



**Finance
& Services**

NSW Government Procurement Discussion Paper

- New government procurement framework
- Sourcing government goods and services
- Government contracts
- Small and medium enterprises
- Innovation and procurement

January 2012

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Purpose of the discussion paper

The NSW Government is overhauling its system for purchasing goods and services. The current system is old and much modified over the decades to meet new purchasing requirements as they arose. Government procurement structures have become overly complex. Mounting red tape is discouraging business from seeking government procurement opportunities.

This discussion paper starts the reform process by setting out proposals to rework four of the critical building blocks which underpin the procurement system. It proposes a new government procurement framework that:

- allows for contemporary means of sourcing government goods and services
- brings the form and content of government contracts in line with modern practice
- expands the ways that small and medium enterprises can effectively gain opportunities to supply goods and services to the government, and
- introduces greater innovation into government procurement to stimulate a more vibrant New South Wales economy.

The NSW Government wishes to hear your perspectives on one, some or all of these matters. This discussion paper provides you with a framework for providing your comments by providing a brief discussion of each area. To further guide your response, the paper sets out some key questions from the perspective of the Department of Finance and Services (DFS). You can use these questions to frame your response or set out your issues as you see them.

If you have questions about this discussion paper, please email procurementconsult@services.nsw.gov.au.

Submitting your comments

DFS invites written comments on the proposals and issues set out in this discussion paper in one of three ways:

- by posting your comments on www.nsw.gov.au/haveyoursay
- for longer and or more detailed submissions, by writing to:
Review of NSW Government Procurement
Government Services Division
Department of Finance and Services
McKell Building
2 – 24 Rawson Place
SYDNEY NSW 2000
- or by sending an email to procurementconsult@services.nsw.gov.au.



To be considered, these comments must include the author's name, telephone number and address. If you do not want your personal details or submission released, please indicate this clearly on your submission. However, all submissions will be made publicly available as required by law.

Comments should be received by Wednesday 29 February 2012.

Following consultation and the Government's decision, proposed amendments to the *Public Sector Employment and Management Act 2002* will be brought to the Parliament in 2012 to bring into effect the new NSW Government procurement governance structure. Subject to the Act's amendment, the Public Sector Employment and Management (Goods and Services) Regulation 2010 will be amended to bring about the reforms.

1 A new governance structure and operating framework for NSW Government procurement

1.1 Current procurement arrangements

The New South Wales Government's current procurement arrangements are complex. They combine a principally centralised procurement system working alongside several decentralised procurement systems:

- The State Contracts Control Board is legally responsible for the purchase and disposal of all goods and services necessary for the operation of the public sector.
- Agencies buy goods and services from suppliers who are party to State Contracts Control Board whole-of-government (State) contracts and agency-specific State contracts.
- Depending on the level of the State Contracts Control Board accreditation or delegation given to them, agencies may purchase goods and services up to a certain amount that are not provided for by State contracts without going to the State Contracts Control Board for approval (including using purchase cards).
- Certain agencies have their own legislative power to undertake procurement activities to meet their statutory functions and are able to procure without reference to the State Contracts Control Board.
- Some government procurement activities (particularly services) are managed as grants and others managed as construction and heavy engineering projects, which are also procured without reference to the State Contracts Control Board.

Based on 2010–11 data, the NSW Government spends an estimated \$12.7 billion on goods and services each year. The State Contracts Control Board's State contracts account for \$3.8 billion of that expenditure.

All NSW Government procurement is subject to the NSW Government Procurement Policy and the policy is supported by a number of Premier's Memoranda, Treasury circulars and procurement guidelines. Construction is managed through separate arrangements.

The State Contracts Control Board is established by the *Public Sector Employment and Management Act 2002*. Its powers are mainly set out in the Public Sector Employment and Management (Goods and Services) Regulation 2010. The Board is responsible for the supply and disposal of goods and services on behalf of the public sector service. It is also the escalation mechanism for complaints relating to public sector procurement, and it provides procurement advice to the Minister for Finance and Services.

NSW Procurement, a business unit within the Department of Finance and Services, is the State Contracts Control Board's operating arm. The main functions of NSW Procurement are to tender and manage State contracts and a number of client contracts (contracts managed by NSW Procurement on behalf of particular agencies)



and to provide procurement advice and support to agencies. DFS also provides policy support to the Minister and the State Contracts Control Board's secretariat.

Individual agency procurement arrangements vary greatly and are being rapidly transformed as many agencies reorganise their procurement functions. Large agencies have centralised procurement teams that are led by Chief Procurement Officers. In other agencies, procurement functions are more decentralised with a significant number of non-procurement officers involved in procurement activities. Contract management is often decentralised in agencies, and many also have large numbers of staff responsible for purchasing goods and services under State Contracts Control Board contracts and other contracts.

1.2 The need for change – and the challenges

Government procurement has changed rapidly and continues to do so today. Procurement was seen (and often is still seen) as an administrative function, frequently overlooked as supporting rather than leading other parts of an agency's business and often seen as the cause of many business problems. In the 1980s, most such procurement was non-aggregated and transactional purchasing was completed at department or business unit level. The 1990s saw greater consolidation of sourcing activities and aggregation of agencies' requirements. More recently, concepts such as eCommerce are influencing procurement practice.

Today, the procurement life cycle spans sourcing strategy, supplier selection, contract management, supplier relationship management, and purchasing and supplier integration. Procurement is now seen as one of the top value creators in any business or government agency, and fundamental to government service delivery.

NSW Government agencies have embraced these shifts in procurement practice and many advances have been made by them. Nonetheless, the NSW Government faces major challenges to achieve the best possible outcomes from its procurement activities:

- The system managed under the Public Sector Employment and Management (Goods and Services) Regulation 2010 is highly centralised but accounts for only a third of the NSW Government's procurement of goods and services. The remaining two-thirds of procurement, although operating under the NSW Government Procurement Policy, is undertaken by agencies outside the requirements of the Regulation.
- The NSW Government lacks a single point of leadership for government procurement. Responding to this point, the Independent Commission Against Corruption¹ recommends that the NSW Government establishes a single entity that is given explicit leadership responsibility for:
 - formulating and maintaining the state procurement policy framework, including standards of conduct or practice

¹ Independent Commission Against Corruption, *Corruption risks in NSW Government Procurement*, June 2011.

