



CENTRALIZING GOVERNMENT PROCUREMENT

By Arun Bruce, Atul Jain and Ayotunde Obashoro

MOST GOVERNMENTS DO not leverage the power of combined sourcing. There are two main reasons for this; firstly, reluctance to let go of the de-centralized set up as it helps them retain full control and power over their sphere of influence, and secondly, legacy reasons – to maintain status quo as it has served them well so far.

Countries with de-centralized procurement, where government entities and state-owned enterprises (SOEs) conduct their respective procurement operations, are increasingly under pressure to capture greater economies of scale by replacing individual purchases with government-wide framework agreements and contracts.

Few developed countries have taken steps to embark upon some level of centralized sourcing and have reaped great benefits. The UK, for example, achieved savings of greater than GBP 500M¹ in 2015 - 16 through centralized sourcing of common spend of several government departments.

We estimate that countries can get up to 15% sourcing savings and 15% - 20% savings through procurement workforce reduction.

According to BCG's 2019 benchmark study of countries worldwide, many governments are adopting greater degrees of centralization in their procurement strategies. Learning from their successes, Middle Eastern countries can make the shift as well. This publication lays out the path for centralization of government procurement for Middle-Eastern countries.

Pitfalls of decentralized procurement

Many countries have long relied on decentralized procurement processes. Typically, requests for goods and services from individual government ministries are procured independently of the rest of the government. The procurement process usually include both sourcing and procure-to-pay (P2P) processes (See Exhibit 1).

EXHIBIT 1

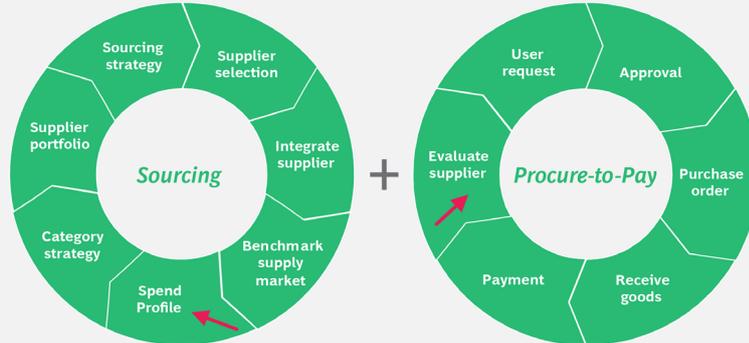
Typical Government procurement cycle: Blend of Sourcing and Procure-to-Pay



...performed "every time"

- Limited volume pooling
- Higher repetitive efforts
- Supplier, purchaser fatigue

Best practice centralized procurement cycle: Separate Sourcing and Procure-to-Pay activities



...conducted "once in few quarters" across entities

...repeated by each entity

- Pooled hence higher savings
- Efficient processes
- Effective supplier engagement

Decentralized procurement can be inefficient because repeatedly sourcing standardized products is time-consuming and costly. Opportunities to realize economies of scale are limited and scattered expertise across different entities makes it difficult to standardize processes and make consistently good decisions. The results: overspending, mismanagement of funds and reduced advantage in supplier negotiations.

In best-practice procurement, by contrast, the centralized procurement team initiates the sourcing process. Sourcing is carried out once per category with pooled volume and the entities are able to leverage already sourced deals. Additionally, processes are mostly automated.

There are several reasons why governments with decentralized procurement processes are unable to focus on savings. First, governments' procurement strategies often rely on demand management, which focuses on saving money. In itself, this is insufficient as a strategy for optimizing costs because it does not result in better prices, better value or better products.

Second, data is either unavailable or inadequate. In addition, each ministry typically

has its own system for categorizing data, making it challenging to consolidate the necessary data needed to assess possible areas for savings. It is worth noting that the total cost of these different systems is often higher than that of a centralized country-wide approach in the long run. Another critical factor is that different government entities usually have their preferred suppliers. Although this may benefit local suppliers, competition during the sourcing process is limited, and prices are higher than they need to be.

