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A $400 Billion Opportunity

10 Strategies to Cut the Fat Out of Federal Procurement

Raj Sharma November 2010

Doing What Works Advisory Board

Center for American Progress

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CAP's Doing What Works project promotes government reform to efficiently allocate scarce resources and achieve greater results for the American people. This project specifically has three key objectives:

- Eliminating or redesigning misguided spending programs and tax expenditures, focused on priority areas such as health care, energy, and education
- Boosting government productivity by streamlining management and strengthening operations in the areas of human resources, information technology, and procurement
- Building a foundation for smarter decision-making by enhancing transparency and performance measurement and evaluation

Contents

Introduction and summary

The federal government can save between $25 billion and $54 billion a year by changing the way it buys goods and services, according to a new analysis from the Center for American Progress. That's roughly $400 billion in savings over 10 years on average, or a 7.5 percent annual reduction from current federal procurement spending levels of more than $500 billion a year.

As the White House and Congress fight over how to reduce the budget deficit amid growing demand for government services, the reduction of procurement costs offers an attractive path forward for all sides, especially in light of private-sector successes in this arena. Indeed, business-affiliated groups including McKinsey & Co., the Tech CEO Council, and the IBM Center for the Business of Government have all also issued reports in the last two years identifying billions of dollars in potential savings.

The good news: The cost-saving approaches we identify are proven to work and make common sense. And every dollar saved by making procurement more efficient is a dollar that doesn't have to come from cutting vital government programs or raising taxes.

The caveat: It's hard. The government's sheer size and multitude of interests are a challenge to any meaningful procurement reform. Coordinating and monitoring activities across multiple agencies and bureaus that employ 1.9 million people is a massive challenge.

To make the challenge less daunting, this paper distills a comprehensive procurement-reform agenda into 10 proven strategies that can be applied by anyone in an agency looking to improve performance and reduce costs. To be sure, some of these approaches are more applicable to certain types of goods and services but collectively they form a roadmap to addressing the problem of procurement waste. These 10 strategies are coordinated with the three phases of the procurement (more broadly referred to as "acquisition") process:

- Planning: Program managers and end-users define what and how much they need to buy.

- Negotiation: Procurement officers, along with other parties, plan the purchase, invite potential suppliers to bid for government work, negotiate with suppliers, and write a contract.

- Management: Program managers, procurement officers, and others make sure the product or service is delivered and used as expected.

The 10 strategies

This paper details the following 10 strategies to cut costs in federal procurement. We identify successful examples currently underway and list specific steps to implement each approach.

- **Estimate demand—know how much you need.** So-called accurate-needs estimates help set budgets, predict required operational capacity, and provide suppliers accurate demand information that can improve government's ability to negotiate better pricing.

- **Plan better, use less—separate what you need from what you want.** The easiest way to reduce costs is often simply to consume less. That starts by tying every purchase requirement to an identified need, not merely a desire.

- **Buy commercial—buy what people are already selling.** It's almost always less expensive and less risky to buy an "off the shelf" product than to commission a customized version. But it requires extensive research and discipline to stick to what the market offers.

- **Source strategically—coordinate and consolidate your purchases.** Instead of purchasing something whenever a need arises, "strategic sourcing" means coordinating across offices and taking a step back to determine the best way to purchase a good or service on an ongoing basis.

- **Maximize competition—make it easy for vendors to save you money.** Competition lowers costs, promotes innovation, and improves performance, so procurement officers should always strive to structure orders that attract multiple serious bidders.

- **Negotiate intelligently—know everything about your bidders.** Smart buyers understand every aspect of cost for a product or service and arrive at the negotiation table armed with extensive knowledge of the bidders.

- **Simplify and automate—keep it simple, stupid.** Procurement officials should eliminate bureaucratic hurdles that deter competition and they should automate processes wherever possible.

- **Manage supplier relationships—get what you paid for.** The buzz phrase "supplier relationship management" refers to a conscious effort at proactively managing supplier performance and relationships across an organization. This improves management of suppliers across multiple contracts and gives buyers better insight into vendor operations.

- **Manage costs jointly—lower your supplier's costs to lower your own.** Working with suppliers to increase efficiencies and remove waste across the entire supply chain can ultimately reduce costs for government.

