Procurement and the Department of Administration

February 12, 2013

What is Procurement and Why Does it Matter?

- 3 primary components
  - Materials Management Office (MMO)
  - IT Management Office (ITMO)
  - State Engineer

- Direct procurement / management of major contracts

- Delegation authority to other agencies / universities

- Establishment of statewide contracts for multi-agency use

- Procurement doesn't stand alone
  - Mechanism through which you make progress in other areas possible
  - Ex.: Statewide IT plan
  - Ex.: Comprehensive real estate strategy

What's Not Working Today?

- Lack of an enterprise-wide focus or strategy

- Room to improve relationships with agencies
  - Billing rates not connected to cost or value
  - Breakdown in trust has a price: "Leakage"

- Entire debate has been over corruption fears
  - What about processing times, service levels, value, quality, savings?
  - There have been integrity problems with the current approach too
  - We've never won a National Association of State Procurement Officers (NASPO) award since they started in 1985 (up to 6 awards/year)

- Missed opportunities
  - Strategic Sourcing Initiative
  - Expansion of cooperative purchasing with locals, schools, etc.
  - Piggybacking

What is Strategic Sourcing?

- Assess spending
  - Inventory vendors and contracts for each good/service
  - Review/compare current pricing

- Evaluate market conditions
  - Competitiveness, by good/service
  - Prioritize opportunities for savings: "The Scatterplot"

- Aggregate spending
  - Proceed to market with new strategy
  - Focus on "addressable spend"…proceed in waves

- Take advantage of new tools and technology
  - Supplier Relationship Management software
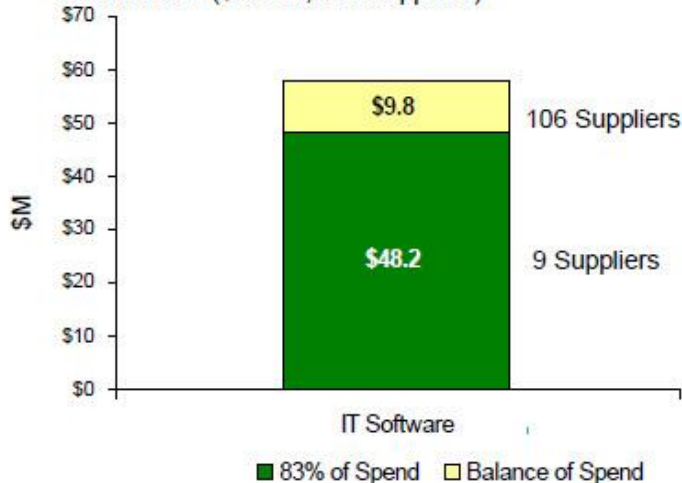 - Online reverse auctions