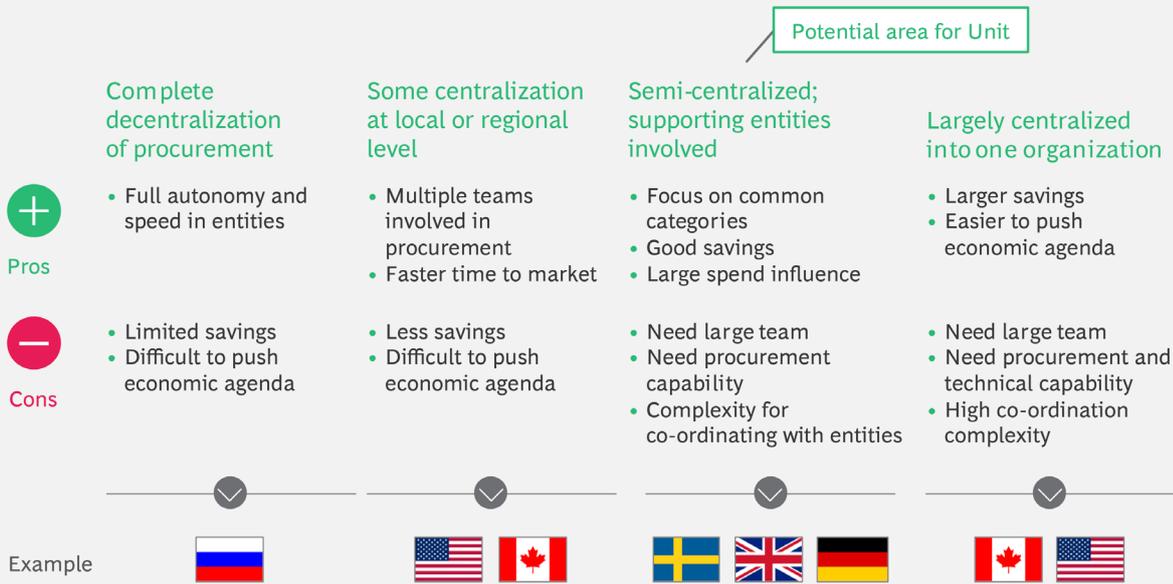
Challenges of centralizing procurement

Over the past 15 years, several governments, including the U.S., the U.K., Canada and the European Union, have made conscious efforts to centralize their procurement functions, primarily to improve cost savings. In addition to reducing costs by up to 15%, they have improved transparency and sustainability (See Exhibit 2).

However, centralizing procurement is not an easy task. It faces four key challenges:

- *Data issues.* First, lack of quality data, which is crucial for buying the product

EXHIBIT 2 | BENCHMARKED COUNTRIES EXHIBIT DIFFERENT DEGREES OF PROCUREMENT CENTRALIZATION



Source: Expert interviews, BCG analysis

with the right specifications and the best cost. Government entities do not usually register purchases with the level of details required for procurement. Some ministries do not have the taxonomy needed to categorize products on a granular level, while others do not categorize products at all. The lack of a uniform taxonomy makes it hard to know what the government purchases and what the specific buyer requirements are.

Second, government entities usually have unique P2P processes along with technology platforms that handle the steps from order management through to invoicing and payment. These P2P platforms can consolidate data, making it possible to construct a spend cube, a sophisticated method for analysing data. However, since there are numerous P2P suites that can be used, collating data from the different systems introduces complexities around data integration. No less important, ensuring the required accuracy from government employees who enter the spend data is challenging because of the tendency to perceive the task as mundane.

- Conflicting goals.* Governments that centralize procurement typically want to maximize cost savings. This goal could inherently conflict with other national goals such as local content development, since one of the levers to maximize savings is to adopt the least-cost supplier, which may be outside the government’s region. Governments have found it challenging to strike a balance between getting the desired savings from their procurement activities and promoting the development of local suppliers
- Increased time to source.* A decentralized organization knows products or services that need to be sourced and local suppliers that can provide it, so that sourcing is not time-consuming. However, when a central organization is in charge of sourcing, it needs to collect the requirements of all the different entities. The sourcing effort becomes much larger, involving more items to source and more suppliers, all of which takes more time. After the first year, though, the time to source goods and services drops significantly.

