

Sourcing Benefits Case & Implementation Plan

January 21, 2011

- Executive Summary
- Approach and Wave Plan Workshop Summary
- Benefits Case
- Implementation Plan
- Appendix

Executive Summary

The State of North Carolina has the potential to realize as much as \$30M – 60M in General and Highway Fund savings in the coming biennium by strategically sourcing 20 target categories with State Agencies and Community Colleges.

- The Benefits Case & Implementation Plan is based on analysis of FY'08 – FY'10 spending for State Agencies and Community Colleges, and incorporates feedback from the State's leadership as to the timing and categories included in the plan.
- The Benefits Case & Implementation Plan includes 32 in-scope categories across three groups or "waves", with 11 categories targeted in wave 1 and 9 categories targeted in wave 2.
- Through execution of strategic sourcing, the State could save as much as \$46M – 96M in annualized procurement savings from all funds over the next three years, or an average of \$1.4M – 3.0M per month.
- Savings are based on anticipated spend from State Agencies and Community Colleges; savings could be expanded by extending contract usage to Universities, LEAs and/or Local Governments.
- Effectively executing sourcing strategies against 32 categories will require an estimated resource pool of 2-3 experienced sourcing professionals per category to support research, analytics, RFx activities, negotiations, contract implementation, and contract management.
- Immediate next steps would include the State finalizing the start date of sourcing activities and identifying the source of the resources needed to execute the eleven categories in wave 1 of the implementation plan.
- Implementation of recommend changes to statutes & policies, organization, technology, and strategy & governance will maximize and sustain benefits from strategic sourcing.

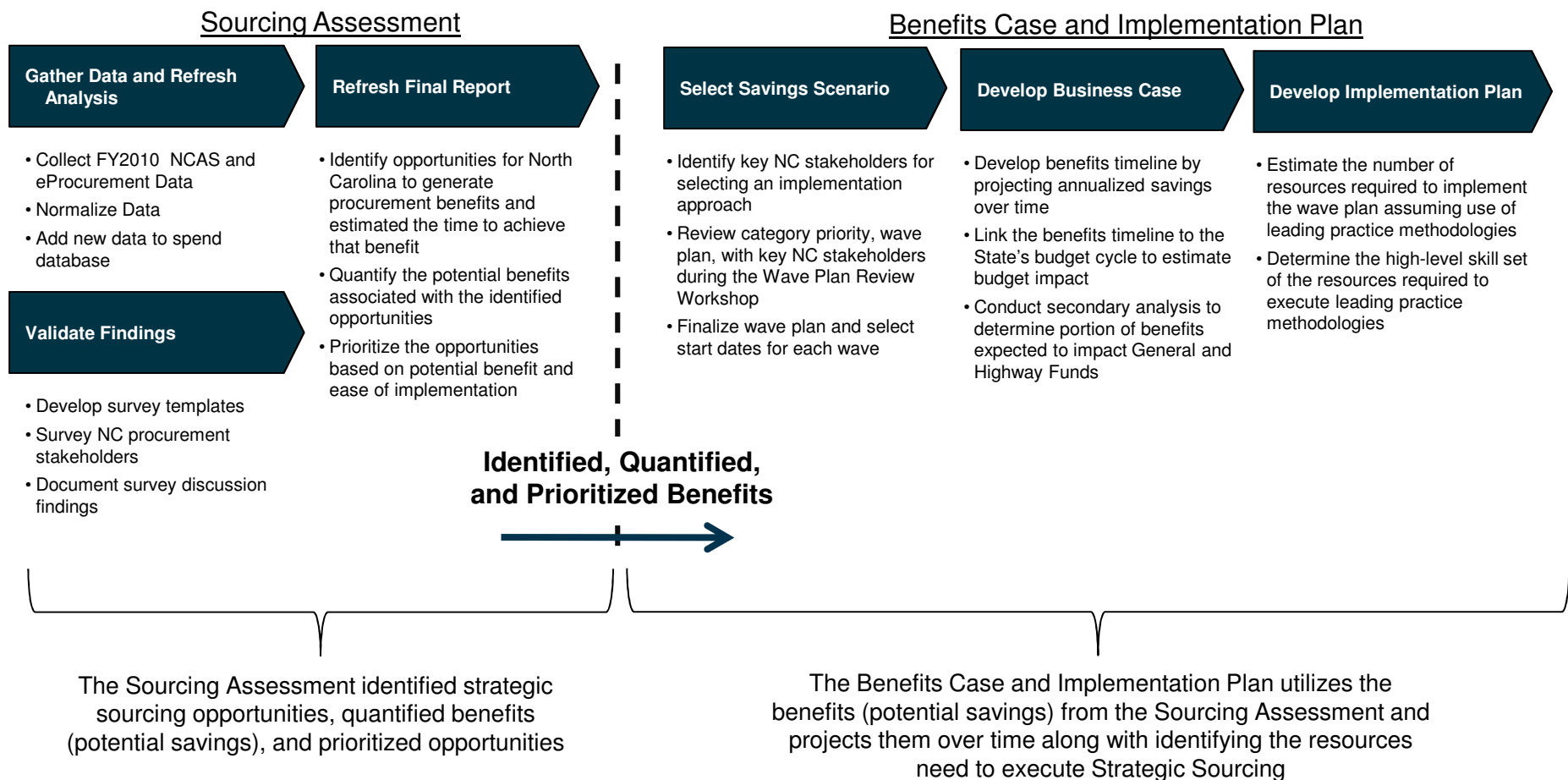
Notes:

1. Annualized procurement savings assumes the current volume of purchasing remain constant with State Agencies and Community Colleges and may include funding sources outside of the General Fund
2. Actual savings realized may be impacted by factors such as the elimination of federal stimulus funds and budget reductions, and will be further dependent on governance, organizational, and statutory changes.
3. The 'spend data' in this report includes direct payment data from NCAS and purchase order data from eProcurement, and does not necessarily represent the exact dollar amount actually paid to third party vendors.

