

April 2013

STRATEGIC SOURCING

Leading Commercial Practices Can Help Federal Agencies Increase Savings When Acquiring Services



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Highlights of [GAO-13-417](#), a report to congressional requesters

Why GAO Did This Study

In fiscal year 2012, the federal government spent \$307 billion to acquire services. The private sector is also reliant on services. Over the last 5-7 years, leading companies have been examining ways to manage their services in order to maximize returns and minimize inefficiencies. Given the amount of federal spending on services, GAO was asked to identify leading practices used by large commercial organizations for purchasing services. GAO identified (1) leading company practices for purchasing services, and (2) potential opportunities for federal agencies to incorporate these practices based on prior work.

To determine leading companies' practices in this area, GAO selected a nongeneralizable sample of companies based upon a literature search and recommendations from Defense and industry organizations that have studied services acquisition. GAO identified and interviewed officials from seven companies, an industry group, and a consulting organization. To identify opportunities for agencies to adopt leading practices, GAO compared the types of services purchased by agencies in fiscal year 2012 with those purchased by companies. GAO also relied on prior, relevant work related to federal procurement of services and OMB initiatives for expanding agencies' use of strategic sourcing.

What GAO Recommends

GAO has made recommendations in previous reports to help agencies strengthen strategic sourcing practices, which agencies concurred with and have planned actions under way.

View [GAO-13-417](#). For more information, contact Cristina Chaplain at (202) 512-4841 or chaplainc@gao.gov.

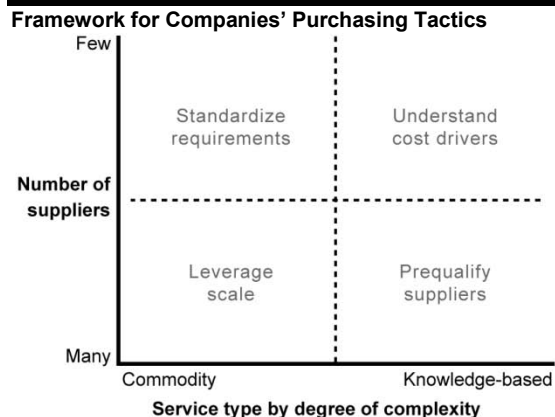
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What GAO Found

Officials from leading companies GAO spoke with reported saving 4-15 percent over prior year spending through strategically sourcing the full range of services they buy—a process that moves away from numerous individual purchases to an aggregate approach. The federal government and leading companies buy many of the same services, such as facilities management, engineering, and information technology. Companies' keen analysis of spending, coupled with central management and knowledge sharing about the services they buy, is key to their savings. Their analysis of spending patterns can be described as comprising two essential variables: the complexity of the service and the number of suppliers for that service. Knowing these variables for any given service, companies tailor their tactics to fit the situation; they do not treat all services the same. Company tactics fall into four basic categories, depicted in the framework below.



Source: GAO analysis.

To illustrate how buying tactics are tailored, Walmart leverages its scale to compete basic or commodity services that have many suppliers, such as maintenance. When buying sophisticated services with few suppliers, such as consulting, Dell negotiates cost drivers such as labor rates. The framework is dynamic: over the long term, companies seek to reduce complexity and bring in additional suppliers to take advantage of market forces like competition.

Federal agencies have sizable opportunities to leverage leading commercial practices to lower costs and maximize the value of the services they buy. In September 2012, GAO reported that large procurement agencies such as the Department of Defense and Veterans Affairs leveraged only a fraction of their buying power through strategic sourcing and faced challenges analyzing reliable data on spending, securing leadership support, and applying this approach to acquiring services. GAO recommended that these agencies and the Office of Management and Budget (OMB) issue guidance, develop metrics, and take other actions. The agencies and OMB concurred. OMB directed agencies to take actions to overcome these challenges. Potential savings are significant considering a savings rate of 4 percent applied to the \$307 billion spent by federal agencies on services in fiscal year 2012 would equate to \$12 billion.

