

THE PRICE IS RIGHT?



Price Benchmarking has become an important part of the efficiency savings drive, explains **Wally Johnson**.

What is Price Benchmarking?', many local authority managers will be asking when a Centre of Excellence promoted Price Benchmarking service is made available to all UK local authorities sometime soon. Supplementary questions such as 'What is it going to cost?', 'Where am I going to find the money?' and 'What can I expect to get from my investment?' will quickly follow as the pressure to use Price Benchmarking to deliver the savings the Government so urgently requires mounts.

The prime driver of the Price Benchmarking initiative is undoubtedly the Treasury's need for budget-balancing purchasing savings, savings on a scale that will offset its reported expectations of an £8 billion shortfall in revenues for financial year (FY) 2008. With UK local authority purchasing expenditure currently running at nearly £40 billion a year (more than one-quarter of the public sector's total expenditure on bought-in goods, services and outsourced business processes), it is a natural place for government to start its search for purchasing savings. Local authorities' savings targets for FY 2008 are already set at higher than £3.5 billion. Government now acknowledges that purchasing savings and effective price benchmarking are inextricably linked.

The Government's dissatisfaction with the savings deliveries of certain corporate purchasing entities which have evolved over the last decade may also be a driver. Evidence of government dissatisfaction with these operations is to be found in the recent transfer of NHS Logistics, whose savings claims of the last five years have still left room for its new, private sector owners to promise a further £1 billion savings yet to come.



ENTER PRICE BENCHMARKING

Price Benchmarking, which has been available for 20 years under Purchasing Index (PI)'s Pricetrak label, offers a continuous and more bottom-up approach to estimating savings by facilitating the networking of unattributed price information across peer groups buying the same or similar categories of goods and services. It is a process that experience suggests is best updated on a monthly cycle basis. Pricetrak's many business unit and regional collective purchasing clients have experienced the often remarkable effects of this new pricing transparency. Discovering that your peers are paying less than you is essentially motivating for purchasers, especially if good management reporting from the Price Benchmarking process controllers ensures that top management too is aware of the pricing shortcomings.

Readers should study Figure 1 closely; the outcome of a Pricetrak-based price comparison exercise across a group of six similar public sector business units, it shows the price spreads revealed by benchmarking the prices of some 150 commonly used, mainly office supplies-related products. You may ask how it is possible for vendors to sell the same products to similar organisations in the same sector at prices up to 20 times and occasionally up to 30 times greater than the lowest prices reported. The answer illustrates the problems likely to

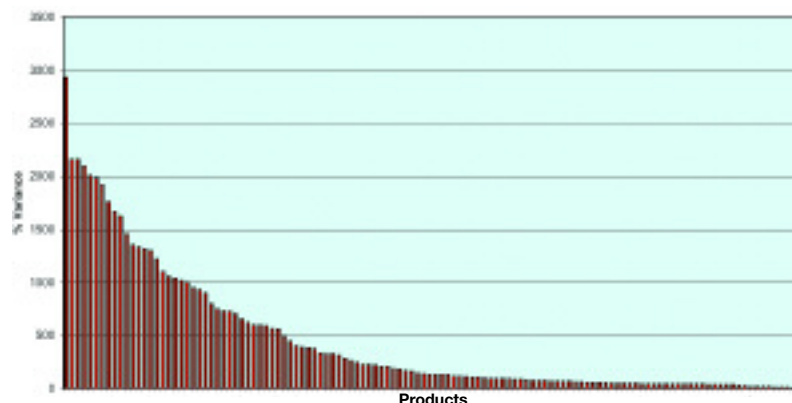
be encountered in identifying savings opportunities. Combinations of auction-driven loss leader prices, reasonably priced core listed items and inflated catalogue prices subject to less inflated discounts can make B2B and B2G pricing seem a supplier-designed jungle. These varied pricing practices are commonly found across catalogue-based vendors and distributors but other sectors have their own pricing 'tricks of the trade' too. Together they make Price Benchmarking more difficult than it should be, but not impossible. Without Price Benchmarking practices such as those described above and shopping basket evaluation facilities, the search for purchasing savings would not take place on a level playing field.

