

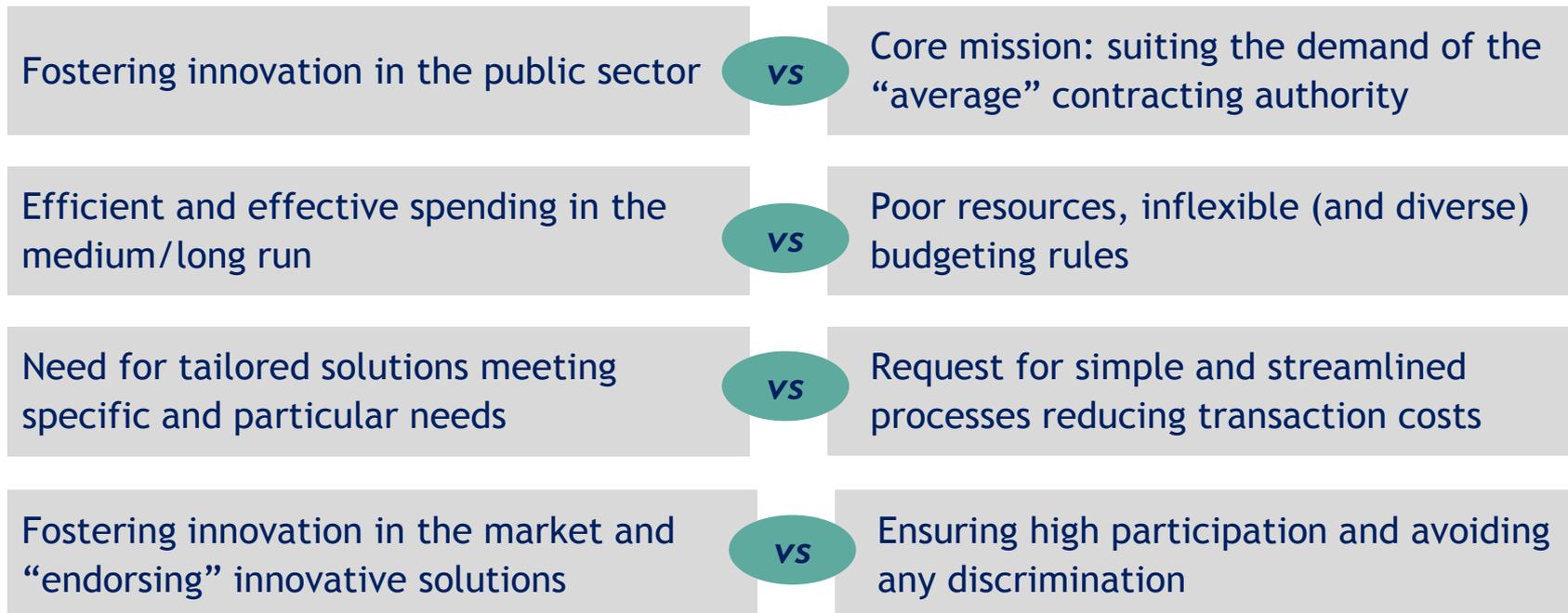
# The role of CPBs in promoting innovation: process and incentives

## Innovation and the role of CPBs

- “Classic” role of CPBs: rationalizing public spending = cutting public spending
- Typically, focus on standardized goods and services
- Specific of Consip case:
  - Evaluation of performance based on transactions volume and managed spending
  - Relevance of number of customers and suppliers: ensuring wide market
  - Main mission: meeting daily procurement needs of *the whole* public sector
  - Consip supports contractor authorities and provides them with procurement services with no actual power to “impose” procurement choices and decisions
  - Contracting authorities have quite heterogeneous needs and differ a lot with respect to willingness to innovate or accept innovative solutions

## Innovation vs business like usual

- In fact, push to innovation has to be implemented gradually...
  - ...benefiting all the contracting authorities...
    - ...and taking into account different (and sometimes conflicting) needs and requests
- When dealing with innovation, a CPB faces several trade offs:



