Transforming Public Sector Sourcing:
Right Sizing Public Procurement Using Power Positioning & Value Flow Management

A new approach for the effective management of public sector sourcing, Right Sizing, builds on traditional thinking to improve value for money.

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In this White Paper a new approach is outlined for the effective management of public sector sourcing. This approach uses Sourcing Portfolio Analysis and Power Positioning techniques to develop a sophisticated understanding of how to improve 'value for money' in public procurement. In doing so this new approach, Right Sizing, builds on traditional thinking about how to improve public procurement using 'cost reduction' techniques based primarily on the aggregation of 'categories of spend' and the award of longer-term framework deals with preferred suppliers.

There are two broad choices facing governments when they seek to improve public sector sourcing. The currently dominant thinking used by most governments can be summarised as *tactical spend management*. In this White Paper the strengths and weaknesses of this orthodox aggregation approach, based on standardisation, aggregation, supply base reduction and volume leverage, are briefly summarised, and compared with a more radical approach based on the adoption of *value flow management* thinking.

This more radical approach uses *Power Positioning* and *Sourcing Portfolio Analysis* tools and techniques to identify the scope for improved 'value for money' from *strategic supply management*. A case study is presented of how this way of thinking has recently transformed public procurement in the UK to deliver improved 'value for money', as well as significant reductions in costs when compared with more traditional approaches based on *tactical spend management*.

A. The Current Aggregation Orthodoxy in Public Procurement Practice

In UK government a new Crown Commercial Service (CCS) was established in the autumn of 2013. Its remit was to deliver cost savings by ensuring that government acts as a true single customer. To this end the CCS will:

- Centrally manage the purchase of common goods and services (such as professional services and energy).
- Introduce a new Complex Transactions Team to work with departments on complex procurements, reducing the need for external advice.
- Enable departments to focus their commercial efforts on their own strategic requirements.
- Further strengthen the commercial leadership within government.
- Further strengthen the procurement profession and improve overall commercial ability across the Civil Service.
- Continue to work closely with the wider public sector to ***ensure that the benefits of aggregation and centralisation are shared across the public sector to maximise savings for the taxpayer***.

This thinking is based on tactical spend management thinking and focuses primarily on the use of aggregation as the basis for improve leverage and reducing costs in public sector sourcing. This traditional approach to leverage can be summarised as follows:

- *Standardise all supply requirements and aggregate all similar items into the same 'category of spend'.*
- *Use supply market analysis to identify a limited number of pre-defined preferred suppliers for market test.*
- *Use market competition to identify the lowest cost supplier, or suppliers.*
- *Reduce the costs of supply by using volume leverage to aggregate spend with one, or if this is not feasible, the fewest number of suppliers possible.*
- *Enhance cost leverage during negotiations, and reduce post-contractual transaction costs, by awarding medium to long-term framework agreements with preferred suppliers.*

This is perhaps the most commonly used strategy by procurement professionals when seeking to reduce costs quickly. Unfortunately, while it can often generate considerable short-term reductions in cost, it can also create a number of problems for users and may not always be the most effective approach to reduce costs for some 'categories of supply'.

These problems arise because this strategy mistakenly assumes that 'cost reduction' rather than 'value for money' is the primary goal of public procurement, and that aggregation and supply base reduction are always the best means available for reducing the costs of supply. As we shall see in what follows, this thinking is based on an outdated approach to sourcing options identification and selection in public sector sourcing.

B. Right Sizing – Buying the Right Stuff at the Right Price

One of the most challenging areas for government sourcing is IT, where there has been considerable evidence of procurement failure. These failures have been recorded within many areas of the public service, although they have been extensively documented in Health and Defence-related contracting in particular. The failure to achieve valued outcomes from IT contracting has normally involved a failure by suppliers to deliver the functionality required and/or within the originally agreed budget—resulting in extensive cost overruns for sub-optimal IT systems and processes.

Given this it is interesting to note that, until recently, CCS thinking about how to improve IT sourcing has focused almost exclusively on the orthodox standardisation, aggregation, supply base reduction and volume leverage approach briefly outlined above. This means forcing requirements whenever possible into a standard specification and then seeking to reduce costs by leveraging aggregated volumes with one, or only a few suppliers.

The consequence of this has been the award of a number of framework agreements with preferred IT suppliers in order to reduce costs. For example, CCS has a framework for the buying managed email, and in the past there had been talks with Blackberry and Nokia about four year bulk deals for the supply of mobile phones. Similarly, Consultancy One is a four year framework with a fixed number of suppliers that provides for lower cost agreed day rates, but limits the choice of consultants that can be used for any particular requirement.

The problem with this current approach to public sector IT sourcing is that there is considerable evidence that this orthodoxy is resulting in poor 'value for money' in sourcing decisions. Interestingly, there is evidence that this approach has been in tension with the IT strategy administered by the Office of the Chief Technology Officer, where disaggregation and getting full value from SMEs has been the primary strategy.

As Figure 1 demonstrates this tension between cost reduction and value delivery can be shown as a series of choices. Buyers can either source the 'Right Stuff' (i.e. what the customer needs and values) or the 'Wrong Stuff' (i.e. what the customer does not need and does not value). Relatedly, a buyer can source at the 'Right Price' (i.e. at the lowest cost possible) or at the 'Wrong Price' (i.e. at a premium price).

FIGURE 1: VALUE FOR MONEY TRADE-OFFS

This results in a segmentation of sourcing decision-making in which the following outcomes can occur:

- *Right Sizing* – Buying what the customer needs / at the lowest cost possible
- *Value Buying* – Buying what the customer needs / at a premium price
- *Wrong Sizing* – Buying what the customer does not need / at the lowest cost possible
- *Cheap Buying* – Buying what the customer does not need / at a premium price

It is self-evident that to obtain 'value for money' buyers must pursue *Right Sizing—obtaining what the customer needs and at the lowest cost possible*. This is different to *Cheap Buying*, which uses cost reduction as the primary basis for making sourcing decisions, irrespective of whether the customer is supplied with what they actually need to fulfil their tasks successfully. Clearly, what should be sourced cannot

be determined solely by what it costs, but rather must be understood as a trade-off between what is required functionally from any supply item, in relation to its relative costs of its acquisition.

Unfortunately, the inability of buyers to understand this trade-off is not new because, as John Ruskin indicated many years ago:

> *"There is scarcely anything in the world that some man cannot make a little worse, and sell a little more cheaply. The person who buys on price alone is this man's lawful prey."*

Similarly, as Oscar Wilde also bemoaned in earlier times:

> *"Nowadays people know the price of everything and the value of nothing."*

It is, therefore, a great pity that so much of current thinking in public procurement still fails to understand these simple rules of thumb when thinking about value in sourcing decision-making. Two simple examples from recent public sector sourcing decision-making are presented below to reinforce the point that knowing the 'cost' of something does not tell us anything about its 'value'.

Example 1: Sourcing Mobile Phones

Some years ago a decision was taken in the UK public sector to explore the scope to standardise the specification of mobile phones, and focus on either Blackberry or Nokia products. The thinking at that time was that if all mobile phone requirements could be aggregated into one specification then volume leverage would be feasible, and a substantial discount could be negotiated from the full cost price. And especially if a four-year framework agreement was entered into for all future mobile phone requirements.

There is nothing wrong with the assumption that, by standardising, aggregating and identifying one or two preferred suppliers, volume leverage will normally lead to a reduction in the full premium price that a one-off or small volume purchaser would receive. The problem, however, is that this thinking is only focused on the cost side of the 'value for money' equation.

If such a decision to enter into a medium-term framework agreement with Nokia and/or Blackberry had been made it is now clear that this would have provided civil servants with outdated technology and limited functionality, that would have seriously undermined their personal productivity. This is because advances in technology have resulted in the development of smart phones, with Google applications. These provide much greater flexibility and productivity than the old technologies, which are locked into Windows XP, with slow booting capabilities and without collaborative apps or Google hangout.

