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Improving public-sector purchasing

To get the most out of the purchasing function, public institutions should gain a consolidated view of purchasing spend, set high aspirations for change, streamline buying processes, and strengthen the purchasing organization.

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and Nicolas Reinecke**

Purchasing is an important lever for public-sector performance improvement. Because the spending base is quite large—purchased goods and services account for one-third of total public spending, or about 5 to 8 percent of GDP in most Organisation for Economic Co-operation and Development (OECD) countries—improvements can have a substantial impact on budgets, freeing up resources for other priorities (Exhibit 1).

And the potential for improvement is large. In fact, in the more than 500 purchasing projects that McKinsey has supported in both the private and public sectors over the past five years, we have seen that improved purchasing yields an average of 15 percent savings, with projects in the public sector delivering the highest savings—an average of 28 percent. In our work with one European

central government, we helped the client achieve savings of €65 million, or more than 40 percent of the addressed spend base, in the first eight months of the program alone. But even a 15 percent savings would be quite significant for a typical public-sector budget.

At the same time, while purchasing improvements may not always be easy to implement, they are easier and quicker to implement than other budget-improvement levers—particularly initiatives that suggest a possible reduction of head count or a tax increase.

There are also important nonmonetary benefits that institutions can achieve by optimizing purchasing. One of these is transparency. Having a clear picture of what is being spent where, as



Brian Stauffer

well as simple and standardized processes for governing spending, enables managers to make better decisions and to plan effectively for the future. Another ancillary benefit is better compliance with regulation, such as a higher degree of assurance that all purchasing across the organization is conducted using the appropriate tender framework. More diligent fraud prevention is another benefit.

Challenges to address

To take full advantage of the opportunity, however, there are several hurdles institutions must clear.

First, public institutions often lack a consolidated view of their spending because purchasing responsibility is spread across many departments, and there is no unifying set of processes. Control of budgets may reside across multiple layers of authority, so there is little centralized oversight. This makes it difficult for institutions to know what they are spending or how many supplier relationships they maintain. This lack of transparency also makes it difficult for the institution, and even sometimes for departments within, to align on strategic priorities and targets. Certainly it makes it impossible to establish a

central performance-management system to track overall spending, employee performance, and quality of goods and services.

A second challenge is that the government's purchasing spend is a powerful tool for advancing various political objectives, leading to situations where capturing savings may be traded off for other goals. As a result, the degrees of freedom for the purchasing organization are often limited—sometimes even to the extent that savings are unwelcome. A typical example of this is when government uses purchasing to support the domestic economy, whether in general or to promote certain regions, industry sectors, or even companies. In connection with this last option, there is often talk of the importance of “national champions.” National security is also used as an argument for spending money domestically even when purchasing internationally would be less expensive. Other examples include supporting expensive but environmentally friendly products, purchasing from smaller businesses to promote innovation and entrepreneurship, or buying from companies owned by minority groups to promote diversity. A final example is that governments often commit

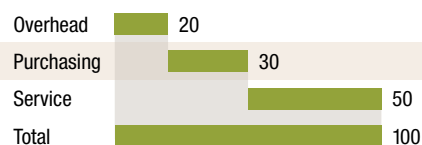
Exhibit 1

Significant share

Purchasing accounts for one-third of public-sector spending.