- *Skill gap.* It can also be difficult to recruit the right kinds of talent. People with experience in large-scale sourcing and category management are also in demand at large companies that can provide more attractive compensation than government entities.

A viable path to centralized procurement

To address these challenges, a few steps are critical.

Outline the Objectives and Key Activities of Centralized Procurement

The rationale for centralizing procurement needs to be clearly articulated. Objectives can range from maximizing cost savings to promoting national security. Given the potential for conflicting goals, it is important to determine upfront that cost savings take priority and delineate the activities required to get there. Articulating priorities ensures that there are no conflicts around the role of centralized procurement. If governments decide to choose conflicting goals, they should be aware of the trade-offs so that they can make the right compromises later on.

Understand the Current Government Procurement Landscape

- *Overall spend.* First, governments need to get a sense of the nature of their overall spend and how it compares to that of similar countries. They should then analyze spend by category. If data is lacking, category size can be estimated based on previous studies or other types of data. It is important to note which categories are common across government entities and can thus be centralized, as opposed to the ones that are specific to one or few entities. It may be possible to customize data of other governments in the Middle East given that their spend is similar.
- *Large entities.* It is essential to identify the biggest entities and the categories of items they purchase the most.

Knowing this will help in pinpointing where to focus the most attention – this is from where the most significant savings will come.

- *Types and quality of data.* Governments need to assess the quality of the data in their systems and ask critical questions. Does it follow a standard taxonomy? Is it categorized correctly, and with the right level of granularity?
- *Current IT system.* It is critical to know the kinds of IT systems in place, the functions they provide, and government ministries they cover. It can then be determined what to leverage from existing systems to avoid duplicating efforts. They can also help determine what kind of IT capabilities to build for specific ministries.
- *Current procurement practices.* To build new procurement processes, governments should have high-level view of current procurement practices. As procurement is mostly decentralized, all entities will be performing unique procurement processes, and these are likely to be at different maturity levels.

Determine Who Does What

After these priorities are clear, governments need to determine the procurement activities to be centralized. In the countries we benchmarked, every government procurement agency runs its own category management and sourcing, but not the procure-to-pay process. The only exception is Sweden, which outsources demand consolidation.

Based on our benchmarking study and our project experiences with several countries and large multinational companies, we recommend that governments in the Middle East centralize four sets of procurement activities:

- *Business intelligence.* The centralized procurement unit should handle spend data collection and analytics, which is the foundation of centralized procurement.

- *Category management.* The central unit should manage the categories that take strategic priority because they typically have the largest spend. Category strategies should focus on which levers to use, which suppliers to build a deeper relationship with, and so on.
- *Strategic sourcing.* It is critical to centralize strategic sourcing because this is where the government can realize the most cost savings through commercial and technical levers.
- *Supplier relationship management.* The central unit should manage relationships with suppliers of strategic categories.

Individual ministries should run other activities such as procure-to-pay processes. It is better for the more-operational activities “such as ordering, receiving goods and making payments” to be managed and funded at a local level since they require local approval, also since they are not the source of significant savings.