- building the procurement capacity of the sector: promoting the procurement policy and compliance with its provisions, and
- monitoring and reporting on compliance and performance standards.
- The Government's procurement policy and regulatory frameworks are complex; it is difficult for agencies and suppliers to understand and comply with the requirements.
- Some agencies have identified a disconnect between the centralised procurement activities (State Contracts Control Board and the Department of Finance and Services) and agencies' procurement needs and activities.
- The importance of procurement to high quality government service delivery is often underestimated. An increased focus on quality, service delivery and the need to drive savings requires more sophisticated sourcing strategies and better contract management.
- The lack of procurement capability across the sector – including in category strategy, risk assessment and contract management – is often the most-noted factor in limiting procurement outcomes.
- Whole-of-government and agency procurement is greatly hampered by the lack of a formalised and consistent procurement data collection and analysis framework.

1.3 Concerns about government procurement

In its report, *Corruption risks in NSW Government Procurement*, the Independent Commission Against Corruption identified concerns about government procurement:

- The NSW public sector procurement system (including local government) is complex and difficult to apply to varying procurement scenarios.
- Accessing practical information to support practitioners in their procurement activities and decision-making is difficult.
- Central agencies fail to provide leadership and support to individual organisations, procurement practitioners and suppliers.
- The public sector is characterised by varying levels of procurement expertise, and
- A lack of compliance with procurement policy and procedures is widespread and there is an absence of effective sanctions within the system.

1.4 What does the Government want to achieve from its procurement system?

The NSW Government's goals for its revised approach to procurement are:

- achieving better value for money and budgetary outcomes from Government procurement
- achieving a Government-wide strategic approach to procurement: fostering procurement as a business enabler through planning and oversight
- reducing administrative costs and duplication of the procurement function across Government



- reducing red tape, improving competition and simplifying access to Government business for the supply community, especially small and medium enterprises and regional businesses
- simplifying the regulatory and governance frameworks for government procurement, with an increased focus on compliance, probity and equity, and
- building procurement competence and professional development across Government.

1.5 Recent initiatives

Some positive steps have been taken to address these matters:

- The NSW Government has developed an agency accreditation scheme for goods and services procurement, which aims at providing more autonomy to accredited agencies. The accreditation scheme provides a robust framework to assess agencies' procurement according to maturity, capability, capacity and practice. The scheme is designed to lift agency procurement capability, and means that an accredited agency can procure goods and services that are not provided for under State contracts without approval of the State Contracts Control Board (up to a certain threshold; at the highest level of accreditation this threshold is 150% of the value of the highest agency-specific contract).
- The NSW Government has organised the public sector into nine Principal Departments and their cluster agencies, which is resulting in rapid restructuring and alignment of their procurement functions.
- The Department of Finance and Services has developed and maintained a variety of procurement technology solutions which are available to all government agencies. These include:
 - eTendering: an online tool which supports and manages the tendering process for NSW Government agencies that use the eTendering website (<https://tenders.nsw.gov.au/>), from public advertisement of tender opportunities to public disclosure of contracts awarded
 - eCommerce: an online marketplace where agencies can procure goods and services available through State contracts. eCommerce can be integrated with agencies' financial systems to provide catalogue management, electronic workflow design, financial delegations and purchasing through to invoice receipt and procurement reporting.
 - Contract Lifecycle Management System: the eProcurement platform for providing contract management workflow, supplier management, procurement benefits realisation measurement, and other features such as open bidding and reverse auctions.
- The Department of Finance and Services has moved to a 'category management' approach, which entails end-to-end visibility and management of a whole procurement category. Within their respective categories, category managers lead procurement strategy development throughout the contracting life cycle and manage their category (including suppliers and buyer agencies) to ensure that all benefits

from the resulting contracts are realised and continuously improved. Category managers analyse expenditure, develop supplier relationships, mitigate risks and add value. For example, the Department of Finance and Services has established procurement categories in:

- energy and environment
 - information and communications technology, and
 - support services.
- Agencies are rapidly expanding their discussion of shared procurement issues and solutions through mechanisms such as the Chief Procurement Officers Forum.

1.6 Comparison with procurement arrangements in other jurisdictions

The NSW Government has undertaken a study of procurement systems in the Australian, Victorian, Queensland, Western Australian and the United Kingdom governments to identify approaches the NSW Government may wish to implement.

The NSW Government appears to be the most centrally concentrated system, with the largest central procurement group in terms of size and services offered. It has the largest expenditure under whole-of-government contracts (in terms of volume and percentage of expenditure under centralised contracts).

1.7 Proposed procurement model for the NSW Government

The NSW Government is proposing a new overarching governance structure and operating framework for its procurement system (see Figure 1).

The proposed new procurement system is intended to address the issues and achieve the objectives outlined above.

The NSW Government has reviewed its existing procurement operating model in consultation with agencies and other key stakeholders, having regard to contemporary practice in other jurisdictions, both in the public and private sectors.

At the outset, four principal premises for building the model were established:

- Sourcing and procurement is more efficient and effective if it is devolved to agencies that have specialist knowledge of the category supply chain and supply sector and that have proximity to both business requirements and the end-point of the supply chain.
- Sourcing strategies for procuring goods and services are more effective if developed by those with direct interests in the service delivery and financial outcomes. Sourcing strategy should therefore be led by the largest-spend agency with the necessary specialist expertise in particular procurement categories, rather than by the central procurement agency. Where required, lead agencies will operate on behalf of all government agencies in delivering the procurement activity.
- The profile of procurement should continue to be raised within the NSW Government to contribute further to achieving the Government's goals for service delivery and value for money, and



- Procurement capability development should be treated as a priority, with emphasis on procurement policy and strategy.