As Figure 2 demonstrates, with hindsight, it can be seen that the approach recommended by current public procurement thinking would have been *Cheap Buying* (i.e. buying the 'Wrong Thing', while attempting to buy it at a discounted or 'Right Price'). While there is no question that with standardising, aggregating, supply base reduction and volume leverage over four years this sourcing strategy would have resulted in considerable cost reduction, it would still have been an exercise in moving from *Wrong Sizing* to *Cheap Buying* and for the 'Wrong Stuff'.

FIGURE 2: SOURCING MOBILE PHONES

In IT the pace of innovation is rapid, and it can be very difficult to identify what will be the leading product or software functionality in the future. Given this, entering into long-term framework agreements with suppliers who cannot guarantee to be leaders in the future is a recipe for incompetent buying. In these circumstances, it is incumbent on buyers to understand the trade-off between the value of obtaining the best functionality available (the 'Right Stuff') or obtaining the lowest cost (the 'Right Price'), but for a lower value functional product/service.

This means understanding whether it is better to have the 'Right Stuff' or the 'Right Price'. As Figure 2 demonstrates, buyers should ideally be *Right Sizing* (in this case buying Tablets or Androids at the lowest cost possible), but sometimes they may prefer *Value Buying* (i.e. buying the 'Right Stuff' at a premium price) rather than *Cheap Buying* (i.e. buying the 'Wrong Stuff' at the lowest cost possible).

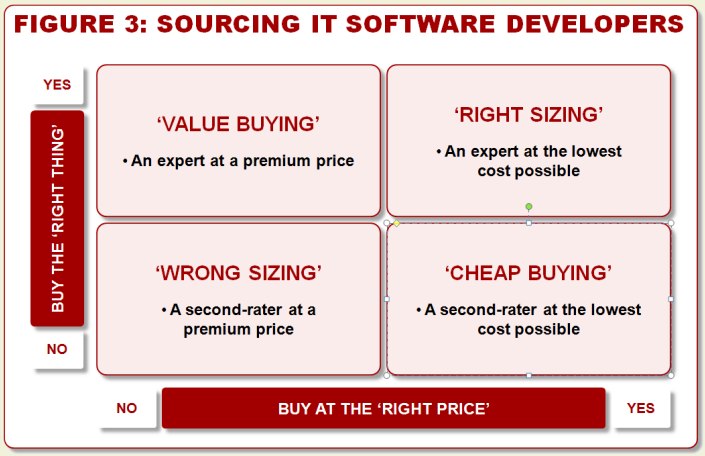
In the absence of detailed discussions about the relative value of different 'value for money' trade-offs such as these, it is debatable whether public sector sourcing can move beyond its currently cost-led focus. Furthermore, as we shall see later when discussing the recent UK public sector G-Cloud approach, even when pursuing the lowest cost outcomes the orthodox approach based on aggregation and volume leverage with preferred suppliers may not always be the most optimal strategy for effective cost reduction. This is because, in technologically innovatory markets, using on-line catalogue technology to constantly monitor the best deals available for any required functionality is often the best approach.

Example 2: Sourcing IT Software Developers

A second example of serious myopia in public sector procurement practice is revealed in the case of the sourcing of IT software developers. Under current thinking the best way to improve sourcing is to aggregate all requirements into one 'category of spend' and achieve cost reduction through volume leverage and the offer of long-term framework agreements to a limited number of suppliers of IT software developers. The problem with this approach is that once again it fails to understand 'value for money' trade-offs.

One of the most important things to understand about software development is that an expert developer can provide a tenfold improvement in productivity relative to second-rate developers (source: McKinsey analysis). This means that the costs of a developer can vary widely with expert developers normally commanding a premium price relative to second-rate developers.

FIGURE 3: SOURCING IT SOFTWARE DEVELOPERS



As Figure 3 demonstrates if the focus of sourcing is based solely on cost reduction then there is always likely to be a desire to undertake *Cheap Buying* (i.e. aggregating all requirements for developers into a number of preferred suppers who may only be able to provide second-rate developers given the low day rates that cost leveraged sourcing strategies normally generate). As a result, in practice customers using framework agreements normally end up receiving the 'Wrong Stuff', but at a low price (i.e. a cheap person) rather than the 'Right Stuff' (i.e. the right person at either a premium price or, ideally, at a keen rate).

In the case of IT software developers the 'value for money' trade-offs that buyers need to debate with their customers are, therefore, whether it is better to undertake *Right Sizing* (i.e. having a much more productive developer, at the lowest possible cost); *Value Buying* (i.e. having a much more productive developer, but at a premium price); *Cheap Buying* (i.e. a second-rater at the lowest possible cost) or, *Wrong Sizing* (i.e. having a second-rater, but at a premium price).

The problem for orthodox procurement practices is that the focus on cost-down savings tends to force them into *Cheap Buying* at the expense of the increased productivity that comes from sourcing expert developers, which is normally a much better 'value for money' trade-off. This is because having the right person is normally better than having a cheap person for this supply requirement, not least because of the high incidence of time and cost overruns from sub-standard software development.

Unfortunately, when trying to source expert developers at a keen price the use of long-term framework agreements is once again not normally very effective. This is because expert developers are in high demand and they know they can command a premium price. As a result, they are unlikely to work for buyers who can only offer them low day rates. Given that they normally have many options, the sourcing of expert developers may best be achieved using the latest available on-line catalogue technology (like the *G-Cloud* approach discussed below). This technology allows individuals or smaller niche suppliers to bid whenever they become available for work, and this can sometimes provide a much more effective mechanism for obtaining keen pricing in the short-term.

These two short examples demonstrate that current orthodox aggregation and leverage approaches to procurement may be delivering low value supply (i.e. the 'Wrong Stuff' rather than the 'Right Stuff'). This would not be so bad if it always delivered *Cheap Buying*, but it may very well be that it is also providing *Wrong Sizing* (i.e. delivering the 'Wrong Stuff' and at the 'Wrong Price').

Below we demonstrate how a recent innovation in sourcing leverage, associated with the adoption of on-line catalogue technology, has demonstrated superior capability in reducing costs (while also providing increased functionality to customers), compared with current orthodox aggregation and volume leverage approaches.

C. G-Cloud – Improving Value & Reducing Costs Through On-Line Technology Innovation

There is often a lack of clarity in public procurement because of the development of contradictory policies being pursed by different parts of the public sector. We saw above that in 2013 CCS decided to pursue an aggregation and volume leverage approach for the whole of the public sector. Unfortunately, this policy decision was taken even though the government had previously announced a very different approach for public sourcing in relation to SMEs.

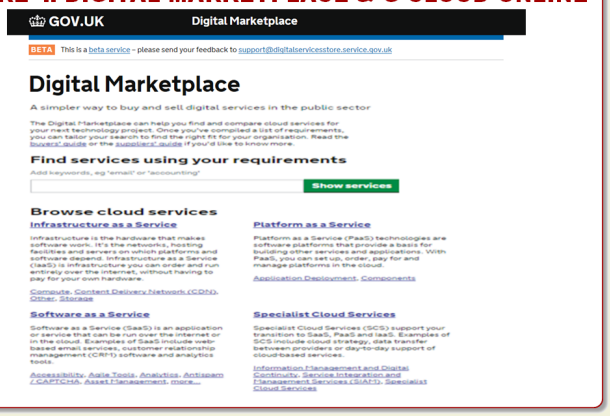
In a 2011 David Cameron made the following quotes or statements:

> *"Today, we are announcing big changes to the way government does business."*
> *"No one should doubt how* ***important*** *this is."*
> *"It's important for getting to grips with our deficit, as it will help us* ***tackle waste and control public spending****."*

*"...the system doesn't encourage **small and medium-sized businesses**, charities and social enterprises to compete for contracts … the very firms who can provide the competitive pressure to **drive down costs**."*
*"...wherever **possible**, we're going to **break up large contracts into smaller elements, so that SMEs can make a bid** and get involved."*

One of the major developments from this initial statement of intent was the creation of an on-line public sector catalogue called *Cloud Store* in the Home Office in April 2012. This was created to enable the Home Office to buy from new suppliers more easily than using standard Home Office framework strategies. Since then *Cloud Store* has gone through six iterations to become *The Digital Marketplace* (DM), as shown in Figure 4.

