

RESPONSE TO SOUTH AUSTRALIAN PRODUCTIVITY COMMISSION

GOVERNMENT PROCUREMENT ENQUIRY



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INTRODUCTION

The Industry Advocate is an independent statutory authority established by the *Industry Advocate Act 2017* (the Act) whose objectives are to facilitate economic contribution and economic development from public expenditure and ensure capable businesses based in South Australia are given full, fair and reasonable opportunity to participate in government contracts.

The Office of the Industry Advocate (OIA) is the only part of the South Australian Government that touches both goods/services and building/construction contracts within the procurement environment.

One of the functions contained in the Act is for the Industry Advocate to make recommendations to responsible officers for procurement and principal officers of public authorities to resolve complaints, remove impediments or improve procurement practices and processes.

Procurement is a broad and complex issue that has been identified as an area that presents opportunities for reform and simplification.

I fully support the South Australian Productivity Commission's (SAPC) Stage 2 findings with respect to the South Australian Industry Participation Policy's (SAIPP) application to construction work, as stated on Page 27:

➤There are clear deficiencies in the information recorded by agencies regarding their application of the SAIPP, and in some cases some deficiencies in practice, particularly the weighting. The Commission notes the OIA has work in progress that has the capacity to at least partially address these issues through better information and exercising the Industry Advocate's authority to seek improvement.

➤The SAIPP appears to be well-established in tendering for the state's construction work and for prescribed public authorities.

The OIA was established to improve industry participation in Government contracts and to act as a catalyst for change by listening to industry concerns. As a result of this, my office receives a wide variety of feedback from businesses and industry associations including members of Advisory Panels that were established for that purpose.

This submission will primarily focus on the experience my office has with the State procurement system and provide a response to the specific Industry Participation matters raised in the Stage 2 Draft report.

I support the Commission's overall view that 'currently the system is fragmented, unproductively prescriptive, cannot assess overall performance and does not focus on developing capability in the SA Government procurement professionals. The leakage of value is significant: the typical 5 per cent annual improvement could deliver this state \$500 million per annum'.

In 2014 the OIA engaged Ernst & Young (EY) to perform procurement review including a "top down" spend analysis, capability assessment and governance model assessment across SA Government procurement to determine if there was a sufficient high level case for change. The purpose of the engagement was to investigate the relationship between procurement efficiency and productivity improvement, while maintaining a balance between global and local supply.

The EY report found overwhelmingly that other government jurisdictions and private sector organisations are transforming their procurement functions end-to-end. This is mainly due to the growing acknowledgement that procurement is a significant economic lever to drive productivity gains whilst also recognising the existence of inefficiencies of the various procurement activities adopted by Government Agencies.

The EY report found that accessing procurement data from Agencies was complex and cumbersome, mostly driven by data sets being maintained in different locations making the central collation and analysis of Whole of Government procurement virtually non-existent.

It is therefore not a surprise that the SAPC found a *'recurring theme that there is a lack of data and information to provide evidence on trends in the procurement system and to support monitoring of performance and identifying areas for improvement. The Commission has heard this point from both stakeholders and public authorities'*.

That said, most Australian Governments have decentralised Agency-led procurement models to accommodate the management of State-wide contracts across major spend areas based on a differential use category management approach.

The EY Report also recommended the further development of the existing procurement capability/skill sets in all government jurisdictions which was partially due to the reductions in experienced and capable workforces. However, further analysis indicated this was due more to a focus on the 'transactional' components of procurement, rather than the more 'strategic' elements (market analysis/testing, supplier engagement/management, vendor negotiations).

THE PROCUREMENT SYSTEM

The *State Procurement Regulations 2005* exclude a number of procurement types, such as:

- a construction project exceeding a cost of \$150,000
- the acquisition and installation of fixtures, plant, equipment, appliances and fittings in conjunction with the construction work; and the acquisition of survey, planning, design and other services in conjunction with the construction work.

I can see no practical reason why these legislative exemptions exist.

As part of the recent Machinery of Government change, my office assumed the responsibility for reviewing Acquisition Plans for contracts where an Industry Participation Plan (IPP) is required, effective from the 1st July 2019. An Acquisition Plan is a document that outlines the methodology and strategy to be undertaken in procuring the required goods or services and is approved before the procurement strategy commences.