Based on these premises, seven major design elements were identified for the new model:

- Procurement practice should be delivered, where possible, by agencies within a sector-wide governance framework.
- Central procurement functions and agencies need to further increase their engagement and collaboration.
- Defining the Government's procurement categories should be undertaken jointly by agencies and any new central procurement functions.
- Where possible, procurement category management should be assigned to the agency with largest expenditure.
- The role of the Chief Procurement Officer in agencies should be enhanced.
- Procurement data collection and analysis across the sector should be a priority central function, and
- NSW Government procurement systems and processes should be simplified.

In developing these design elements, many of the barriers to innovation (set out in Part 4 of this discussion paper) are also recognised.

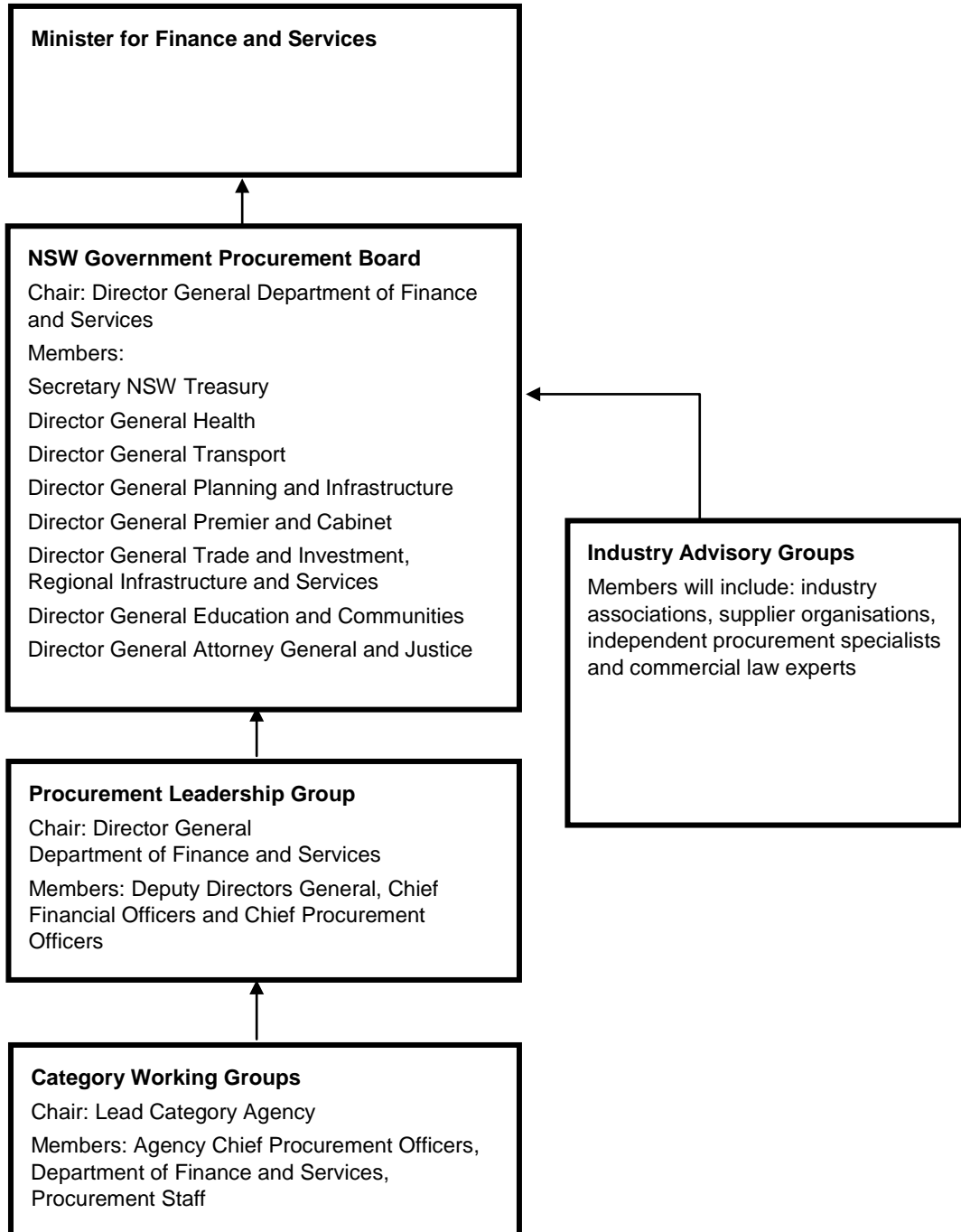
Under this new framework, the centralised procurement function should be a strategic coordination point that provides enabling functions to the agencies, including:

- policy development and compliance
- agency accreditation and sector-wide capability development
- procurement category management and support
- procurement data collection and analysis
- performance reporting
- tendering and contract management and support
- vendor management for particular categories
- complaint and investigation mechanisms
- procurement systems development and implementation, and
- client relationship services.

Most whole-of-government contracts will be managed by agencies, in consultation and collaboration with the Department of Finance and Services, and with other agencies.

A small group of whole-of-government contracts will continue to be managed centrally by the Department of Finance and Services.

Figure 1: Proposed governance structure and operating framework for NSW Government procurement





NSW Government Procurement Board

The State Contracts Control Board will be abolished and replaced by the NSW Government Procurement Board, with its membership to be drawn from the Directors General of the NSW Government's Principal Departments. The statutory-based Procurement Board will have responsibility for overseeing the Government's procurement system, setting policy and ensuring compliance.

It will have statutory power to issue directions to agencies, and make decisions and monitor the progress of agency compliance. It will accredit agencies to undertake their own procurement of goods and services.

Unlike the State Contracts Control Board, the Procurement Board will not be a contracting body primarily (but will have reserve power to arrange contracts, if required). Its key role will be to make decisions on what categories of goods and services should be procured centrally, and it will charge specific agencies (including DFS) with leading that central procurement role.

