

# REFORMING PUBLIC PROCUREMENT

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## About the author

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## RECOMMENDATIONS

- 1. Strengthen the drive to expand e-procurement beyond ICT contracts, aim to match the EU's ambition to make it mandatory by 2018. Digitalisation of the process has shown itself to be by far the most effective way to make procurement more efficient, and should therefore be a number one priority.**
- 2. As indicated by the Commission's Public Procurement Indicators, partitioning contracts and reducing the UK's concentration of procurement spend in awards worth €100 million or over should be a key part of a strategy based on opening up the markets to new entrants. The sheer extent of the UK's derivation from European averages is at the very least food for thought for UK procurement professionals and more research into the causes behind the patterns would be very useful.**
- 3. There should be a genuine move towards agile procurement – i.e. open-ended contracts which make room for adjustments should the circumstances change - where appropriate, but with strengthened emphasis on skills and contract management. The principle should be that the more flexibility and discretion is afforded to a contracting authority, the stronger the performance monitoring mechanisms incorporated into the contract, for example, regular disclosure of relevant data to be compared against performance benchmarks feeding into a system of rewards and sanctions, as far as the circumstances will allow.**
- 4. Involve Small and Medium-sized Enterprises (SMEs) to a greater degree in order to reap the benefits from e-procurement and agile, but be aware that greater SME participation should not be an end in itself. There will be numerous instances where increasing competition will not be possible, and the focus there should be on strengthening oversight on large suppliers through emphasis on regular reporting, benchmarking of performance and a strong incentive structure to act as a safeguard against lack of competition.**
- 5. Weaknesses in the ability of the civil service and the contracting authorities to effectively monitor and manage multi-million pound contracts held with large suppliers is a serious impediment to efficient public procurement. There is no question that recruitment, retention and the development of sector-specialist expertise is a necessary component of a good sourcing strategy. However, it may be the case that the public sector is simply unable to compete with the private sector for top commercial expertise. For that reason, strategies based on opening up the process to competition may be preferable to skills-intensive strategies based on managing large suppliers.**
- 6. The legal regime governing public procurement, originating mainly from EU law, has improved since 2015 and is largely geared towards the**

**principles of openness and competition. Given one of the problems in procurement is often lack of a big enough pool of capable suppliers, opening up the domestic market to foreign competition as much as possible (as well as resisting any attempt at moving towards 'buying British' post-Brexit) will be an opportunity to address this problem.**

## EXECUTIVE SUMMARY

- The dispersed nature of public procurement means that there is no accurate data being collected regularly, making it difficult to give a relatively accurate image of the total public procurement spend in the UK in the past decade. According to some estimates from 2013 carried out by the National Audit Office (NAO) on the basis of Cabinet Office monthly data returns from departments (not publically available) total public sector spending on procurement was approximately £187 billion.<sup>1</sup> Estimates for 2013-14 by the House of Commons Library put the figure at £242 billion, a third of total public spending for that year.<sup>2</sup> The European Commission's own estimates indicate that the 2015 UK procurement spend was €349.7 billion (£201.4 billion).<sup>3</sup> The OECD estimates that their members spend on average 12 per cent of GDP on public procurement.<sup>4</sup> On the latest available data (2015) the UK spends 13.7 per cent of GDP, which for 2015 was the OECD median, whilst the mean was 13.3.<sup>5</sup> The inconsistencies in the methods and timings of collecting this data means that it is only possible to give a rough indication.
- A key tenet of public procurement policy since 2010 was the opening up the public procurement markets to new entrants, especially SMEs. Since the beginnings of outsourcing and contracting out which began in the 1980s, we have witnessed two worrying trends: firstly, a consolidation of the increasingly uncompetitive market in the hands of a small group of large outsourcing companies,<sup>6</sup> and secondly, what seems a scandal and after scandal; failure after failure<sup>7</sup> – all undermining public trust in the fact that free markets can deliver better public services.
- To address this problem, a number of measures were introduced, such as the scrapping of the Pre-Qualification Questionnaire (PQQ), 'comply or explain' requirements to partition contracts, and expansion of e-procurement platforms in order to make the bidding and engagement process easier and less burdensome. While it is clear that e-procurement had considerable success, it appears that partitioning large contracts is still not as common as in other European countries.
- The key tension in this area is between the need for information, and the cost of it. In order to operate effectively, markets need low transaction and informational costs, as

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<sup>1</sup> National Audit Office, *Managing government suppliers*, 12 November 2013, 6

<sup>2</sup> Lorna Booth, *Public Procurement*, Briefing Paper No 6029, 3 July 2015, 4

<sup>3</sup> European Commission, *Public Procurement Indicators 2014 and 2015*, 8, available at <http://ec.europa.eu/DocsRoom/documents/20679> (last accessed 14/08/2017)

<sup>4</sup> OECD, <http://www.oecd.org/gov/public-procurement/>

<sup>5</sup> Australia, Japan, New Zealand and Turkey did not submit figures for 2015 and so are excluded from the sample

<sup>6</sup> According to the Chair of the Public Accounts Committee, Margaret Hodge, "...Government must guard against quasi-monopoly suppliers becoming too important to fail, and encourage competition through, for example, splitting up contracts to encourage SMEs to bid for work.", see McCann, K, 'Outsourcing giants targeted by MPs' report' *City AM*, 10 December 2014, available at <http://www.cityam.com/1418176776/outsourcing-giants-targeted-mps-report> (last accessed 16/08/2017)

<sup>7</sup> Hazelhurst, J, 'Murdering scumbags: How did outsourcing get into this mess?' *Management Today*, 10 November 2015, available at <http://www.managementtoday.co.uk/murdering-scumbags-outsourcing-mess/article/1286576> (last accessed 16/08/2017)

only informed agents will be able to make the most efficient decisions. In public procurement, information is not always easily available. Asymmetries in expertise, incentives to misrepresent and political impetus to award contracts to domestic suppliers are just some of the reasons why public procurement markets experience failures. Burdensome administrative procedures such as the PQQ or EU requirements to publish invitations to tender intend to overcome them. But they do have a cost in the form of locking out some otherwise viable suppliers who cannot afford the increased cost of engagement. Whether efficiency gains achieved as a result outstrip the costs incurred remains an empirical question into which more research is needed, but there is evidence to suggest that strategies involving expansion of e-procurement are particularly effective due to their low cost.

- It is clear that SMEs are enjoying increased participation in the public procurement market since the drive towards opening up the markets began by the Coalition government of 2010-2015. The government has reached and exceeded its target of 25 per cent of procurement spending to reach SMEs by 2015 by 2 per cent. In 2014-15, an estimated 27 per cent – or £4.9 billion – has reached SMEs. However, 60 per cent of total government spending with SMEs is classified as ‘Indirect’, meaning as part of a supply chain to a larger contractor. Questions remain as to the efficacy and even equity of such arrangements, in the light of allegations of mistreatment.
- The proportion of ‘direct’ spending with SMEs has increased somewhat since 2009 from 6.5 to 10.9 per cent. Whether or not this strategy has been successful at achieving greater value for money as defined by the treasury is difficult to measure because there are simply too many possible factors responsible for the amount of procurement spend varying (such as fluctuations in demand or commodity prices) and in many instances even ascertaining that amount is not possible. However, according to the latest data available on procurement spending with major suppliers only, in 2012-13 Capita, G4S and Serco collectively received £3.6 billion from UK public sector contracts. It is not possible to express this data in a time series as these figures are not compiled regularly.
- Individual case studies carried out by the NAO and the Public Accounts Committee (PAC) as well as wider literature on the topic repeatedly point to the issue of post-tender contract management as a key source of failure of an otherwise viable contract. Lack of performance monitoring, for example, has in the past led to situations where a supplier repeatedly overcharged for an inadequate service, highlighting the need for consistent data gathering and performance supervision. Further, the performance data should be fed into a clear structure of rewards and penalties which should work towards aligning the incentives of the supplier and the contracting authority.
- These measures will require significant changes in the way the public sector hires, treats and rewards commercial staff charged with administering the system. High levels of staff turnover in this area and an inability to tap into the relevant expertise quickly and efficiently (due to the dispersed nature of the purchasing process) point to a possible need for more generous reward structures for the highest-performing procurement professionals, and a more coordinated approach to acquiring and

retaining sector expertise through keeping procurement staff engaged in a single sector.