FIGURE 4: DIGITAL MARKETPLACE & G-CLOUD ONLINE



The DM is built in-house by the Government Digital Service in London using open source software components. The DM uses an OJEU framework that is now regularly updated on a six-monthly basis to populate it with *G-Cloud* suppliers.

FIGURE 5: DM PUBLIC SECTOR BUYERS ONLINE ON GOVSPEND

	Customer	SME %	IaaS Lot 1	PaaS Lot 2	SaaS Lot 3	SCS Lot 4	Total
1	Home Office	41%	£2,480,294	£483,698	£5,269,593	£83,877,721	**£92,111,308**
2	Cabinet Office	55%	£1,690,795	£206,581	£1,841,709	£27,279,043	**£31,018,129**
3	Ministry of Justice	64%	£424,116	£197,881	£2,203,525	£27,630,797	**£30,456,320**
4	Driver and Vehicle Standards Agency	4%	£2,748	£0	£182,762	£24,318,376	**£24,503,888**
5	HM Revenue and Customs	93%	£2,345,907	£162,360	£1,700,169	£16,561,725	**£20,770,161**
6	Health and Social Care Information Centre	45%	£6,889,183	£473,750	£5,555,498	£6,206,169	**£19,124,601**
7	Department of Health	10%	£122,000	£102,692	£334,617	£18,329,591	**£18,888,901**
8	Department for Education	82%	£5,393,768	£0	£252,643	£12,911,061	**£18,557,473**
9	Financial Conduct Authority	82%	£0	£59,928	£1,141,307	£12,722,826	**£13,924,061**
10	Foreign And Commonwealth Office	13%	£28,429	£0	£147,207	£13,285,513	**£13,461,151**
11	Chief Executive of Skills Funding	40%	£3,226,590	£0	£248,258	£9,032,539	**£12,507,388**
12	Driver and Vehicle Licensing Agency	60%	£1,883,993	£0	£432,484	£10,152,566	**£12,469,043**
13	Office for National Statistics	60%	£121,902	£6,055	£60,220	£11,050,842	**£11,239,020**
14	Department for Environment Food And Rural Affairs	35%	£633,489	£1,264,307	£1,128,745	£7,088,238	**£10,114,781**
15	Care Quality Commission	49%	£4,354,869	£56,580	£182,121	£4,620,136	**£9,213,707**
16	Department For Business Innovation And Skills	70%	£82,601	£1,716,786	£1,777,853	£4,679,557	**£8,256,798**
17	Student Loans Company Limited	56%	£0	£0	£64,992	£7,309,026	**£7,374,018**
18	Bristol City Council	86%	£12,650	£0	£106,988	£7,232,515	**£7,352,153**
19	Maritime and Coastguard Agency	38%	£0	£0	£0	£7,031,960	**£7,031,960**
20	Department for Work And Pensions	27%	£135,800	£0	£78,964	£6,717,759	**£6,932,524**
21	Health Research Authority	5%	£0	£96,806	£2,300	£6,775,763	**£6,874,870**
22	Defence Equipment and Support DEandS	100%	£0	£0	£4,708,965	£0	**£4,708,965**
23	Department Of Energy And Climate Change	92%	£304,128	£22,917	£627,700	£3,686,869	**£4,641,616**
24	Navy Command	32%	£0	£0	£43,867	£4,566,115	**£4,609,982**
25	London Borough of Hounslow Council	20%	£21,708	£0	£904,850	£3,532,318	**£4,458,877**

The commercial construct is that DM is a catalogue of services bought by public sector buyers and that is transparently visible on-line, as shown in Figure 5.

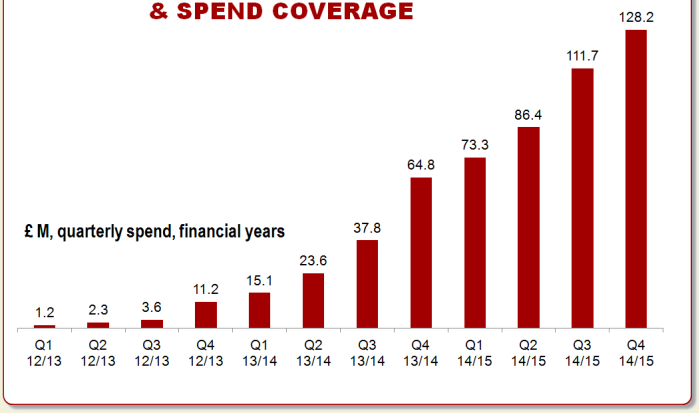
Each service line is defined and the price published in the catalogue, with currently some 19,996 services on offer on-line from 1,852 suppliers, as shown in Figure 6. Prices can be lowered in the system, but they cannot be raised. All trades are public (on http://govspend.org.uk/).

FIGURE 6: DM PUBLIC SECTOR SUPPLIERS ONLINE ON GOVSPEND

	Supplier	SME %	IaaS Lot 1	PaaS Lot 2	SaaS Lot 3	SCS Lot 4	Total
1	BJSS LTD	0%	£0	£0	£0	£23,751,034	**£23,751,034**
2	Valtech Ltd	0%	£0	£0	£0	£21,986,019	**£21,986,019**
3	Methods Advisory Ltd	0%	£32,250	£0	£54,938	£18,831,919	**£18,919,107**
4	Equal Experts	100%	£0	£0	£0	£16,167,437	**£16,167,437**
5	IBM United Kingdom Ltd	0%	£0	£0	£0	£15,135,694	**£15,135,694**
6	Mastek UK Ltd	0%	£0	£0	£0	£14,319,157	**£14,319,157**
7	PA Consulting Services Ltd	0%	£0	£0	£0	£13,721,134	**£13,721,134**
8	Kainos Software Ltd	0%	£65,644	£0	£0	£12,977,672	**£13,043,316**
9	SKYSCAPE CLOUD SERVICES LTD	100%	£11,373,173	£0	£9,947	£0	**£11,383,120**
10	Innoveer Solutions	100%	£0	£0	£0	£10,275,179	**£10,275,179**
11	THOUGHTWORKS LTD	0%	£0	£0	£0	£9,911,806	**£9,911,806**
12	Alpine Resourcing Limited	100%	£0	£0	£0	£8,888,387	**£8,888,387**
13	Capgemini Uk Plc	0%	£0	£0	£35,090	£8,748,881	**£8,783,971**
14	The Engine Group	0%	£0	£0	£0	£8,130,757	**£8,130,757**
15	LA International Computer Consultants Ltd	0%	£0	£0	£0	£8,128,319	**£8,128,319**
16	INTECHNOLOGY PLC	100%	£6,889,183	£473,750	£631,585	£0	**£7,994,518**
17	Sopra Group Ltd	0%	£0	£0	£0	£7,901,633	**£7,901,633**
18	BAE Systems Applied Intelligence Ltd	0%	£0	£0	£0	£7,874,259	**£7,874,259**
19	EMERGN LTD	100%	£0	£0	£0	£7,710,275	**£7,710,275**
20	Parity Group PLC	100%	£0	£0	£0	£7,283,661	**£7,283,661**
21	Edusery	100%	£5,422,360	£0	£0	£1,666,928	**£7,089,289**

G-Cloud is highly innovative legally, allowing large numbers of suppliers onto a framework and allowing buyers to choose suppliers from information provided (and updated) rather than from using competitions. Currently the *G-Cloud* focuses on cloud services and related consulting but the concept can and will be extended widely in the UK public sector. To date some 700 buyers have, however, bought from some 500 suppliers and there has recently been an exponential increase in participation amongst public buyers, as shown in Figure 7. The current annual run rate for services being purchased through *G-Cloud* is now over £0.6bn.