Contents

Letter		1
	Background	3
	Leading Companies Achieve Significant Savings through a Strategic Approach That Establishes Goals, Builds Market Knowledge, and Tailors Procurement Tactics to Different Services	7
	Opportunities Exist for Federal Agencies to Adopt Commercial Practices	21
	Concluding Observations	27
	Third-Party Comments	28
Appendix I	Objectives, Scope, and Methodology	30
Appendix II	Profiles of Leading Companies	32
Appendix III	GAO Contact and Staff Acknowledgments	40
Related GAO Products		41
Tables		
	Table 1: Top 10 Services Categories Purchased by the Federal Government in Fiscal Year 2012	5
	Table 2: Selected Leading Companies' 2012 Results at a Glance	9
	Table 3: Examples of Services Based on Complexity and Number of Suppliers	17
	Table 4: Key Tactics by Quadrant	19
Figures		
	Figure 1: Federal Government Spending on Services since Fiscal Year 2008	4
	Figure 2: Companies' Transactional Framework	16
	Figure 3: Companies' Long-Term Goal Is to Commoditize Services to the Extent Possible	18

Abbreviations

CPO	Chief Procurement Officer
DHS	Department of Homeland Security
DOD	Department of Defense
FPDS-NG	Federal Procurement Data System-Next Generation
FSSI	Federal Strategic Sourcing Initiative
GSA	General Services Administration
OMB	Office of Management and Budget
VA	Department of Veterans Affairs

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Accountability * Integrity * Reliability

United States Government Accountability Office
Washington, DC 20548

April 15, 2013

The Honorable Thomas R. Carper
Chairman
The Honorable Tom Coburn
Ranking Member
Committee on Homeland Security and Governmental Affairs
United States Senate

The Honorable Susan M. Collins
United States Senate

In fiscal year 2012, the federal government obligated \$307 billion to acquire services ranging from the management and operation of government facilities, to information technology services, to research and development. Spending on services has increased significantly since fiscal year 2000.

The private sector is also increasingly reliant on services, many of which are similar to those that the federal government buys, such as information technology services. Leading companies have been examining ways of managing their services in order to stay competitive, respond to market and stockholder pressures, and deal with economic downturns. We have previously reported that leading companies implemented a strategic approach to improve service acquisition outcomes and identified opportunities for federal agencies, specifically the Department of Defense (DOD), to implement improvements across the range of services they purchase.¹ Under the strategic sourcing approach, companies took a hard look at how much they were spending on services and from whom they were buying these services. This approach included identifying the number of suppliers, the number of contracts, and prices paid across the company to identify inefficiencies such as paying different rates for similar services and suppliers, or not consolidating purchases across the company to lower prices. Armed with this knowledge, companies were

¹GAO, *Best Practices: Taking a Strategic Approach Could Improve DOD's Acquisition of Services*, [GAO-02-230](#) (Washington, D.C: Jan. 18, 2002).

able to leverage their buying power, reduce costs, and better manage their suppliers.²

Given the trend of increased federal government spending on services and today's constrained fiscal environment, there has been a renewed focus on maximizing return on investment. You requested that we identify practices used by large commercial organizations in purchasing services. We briefed your staff on the results of this review. This report presents those results. Specifically, we (1) identified leading company practices for acquiring services, and (2) examined potential opportunities for federal agencies to incorporate these practices.

To determine leading companies' practices in this area, we selected a nongeneralizable sample of companies based on (1) a literature search, including our prior leading practices reports on services acquisition, and (2) recommendations from the Defense Business Board, Defense Science Board, and industry experts who have studied the issues. Based on this approach, we identified and interviewed seven leading companies: Boeing, Dell, Delphi, Humana, MasterCard, Pfizer, and Walmart; an industry group: Institute for Supply Management; and a consulting organization: A.T. Kearney. We identified key practices reported by companies, including procurement organization structures, services procurement history and strategies, initiatives and resultant savings, and contracting methods. We also compared companies' procurement practices with those identified in our prior work. To maximize the applicability of our findings to the federal government, we identified the top categories of services that the government acquired in fiscal year 2010 from the Federal Procurement Data System-Next Generation (FPDS-NG)—the government's system for tracking contracting data—and interviewed companies about their practices in those categories. We analyzed company practices to identify common themes. We then provided this information to the companies and they confirmed our analysis. To assess the reliability of companies' data on acquisition savings, we requested information on data quality control procedures and system safeguards from company officials. In addition, we provided relevant sections of a draft of this report to companies for review and comment. To assess the reliability of FPDS-NG data, we reviewed

²GAO, *Best Practices: Improved Knowledge of DOD Service Contracts Could Reveal Significant Savings*, [GAO-03-661](#) (Washington, D.C.: June 9, 2003).