- **Manage internal and contract compliance—show me the money.** When agencies don't ensure cost-saving strategies are being used and suppliers are complying with contract terms, predicted savings can "leak" out. Compliance management requires an unrelenting focus on implementation to ensure "identified" savings become "real."

By adopting these 10 strategies, the federal government could rein in the growing share of the federal budget that goes toward procurement costs, which ballooned in the first decade of the 21st century under the Bush administration. (see Figure 1)

But a cost-containment initiative will only work if agency heads are required to reduce their budgets to account for estimated savings. It must be a use-it-or-lose-it proposition: Either you use these strategies to cut costs—or you cut your budgets elsewhere.

In the pages that follow, this report will detail the current procurement problem to highlight the opportunities available to the federal government to operate more efficiently and effectively, then offer the cost-cutting framework needed to make these reforms happen. We then detail our 10 strategies for procurement reform to demonstrate that progressive reforms to the procurement process can ensure the federal government is doing what works to help rein in unnecessary government spending.

Procurement reforms are critical

The cost of government procurement exploded during the Bush administration

Year	2001	2002	2003	2004	2005	2006	2007	2008	2009
Purchases	$ 223.1	$ 262.1	$ 304.2	$ 345.7	$ 390.9	$ 432.0	$ 468.0	$ 540.6	$ 538.8

Source: www.usaspending.gov.

The procurement problem

The federal government spends more than $500 billion a year procuring—or buying—everything from consulting services to ballpoint pens to fighter jets. Procurement outlays rose by $316 billion, or 142 percent, during the Bush administration as the table on page 4 shows.

The surge in federal procurement has also resulted in a significant increase in waste. "Far too often, the spending is plagued by massive cost overruns, outright fraud, and the absence of oversight and accountability," President Barack Obama said in March 2009. "We are spending money on things that we don't need, and we're paying more than we need to pay."

Consider two telling examples from 2008:

- More than 400 active information technology projects, representing more than $25 billion in spending, were poorly planned or poorly performing, according to the Government Accountability Office. Some of the projects had been delayed for more than a decade and cost billions more than originally budgeted.[1]

- The Department of Homeland Security in its first five years of existence oversaw $15 billion worth of failed contracts. "You're talking about a third of the agency's contracting spending that's resulted in failed contracts," said Scott Amey, general counsel for the Project on Government Oversight, in 2008.[2]

The Obama administration, to its credit, recognized the problems early on and made reducing waste in procurement a key priority, establishing a $40 billion savings target over two years.[3] The White House appropriately emphasized in a March 2009 directive that officials should better manage the government's risk in contractual relationships, strengthen competition, and reduce the use of contractors where government has relinquished too much control to the private sector.[4] The administration has also began to rebuild the procurement workforce, aiming to increase the ranks by 5 percent at every civilian agency.

The Defense Department in September 2010 released its own detailed plan to reduce procurement waste. There, the focus is on measures that control cost growth, incentivize productivity and innovation in industry, promote competition, improve the purchase of services, and reduce unnecessary processes.[5]

Experts remain skeptical about whether these initiatives will lead to real change and measurable savings. "[President Obama] pledges to reduce cost-reimbursement contracts and sole-source awards," Steve Kelman, procurement director under Bill Clinton, told the *Federal Times* soon after the initial guidelines were released in April 2009. "Most contracting experts, however, would put these low on the priority list of the myriad targets of opportunity for improving the procurement system," said Kelman, now a policy professor at Harvard University's John F. Kennedy School of Government.[6] The priority, Kelman added, should be adding procurement specialists to the federal workforce.

The government also lacks engaged leadership at the agency level, according to David Litman, a former senior procurement executive in the Transportation Department. "The real savings are in making thoughtful, strategic decisions about what to buy and how to buy it, and that is an agency leadership issue," Litman said in an interview. "Leadership is not engaged. Until they are, not much will change."

But when they do, they'll find an opportunity for major change staring them right in the face.

The opportunity

The federal government can save between $25 billion and $54 billion a year through a comprehensive and coordinated approach to purchasing, according to our analysis. An average of that range suggests about $400 billion in savings, or a 7.5 percent reduction in federal procurement spending over 10 years.

To be sure, it may take a few years until all the reforms suggested in this paper can be fully implemented. But even when we factor in the "ramp up" time, we still predict $330 billion in savings after a decade, savings that can be used to take a meaningful bite out of the national deficit.

