm’s length” approach to managing suppliers. Areas for improvement that may be addressed collaboratively with suppliers include: quality, delivery, price or cost, transaction efficiency, value add ideas, innovation ideas, logistics, service needs and assurance of supply.¹³

SUPPLY CHAIN MANAGEMENT

A supply chain is a system of organizations, people, activities information and resources involved in moving a product or service from supplier to customer.¹⁴ The complexity of coordinating supplier actions, transportation, inventories and delivery systems requires continuous attention to detail. In most organizations, procurement is responsible for managing the supply chain. The NIGP Dictionary defines this procurement responsibility of supply chain management well:

1. Those actions and values responsible for continuous improvement of the design, development and management process of an organization’s supply system, with the objective of improving its profitability and survival of its customers and suppliers. It has a major impact on net income and shareholder value. (Burt. Dobler, Starling, 2003)
2. The identification, acquisition, access, positioning and management of resources the organization needs in the attainment of its strategic objective. *Also see* Materials Management. (ISM, 2005)¹⁵

Without effective supply chain management, an organization loses valuable time and resources. Procurement’s objective is the proactive coordination of supply chain activities in order to ensure the organization has what is needed, where and when it is needed.

CONTRACT MANAGEMENT AND ADMINISTRATION

Procurement departments should be actively involved in the creation and management of contracts as well as their post award administration. The importance of effective contract management is high because “organisations in both the public and private sectors are facing increasing pressure to reduce costs and improve financial and operational performance.”¹⁶

¹² NIGP Online Dictionary of Procurement Terms, *Supplier Relationship Management*

¹³ ISM, *Supplier Relationship Management*, <http://www.ism.ws/tools/content.cfm?ItemNumber=20233>

¹⁴ Wikipedia, http://en.wikipedia.org/wiki/Supply_chain

¹⁵ NIGP Online Dictionary of Procurement Terms, *Supply Chain Management*

¹⁶ The Chartered Institute of Purchasing & Supply, *Contract Management Guide*, http://www.cips.org/documents/CIPS_KI_Contract%20Management%20Guidev2.pdf

Improving the strategic value of contracts requires that procurement seeks input from multiple functions within a public entity. Procurement professionals are knowledgeable in the aspects of developing, negotiating and administering contracts. Good contracts ensure that needs are met in a timely and effective manner. Procurement professionals understand basic contract law and the proper use of terms and conditions to protect the organization. They also know how to develop performance measures and measurable contract deliverables in order to achieve best value. Procurement departments monitor contract performance during the life of the contract to ensure a public entity's needs are being met and that contract deliverables are being achieved. Further, they can initiate contract modifications as necessary to ensure the contract continues to provide value over its lifetime.

RISK MITIGATION

Risk is defined as “the chance of injury, damage or loss; the probability of some occurrence (e.g. a failure) and the consequences and impact of the occurrence.”¹⁷ Procurement professionals mitigate risks and ensure the organization is protected by developing contracts and purchase orders that cover areas of potential risk. These may include product safety, on-the-job safety, insurance requirements, operational effectiveness, risks related to new technology and mitigation of unacceptable performance.

Risk mitigation starts in the planning stages of a project or procurement by identifying areas of potential risk. The procurement professional helps ensure risk factors are considered in solicitations and requests for proposal. This includes the use of specific language covering insurance requirements, performance bonds and safety issues.

Mitigating risk in government contracts requires the close coordination of procurement, legal resources and project managers. Contractors typically seek contract terms that mitigate their risk of doing business. Procurement professionals are knowledgeable in negotiating terms and conditions which strike a reasonable balance for both the contractor and the government during contract performance. Involving procurement professionals in helping to plan risk mitigation efforts is an important consideration when spending public funds.

ROLE OF THE PROCUREMENT PROFESSIONAL

Even the best of strategies are of no value without proper execution. Today's procurement professional has the knowledge and skills necessary for turning plans into actionable objectives. A procurement professional's job responsibilities require them to not only understand requirements, but to effectively communicate them to both internal stakeholders and suppliers/contractors. “It is essential that public procurement professionals adhere to a well-

¹⁷ NIGP Online Dictionary of Procurement Terms, *Risk*

defined and established code of ethics,”¹⁸ and procurement professionals are trained to ensure there is fairness and transparency in the conduct of a public entity’s business.

Public entities benefit when procurement professionals are given the opportunity, and the responsibility, of delivering strategic value for their public entity every day. Through the effective use of dynamic forces such as competition, price and cost analysis, life cycle cost analysis and performance criteria, procurement professionals have the tools necessary to achieve best value on a continuous basis. They have direct experience setting specific, measurable and timely objectives for contracts covering a wide array of materials, services, projects and systems. Further, the application of value based procurements and performance based contracts by procurement professionals are proven methods for improving outcomes and lowering overall costs. The contributions of procurement professionals in the strategic planning process are a positive asset for optimizing organizational systems, processes and outcomes.

CONCLUSION

Realizing the strategic value of any organizational function requires that an entity’s leaders understand how the function contributes to the achievement of organizational goals, enable and align that function for maximum contribution, and set performance expectations that reflect the aptitudes of that business function. The complementing corollary is that those responsible for carrying out the function have the capability to deliver on the promise and expectation of a “strategic contribution.”

Organizational understanding of the procurement function and the professional nature of procurement practitioners has been an evolutionary process. While public sector leaders, in general, may have been somewhat slower than their private sector counterparts to realize the strategic potential of procurement, the community demands made of public leaders and the resources they have available to meet those demands requires a strategic approach to all aspects of organizational function. Organizations that only recognize and demand of their procurement function that they “get the lowest price and efficiently process purchase orders” miss the greater value of a professional procurement organization.

Transactional practices in procurement can be - and increasingly are - handled through technology-based means. Thankfully so when we consider that the greater value procurement brings to organizations is only through the professional application of skills and knowledge to core procurement-related activities. Supply chain management...strategic sourcing...supplier relationship management...negotiation...procurement and contract law...contract management, and risk mitigation.

¹⁸ NIGP Principals and Practices of Public Procurement, *Ethical Procurement*

Leading, successful organizations – public and private – recognize that maintaining an archaic view of procurement as a primarily clerical function restricts their capacity to maximize success. Instead, incorporating procurement into the organization’s strategic mindset, equipping procurement practitioners with the tools that allow them to perform at a professional level and setting expectations accordingly brings to government leaders and their communities greater value, greater trust and greater success.