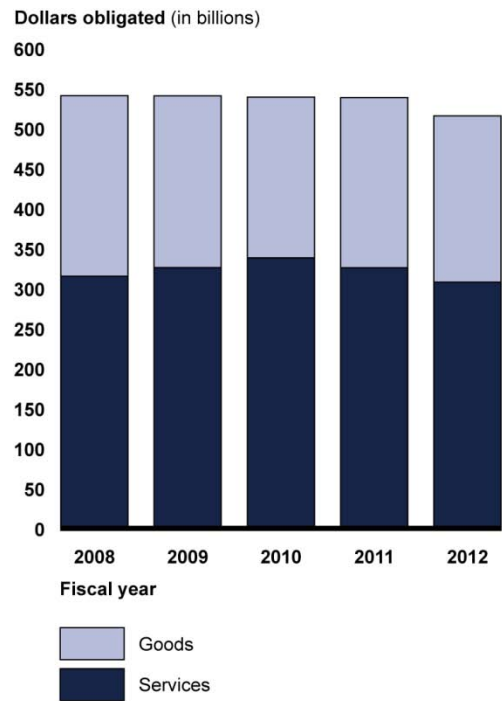
documentation and electronically tested data for obvious problems. We determined that the company and FPDS-NG data were sufficiently reliable for the purposes of this report. To further identify opportunities for agencies to adopt leading companies' practices, we also compared the types of services purchased by companies and agencies in fiscal year 2012 and relied on our recent, relevant work that examined federal strategic sourcing efforts. Appendix I provides further details on the scope and methodology used for this work.

We conducted this performance audit from December 2011 to April 2013 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Background

As figure 1 shows, services spending for the federal government has accounted for over half the annual procurement spending since fiscal year 2008.

Figure 1: Federal Government Spending on Services since Fiscal Year 2008



Source: GAO analysis of FPDS-NG data.

Note: Amounts are in then-year dollars.

In fiscal year 2012, the federal government obligated about \$307 billion to acquire services. Table 1 lists the top services purchased by federal agencies in fiscal year 2012, which range in complexity from defense research and development to housekeeping.

Table 1: Top 10 Services Categories Purchased by the Federal Government in Fiscal Year 2012

Category	Amount (dollars in billions)	Examples of types of services within category
Professional services	\$49.8	Legal, engineering, human resources, market research.
Automated data processing (information technology) and telecommunications	29.5	Data entry, telecommunications and transmission, programming, cyber security and data backup, web-based subscription(s), help desk.
Building construction	23.8	Construction of storage, parking, utilities facilities.
Defense systems research and development	22.0	Research and development for systems such as aircraft, ships, tanks.
Equipment maintenance and repair	20.0	Repair and maintenance of plumbing, heating, waste disposal equipment, furniture.
Building operations	19.1	Operations of storage, parking, utilities facilities.
Management support	18.2	Advertising, accounting, public relations, data collection, auditing.
Housekeeping	12.2	Snow removal, landscaping, garbage collection, pest control.
General health care	12.0	General medical services for health care.
Other defense research and development	9.5	Research and development for items such as ammunition, textiles, fuels.

Source: GAO analysis of FPDS-NG fiscal year 2012 data.

We previously reported that agencies have had difficulty managing services acquisitions and have purchased services inefficiently which places them at risk of paying more than necessary.³ These inefficiencies can be attributed to several factors. First, agencies have had difficulty defining requirements for services, such as developing clear statements of work which can reduce the government's risk of paying for more services than needed. Second, agencies have not always leveraged knowledge of contractor costs when selecting contract types, including time-and-materials contracts, performance-based contracts, and undefinitized contracts. Third, agencies have missed opportunities to

³GAO, *Defense Acquisition: Actions Needed to Ensure Value for Service Contracts*, [GAO-09-643T](#) (Washington, D.C.: Apr. 23, 2009).

increase competition for services due to overly restrictive and complex requirements; a lack of access to proprietary, technical data; and supplier preferences.⁴

Agencies purchase services under the Federal Acquisition Regulation, which places some constraints on how contracts are competed and awarded. Generally, agencies are statutorily required to award contracts using full and open competition, unless an exception applies. Additionally, agencies are subject to certain requirements when awarding contracts, such as meeting the Small Business Administration's annual statutory goals to make awards to various kinds of small businesses.