Example: Ohio
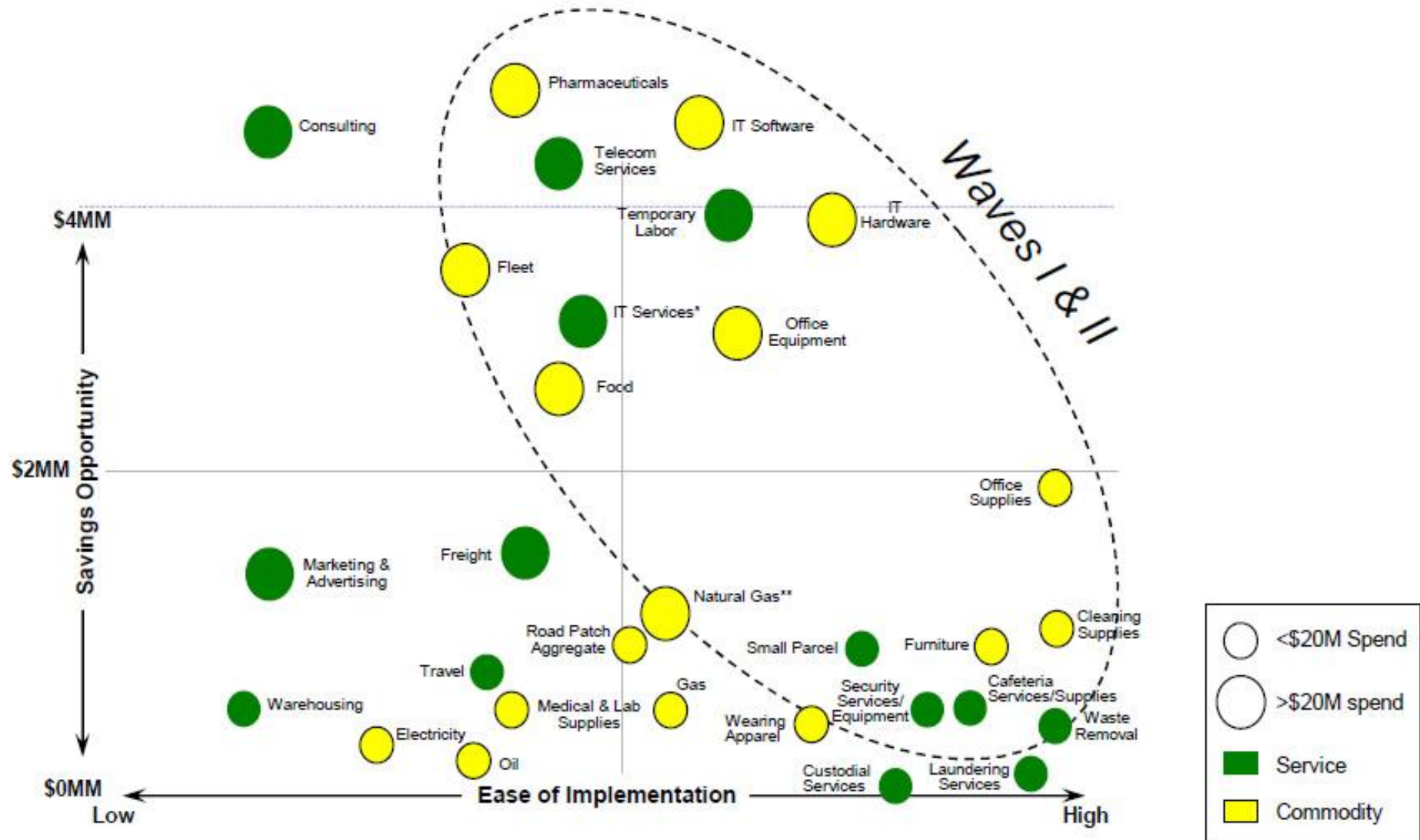
Example: Ohio

IT Software has $58.0M in addressable spend with an estimated savings range of $5.2M (9%) to $8.7M (15%). There are 115 suppliers who provide IT Software to 68 different state agencies.

Annual Opportunity Sizing

Annual Spend	$58.0M[1]
Addressable Spend	$58.0M
Opportunity (9% - 15%)	$5.2M - $8.7M
Timing	~ 6 months

Supplier Concentration[1]
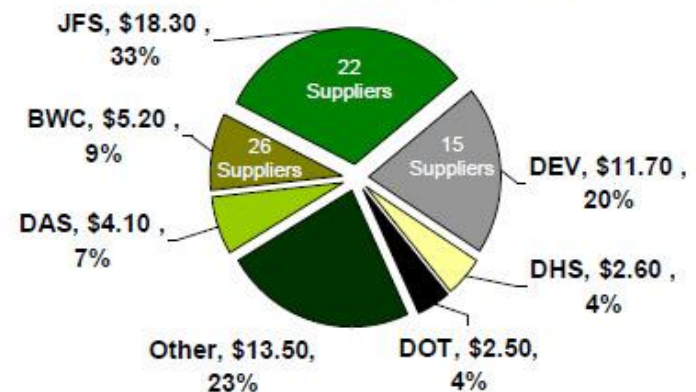
IT Software - ($58.0M, 115 Suppliers)

- $9.8 — 106 Suppliers
- $48.2 — 9 Suppliers

■ 83% of Spend   □ Balance of Spend

(1) Source: Central Accounting System (CAS)
(2) Source: FY07 Term Contract Expenditures
(3) Source: FY07 P-Card Report from OBM

Commodity Profile

- JFS, DEV, and BWC are the largest users and represent 62% of the total addressable spend
- There are 115 suppliers within the IT software category
  - Top 10 suppliers represent 85% of the total addressable spend
  - 106 suppliers consist of over $9.8M in spend
- MBE/EDGE total spend: $1.1M made up of 1 supplier[2]
- P-Card FY07 spend is $0.2M[3]

- FY07 Spend ($M) by Agency -

- JFS, $18.30, 33% — 22 Suppliers
- BWC, $5.20, 9% — 26 Suppliers
- DAS, $4.10, 7%
- DEV, $11.70, 20% — 15 Suppliers
- DHS, $2.60, 4%
- DOT, $2.50, 4%
- Other, $13.50, 23%

Example: Ohio

The total amount of addressable spend is $717.3M with annual estimated savings ranging from a low of $42.9M (6.0%) to a high of $79.9 (11.1%).