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Approach - Overview

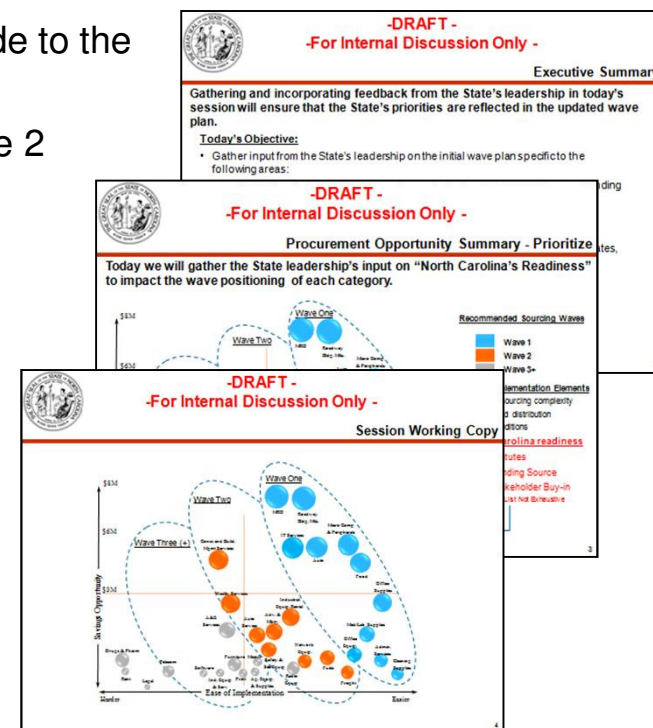
To develop the benefits case, potential annualized procurement savings are projected over time building on the findings of the Sourcing Assessment.



Approach - Wave Plan Workshop Summary

The Wave Plan Review Workshop served as the forum to gather additional feedback from the State's leadership on the initial wave plan provided as part of the Sourcing Assessment Deliverable.

- As a result of the workshop, the following adjustments were made to the Wave Plan:
 - Freight and Freight Supplies – Moved from wave 1 to wave 2
 - IT Services – Moved from wave 2 to wave 1
 - Office Equipment – Moved from wave 2 to wave 1
- The updated wave plan reflects:
 - Potential annual savings of \$46M-96M
 - 32 in-scope categories
 - 3 waves of strategic sourcing
 - Wave 1: 11 Categories
 - Wave 2: 9 Categories
 - Wave 3: 12 Categories

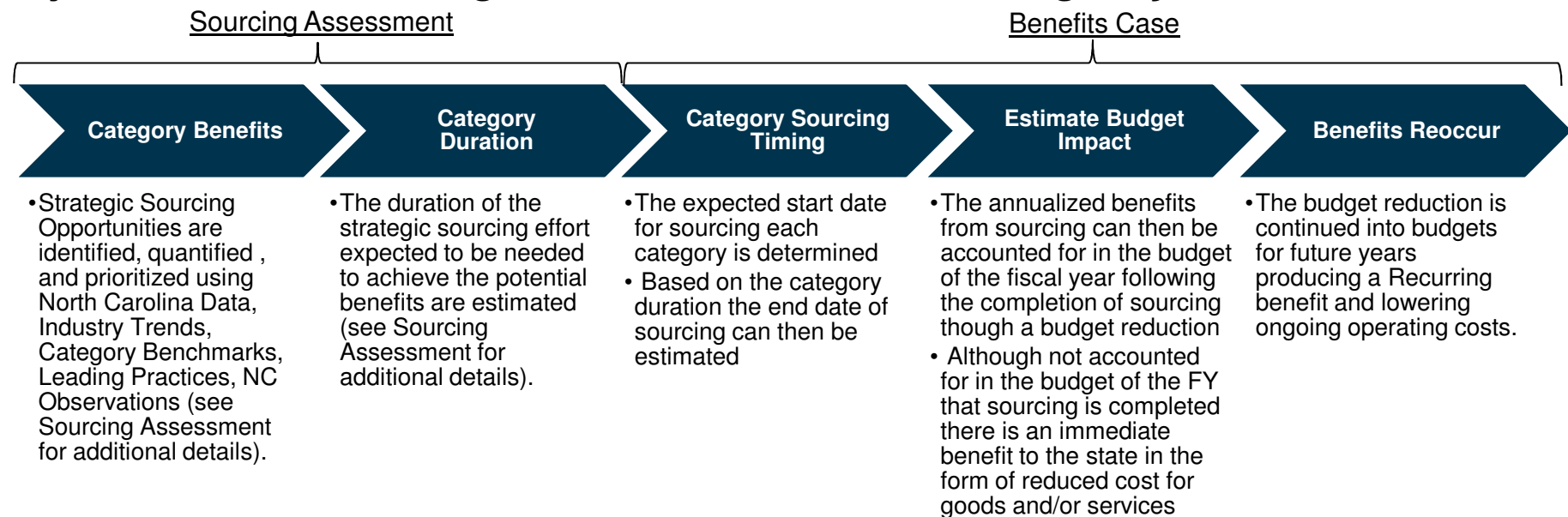


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Approach – Benefits Case

To develop the benefits case, potential annualized procurement savings are projected over time taking into account the state's budget cycle.