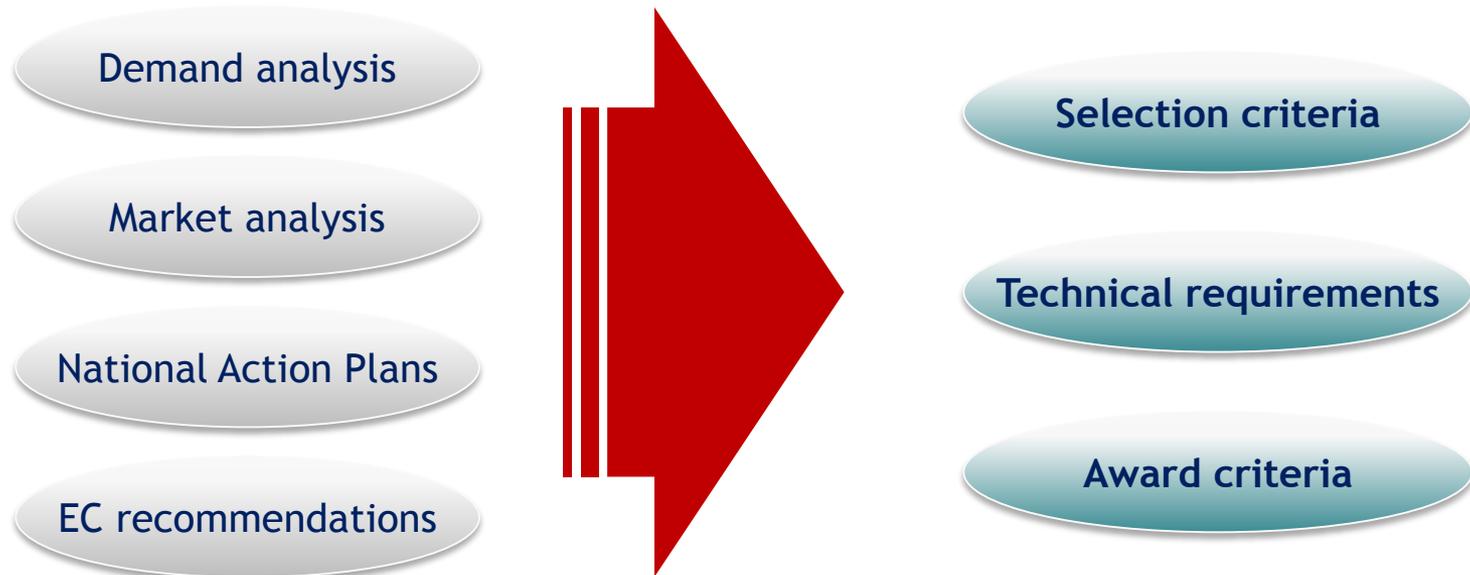
## Main lines of actions for innovation through demand aggregation initiatives

- Continuous increase in managed categories and continuous update of qualitative and technological standard of supplied goods and services
- Clear trend from provision of standardize supplies (“inputs”) to integrated provision of complex/global services (“output”)
- Focus on management, monitoring and spending control services
- Incentives to innovate through performance-based contracts
- Care for the whole life-cycle of products/services (GPP)
- Attention to innovative proposals from the competitors at the tendering stage

## In few examples of innovation through framework contracts and agreements

- **Facility Management:** integrated management of services for real estate (cleaning, maintenance, concierge, call center...), relevance of “management services”
- **Integrated Energy Service and Public Lighting Service: Energy Performance Contract** models, provide the suppliers with incentives to innovate so as to increase savings
- **Vehicles (purchase and rent):** early application of the “green vehicles” directive, with measure and evaluation of the whole life-cycle cost accurately managed through the award criteria
- **Business Travels management:** performance-based contract, shifts the focus from the transaction fees to savings achieved on the whole cost of travelling and spending control; includes an (optional) innovative mobility management service
- **Desktop Outsourcing:** fully outsourced management of the desktop (ICT, hardware, software, assistance, maintenance), plenty of options for customization, introduction of innovative services for desktop virtualization
- **Print & copy management:** output-based contract for the efficient management of the whole printing & copying facilities

# Innovation and competitive tendering design



- Fine-tune the impact on the market from introduced innovation by careful calibration of (minimum) technical requirements and ameliorative features (award criteria)
- Sound methodology to set appropriate weighting?