Procurement Leadership Group

The Procurement Leadership Group, reporting to the Procurement Board, will comprise senior executives drawn from across the public sector. The Group will support and make recommendations to the Board on matters determined by the Group or referred to it by the Board. A primary purpose of the Group will be to achieve and maintain consistent approaches to procurement across agencies and senior procurement leadership within agencies. It will also make recommendations to the Board on goods and services which should be subject to centralised procurement, and possible sourcing strategies.

Support functions

The activities of the Procurement Board, the Department of Finance and Services, and lead category and individual agencies will be complemented by two support functions:

Category Working Groups

The Procurement Board will establish Category Working Groups around particular procurement categories. Generally they would be the responsibility of the designated lead category agency but the Department of Finance and Services may fulfil the function for some categories. These groups would generally comprise Chief Procurement Officers and other government procurement specialists along with senior executives with service delivery and financial responsibilities in an agency.

Private sector consultative group/industry advisory group

The Procurement Board will establish private sector industry advisory or consultative groups, either on a standing or ad hoc basis.

The Minister for Finance and Services has established the first such committee: the Industry Reference Group for the Review of NSW Government Procurement.

Agencies

Principal Departments and certain cluster agencies will be responsible for sourcing and contract management after being accredited by the Procurement Board. The agency's role will have two aspects:

Leaders in whole-of-government procurement categories

In the case where an agency is the largest spender in a particular procurement category and holds the necessary specialist expertise, the Procurement Board may assign it as the whole-of-government lead agency for that category. That is, those agencies will operate on behalf of the whole-of-government, and this would entail defining category and sourcing strategies, and leading supplier selection and contracting. The agency will fulfil these functions in conjunction with other stakeholder agencies and the Department of Finance and Services. Depending on the category, the Procurement Board may require the lead agency to establish a Category Strategy Working Group to help it fulfil the role.

The Procurement Board will assign lead category roles to specific agencies when it accredits the agency.

Agency-specific procurement

Agencies will be responsible for managing their own procurement of goods and services to meet their own specific requirements, where a whole of government contract or opportunity for a contract does not exist.

Agencies with their own legislative powers to procure goods and services will retain them. However, these procurement activities will now be subject to the overarching supervision of the Procurement Board.

Agencies will need Procurement Board accreditation in order to assume responsibility for their procurement activity over a certain financial level. For some agencies, particularly smaller agencies with fewer contracts, the Procurement Board and Department of Finance and Services may need to assist the agency to develop its procurement capacity to achieve accreditation.

Department of Finance and Services

The Department of Finance and Services will be the category manager for those categories that will remain best managed by a central function, usual highly commoditised goods (examples include but are not limited to energy, motor vehicles, certain information and communications technology [ICT] purchases, and travel).

A range of government procurement functions will continue to be performed centrally by the Department of Finance and Services under the auspices of the Procurement Board:

- policy development, compliance and probity: the Department of Finance and Services will develop procurement policy and guidelines for the Procurement Board to define compliance mechanisms, verify compliance, and define strategy for capability development



- procurement capability development and accreditation management on behalf of the Procurement Board: implement the accreditation scheme and the capability development program
- procurement life cycle management for nominated whole-of-government categories where there is a clear benefit to leading them centrally
- investment, performance and procurement data collection and analysis
- category strategy management and support, and working group coordination, based on the circumstances and needs of each category
- vendor management for particular categories
- sourcing and contract management support
- procurement systems development, implementation and management, including e-Tenders, eCommerce, Contract Lifecycle Management System and business intelligence solutions
- complaint and investigation management
- liaison between the Department of Finance and Services (as the central procurement agency) and other agencies.

Chief Procurement Officers

The NSW Government is considering requiring Principal Departments and agencies with large procurement functions to have a designated Chief Procurement Officer with recognised qualifications or equivalent.

Your comments

- 1 What are your views on the proposed new governance structure and operating framework for NSW Government procurement?
- 2 Are there aspects of the current procurement arrangements that need to be addressed by revising the procurement framework?
- 3 How can the new framework improve government procurement practices, and in turn provide better government services?
- 4 What are your views on Principal Departments and agencies with large procurement functions having appropriately qualified and designated Chief Procurement Officers?

2 Mechanisms for sourcing government goods and services

2.1 Panel or standing offer arrangements

The Department of Finance and Services is seeking comments and suggestions about how suppliers interact with the NSW Government in relation to supplying goods and services, including matters that are dealt with by means of government contracts.

The NSW Government procures a broad range of goods and services. Under the current procurement system, it is mandatory for government agencies to use State Contracts Control Board whole-of-government contracts to buy these goods and services.

These contracts are established as 'panel', or 'standing offer' arrangements set up for a fixed term (typically three to five years), under which one or more suppliers of similar goods and services are appointed as suppliers to government agencies. The agencies then decide on the details of the goods or services they need to purchase (e.g. the quantity and other arrangements, such as delivery details) and enter into separate customer contracts with the supplier, which may include negotiated prices below the head contract's ceiling prices.

The contracts include the terms and conditions of the panel or standing offer agreement and also additional terms which are outlined in the separate customer contracts.

2.2 Supplier interactions with government sourcing and tendering processes

Currently, the majority of centralised government procurements are undertaken by means of open tendering processes with a view to establishing whole-of-government, long-term panel contracts. The long-standing principle underlying this approach (held by many governments) is to ensure that the process of appointing suppliers realises value-for-money competitive arrangements, while achieving the necessary standards of probity in the procurement process, including transparency and fairness.

This 'one-size fits all' approach is required by the Public Sector Employment and Management (Goods and Services) Regulation 2010, unless the State Contracts Control Board grants an exemption from using this model.

In recent times there have been calls for more flexible mechanisms for sourcing goods and services. Tendering processes and their supporting regulatory and policy frameworks are cited as possibly inhibiting procurement outcomes that fit agencies' needs at better prices.