Office Supplies Example

- Annual Addressable Spend: \$18.2M
- Potential Savings: 10% - 20%
- Potential Annual Savings (Lowest %): \$1.8M

- 6 Months expected to achieve potential benefit

- Sourcing Start Date: March 2011
- Sourcing End Date: August 2011

- \$1.8M in annualized reduced cost for office supplies is accounted for in the FY13 budget (additional savings would begin in FY12 as soon as a new contract is in place)

One Time Budget Reduction	Recurring Benefit (lower ongoing operating cost)				
	FY'13	FY'14	FY'15	FY'16	FY'..
	\$1.8M	1.8M	1.8M	1.8M	1.8M

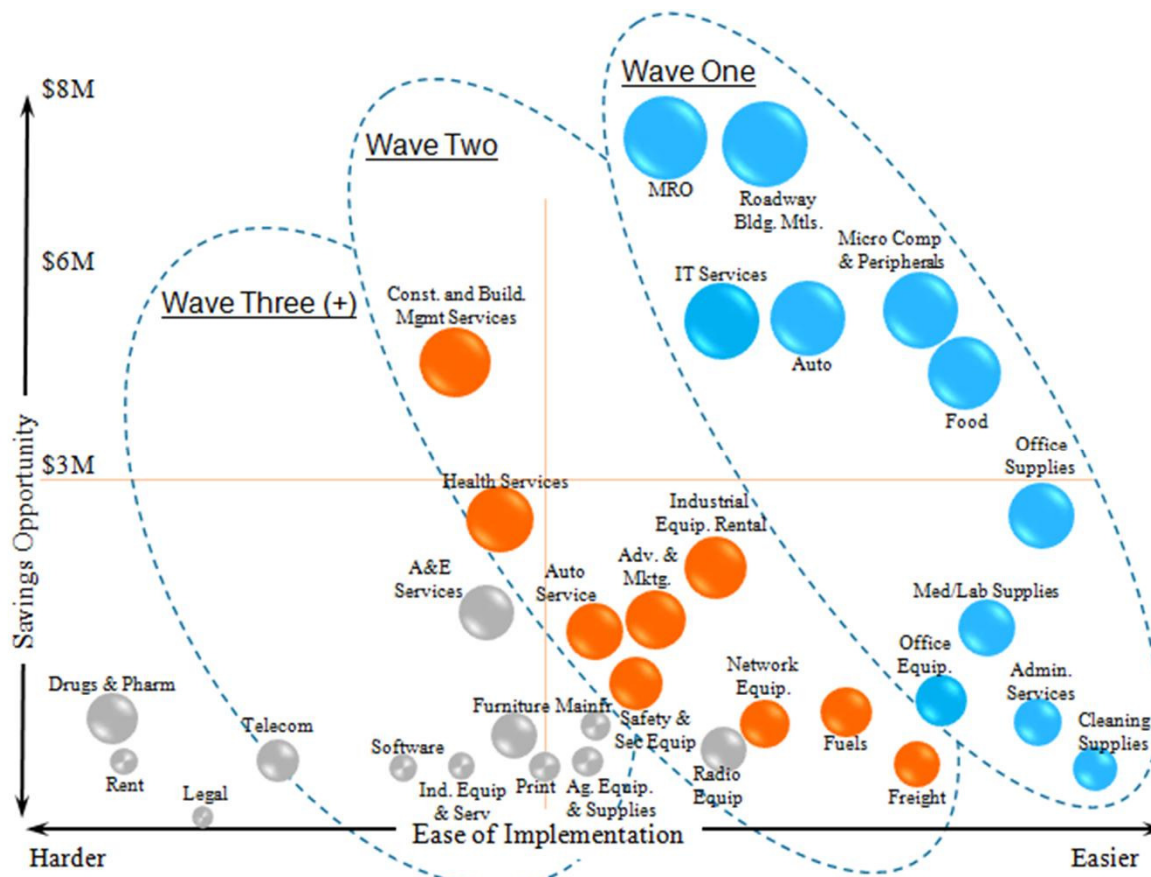
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Benefits Case - Sourcing Wave Plan Summary

The wave plan prioritizes the 32 in-scope categories into three waves based on savings opportunity and ease of implementation elements.