## Why weighting matters

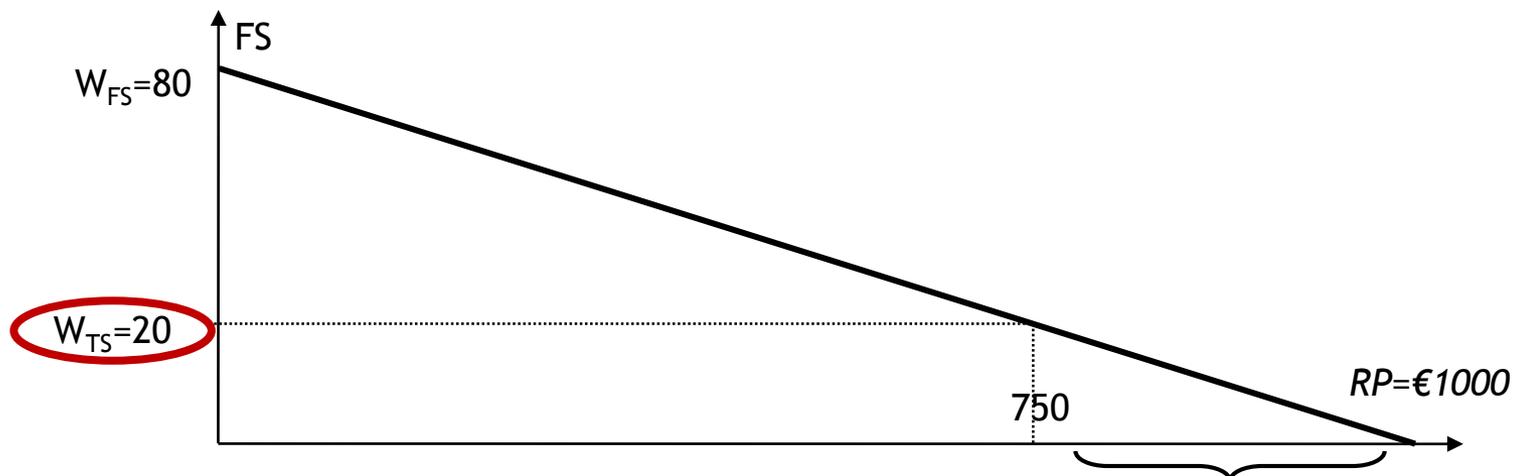
- Undesired effect of inaccurate weighting of one technical award criterion:
  - Too a low weight may result ineffective so leading to loss of improved features
  - Too a high weight may be discriminatory or result in excessive award price
- The trade-off between quality and price needs to be carefully addressed, caring about the impact on market, incentives and competition
- Technical criteria have a “financial” counterpart: awarding additional technical points implies willingness to accept a higher award price
- **Main idea: the weight of each criterion should equate the additional points ensured by a discount which is worth the same as the economic value of the technical criterion (i.e., the contracting authority’s additional willingness to pay for it)**

## Technical points mean money!

- Assume a contract to be awarded to the MEAT, where the financial score is assigned through a linear scoring rule:

$$FS = W_{FS} \cdot \frac{RP - P}{RP}$$

- Assume: Reserve Price (RP) = €1,000; Weight of Technical Score  $W_{TS} = 20$  points; Weight of Financial Score  $W_{FS} = 80$  points
- On the FS score side, 20 points = 25% discount = € 250
- Hence,  $W_{TS} = 20$  means that the buyer is willing to pay up to €250 more for the best technical offer with respect to the basic configuration of the contract



