KIAH CONSULTING

WHY TENDERING DOESN'T ALWAYS GIVE BEST VALUE FOR MONEY

It is conventional wisdom that competitive tendering will deliver the best value outcome, particularly in government procurement, and is often the only mechanism employed in pursuit of that value. Often this results from an overly constrained interpretation of government procurement guidelines that interprets tendering as the only viable process to achieve competitive outcomes.

To quote Abraham Maslow "It is tempting, if the only tool you have is a hammer, to treat everything as if it were a nail"[1].

Our experience is that procurement guidelines do offer sufficient flexibility to support sound strategy. We have a recent example where direct negotiation on behalf of an Australian Government agency reduced the annual cost of a services contract—which had originally been awarded through a competitive process—by 30 per cent (tens of millions of dollars). This approach avoided the costs, risks and delays of competitive tendering and while improving the performance and service delivery. We unequivocally demonstrated that the final contract delivered the best sustainable price.

Competitive tendering delivers the most competitive outcome, not necessarily the best achievable value and price. It is a useful tool but it should be used with consideration and not slavishly, and where it is used it should be employed as part of an encompassing strategy, not in isolation.

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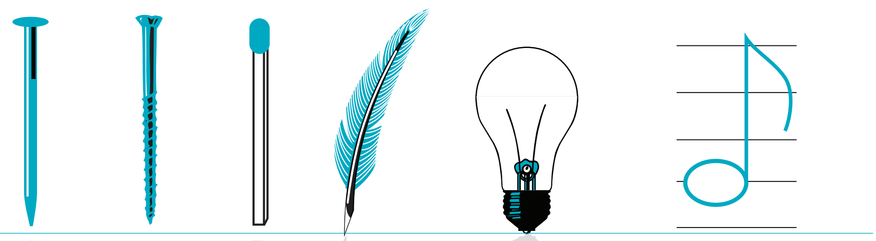

1 Abraham H. Maslow (1966), *The Psychology of Science*.

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The tender shapes the market

Like any experiment, the process of taking a measurement can influence the factor being measured. Industry will structure responses to satisfy the question asked, particularly for large deals or where there is a powerful and narrow client base (such as the Defence sector). Industry will 'shoe-horn' a competitive and compliant response, regardless of the appropriateness of the question or response.

Acquisition design, particularly the bundling of services and technologies where there is little synergy or where industry is not naturally aligned, may offer little integration value and impose a significant management and risk price premium and complexity in service delivery. An example would be the bundling of transactional services, such as pathology and radiology, into a contract for the provision of GP clinics. Forcing the integrating of the transactional and vertical service offering offers no value other than perhaps the outsourcing of an administrative overhead while incorporating the risks associated with transactional services - over which the integrator has no control. This increases the complexity of the contract, the risk profile and the price for potentially little value.

A tender framed inappropriately will give the best competitive solution for the question, not the best value solution for the purchaser.

Tendering can deliver sub-optimal solutions

Integrated solutions invariably require respondents to partner or engage subcontractors in delivery. We have observed five common threads to industry's choice of partners and subcontractors in tendered responses:

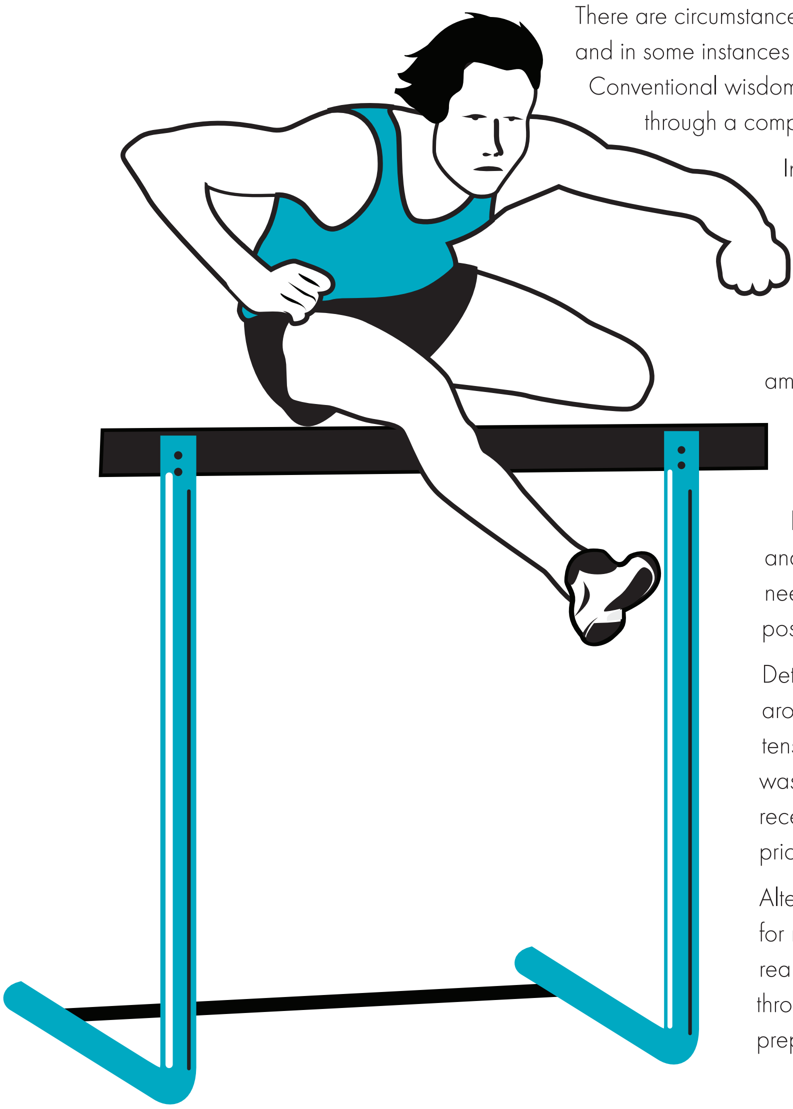
- the competitive advantage offered by the prospective partner, especially in regard to technology and service delivery components
- the commercial arrangements between the parties
- the availability of the subcontractor/partner—that is they have not been conflicted with some other respondent through previous or current activity or ownership issues
- who the tender design team actually knows from previous experience, corporate relationship, or often simply through unsolicited meetings at industry forums or through searches
- the trust and belief that the parties can work together both immediately in the delivery and in the longer term sustainment.

It would be trite to suggest the choice of partners in bid architecture is a process left to chance by the industry participants; however a level of serendipity does apply. Similarly, while we wouldn't suggest that these are prioritised factors, the competitive proposition does appear to supplant other considerations. The number of difficult relationships between primes and subcontractors suggests that consideration of a sustainable relationship is not given a high weighting, ultimately to the detriment of both the acquirer and the prime contractor.

In addition to the cost and distraction to management when dealing with dysfunctional contracts, the other consequence of leaving partnering to the respondents is the likelihood of a sub-optimal solution design. Various offers will contain the best solution for the differing tendered elements. This leaves the purchaser with a Hobsons's Choice, any selected tendered solution will have sub-optimal components to the solution and the optimum solution is inaccessible because of the tender construct, probity and the tenderers' commercial arrangements. A simple example is where the best technology solution resides in one offer and the best integrator in another. The construction industry tackles this problem by employing managing contractors, separating design and integration management from the delivery contractors allowing a choice of sub-contractors based on their capability and price at the time the services are needed. Some segments of the IT industry have moved to identifying preferred technologies and engaging separately the integration and change/implementation contractors.

Separating tenders and adopting selective sourcing does require solution design, a more complex approach than simply the articulation of the problem (requirement) in a tender. The design of the solution, the tendering and contract constructs should unleash the value proposition of the industry, not deny access to it.

Cost of entry is high



There are circumstances where incumbency provides natural advantage and in some instances that advantage is almost insurmountable. Conventional wisdom would suggest that the market be tested through a competitive process.

In a recent assignment, illustrated earlier, there was significant pressure to take the requirements to the market and not engage in negotiation. We had calculated that the incumbent had invested $10–$15 million to establish a bespoke service delivery capability for that contract. This had been recovered, reasonably, through amortised payments over the life of the contract. The client had essentially paid for that infrastructure and start-up investment and if it engaged in a competitive process would pay for it again. The incumbent most probably would have priced lower than the competitors as they better understood the risk and could re-use the infrastructure, but they would only have needed to price better than the competitors, not at the best possible price.