My office has identified that in order to effectively track the progress of IPP assessment, an IPP Reporting System was required that could capture the relevant data from Agencies/Authorities as part of the tender evaluation process. The reporting system needs to be able to generate meaningful reports and provide a summary of highlights. Investigating the establishment of such a system highlighted the various inconsistencies in the way data was collected by agencies over time such as:

- missing data - eg contract awarded, date of award, contract value;
- inconsistent data – eg does not match with data that found on Tenders SA website;
- IPPs are not always reported for each contract even where required; and
- some IPP's were provided where criteria did not require it.

This is consistent with the SAPC's findings and highlights a fundamental problem with the current system and reinforced the observations made in the Procurement Efficiency Review conducted by EY - that a major deficiency with the current system was the quality of the data collection.

In my evidence to the Statutory Authorities Review Committee on 19 November 2018 I stated a view that the State Procurement Board should be held more accountable for the procurement results of agencies and it was inadequate to simply devolve responsibility to agencies. This situation has changed somewhat in recent years but there is still a need for substantial improvement in the procurement processes and practices of agencies and authorities.

It would be fair to say that both the State Procurement Board and the Industry Participation policies are more than adequate however, it is in their interpretation and application where the problem exists.

The SAPC's Draft Report Stage 2 outlines three options that favour fundamental change for further discussion as follows:

- *abolishing the current fragmented arrangements;*
- *replacing the State Procurement Board with Procurement SA covering all procurement, led by a qualified Chief Executive reporting to a Minister with scope to implement targeted or whole of government procurement policies and initiatives; and*
- *driving the shift from the current rules-based, compliance-heavy procurement culture to a more professional judgement based model.*

The SAPC proposes that changes be phased in, with a focus on priority areas thereby enabling the effective management of any implementation risks and I support this approach and would like to have direct involvement in this process.

To assist with transitional arrangements, I suggest consideration be given to adopting a 'Hub and Spoke' model where one agency manages key parts of the value chain and common governance arrangements are promoted across all agencies by the 'Hub.' Each agency would still be responsible for executing the majority of procurement related activities but would cooperate to promote co-sourcing and standardising selected aspects of an agreed procurement operating model.

This approach would require limited structural changes to each Agency, could be implemented quickly and used as a 'stepping stone' to other models. The primary role of the Hub is to provide a single point of accountability for particular aspects of the procurement value chain and to leverage skills and resources across the SA Government, which can be adjusted over time to respond to changing levels of procurement maturity.

A very experienced Chief Procurement Officer would need to be appointed to take carriage of these changes and be given the 'authority to act' by the Government. Without such authority I cannot see the reform recommendations having the impact the Government is looking for.

At the same time there would be a need to seek greater clarity of the roles and responsibilities of procurement officers as a number of activities such as the preparation of acquisition plans are completed by budget holders (project owners) with little involvement from procurement specialists.

Clearly the purpose of State Government tendering processes is to ensure transparency, accountability and equity for participants in the expenditure of public money. The burden of such processes is that the cost of participating can be very high for both government and bidders. The business experience with procurement is often that processes can dominate the tender, rather than the strategic goals of the purchase being clear.

A new model should aim to provide more flexibility, particularly at the market engagement stage, thus enabling the government to gain an understanding of the business's contract needs and establish terms that would make the contract performance excel. Effectively, this enhancement to the procurement design would eclipse the risk of any potential contract failure.

Good procurement outcomes start with comprehensive and commercially astute plans that are informed by rigorous market analysis and a focus on building relationships with business pre-tender.

If a business is to operate as a partner in the delivery of government requirements, then it should have a more equal commercial relationship. The dissatisfaction of business with current contract terms and the quality of contract management will need to be addressed as a priority in any reform model being considered by government.

INNOVATION

I support all the proposed Recommendations and I would like to see a particular focus on Draft Recommendations 4.2 and 4.3. In Draft recommendation 4.2 there is point which states *'agencies to accept and manage the inherent risks involved in procuring innovative products, including the approach to helping businesses developing their IP.'*

Having appropriate procedures and protocols in place is critical if this objective is to be met and I would suggest a separate working group be established with both government and industry representation to take these two Recommendations forward.

New businesses - particularly in sectors such as the technology and services sector - often bring innovative new products and services to the market that can challenge traditional and established markets. Innovative start-ups can also create new markets and demand for services and products that previously did not exist.

