# **Achieving value for money – Goods and services procurement guide**

## What is value for money?

Value for money (VFM) underpins Victorian Government procurement. It is the achievement of a desired procurement outcome at the best possible price—not necessarily the lowest price— based on a balanced judgement of financial and non financial factors relevant to the procurement.

It is a common, internationally recognised test for benchmarking expenditure to achieve policy objectives. It supports the concept that better outcomes can be achieved when resources are used more efficiently and are procured in a more competitive market.

VFM takes into account the total cost of procurement from planning to disposal and everything in between. This is commonly known as total cost of ownership.

## When to implement VFM?

The Victorian Government is committed to achieving VFM in all procurement projects. It is therefore a key driver in any procurement engagement. VFM needs to be considered at the front end of the procurement process during your spend analysis, category identification, complexity assessment and supply market analysis. This identifies the key VFM drivers that give context to subsequent stages of procurement.

Considering VFM during the market analysis stage can identify opportunities to leverage competition and market dynamics, promote productivity and take advantage of innovations in the market.

It is also worth considering VFM at later stages of the procurement process, such as contract management to drive continuous improvement during the contract period.

## Applying and measuring VFM

There is no universal formula for measuring VFM in procurement. VFM takes into account the entire mix of quality, costs and resources, as well as fitness for purpose, timelines and risk. Financial and non financial factors are both critical elements for measuring VFM.

The following figure shows VFM drivers aligned against key elements of the procurement process.



The figure shows a triangle. Value for money is shown at the top of the triangle. Market competition is shown at the lower left corner. Financial and non-financial are shown at the lower right corner. Arrows point from market competition and financial and non-financial to value for money. The following text appears inside the triangle:

* Analysis
* Stakeholders
* Market engagement
* Innovation
* Delivery
* Reporting

The **VFM evaluation checklist template** provides a template for identifying and measuring VFM drivers.

## Total cost of ownership

Calculating the total cost of ownership (TCO) includes a ‘whole of lifecycle’ analysis. It estimates the accumulated costs of acquiring, operating, maintaining and disposing or decommissioning procured goods or services, including revenue from disposal. The following figure illustrates the important elements of TCO.



The figure shows the elements of TCO:

TCO equals price, plus usage, plus disposal.

TCO includes:

* Involves all costs associated with ownership
* Calculated over whole of life of procurement and contract cycle
* Includes residual / salvage values

Price includes:

* Unit price
* Tendering, evaluation and selection processes
* License(s) or permits
* Demand planning
* Internal systems support
* Legal
* Training and personnel
* Risk margins / premiums
* Transition in

Usage includes:

* Costs to operate
	+ Reviews
	+ Maintenance
	+ Upgrade
	+ Demand management
	+ Distribution and logistics
	+ Supplier relationship management
	+ Security and safety
* Support costs
	+ Insurance
	+ Rates and taxes
	+ Management fees and charges
	+ Safety and security compliances
	+ Quality management
	+ Reporting
	+ Ordering and payments
	+ Training and personnel
* Costs to upgrade and customise
	+ Integration and replacement
	+ Systems maintenance / upgrade
	+ Customisation

Disposal includes:

* Costs to end
* Decommissioning and / or demolition / destruction
* Replacement
* Data migration
* Safety and security
* Carbon footprint and environmental
* Support costs
* Statutory compliance costs
* Associated labour and personnel
* Method (i.e. auctioneers, agent(s), fees)
* Residual / salvage valuation
* Transition out

### Scope of application

There are a number of ways (or metrics) to analyse cash flow to calculate TCO. For example, net present value, return on investment, and internal rate of return. These metrics are most applicable to procurement categories assessed as high risk/high value with a focused or strategic level of complexity, which also require specialist capability.

For most procurements assessed as transactional, leveraged, and of a low risk/ focused nature, you can determine the TCO of a procurement activity using the TCO analysis framework in the following table. The following assumptions apply:

* costs are total project costs (including price, usage, disposal and ongoing maintenance/warranty commitments);
* use of full dollar value;
* application of a standard three to five year contract timeframe, including options to extend; and
* identified cost increases arising from Consumer Price Index and Carbon Pricing Mechanism adjustments.

Applying TCO assumptions to levels of procurement complexity

|  |  |  |
| --- | --- | --- |
|  | **Standardised goods and services market** | **Specialised goods and services market** |
| **High value created through procurement** | Leveraged(quadrant 2)TCO framework should apply | Strategic(quadrant 4)Additional financial analysis / methodology is required |
| **Low value created through procurement** | Transactional(quadrant 1)TCO may apply in limited circumstances | Focused(quadrant 3)May require additional financial analysis and TCO in limited situations |

Notes: A TCO analysis for a short-term procurement activity of a transactional and leveraged nature and/or with ‘off the shelf’ specifications would not add value to the VFM assessment unless it involves longer term service support commitments and warranties.

A TCO analysis could be considered for some focused procurement activity with a short contract period at the lower risk level of the focused quadrant.

## Competition and market development/innovation

Competition and contestability are important drivers in achieving value for money. However, participation in a procurement exercise is a cost to suppliers and is particularly significant for SMEs. The cost of unsuccessful bids by an SME can be a major disincentive to participation. These costs should be considered when selecting a market engagement strategy. Letting the market know that VFM is an important consideration, alerts suppliers to the fact that they can include product and service enhancements and innovation when submitting a bid.

## Non financial factors

Non financial aspects of VFM can be more difficult to measure. However, these indicators can be used to predict the overall value of the procurement. Non financial factors are best measured on a case by case basis. Variables include stakeholder satisfaction, community/client participation and outcomes outside of the intended procurement objectives.

Examples of benefits that can arise from procurement include:

* enhancing market competition;
* job creation;
* economic and social benefits of procuring from Australia and New Zealand small to medium size enterprises (SMEs), and not for profit organisations;
* reducing carbon footprint; and
* encouraging innovation and productivity in a particular industry sector.

### Measuring non financial factors

There are multiple methodologies for measuring non financial factors including welfare economics, Pareto efficiencies and equity economics, etc. which have particular relevance to procurement of strategic importance or where there is significance/social impact.

However, for the majority of goods and services procurement of a transactional, leveraged and low risk, focused nature, a simple approach using KPIs is recommended.

## Using KPIs

Procurement managers will determine a range of performance objectives relevant to the procurement as shown in the **Non financial performance indicators checklist**. They can decide whether to specify the scope of the indicators or let the market define how the indicators are addressed.

## Using this guide

This guide accompanies the [goods and services supply policies](https://buyingfor.vic.gov.au/goods-services-supply-policies). There are 5 supply policies:

* Governance policy
* Complexity and capability assessment policy
* Market analysis and review policy
* Market approach policy
* Contract management and disclosure policy

This guide supports the [Governance policy](https://buyingfor.vic.gov.au/governance-goods-and-services-policy-and-guides).

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