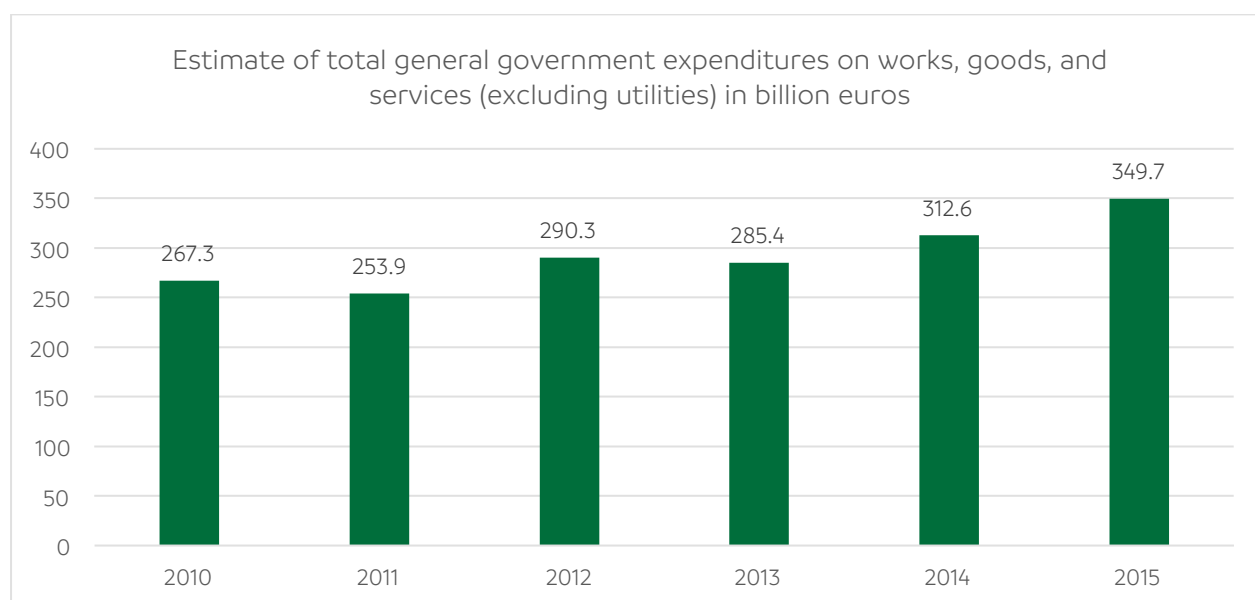
- At present, there is compelling evidence in favour of a strategy based on continuous opening up of the market to as many viable providers as possible through measures such as contract partitioning requirements, setting limits on the maximum value of contracts, continuous reduction of administrative burdens associated with submitting bids and making the decision-making process more flexible in order to allow SMEs – which often do not meet turnover requirements – to make a fair case.
- The importance of post-tender contract management cannot be overstated. Although a move to a more competitive system should address some of the challenges presented by managing large suppliers, issues such as lack of performance monitoring will be no less important in an environment where a smooth flow of accurate information is vital.
- The 2015 EU reforms, implemented by the Public Contracts Regulations 2015, are a positive step towards greater competition and openness in public procurement. In particular, the introduction of 'Innovation Partnerships' as well as greater scope for changing the parameters of a contract after a deal has been agreed all contribute towards making the system more flexible.

## Introduction

Though the exact figure is unknown, procurement of goods and services is estimated to account for over a third of government spending.<sup>8</sup> In 2015-16, public bodies spent approximately £268.3 billion acquiring assets, inventories and services deemed necessary for their functioning – everything from office equipment in No. 10 Downing Street to *HMS Forth*, a 1,600-tonne warship completed last year for the Royal Navy.

Though it is never a significant electoral issue, the sheer scale of resources involved means that the state of public procurement deserves close attention. The TaxPayers' Alliance has previously highlighted numerous inefficiencies in the way that the Government purchases goods and services – from a troubled multi-million contract for managing the tax credits framework,<sup>9</sup> to the way the NHS buys basic items such as bandages and syringes.<sup>10</sup> Tackling the causes of these problems has the potential to make substantial savings in the public budget.

This paper will firstly outline the key reasons for failures in public procurement markets, before going on to evaluate a number of proposals for reform.



Source: European Commission, *Public Procurement Indicators 2014 and 2015*

### I. Key sources of failure in public procurement markets

Basic economics tells us that it is far cheaper to buy your staplers and warships from someone who makes lots of them. Their technical knowledge and ability to leverage economies of scale when purchasing raw materials means they are able to achieve infinitely

<sup>8</sup> 35.6 per cent of the Total Managed Expenditure for 2015/2016, see HM Treasury, *Public Expenditure: Statistical Analysis 2016*, 19

<sup>9</sup> TaxPayers' Alliance, *Clause and effect – how to prevent government contracts from going wrong*, 17 January 2017, available at [http://www.taxpayersalliance.com/clause\\_and\\_effect](http://www.taxpayersalliance.com/clause_and_effect) (last accessed 08/07/2017)

<sup>10</sup> TaxPayers' Alliance, *Transparency would help solve the £500m a year wasted on inefficient NHS consumables purchasing*, 20 May 2011, available at [http://www.taxpayersalliance.com/transparency\\_would\\_help\\_solve\\_the\\_500m\\_a\\_year\\_wasted\\_on\\_inefficient\\_nhs\\_consumables\\_purchasing](http://www.taxpayersalliance.com/transparency_would_help_solve_the_500m_a_year_wasted_on_inefficient_nhs_consumables_purchasing) (last accessed 08/07/2017)



better marginal costs than someone who has never made either.<sup>11</sup> This phenomenon – known as comparative advantage – is the foundation of commerce and markets.

Whereas private enterprise has a simple, easily measurable objective of profit, a government has a nuanced, difficult to measure objective of fulfilling its electoral mandate and needs to balance competing priorities. The former is staffed by people appointed for their commercial skills, the latter is made up of a wide range of talents in recognition of the fact that value for money is just one of government's aims. The former is able to make swift executive decisions, the latter engages in lengthy processes.

In essence, the public sector is akin to a corporation which despite vast reserves of wealth and stable cash-flow year on year is nevertheless administered by staff not used to thinking in terms of profit and loss, led by directors elected not always on merit but on popularity, while its shareholders struggle to make up their minds about what it is that they want.

As a result, markets for public procurement frequently run into trouble. There are a number of reasons why this happens:

- 1. Scale of demand advantages large suppliers** – the sheer scale of the contracts public bodies are able to offer means fewer suppliers are able to meet the demands. Additionally, large suppliers are able to leverage economies of scale and bring down marginal costs to levels smaller suppliers are unable to match.
- 2. Regulating for market integrity is costly** – the procurement process is extremely bureaucratic because a market is created in conditions where competition is difficult. Measures such as extensive pre-tender questionnaires regarding capability are designed to help the procurers make the best decision possible about which supplier has submitted the best bid. So it is important to find a way for them to convey this information in a less costly way.
- 3. Insufficient resources dedicated to monitoring contract performance** – analysis by Reform suggests that most of the effort and resources are dedicated to the middle-stages of the process, when it should be diverted to the pre-tender market engagement and post-tender contract management.<sup>12</sup>
- 4. Civil servants are not businesspeople** – this is not a problem *per se*, but it does create a situation where in many places there is a shortage of commercial skills necessary to effectively negotiate contracts, monitor their performance, understand the language and mindset of the contractors as well as the wider commercial objectives of their department.

Markets for public procurement are not homogenous. There is no one-size-fits-all solution which is guaranteed to work in all cases. However, the above provide a starting point for elucidating the trade-offs and tensions present in this area.

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<sup>11</sup> For a classic exposition of this concept see David Ricardo, '*Principles of Political Economy and Taxation*', Chapter VII

<sup>12</sup> Hitchcock, A and Mosseri-Marlio, W, Cloud 9: the future of public procurement (Reform: March 2016) 26, available at <http://www.reform.uk/publication/cloud-9-the-future-of-public-procurement/> (last accessed 04/08/2017)

There are essentially two main kinds of approaches to improving public procurement: firstly, by increasing competition through widening the supplier base, and secondly, by sacrificing competition in order to negotiate better deals with established suppliers and placing more emphasis on monitoring contract performance. The choice of approach will largely depend on:

- How commoditised/bespoke the procurement objectives are
- Ability to accurately monitor the contractor's performance
- Number of capable providers
- Reliability of the information submitted by the bidder

## II. Widening the supplier base

Since the turn towards contracting out in the 1980s, the UK public procurement market became naturally dominated by a small number of large providers such as G4S, Capita and Serco.<sup>13</sup> This is largely because the scale of demand for goods and services means that only the largest operators are – at least in theory – able to offer a price adequate to the Exchequer's bulk-buying potential and have the requisite scale to fulfil such large contracts in their entirety. Relying on this potential to drive down costs – which may be labelled the 'Aggregate & Volume Leverage' strategy<sup>14</sup> – became the established philosophy of purchasing in Whitehall.