Detailed preparation and analysis allowed a direct negotiation around the reasonable cost of service delivery. Competitive tension was applied by the threat of competition if an outcome was not achieved within an acceptable timeframe. The client received an outcome that was the best possible commercial price, rapidly, and without the risks and costs of tendering.

Alternatives to tendering almost certainly deliver better value for money in certain circumstances. That value proposition is realised by developing a strategy, and negotiating power through circumstances (the threat of competition) and detailed preparation (understanding the business dynamics).

Tendering encourages 'price-free policy'

Tender development is undertaken in isolation from the market. It engages a broad congregation of stakeholders, each holding the keys to the release of the tender and achievement of the project timeframes. Individual stakeholders have to approve release and if their specific agendas are not met, often in their prescribed manner, then approval for release is withheld. The project team, taking the path of least resistance and often not recognising the likely commercial impacts, includes the specific requirement without it being tested. Client policies are therefore implemented by the policy owner (stakeholder) without care to the commercial implication for the purchasing organisation.

These are 'price-free policy zones' and they abound in public and private sector organisations alike, often imposing pseudo-sacred guidelines as inviolable rules. In a recent program in which we were engaged, the requirement was for the contractor to deliver an agreed performance against inventory record accuracy (the matching of the actual holdings to the record of the holdings). The stakeholder policy imposed stocktakes were to be undertaken by two people instead of one. The incremental cost was estimated at $2.8 million per annum and arguably the policy offered little value as the contractor was held to an accountable performance standard regardless of how the service was delivered.

There are policies that must be implemented and they will cost: environmental, occupational health and safety, mission critical and security to list a few. However, the tendering process encourages the inclusion of all policies regardless of their importance or commercial impact.

Adopt a strategic approach to deal making

Finally we observe that tendering is often implemented as an unambiguous linear process: conduct an RFP/EOI, potentially shortlist, finalise requirements and stakeholder wishes, release tender, evaluate and select, negotiate and contract. Sometimes a parallel negotiation is undertaken between two shortlisted contenders.

The most significant weakness is that the tender process is seen as the mechanism for achieving value for money. Value for money is actually assembled through the crafting of a deal, realised through the final negotiations. The tendering process is merely the process for selecting the parties with whom one wishes to negotiate. It is the negotiation that develops the value in the deal.

Too often we see negotiations at the end of a tender process relegated to an argument over contractual terms and conditions, definitions of requirements in the statement of work and a debate over price. Even where parallel negotiations are held they become a point of leverage rather than a mechanism for developing a better outcome. Contractual terms and conditions, including the detail of the statement of work, describe the deal. Negotiating those issues does not create a better deal, it just better describes the one that has already been done.

There is an old adage that says 'start with the end in mind'. We recommend a more strategic approach to deal making than simply the prosecution of a tender.

Begin with an understanding of what constitutes a 'value outcome'. This is not price, though affordability ought to be part of the discussion. A clearly articulated view of what satisfies *value* should be settled before embarking on the procurement process.

Then develop the strategic pathways that will get you to the negotiating table with the parties best able to deliver the value you seek. It might be competitive tendering, but it might not. If it is tendering, beware and test for the pitfalls. We have, in the past, adopted the industry practice of independent bid review (generally known as 'red teams') to tender development with a specific remit to ensure that the tendering opens the opportunity for commercial deal making and doesn't unnecessarily constrain it. Prepare a parallel view of responses, whether they are from tendering or through some other process, so that the value of the proposal offered is clear.

Use the negotiation process to improve the solution and the price and avoid the temptation to immediately start arguing over terms or detail of the offered solution. Use the initial stages to explore what constrained the respondent:

- what could they do better if the RFT was changed?
- what would they change in the tender?
- what constrained their price?
- where were their risks?
- how did the risks affect price and the solution?
- what could be changed to improve value?

Engage the respondents in improving the requirements and the solution. Then you can choose which deal provides better value for money which can then be reflected in a contract. Competitive tendering is a valuable tool, and will always be used widely. The mistake is to consider it to be the only tool at hand. Even when adopted it should be used as one element of a considered strategy for getting what you want on the terms you want—the definition of value.

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