Specific comments often made of the panel contract system include:

- Panel contracts over long periods limit the government's ability to achieve value for money over the long term and take advantage of changes in the market, both in terms of price and changes to delivery models.
- As a guarantee of supply is not provided to suppliers under the contract, government will often not get best the best price when the panel is established. Suppliers generally won't commit to their best price until the volume is known, which is normally when individual agencies run a request for quote (RFQ) under the panel contract. Large agencies are able to get better prices if they have a large volume requirement, while small agencies can be left to buy at the panel contract price which is often higher than the price which can be obtained if they approached a supplier directly.
- Processes for establishing the panels are complex and lengthy, discouraging many suppliers from bidding at all, and
- The long-term nature of these contracts locks out unsuccessful suppliers for extended periods.

There are many instances where it makes sense for government agencies to purchase goods and services using panel contracts established through a whole-of-government open public tender process. Equally, however, the NSW Government recognises there is a need to adopt more strategic sourcing approaches for particular categories of goods and services.

Potential for risk

Commenting on the risks to such approaches, the European Commission notes:

The possible advantages of more flexibility and potential simplification (of procurement procedures) must be weighed against the increased risk of favouritism and, more generally, of overly subjective decisions arising from the greater discretion enjoyed by contracting authorities in the negotiated procedure ... Moreover, giving more leeway to contracting authorities will deliver useful results only if they have the necessary technical expertise, knowledge of the market and skills to negotiate with the suppliers.²

Your comments

- 5 What procurement models (including calls for tenders) would be appropriate for the NSW Government to use to buy goods and services?
- 6 What procurement models would make it easier for suppliers to tender?
- 7 What advantages and risks do such models present?

² European Commission, *Green paper on the modernisation of EU procurement policy: towards a more efficient European procurement market*, Brussels, 2011, p 15.

- 8 Are open tender processes clear and easy for potential tenderers? Are suppliers discouraged from tendering because of complex processes?
- 9 Do open public tenders to establish panel contracts have an impact on tendered prices?
- 10 Are there particular goods or services which should be subject to whole-of-government panel contracts established through open public tenders? If so, what principles should the NSW Government apply when it makes a decision to pursue panel contracts?
- 11 If there are open public tenders, should the current arrangements be changed, and if so, how? (For example, how would you change the documentation?)

2.3 Contract issues

Currently, the NSW Government's (non ICT) panel or standing offer arrangements are based on a suite of standard template documents which are then built into a draft contract for the purposes of approaching the market and engaging suppliers. The current standard contracts can be viewed at www.nswprocurement.com.au/Tenders/Goods---Services-Standard-Form-Documents.aspx.

These templates contain numerous detailed provisions dealing with legal and commercial matters and government policy matters. The objective for using standardised contract templates is to reduce the time and cost of tendering for both suppliers and government because the government approaches the market with a consistent risk allocation framework which is known to all parties.

The documents are voluminous when considered in total. The detailed provisions have arisen in response to the government's needs and are aimed at managing the government's risk in procuring goods and services.

In sourcing goods and services for the government, it is necessary to weigh up the commercial considerations for the suppliers against the need for the government to achieve value for public money and fairness between suppliers. Indeed many suppliers argue that the contractual terms and conditions on which the government approaches the market are too complex, 'uncommercial', unnecessarily risk adverse and discourage suppliers from bidding at all (particularly small to medium enterprises).

Further, the documents also result in extensive negotiations of contractual terms before tenders are awarded, resulting in significant cost for suppliers and government, and delaying the finalisation of tender processes. This is demonstrated by the Department of Finance and Services experience in managing procurement.

It is argued that this has a significant impact on government's ability to achieve value for money because of an over-conservative allocation of risk to the private sector and reduced competition.

The NSW Government has recently released a new set of templates for ICT procurement (www.nswprocurement.com.au/Tenders/Goods---Services-Standard-Form-Documents.aspx). These templates were developed following extensive



consultation with the Australian Industry Information Association and are intended to establish a more realistic commercial framework for government to interact with the ICT industry. By standardising terms and conditions on a commercially realistic basis, it is intended that tendering time and cost will be reduced for suppliers and government, while encouraging competition as a result of more suppliers being willing to participate.

Your comments

- 12 What are your views on how government contracts for non-ICT goods and services (excluding construction) could be improved?
- 13 Would improvements to the contract documents lead to better procurement outcomes and more appropriate risk allocation between suppliers and government agency customers?

2.4 Structure of contract documents and the formation of contracts

When establishing panel contracts, the State Contracts Control Board enters into a single deed with suppliers which sets the terms and conditions of both the panel arrangement with the State Contracts Control Board (the relationship over the life of the three to five-year panel), and the terms of supply to individual customers (that is, government agencies) when purchases are made. These are combined in a single document which may be confusing for suppliers and agencies.

In addition, the same templates are used regardless of the value of the purchases off the contract, or the complexity of the goods and services being procured.

Your comments

- 14 Should the panel contract be separated from the customer contract?
- 15 Are the contract structures too complex, and if so, how can they be streamlined?
- 16 Is there a different way to set out the terms and conditions on which a supplier supplies goods and services as part of a panel arrangement?
- 17 Should there be separate template contracts which vary according to the value and/or complexity of the contract? If so, how should these distinctions be made?

2.5 Contract terms and conditions

Specific concerns and issues are often raised in relation to the contract terms and conditions used by the State Contracts Control Board. These concerns are raised either on an ad hoc basis with government or when negotiations proceed to finalise contracts. For ICT contracts, the NSW Government addressed many of these issues through the release in 2010 of *Procure IT (Version 3)*. They remain current for non-ICT goods and services contracts.

While some issues are about technical provisions of the contract which relate to the specific goods and services being procured, many of these concerns generally relate to the allocation of risk between government agencies and suppliers, or the imposition of requirements (such as government policy). Following are some of the most frequently raised concerns relating to the key commercial issues:

Financial undertakings and performance guarantees

In relation to certain goods and services or certain suppliers, government retains the right to ask for financial undertakings from potential suppliers and/or to request performance guarantees from parent companies, where appropriate. While these are often necessary in order to protect the legal and financial interests of the State and its taxpayers, suppliers complain that the circumstances where these are requested are not appropriate and the requests made are onerous or costly.