Our annual savings range is not that far off from the Obama administration's goal of $40 billion savings over two years, though we go after more sources of waste. We also emphasize the need to set budget-reduction targets, much as the Defense Department is doing, to make the savings "real" in the eyes of the government managers, lawmakers, and the public.

We arrived at these numbers by applying a set of benchmarks collected from consulting firm A.T. Kearney's so-called Tangible Results Database. The proprietary database, which includes low and high ranges of savings based on thousands of real projects, is used to predict savings at any organization. See the "Methodology" box below for a detailed explanation of our calculations.

Policymakers who follow activity in this space will notice that our estimates are low compared to other cost-reduction claims:

- McKinsey & Co. in 2009 said that a 5 percent to 15 percent improvement in the efficiency of federal government operations could generate $450 billion to $1.3 trillion in savings over 10 years.[7]

- The Technology CEO Council, which represents chief executives from companies including Motorola, Dell, and Intel, said in October 2010 that "decreasing duplicative supply chains" could save $500 billion over 10 years, and that reducing fraud would shave another $200 billion during that period.[8]

- The IBM Center for the Business of Government this year identified potential savings of $500 billion over 10 years through "streamlining government supply chains."[9]

We have intentionally moderated our estimates to account for the precautions government agencies must take when procuring goods and services from the private sector. Regulatory requirements for competition, transparency, and minority participation all add to the cost of public procurement, and for good reason.

The next section lays out a comprehensive cost-reduction framework—strategies to squeeze out waste across the purchasing process and throughout the government supply chain.

Methodology

Our analysis shows the government can save $40 billion a year by following 10 cost-saving strategies proven to work in the private and public sector. Here's how we arrived at this number.

We first aggregated raw purchasing data in the Federal Procurement Data System into "spend categories," which are groupings based on how suppliers are organized. "Motor vehicles," for example, is a category that includes suppliers of passenger and other four-wheel vehicles. We used fiscal year 2009 data, the last year for which complete data were available at the time of this analysis. Total federal procurement spending that year was $534 billion.

We then used consulting firm A.T. Kearney's Tangible Results Database* to identify potential savings ranges, both a low and high number, for each spending category. We adjusted the savings range to account for outliers and higher compliance costs associated with government contracts. Specifically, we adjusted the bottom number up by 10 percent, accounting for outliers on the low end. On the high end, we took a conservative approach and reduced the upper number by 20 percent, accounting for the increased complexity of government procurement.

The database predicts possible savings for IT equipment procurement between 5 percent and 11 percent. A 10 percent adjustment up on the low side yields 5.5 percent. An adjustment to reduce the high end by 20 percent yields 8.8 percent. So the range we applied for our savings estimate on government purchasing of IT equipment was 5.5 percent to 8.8 percent.

We then applied an "addressable" spending range to each category. "Addressable" is defined as the percent of total government spending that can benefit from cost-reduction strategies. In the long term one might assume that 100 percent of spending is addressable. But we took a more conservative approach. For "commercial" categories, where government isn't the only customer and a commercial market exists (i.e. office supplies), we applied a 90 percent adjustment. That assumes that cost-reduction strategies can be applied to 90 percent of what the government spends in this category.

For "government" categories, where government is the primary buyer and no commercial market exists, such as weapon systems, we applied a conservative 60 percent addressable number. We used a more conservative number for government categories because there may not be as competitive a market for government-specific requirements and those products are likely more subject to government regulations and appropriation rules.

For example, annual spending on information technology equipment and software is roughly $11.2 billion. Since IT equipment is commercially available, we applied a 90 percent adjustment, giving us approximately $10.1 billion in addressable spending. Explosives, which cost the government about $2.9 billion a year and are a government-only category, were subject to a 60 percent adjustment, yielding $1.75 billion in addressable spending.

We then applied the adjusted savings range detailed above to the "addressable" spending to give us a total range. We applied, for example, the 5.5 percent to 8.8 percent adjusted savings range to the $10.1 billion of addressable IT equipment spending, giving us a total savings potential of $600 million to $900 million a year.