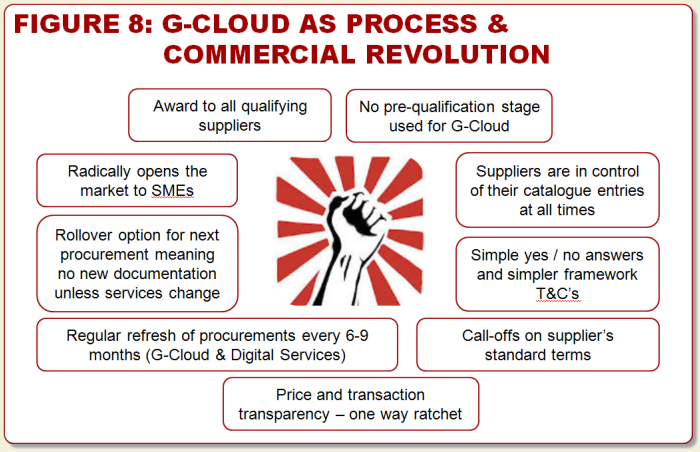
FIGURE 7: RAPID GROWTH IN G-CLOUD CUSTOMERS & SPEND COVERAGE



Most importantly than mere usage, however, are the 'value for money' benefits that have been delivered by DM and *G-Cloud*. In pursuit of opening up the public sector to new SME suppliers (as desired initially by the Prime Minister in 2011) so far 50% of sales have been with SMEs, compared

with only 10% within normal legacy central Government procurement processes. Perhaps the most important finding from this exercise in on-line bidding is that *G-Cloud* has reduced transaction costs for buyers and sellers and provided an easy way for public bodies to buy within days rather than months. Many of the revolutionary process benefits from the use of this new on-line process are identified in Figure 8.

FIGURE 8: G-CLOUD AS PROCESS & COMMERCIAL REVOLUTION



Furthermore, the process is compliant by default and matches buyers with best 'value for money' suppliers with zero friction, and without time-consuming attempts to force through standardisation and aggregation or complex market testing activities to identify preferred suppliers. This has generated a high degree of customer and supplier satisfaction.

Most importantly of all, research shows that typical cost savings are in the order of 50% when compared with legacy and/or aggregation and framework-based leverage strategies. Examples below confirm the radical improvement in costs from this iterative and multiple supplier on-line bidding process:

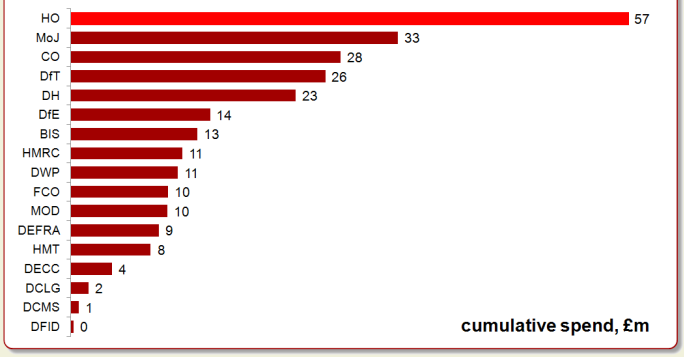
- Some Departments were paying £57 for IT power cables that could be bought on-line for £20 individually, and £8 wholesale – a potential saving of between 65% and 86%.
- In 2015, a Department reduced their cost of web-hosting by 90% using *G-Cloud*.
- An SME bid using digital was 87% less than the incumbent central Government centralised supplier.
- Managed email services on *G-Cloud* is less than half the price of current CCS managed email framework pricing.
- DFE received a total service cost for educational services that was 40% cheaper than any other bids.
- Employment Tribunals received a digital payment service 25% cheaper than any other bids, and it was delivered a year earlier than originally planned.
- MOJ saved 1.1M per Megawatt energy/year and 6000 tons of carbon against industry average from bidding on Data Centre hardware containers .
- DVLA saved 75% on the original business case estimates for an Enquiry Platform SME cluster.

The evidence so far shows that *G-Cloud* provides a considerable number of benefits over orthodox aggregation and volume leverage approaches. These include the following:

- "Red Tape Buster": reduces procurement time from 227 days (2010) to a typical 2 to 4 weeks (and fastest in 3 minutes). Delivers procurement reform (faster, simpler access to best VFM).
- Increases Government spend with SMEs directly and substantially. 90% of SMEs benefitting are UK-based. SMEs have created 60% of jobs since 2010.
- Saves money for the taxpayer: *G-Cloud* saves 50% of spend on average.
- Elegant use of EU regulations: Systems Up CEO: "*G-Cloud* is transformational".
- Helps economic growth and exports of technology.
- Is a British first: world leading design visible to citizens.
- Uses transparency, competition and digital to deliver results.

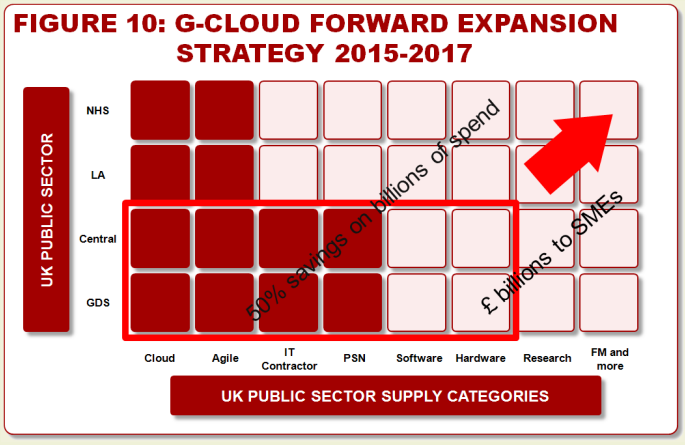
The future opportunities for improvement are of course immense and, as Figure 9 shows G-Cloud has only just started to impact upon UK public sector sourcing and supply management since its inception in 2012 in the Home Office.

FIGURE 9: CURRENT DEPARTMENTAL USAGE SINCE MARCH 2012



Given its current growing success in other Departments the forward strategy for G-Cloud is, as indicated in Figure 10, to expand widely into the public sector.

FIGURE 10: G-CLOUD FORWARD EXPANSION STRATEGY 2015-2017



The current forward implementation strategy is briefly shown on the following page:

- ***Extend functionality*** from a public catalogue to full self-service platform:
  - *One stop shop for digital project components*
  - *Click for reference customers and their contact details*
  - *Auto-document the award decision. "Compliant by default"*
  - *One click purchase full integration to purchase to pay and ERP systems*
  - *Detailed feedback to losers who can the improve their offering*
  - *Geographic and SME search capability*
- ***Achieve category range authority*** (it stocks all you need) through proactive best-of-breed management of suppliers, who can join and leave the *G-Cloud* dynamically.
- ***Extend customer base*** from Central Government to Local Authorities (LAs), Health and WPS. Contracting authorities can let their own frameworks. *G-Cloud* provides the front-end.
- ***Extend product categories*** as far as appropriate (strong interest from PSN, IT contractors, IT software and hardware, FM, Construction, Health, MOD Research Cloud, Home Office ESCMP and more).
- ***Support export opportunities*** for "Best of British" suppliers.

Given this success does this mean that the traditional procurement approach of CCS based primarily on aggregation thinking is now completely outdated for the public sector? The simple answer, as we show below, is no. But what the G-Cloud revolution (and similar developments in Digital Marketplaces) is showing is that traditional thinking about best practice in procurement and sourcing needs to be significantly modified. Why and how is discussed in the next section.