Best price contract clauses

Many contracts include a 'best price' clause which requires suppliers to continually offer their best price to government agencies where 'similar circumstances' apply. However, what constitutes similar circumstances is often not clear and some suppliers have suggested it discourages discounting, particularly for large government agencies.

Unlimited liability

In the past, liability under government goods and services contracts has generally been uncapped for all forms of loss and damage suffered by government. While it is necessary to protect taxpayers appropriately from the failure of others (because suppliers can control the risk of loss better than the government can), many suppliers argue that these requirements, or the imposition of inappropriate caps, result in considerable risk for suppliers, often in excess of the contract value, and affect the price at which they are prepared to supply goods or services.

Insurance

Depending on the goods or services supplied, suppliers are required to maintain and provide insurance for public liability, product liability, professional indemnity and workers compensation, whether any order has been placed or not. Suppliers frequently argue that insurance requirements requested by government are too high, and often represent a barrier for small to medium enterprises. One solution would be to introduce a 'baseline' for insurance requirements which applies to all procurement, and then require higher levels of insurance if the risk involved in the procurement necessitates it.



Indemnities

The government's standard contract templates require suppliers to indemnify both the State Contracts Control Board and the customer agency against all loss or damage suffered by them in the event of any action of a supplier whether the result of negligence or deliberate acts or omissions. Suppliers have argued that the indemnities sought by government are unnecessarily broad, take no account of the risks involved in a transaction, discourage suppliers from bidding and also increase the price.

Intellectual property

The government's 'default' position is that intellectual property in goods and services produced under a contract vests in the government. This does not apply to intellectual property which the supplier brings to the contract. This is especially inappropriate for 'off-the-shelf' goods. While appropriate in some cases, it has been suggested government often does little to develop or commercialise the IP it requires, locking up the IP and possibly stifling further innovation.

Termination for convenience

As a general rule, the government requires the right to terminate at its convenience and without breach of contract. While this is often necessary as a result of significant potential policy changes by government, it creates uncertainty for suppliers, potentially adversely affecting bidders and price.

Dispute resolution procedures

The government's template-based contracts provide for alternative dispute resolution (specifically expert determination) before a dispute can be litigated. It is government policy to internally escalate disputes to senior managers to seek to resolve them, and then use expert determination, and litigate only as a last resort.

As a policy position, the government's general preference is for disputes to be managed through alternative dispute resolution mechanisms rather than litigation.

Provision of information

The government needs to have information provided to it and shared between agencies for the purposes of monitoring expenditure, contract use and contractor performance. However, such requirements may impose a red tape burden on suppliers and also cause them concern about the nature of the information that is being shared.

Compliance with NSW Government policy

Currently government contracts require suppliers to comply with a series of policy requirements and provisions about conflict of interest. These requirements are imposed through procurement contracts as a genuine attempt to achieve government's social and economic objectives. However, suppliers often argue that these requirements are not transparent, too onerous and difficult to identify and comply with. Consideration could be given to alternative compliance strategies which reduce red-tape costs.

Other issues

Government supply contracts also cover other matters that impact on suppliers, including:

- price variations which have to be approved during the life of the contract (based on CPI, wage or exchange rates)
- product variations which have to be approved during the life of a contract including where goods tendered for are discontinued or superseded
- transition-in and transition-out arrangements potentially requiring cooperation between competing suppliers
- efficiency of the mechanism for placing orders
- remedies that the government has for non-performance
- term of panel arrangements
- reporting by suppliers, and
- establishing a panel contract with no guarantee of orders.

Your comments

- 18 As a supplier dealing with government agencies, what is your experience of the contract-related matters discussed above? What improvements could be made as a result of your experience?
- 19 Does the government's positions on these matters adversely affect price, or discourage suppliers from bidding?
- 20 What structures could be put in place to ensure that government agencies can get the best value for money that suppliers can offer?
- 21 What is a suitable term for a panel contract arrangement?
- 22 What price variation mechanisms could be used that would balance supplier needs against government's requirement to achieve value for money in long-term contracts?
- 23 How should government deal with the matters discussed above?
- 24 What are your views on whether the NSW Government should introduce a 'baseline' for insurance requirements for non-ICT goods and services contracts, especially for low-value contracts?
- 25 Are there any other issues with government contracts that need to be considered?



3 Government procurement opportunities for small and medium enterprises

3.1 Government support for small and medium-sized businesses

Small businesses are key drivers for the NSW economy, employing more than 1.8 million people in metropolitan and regional areas. Currently, there are around 580 small and medium-sized enterprises engaged in State Contracts Control Board whole-of-government (State) contracts. Supporting small business growth is a key commitment of the NSW Government.

The NSW Government's Procurement Policy recognises that value for money is about broader economic benefit and not just the lowest price. Providing opportunities for small to medium enterprises to access government procurement and compete on a value-for-money basis is an important government objective.

The NSW Government's Local Jobs First Plan seeks to enhance opportunities for Australian and New Zealand small and medium enterprises to supply goods and services to government. The plan uses procurement to achieve industry development objectives by giving weighted preferences to small and medium enterprises involved in supply chains for NSW Government contracts. The Government is reviewing the plan to assess its effectiveness and to consider whether other proposals and ideas may provide better outcomes for small and medium enterprises.

While the review of the Local Jobs First Plan is underway, the NSW Government has taken other important steps to help small to medium enterprises build their businesses. It has implemented a 30-day payment policy requiring government agencies to pay small businesses within 30 days or else automatically pay interest on the outstanding amount. Through its ten-year plan *NSW 2021* the Government has established industry-led taskforces to develop Industry Action Plans that will position key industry sectors, for example, manufacturing, to increase productivity and boost the NSW economy over the next decade.