Next we added up the savings estimates across all categories, giving us a total range of $25 billion to $54 billion. An average of that range multiplied by 10 years comes out to about $400 billion. Finally, we assume cost-reduction initiatives take some planning and time to "ramp up." Based on past experience, we assume a conservative $5 billion in savings the first year, followed by $10 billion more in the second year, an additional $15 billion in the third, and then finally $10 billion more in the fourth. Since savings are recurring and therefore counted for each subsequent year, we can expect $330 billion in cost savings over the first decade.

*The A.T. Kearney Tangible Results Database is a compilation of historical savings achieved by A.T. Kearney clients when pursuing cost savings strategies similar to those described in this paper. Most examples are from the private sector. In addition to this proprietary database, we also relied on information from Censeo Consulting Group, and from media accounts of successful cost-containment exercises.

A cost-cutting framework

"The current state of the acquisition process is unacceptable and in desperate need of reform," proclaimed the Defense Science Board in an April 2009 report.[10] To address the problem, we need to first define the government's purchasing process. Our cost-reduction strategies target each of the following three phases in the acquisition process:

- Planning phase: Program managers and end-users define what and how much they need to buy.

- Negotiation phase: Procurement officers (more commonly referred to as contracting officers), along with other parties, plan the procurement, invite potential suppliers to bid for government work, negotiate with suppliers, and write a contract.

- Management phase: Program managers, procurement officers and others manage contracts, supplier relationships, and total costs.

The inefficiencies that plague the federal purchasing system exist across each of these three steps and have been acknowledged for years. "It is no secret that the acquisition process is complex and encounters many problems, from poor planning to ineffective vendor management," said Allan Burman, former administrator of the Office of Federal Procurement Policy, in an interview. "Taken together, these problems can undermine any procurement."

Cost-cutting initiatives tend to focus mostly on the second step of the process: negotiation. To be sure, increasing competition and taking better advantage of the government's buying power will save taxpayer dollars. But those efforts, both appropriately emphasized by the Obama administration, do not address other root causes that lead to massive procurement failures.

The Defense Science Board cites problems in the first phase—"determining what to buy"—as the biggest problem plaguing government procurement. By failing to properly define what it needs, government often buys the wrong thing. No amount of negotiation or competition can fix that problem.

Consider the infamous "Katrina trailers," bought by the Federal Emergency Management Agency to house flooding victims in New Orleans. Not only did government waste $2.4 billion because it bought too many trailers (a planning phase failure), but it ended up paying more than $225 million to store them (a management phase failure).[11]

The next section of this paper proposes 10 strategies for comprehensive cost reduction, organized around the three-phase purchasing process. Put simply, we want the government to:

- Buy only what it needs: One current senior defense department official who asked not to be identified told us, "the best way to save money is to not spend it at all." His point was that we should make sure we buy only what we really need—and nothing more.

- Buy smarter: Just as the average American shops at wholesalers like Costco to save money through bulk purchases, the government must become an intelligent buyer fixated on cost savings.

- Manage for results: You wouldn't pay a contractor in full for a house-remodeling job without seeing that the work was properly done. Likewise, government needs to proactively manage for results and work with suppliers to reduce costs over time and across the entire supply chain.

Ten strategies for cutting costs in procurement

Each of the 10 strategies outlined in this section touches on many root causes, far too many to discuss in a short paper. The goal of this section is to provide a simple and digestible checklist of strategies that can be applied by anyone in the "acquisition" community seeking to drive efficiencies and reduce costs. To be sure, some of these strategies are more applicable to certain types of goods and services. But collectively, they form a roadmap for addressing all facets of the problem. Adhering to these strategies will require:

- A shift from focusing on mere price reduction to comprehensive cost reduction
- Collaboration across government's organizational silos
- Early and ongoing engagement with suppliers
- Sustained investment in the acquisition workforce

The first three strategies: Buy only what you need

"Government agencies are spending billions of dollars on IT investments that are redundant, [and] lack clear goals," Sen. Tom Carper (D-DE) said in 2008, referring to a spate of failed information technology procurements.[12] Whether making large IT investments, building an electronic fence along the Mexican border, or just buying computers, it's key to plan before jumping into a contract with a supplier.

Good planning starts with an understanding of the government's needs, a precise vision of the desired outcome, and knowledge of important constraints like timelines and budgets. Improving planning will require more than changing a process or writing new policies. It will require a change to the culture, from one of excess to one of frugality.