The new business models and innovative product offerings emerging from start-ups can present a challenge for buyers and procurement professionals. Buyers can be focussed on risk and may be unwilling to explore the new offerings and suppliers. For start-ups, the challenge of demonstrating a long track record of successful delivery and lack of brand awareness as part of traditional procurement processes may represent a barrier to supplying to the public sector.

These issues will need to be overcome in order for South Australia's emerging entrepreneurial and innovation ecosystem to grow and thrive.

Two options proposed below would complement the Recommendations made in the SAPC's Stage 2 Draft report and could be considered for an innovation procurement pathway plus an enhanced industry engagement strategy:

- Option 1 - To simplify the procurement process, the existing Simple Procurement Guideline could be augmented to include a provision for selecting a single supplier (up to \$220k), where that supplier was defined as a start-up, similar to the existing provision for Aboriginal businesses.
- Option 2 - To establish an Innovation Panel as a Whole of Government contract, based on the State Procurement Board's Panel Contracts Guideline. The Innovation Panel would include in its objectives the desire to support start-ups and innovation.

A single supplier selection based on the inclusion of statement in the Acquisition Plan/Purchase Recommendation could be outlined in a Start-up Procurement Policy or similar (which may include a provision along the lines of the supplier demonstrating that they are a South Australian based business, established within the past five years, delivering an economic contribution to the State with a product/service that is innovative and/or unique).

Based on a total contract value of up to \$550K, a significant number of Proof of Concept (PoC) and entry level technology procurements could be accommodated within this threshold. Such an approach would have quite a different objective and outcome than using the current eProjects Panel.

INDUSTRY PARTICIPATION

With regards to the Overview and Application of the South Australian Industry Participation Policy (SAIPP) to construction projects I provided the following summary of the SAIPP section of the SAPC Stage 2 Draft report, together with a brief response.

Most business associations and external stakeholders support the intent of the SAIPP.

- *However many stakeholders told the Commission they perceive there has been a limited impact as a result of the SAIPP.*
- *They have not seen much or any demonstrable effects from the policy*
- *It is too easy to get a high score*
- *There is no preference to SA businesses*
- *'Other state governments have a support local policy'*
- *Several public authorities who have indicated that national constructors tend to perform very well on the SAIPP perspective as they usually have a presence in SA and employ a strong local team.*
- *The Commission noted that there is limited awareness of South Australia's obligations under free trade agreements that do not permit preferences for local suppliers but do allow emphasis on capital investment, labour, supply chain and associated economic contribution.*
- *'in that sense, the objectives of the SAIPP, which is not to favour local businesses, but to encourage the use of local labour, local goods and services and investment in SA.'*

I would agree with the sentiment that some businesses that are experienced at tendering will find it easy to get a higher Industry Participation Plan (IPP) score as they know how the key performance indicators (KPI's) apply to inputs. This business attitude motivated my office to initiate 'Ready to Tender', an online guide designed to help South Australian Businesses navigate the government procurement process.

I also agree with the SAPC's view there is limited awareness of SA obligations under the Australian New Zealand Procurement Agreement which is why the application of the SAIPP does not create a preference on price or location of the business rather the retained economic benefit to the State.

The data collected by the Office of the Industry Advocate (OIA) contains significant differences to the Commission's data.

- *Generally the OIA data collected on ECT and IP Plan scores is of better quality than the data that was provided to the Commission.*
- *Overall, scores or exemptions to the SAIPP were recorded for 96% of contracts for the period of 2017-18 (compared to 5% in the Commission's database). This suggests that the process for collecting SAIPP information may be disconnected from public authorities.*
- *Differences will be investigated during the consultation process following publication of the draft report.*
- *There is no information readily available on the runner up or the other bidders.*
- *The type of data collected by agencies on the location of the winning supplier varies considerably.*

Firstly I would like to clarify the point that until very recently my office had not been collecting any data about IP Plan or Economic Contribution Test (ECT) scores as this was the responsibility of the (then) Department for Industry and Skills plus individual agencies.

These concerns are part of a much bigger problem which is reflected throughout the SAPC's Draft Report. With regards to relevant SAIPP data, the quality and a data gap is currently being addressed through systemising the process and collation of data. This will only improve over time once agencies apply the new processes accordingly. Currently agencies do not collect runner up details and location data is limited to metropolitan, regional or outside SA.