Such approach to procurement is firmly rooted in a traditional analysis of buyer-seller relationships based on the principle of comparative advantage outlined above. In the context of managing supply chains, Michael Porter – whose book *Competitive Strategy* has been labelled 'a bible of business thinkers in the late 1980s'<sup>15</sup> with Porter himself referred to as 'the doyen of living management gurus'<sup>16</sup> – proposed several strategies for buyers wanting to achieve a better price. In order to get ahead, buyers should strive to, amongst other things, purchase large quantities relative to the sales of sellers, opt for commoditised (standard; undifferentiated; off-the-shelf) products whenever possible, be in command of as much of the information as possible, and put yourself in a position where you are able to pose a credible threat of walking away with nothing.<sup>17</sup> Wherever possible, it should also be ensured that the market in which the goods are being procured is highly contested, has low barriers to entry and there are low switching costs.<sup>18</sup>

However, if satisfying the conditions above is the litmus test for using such an approach, it is difficult to see why it continues to dominate despite clear evidence that key conditions are not being met. The crux of the problem lies in the fact that although the Crown is indeed able

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<sup>13</sup> Pre-2009 data is unavailable

<sup>14</sup> Allott S and Cox A, 'Transforming Public Sector Sourcing: Right Sizing Public Procurement Using Power Positioning & Value Flow Management', *International Institute for Advanced Purchasing & Supply*, 2017, available at <http://www.iiaps.org/pdf/WP-PublicSectorSourcing.pdf> (last accessed 07/08/2017)

<sup>15</sup> *The Economist*, 'Idea: Competitive Advantage' 4 August 2008, <http://www.economist.com/node/11869910> (last accessed 30/05/2017)

<sup>16</sup> *The Economist*, 'Guru: Michael Porter', 1 August 2008, <http://www.economist.com/node/11848432> (last accessed 30/05/2017)

<sup>17</sup> Michael Porter, *Competitive Strategy: Techniques for Analyzing Industries and Competitors* (New York: The Free Press, 1980) 119

<sup>18</sup> *Ibid*, 113

to purchase large quantities relative to the supplier's sales, and in some cases, opt for commoditised products, it struggles with all other aspects of this strategy.<sup>19</sup>

The convergence of the market into a small group of suppliers means that the market is no longer highly contested, the scale demand raises significant barriers to entry (as not many suppliers have operations big enough to be able to deliver on the kind of multi-million pound contracts the Government is offering) it is difficult to walk away with nothing when there are so few alternatives and there are significant informational asymmetries, not just with regards to the major suppliers (as they are increasingly under adverse incentive to misrepresent their abilities and win contracts at all costs) but also in terms of being aware what smaller suppliers

Name	Revenue (£, m)	Pre-tax profit (£, m)	Margin
Capita Group	4909	75	0.02
G4S	6863	78	0.01
Serco Group	3011	30	0.01
<b>FTSE 250 (Ave.)</b>	<b>1268</b>	<b>165</b>	<b>0.06</b>

are able to offer.

Yet there was continuous push towards strategies based on aggregating supply as much as possible in order to create economies of scale despite obvious drawbacks, most likely due to factors such as a limited number of suppliers and a short-sighted strategy of driving down per-unit cost without considering long-term value. But this often results in purchasing inadequate products and services – a phenomenon labelled elsewhere as 'wrong-sizing'.

Even in circumstances where such a strategy is appropriate, pursuing it means a risk of low competitive pressure incentivising the supplier to push up their profit margins by under-delivering. Going with a large supplier, therefore, must involve an emphasis on performance monitoring and a constant threat of re-tendering should performance fall below certain levels. The ability of the contracting authority to do that needs to be considered when choosing a strategy, and any doubt as to whether it is possible should mitigate against it.

Since the 2010-2015 Coalition Government, the thinking on procurement inside Whitehall has generally shifted from a tendency to opt for such large-scale contracts with established outsourcers, towards greater emphasis on making it easier for SMEs to compete.<sup>20</sup> In other words, the achievement of a key procurement performance indicator – that of Value for Money defined as 'securing the best mix of quality and effectiveness for the least outlay over the period of use of the goods or services bought'<sup>21</sup> – was deemed to be more achievable through allowing competitive pressure to push down prices, than through securing better deals through concessions such as longer contracts. This followed and came largely as a result of several highly publicised scandals, brought about precisely by a failure to monitor an initially enticing contract offered by a large supplier, such as a Ministry of Justice contract with G4S and Serco for the provision of an electronic monitoring system. One of the ways to evaluate the state of public procurement, therefore, is to assess to what extent the drive to open it up to competition has been successful.

<sup>19</sup> See *Supra note 6* on pages 2-4 for a discussion of 'Right-Sizing' and when opting for standardisation can result in suboptimal outcomes, throwing into doubt even this aspects of Aggregate & Volume Leverage

<sup>20</sup> Cabinet Office, *2010 to 2015 government policy: government buying*, 2015

<sup>21</sup> HM Treasury, *Managing public money*, July 2013, A4.6.3

## 1. Is the procurement process too burdensome for SMEs?

One of the most common criticisms of the current system is that the procurement process is unnecessarily burdensome and bureaucratic, which puts off non-established providers from bidding, narrowing the pool of viable suppliers and weakening competition.<sup>22</sup>

A report by the Centre for Economics and Business Research estimated in 2013 that the average total cost of a competitive procurement process in the UK is £45,200, of which 82 per cent falls on the bidders.<sup>23</sup> The report also estimates the average cost of placing a bid to be around £5,800 depending on the type of contract, method of procurement and the bidder. To put this in context, the current EU average is £3,200 per bid.<sup>24</sup>

There is little doubt this has a negative impact on who is able to afford to bid. Large, established providers such as Serco, G4S and Capita are able to leverage economies of scale and incorporate entire departments dedicated to handling the tendering process. This means they can minimise the marginal cost of each individual bid and strengthen their competitiveness when compared to bids lodged by providers forced to pass on those costs to the tendering authority. They are also able to consolidate their grip on the market through techniques such as predatory pricing<sup>25</sup> – absorbing losses made on unviable bids to undercut the competition until they are forced out of the market – or aggressively pursuing a strategy of expansion at all costs, acquiring every competitor that arises.<sup>26</sup>

## 2. The 2010-2015 Coalition Government reforms

Several measures aimed at making it easier for SMEs to engage in the procurement process have so far been implemented, with varying degrees of success.<sup>27</sup> The most significant of those are the scrapping of the PQQ for contracts below £100,000 (and streamlining the process on contracts above this threshold) and introducing a ‘comply or explain’ requirement for contracts to be broken up into lots, in order to fall within the scope of what a smaller provider is able to do. There is also a requirement for all procurement contracts to require the payment of invoices within 30 days, and for advertising all contracts above a certain value. As the latter are relatively unproblematic, this section will focus solely on the two former measures.

### a) The overhaul of the PQQ process

Surveys suggest that the PQQ process was the most problematic aspects of the procurement policy, with the Cabinet Office’s ‘Mystery Shopper’ results pointing to it being the issue behind five out of every 14 cases reported.<sup>28</sup> Providers were extensively citing their frustration at

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<sup>22</sup> See for example Green, *Efficiency Review by Sir Philip Green: Key Findings and Recommendations*, 2010, 21-23; Maude, *Speech at the Public Procurement Briefing*, 9 March 2012

<sup>23</sup> <https://www.cebr.com/reports/uk-procurement-most-expensive-in-eu/> (last accessed 07/08/2017)

<sup>24</sup> *Ibid*

<sup>25</sup> OECD, *Predatory Pricing*, 1989, p. 7

<sup>26</sup> Plimmer, G and Oakley, D, ‘Capita to assess contracts as part of a strategic review’ *Financial Times*, 30 October 2016, available at <https://www.ft.com/content/c6f24f1e-95ec-11e6-a1dc-bdf38d484582> (last accessed 07/08/2017)

<sup>27</sup> National Audit Office, *Government’s spending with small and medium-sized enterprises*, 2016, 22

<sup>28</sup> Cabinet Office, ‘Mystery Shopper results: 2011 to 2014’, 05 January 2015, available at <https://www.gov.uk/government/publications/mystery-shopper-results> (available at 07/08/2017)

having to spend several working days completing the questionnaire, only to be rejected.<sup>29</sup> Again, while large suppliers have the back-office capability to handle multiple questionnaires simultaneously and absorb losses incurred as a result of failed bids, this is something which SMEs cannot afford. The impact of this measure should be fewer SMEs put off from bidding by the amount of time 'wasted' on the PQQ.

It must be noted, however, that this move is unlikely to be without cost elsewhere. The purpose of the PQQ – or the Standard Selection Questionnaire (SQ) as it is now known – is to reduce the information costs incurred in an adequate assessment of bids by the tendering authority. Scrutinising PQQ submissions is much less onerous than scrutinising bids submitted as part of the invitation to tender. In order for the public procurement markets to function efficiently, the contracts must be awarded on the basis of information giving a full, clear and accurate picture of the bidder's capabilities, business models and risk appetites. Tenders won on the basis of inaccurate data or overly optimistic business models are frequent cause of failures, leading to both losses incurred by the bidder as they struggle to match their contractual obligation and substandard goods and services for the contracting authority.

#### **b) 'Comply or explain' requirement to partition contracts**

According to an NAO survey, SMEs 'tend to have a more specialist range of products or services and so may only be capable of delivering a small proportion or certain parts of contracts' and 'do not have the resources to invest in developing relationships, prepare lengthy bids or deliver large contracts.'<sup>30</sup> From the point of view of the Government, 'limited capacity means commissioners are more likely to outsource their supply chain management to prime contractors.'<sup>31</sup>

The 'comply or explain' requirement for breaking up large contracts into smaller parts addresses the second important obstacle to SMEs – namely, their limitations to the scale of the services they are able to offer. Entrenching the practice of partitioning contracts into more manageable 'lots' – i.e. separating out different aspects of the service being procured and contracting for them separately – has considerable potential to greatly increase the number of contracts viable for SMEs, which in turn should increase their share of the procurement market and the degree of competitive pressure they exert on it.