Estimate demand—know how much you need

Accurate estimates of needs help set budgets and predict operational capacity required to efficiently use the purchase. Giving suppliers accurate demand information can also improve negotiations as it helps them better manage their own operations and costs. The National Association of State Purchasing Officers notes that "definite order, definite delivery" contracts, with specific quantities to be purchased, result in "lowest possible price because of guaranteed demand."[13]

Example: A major U.S. military operation operates dozens of food service facilities around the world. When it examined them, the organization found that many of its facilities were essentially sitting empty and racking up operating costs. It then developed a model and established policy to better estimate how many facilities it needed to adequately serve its soldiers and families. It saved more than $10 million a year—or more than 4 percent of its total budget.[14]

Going forward: Program and procurement professionals should develop detailed understanding of required quantities of a product or service, not just high-level estimates. This information should be provided to potential suppliers and used to enhance negotiations and drive down total costs. Government agencies should also periodically review operations to ensure any excess capacity is being discarded.

Plan better, use less—separate what you need from what you want

The easiest way to reduce costs is often simply to consume less. That starts by tying every purchase requirement to an identified need, not merely a desire. This goes for simple decisions, like getting the right number of minutes on a wireless plan, and complex ones, such as eliminating redundant capabilities within a weapon systems portfolio.

Example: The Justice Department estimated that it could save $573,000 through fiscal year 2010 by setting up its printers and copiers to use both sides of the paper.[15] The U.S. Army decided not to buy a short-range guided missile system after determining it already had sufficient weapons with some of the same features. That decision saved $300,000 for each system not purchased, or millions of dollars in total.[16]

Going forward: Each purchase should undergo a "need" versus "want" test to ensure that requirements are prioritized according to degree of necessity. Requirement decisions should incorporate cost/value tradeoffs and a test for affordability. Environmental waste reduction should be factored into product decisions. These decisions will often require program managers and leaders who are empowered and understand the "big picture."

Buy commercial—buy what people are already selling

Just as "off the rack" suits are less expensive than bespoke versions, it's cheaper and less risky to buy an "off the shelf" product than commissioning a customized version. To buy what is readily available in the market, planners must simultaneously evaluate the market against their needs and have the discipline to stick to what the market offers unless customization is truly necessary. Buying commercial should increase competition because more suppliers can bid on standard products.

Examples: When a Defense Department office stopped requiring its supplier to customize computers with obsolete 3.5-inch floppy drives and other custom components, it saved as much as 32 percent for each computer.[17] When the Air Force examined using commercial fuel instead of specially formulated jet fuel, it estimated it would save nearly $52 million in one year.[18] The Army attributes its impressive track record since 2007 of receiving 133 helicopters on time and within budget to a decision to purchase commercially available helicopters for medical evacuation, security, and logistics needs.[19]

Going forward: Program managers should thoroughly research early in the purchasing process what is readily available in the marketplace. Requirements should be tied to a real "need" and matched to market standards where possible. Also, buyers should be mindful of requirements that increase supplier costs and limit competition. For larger procurements that may have been combined in the past, it may make sense to "unbundle" big orders into smaller ones, increasing competition and providing better and direct access to commercially available standard products.

The next four strategies: Buy smarter

It's no secret that the government purchasing process is cumbersome and slow. Most agencies have trouble coordinating purchasing activities across their own offices. Moreover, inadequate market research and poor understanding of supplier costs leads to higher taxpayer costs because of poorly structured purchasing approaches and ineffective negotiations.

The four smart-buying strategies below underscore the need to improve government's buying process and transform the federal government's decentralized purchasing culture into one characterized by collaboration and coordination.

Source strategically—coordinate and consolidate your purchases

Instead of purchasing something whenever a need arises, "strategic sourcing" means taking a step back and determining the best way to purchase a good or service on an ongoing basis. For common goods and services purchased across an agency or across the government (such as security guard services or express shipping), it entails working with other offices to share knowledge, understand suppliers, and determine a coordinated purchasing approach. Strategic sourcing often means pooling multiple purchases to leverage the purchasing power of an agency and "going to market" as a single buyer. Even in cases where it makes sense to purchase as independent buyers, sharing knowledge and resources often generates enormous efficiencies.