- *Figures from DPTI (97% of contracts going to SA suppliers) are inconsistent with the feedback received from local businesses that many contracts go interstate.*
- *In a few cases the tender assessment is based on the fraction of the total contractor value.*
- *For contracts over \$4M, the financial and productivity costs of tendering for the unsuccessful bidders can be significant, particularly when multiplied by the number of unsuccessful tenderers.*
- *Businesses have indicated repeatedly that a multistage process is more appropriate, as it means that only two or three preferred suppliers are exposed to more costly information requests.*

Based on the data captured by my office, I would disagree that many contracts go interstate, and the ones that do are usually through direct negotiations and effectively the SAIPP has little, if any, effect. However, when commitments are 'owned' by an interstate business they are still delivering KPI's in favour of retained economic benefit to the State.

I agree there is a substantial cost when tendering in the IPP threshold of \$4M and above and my office has started implementing multistage process (Statement of Intent Stage 1, Tailored IPP Stage 2) for complex procurements that would otherwise prove costly to many proponents.

In 78% of cases the difference in ECT or IP Plan scores between the winner and runner up was less than two points (out of 15). 45% of tenders had identical scores for the winner and runner up.

- *Scores are in general very high in the construction field, with little variability (as opposed to goods and services).*
- *This is consistent with the comments from stakeholders that businesses seriously consider SAIPP scoring.*
- *For a further 40% of cases, if the ECT or IP Plan score had been different between the winner and the runner up it would be sufficient to change the outcome of the tender.*

The ECT scores can be quite tight and easy to attain a high score if the services and products tests are done properly (high economic input into the State) which would level the playing field substantially. A high score only means that the policy is influencing businesses in the way it should (investing in the State through labour and sourcing).

Our evidence further shows that businesses are taking the policy seriously and regarding it as a substantial attribute to their tender, which is positive and considered a desirable outcome.

- *In many circumstances the bidder with the higher score had a lower number of labour hours committed to SA but a higher percentage.*
- *A few businesses have reported low ECT scores despite being South Australian and using 100% SA supply.*
- *The lack of transparency of the scoring system makes it difficult for businesses to understand where their effort has the most impact.*

Depending on how the inputs are calculated and the strength of the KPI, whether it's local labour at a higher percentage but fewer hours, or greater supply chain of goods but at lower value will result in a higher score. This is due to the measure of quality of inputs over quantity of inputs. Again, my office has had no involvement in the application of these methods until recently and I would need to have my office investigate further why a few businesses are receiving lower scores with high quality KPI (100% SA) as this goes against the scoring 'logic' of the forms.

Stakeholders have reported the absence of consideration given to the back-office expenditure of local firms in the scoring of ECT or IP Plans and feel they are not considered in the scoring methodology.

The Commission noticed a few elements of the scoring methodology that do not seem to appropriately reflect the effort committed to by a supplier.

- *For employment of apprentices and trainees, investment in R&D/IP and Aboriginal participation, the questions are only "yes/no"*
- *The reference to an economic benefit descriptor is not straightforward and the matrix provided could be made simpler.*
- *Physical presence in SA is asked but not taken into account.*

The reference to 'back office' is often misunderstood by businesses and should be made clear in the forms when presented as questions. It is my understanding this will be improved going forward when DTF update the forms that are available on the IT system known as Nimblex which my office will endorse.

Currently it is the case that questions about engagement of Aboriginal business are yes or no questions unless it is a Tailored Plan with specific Aboriginal employment and business KPI's.

The inclusion of apprentices and trainees does have a score allocation, as is the case with Research & Development. With either of these indicators it triggers further questioning when working with the Head Contractors on the implementation methodologies submitted in the IPP and how my office tracks these commitments. The physical presence of a business is not taken into consideration this is consistent with Australian New Zealand Procurement Agreement not to preference on location or price and is something my office continues to communicate to businesses.

A few businesses indicated that applying thresholds for indigenous employment or regional development based on construction value is not the best way to meet these objectives.

- *Quotas for employment of Aboriginal people is also seen as very difficult by some stakeholders and sometimes not possible to reach those quotas.*

The Skilling South Australia – Procurement Guidelines does consider KPI's for Aboriginal employment as a target group and the Policy applies for construction projects above \$50 million where there is financial capacity and supply chain resources to allow for quotas. There

have been a number construction projects where the businesses have achieved above the Aboriginal employment targets set in their Industry Plans which indicates these targets can be achieved if the right approach is taken early in the project.

