

Submission for 2004 Cronin Club Innovation Award

State of Illinois

Transformation of Procurement Performance

Procurement Agency: State of Illinois, Central Management Services

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Implementation group: State of Illinois, Central Management Services

State of Illinois Transformation of Procurement Performance

While improving any one element of state procurement can be challenging, attempting to *transform procurement performance* – financial outcomes, organizational capabilities, procurement processes, and culture – may sound daunting if not impossible. Yet, to address a large budget deficit, the State of Illinois launched a comprehensive procurement initiative in August of 2003, driven by a set of aggressive savings goals and complemented by an equally ambitious set of aspirations for organizational change.

Our starting point stemmed from decades of decentralized practices - multiple contracts for the same item, spending in haphazard strategies, and reinventing of the procurement wheel without taking advantage of prior learning from other agencies. (Exhibit 1 describes the findings from a procurement diagnostic completed in early 2003.) Processes in the State were expensive, slow, inflexible, and delivered poor service to our customers—state agencies as well as vendors..

Our impact--in a short ten months—has been dramatic:

- ¶ More than \$100 million in captured savings in the current fiscal year (FY 04), and \$240 million projected for the next fiscal year through Total Cost of Ownership (TCO) and “Quick Sourcing” methods that use multi-agency teams
- ¶ Creation of a new “center-leading” procurement organizational model that is implementing a dozen newly-redesigned processes as our Governor’s single point of contact for procurement, supported by a procurement and financial skills training program that built skills for hundreds of state employees
- ¶ Cultural change on two dimensions: (a) Destruction of the “silo” mentality separating procurement groups, and (b) Shift from a “compliance” mentality to a “financial accountability” mindset.

Success #1 – Financial savings of more than \$100 million

Fundamentally reducing the State’s spending across hundreds of categories on various items required us to depart from a traditional focus on “bid price only” and instead consider a more comprehensive set of procurement levers and approaches. Our new approach, helped us to: (1) hold vendors accountable to “play fair” with the State, and (2) redesign sourcing specifications and strategies (i.e., changing the “what” and “how” of procurement).

The first of these approaches, “Quick Sourcing”, uses price benchmarks to determine whether current prices are reasonable. Vendors frequently acceded price concessions or other service improvements when confronted with the potential label of “robbing the taxpayers.” We gathered a wide variety of publicly available benchmarks, and supplemented them with information provided by an external consultant. Following this analysis, dozens of negotiations were conducted with vendors leading to over \$40 million in run-rate savings across 15 spend categories (including office supplies and telecom, among others.) Exhibit 2 illustrates the application of Quick Sourcing to telecom.

The Total Cost of Ownership (TCO) methodology complemented the Quick Sourcing approach, and added an additional \$60 million in run-rate savings across 20 spend categories. TCO is an innovative, systematic approach to move beyond traditional procurement categories, sourcing methods, and specification development. TCO uses hypothesis-driven, fact-based techniques to determine the lowest total cost for procuring an item once all factors are considered. We often found that these factors—like delivery, service/warranty, over-specification, order-to-payment processing, and reduction of unnecessary demand—caused more expense than the price of the good or service itself. For example, Exhibit 3 describes the \$2 million in savings from redesign of food specification.

We strongly believe that both the Quick Sourcing and TCO tools can be successfully transferred to any state, and look forward to opportunities to help make this a reality.

We also concentrated on a number of spend categories not traditionally included within the umbrella of procurement, including a broad array of externally-provided social services. This innovative work, which focused on contract restructuring and order-to-payment error elimination, brought tens of millions of dollars in immediate cash value to the State without reducing service levels to citizens. Exhibit 4 describes the methodology we used. In short, we carefully broadened our definition of procurement to allow us to add value in situations where no user agency would have expected us to contribute.