Set Up the Organizational Structure

To ensure the effectiveness of the central-

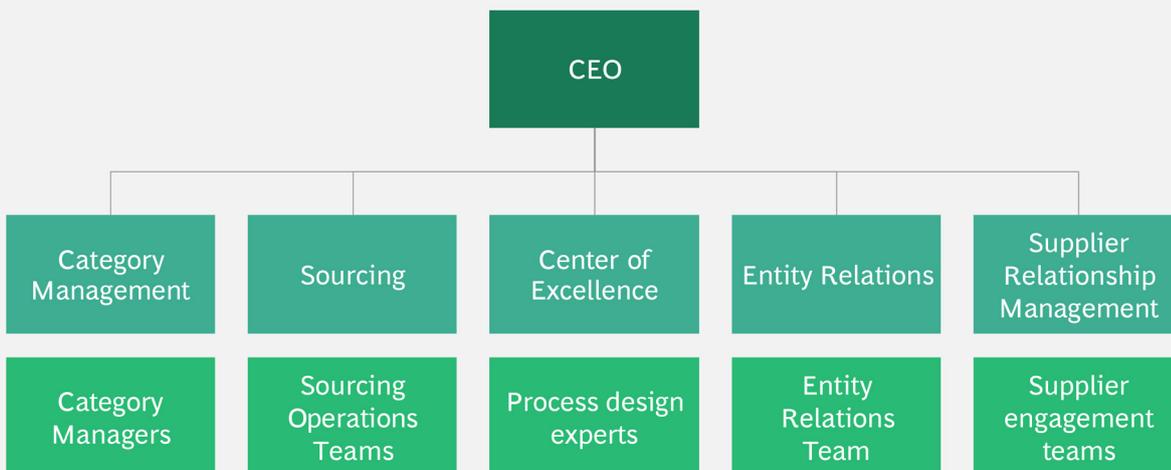
ized approach, the new central procurement unit needs to set up an organizational structure that is appropriate for the government structure. For example, the U.S.’s central procurement unit has a very complex structure because of the country’s central and regional layers of government. By contrast, a simpler structure will work in a country in the Middle East that has fewer layers of government.

A simple organization structure needs to have five departments: category management, strategic sourcing, centre of excellence, entity relations and supplier relationship management.

This simple organization structure should differ from the centralized approach in a few important ways (See Exhibit 3).

- *Separate category management from sourcing.* Creating different structures for category management and sourcing will make it possible to focus strategically on the most important categories, while sharing best sourcing practices across categories. Once strategic sourcing reaches critical mass, sourcing can be integrated into category management for each category (See Exhibit 4).