The government's small business programs, available on the Department of Trade and Investment 'Small Business NSW' website, provide accessible information for people starting, running or growing a small business. The government assists businesses through advisory services, grants and funding, and online resources including a toolkit. This support includes programs for specific target audiences, e.g. Aboriginal Business Programs and Women in Business.

A major step in helping small to medium enterprises to access government business is seeking to simplify sourcing mechanisms (including tendering) and contract terms and conditions. Matters included in this process include suppliers' issues (for example insurances, liabilities, onerous schedule structures), as well as an overall consideration of contracts' architecture and commercial 'fitness for purpose'. These matters are set out in more detail earlier in this discussion paper.

3.2 Developing further opportunities for small and medium-sized businesses

As part of its Review of NSW Government Procurement, the government is also considering possible initiatives to provide greater opportunities for small and medium enterprises to engage with government business.

The Department of Finance and Services is working closely with the Department of Trade and Investment and the Department of Premier and Cabinet on defining these proposed initiatives. Options identified for consideration include the following:

Price preference schemes provide a price preference margin in tenders, giving preference to local content over imported content. The preference is applied by the government agency at the tender evaluation stage. The Local Jobs First Plan is one such scheme.

Industry participation plans are prepared by tenderers to show how their tender will support local industry. This may include jobs, skills and capability development. Such plans are considered by government agencies at the tender evaluation stage and if successful become part of the contract.

Set-aside contracts allow government agencies to reserve certain government contracts exclusively for targeted areas, for example for small and medium enterprises where a competitive process applies.

Contract sizing considers the size of contracts and opportunities for small and medium enterprises to be subcontractors where they are not in a position to be a prime contractor.

Supplier panels provide lists of suppliers pre-qualified by the government for specific categories or work areas.

Exemptions can be given to government agencies, for example in rural areas, where they are exempted from the current requirements to purchase from state contracts for small purchases. The proviso is that the rural suppliers' rates for the goods or services are reasonable and consistent with normal market rates.

Better communication to publicise government procurement opportunities is often cited by small to medium enterprises as being potentially useful. A one-stop shop government procurement website with clear guidance material for suppliers has also been identified as priority. The guidance material would need to be underpinned by streamlined and up-to-date government procurement policies.

Industry Capability Network (ICN) is a national network of not-for-profit organisations managed by industry and funded by the NSW Government. ICN promotes Australian industry by providing a technical service to buyers. It nominates competitive manufacturers of locally made goods and services across all industry sectors and major projects. The NSW Government may seek to form a greater alliance with ICN to assist and promote government procurement opportunities for small to medium enterprises.



Your comments

- 26 What are the opportunities for helping small to medium enterprises to increase their participation in government procurement?
- 27 How effective is the Local Jobs First Plan in meeting its objectives? What do you consider are the advantages and disadvantages of this Plan?
- 28 What other mechanisms would meet the objectives of assisting small to medium enterprises?
- 29 What impediments are there to small to medium enterprises interacting with government procurement?
- 30 What opportunities should the NSW Government pursue to address these impediments?

4 Innovation and procurement

4.1 Procurement's role in promoting innovation

As noted earlier in this discussion paper, the NSW Government spends about \$12.7 billion on goods and services each year. Accordingly, government procurement impacts on the State's economy. As one of the largest purchasers, the public sector can influence markets through its purchasing power, including promoting creativity and innovation.

The NSW Government wishes to be a leader in promoting innovation. Using the NSW Government's procurement system to promote innovation is an important policy objective. This includes seeking new products, processes or services, or delivering services in new ways. These results can also be achieved by procuring goods and services in new ways that promote innovation and creativity.

By being open to innovation in its procurement processes, the NSW Government gives the market the opportunity to offer solutions that may be more productive, a better fit for the need and, in some cases, more cost and resource efficient. Potential benefits derived from innovation within public procurement include:

- **Meeting unmet needs:** obtaining solutions to unmet public sector needs and in turn offering better public services
- **Achieving productivity gains and value for money:** with growing pressure on public services to meet increasingly complex needs while also reducing public spending, innovation provides opportunities for new or existing ideas to achieve needs in a more efficient and effective manner
- **Creating globally competitive goods and services:** by encouraging the market to offer innovative goods and services, government has the ability to stimulate local and international competitiveness, and
- **Creating a diverse business environment:** by becoming an intelligent customer with robust outcome-based strategies and by implementing tools such as e-procurement, government has the potential to engage with a diverse range of businesses it may not otherwise reach, which, in turn, is more likely to result in the best possible solutions.

4.2 Barriers to innovation: international research findings

The Department of Trade and Investment has conducted international research into the barriers experienced by industry and suppliers to delivering innovative solutions to government:

Communication

Suppliers are often not informed of unmet government needs. They are often not engaged in the development of solutions that will meet a government's goods and service needs. Suppliers are often able to assist agency buyers in specifying what



the solution could be, and therefore able to recommend the best possible product or service while delivering value for money.

Policy/regulation

Governments often set highly specific tender requirements, which minimise opportunities for the market to suggest alternative and potentially better fitting solutions. Existing policies and regulations promote the use of established suppliers through panel contracts. Standardisation of tender processes may improve efficiency but can limit consideration of innovative proposals.

Supplier perceptions

Suppliers perceive that government contracts are awarded based on unit price, rather than the whole-of-life cost or other important factors such as productivity or fit with the need. As a result, suppliers may not enter into the tendering process due to perceived lack of consideration.

Risk aversion

Public sector staff can fear the risks and uncertainties associated with innovation, and may lack knowledge about the correct process for procuring innovative products or services. Furthermore, the public sector also fears the uncertainties and potential for perceived corruption in looking beyond large, previously approved and successful firms.

Reward

There is often a lack of incentive and reward for government agencies to seek and undertake potential risks in the procurement of innovative solutions. Agencies' key performance indicators often do not adequately reflect the need to purchase outside standard procurement processes as the means to seek the best possible solution.

Knowledge and skills

Procurement specialists often need knowledge spanning across diverse fields of government procurement, and may lack knowledge and skills in specific procurement areas or projects.