Again, however, there are pitfalls to this strategy. A frequent criticism of the procurement process is that it is too piecemeal and uncoordinated, with individual departments, local authorities and NHS Trusts holding separate contracts for highly similar goods and services, thus diluting the Crown's bulk-buying power.<sup>32</sup>

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<sup>29</sup> Waring, G, '2015 Procurement Regulations – Changes to the PQQ stage – What suppliers need to know' *TendersDirect*, 2 March 2015, available at <https://blog.tendersdirect.co.uk/2015/03/02/2015-procurement-regulations-changes-to-the-pqq-stage-what-suppliers-need-to-know/> (last accessed 04/08/2017)

<sup>30</sup> Cabinet Office, 'Central Government Direct and Indirect Spend with SMEs 2013-14', 2015, 29

<sup>31</sup> *Ibid*

<sup>32</sup> According to a *Health Service Journal* roundtable event with NHS Supply Chain, '...this disaggregation in the ordering of the same goods and services and fracturing of the procurement expertise has led to suboptimal results. It means there is no common face of NHS procurement, but also that suppliers can exploit the fragmentation.' Available at <https://www.supplychain.nhs.uk/news/supplier-news/hsj-roundtable-carter-challenge-on-procurement/> (last accessed 28/04/2017)

According to a 2010 report by the Institute of Directors, fixing this disaggregation by consolidating the process in a small number of specialist and regional 'hubs' could save £3.2 billion over three years.<sup>33</sup> Colin Cram, the author of the paper, puts it in the following terms:

*"HSBC Bank would not be in business if each of its branches had its own IT, its own finance system, did its own procurement, did its own processing, had its own call centre and offered its own financial products, albeit to a common theme. Yet that is how much of the public sector behaves."*<sup>34</sup>

In his paper, he proposes a strategy based on 'Integrated Procurement' as means of harnessing the Government's bulk buying power without making the market overly uncompetitive. Rather, the approach that he proposes involves creating an umbrella organisation of few highly specialised purchasing bodies. These would be divided into four categories – Central Departments, Regional Hubs, Local Departments, and Industry Specific. Each type would be assigned specific procurement activities – for example, Industry Specific bodies would comprise of category experts procuring complex and/or highly bespoke goods which require specialist knowledge to be able to bridge the informational asymmetry involved in procuring such goods. Large central government departments would retain their in-house teams as they will be able to leverage volume without the need to aggregate with other public sector bodies.

Regional Hubs – the cornerstone of the strategy – would serve as the aggregating point for a given geographical area. More specifically, it would eliminate competition in a given area between different contracting authorities for top procurement talent and concentrate commercial skills in one place, and allow aggregation of commoditised goods on a larger scale, but still confined to a smaller geographical area. This would mean best of both worlds – access to public contracts for local SMEs but still creating economies of scale for the region.

### **3. Improving transparency of information: expanding e-procurement**

E-procurement, refers to digitalising the process of procurement at all stages of the process. Contractors are now able to quickly and efficiently find and bid for appropriate contracts. It also acts as a 'market maker' – it allows sellers to list their services together with specifications and an asking price, for the contracting authorities to choose.

In the UK, the 'Digital Marketplace' administered by the Crown Commercial Service (CCS) is the online platform which performs this function.<sup>35</sup> It comprises of a number of frameworks, each one performing a different function – for example, G-Cloud is used for procuring cloud computing services such as hosting and analytics, whereas eMarketplace allows public sector buyers to purchase simple goods and services from a wide range of suppliers. According to current government policy, these networks are due to be merged into a single Crown Marketplace.<sup>36</sup>

The idea behind e-procurement is that it lowers bureaucratic barriers to entry through making all the goods listed automatically compliant. This makes it easier to quickly locate the

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<sup>33</sup> Cram, C, *Towards Tesco – improving public sector procurement* (Institute of Directors: Big Picture, 44)

<sup>34</sup> *Ibid*, 45

<sup>35</sup> <https://www.digitalmarketplace.service.gov.uk/> (last accessed 14/08/2017)

<sup>36</sup> Brecknell, S, 'Crown Marketplace to provide central shop for public sector buyers' *Civil Service World*, 2 December 2015, available at <https://www.civilserviceworld.com/articles/news/crown-marketplace-provide-central-shop-public-sector-buyers> (last accessed 04/08/2017)

opportunities adequate to a business, reducing the need for pre-market engagement in order to locate adequate bidders for whom to extend an invitation to tender, but also making it easier for buyers and sellers to engage by creating easy-to-use communication channels.

E-procurement is also about increasing competitive pressure on providers. Aside from the positive effect an increased number of participants will have on competition, easier and less costly access to information means more efficient markets, as optimal choices are not obscured by transaction cost trade-offs. More importantly, digitalising procurement brings the ability to frequently update the information available, which means stronger incentives for innovation – a fledgling start-up with high potential but low capital will be able to engage easily (taking advantage of the lower barriers to entry) and threaten established providers, which in turn incentivises them to innovate.

Savings offered by e-procurement are substantial, and the consensus is firmly on the side of expanding the Crown Marketplace to encompass as much of the procurement spend as possible. Indeed, whilst so far every policy option has been framed in terms of a trade-off, e-procurement is a solution which brings enormous benefits at minimal costs. Barring the expenditure for the design and maintenance of the online system, all other processes – pre-market engagement, bidding, evaluating bids, etc. – are significantly cheaper. The analysis carried out by Reform, a think-tank, suggests that up to 2016, the use of G-Cloud to source ICT services has delivered savings of 20-50 per cent on legacy contracts, and could translate to real terms savings in the region of £10 billion if e-procurement is scaled up to 50 per cent of total procurement spend:

*“If central government e-procurement spend continues on trend, 20 per cent efficiencies could deliver close to half a billion pounds of savings in 2020-21. A more stretching target would be 20 per cent of procurement spend, which could deliver between £1.8 billion and £4.5 billion of savings depending on the level of pro-rata savings. Reaching Estonian or even South Korean levels of e-procurement expenditure could generate savings in the order of £10 billion.”<sup>37</sup>*

We can be fairly certain that the savings can be attributed to the increased competitiveness of the process – their analysis shows a rapid diversification of the supplier base after the implementation of the G-Cloud.<sup>38</sup>

#### **4. What was the effect of the reforms?**

It is difficult to assess the impact of the Coalition Government reforms, or indeed carry out any meaningful evaluation in this area. The data collected on this subject is limited, and the methodology for its collection varies considerably between the UK and the EU. However, on two parameters, participation of SMEs in the public procurement process did increase. Firstly, from 2010 to 2015, the percentage of contract award notices below threshold – i.e. below the overall value of £106,047 for central government, £164,176 for all other contracting authorities and £62,842 for each 'lot' of a portioned contract<sup>39</sup> – rose somewhat since 2010 from 5.5 to 8.5 per cent, falling from a peak of 9.9 per cent in 2012.<sup>40</sup>

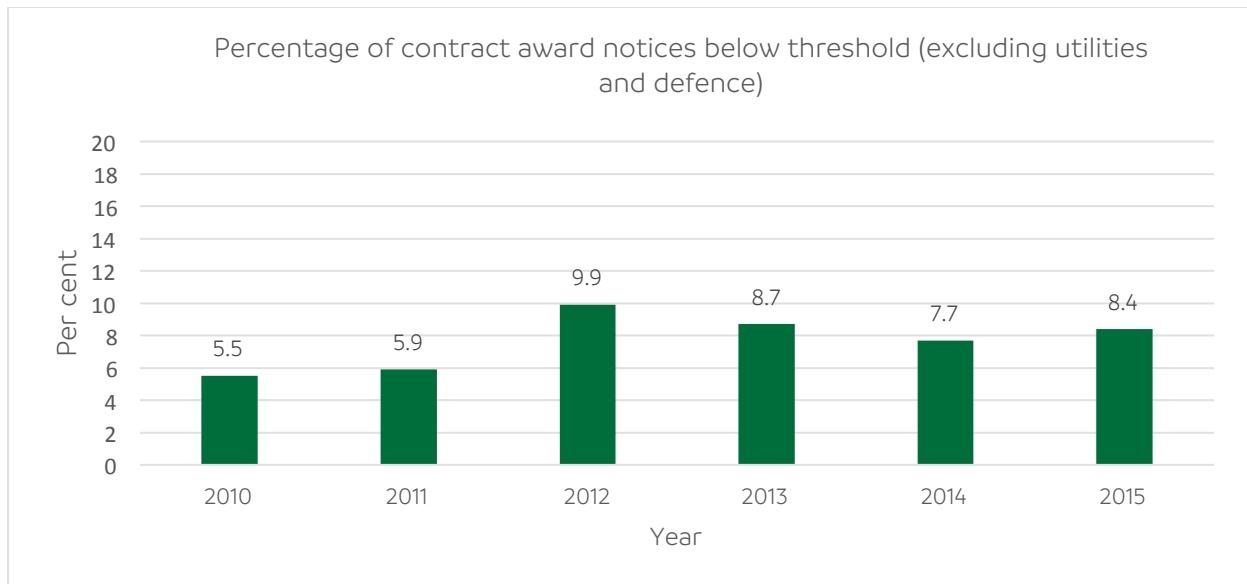
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<sup>37</sup> *Supra* note 12, 28