GAO has been assessing strategic sourcing and the potential value of applying these techniques to federal acquisitions for more than a decade. In 2002, GAO reported that leading companies of that time committed to a strategic approach to acquiring services—a process that moves a company away from numerous individual procurements to a broader aggregate approach—including developing knowledge of how much they were spending on services and taking an enterprise-wide approach to services acquisition.⁵ As a result, companies made structural changes with top leadership support, such as establishing commodity managers—responsible for purchasing services within a category—and were better able to leverage their buying power to achieve substantial savings. We have emphasized the importance of comprehensive spend analysis for efficient procurement since 2002. Spend analysis provides knowledge about how much is being spent for goods and services, who the buyers are, who the suppliers are, and where the opportunities are to save money and improve performance. In 2005, the Office of Management and Budget (OMB) defined strategic sourcing as a structured process based on spend analysis to make business decisions about acquiring commodities and services more efficiently and effectively.⁶

In 2007, GAO reviewed DOD's processes for acquiring services and found that DOD could take further action to improve its strategic sourcing.

⁴GAO, *Defense Contracting: Competition for Services and Recent Initiatives to Increase Competitive Procurements*, [GAO-12-384](#) (Washington, D.C.: Mar. 15, 2012).

⁵[GAO-02-230](#).

⁶OMB, Memorandum, *Implementing Strategic Sourcing*, (Washington, D.C.: May 20, 2005).

GAO reported that the department's approach had tended to be reactive and did not fully address key factors for success at either the strategic (organization-wide) or transactional (individual services transaction) level. GAO recommended that DOD take a proactive approach to managing strategic and transactional level service acquisitions elements, including communicating where individual transactions can then be made to support strategic goals. Key factors at the transactional level included clearly defined requirements, appropriate contracting vehicles, and effective contractor oversight.⁷

Leading Companies Achieve Significant Savings through a Strategic Approach That Establishes Goals, Builds Market Knowledge, and Tailors Procurement Tactics to Different Services

The leading companies we studied used a strategic sourcing approach to achieve sustained annual savings, over prior year spending, of 4-15 percent in services over the last 5-7 years. This strategic approach drives companies to continually strive for savings, partly spurred by annual goals. To enable this process, companies rely on five foundational principles to build spending and market knowledge and gain situational awareness of their procurement environment. In the short term, companies use this knowledge to adjust their procurement tactics for different types of services depending on service complexity and number of available suppliers in order to best achieve savings and efficiencies. This enables companies to target the full range of services they buy. In the long term, companies try to address their procurement constraints by reducing requirements complexity to commoditize services and developing new suppliers to increase competition. This allows companies to more aggressively leverage their buying power for all types of services.

Companies Foster a Culture of Savings through Setting Goals and Ensuring Accountability

Each of the leading companies we reviewed used annual savings expectations to drive a corporate culture of savings. For example, Walmart's executive leadership sets annual savings goals for their services procurement division; in 2012, the goal was to save around \$100 million, or about 8 percent, of the division's \$1.2 billion budget. A Walmart official emphasized the importance of savings expectations and accountability, noting that the very act of establishing goals and metrics helps enable a culture of savings.

⁷GAO, *Defense Acquisitions: Tailored Approach Needed to Improve Service Acquisition Outcomes*, [GAO-07-20](#) (Washington, D.C. Nov. 9, 2006).

“If you measure it, it will happen.”

Companies further translate savings expectations into individual performance goals to which executives and employees are held accountable. Savings expectations are allocated to each procurement team member and the head of procurement regularly reviews progress. This metric-based accountability spurs companies’ culture of savings, but is not necessarily dictated by leadership.