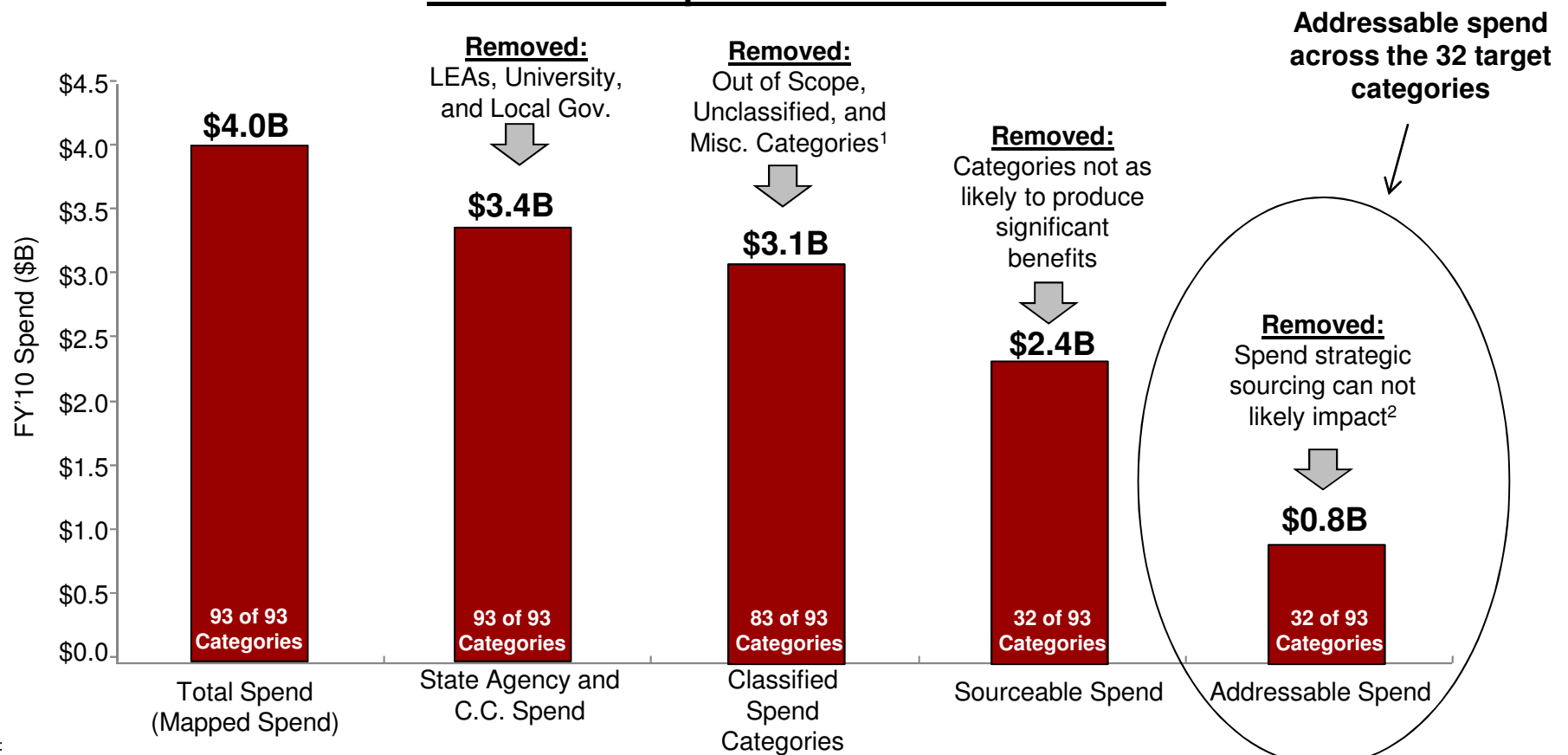
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Benefits Case - Addressable Spend Overview

The team reviewed \$4.03 billion in total FY'10 spend to identify the spend most likely addressable through strategic sourcing.

Addressable Spend Identification Process



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Benefits Case – Annualized Savings Summary

The potential annualized procurement savings of \$46M - \$96M is divided among the 32 categories and three waves of sourcing.

Category	Wave	Annual Addressable Spend (\$M)	Annual Savings Low (\$M)	Annual Savings High (\$M)
Roadway Building Materials	1	\$125.2	\$5.0	\$10.0
Micro Computers and Peripherals	1	\$38.1	\$3.8	\$7.6
IT Services	1	\$44.1	\$4.4	\$6.6
Food	1	\$37.8	\$3.0	\$5.7
Office Supplies	1	\$18.3	\$1.8	\$3.7
Med/Lab Supplies and Equipment	1	\$24.8	\$1.2	\$2.5
Administrative Services	1	\$9.0	\$0.7	\$1.3
Cleaning Equipment and Supplies	1	\$5.1	\$0.5	\$1.0
MRO Supplies and Equipment	1	\$66.8	\$5.3	\$10.0
Auto	1	\$73.9	\$3.7	\$7.4
Office Equipment	1	\$8.6	\$0.9	\$1.7
Total (Wave 1)		\$451.7	\$30.5	\$57.5

Category	Wave	Annual Addressable Spend (\$M)	Annual Savings Low (\$M)	Annual Savings High (\$M)
Freight and Freight Supplies	2	\$11.0	\$0.6	\$1.1
Industrial Equipment Rental	2	\$35.6	\$1.4	\$2.8
Safety and Security Equipment and Supplies	2	\$13.5	\$0.7	\$2.0
Fuels	2	\$43.1	\$0.9	\$1.7
Network Equipment	2	\$10.5	\$0.5	\$1.6
Advertising and Marketing	2	\$25.7	\$1.3	\$2.6
Auto Service and Parts	2	\$20.8	\$0.8	\$2.5
Construction and Building Management Services	2	\$45.8	\$2.3	\$6.9
Health Services	2	\$34.8	\$1.7	\$3.5
Total (Wave 2)		\$240.8	\$10.2	\$24.7