Timeliness

Government procurement staff are not usually given enough time and resources to engage in market consultation about issues and solutions. They also need to plan future needs and communicate them to the market to allow time for finding solutions. Current tendering processes can be time-consuming.

Contract management

The constraints of contract management often lead to inflexibility in the expectations of productivity. Suppliers are expected to uphold the same standards as applied at the allocation of a contract, rather than being expected to continue to improve productivity over time and reflect changes and improvements within the general market.

Evaluation scope

The scope of evaluation models are often too narrow, not including broader demands on the public service, such as social, environmental and economic needs. Evaluation models can also often be too broad and standardised across many technical and diverse areas, inhibiting conditions when evaluating unique contracts.

Reluctance to trial new processes

Government procurement staff are often unclear about correct procedures and uncertain about the reaction of procurement bodies and senior management when seeking to procure outside the accepted scope of procurement practices.

4.3 Identifying barriers to innovation in the NSW procurement system

Some or all of the above factors may relate to NSW Government procurement. The current Review of NSW Government Procurement provides an opportunity to overcome some or all of these barriers, although the scope of this discussion paper is limited to the extent to which the current procurement system stifles innovation (as opposed to the extent to which government can promote innovation through grants and other similar measures). Reform in this area requires a careful balancing of the costs (from the reduction in standardised processes) with the benefits, and careful consideration of risks (such as probity and fairness).

As is noted earlier in this paper, the legislation establishing the State Contracts Control Board creates a strong presumption in favour of long-term whole-of-government panel contracts established through open public tender.

Recent research by ICAC has highlighted the complexity of rules and processes applying to procurement, and clearly this can have an impact on suppliers wishing to engage with government. As noted earlier in this paper, future stages of the Minister's Review of Procurement will focus on reviewing the codes of practice and regulations that apply to procurement in NSW.

At the Ministerial Forum on ICT, held in June 2011, it was noted that in ICT procurement there is a tendency for government to approach the market with detailed tender specifications, rather than detailing the outcomes it is seeking to achieve. It was also noted that there are greater opportunities for collaborating with industry to assist in identifying innovative solutions.

Your comments

- 31 What are your views on the capacity of the NSW Government's procurement system to provide innovative solutions to delivering its services?
- 32 Do the above procurement-related barriers to innovation exist in the NSW Government?
- 33 Are there other barriers which need to be considered further during the Review of NSW Government Procurement?
- 34 How can these barriers be overcome?



4.4 Options for improving innovation through procurement

The following strategies and opportunities are available to the NSW Government to allow it to use its procurement system to take greater advantage of innovation. These approaches are based on research undertaken by the Department of Trade and Investment, and draw on research undertaken in the United Kingdom and the European Union.

Consultation with market prior to tendering

Consultation and/or collaboration with the private sector before government agencies call for tenders would allow agencies to identify what is currently being offered in the market; to access current research; and to see what the private sector may be capable of designing or offering. As noted earlier in Part 2 of this discussion paper, strategies and mechanisms would need to be developed to ensure fairness and transparency in such processes. The Independent Commission Against Corruption notes that both suppliers and agencies most frequently ranked direct negotiations and non-tendered quotations as particularly vulnerable to corruption³. Experience in the United Kingdom indicates that such approaches can be undertaken successfully.

Reforming procurement guidelines and processes

As a means to encouraging new ideas and solutions, and encouraging businesses to submit an application for tender, procurement (including tendering) guidelines and processes could be reformed to make it clear to suppliers that innovative solutions are welcome and will be considered. The extent to which such increased flexibility can be adopted needs to be carefully considered, taking into regard cost effectiveness and risk.

Redefining value for money

The NSW Government uses value-for-money as a primary objective for procurement. It may be useful to expand the definition of this concept so it includes the whole-of-life costs of goods and services.

Outcome-based procurement

By allowing the market to devise (often creative and innovative) solutions in response to specified needs (outcomes) rather than specified means, outcome-based procurement allows the market to offer solutions beyond the constraints of highly specific tendering requirements. There may be an opportunity to give greater guidance to government agencies and prospective suppliers to achieve such an approach. It may be useful to remove the impediments to such outcome-based procurement, within an appropriate probity framework.

³ Independent Commission Against Corruption, *Corruption risks in NSW Government Procurement: Suppliers' Perceptions of Corruption*, June 2011

Transparency in regard to future needs

To sound out the market and to generate new solutions, suppliers need time to develop their proposals. This requires a high level of forward planning by government agencies and making information available so that industry has time to research, develop ideas and respond. To stimulate innovative solutions, agencies need to provide a clear understanding of their requirements and to emphasise that innovative solutions are encouraged.

Underpinning all of the above strategies and opportunities is the need to develop the public sector's capability to manage alternative procurement strategies.

Your comments

35 Would the options set out above be of assistance in promoting innovation?

36 What other strategies might be available?



5 Reviewing NSW Government Procurement

5.1 Next stages for review

This paper set out the first steps to reforming the NSW Government's procurement system. The next four areas of major reform have been defined:

- **Procurement capability:** as noted throughout this discussion paper, successful transformation to a new system depends on agencies having the necessary level of procurement capability. An important question will be, how will the government provide agencies with the necessary procurement knowledge and skills?
- **Procurement data:** what is required to provide the Procurement Board, the Department of Finance and Services and other government agencies with the right data and analysis to inform their procurement decisions?
- **Review of the regulations:** the Public Sector Employment and Management (Goods and Services) Regulation 2010 is the principal statutory mechanism for delivering procurement. It requires extensive revision to allow for implementation of the proposals in this discussion paper.
- **Review of the NSW Government Procurement Policy**, including the *Code of Practice for Procurement* and other related documents.

Your comments

This discussions paper deals with four areas of the NSW Government's procurement reform. Other matters will be addressed in coming months.

37 What are your concerns and issues with the NSW Government's procurement system that should be addressed during the next stages of this review?



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