- Dell establishes savings expectations and metrics in cooperation with procurement staff. These metrics are tied to individual performance contract goals to which staff are held accountable with quarterly reviews. Top performers are tapped to lead teams and manage critical procurement projects.
- At Delphi, savings targets are initiated by both procurement staff and leadership. The process continues iteratively until all parties agree to a final savings target, including after considering areas where costs are expected to actually rise due to economic conditions.
- Additional incentives can drive this culture of savings; for example, one company allows business units to reinvest savings into their operations, primarily to fund innovation and strategic initiatives.

Having such a culture is critical to companies’ continual pursuit of savings and efficiencies. A Pfizer official described this culture as being part of the company’s DNA.

“Savings is in our DNA.”

Leading Companies Have Achieved Significant Savings after Prioritizing Services

Leading companies reported achieving a sustained savings rate of 4-15 percent annually on services procurement by strategically sourcing the full range of services they buy. Companies achieved these savings after increasing their focus on services acquisitions over the last 5-7 years. Companies reported using the same general procurement strategies and tactics for both goods and services. However, the impetus for an increased focus on services was leadership recognition that spending had significantly increased, resulting in additional dedicated resources to manage this area.

Companies chose different paths to begin the process of improving the efficiency of services acquisition. For example, Pfizer conducted a spend analysis in 2007 which revealed increased spending on legal, consulting, and financial services, as well as opportunities for improving the efficiency of its processes. Boeing’s Chief Executive Officer made tackling services spending a priority after noticing how much was being spent in this area compared to the company’s spending on items directly affecting customers. This led Boeing to adopt a company-wide procurement model in 2006. Delphi centralized indirect procurement—products and services used in support of Delphi’s operations—between 2005 and 2007 in order to improve efficiency and drive savings. Some companies reported achieving the greatest amount of savings in the initial years after prioritizing their procurement of services. For example, Dell reported achieving 23 percent savings in the first year after increasing its focus on improving services acquisition, and has been able to sustain 10 percent in savings thereafter. Another company noted that it is typical to achieve larger savings at the beginning and that the savings percent goes down over time, to around 4-7 percent annually. Table 2 below highlights examples of the annual savings companies reported in 2012, and the main services they buy.

Table 2: Selected Leading Companies’ 2012 Results at a Glance

Company	Spending on services (dollars in billions)	Savings (percent)	Main services purchased
Boeing	\$7	10%	Information technology, professional services, contingent labor, site services, travel, manufacturing support, freight and logistics, benefits administration.
Dell	55 (overall spend portfolio) ^a	10	Internal and external consulting, third-party customer support, technicians.
Delphi	1.2	6	Transportation and logistics, healthcare and benefits, contract labor, engineering, warehousing.
Pfizer	16-17 ^a	4-6 ^a	Legal, management consulting, information technology services, human resources consulting, research, development and medical, business process outsourcing, fleet, marketing and sales, media, agencies, raw materials, contract manufacturing, capital equipment and construction.
Walmart	1.5	12-15	Facilities maintenance, capital expenditures.

Source: Listed companies’ data.

Note: Two companies declined to publicly share their spending and savings information; however, their results were consistent with those of other companies. Savings metrics varied between companies, such as annual change in spending, unit price reduction, and change in average invoice price.

^aFigure includes both goods and services.

Companies Follow Five Foundational Principles to Leverage Spending and Market Knowledge for More Efficient Procurement

Leading companies generally agreed that foundational principles—maintaining spend visibility, centralizing procurement, developing category strategies, focusing on total cost of ownership, and regularly reviewing strategies and tactics—are all important to achieving successful services acquisition outcomes. Taken together, these principles enable companies to better identify and share information on spending and increase market knowledge about suppliers to gain situational awareness of their procurement environment. This awareness positions companies to make more informed contracting decisions.

Principle 1: Maintain Spend Visibility

Each company we spoke with had a history of struggling with fragmented information on spending, which did not allow them to spot inefficiencies or opportunities for consolidating purchases. For example, Humana’s Chief Procurement Officer (CPO) conducted a year-long spend analysis effort which revealed, among other things, cases where a supplier charged different rates to different departments for the same service. Dell emphasized the importance of actively monitoring spending trends in order to identify opportunities for savings. As one official put it, unmanaged spend is by definition inefficient.

“Unmanaged spend equals inefficiency.”