Category	Wave	Annual Addressable Spend (\$M)	Annual Savings Low (\$M)	Annual Savings High (\$M)
Architecture and Engineering Services	3	\$28.2	\$1.4	\$2.5
Drugs and Pharmaceuticals	3	\$21.7	\$0.4	\$1.7
Radios and Communication Equipment	3	\$15.0	\$0.3	\$1.5
Furniture and Fixtures	3	\$11.8	\$0.6	\$1.2
Telecommunications	3	\$13.0	\$0.3	\$1.3
Mini/Mainframe Computers and Peripherals	3	\$10.3	\$0.5	\$1.0
Agricultural Equipment and Supplies	3	\$7.0	\$0.6	\$0.8
Rent/Real Estate	3	\$12.5	\$0.4	\$0.9
Print	3	\$7.6	\$0.4	\$0.8
Software	3	\$10.9	\$0.2	\$0.9
Industrial Equipment and Service	3	\$6.8	\$0.3	\$0.7
Legal Services	3	\$1.7	\$0.1	\$0.2
Total (Wave 3)		\$146.5	\$5.4	\$13.5

Total (All Waves)		\$839.0	\$46.1	\$95.7
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Notes:



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Benefits Case – All Funds

Accounting for annualized savings, resulting from strategic sourcing, in the budget process reduces ongoing operating costs.

Sourcing Wave	Potential Annualized Benefit	Expected Month of Sourcing Completion	FY'12	FY'13	FY'14	FY'15	FY'16
Wave 1	\$30.5	Oct '11	-	\$30.5	\$30.5	\$30.5	\$30.5
Wave 2	\$10.2	May '12	-	\$10.2	\$10.2	\$10.2	\$10.2
Wave 3	\$5.4	Oct '12	-	-	\$5.4	\$5.4	\$5.4
Potential Budget Reduction (sum of budget reductions)	N/A	N/A	-	\$40.7	\$5.4	-	-
Potential Annual Benefit (sum of budget reduction and Recurring benefit)	N/A	N/A	-	\$40.7	\$46.1	\$46.1	\$46.1
Potential Cumulative Benefits (sum of potential annual benefit for all fiscal years)	N/A	N/A	-	\$40.7	\$86.8	\$132.9	\$179.0

Note: Successful procurement transformation preserves achieved benefits and should result in additional benefits beyond the three identified waves.

 : Budget Reduction
 : Recurring Benefit

*See page 21 for General and Highway Fund Benefits Case

*Numbers In Millions

Benefits Case Assumptions

- Assumes full purchasing compliance from State Agencies and Community Colleges and current purchasing volumes of sourced categories remain constant
- Assumes benefits from sourcing are accounted for in the budget of the fiscal year following the completion of sourcing
- Assumes lowest percent savings for each category and wave are achieved (see page 10 for ranges)

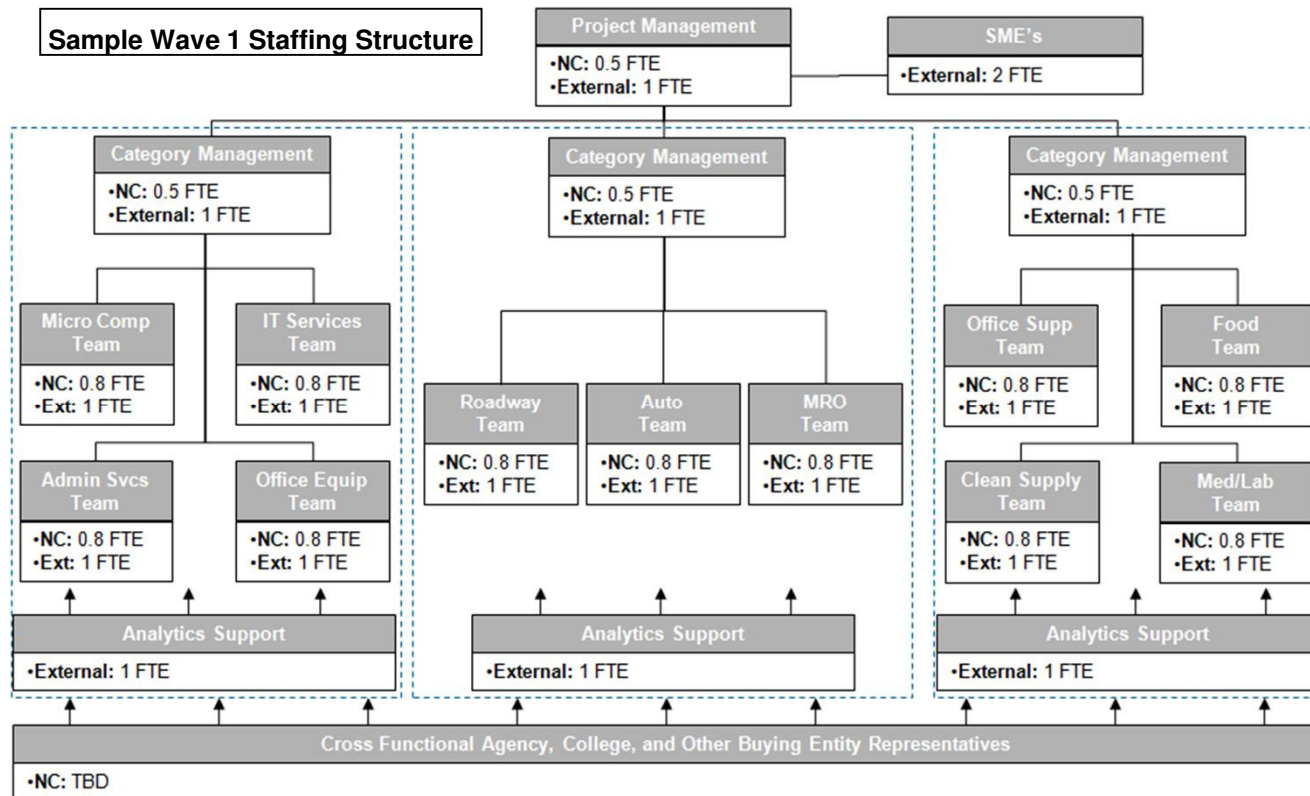
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Sample Wave 1 Staffing Structure