<sup>38</sup> *Ibid*, 24

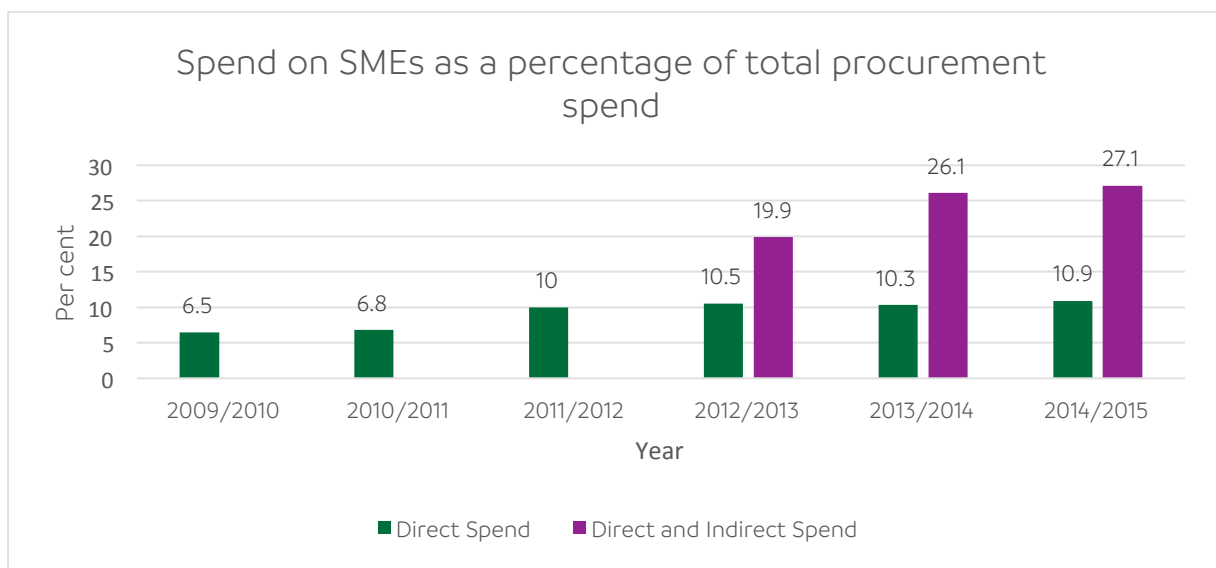
<sup>39</sup> Different thresholds also apply depending on the type of contract, for a full breakdown see Appendix A

<sup>40</sup> *Supra* note 3, 27



Source: European Commission, *Public Procurement Indicators 2015*

Secondly, on UK data analysed by Reform, the percentage of the total central government procurement budget spent directly on SME also rose somewhat since 2010 – from about 6.5 to about 11 per cent.<sup>41</sup>



Source: Cabinet Office, *'Central Government Direct and Indirect Spend with SMEs 2013-14'*, 2015

The discrepancy is likely to be down to, firstly, the total public procurement spend instead of just central government being included in the EU figures, and secondly, not every below-threshold contract will be awarded to an SME, in the same way that some SME will be able to win above-threshold contracts. Nevertheless, the trend does suggest an overall modest increase in SME participation in public procurement markets.

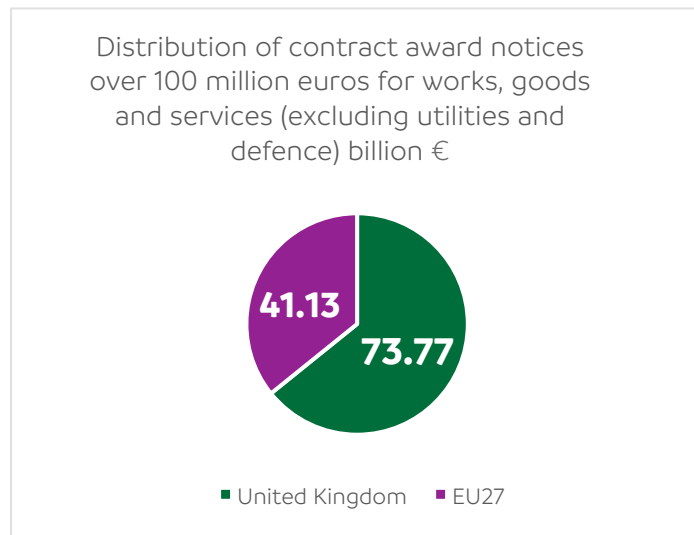
On the other hand, this increase has to be contrasted with the findings of the latest set of Public Procurement Indicators published by the European Commission, which give an idea of how the UK compares against its European partners. These statistics look at the contracts award notices (CANs) published in the Tenders Electronic Daily (TED) the EU's online facility

<sup>41</sup> *Supra* note 33, 16



through which all tenders meeting the OJEC publication thresholds must be published. Therefore, these results do not give a full image of a given country's public procurement market, especially when a member state stringently pursues a policy of publishing smaller contracts which would fall outside of the EU's publication thresholds.<sup>42</sup>

According to the figures, in 2015, the UK awarded 167 public procurement contracts worth 100 million euros or above, thus topping the list by 138, as France, next highest, had just 29. For context, Italy had 25, Netherlands had 14, Spain had 10 and Germany had just 5. EU total was 322, which means that the majority of such contracts (52%) came from the UK.<sup>43</sup> Expressing the above in terms of total procurement spend, UK spent 74 billion on procurement through contracts of 100 million euros or above. For context, Italy, next highest, spent 12 billion, France spent 7 billion, Netherlands spent 4, Spain spent 3 and Germany spent 1. The EU total was 115 billion, meaning 64% of that came from the UK.<sup>44</sup> Finally, the percentage of contracts award notices which fall below the value of €134,000 was 8.4 per cent in 2015, second-lowest in the EU. For context, Germany's was 23.8, France's was 36.9, The Netherlands' was 27.3 and Spain's was 13.9, but it is worth mentioning that Italy's was 6.5, the lowest in the EU.<sup>45</sup>



These findings do not necessarily mean that none of these €100 million contracts cannot be held by SMEs. However, they do suggest that the UK is in dire need to start partitioning contracts if it is serious about making it easier for SMEs to engage. It is still relatively early days since the policies came into effect and it might be that these ratios will start falling. However, the sheer scale of how much out of step with the rest of the EU the UK is does give cause for concern.

<sup>42</sup> See Appendix B

<sup>43</sup> *Supra* note 3, 18, 20 and 22

<sup>44</sup> *Ibid*, 17, 19 and 21

<sup>45</sup> *Ibid*, 26



Source: European Commission, *Public Procurement Indicators 2015*

## 5. Conclusions: Impact of SMEs on public procurement

We can therefore see two main tensions emerging in this area. Firstly, any market requires as frictionless flow of information as possible for participants to make the right decisions. In a public procurement setting, this is particularly important because the goods being traded are ‘credence goods’ – things with qualities that cannot be readily or immediately observed or experienced.<sup>46</sup> This informational asymmetry between the buyer and purchaser is a source of adverse incentives for the seller and can lead them to misrepresent their offering. If on top of this the seller’s margins are under pressure, there is an additional incentive to try and stay afloat at any cost.

There are numerous examples of this phenomenon in practice. According to Richard Johnson, formerly of Serco, when the company got into financial trouble in late 2014, the first reaction was to:

*“The pressure came down from on-high [at Serco] to grow and win more contracts at almost any cost while the government customer was, and is, awarding the contracts to the cheapest bidder, without adequate consideration of which corners that would mean cutting.”<sup>47</sup>*

The degree to which this happens depends on factors such as the buyers capability of processing the sellers incentives and the threat of reputational damage, but mostly from the extent to which the asymmetry can be minimised with the verifiability of the representations.

For that reason, assessing the value of a tender bid is not limited to purely comparing bids and evaluating them against previously stated criteria, because that would take the seller’s information at face value, something which is dangerous when trading credence goods. It also

<sup>46</sup> Emons, W, ‘Credence Goods and Fraudulent Experts’ (1996) *The Rand Journal of Economics*, 28(1) 107-119, available at [http://staff.vwi.unibe.ch/emons/downloads/fr\\_expert\\_eng.pdf](http://staff.vwi.unibe.ch/emons/downloads/fr_expert_eng.pdf) (last accessed 04/05/2017)

<sup>47</sup> Plimmer, G, ‘Serco foots the bill for “win at all costs” public sector contracts’ (*Financial Times*, 5 March 2015) available at <https://www.ft.com/content/8ed1f97e-b040-11e4-a2cc-00144feab7de> (last accessed 04/05/2017)

involves looking at data such as past performance of the company and its financial disclosure information in order to determine the plausibility of their bid. This in turn requires a costly transfer of information – for example, in the form of PQQs or SQs – which has the aforementioned effect of raising barriers to entry.

However, it is also true that attempts to extract information from bidders are not costless and there comes a point where the process starts excluding otherwise potentially viable providers, harming the competitiveness of the market. For that reason, a successful procurement policy should, for example, lower disclosure requirements when dealing with very low-value or low-uncertainty contracts, or create different disclosure standards depending on turnover. If there are worries of potentially unfit SMEs ‘slipping through the net’ in this way, a system of penalising suppliers with bad track record could be created, losses incurred as a result of those contracts failing recouped through successful contracts with innovative suppliers who would otherwise be excluded.