To address these issues, companies maintain visibility into spending by integrating procurement and financial systems across the organization. For example, in 1999, Boeing upgraded its paper-based manual processes for procurement to a new, automated system which enabled more efficient spend analysis. The new system also increased operational efficiency because it provided a common language and data set for the procurement staff. To aid efficient spend analysis, Boeing defined a services taxonomy to allow analysis at the invoice line item level. Invoice line items are defined beforehand—called billing units—and are built into contract statements of work. Dell, Delphi, and Humana also reported using centralized databases that provide transparency into their global spend. Similarly, in 2012, Walmart started implementing a centralized database to increase spend visibility.

Principle 2: Centralize Procurement

In addition to leveraging knowledge about spending, leading companies centralize procurement decisions by aligning, prioritizing, and integrating procurement functions within the organization. The companies we spoke

with overcame the challenge of having a decentralized approach to purchasing services, which had made it difficult to share knowledge internally or use consistent procurement tactics. Without a centralized procurement process, officials told us, companies ran the risk that different parts of the organization could be unwittingly buying the same item or service, thereby missing an opportunity to share knowledge of procurement tactics proven to reduce costs. Company officials noted that centralizing procurement does not necessarily refer to centralizing procurement activity, but to centralizing procurement knowledge. For example, Dell’s procurement organization is centralized, and utilizes a common tool, enabling cost data to be shared globally. Global Category Managers are expected to have a good understanding of all aspects of the services within their category. Clearly defined and communicated policies ensure users cannot engage with suppliers without procurement organization involvement. Similarly, Pfizer has “category teams” with a global reach for broad groupings of services with category managers assigned to each category. The global category zone leads are managed by Vice-Presidents who report directly to the head of the procurement organization and work with internal business partners, who execute contracts on a company-wide basis or locally as needed. Boeing has a team of financial analysts that support the procurement function by conducting “should cost” analyses and providing supplier or service cost breakdowns to procurement agents.⁸

“Centralize the knowledge, not the activity.”

Company officials told us that the key to an effective centralized process is ensuring that services spending goes through approved contracts. A Walmart official referred to non-approved spending as “rogue buying.” Companies focus on compliance in order to eliminate unapproved purchases. For example, Delphi aims for 95 percent of its sourcing to adhere to pre-approved category strategies. The company uses an internally developed database to manage all sourcing initiatives from concept to business case to approval by the procurement and financial

⁸Should-cost reviews are a type of cost analysis that help organizations ascertain what a product or service should actually cost based on analyzing the components of that product or service. This allows organizations to determine how much they should pay when negotiating with suppliers.

organizations. Pfizer has a policy that procurement transactions over \$100,000 must be competitively bid with limited, documented exceptions.

“You must eliminate rogue buying.”

Principle 3: Develop Category Strategies

Companies develop category-specific procurement strategies with stakeholder buy-in in order to use the most effective sourcing strategies for each category. Category-specific procurement strategies describe the most cost-effective sourcing vehicles and supplier selection criteria to be used for each category of service, depending on factors such as current and projected requirements, volume, cyclical demand, risk, the services that the market is able to provide, supplier base competition trends, the company’s relative buying power, and market price trends. For example, Dell’s Global Category Managers oversee teams that develop detailed sourcing strategies for each commodity. The major components of the sourcing strategies are (1) internal analyses which include spend analysis, stakeholder analysis, business requirements, and cost modeling; and (2) external analyses which include market research and supply market analysis.

Company officials told us that category strategies help them conduct their sourcing according to a proactive strategic plan and not just on a reactive, contract-by-contract basis. One company’s CPO referred to the latter as a “three bids and a buy” mentality that can be very narrowly focused and result in missed opportunities such as not leveraging purchases across the enterprise or making decisions based only on short term requirements. For this reason, Boeing sometimes chooses to execute a short-term contract to buy time if market research shows a more competitive deal can be obtained later.

“You cannot just go with a ‘three bids and a buy’ contracting approach.”