%

Typical breakdown of public-sector spending



Purchasing share of total spending

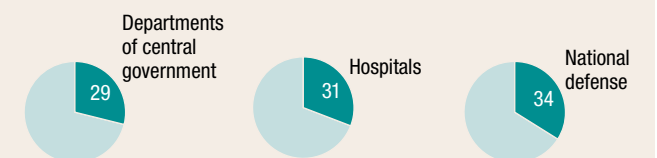


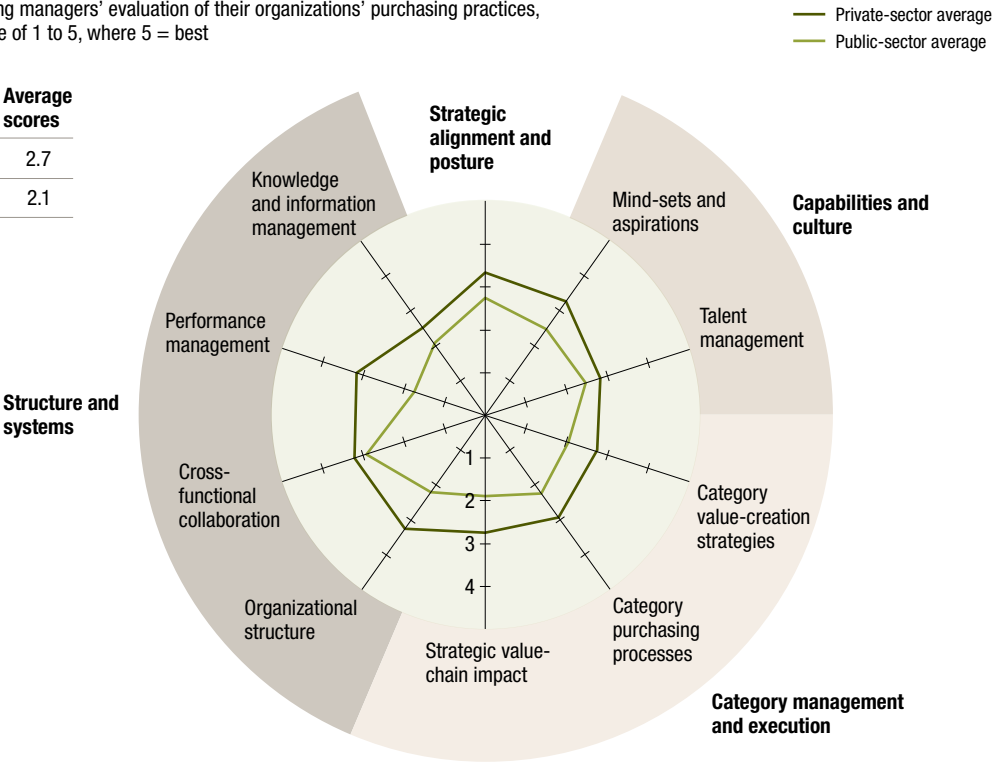
Exhibit 2

Comparing purchasing performance

In several dimensions, public-sector institutions trail private-sector companies.

Purchasing managers' evaluation of their organizations' purchasing practices, on a scale of 1 to 5, where 5 = best

	Average scores
Private	2.7
Public	2.1



Source: Institute for Supply Management; McKinsey analysis

to a fixed spending profile for a certain area (for example, 0.5 percent of GDP on foreign aid or 3 percent of GDP on research)—so the money “will have to be spent anyway.”

Third, the public sector is subject to complex and constraining procurement laws, which were established to ensure openness for every bidder and fair and nondiscriminatory practices in general. Institutions must solicit bids from many suppliers, provide detailed descriptions of the products and services they want to obtain, and follow predetermined time schedules in order to meet tender rules set out by the relevant authorities, such as the European Union, the World Trade Organization, US federal and state laws,

and so on. These regulatory frameworks often constrain the ability of a public-sector purchasing organization to leverage the same battery of purchasing tools available to their private-sector counterparts—and, consequently, their ability to claim the same level of savings.

Finally, basic performance in purchasing organizations in the public sector represents a challenge. A McKinsey survey of purchasing practices in more than 300 organizations in a wide range of industries revealed that public-sector institutions lag behind private-sector companies on several performance dimensions, including efficiency of purchasing tools and processes, capabilities, and performance management (Exhibit 2).

While there is a gap between public- and private-sector performance in almost every area, the gap is particularly large for “softer” dimensions, such as mind-set, aspirations, and talent management. Why should this be so? Two important reasons are that, first, the members of the purchasing staff are typically not on a career track as attractive as that of civil servants, which makes it difficult to attract and retain the best people. Second, a culture that rewards zero errors—for instance, one dedicated to “protecting the minister”—tends to favor preserving existing processes and mandates and offers limited incentives to aim for anything more ambitious.

Delivering the value

There are ways to address each of these challenges. In our experience, institutions can improve purchasing by gaining a consolidated view of purchasing spend, setting an appropriate aspiration for change, streamlining purchasing processes, and strengthening the purchasing organization. They can then take a phased approach to implementing these changes, beginning with a few key spending categories.