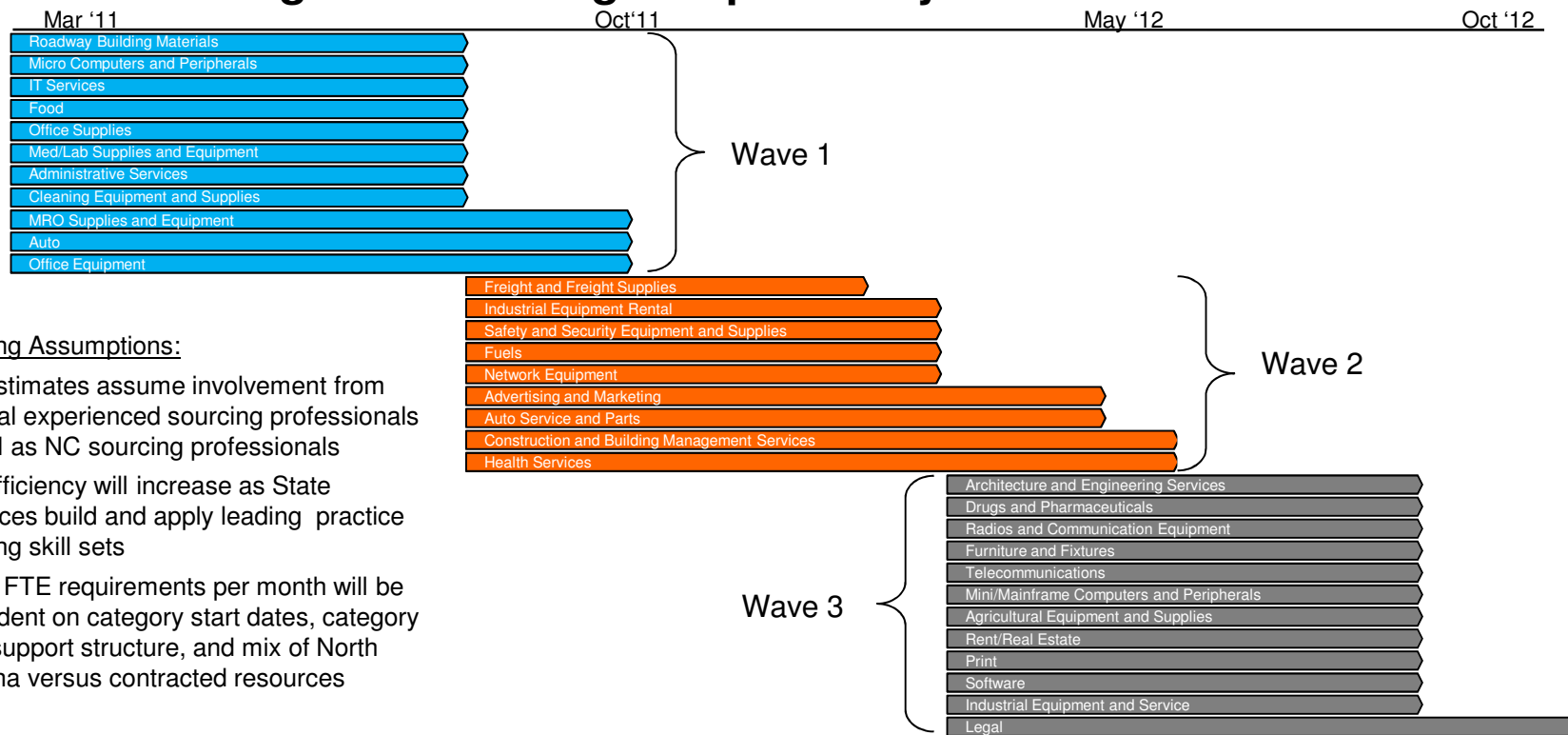
Successful implementation of strategic sourcing as a component of long-term procurement transformation will require participation from North Carolina resources and support from external resources.



Notes: NC team resources are expected to be 80% of a single resources time not .8 FTE spread across multiple resources

Implementation Plan

The Implementation Plan begins sourcing activities in March 2011, with three waves and 32 categories reaching completion by November 2012.



FTE Staffing Assumptions:

- FTE estimates assume involvement from external experienced sourcing professionals as well as NC sourcing professionals
- FTE efficiency will increase as State resources build and apply leading practice sourcing skill sets
- Actual FTE requirements per month will be dependent on category start dates, category team support structure, and mix of North Carolina versus contracted resources