Category	Addressable Spend ($M)	Low	High
Professional (Consulting, Temp. Labor, 3rd Party Admin.)	$ 192.55	$ 5.90	$ 14.63
IT (Hardware, Software, Services)	$ 125.98	$ 10.80	$ 17.00
Pharmaceuticals (Pharmaceuticals)	$ 77.53	$ 7.75	$ 13.18
Utilities (Electricity, Natural Gas)	$ 49.16	$ 0.33	$ 2.30
Telecom (Telecom Services)	$ 43.02	$ 3.44	$ 6.02
Fleet (Fleet)	$ 34.58	$ 2.77	$ 4.15
Office Services (Office Supplies, Furniture, Office Equipment)	$ 34.50	$ 4.30	$ 6.81
Logistics (Freight, Warehousing, Small Parcel)	$ 27.79	$ 1.62	$ 3.59
Advertising and Marketing (Advertising, Marketing Services)	$ 27.65	$ 1.11	$ 2.21
Food (Food)	$ 25.55	$ 2.04	$ 3.06
Fuel (Gas, Oil)	$ 17.56	$ 0.40	$ 1.11
Roadway (Road Patch / Aggregate)	$ 14.06	$ 0.28	$ 1.40
Travel (Airfare, Hotel, Car)	$ 10.37	$ 0.30	$0.90
Other (Cafeteria Services, Cleaning Supplies, Security Services, etc.)	$ 37.03	$ 1.87	$ 3.52
Totals	**$ 717.3M**	**$ 42.9M**	**$ 79.9M**
Two Year Savings		**$ 85.8M**	**$ 159.8M**

Example: North Carolina
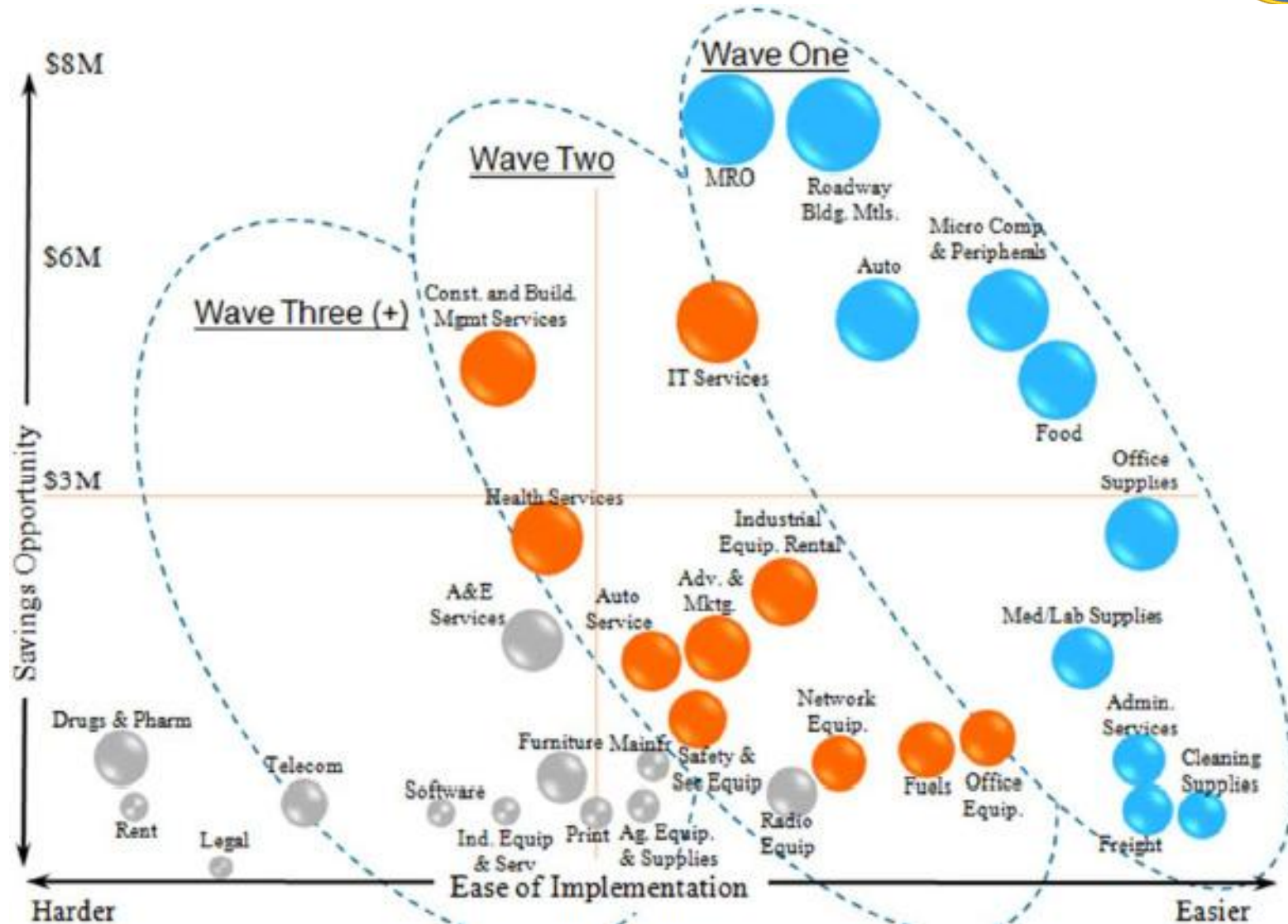
Example: North Carolina