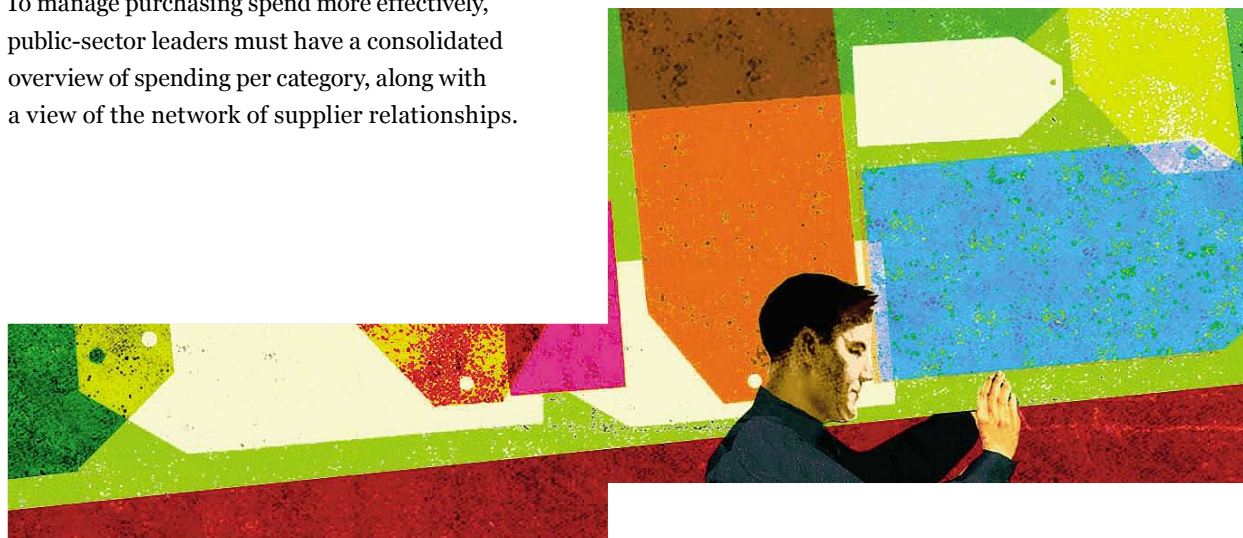
Create a consolidated overview of purchasing

To manage purchasing spend more effectively, public-sector leaders must have a consolidated overview of spending per category, along with a view of the network of supplier relationships.

Initially, this should be approached pragmatically, rather than attempting to establish a detailed picture of what is going on in all categories prior to capturing any savings. The information required to create the overview will typically not be readily available in the organization’s internal systems; many public-sector purchasing systems contain only an aggregated view for budget purposes (that is, the types of goods and services the organization buys) and an item-by-item record of purchases from each supplier. Therefore, managers should establish a manageable number of homogenous categories (typically around 30). To estimate the size and composition of these categories, managers must gather data from a variety of sources—including invoices, department budgets, and existing suppliers—to “triangulate” a perspective on the amount of money spent in each category.

Set the aspiration for change

How can public institutions manage the trade-offs described above between savings and other purchasing objectives (such as buying locally made products)? The answer is to ensure that the



Efficient purchasing frees up resources that can be reallocated to other priority areas, maximizes competition in the private sector (the core engine for long-term economic growth), and creates a strong supplier base that will be able to withstand open competition

purchasing decisions are made at a significantly higher level than is typical. The rationale is that while it might make a certain kind of sense to trade off *against* purchasing efficiency at a regional or local level, it will almost always be desirable at the level of the government as a whole to establish efficient purchasing as the leading objective. This is because efficient purchasing frees up resources that can be reallocated to other priority areas, maximizes competition in the private sector (the core engine for long-term economic growth), and creates a strong supplier base that will be able to withstand open competition. One European government anchored its purchasing optimization program in its Finance Committee, a group consisting of six high-profile ministers, chaired by the Finance Minister. The committee provided direction to other ministries during the program's rollout, addressing any resistance by explaining why the changes were necessary to provide funding for various government priorities.

Streamline purchasing processes

Each category of spend requires its own sourcing approach and bidding strategy. Our experience suggests that it is possible for public-sector institutions to apply the same approaches and tools as those used in the private sector and still operate a rigorous tender process within the constraints of relevant rules and legislation (Exhibit 3).

The purchasing organization should design the category strategies to take into account elements

such as product complexity and the competitiveness of the supplier market. One European government achieved savings of more than 30 percent on office supplies by combining a prequalification and an e-auction process. Generally, supplier workshops can be conducted within the tender rules if implemented at the appropriate point and in adherence to the principle of equal treatment of all suppliers. Analytical preparation (for example, cost-driver analysis or total-cost-of-ownership modeling) is obviously as important in the public sector as in the private sector. Some of the work, however, must be conducted earlier in the process to meet the requirements of describing all specifications and terms in the tender documents.