D. Power Positioning and Sourcing Portfolio Analysis – Why Orthodox Aggregation & Leverage Thinking Is Only Sometimes Correct

According to Vivek Kundra, the US Government's CIO:

> *"G-Cloud is the model for Governments around the world"*

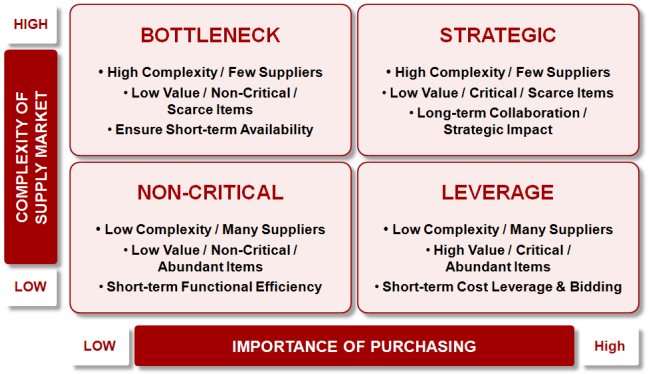
With many governments now copying this innovative on-line approach, it is important to ask why *G-Cloud* can achieve relatively frictionless, high 'value for money' sourcing, and deliver much lower costs (i.e. *Right Sizing*), than the orthodox aggregation and volume leverage approaches with preferred suppliers developed by CCS? The explanation is not that the CCS leverage approach is wrong, rather it is that the aggregation and volume leverage approach is only sometimes (and not always) the right approach to take to obtain improvements in 'value for money'.

To understand why this should be so it is necessary to explain where aggregation and volume leverage thinking comes from, and why this thinking is flawed for many of the public goods and/or services that must be sourced. Historically most thinking about appropriate sourcing strategies in the procurement profession has been derived from the work of two authors. Michael Porter (1980) outlined some of the strategies that buyers can use to augment their power and leverage over suppliers. In particular he argued that buyer power could be improved significantly if buyers could use the following levers:

- Purchase large volumes relative to supplier sales (*supplier dependency*)
- The product required is standardised and undifferentiated (*commoditised*)
- The supply market is *highly contested*
- There are *few sunk* (already incurred) or *switching* (will be incurred if we move supplier) *costs*
- The buyer poses a credible threat of *backward integration*
- They buyer has *full information* about total demand and supply characteristics
- The buyer has available *credible substitute* products/services
- The *barriers to market entry are low* in the supply market

This work was later adapted by Kraljic (1983) to create a segmentation approach known as *Purchasing Portfolio Analysis* (PPA) to manage categories of supply/spend.

FIGURE 11: PURCHASING PORTFOLIO ANALYSIS



Adapted from Kraljic, P. (1983)

As Figure 11 shows Kraljic's model recommends four different sourcing strategies based on the position of the buyer relative to the 'Importance of the Supply Item' being purchased and the 'Difficulty of the Supply Market' being sourced from. According to this model, depending on the location of the category to be sourced, a buyer should follow the following simple rules of thumb:

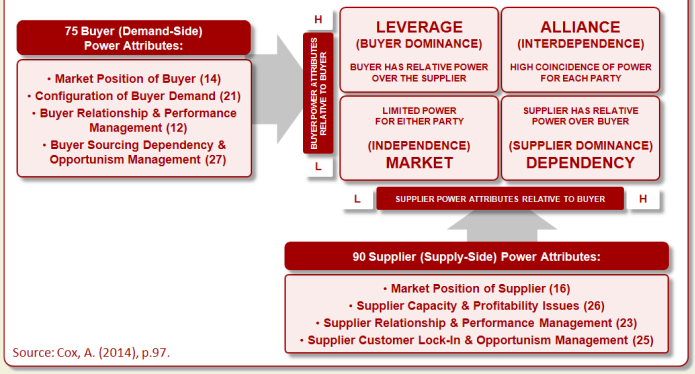
- ***Leverage***: Regular Competitive Tendering
- ***Bottleneck***: Ensure Supply Availability
- ***Non-Critical***: Functional Efficiency
- ***Strategic***: Collaborate with Suppliers

It would appear that this thinking has had a significant impact on current thinking about best practice in public sector procurement. It would appear that Porter's levers have been identified as the most appropriate for improving sourcing of all public goods and/or services, when they may only be appropriate for standardised production parts that can be easily standardised and aggregated (unlike most public goods and/or services). Furthermore, it appears that only the *Leverage* approach in Kraljic's model, using regular market testing with preferred suppliers, is seen as appropriate.

Many public procurement professionals appear therefore to have fallen into the trap of thinking that one approach is 'fit for purpose' for all sourcing circumstances in the public sector. This error is revealed by the superiority of the *DM* and *G-Cloud* approach in delivering improved 'value for money' to public sector customers and at significantly lower cost. To fully understand why the *DM* and *G-Cloud* approach has been successful it is, however, necessary to understand when, and also why, on-line bidding using a marketplace is a more appropriate sourcing strategy than aggregation and volume leverage for many (if not all) public sector sourcing categories.

The starting point for understanding appropriateness in category sourcing strategies is *Power Positioning* and *Sourcing Portfolio Analysis* (Cox, 2104; IIAPS White Paper 15/2). In this model the main focus of analysis is the dyadic exchange relationships between buyers and suppliers, and the concepts of *static* and *dynamic leverage*. There are over 150 variables that must be analysed to fully understand the current balance of power between a buyer and potential suppliers (Cox and Ireland, 2015 forthcoming), but some of the major attributes are identified in Figure 12.

FIGURE 12: BUYER & SUPPLIER ATTRIBUTES IN THE POWER MATRIX



Source: Cox, A. (2014), p.97.

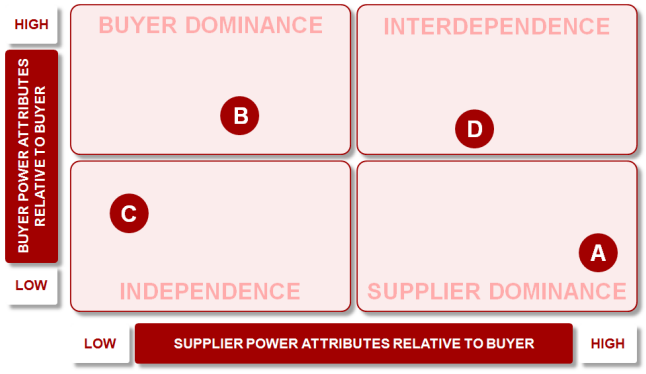
The Power Matrix identifies four Power Scenarios in which buyers and suppliers can operate:

- ***Leverage*** – this is *Buyer Dominance*, where the buyer has all, or most, of the power resources to leverage improved value for money from the supplier, who possesses few countervailing power resources.
- ***Alliance*** – this is *Interdependence*, where both the buyer and supplier have many power resources that countervail those of the other party. Value will normally be shared in such relationships because neither party has the upper-hand.
- ***Market*** – this is *Independence*, where the buyer and supplier have few power resources with which to leverage the other. The relative competence of both parties in bidding and negotiation will normally determine the share of value.
- ***Dependency*** – this is *Supplier Dominance*, where the supplier has all, or most, of the power resources to determine value for money outcomes and also to retain the lion's share of value from the buyer, who possesses few countervailing power resources.

This approach provides a comprehensive way of thinking about the dyadic exchange relationships that actually occur within supply markets. This is because it insists on the analysis of the power and leverage position between the buyer and *all of the potential suppliers within a supply market*. The methodology recognises, therefore, that a supplier may be operating in the same supply market as other suppliers, but have a very different power and leverage position with the same buyer.

Figure 13 demonstrates this point. In the example provided a power analysis has been undertaken for four suppliers. In this case this is the 'actual' supply market that is available to the buyer. The analysis shows that the four potential suppliers do not operate in the same power positions. In fact some suppliers (A and D) are much more powerful than others (B and C) in this market.

FIGURE 13: STATIC POWER POSITIONING



Source: Cox, A. (2014), p.101.