### **CASE STUDY #1 – COMPASS asylum accommodation provision by Serco, G4S and Clarel**

In 2012, the Home Office decided to consolidate the structure of asylum seeker accommodation provision by enlisting Serco, G4S and Clarel to roll out a uniform programme throughout England, Wales, Scotland and Northern Ireland. This framework (known as COMPASS) replaced the old system of 22 separate contracts with a diverse group of 13 different suppliers. The shift was projected to generate savings of approximately £140 million over seven years, envisaged by the reductions in marginal cost by leveraging economies of scale.

However, the contract was beleaguered from the start and went on to become a byword for public procurement problems.<sup>1</sup> An investigation by the public accounts committee has revealed several failings both by the Home Office and the contractors:<sup>1</sup>

- The risk of a decision to dramatically reduce the diversity of providers was underestimated
- Data and information provided by both parties was inaccurate and led to erroneous assumptions being made
- Penalties for delays and inadequate housing were not enforced, leading to additional cost
- The transition between contracts was insufficiently managed, leading to delays resulting from a lack of communication between the old and new providers
- G4S and Serco have never previously carried out this type of activity

Aside from general issues of commercial competence and project management, there are two key issues to be taken from the COMPASS contract. Firstly, the argument for more consolidation and leveraging the Government's bulk-buying power to achieve value for money has serious limits particularly in cases where an inexperienced provider needs to rely on external information in order to formulate all their assumptions relating to the contract, such as their business plan, the terms, etc. The theoretical savings made this way may well be offset and even exceeded by unforeseen problems which were unaccounted for due to lack of experience, relying on faulty data as well as the general concentration of risk that comes from narrowing the pool of providers, since a problem encountered by them will spread much more widely.

Source: *Public Accounts Committee*<sup>48</sup>

### **III. Post-tender contract management**

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<sup>48</sup> HC Committee of Public Accounts, *COMPASS: Provision of asylum accommodation*, 24 April 2014, available at <http://www.parliament.uk/business/committees/committees-a-z/commons-select/public-accounts-committee/news/asylum-accommodation-substantive/> (last accessed 07/08/2017)

The second major theme of this paper focuses on the second part of the equation. If the circumstances of a given procurement need do not lend themselves to competition – for example, due to few capable suppliers or a natural monopoly – how do we ensure that lack of competitive pressure does not result in excessive profits and suboptimal contractor performance?

**CASE STUDY #2** – *Ministry of Justice contract with G4S and Serco for provision of an electronic monitoring system*

Electronic monitoring is used by a number of bodies within the UK justice system in order to independently verify whether an individual is at the location specified by a court of law. This could be for the purposes of bail supervision, curfew or a community-based sentence. The devices which enable such monitoring comprise of a home monitoring unit, installed at a specified location (usually the individual's home) and a personal identification counterpart, colloquially referred to as a 'tag.'

In 2013, the Ministry of Justice sought to renegotiate an expiring contract for provision of these services with G4S and Serco, and requested additional information relating to past performance of their contracts. At that point the MoJ spotted a number of inconsistencies in the reported data, primarily relating to charging practices used by the providers. The Ministry was unable to obtain the assurances that it required, and referred the contracts to PricewaterhouseCoopers for forensic analysis.

The audit revealed three key failings:

- 1. Charging per order, rather than per subject** – as the courts are able to impose more than one monitoring order, it is feasible that costs per subject will vary with regards to requiring multiple visits from the installation staff, but not with regards to the cost of equipment. Separate fees were charged by the providers for every monitoring order imposed, which according to the Ministry was not in line with the agreed contract. Irrespective of which interpretation of the agreement is correct, both providers claimed they were open with the Ministry with regards to their charging practices from the very beginning. This suggests a worrying lack of performance monitoring and scrutiny during the ordinary duration of the contract, given it was not until the contract's conclusion.
- 2. Continuous charging even after the monitoring has ceased** – in the view of the providers, it was the responsibility of the local authority to alert them to when the monitoring period has ended. However, this would not always happen immediately and many orders overran in this way for months and even years.
- 3. Charging fees irrespective of a successful installation of equipment** – in the view of the providers, charges were applicable immediately after the first visit, regardless of whether the equipment was successfully installed or not. In a number of cases the equipment was never installed but because the local authority failed to issue a formal notification, the order remained open for months.

**1. Failure to monitor performance**

According to proposals put forward by Reform, considerable resources should be shifted from the middle-stage of contracting to the late stage of contract-management.<sup>49</sup> A key part of that stage is monitoring the performance of the contract, constantly checking it against agreed performance indicators. The case study below is a good illustration of this point:<sup>50</sup>

All three failings could have been avoided or alleviated if spotted earlier, but they were not due to lack of monitoring. The case study clearly mitigates for establishing robust methods of reporting performance and orientating the entire approach away from seeing procurement as a 'project' and towards viewing it as an ongoing process which requires monitoring.

The NAO, on investigating the contracting process and subsequent management, has identified a number of ways in which contract management needs to be reformed in response to the case above and others, which are generally applicable across public procurement.<sup>51</sup> The table summarises the report's recommendations:

<b>Enabling a commissioning approach</b> - Establishing the governance, information systems and structures to enable senior management to scrutinise, challenge and manage delivery by others.	Governance
	Basic contract information
	Integrated structures
	Integrated processes
<b>Understanding and influencing suppliers</b> - Placing responsibility for delivery with contractors, ensuring they have the appropriate control systems in place, and using transparency, assurance and incentives to align their interests with the taxpayer.	Intelligence on strategic suppliers
	Transparency
	Incentives
<b>Making the most of limited commercial capability</b> - Deploying commercial expertise as a scarce resource, strengthening career paths and training and making effective use of information to target activity.	An enhanced role for commercial staff
	Central support
	Structured professional development

## 2. The role of 'agile parts'

'Agile' procurement is a well-known concept especially with regards to the sourcing of IT services, but can be applied more widely and is frequently used in the context of project management.<sup>52</sup> At the most basic level, it means an approach to purchasing which places an emphasis on making the contract easily adaptable to a change in circumstances. In practice, it translates to measures such as 'agile parts' in procurement contracts, which allow for aspects of the agreement to be changed *ex post*, in order to allow for unforeseen costs or higher than

<sup>49</sup> *Supra* note 32, 26

<sup>50</sup> National Audit Office, *The Ministry of Justice's electronic monitoring contracts*, 19 November 2013

<sup>51</sup> National Audit Office, *Transforming government's contract management*, 4 September 2014, 12-15

<sup>52</sup> Stephen J, Page J, Myers J, Brown A, Watson D, Magee I, *Systems Error: Fixing the flaws in government IT* Institute for Government, 47

expected demand. This is in stark contrast to the traditional 'Waterfall' philosophy, which stipulates that as much as possible needs to be agreed and fixed in advance.<sup>53</sup>

Again, the contrast between the two ways of approaching procurement can be placed within the theoretical framework of conflicting methods of improving value in public procurement. Traditional Waterfall thinking incorporates orthodox assumptions about leveraging bulk-buying power, because it is designed for a market where actors are assumed to be in possession of accurate and full information, and offers the ability to commit to a long-term, large-volume transaction. By contrast, an agile approach is much better suited to a procurement strategy based on enabling competition, since such a contract will proceed step-by-step; commitment be limited to small chunks; allowing for a quick and inexpensive exit should problems arise, and opting for a different supplier.

Crucially, it assumes a much lower level of certainty and allows for a wide ranging change in circumstances. Planning and agreeing all the details in advance is hugely vulnerable if any of the assumptions turns out to be wrong. A number of procurement failures can be at least in part attributed to a badly struck balance between flexibility and rigidity in the face of unknown unknowns.<sup>54</sup> Serco's contract with the Home Office for provision of asylum seeker accommodation (mentioned above) was a textbook example of this and primarily a disaster for Serco, leading to a situation where it was making a loss on every applicant processed after significant delays to the start of the contract due to difficulties with becoming operational. As the case study has shown, it was a failure to anticipate unknown unknowns – the level of demand for the service, inadequate or insufficient information transfer from the incumbents to the new operators, unanticipated bad state of existing accommodation, etc.

Setting aside the question of whether the government should have awarded the contract to operators with no prior experience of this type of work in the first place, the problem might not have been allowed to progress quite as far as it did if there was more flexibility in the contract allowing for accommodations to the change in circumstances. That said, it also needs to be recognised that in extreme circumstances those accommodations may well need to be contract termination, depending on how likely it is the provider will be able to overcome the obstacles in a way which is beneficial to both parties.

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<sup>53</sup> Unattributed, *Procuring IT systems: waterfall vs. agile* (Bond Dickinson, Insights, 19 November 2016) available at <https://www.bonddickinson.com/insights/publications-and-briefings/procuring-it-systems-waterfall-vs-agile> (last accessed 04/08/2017)

<sup>54</sup> See case study #3

### 3. Is agile procurement the best way to go for the public sector?

But this may not sit easily with some of the peculiarities of *public* procurement as opposed to supply chain management in the private sector. There are essentially two reasons for this. Firstly, unlike in a corporation, the networks of accountability play a much bigger role in the public sector. As stated in the introduction, decisions are evaluated to a multitude of performance goals and need to adhere to a strict hierarchy which makes executive decisions difficult. What 'fixed price, fixed outcome' and 'fixed price, fixed scope' contracts allow is a degree of certainty which can then be used as defence to any accusation of mismanagement when things go wrong.