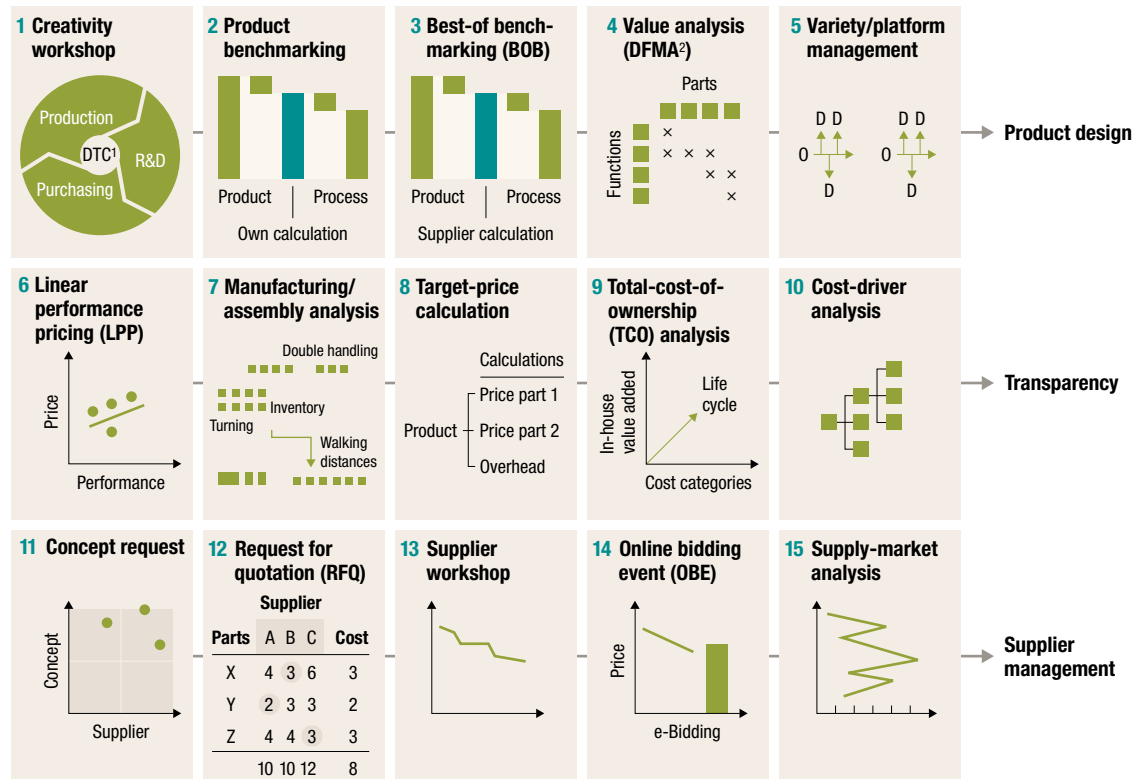
Complex product categories are typically best suited to functional tenders, in which the purchasing organization describes the functions of the product or the desired outcomes rather than technical specifications, and gives suppliers leeway to identify the best solutions. Selecting the right procurement channel ensures an optimal trade-off between the resources needed to procure the product, its quality, and its price.

The purchasing team should also establish binding rules for stakeholder participation—that is, formal channels for customers or other agencies to submit requests and access information. These processes will make it easier to manage competing stakeholder interests. Different players

Exhibit 3

Purchasing toolbox

These 15 methods can help improve product design, drive transparency, and manage suppliers.



¹Direct to consumer.

²Design for manufacture and assembly.

will always seek political leverage where they can, but it will be harder for them to prevail when there is a transparent and defensible process for evaluating requests based on need, budget, and institutional priorities. Making the tender process rigorous also makes it easier to spot inappropriate behavior, intentional or otherwise, thus minimizing the risk of complaints and lawsuits.