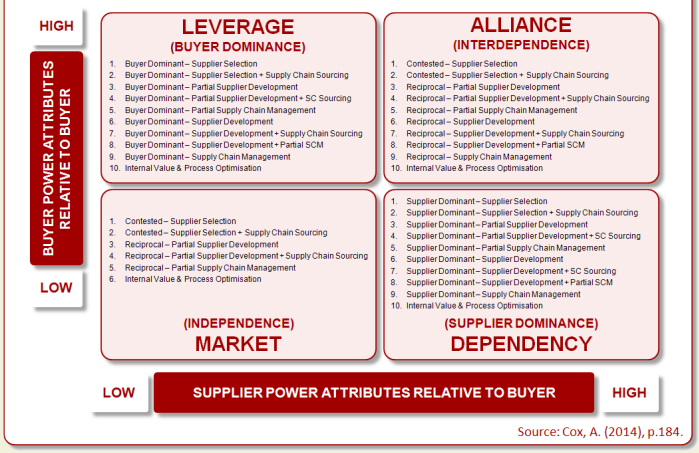
This is one of the most significant insights that the *Power Matrix* provides. It allows buyers to understand which suppliers are more or less amenable to 'value for money' leverage, and why this is so. This is important because, as we shall see, sourcing strategy options and 'value for money' outcomes can vary widely if suppliers are operating in very different power positions.

In *Sourcing Portfolio Analysis* (excluding Insourcing and Joint Ventures) there are ten potential sourcing strategy options for buyers to select from:

1. ***Supply Chain Management*** – full lean/agile/agilean supply chain collaboration with the first-tier supplier and in the supply chain.
2. ***Supplier Development + Partial Supply Chain Management*** – full lean/agile/agilean supplier collaboration at the first-tier + information-based collaboration only within the supply chain.
3. ***Supplier Development + Supply Chain Sourcing*** – full lean/agile/agilean supplier collaboration at the first-tier + arm's-length sourcing from within the supply chain.
4. ***Supplier Development*** – full lean/agile/agilean supplier collaboration at the first-tier only.
5. ***Partial Supply Chain Management*** – information-based supply chain collaboration with the first-tier supplier and in the supply chain.
6. ***Partial Supplier Development + Supply Chain Sourcing*** – information-based supplier collaboration at the first-tier only + arm's-length sourcing from within the supply chain.
7. ***Partial Supplier Development*** – information-based supplier collaboration at the first-tier only.
8. ***Supplier Selection + Supply Chain Sourcing*** – competitive arm's-length sourcing at the first-tier + arm's-length sourcing from within the supply chain.
9. ***Supplier Selection*** – competitive arm's-length sourcing at the first-tier only.
10. ***Internal Value & Process Optimisation*** – value and lean process improvements internally.

This list indicates that selecting appropriate strategic sourcing options is not as simple as selecting from the four simplistic choices proffered by the Kraljic methodology. Despite this, in *Sourcing Portfolio Analysis* not all sourcing options are potentially feasible in all power positions. As Figure 14 demonstrates, those operating in the **Market** (*Independence*) power position have fewer potential feasible sourcing options (when insourcing and joint ventures are excluded) than those operating in the other three quadrants.

FIGURE 14: POWER POSITIONS & FEASIBLE STATIC SOURCING OPTIONS

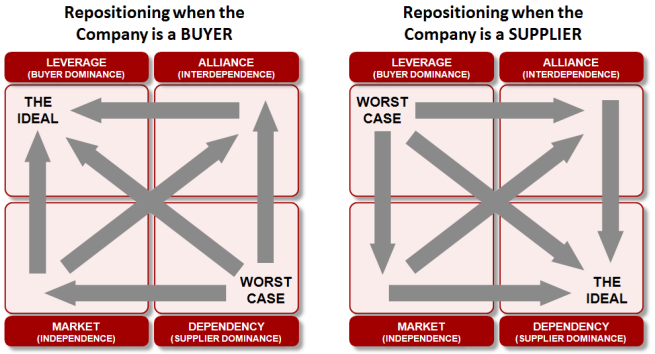


Source: Cox, A. (2014), p.184.

When making sourcing strategy selection decisions, therefore, the first task for buyers is to understand their current power positions with their potential suppliers. Having achieved this, it is then possible to identify (within each of the four quadrants of the *Power Matrix*) which of the strategic sourcing options identified earlier are potentially viable options with the supplier, or suppliers, in the most currently leveraged power position.

Unfortunately, even this much more comprehensive analysis of power positioning and options has limitations. This is because electing to work with suppliers who are currently in the most favourable leverage position is only a *static* approach to sourcing. The beauty of power positioning, however, is that it is also provides scope for a *dynamic* approach to sourcing. This is because it is based on the assumption that there are ***preferable power positions*** that a buyer or supplier would 'ideally' wish to move to, and operate within, in the future.

FIGURE 15: IDEAL BUYER AND SUPPLIER POWER POSITIONS

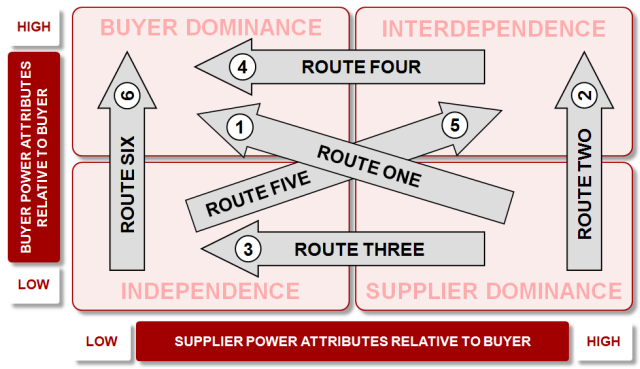


Source: Cox, A. (2014), p.102.

As Figure 15 shows the ideal position for a buyer is to operate in the **Leverage** (*Buyer Dominance*) position. Conversely, the ideal position for the supplier is to operate in the **Dependency** (*Supplier Dominance*) position. Given this, it should be obvious that buyer and supplier exchange relationships are inherently conflictual. This is because, if buyers and suppliers are competent, they should always be seeking ways to operate within their ideal or optimal, rather than sub-optimal, power positions.

If this is the case, then a competent buyer (or competent supplier for that matter) should not just understand their current (*static*) power circumstance, and identify what they should do given this. Their first task should be to understand the scope for *dynamic* movement. That is understand, assuming they are not already in their ideal leverage position, what in the future are the most appropriate strategies and tactics to move from their current less advantageous to a more advantageous leverage position.

FIGURE 16: DYNAMIC BUYER MOVEMENT IN THE POWER MATRIX



Source: Cox, A. (2014), p.101.

As outlined in Figure 16 the potential routes by which buyers can improve their power positions with suppliers to achieve *more favourable locations from the buyer's perspective* are:

- *Route 1: Dependency to Leverage*
- *Route 2: Dependency to Alliance*
- *Route 3: Dependency to Market*
- *Route 4: Alliance to Leverage*
- *Route 5: Market to Alliance*
- *Route 6: Market to Leverage*

This means that before considering '*static* leverage' options a buyer must analyse the scope to move dynamically from their current into more favourable power positions in the future. When considering *dynamic leverage routes* the key is normally to identify sourcing strategies that augment the power resources of the buyer, while diminishing the countervailing power resources of the supplier. The one exception is *Route 5*. In this case the power resources of the buyer and the supplier are both increased in the search for reciprocal 'value for money' improvements.

Nine potential *dynamic leverage strategies* are normally considered when seeking to use these *six dynamic leverage routes*, although these are not all available for buyers in all routes (Cox, 2014):

- *Rationalise Supplier Power Positions*
- *Optimise Design and Specification Leverage*
- *Optimise Demand Management Leverage*
- *Increase Competition and New Entry*
- *Minimise Risks of Post-Contractual Lock-In*
- *Reduce Information Asymmetry*
- *Increase Supplier Hold-Up and Dependency*
- *Joint Ventures*
- *Insourcing*

It should now be clear that when selecting strategic sourcing options ***The First Principle of Leverage*** applies. Namely, a buyer should seek all opportunities to use dynamic leverage to change the current power scenario to a more advantageous one. Once this has been achieved, or if no such opportunities for movement exist, only then should a buyer select the currently most appropriate static sourcing option(s) that is currently available in the most favourable power position they can manage from in order to achieve improvements in value for money (not just cost savings).