## Weighting: a sound methodology

- Define a reserve price for the contract;
- Estimate the monetary value of all technical aspects included in the award criteria (MVT): it should equal the *willingness to pay* of the buyer for the highest quality:

$$MVT = \sum_i MVT_i$$

- The weight (technical score) of each technical aspect ( $TS_i$ ) should reflect its relative economic importance with respect to the overall maximum value of the contract (price + quality = RP + MVT). Thus, for each technical aspect:

$$TS_i = MVT_i / (RP + MVT)$$

- The same methodology should be applied for “standard”, innovation and sustainability-related criteria
- *To be sure, estimating the monetary value of “green” or “innovative” aspects may be a very hard task...*

# The value of introducing innovation

For appropriate tendering design, it is crucial to determine the buyer's willingness to pay for "better" quality. Distinguish:

**Private benefit:** directly accruing to the purchasing authority (savings, better working conditions, improved performance)  
*Examples: energy/water savings, long lasting batteries, improved characteristics of ICT applications*

**Social benefit:** (pure externality) accruing to the whole society  
*Examples: CO<sub>2</sub> emissions, noise emissions, job opportunities, spillover on the private markets, market growth*

- In many cases both components coexist and may be very hard to measure
- Often private benefits can be assessed more easily than externalities
- **Where feasible, evaluate both components using whole life cycle costing (LCC) approach**

## Weighting: a sound methodology

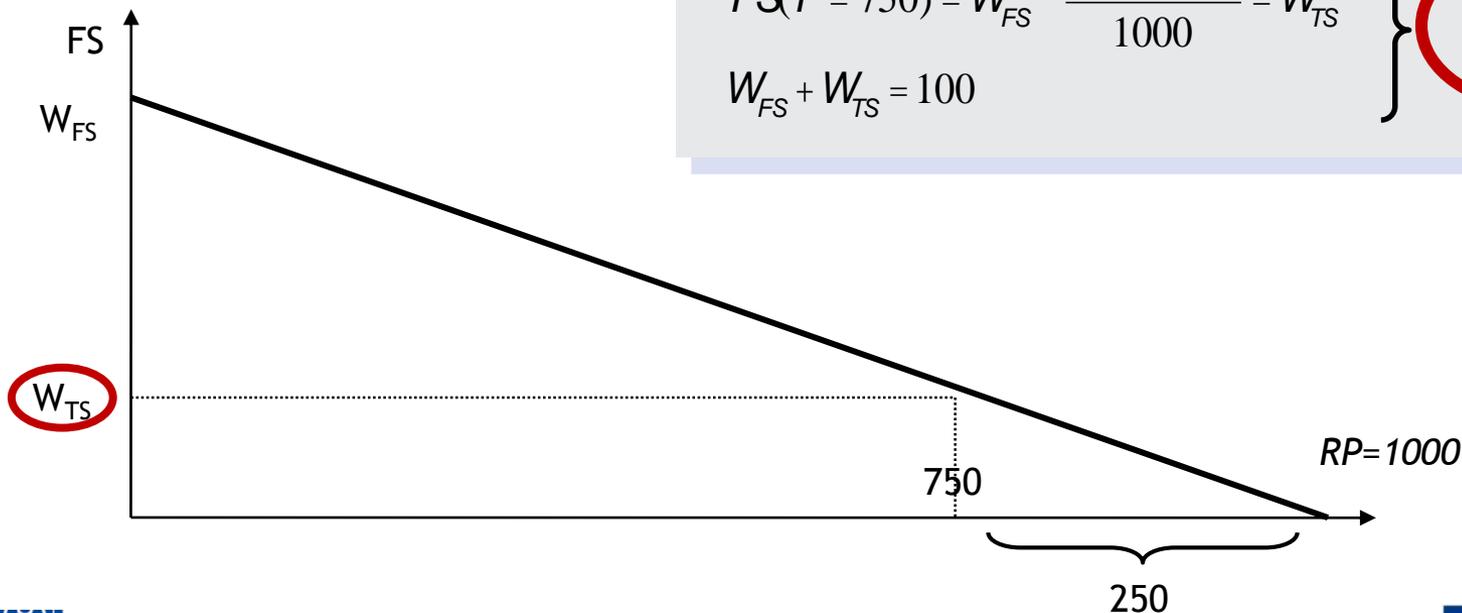
- How to set the “optimal” weights (W) for the Technical Score, given the economic value of technical criteria?