**CASE STUDY #3** – *Contract between Atos and the NHS Information Centre (NHSIC) for provision of the General Practice Extraction Service (GPES)*

#### **Background:**

GPES was envisaged as an ICT system which automatically extracted patient data from GP's computers. In doing so, it would create a quick and easy way for health professionals to access a comprehensive set of vital data on any patient registered with an NHS-contracted GP clinic. In other words, it was designed to be a significant step towards adopting electronic patient records. However, the procurement process was ridden with problems from the start:

#### **Key failures:**

- 1. Significant delays undermined the business case as NHS bodies found new ways of sourcing the data** - Uncertainties over funding, difficulties in recruiting appropriate staff, Cabinet Office review of major ICT projects after the 2010 general election and general difficulties in procuring adequate software resulted in significant delays to the project. In the meantime, much of the original business case behind GPES was rendered questionable as more and more elements of the NHS started using alternative methods of sourcing the data.
- 2. NHSIC and Atos could not agree the requirements for the query system** – a specific part of the project, namely the query tool, was an 'agile part' in an otherwise 'waterfall' contract. Due to time constraints described above, Atos had to go ahead with development before crucial details of the tool were agreed. However, the two parties found it difficult to agree on those, for reasons such as limited staff capacity at NHSIC, high staff turnover, and perhaps most importantly, reliance on contractors for development and procurement expertise.

#### **Conclusions:**

The above contract could be construed as a good example of what happens when a highly uncertain project is, firstly, too constrained by aspects of the waterfall parts to the point where the agile part brings none of the advantages of that strategy, whilst still remaining exposed to its disadvantages. More specifically, pre-set timelines, top-down budgetary constraints and other fixed parts which affect the entire contract essentially render the agile part meaningless – in the above example, it was the time pressure which did not allow for a resolution of the issue with the query tool. On top of that, it produced parts which ended up not being used, but had to be paid for.



This is particularly pronounced in the case of problems associated with spiralling costs. Intuitively, the more flexibility present within in a contract, the higher the possibility of overspend as suppliers are incentivised to push to broaden the scope, which is especially likely to be the case with large outsourcers who have the capability to provide a range of services at competitive margins. If definitions and meanings of the scope of the contract are not always clear, then in a situation of a significant informational asymmetry in favour of the contractor, we can expect some attempts by the advantaged party to extract additional value. This can be done through, for example, misrepresenting the extent to which an additional service is required if the overall objective of the contract is to be fulfilled to the required standard.

It is difficult to tell with a degree of certainty the extent to which suppliers actually attempt to do this, barring anecdotal evidence.<sup>55</sup> But a much better documented instance of contract failure is when agile parts are used in conjunction with waterfall, which results in an adverse interaction of the two. As pointed out by Dominic Campbell – founder of FutureGov, a local government consultancy – ‘agile’ in public procurement is facing a hostile environment which still operates in a culture addicted to the illusion of control that waterfall provides:

*‘However, in much of government there remains a culture of ‘fixed price, fixed outcome’ when it comes to procurement and - perversely - Agile has exacerbated the problem, because we now are facing a proliferation of ‘fixed price, flexible scope’ contracts: the worst of both worlds for suppliers. In an Agile setting, there isn’t the same structure as the old enterprise approach: there tends not to be a piece of paper (‘change control’) that authorises changes to an upfront (best guess) scope. This is because Agile works best when a detailed scope is not pre-determined, but developed through on-going insight and agreement, with decisions on project priorities made in small increments on a regular (often bi-weekly) basis.’<sup>56</sup>*

What this suggests is that agile is an all or nothing strategy. Everything in the contract, bar the definition of the final objective, needs to be movable and the supplier should be left alone to figure out the best way of achieving that. Unknown unknowns are inevitable, and so a very high degree of flexibility is needed to respond to challenges and changes in circumstances which arise.

#### **4. Difficulties of with going ‘full agile’ and how to overcome them**

Understandably, ‘letting go’ of control in this way is difficult. An excellent summary of why public institutions are uncomfortable with agile is provided by Callum Sinclair, partner and Head of Technology at DLA Piper, a leading commercial law firm:

*However, when presented with (or asked to draft) a contract to embody an agile approach, a lawyer sees lack of certainty around price, timescales and ultimate deliverable. He or she will also be concerned about a series of "agreements to agree" – such as deferring decisions about scope, acceptance criteria and budget for a sprint until just prior to that sprint's commencement - these are generally difficult to enforce at law in the event of dispute. A*

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<sup>55</sup> *Supra* note 40 as evidence of ‘expansion by any means’

<sup>56</sup> Campbell D, ‘Tipping point: Agile procurement is in a precarious position as waterfall looms large’ *PublicTechnology.net* 22 May 2017, available at <https://www.publictechnology.net/articles/features/tipping-point-agile-procurement-precarious-position-waterfall-looms-large> (last accessed 25/07/2017)

*combination of these factors will unfortunately defeat the risk control systems of most large organisations and militate against the use of agile methodologies.<sup>57</sup>*

It is crucial to consider that many IT projects and procurement reforms in general are undertaken precisely in order to generate savings. The need to draft a business case with reasonable estimations of savings is impossible to satisfy because the cost is, by definition, largely unknown. For that reason, it is clear that agile will only be appropriate in situations where the business case is so strong as to withstand significantly higher costs or delays, or is based on more than cutting costs. Naturally, this will not be the case in most procurement projects and reforms.

## **5. Skills and Capabilities**

It is also worth pointing out that agile procurement relies heavily on commercial and project management skills of all the parties involved, including the civil servants. Yet we know that historically, acquiring and retaining top procurement professionals with the right sector-specific expertise has been a huge problem, and has been cited time and again as a contributing factor, in all of the case studies mentioned in this paper. As mentioned before, informational asymmetry between contracting parties places one at an advantage, whereby they can make representations with regards to the contract in a way which advantages them in the negotiations. This can either lead to a situation where the contracting authority pays above the equilibrium price for the service, or, if the contractor is pursuing an aggressive expansion strategy (as tends to be the case in industries with extremely tight margins, such as public sector outsourcing) take on contracts which they are not able to fulfil.

Addressing this problem will not be easy, particularly in the current fiscal climate of a tight control of public pay budgets. The reality is that the public sector will never be able to offer the sort of incentives the private sector is able to offer to commercially-minded individuals. Indeed, a key reason why people choose the civil service as a career is because they do not wish to be in an environment where these skills and mindsets are dominant. As a result, procurement as a career track is not held in high esteem:

*Procurement has been seen as a low-status profession in the civil service. It has few senior positions and most procurement professionals do not work with ministers and senior management. There have not been the career paths to ensure those working on commercial issues have the experience necessary. The result has been a clear divide between those trained-up through the civil service and those brought in from outside. Relatively few within the civil service have the ability to negotiate with contractors on an equal basis.<sup>58</sup>*

Offering higher salaries to sourcing professionals within the public sector could attract more capable people to the sector,<sup>59</sup> and indeed doing so may be easier than in other parts of the civil service because the work carried out by procurement professionals can easily be measured against the savings they deliver, which makes bonuses and salary increases easier

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<sup>57</sup> Sinclair C, 'How to make IT contracts agile' *ComputerWeekly.com* October 2012, available at <http://www.computerweekly.com/opinion/How-to-make-IT-contracts-agile> (last accessed 26/07/2017)

<sup>58</sup> *Supra* note 43, 37, para 2.18

<sup>59</sup> Deloitte and Reform, *The State of the State 2015-16: Recalibrating government*, 17, available at <https://www2.deloitte.com/content/dam/Deloitte/uk/Documents/public-sector/deloitte-uk-sots-report.pdf> (last accessed 14/08/2017)

to justify. Away from pecuniary rewards, a cultural shift towards greater appreciation of the value brought by effective sourcing would make it more likely that fewer talented people leave for the private sector where they feel more appreciated, assuming a key reason why they chose the civil service in the first place is because they share some of the other values espoused by it.

## **Conclusions**

To recap, there are two main strategies through which the Government is able to pursue value for money in public procurement: seeking to make the markets competitive, or, if that is not possible, rigorous contract management and review. There is no neat dividing line between the two – most of the time, a blend of both will be needed. It may be more appropriate to think of them as two necessary elements of a successful procurement strategy – too much or too little of either at the expense of the other, and the system is out of balance.

Fundamentally, public procurement should be about securing long-term value for money. Too often business cases for overhaul of various contracts are made on the basis of assumptions about savings which could be made by economies of scale offered by large suppliers. There are instances when such assumptions are reasonable – for example, in the case of very simple, very highly commoditised products such as staplers. The reason for that is a relatively low level of uncertainty and therefore low chance of something going wrong.

However, most of the time, the public sector needs to source complex products and services such as medical equipment, ICT systems or fighter jets, the value of which is difficult to estimate. Furthermore, it gets put to complex uses which add a great deal of uncertainty to the business calculations necessary to work out the most cost-effective ways of sourcing them. Items as simple as syringes and needles can cause headaches for procurement professionals – how do you adjust the projected savings from switching to a cheaper model for the fact doctors may dislike them and take longer to perform simple operations or waste one or two before they get the injection right?