Using Technology to Reduce Information Asymmetry and Change the Balance of Power – Explaining the Causes of DM and G-Cloud Sourcing Improvement

Given this, it is now possible to explain why the *DM* and *G-Cloud* approach provides a much more effective strategy for delivering improvements in 'value for money' for some 'categories of supply' than the traditional aggregation and volume leverage approach. The first thing to recognise is that the aggregation and volume leverage strategy developed has a number of strengths but also considerable countervailing weaknesses.

The first major strength is that, if standardisation can occur across all buyer requirements for a particular category, then it may be possible to aggregate spend and increase the volumes that are available to offer suppliers. Unfortunately, set against this potential volume lever is the time and effort that must be expended in agreeing to standardisation (and policing compliance once a standard specification of requirement has been established).

It is clear, however, that the transaction costs that must be incurred in creating standardisation and aggregation across public bodies (and especially for services that are not standard generic parts) are immense. These also often add considerable costs to the process. Unfortunately, even if standardisation and aggregation can be achieved the volume required often has a deleterious impact on the types of suppliers capable of making bid lists.

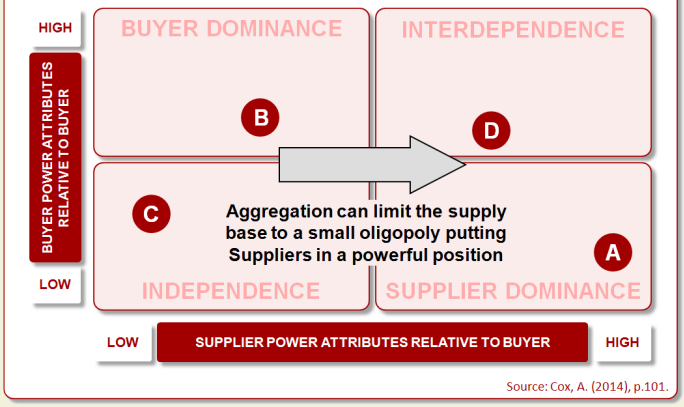
Given the scale of volume required it is often the case that these approaches ensure that only a few, larger suppliers are capable of making bid lists. The consequence of this is that, while there may be many better 'value for money' smaller suppliers (who may provide superior functionality and/or lower costs) who could take the work, they are precluded because they do not meet all of the volume and scale requirements.

As a result of this, aggregation and volume leverage strategies often artificially reduce the supply market and create information symmetry between buyers and suppliers. This latter problem arises because buyers are faced only with limited choice and do not have full awareness of the competencies or costs of alternative suppliers.

Figure 17 shows the dilemma with aggregation strategies. While they may offer volume leverage they can significantly reduce the number of suppliers available through long-term framework agreements, and lock buyers into suppliers who may fail to keep pace with new innovations in supply mar-

kets. The overall effect of this may be to create myopia and information asymmetry favouring the preferred suppliers (A or D). This is because buyers are not aware of the 'value for money' offerings from alternative or new entrant suppliers (such as B and C). In effect aggregation strategies (and especially in technologically innovatory supply markets) may shift power from *Leverage (Buyer Dominance)* (B) or *Market (Independence)* (C) scenarios to *Alliance (Interdependence)* (D) and/or *Dependency (Supplier Dominance)* (A) scenarios.

FIGURE 17: SUPPLIER DOMINANCE THROUGH AGGREGATION



It would appear that this is what can happen with some aggregation initiatives. Although they may initially have generated some headline costs savings they have often done so by reducing the functionality desired by customers and increased transaction costs within the sourcing process. What the *DM* and *G-Cloud* initiative has demonstrated is that a more effective approach is to link two sourcing strategies together to transform the power structure in favour of the buyer. The two strategies are *Internal Value and Process Optimisation* and *Supplier Selection* (but using on-line iterative, decremental bidding rather than regular market testing).

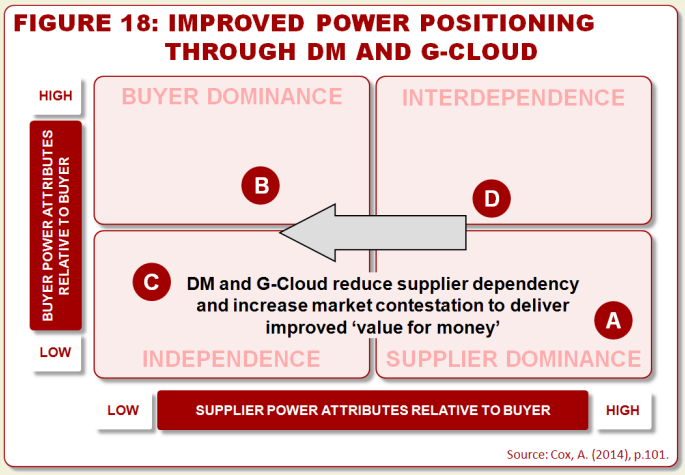
This conjunction has also been facilitated by using the following dynamic sourcing strategy levers:

- Rationalise Supplier Power Positions
- Increase Competition and New Entry
- Minimise Risks of Post-Contractual Lock-In
- Reduce Information Asymmetry

The result has been an increase in the number of suppliers, while simultaneously reducing the transaction costs of organising market bidding and reducing potential lock-in with framework suppliers. The significant reduction in information asymmetry has been generated by allowing a wider range of potential suppliers to bid in a transparent manner.

As Figure 18 demonstrates, the consequence of this approach has been to significantly augment the power of the buyer by moving the relationship from *Dependency (Supplier Dominance)* or *Alliance (Interdependence)* (C) into *Market (Independence)* (C) or *Leverage (Buyer Dominance)* (B) power positions. Effectively the strategy has increased market contestation and allowed buyers to source from more technically competent and/or lower cost suppliers.

FIGURE 18: IMPROVED POWER POSITIONING THROUGH DM AND G-CLOUD



There is little doubt that this approach has improved functionality for both the buyer and supplier, while also significantly reducing the costs of ownership. This is a clear example of *Right Sizing*, as opposed to the previous aggregation and volume leverage strategy of *Cheap Buying*. *Right Sizing* has occurred in this case because the buyers have adopted a sourcing strategy that uses dynamic levers to move from a less to a more congenial power position.

E. From Tactical Spend Management to Value Flow Management – What Next to Improve Public Sector Sourcing?

This analysis shows that relying solely on aggregation and volume leverage is unlikely to be the most effective strategy for all public buying in the future, although it can be a most effective strategy in certain power and leverage circumstances, as historic CCS frameworks have shown when applied in appropriate areas. This is normally in *Buyer Dominance (Leverage)* power positions, when there are standardised requirements, and the award of high and regular volumes to one, or only a few, suppliers, enables them to use economies of scale/scope to produce lower unit costs, that can be passed on to the buyer.

As the case examples above demonstrate, for goods and/or services where there are no or few cost benefits from more effective physical capacity utilisation aggregation and volume leverage is not always the most appropriate sourcing strategy. As a result, the primary issue that has to be addressed by public sector buyers (as it is for private sector buyers) is what is the most appropriate sourcing strategy to pursue given a particular power circumstance?

Obviously, while we expect to see how widely iterative, on-line decremental bidding can be used within the whole of the UK public sector using the *DM* and *G-Cloud* approach, it is already clear that this is not likely to be the most appro-

priate sourcing approach for all public sector sourcing. Where there are power scenarios of *Dependency* and *Alliance*, with few dynamic levers to move power positions into more congenial leverage positions (such as *Market* or *Leverage*) it is inevitable that on-line bidding strategies are unlikely to be viable and more collaborative ways of working will be required (see the discussion on the appropriateness of collaborative approaches in Cox (2014) and IIAPS White Paper 15/2).