$W_{FS}$  and  $W_{TS}$  should be consistent with the relative value of technical attributes and the Reserve Price (RP).

$$FS(P=750) = W_{FS} \cdot \frac{1000 - 750}{1000} = W_{TS}$$

$$W_{FS} + W_{TS} = 100$$

$$\left. \begin{array}{l} W_{FS}=80 \\ W_{TS}=20 \end{array} \right\}$$



## Incentives to internalize externalities

- Innovative products can be considered as higher quality products with respect to non-green ones, and they may have higher purchasing price.
- However, big gains from higher quality may:
  - not to accrue to the procurer, but to someone else (say other departments of a public administration, or the whole society in case of externalities)
  - occur in the long run only, so that budget constraint results more binding than it should
- At single contracting authority level, green goals might not be pursued, unless strong sensitivity or legislative constraints.

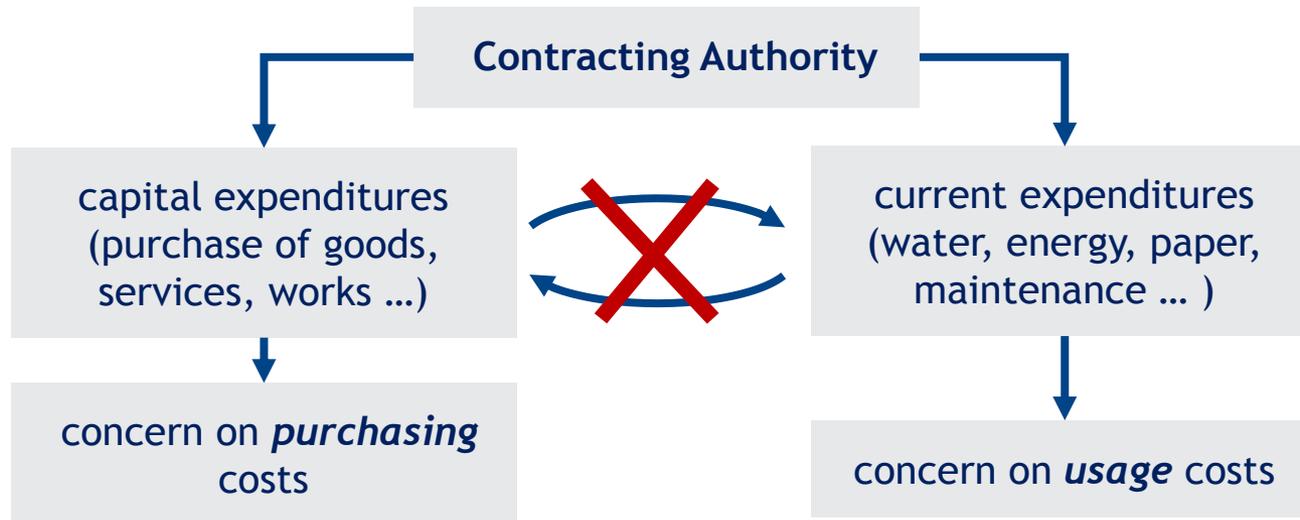
**Centralized procurement** can play a key role in:

- ✓ internalizing innovation/sustainability goals for many contracting authorities
- ✓ exploiting benefits of nation-wide competition, so limiting the cost of green products and sustaining the industry development

Mandatory programs considerably strengthen the role of demand aggregation

## The role of demand aggregation

Independent expenditure centers or legal constraints may prevent from shifting resources from one budget item to another. This strongly limits the possibility to pursue green goals through a sound LCC approach.



Again, demand aggregation can play a key role: de facto, a CPB acts as a “coordinated” contracting authority, so avoiding acquisitions at (apparently) low price with negative impact on the current expenditures.