Interestingly, the National Audit Office is also beginning to acknowledge the linkage between the delivery of savings and the application of ongoing Price Benchmarking. Two of the five recommendations in its latest report, *Assessing the value for money of OGC buying solutions* (December 2006), concern practices that have long been integral to effective Price Benchmarking.

MANAGING PRICE BENCHMARKING

The PI Group, which has more than 20 years' hands-on public and private sector Price Benchmarking experience over three continents, offers the following advice to those with ultimate

FIGURE 1: PRICETRAK PRICE SPREADS – VARIANCE (LOW TO HIGH PRICE) BY PRODUCT



responsibility for the implementation of price benchmarking facilities across UK local authorities.

Purchase Price Benchmarking must:

1. be ongoing rather than ad hoc. It has to establish the datum prices from which future savings will be calculated, identify specific savings opportunities and, most importantly, confirm savings deliveries when – and only when – that happens.
2. be corporately mandated at all levels in all business units across the sector. It cannot be left as a business unit option, nor can purchasing units at any level in their management hierarchies be allowed to opt out.
3. be owned and controlled by top management, preferably at CEO/CFO levels in the businesses within which purchasing is taking place. Ownership and control of Price Benchmarking cannot logically be vested in the purchasing department. Buyer ownership of the Price Benchmarking process means they are in a position to opt out of measurement if their own prices do not compare favourably.
4. trigger prompt savings-delivering actions.
5. be used by top management to extend their control over supplier management, a key issue for those managing today's increasingly virtual organisations. Are CEOs destined to be the Heads of Purchasing or are the Heads of Purchasing going to become the CEOs?
6. be applicable also to public sector purchasing operations managed by outsourced purchasing service providers. A half share of the savings as measured by independent Price Benchmarking service providers might not be so appealing as those currently being claimed.

GETTING THE SHOW ON THE ROAD

Assuming the savings opportunities to be identified by Price Benchmarking are of the order of ten per cent of local government expenditure on goods, services and outsourced business processes – perhaps an underestimate in the PI Group's experience of the savings opportunities available – the delivery of £3.5 billion annual savings by FY 2008 will require Price Benchmarking to be applied to more than £35 billion of local government annual spend, most of it before the end of FY 2007.

Price Benchmarking is not an end in itself. It is an essential part of a wider savings-delivery process that starts with setting price datums from which

future savings will be calculated, and is followed by identifying potential savings-delivering opportunities. It then moves on to the development and implementation of alternative, price-reducing purchasing strategies, secures consensus on acceptable specifications across large numbers of end-users and contributes to the subsequent implementation of the new

Comprehensive Spending Review with its competence-measuring implications for those charged with implementing new government purchasing strategies, structures, processes and policies. Many finance-led initiatives will have far-reaching influence over future relationships between purchasing units and the communities they serve.

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procurement process before securing the most important and most difficult consensus of all – agreeing the award to the best savings-delivering, value for money option available and then launching it.

This process would undoubtedly take longer to implement for OJEU-led national solutions than it would for regional or local collective solutions and there is no certainty that even if the national option did prove manageable within the allocated timeframes, it would deliver the lowest prices.

It would be unwise to consider the linkage between Price Benchmarking and the Government's concerns to achieve budget-balancing savings in its expenditure on goods, services and outsourced business processes in isolation from the broader government change programme. Wider change drivers certain to impact on purchasing include business unit Annual Efficiency Reviews, the better management of resource requirements as a result of the CPA Harder Test regime and the likely future demands of the

The purchasing profession will need to change its culture and expand its capabilities if it is to design and lead performance-enhancing best practice changes in B2G purchasing. For better or worse, purchasing's future contributions to saving deliveries will be exposed to far greater and more informed scrutiny than ever before.

Wally Johnson is Chairman of Purchasing Index Ltd

IN SUMMARY...

- Local authorities' savings targets for FY 2008 have been set above £3.5 billion
- Price Benchmarking has been available for approximately 20 years under Purchasing Index's Pricetrak label

FURTHER INFORMATION...

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