Category strategies also help companies choose sourcing tactics appropriate to their circumstances. For example, as one company noted, in one category it may be very beneficial to conduct competitive bidding via online reverse auctions, while in another category it may be wise to forego any competitive bidding and extend and lock in pricing based on

market dynamics.⁹ In another instance, Delphi has global, company-wide strategies for travel and information technology services in order to leverage purchases globally, but region-based strategies for services such as facilities management which are used by individual Delphi facilities. Companies develop strategies that identify the choice of sourcing vehicles and supplier selection criteria only after extensive consultation with internal users. This consultation helps procurement staff better understand user requirements as well as obtain their buy-in. According to one company CPO, user buy-in is critical; otherwise users may think that a desire to reduce cost is the only factor driving the choice of sourcing tactics.

Risk is an important consideration when developing category strategies and setting priorities. Dell considers factors such as data privacy and security, financial stability, continuity of supply, and geographic economic conditions to ensure the proper considerations and protections are in place prior to finalizing supplier selection decisions. Routine services such as store and parking lot maintenance services are critical to Walmart's mission of retail, demanding a high level of attention. Delphi and Boeing have a policy of minimizing the risk of transitioning to new suppliers. For this reason, Boeing retains some staff with subject matter expertise to oversee contracts in each category and know how the supplier is meeting those requirements. This ensures flexibility for Boeing in case the company chooses to change suppliers in the future.

Principle 4: Focus on Total Cost of Ownership

Companies focus on total cost of ownership—making a holistic purchase decision by considering factors other than price. At the strategic—or higher—level, managing internal demand is an important element of reducing total cost of ownership. For example, Humana closely examines services requirements in order to prevent unnecessary spending on services the company does not absolutely need. Boeing considers internal costs, such as the administrative cost per transaction or purchase order to determine price and efficiency trade-offs. Dell considers factors such as risk to the company's mission, innovation, operational performance, and demand management. Dell and Delphi examine

⁹Reverse auctions are a type of procurement tool that, as the name suggests, are the reverse of traditional auctions—where buyers progressively submit higher bids on an item until the highest bidder wins that item. In reverse auctions, sellers submit bids and progressively lower them until someone wins the buyer's business. Use of this procurement tool can help drive prices down for the buyer.

suppliers' management models for maturity, including how well they manage and train staff and use appropriate cost management tools. In fact, a Dell official said that the quality of a service is largely determined by the quality of the supplier's management structure.

"When purchasing a service, you are essentially paying for the quality of suppliers' management processes."

At the transactional—or lower—level, incorporating non-price factors can be important inputs into decision making. For example, while Walmart may often award a contract to the lowest bidder, it takes other considerations into account—such as average invoice price, time spent on location, average time to complete a task, supplier diversity, and sustainability—when awarding contracts. Humana is developing internal rate cards for consulting services that would help the company evaluate contractors' labor rates based on their skill level. Pfizer's procurement organization monitors compliance with company processes and billing guidelines. The company considers its procurement professionals as essentially risk managers rather than contract managers because they need to consider what's best for the company and how to minimize total cost of ownership while maintaining flexibility.

Principle 5: Regularly Review Strategies and Tactics

Companies regularly review strategies and tactics to adapt to market trends. This provides room for flexibility in managing suppliers—something companies we spoke with valued. Walmart officials emphasized the importance of frequently reviewing tactics in order to identify new opportunities for savings. For this reason, Walmart constantly evaluates new ways to invite bids and new types of pricing tiers by which to lower prices, such as by state or region or volume. Delphi's strategies are formally reviewed and documented annually by Delphi's strategic council comprised of senior company executives. These reviews may result in changing tactics or suppliers according to predetermined goals. For example, for a particular category, Delphi may not want to represent more than a certain percentage of any supplier's revenue in order to minimize risk that the supplier may be overly dependent on Delphi for long-term viability. If the reviews highlight cases where the limit is exceeded, Delphi examines ways to bring in an additional supplier.