Opportunity Sizing

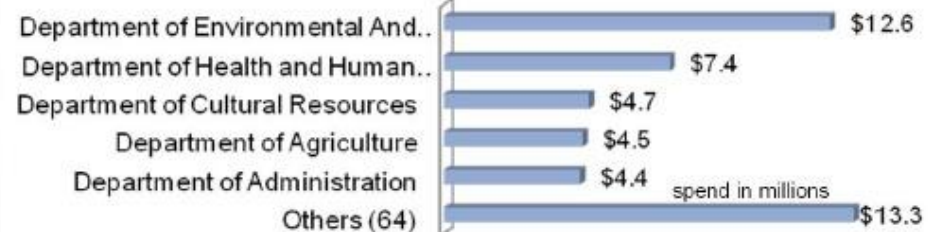|		
Total Spend – FY '08 – '09 (annualized)		$68.9M
Total Spend – FY '10		$46.9M
Est. Addressable Spend	60%	$28.2M
Savings Opportunity	5% - 9%	$1.4M – 2.5M
Estimated Sourcing Duration		6 Months

Opportunity Assessment

- Current market conditions are favorable to seek competitive pricing:
    - Intense market competition, strong buyer power, and weak demand
- Spend for Architecture and Engineering is fragmented
    - Top 80% of spend is with 50 vendors
    - 557 total vendors
- 59% of the category spend data is direct payments
- Engineering Services commands the majority of the spend at 63% ($29.5M)
- Lack of spending with leading industry vendors indicates opportunity
- Aggregate A&E services (cross-agency and cross-functional) to achieve the highest value (high service levels at low cost) resulting in Master Service Agreements with preferred suppliers
    - Leverage the current market conditions to achieve lower labor rates, renegotiate pricing
    - Utilize e-Auctions during strategic sourcing process

Top Vendors (FY '10)

Top 10 Vendors	$M	% Total	Cum %
THE FREELON GROUP INC	4.80	10%	10%
PEARCE BRINKLEY CEASE & LEE PA	2.50	5%	16%
O'BRIEN/ATKINS ASSOC PA	2.35	5%	21%
PERRY BARTSCH JR CONTRUCTION	2.15	5%	25%
DAVID R POLSTON ARCHITECT	1.76	4%	29%
BJAC	1.68	4%	32%
SCHENKEL SHULTZ INCORPORATED	1.44	3%	36%
HEATON CONSTRUCTION	1.44	3%	39%
CAROLINA ENVIRONMENTAL CONTRACTING, INC.	1.15	2%	41%
DUDA PAINE ARCHITECHTS LLP	1.04	2%	43%
Others (547)	26.62	57%	100%
Total	46.93	100%	100%

Spend by Entity (FY '10)

	spend in millions
Department of Environmental And..	$12.6
Department of Health and Human..	$7.4
Department of Cultural Resources	$4.7
Department of Agriculture	$4.5
Department of Administration	$4.4
Others (64)	$13.3

Vendor Fragmentation (FY '10)