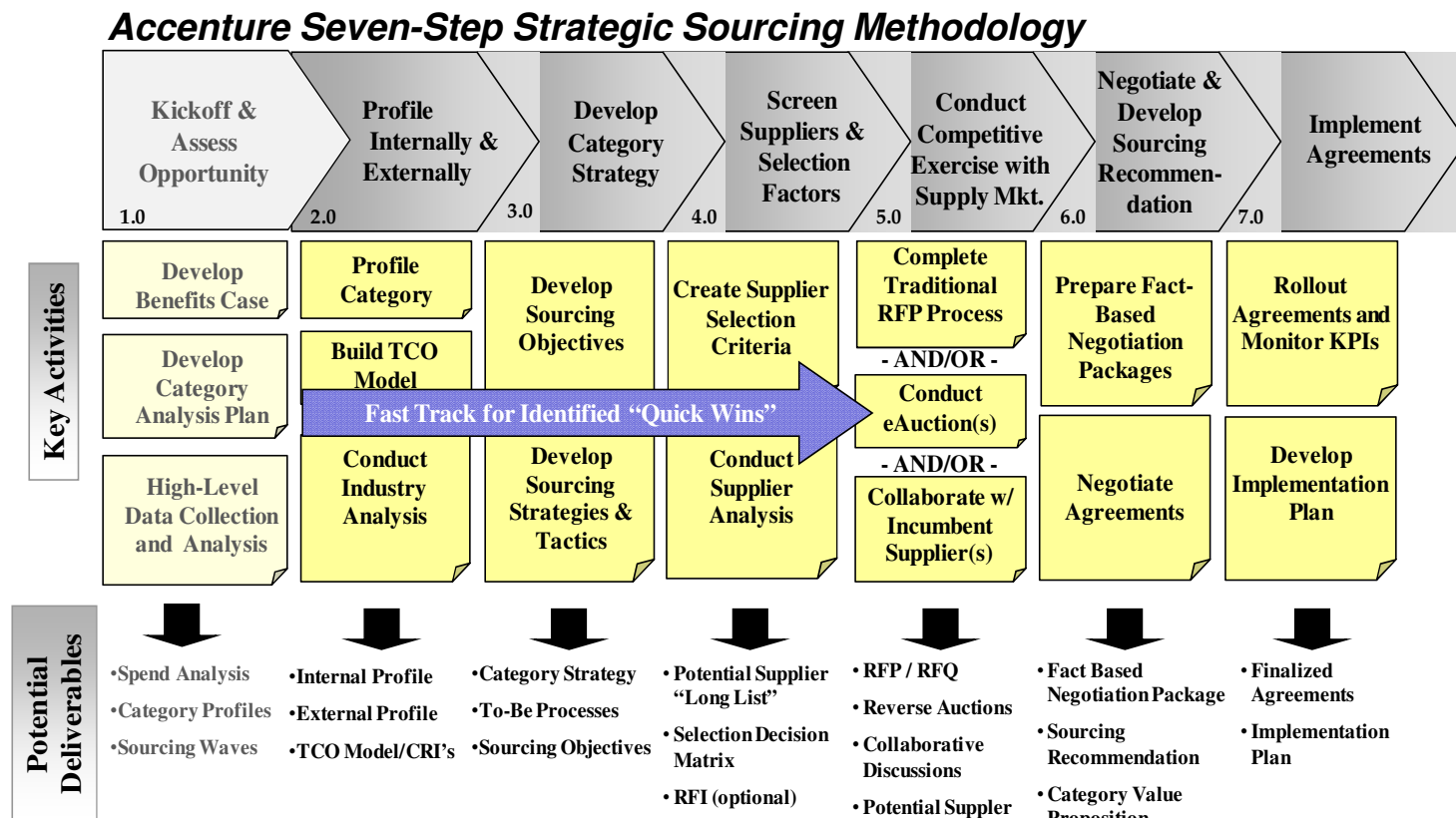
FTE Estimates	Month 1	Month 2	Month 3	Month 4	Month 5	Month 6	Month 7	Month 8	Month 9	Month 10	Month 11	Month 12	Month 13	Month 14	Month 15	Month 16	Month 17	Month 18	Month 19	Month 20
Low FTE	28	28	28	28	28	28	35	35	23	23	20	20	35	35	30	28	28	28	2	2
High FTE	34	34	34	34	34	34	38	38	27	27	26	26	40	40	35	34	34	34	3	3

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Sample Sourcing Methodology

The current implementation plan requires resources that have skills in each area of a strategic sourcing methodology.



Role Requirements

In order to implement each wave of strategic sourcing, resources will need a strong procurement skill set.

- **Kickoff and Assess Opportunities**

- Continually evaluate category priorities based on current opportunities
- Leverage spend database to confirm present opportunities and evaluate future opportunities
- Conduct spend analysis and create spend reports
- Define commodity segmentation/ spend breakdown via spend analytics
- Understand high level spend and opportunities as identified in spend database
- Identify commodity stakeholders for key commodities
- Review categories for potential sourcing triggers such as contract renewal alerts, new demand arising from new capital projects, changes in market conditions, vendor issues, changes in operational demand forecasts, revisions to financial targets, etc.
- Identify commodity constraints and requirements through stakeholder engagement

- **Profile Internally & Externally**

- Work with key entity stakeholders/core team to gather and assess requirements and map procurement flow
- Evaluate category importance and measure customer values
- Leverage specific category knowledge from known experts in category profiling
- Profile current sourcing / buying practices, category characteristics, constraints
- Understand key drivers of Total Cost of Ownership for the category, including price, administrative / process costs, usage costs, etc.
- Develop TCO category baseline; allow for adjustments based on future changes in TCO elements
- Gather transaction-level spend details from data sources
- Collect existing specifications and standards
- Understand industry trends and competitive forces using tools like Porter's Five Forces analysis, industry cost analysis, etc.
- Identify potential vendors and market segments
- Understand current cost structure of vendor industry
- Develop internal and external profiles for each category
- Assess potential supplier capabilities, positioning and financials

Role Requirements

In order to implement each wave of strategic sourcing, resources will need a strong procurement skill set.