To dispel any potential skepticism about savings claims, we developed a rigorous savings validation process to tie results to the State's bottom line. Each implemented idea was independently evaluated by six-person committee, who used a standardized reporting template (see Exhibit 5) accompanied by supporting documentation such as new contracts. Only cash savings or verifiable obligations (against strict, agreed-to baselines, rather than retail prices) approved by consensus, could be counted towards the initiative's goals. The State's budget office and comptroller further evaluated captured savings to ensure benefits did not disappear in the budgetary shuffle. Counting savings has always been a problem for procurement groups. From commodities to services, we have developed a set of category-based formulas and methodologies to quantify and validate savings. These could be utilized easily by other states working to lower costs.

Success #2 – Creating Center-led Procurement

Traditional procurement organizations have often moved in one of two extreme directions: highly decentralized or highly centralized. Each, of course, has limitations and pitfalls. Centralization can create bottlenecks and inflexibility, while decentralization allows variability and wasteful redundancy. To address these problems, we shifted towards a third model – the “center led” approach. Exhibit 6 describes our new model.

We began the path to center-led procurement by breaking our \$15 billion of procurable spend into five categories based on industry sector (Healthcare, facilities, IT-telecom, equipment, and general services). We then formed a new bureau within the State's existing Central Management Services (CMS) agency (see Exhibit 7) to center-lead procurement.

This innovative organizational structure relies on a central procurement personnel collaborating with a network of user agency purchasing officers to make decisions, thereby merging procurement expertise with industry/sector knowledge to develop sourcing strategies. To avoid the problem of finger pointing between procurement and agencies, the purchasing officer in each agency reports

directly to the Director of their agency but with a “dotted line” to the Director of CMS. This network also strengthens the potential for using demand management levers, as the within-agency purchasing officers can locally monitor activities and spending (The tool our network used to reduce \$2 million in unnecessary “end of the fiscal year” IT spend is at Exhibit 8).

Given our history of redundant efforts to reduce costs, a Chief Knowledge Officer (CKO) role was created to capture work products, manage existing knowledge, and supervise dissemination of insights through an electronic knowledge management (KM) system and training programs. Exhibit 9 displays the KM system. The creation of this experience repository will support the portfolio managers and state purchasing officers in their ongoing work to improve procurement.

Success #3 – Cultural change

We identified 2 major cultural inhibitors to implementing best practices – “silo thinking” and “compliance mentality.”

Cultural change was catalyzed by: (a) A comprehensive training program designed to provide group problem solving experience to a wide cross-section of over 300 State employees, (b) Multi-agency representation on the sourcing teams charged with identifying savings opportunities, and (c) Town hall meetings held between leaders of CMS and state purchasing officers from every agency. These monthly meetings represented the first time in decades that such a diverse gathering of procurement personnel had occurred, and developed a “One State” philosophy towards procurement. We cannot function as separate entities any longer. We have to be the “Land of Lincoln”, not the “Islands of Lincoln”.

Fundamentally, we believe that “If you put good people into a bad process, the bad process always wins.” Our initiative focused on changing how the *system* of procurement should be conducted within the state. Our redesign of both core and supporting procurement processes, including the development of a consolidated “business case” to build fact-based analysis into all procurements (exhibit 10). This was supported by a broad-ranging training program to reinforce new mindsets (see Exhibit 11).

Conclusion

The challenges we faced in Illinois were neither new nor different, but we believe the magnitude of our comprehensive approach and rigorous application of innovative procurement methodologies (e.g., TCO) were a potential model for others to follow. The approach required little in the way of short-term technology investment, and produces significant near-term ROI impact.

We believe this approach is broadly and quickly transferable to other public sector organizations. Alignment of key stakeholders allowed us to achieve \$100 million in in-year savings in addition to involving state purchasing officers to rebuild organizational structure, improve processes, develop capabilities, and change culture.

Our view of the “end zone” is what keeps us motivated to continue the transformation process. We are not done yet – we see this as a three year journey towards excellence across multiple dimensions. We hope that by working with states around the country—and sharing best practices among all the states—we can together deliver value to taxpayers.