Given this it is to be hoped that public sector buyers will begin to adopt the *Power Positioning* and *Sourcing Portfolio Analysis* techniques that provide a more sophisticated understanding of the range of sourcing options available for buyers under different power scenarios. On top of this it will be essential for the public sector to address in the future the major problem with current procurement practice, and one that is also evident in the private sector. This is the continuing attachment to *Tactical Spend Management* rather than *Strategic Value Flow Management* thinking.

Within the Procurement and Supply Management profession there are two broad schools of thinking about *what is meant by category management and strategic sourcing as a process and methodology*; *who should be involved in the process*; and, *how does an individual or organisation develop and then demonstrate competence*.

1. Tactical Spend Management
In this school the following approach is taken to competence development:

i. *What is meant by category management and strategic sourcing as a process and methodology?*
In this approach category management and strategic sourcing is normally seen as a 'project' rather than a continuous process. The process normally involves segmenting categories by the size of spend (i.e. Spend Cube analysis) and then the creation of 'category project teams' to deliver cost savings. The process is very much about Procurement (pre-contractual phases) rather than pre- and post-contractual phases. This is because the goal is *cost-down savings only in categories of spend*. The methodologies used tend to be the traditional Kraljic, and Porter ways of thinking.

ii. *Who should be involved in the process?*
Since this is really a project rather than a process, only lip service is normally given to the need for cross-functionality. In practice these are Procurement-led projects that are trying to win cross-functional support for Procurement Function KPIs based on cost-down savings targets. In practice this means the Function is trying to drive cost savings in the organisation using traditional cost leverage strategies. Stakeholder engagement is about winning support for Procurement *cost-down KPIs*.

iii. *How does an individual or organisation develop and then demonstrate competence?*
Most competence development involves a mixture of on-the-job training around a category management and strategic sourcing process or project methodology, and/or professional certification with one of the major awarding Institutes in Europe or the USA and Canada. Increasingly there are managers who have had prior training on University degree courses at undergraduate and/or postgraduate levels, although most, if not all, of the training is given to Procurement managers within the Function and without any cross-functional participation.

At best, the attainment of competence is demonstrated by the passing of examined courses at Universities or by Institutes providing examined certification, but mostly by achieving cost savings on specific *category of spend* projects. At worst, there is no test of attainment for managers other than attendance at a training course (maybe for 1-3 days) without any post-course assessment of competencies attained.

2. Strategic Value Flow Management
In this school the following approach is taken to competence development:

i. *What is meant by category management and strategic sourcing as a process and methodology?*
In this approach category management and strategic sourcing is a continuous 8-Step end-to-end process covering all of the pre- and post-contractual phases, and never a 'project'. The process is always managed cross-functionally within the business and, depending on the *criticality* of the *category of supply* being managed to the strategy of the organisation, Procurement may, or may not, have the leading role. The KPIs for all *categories of supply* are *value for money outcomes* rather than *cost-down targets*. The methodologies used focus on *Criticality Analysis*, *Power Positioning* and *Value Flow Management* ways of thinking.

ii. *Who should be involved in the process?*
Since this is a continuous process driving *value for money* KPIs in all *categories of supply*, rather than a *cost-down* project, the pre- and post-contractual phases must be managed cross-functionally. In practice, since *categories of supply* are more or less critical for an organisation, there will always need to be different 'levels of analysis' for managing particular types of categories. In some categories Procurement may take the lead, in others they may jointly lead, but in more strategic categories they may play only a very junior, supportive, role. In all *categories of supply* engagement of stakeholders is always cross-functional, and all managers involved post-contractually must also be involved in the pre-contractual phases of sourcing strategy development.

iii. *How does an individual or organisation develop and then demonstrate competence?*
Partial competence development can occur through a mixture of traditional on-the-job Procurement training, and/or professional certification with one of the major awarding Institutes in Europe or the USA and Canada (as above). As there are also managers who have had prior training on University degree courses at undergraduate and/or postgraduate levels, any training they may have had in lean/agile ways of working will provide valuable pre-training in this respect.

Despite this, given the historic attachment of most Procurement managers to traditional ways of thinking associated with cost-down targets and Kraljic and Porter ways of thinking, a considerable amount of re-training is normally necessary in the principles of *value for money*, *Criticality Analysis*, *Power Positioning* and *Value Flow Management*. It goes without saying that all of this training must be undertaken cross-functionally because this is not a *cost-down* savings exercise. Such training programmes cannot be undertaken in 1-3 days, and certainly not if they are explaining how to implement a new end-to-end process, and all of the new tools that will be used to manage it.

The attainment of competence is demonstrated in this approach, not by the award of a University degree or traditional Institute examined certification, but by 'doing'. IIAPS believes that individuals must demonstrate competence by showing that they can actually operationalise all (over 100 were identified above) of the activities and tasks in a world-class category management and strategic sourcing process, as well as achieve demonstrable *value for money* outcomes for a particular *category of supply* in the 'real world'.

This means that competence development must involve course-based training in the advanced principles outlined above, but it must primarily be based on the ability of managers to operationalise what they have learnt in practice. We call this a 'no hiding place' approach to competence development. Attendance at a course does not 'cut the mustard'; only delivery of a world-class category strategy, with validated *value for money* benefits being delivered, will do.

It will come as no surprise that IIAPS believes that most of the organisations seeking assistance with competence development in Procurement and Supply Management are currently locked into *Tactical Spend Management* approaches. In our view this can only result in sub-optimal ways of thinking, with sub-optimal ways of developing competence.

IIAPS established its *PSCM Index* (organisational/process) and *ICA Index* (individual competence) benchmarking tools in 2010 (see our *Corporate Services Brochure* and our *Beyond Kraljic*, *World-Class or Best-in-Class* and *Improving Procurement Competence* White Papers) to address this problem. The idea then was that, if CPOs and Commercial Directors understood where their organisation and staff are in relation to world-class best practice, this would provide them with the ability to begin their transformation journey.

The transformation journey requires the rejection of a focus on 'categories of spend' in favour of a focus on 'categories of supply'. This thinking also requires the creation of a cross-functional category management and strategic sourcing process that focuses on 'strategic, value for money trade-offs', not just 'tactical, cost savings' as the basis of engagement with the organisation (see IIAPS White Paper 15/1).

Unfortunately current thinking within public sector sourcing still appears to be primarily focused, as it is in the private sector, on *Tactical Spend Management* rather than *Strategic Value Flow Management* thinking. If this is so then it would appear that current public procurement practice needs considerable *Right Sizing*. In our view this can only be achieved effectively if *Power Positioning* and *Sourcing Portfolio Analysis* techniques are adopted.

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Further Reading

Relevant 2015 IIAPS Blogs (www.iiaps.org/blog):

1. 12 Causes of Sub-Optimal Category Management & Strategic Sourcing
2. Improving Category Management & Strategic Sourcing
3. The Problem with Cross-Functional Involvement & Buy-In
4. Tactical Solutions to the Lack of Cross-Functional Involvement & Buy-In
5. Value Flow Management: Value-Driven Category Management & Strategic Sourcing

Relevant IIAPS White Papers (www.iiaps.org):

1. Beyond Kraljic (IIAPS White Paper 2010/1)
2. World-Class or Best-in-Class (IIAPS White Paper 2010/2)
3. The QV Way (IIAPS White Paper 2012/1)
4. Improving Procurement Competence, (IIAPS White Paper 2014/1)
5. Developing Competence in Procurement & Supply: The Two Options of Tactical Spend Management or Strategic Value Flow Management (IIAPS White Paper 2015/1)
6. From Spend Management to Supply Management - Improving Category Management & Strategic Sourcing (IIAPS White Paper 2015/2)

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