Example: In 2009, the Obama administration urged federal agencies to buy office supplies jointly through the Federal Strategic Sourcing Initiative. The government expects to realize more than $200 million in savings over four years even without the participation of every agency.[20] The U.S. Postal Service saved more than $2.5 billion by instituting a set of strategic sourcing practices and supply-chain transformation initiatives.[21] These included setting up several category management centers to coordinate purchases across various buying offices.[22]

Going forward: Agencies should be required to have strategic sourcing programs focused on central coordination of common goods and services. The government should pool purchasing volume across agencies whenever possible. And agencies should always catalog and share with one another—through formal "knowledge sharing communities"—contracts and other information. Leaders of program offices and other major "budget holding" entities should be required to participate.

Maximize competition—make it easy for vendors to save you money

Competition lowers costs, promotes innovation, and improves performance, so procurement officers should always strive to structure orders that attract multiple serious bidders. This may mean breaking up big procurements into smaller pieces so that more potential suppliers can come to the table. It also entails being wary of bidding criteria, such as "past performance," that disadvantage new companies. Finally, to attract bidders, procurement officers should be mindful of how the pricing structure—fixed price or "cost plus"—affects risk sharing between government and suppliers.

Examples: The National Nuclear Security Administration split what used to be one contract for cyber security and IT support services into two contracts in order to generate more competition.[23] The two contracts received numerous bids, resulting in $22 million, or 15 percent, savings over the life of the contract. The Department of Energy estimated it shaved $400,000 a year from a $2.3 million security services contract by swapping a sole-source contract with a competitively bid one.[24] Finally, the IRS's Enterprise Architecture Office switched one of its "cost plus" contracts to fixed price, resulting in approximately 20 percent cost savings.[25]

Going forward: Government should focus on increasing the "quality" of competition by breaking requirements into multiple contracts where consolidated requirements combine distinct supplier markets, such as administrative and professional services, and eliminating artificial requirements that may limit competition, such as past performance criteria that can only be met by the current supplier. To do this the government should provide adequate time to respond to a requirement, especially for larger purchases, and select the appropriate pricing mechanism to manage risk.

Negotiate intelligently—know your bidders

Smart negotiators understand every aspect of costs for any product or service they are buying. They understand what drives the costs up or down and use that knowledge to conduct focused negotiations. They are intimately familiar with the capabilities, history, and past performance of all the suppliers sitting around the negotiation table. And they know how to set up innovative and transparent competition tools, like reverse auctions. These qualities require experience and training. Therefore, smart procurement operations provide extensive negotiation training—especially for larger, more complex purchases.

Example: A procurement team in Minnesota negotiated prices for management services down 13 percent after the state established a negotiation training program and a centralized negotiation support staff.[26] The Department of Homeland Security spent $27 million less than anticipated on IT purchases by using reverse auction technology that allows bidders to place successive bids online.[27]

Going forward: Program managers and purchasing officers should research and understand the cost structure, including "cost drivers," going into any major negotiation. They should develop detailed "negotiation playbooks" to guide a focused negotiation approach with each bidder. Negotiations should also incentivize suppliers to reduce costs over time, with government and supplier potentially sharing in any overall savings. Given the technical nature of cost analysis, government agencies should centralize analysis and negotiation expertise for technical and large purchases. The training regimen should emphasize negotiation, with a focus on cost analysis and benchmarking.

Simplify and automate—keep it simple, stupid

Doing business with the government often requires vendors to negotiate a maze of regulatory and procedural hurdles, resulting in unnecessary costs. Varying formats for routine submissions, such as resumes, also add to suppliers' costs—and those ultimately get passed on to the taxpayer. Procurement officials should eliminate bureaucratic hurdles that deter competition and they should automate processes wherever possible.

Examples: A recent national study found that companies that use electronic tools to streamline purchasing reduce process costs by 48 percent and cut the overall transaction cycle in half.[28] The Department of Homeland Security decreased lead times required for IT purchases by more than 15 percent thanks to online procurement technologies.[29]

Going forward: The federal government should review and then eliminate all policies and regulations that add unnecessary costs to procurement. Agencies should develop standard templates for commonly requested bid documents, such as resumes and past performance data. Finally, every agency should use electronic platforms to manage procurements if they don't already.

The last three strategies: Manage for results

A signed contract signals the beginning, not the end, of the purchasing process. Indeed, organizations report that they only get about 54 percent of the potential value of their supplier contracts.[30] In order for the government to get it what it pays for, program and procurement officials must engage in a formal campaign of sustained "supplier relationship management."