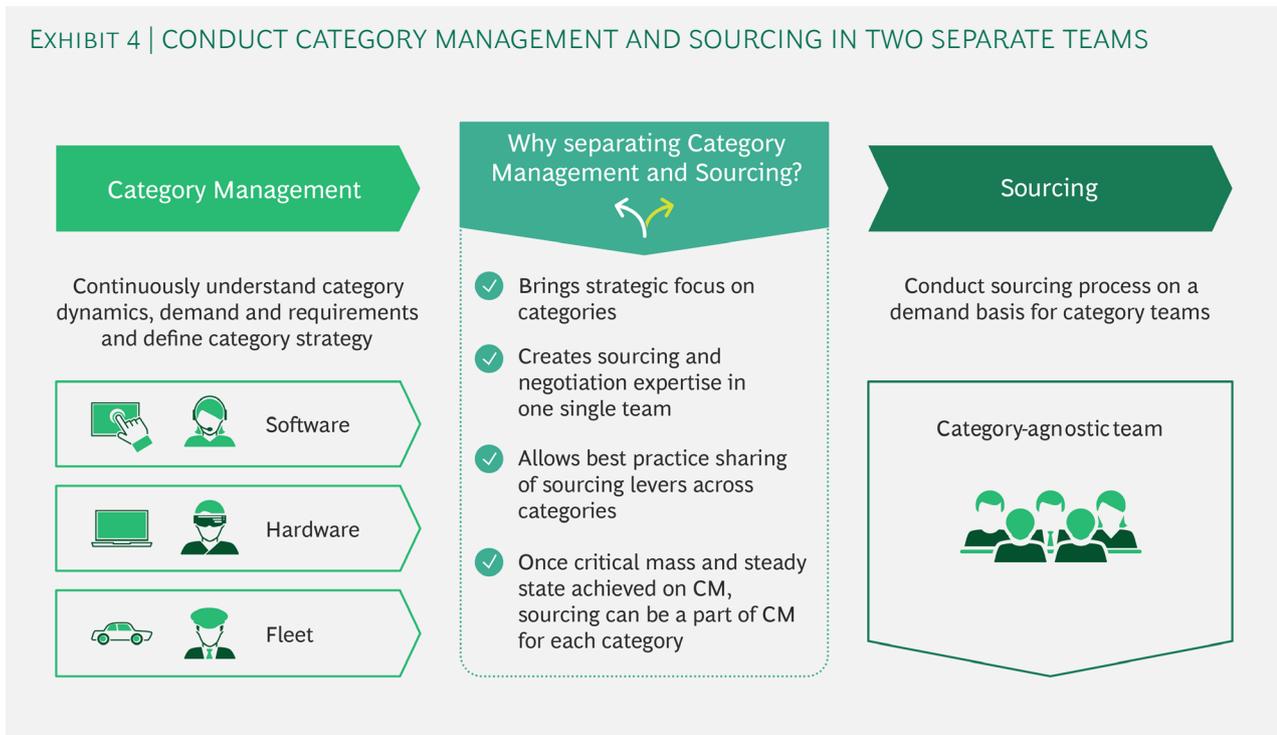
EXHIBIT 3 | THE GOVERNMENT PROCUREMENT UNIT SHOULD HAVE FIVE FUNCTIONS



Leadership level

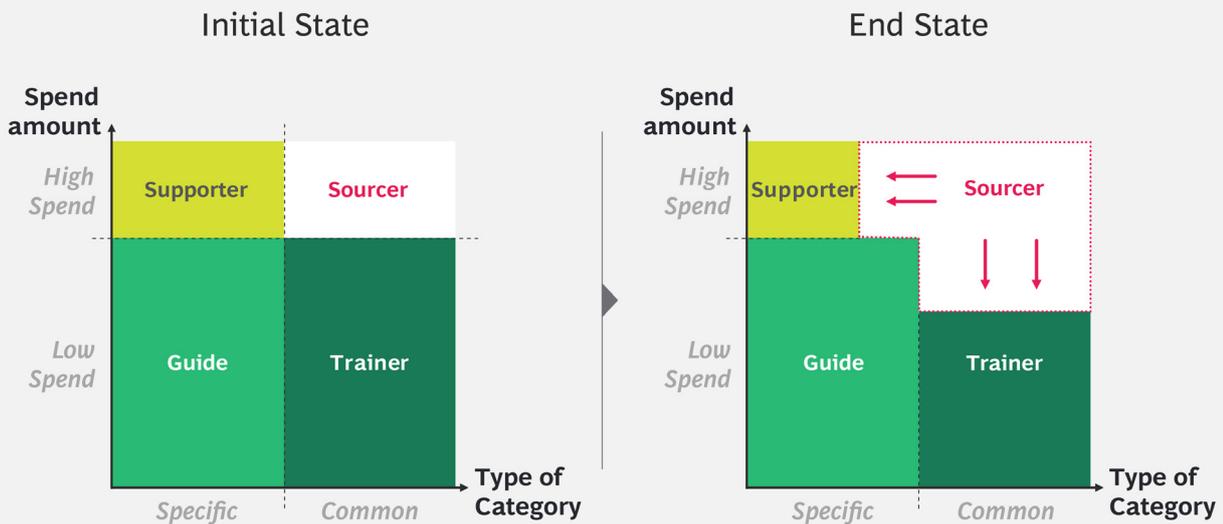
Note: ■ Level 1 ■ Level 2 ■ Level 3

EXHIBIT 4 | CONDUCT CATEGORY MANAGEMENT AND SOURCING IN TWO SEPARATE TEAMS



- *Create an Entity Relations function.* Due to the size and complexity of different procurement functions of government entities, the central unit needs a department dedicated to managing the relationships with them. This function, Entity Relations, should serve as a first point of contact with the entities. It will communicate with entities to promote centralized procurement and secure buy-in from various entities. The department will help in defining and collecting spend data that is critical for making centralized procurement effective.
 - *Build a Centre of Excellence (CoE).* If the new centralized unit is to have an impact on a broader swath of government procurement, we recommend creating a dedicated centre of excellence. The centre will develop methodologies, tools and templates to standardize procurement activities and promote a high level of performance for non-centralized government entities.
- Define Different Roles**
- The central procurement unit can play four roles — Supplier, Supporter, Trainer, and
- *Guide* — that can be defined along two dimensions, the type of category and the amount of spend involved (See Exhibit 5). Common categories are products and services that many, if not all, ministries source: laptops and transportation are good examples. Specific categories are sourced by only one ministry. For example, MRIs constitute a category that only the Ministry of Health would source.
 - *Common category/High spend - Sourcer:* The sourcing team of the centralized procurement function sources products or services.
 - *Specific category/High spend - Supporter:* The centralized procurement team do not source themselves but can support individual ministries by working alongside them in a team and providing procurement expertise.
 - *Common category/Low spend - Trainer:* The CoE should provide training programs to help improve procurement skillsets of various ministries.
 - *Specific category/Low spend - Guide:* The CoE should share best practices and provide guidance on sourcing.

EXHIBIT 5 | PROCUREMENT ROLES SHOULD EVOLVE OVER TIME



At first, the central procurement unit should focus on common categories with high spend since that is where best opportunities are for large-volume buying at lower prices. Individual ministries should handle everything else. Over time, the central unit should take on more categories from other quadrants of the matrix to increase savings. Common, low-spend items should remain within the purview of the individual ministries.

Address Key Obstacles

The central procurement unit needs to address data and skill obstacles standing in the way to ensure that the newly centralized setup can deliver

- *Collect high-quality data.* This can be done manually or technologically.
 - Manual collection. Having people to collect data is extremely labour-intensive, which involves not only collecting, but also collating, cleaning and categorizing spend data from various government entities. Aiming for 100% coverage is neither practical nor value adding. The goal should be to collect simple enough