Strengthen the purchasing organization

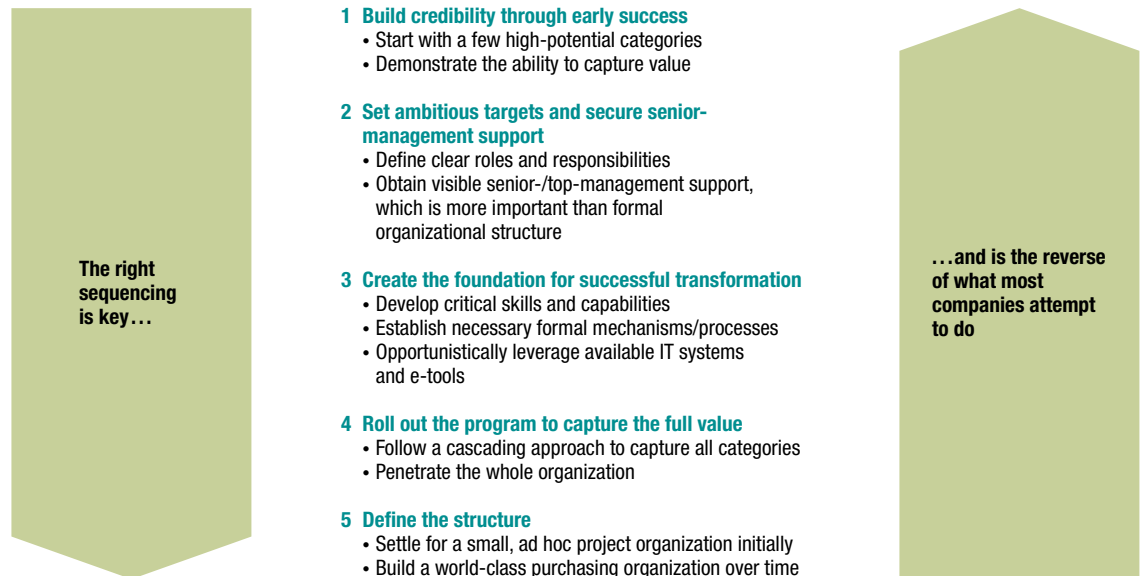
When creating the organizational platform for the effort described above, typically the best approach is to begin by establishing a small team of high performers to lead a centrally coordinated effort. As the processes become grooved in

key categories, the team can replicate successful methods from early initiatives in additional spending categories, training employees in those new areas and thus gradually building up the necessary capabilities throughout the organization. Leaders should also establish career paths for employees and require them to create personalized development plans aligned with the organization's priority activities and performance metrics. Public institutions can further build skills in the purchasing organization by establishing formal training programs in areas specific to procurement such as contract negotiation and category expertise (technology skills for the procurement of IT services, for example), as well as programs to

Exhibit 4

Starting small

A carefully phased rollout is crucial to a successful transformation.



develop organizational skills, such as coaching and mentoring.

One challenge must be carefully navigated in taking these steps. Instituting a more centralized purchasing process can result in poorer purchasing decisions if those decisions are made further from the point of use. Organizations must take care to ensure that those doing the purchasing work closely as partners with the relevant departments to understand and meet their needs.

Making it happen

When embarking on a program of this kind, sequencing is crucial. Many institutions start big and broad by defining an entirely new organization structure, along with new reporting lines and procedures. In our experience, it is best to take the opposite tack by beginning with changes in a few discrete spending categories and using the success of these changes as a foundation for making similar improvements in other areas (Exhibit 4).

By first demonstrating the potential for change, the leaders of public institutions will be more likely to gain the support of stakeholders and employees alike. The first wave of change should include a modest number of categories—typically four or five—where the ability to deliver value is most easily demonstrated. Relatively simple categories like IT hardware, office supplies, furniture, and office equipment are usually good candidates.

After demonstrating early successes, management can identify a set of ambitious savings targets for other spending categories and for the program overall. Throughout the effort, visible commitment among senior management is critical to maintaining momentum.

Over time, the initial pragmatic approach must be buttressed by a broader set of initiatives to create a foundation for capturing the full potential across all categories, and to make the improvements stick. As noted above, this requires transferring the capabilities developed in the core team

to the whole purchasing organization. Best practices for approaches, processes, and tools developed during the first waves of the program should be instituted as standard, and the organization trained accordingly.

through closer and more supportive management of its employees, and rolling out the change program in deliberate phases, public-sector organizations can generate significant value for other priorities. ○



Building a world-class purchasing organization takes time, but public-sector organizations can start small and capture considerable savings. By looking comprehensively at purchased goods and services, setting an appropriate aspiration for change, streamlining purchasing processes, strengthening the purchasing organization