For that reason, it increasingly makes sense to shift the heavy lifting from procurement professionals and onto the market. It is true that traditionally, things like existence of natural monopolies, scale of demand and ability to leverage economies of scale (and, sometimes, overly cosy relationship between outsourcing representatives and civil servants) meant that there is no way to have a competitive market, and the only option to create one artificially through running tenders and having strict oversight mechanism over the performance of those contracts. However, technology is increasingly allowing us to overcome natural obstacles to effectively functioning markets by, as in the case of the G-Cloud and the Digital Marketplace, lower the barriers to entry for new, innovative participants able to challenge large incumbents. Indeed, this may be one of the ways in which the UK can start to address the problem of scaling up faced by many start-ups unable to match the demand.

That is not to say, however, that post-tender contract management is now less important. On the contrary – enabling SMEs to engage is one thing, but if it is to be a truly free market, performance monitoring is just as important and if a solution is not working, mechanisms for addressing it are needed.

## **APPENDIX A: The Brexit dimension – to what extent are EU rules to blame?**

It has previously been suggested that a key factor influencing the administrative burden of tendering are the EU procurement regulations, adding £1.7 billion to the total cost of Whitehall contracts.<sup>60</sup> The figure is based on a 2011 study by the European Commission into costs of public procurement contracts, which proposed that 0.7 per cent of procurement spending can be accounted for by the EU procurement legislation. According to Vote Leave, this amounted to £8.4 billion between 2010 and 2014.<sup>61</sup>

EU procurement law prescribes, in the interest of deepening the Single Market, specific rules governing the way contracting public bodies select winning bidders. This is to prevent domestic suppliers receiving favourable treatment for political reasons, which contravenes the Treaty on the Functioning of the European Union (TFEU) principles of non-discrimination, equal treatment, transparency and proportionality.<sup>62</sup>

### **1. Background**

Prior to 2015, the regime was governed by our implementation of three Directives: the Utilities Directive (2004/17/EC), the Public Sector Directive (2004/18/EC) and the Remedies Directive (2007/66/EC). The combined effect of the three was to create a regime which made fairly specific prescriptions for contracting authorities about how to go about conducting their procurement. The two most important aspects of the framework were, firstly, the requirement to publish all contracts above a certain threshold in the Official Journal, and secondly, rules governing the criteria on which the contracting authorities can base their decisions when awarding contracts. In essence, the bidder whose bid incurred the lowest cost or was the most economically advantageous (MEAT) had to win it.

Adjoined to the second aspect was also a remedy procedure which allowed bidders who were passed over to challenge the decision, if they had grounds to believe that the prescribed criteria was not followed. Depending on the circumstances there was scope to vary the weight in the decision-making process different aspects of the bid would have, but essentially – following the general intention of Treaty principles – the aim was (and is) to deepen the Single Market by eradicating barriers to entry for and stopping discrimination of foreign suppliers from within the EU.

In 2015, this regime was amended by a new set of Directives: the Public Procurement Directive (2014/24/EU) repealing the old Directive 2004/18/EC, a new Utilities Directive (2014/25/EU) repealing the old Directive 2004/17/EC, and a Concession Contracts Directive (2014/23/EU) which governs the procedure associated with awarding concession contracts, i.e. not commercial contracts for provision of services with the Crown, but an exclusive permission to exploit a certain market with a right to the proceeds.

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<sup>60</sup> Stuart, H, 'Vote Leave: EU rules add almost £1.7bn to costs of Whitehall contracts' *The Guardian*, 26 May 2016, available at <https://www.theguardian.com/politics/2016/may/26/vote-leave-eu-rules-add-almost-2bn-costs-whitehall-contracts> (last accessed 07/08/2017)

<sup>61</sup> *Ibid*

<sup>62</sup> The relevant parts of the TFEU in this context are Articles 26, 34, 53(1), 56, 57, 62 and 114, for a detailed breakdown see Maciejewski, M, 'Public procurement contracts', *Fact Sheets on the European Union*, March 2017, available at [http://www.europarl.europa.eu/atyourservice/en/displayFtu.html?ftuld=FTU\\_3.2.2.html](http://www.europarl.europa.eu/atyourservice/en/displayFtu.html?ftuld=FTU_3.2.2.html) (last accessed 07/08/2017)

The key changes introduced by the new structure primarily aim to increase efficiency and reduce administrative burden associated with procurement by expanding the e-procurement agenda, making it easier for SMEs to participate and introducing more scope for entering into innovative contracts. The European Commission breaks it down into four different areas: higher efficiency, more eProcurement and easier participation for SMEs, modernising public services and slashing administrative burden, addressing societal challenges through public procurement and preventing corruption through creating a culture of integrity and fair play.<sup>63</sup> For the purposes of this paper, it will suffice to focus on those areas which directly interact with aspects of procurement policy discussed here, i.e. administrative burden, ease of access for SMEs, e-procurement and the criteria on which winning bids are selected.

## **2. Analysis: towards greater discretion and flexibility**

A recurring theme running through almost all aspects of this reform package is greater discretion and flexibility for the contracting authorities. In this way, it is paradoxically a deregulatory exercise, whereby tendering bodies have much wider options than before in the choice of a contracting strategy. Once again, framing it within the theoretical framework used throughout this paper, the previous regime was geared towards concepts such as leveraging scale and ability to drive down marginal cost. This is because stricter rules around selecting winners on the basis of low-cost/MEAT, taking into account the turnover-to-contract value ratio and giving losers extensive legal rights to a remedy if it subsequently turned out that these rules were not adhered to contain a number of assumptions about the economic environment that the actors are operating in. Namely: high degree of certainty as to the future, full information between the contracting parties, low-cost access to the process for any viable provider, etc.<sup>64</sup>

By contrast the new regime recognises that these assumptions are often erroneous. The introduction of the European Single Procurement Document (ESPD) – a standardised form used by all prospective bidders to show that they satisfy initial exclusion criteria – will now replace a myriad of different forms used by different countries, reducing the costs associated with contracting in another member state. The existing requirement to exclude bidders with a turnover below a threshold derived from the value of the contract will be curtailed, as will the requirement to choose on the basis of the lowest price/MEAT – indeed, contracting authorities will be able to eliminate price entirely from their considerations. E-procurement will largely be made mandatory by 2018. ‘Innovation Partnerships’ have also been introduced, a means by which an incredibly risky project which would never have passed previous checks can be taken on within special legal confines.

Parallels between the procurement objectives of previous UK governments and these reforms can clearly be spotted. Greater access for SMEs; greater emphasis on e-procurement solutions and expansion of them to all aspects of supply management, not just ICT contracts; relaxation of minimum turnover and price/MEAT requirements in recognition that the treasury’s definition of value for money is broader and more nuanced than the bid price can reflect. Perhaps the starkest and most daring reforms lie in the allowing of ‘Innovation Partnerships’ – essentially a mechanism for overcoming legal issues posed by truly ‘agile’ procurement. Contracting authorities are able to publish notices outlining a given problem that needs an innovative solution which is not currently available wholesale, and are then able

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<sup>63</sup> European Commission, ‘EU Public Procurement reform: Less bureaucracy, higher efficiency’, 20 April 2016, available at <http://ec.europa.eu/DocsRoom/documents/16412> (last accessed 27/07/2017)

<sup>64</sup> *Supra* note 10

to select one or more ‘innovation partners’ with whom they go through an extensive pre-contract process, allowing the potential contractor to work out the most cost-effective solution. Regulations governing pre-contract engagement in the past – in the interest of preventing collusion – did not allow such a collaborative approach.<sup>65</sup>

### 3. Verdict: slashing red tape must not create incentives to ‘buy British’

There is little doubt that there are immediate costs and restrictions associated with compliance with EU procurement regulations. Publishing notices in the OJEU, restrictions on which tendering procedures may be used and availability of remedies running the risk of costly delays all contribute to the red tape associated with procurement. On the other hand, the intention behind these rules is largely about creating a deep and liquid market for public procurement, where suppliers from one member state are treated no differently to domestic suppliers from another. A genuine shift to making procurement more open and competitive must surely mean broadening the pool of available suppliers to other countries, and the EU regime provides a ready-made framework for doing so. That said, Brexit undoubtedly offers an opportunity for regulatory experimentation.

#### APPENDIX B: The European Public Contracts Directive (2014/24/EU) Thresholds

	Supply, Services and Design Contracts	Works Contracts	Social and other specific services
<b>Central Government</b>	£106,047	£4,104,394	£589,148
	€ 135,000	€ 5,225,000	€ 750,000
<b>Other contracting authorities</b>	£164,176	£4,104,394	£589,148
	€ 209,000	€ 5,225,000	€ 750,000
<b>Small Lots</b>	£62,842	£785,530	n/a
	€ 84,000	€ 1,000,000	

Source: *Official Journal of the European Union*<sup>66</sup>

<sup>65</sup> Nourry, A, Rueter, M, ‘The New EU Public Procurement Rules’ *Clifford Chance*, March 2014, available at [https://www.cliffordchance.com/briefings/2014/04/the\\_new\\_eu\\_publicprocurementrules.html](https://www.cliffordchance.com/briefings/2014/04/the_new_eu_publicprocurementrules.html) (last accessed 28/07/2017)

<sup>66</sup> OJEU, EU Procurement Thresholds, available at <http://www.ojec.com/thresholds.aspx> (last accessed 07/08/2017)