- **Develop Category Strategy**
 - Leverage current data and profiling analysis, working collaboratively with the stakeholder team, in order to determine appropriate sourcing objective(s), strategies and internal change tactics. Examples include: Best Price Analysis, Demand Management, Volume Leveraging, Process Improvement, and Strategic Relationship Management
 - Evaluate strategy potential risks, business impact and opportunity sizing
 - Determine bid mechanism, such as RFP, RFQ, eAuction, collaborative discussions, direct negotiation, etc.
- **Screen Suppliers and Selection Factors**
 - Conduct RFI (as needed)
 - Review vendor long list and pre-qualified suppliers
 - Evaluate supplier financials
 - Identify selection factors based on stakeholder input and industry knowledge that accurately capture business requirements and facilitate vendor differentiation.
 - Compile selection factors into vendor scorecard to determine which vendors to include in bid process
- **Conduct Competitive Exercise with Supply Market**
 - Determine scope/timing of competitive exercise
 - Build competitive tender and solicit internal input / approval
 - Develop effective qualitative questions that allow a vendor to thoroughly explain their capabilities as they apply to the stakeholders, while also soliciting the answers to allow scoring using the established selection criteria
 - Build Bid Analysis Worksheet or Database allowing comparisons of basic price quotes across vendors
 - Coordinate and prepare vendor communications
 - Communicate event and distribute RFP
 - Answer questions from vendors and clarify as needed
 - Conduct vendor bid conferences as needed
 - Evaluate and confirm RFP responses and supplier capabilities
 - Identify/confirm ranges for savings potential based on RFP responses as compared to the TCO category baseline

Role Requirements

In order to implement each wave of strategic sourcing, resources will need a strong procurement skill set.

- **Negotiate and Develop Sourcing Recommendations**

- Develop RFP response scenarios including sourcing alternatives such as “As-Is” (current situation), current vendors with new prices (post RFP), \$0 on the table (highest savings), and “To-Be” (recommendation).
- Define negotiation strategy, clearly documenting objectives, location, timing and participants involved in negotiations
- Identify and document all strategic levers and counter levers
- Define negotiation team, roles and responsibilities
- Conduct negotiations (one or multiple rounds)
- Document results achieved
- Obtain approval from management for award
- Sign letters of intent or contingent agreement
- Ensure business requirements are agreed-to by both parties, including service level agreements, key performance indicators, vendor reporting requirements, etc.
- Calculate final identified savings as compared to the TCO baseline, including projections for savings through the life of the contract term

- **Implement Agreements**

- Develop preliminary implementation plan describing the process to implement the new agreement, any process changes, or other improvements
- Develop communication plan incorporating the steps required to facilitate the various stages of the transition to the new sourcing environment
- Communicate award strategy and implementation plan internally and externally
- Identify vendor metrics critical to making sure your selected vendors are on track to meet expectations
- Refine and finalize implementation plan after integrating operations and vendor input
- Execute implementation plan by issuing communications both internally and externally, conducting the first vendor performance meetings, and managing any required vendor transition
- Track and report category performance metrics and savings; develop and review vendor scorecards/KPIs
- Manage relationships with vendors for specified categories, resolving issues between vendors and internal customers

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General and Highway Fund Analysis – Process

The benefits case for the General and Highway Fund is estimated by utilizing the FY09 North Carolina Budget by Function, Department, and Source of Funds.

General Fund Analysis Process

1. The percentage of each entity's Total Budget Excluding Transfers from the General and Highway Fund was estimated (source: North Carolina, Post-Legislative Summary, 2008-09; Appendix Table 3B: Total North Carolina State Budget by Function, Department, and Source of Funds) (Source: Community College Budget Documents)
2. The percentage of General and Highway Funding for each entity (from step 1) was multiplied by the Total Spend for each Entity by Category as determined by the Sourcing Assessment
3. The General and Highway Fund Spending for each entity in each category was added to determine the General Fund Spending for each category
4. Addressable Spend and Estimated Savings percentages from the Sourcing Assessment are applied to determine the potential General Fund benefits
5. The General and Highway Fund benefits were projected over time using the benefits case process (see slide 6)

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Benefits Case – General and Highway Funds

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Sourcing Wave	Potential General and Highway Fund Annualized Benefit	Expected Month of Sourcing Completion	FY'12	FY'13	FY'14	FY'15	FY'16
Wave 1	\$22.3	Oct '11	-	\$22.3	\$22.3	\$22.3	\$22.3
Wave 2	\$7.3	May '12	-	\$7.3	\$7.3	\$7.3	\$7.3
Wave 3	\$3.9	Oct '12	-	-	\$3.9	\$3.9	\$3.9
Potential Budget Reduction (sum of budget reductions)	N/A	N/A	-	\$29.6	\$3.9	-	-
Potential Annual Benefit (sum of budget reduction and Recurring benefit)	N/A	N/A	-	\$29.6	\$33.5	\$33.5	\$33.5
Potential Cumulative Benefits (sum of potential annual benefit for all fiscal years)	N/A	N/A	-	\$29.6	\$63.1	\$96.6	\$130.1

Note: Successful procurement transformation preserves achieved benefits and should result in additional benefits beyond the three identified waves.

Legend:
 : Budget Reduction
 : Recurring Benefit

*See page 11 for all Funds Benefits Case

*Number in Millions

Benefits Case Assumptions

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