Some weightings were distorted through formulas used to calculate scores.

- *Some has price at 70%, non-price at 30% and IP Plan at 20%, totalling 120% which gave IP Plans an effective weighting of 16.7%.*

This distortion in agency scoring is a concern and needs to be communicated to them as it is the incorrect application and contravenes the SAIPP requirements.

Stakeholders consider oversight at contract management level is inadequate and can compromise the objectives of SAIPP:

- *'Non-compliance on capital works projects tends to be the result of product or system substitution...delivery within strict time and cost parameters '*

I accept this view and expect some of the recent changes eg my office reviewing Acquisition Plans and the use of a Statement of Intent followed by a Tailored IP plan will go some way to addressing this concern.

The Commission concludes there is a high level of compliance with SAIPP in the construction industry. This finding indicates a higher level of compliance for construction than goods and services.

- *However from the viewpoint of reporting and performance analysis, much improvement is needed in the way public authorities record the ECT/IP Plan scores in their central database.*

There is a high level of maturity and compliance of SAIPP within the building and civil construction sector. However, I agree there is a lack of sophistication when it comes to data collation from the client agency through to the delivery agency (in most cases Department of Planning, Transport and Infrastructure). The lack of a central government database and the requirement to meet minimum data capture is major problem.

Some agencies indicated that the scoring of IP Plans, or the involvement of OIA in the market approach, sometimes delayed the tender evaluation process and in those cases there was no added value from that process.

- *Stakeholders have reported that broad social goals (support for disadvantaged groups like aboriginal employment) are important and need to remain an objective of the procurement process.*
- *Stakeholders also submit that the policy needs to ensure that it supports those local businesses that are capable, competitive in the market and sustainable.*

I strongly disagree with these comments, firstly the scoring of IPPs at the point of tender evaluation is not a function of the OIA.

When the OIA started reviewing Acquisition Plans on 1 July 2019 a Service Standard was established to provide a response to agencies within five working days, otherwise the agency can assume the Acquisition Plan is supported. I can confidently say since these changes have been in place there is a value-add to the procurement process where the appropriate

application of IPP questions specific to that industry sector is made. The value loss is through agencies not consulting with OIA about application of the IP policy early enough in the procurement process and applying a stock standard plan which does not ask the right questions or leverage the right commitments to drive desirable outcomes and ultimately value.

More needs to be done in the ECT and IP Plan to encourage upskilling of local businesses by the bigger interstate or overseas businesses winning contracts in SA.

- *They would like to see ‘...an increased application of IPP to procurement of consultancy services’.*

I support this view and with the introduction of the Statement of Intent process my office has incorporated questions for businesses when tendering to explain how they will deliver skills and technology transfer to staff and businesses in the supply chain. Upskilling is something that is lacking in the standard IP Plans and ECT's entirely. Currently Tailored Plans (specifically in the professional services space) includes upskilling.

SUMMARY AND CONCLUSION

I would like to offer my strong support to the SAPC's view '*there are clear deficiencies in the information recorded by agencies regarding their application of the SAIPP, and in some cases, some deficiencies in practice, particularly the weighting.*'

If the recent changes outlined earlier in this document result in agencies providing Acquisition Plans to my office in timely manner there could be some improvement.

The establishment of an SAIPP Group as part of the revised Heads of Procurement arrangements should create an appropriate forum for raising concerns with the application of the SAIPP.

I would like to acknowledge my office does have work in progress that has the capacity to at least partially address some of these issues through the provision of better information and I will be exercising my authority under the Act to seek that improvement.

As mentioned previously, the Act allows recommendations to be made to responsible officers for procurement and principal officers of public authorities to resolve complaints, remove impediments or improve procurement practices and processes.

In closing, I would like to see the SAPC's findings from the Draft Report for Stage 1 about the overuse of the direct negotiations provisions within the State Procurement Policies be given greater attention. Businesses continue to raise concerns with me about the volume of contracts used via direct negotiation and the State Procurement Board's statistics also support these concerns.

The reasons provided by Agencies for selecting this procurement option is concerning – 62% stating limited number of suppliers and 20% gave no reason at all, however my office has been active in identifying and promoting local business capability. I would also be concerned if procurement requirements in these cases are defined in such a way as to exclude local operators (eg through specifying particular products or methods of delivery, rather than outcomes to be achieved).