Good relationships with suppliers have benefits beyond cost containment. "Partnerships [with suppliers] not only help with risk sharing, but they promote a better understanding of government needs and promote a continual improvement of services," according to the National Association of State Purchasing Officers.[31]

Our final three strategies are designed not only to better manage the delivery of negotiated contracts but also to ensure collaborative relationships with suppliers that can drive down costs over time.

Manage supplier relationships—get what you paid for

The buzz phrase "supplier relationship management" refers to a conscious effort to actively manage supplier performance and relationships across an organization. These relationships improve performance across multiple contracts and give buyers better insight into vendor operations. Another aspect of managing the relationship is helping suppliers improve service delivery and reduce costs throughout the term of a contract.

Just as we reward high-performing employees for exceptional performance, we should also reward high-performing suppliers for exceeding goals. As Mark Brown, then senior vice president and chief procurement officer for Whirlpool Corp. said during a procurement summit at Michigan State University in 2008, "Supplier relations [should] be managed with the same intensity as customer and employee relationships."[32]

Examples: The state of Connecticut is working with suppliers to structure payment terms that benefit both the state and suppliers. Under the win-win deal, vendors are paid earlier in exchange for price discounts to the state.[33] One company reported that its SRM program, as it gained momentum, progressively delivered increasing levels of savings, going from $20 million during the first year to more than $350 million in savings by year four.[34]

Going forward: Agencies should establish supplier relationship and performance programs that include key performance metrics, beginning with their largest suppliers. Performance information, in the form of live interviews and discussions with government managers, should be shared and used for past performance evaluation. Procurement contracts should include incentives for reducing costs and exceeding performance goals.

Manage costs jointly—lower your supplier's costs to lower your own

Negotiating price lowers the buyer's costs but may not necessarily take waste out of a supplier's operations. Changing payment terms from 30 days to 60 days, for example, may reduce a buyer's "cost of capital" but only passes that cost on to a supplier. Eventually, these costs may be charged back in the form of overhead and other expenses. By working with suppliers to better understand costs in the supply chain, companies such as Honda Motor Co. are able to improve product quality while lowering costs. As management guru Michael Hammer says, "collaboration with suppliers is not an option, it's an imperative."[35]

Example: Honda decided to cut the cost of producing a car by a staggering 30 percent for the 1998 Accord.[36] Dave Nelson, former head of the Honda of America supply chain, said in an interview that the company worked hand in hand with suppliers "to jointly analyze manufacturing processes and identify where waste could be taken out of the system." Honda was able to achieve their target cost position while ensuring suppliers remained healthy and viable.

Going forward: The federal government should work with suppliers to collaboratively reduce waste from supply chains. The priority of these efforts should be on the largest spending categories and largest suppliers. These programs must be led at the highest levels and also require supplier leaders to be fully engaged.

Manage internal and contract compliance—show me the money

Procurement reform business cases often "identify" savings that don't materialize, because employees don't follow the recommended strategies. Similarly, suppliers don't always comply with negotiated terms of a cost-saving initiative. In a 2008-09 study by Vantage Partners, procurement officers said they only got about 54 percent of the potential savings negotiated in supplier contracts.[37] Compliance management requires an unrelenting focus on implementation to ensure "identified" savings become "real."

Example: GlaxoSmithKline, one of the largest pharmaceutical companies in the world, estimated it increased contract compliance by more than 20 percent through a focus on implementation and an e-procurement system.[38] The University of Pittsburgh Medical Center is saving nearly $3 million through "improvement in contract compliance," according to James Szilagy, chief supply chain officer.[39]

Going forward: Agencies should establish a library of easily accessible key contracts, especially those requiring vigilance to ensure compliance. They should also establish contract compliance metrics to monitor performance. So-called e-procurement technologies should be used to increase contract compliance to the extent possible.

Getting started

The cost-reduction strategies described above are not new. They have been well understood for decades and been shown to work. Indeed, they are fairly simple. So why is it so difficult to enact them? Because of inadequate leadership, incentives, planning, and metrics. Let's take these hurdles one at a time.