data to generate the volume needed to realize sufficient cost savings. If manual collection is necessary, the centralized procurement unit first needs to make a list of prioritized categories that will and will not be sourced. It is also important to prioritize spend data that should be collected, focusing on the entities that are likely to have a large spend for the short-listed categories.

To collect data manually with less effort, we recommend sampling and extrapolation. Once the categories are finalized, data should be collected from only the one or two largest entities. Then logical extrapolation can be used to estimate spend of other entities.

- Digital collection. The ideal solution is to locate all spend data in a single IT system, but this poses several challenges. Recall that government entities have their own IT systems and way of categorizing data (if at all). It will take enormous efforts to develop a single categorization hierarchy that can be used across all entities.

For smaller countries, it is possible to develop a centralized payments system. Data cleaning and re-categorization are still needed not only because of different categorizations, but also because of lack of discipline in entering data. For larger countries, however, centralized payments may be a challenge because spend data will need to be consolidated and cleaned on a much larger scale. In either case, the results are well worth the effort: a centralized procurement function that delivers sustainable value in the long term.

- *Address skill gaps.* Middle Eastern governments typically do not have enough employees with the requisite procurement skills. There are a variety of options for alleviating this shortage:
 - External service providers. Using third-party providers to set up training programs will help kick-start the effort.
 - Recruiting from the private sector. Middle Eastern government positions come with the prospect of a good salary and the opportunity to potentially source goods worth billions. This may be an attractive incentive for private sector procurement experts.

- Internal or external training. Governments can train people internally or send them to another country for training. Sometimes, it works to create a bilateral agreement that allows two countries to share best practices.
- Job rotation. Another option is to transfer people from ministries that have more-mature procurement practices to the CoE for a stint and then on to another ministry where practices are less mature.

AS THE PRESSURE ON oil prices continues and budgets dependent on them get thinner, governments need to find new ways to cut costs. Centralizing procurement, with the potential to boost savings substantially, is one such way. Now that many categories can be sourced globally, there are the opportunities to reduce costs abound.

About Our Research

BCG conducted its government procurement benchmarking study in 2019, based on interviews with more than 30 experts. The study focused on seven countries: the US, UK, Canada, Germany, Sweden, Russia, and Saudi Arabia.

NOTES

1. National Audit Office, UK Cabinet Office, January 2017

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