% Spend	$ Spend (M)	# Vendors
Top 80%:	$37.5	50
Last 20%:	$9.6	507

Example: North Carolina

Industry Summary

Industry Trends:
- Architecture and Engineering services are part of a larger industry category , "Pre-Construction Services", where similar sourcing strategies can be employed across Surveying, Due Diligence, Environment and Ecological Studies, and other Design-related activities.
- Intense competition between large supplier base of architects and engineers – indicates buyer opportunity to foster competition and renegotiate current contracts
  - Despite some large players, the engineering industry is highly fragmented: U.S. has ~40,000 non-residential construction and ~ 50,000 heavy construction/civil engineering companies
  - ~80% of companies have less than 20 employees (Source: Datamonitor)
  - 50 largest firms account for 35% of total industry revenue (Source: FirstResearch 2009)
  - Architecture industry is fragmented as well; the top 50 vendors make up less than 20% of the total revenue (Source: Hoovers)
- Strong buying power of government entities because industry demand for pre-construction services is highly driven by construction needs of large companies and governments
- High unemployment (9.1% in NC as of 10/2010), lower employment costs, and low demand for construction projects

Key Industry Vendors:

- Architecture: AECOM Technology, HDR, Heery International, Gensler, and HKS

- Engineering: Jacobs Engineering Group, URS Corp, Fluor, and Bechtel

Observations

- 59% of the category spend data is direct payments to vendors
  - During agency discussions, purchasing agents had difficulty verifying this spend due to lack of visibility
- $20.3M (43%) falls under "Building Design Contracts" commodity code
- NC does not have significant spend with industry major vendors
- Professional Services Management within DOT Technical Services handles A&E services contracting
  - Further research required to determine whether term contracts are being utilized by DOT
- Further information required to:
  - Analyze procurement process – *existing requirements for vendors, qualification process, work forecasting, etc.*
  - Clarify estimated future spend on Engineering Services

Example: North Carolina

Recommended Sourcing Approach

- A leading practice is to source pre-construction services at an aggregate level across the organization resulting in large multi-year agreements
  - Standardize job titles to create a standardized
  - Establish/re-negotiate rate cards with preferred supplier relationships
  - Standardize/rationalize specifications/requirements
- Proactive supplier management program is key success factor to maintaining the lowest total cost of ownership
  - Negotiate strong SLAs and penalties for non-performance

Additional Information

- Sample line item spend data includes project design fees, stream restoration, building renovations.
- Minimum contracted spend as identified in E-Procurement (IT convenience, agency, and state term contracts): $1.2M (2.6%)
- State term contracts identified for this category during analysis: N/A

Does This Really Save Money?

- Georgia: Procurement Transformation Initiative ($135 million)

- Florida: MyFloridaMarketPlace
  - $233 million in 32 agencies, through September 2011
  - Also saved $420 million through a 3-month mass renegotiation in 2008 (Pew)

- Virginia: eVA ($280 million since 2001) – single statewide portal

- Minnesota: Strategic Sourcing ($210 million through 2011)

- Pennsylvania: Strategic Sourcing Initiative
  - Over $260 million in first four years (through 2007)
  - Independently validated by opponents (Legislative Budget & Finance Cmte)

- Texas
  - Recent report identified potential savings of $252M-539M through changes in strategic sourcing, delegation authority, and organizational structure.

So what about S.22?

Procurement Oversight Board

- Concept and application have major flaws…

- A group that meets quarterly can't oversee anything
  - Debilitating to those services
  - No meaningful oversight or control
  - Completely unmanageable

- No draft has ever explained what the board would actually do

- Let's not forget that each new "set of eyes" is connected to another set of hands
  - Bringing more people in means more "oversight" but also more risk

- There are other ways to address any specific concerns over integrity issues…let's focus on effectiveness and outcomes, too

More than this?

- Substantive committees
- New Legislative Oversight process
- Legislative Audit Council
- Inspector General
- Protest process – Procurement Review Panel, Circuit Court
- Federal granting agency review
- Single Audit
- New reporting language
- Prosecutorial authorities
- Blogosphere / FOIA
- Improved management / accountability
- Existing statutes and regulations

Can the Executive Branch Be Trusted?

- According to the National Association of State Chief Administrators (NASCA), the Department of Administration is responsible for procurement **in at least 45 states**
    - Most of the others have some or all of procurement in another executive agency that's called something else (Department of General Services, etc.)
    - **Across the country, procurement appears in more Departments of Administration than any other function**

- We can't remove the human element from procurement
    - Creating another board isn't the answer
    - Processes, controls, and the right people are

Questions?