Successful cost-saving initiatives in the procurement space require the committed support of leaders who control programs and budgets. When procurement reform efforts fail, it's often because of insufficient attention from the most senior leaders. Successful cost-reduction efforts, in contrast, start with engaged and accountable leadership, as the accompanying case study of Pennsylvania shows. (see box on page 21)

In addition to a lack of leadership, most organizations within the federal government have no real incentive to cut costs. Federal government budgets are based on the previous year's budget and historically increase every year. People don't get rewarded for reducing costs. Indeed, budget cuts are vigorously opposed by the various interests—business, political, and bureaucratic—that benefit from government waste. Appropriate counter-incentives are critical.

Any major initiative in a large bureaucracy requires a plan that clearly articulates goals, prioritizes initiatives, and provides a blueprint and schedule for implementation. Finally, an evidence-based system for measuring the results of any cost-saving strategy is essential. That's why Illinois hired an independent firm to audit its savings from a procurement-reform initiative and validated more than $529 million in savings during 2004 and 2005.[41]

Accurate measurement makes it easier to translate savings into concrete budget cuts or added investments. Without metrics, savings will evaporate. To avoid these pitfalls, the federal government should strengthen all procurement cost-containment initiatives by:

Leading the way in Pennsylvania

Gov. Ed Rendell shows how to make cost reduction initiatives pay off

Facing a $2.4 billion budget deficit, Gov. Ed Rendell of Pennsylvania immediately eyed the state's purchasing dollars as a source of savings. "We are determined to buy smarter," Rendell pledged in 2003 after taking office. "With initiatives that take advantage of our huge purchasing power for office supplies, parts and equipment, and even prescription drugs."

Through the end of 2009, the so-called Commonwealth Strategic Sourcing Initiative was generating an estimated $325 million in annual savings, averaging 20 percent in savings per initiative and amounting to roughly 8 percent in savings of the state's $4 billion in annual purchasing.[40]

Here are some notable lessons from Pennsylvania's success.

Budgeting for savings

Gov. Rendell required his budget office to incorporate reasonable savings estimates for each procurement initiative into the state budget, despite agency resistance. That meant each cabinet member had to successfully execute procurement reforms—or cut their budget in other ways.

Committed leadership

Gov. Rendell remained closely involved in efficiency initiatives, personally running team meetings nearly every month where new proposals for savings were reviewed and relevant assumptions for savings were evaluated. State officials credit that involvement as key to the state's success. "In the end, the Governor, his Chief of Staff, have to be supportive and back you up," said James Creedon, former secretary of general services.

Communication

Key to the initiative's success was direct communication with the public. Each procurement cost-savings initiative was launched with fanfare and easy-to-understand explanations. This public approach to driving procurement reform was critical to pushing back against interests who benefited from the state's old way of doing business. "Rather than being defensive about our new contracts, we were enormously proud of the savings and small business participation levels we achieved," David Yarkin, former Pennsylvania deputy secretary for procurement, said in an interview. "We used a variety of communications tactics to get the word out, including press conferences with the governor, editorial board meetings and legislative testimony."

Leading from the top

Cost-reduction efforts should be led directly by department deputy secretaries—or by the chief financial and acquisition officers with deputy secretary involvement. Agency and program leaders should be held accountable to "deliver" savings in the form of budget reductions.

Creating a culture of efficiency

Leaders should emphasize the importance of eliminating waste and communicate successes as they happen. They should give workers tangible incentives to reduce budgets by incorporating cost reduction in performance assessments. Specialized training in procurement strategies should be a priority.

Developing and managing a plan

When dealing with massive bureaucracies and billions of dollars, rooting out inefficient practices is hard work. Implementing any of the above strategies requires careful plans that articulate short-term and long-term goals, identify individuals responsible for discrete tasks, set clear timelines, and establish measures of success.

Measuring constantly

Cost-reduction plans should contain regular and rigorous measurement about how well the strategies are working—and precisely how much money is being saved. Without reliable measurements, it's hard to know what strategies work, and it will be difficult, if not impossible, to persuade the public and employees that government can be efficient.

Conclusion

As the Obama administration and Congress wrestle with how to reduce the budget deficit amid growing demand for government services and economic stimulus, reducing procurement costs offers a relatively attractive path forward. The money is there for the taking: $40 billion a year, on average, according to our conservative estimate. And it's an approach that appeals to politicians and people across the political spectrum. It will ensure our government procurement programs operate efficiently and effectively so that our government can save money and focus federal resources on other programs that protect our nation and the common good.

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