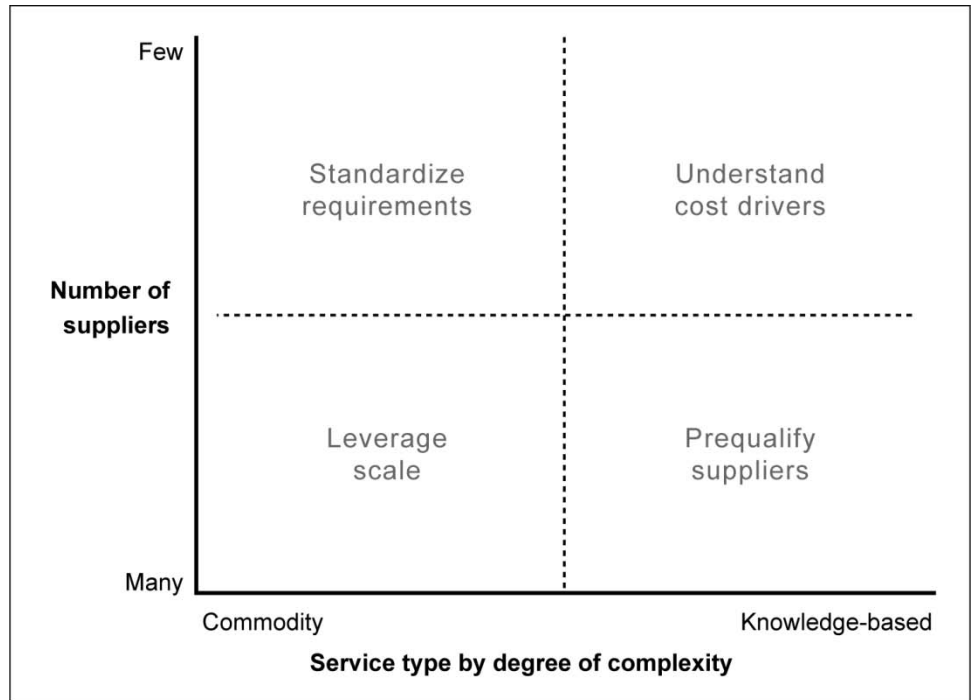
“You must continually stay ahead of suppliers or they will figure you out.”

Similarly, Dell regularly assesses whether to “make or buy” services, conducting objective evaluations of internal capability versus that of external providers. In some instances, although Dell may have the capability in-house, they may not have available resources at that point in time, and may therefore elect to purchase that particular service. In order to retain flexibility to adapt to market trends, companies view long-term contracts (generally over 3 years) as risky. For example, Pfizer will examine market conditions and unbundle contracts—use separate contracts for multiple services—for greater transparency and to bring more suppliers into the mix; later on Pfizer might bundle contracts to gain leverage as part of the strategy. Similarly, Delphi prefers contract lengths of under 3 to 4 years because of the difficulty of predicting the future price trends of key cost components—for example, fuel, which is a significant cost component of services involving travel.

Companies Tailor Their Procurement Tactics to Each Type of Service Depending on Complexity and Availability of Suppliers

By following the foundational principles to improve knowledge about their procurement environment, companies are well positioned to choose procurement tactics tailored to each service. While companies emphasize the importance of observing the principles, including category strategies, they do not take a one-size-fits-all approach to individual service purchase decisions. Two factors—the degree of complexity of the service and the number of available suppliers—determine the choice of one of four general categories of procurement tactics appropriate for that service: leveraging scale, standardizing requirements, prequalifying suppliers, and understanding cost drivers. Figure 2 below shows how the two factors help companies categorize different services and select appropriate tactics.

Figure 2: Companies' Transactional Framework



Source: GAO analysis.

Complexity and Supplier Availability Vary by Service

Complexity is defined as the relative difficulty of defining performance requirements, and varies for different types of services. Less complex services—referred to as commodity services—are those where requirements are relatively easy to define and performance more clearly measured; for example, housekeeping, telecommunications, and maintenance services. More complex services—referred to as knowledge-based services—are those where requirements are more complex, performance more difficult to measure, and where service provider staff skill levels are paramount; for example, research and development, engineering and management support, and legal services.

The number of suppliers that can fulfill a service varies depending on market conditions and whether specialized skills and knowledge are required. Based on our discussions with companies, table 3 shows how different services may be categorized according to these two factors. For illustration purposes, the table shows the two factors at the extremes of their range of possibilities.

Table 3: Examples of Services Based on Complexity and Number of Suppliers

	Commodity services	Knowledge-based services
Few suppliers	<ul style="list-style-type: none"> • Certain types of security • Specialized logistics • Specialized maintenance and repair • Utilities 	<ul style="list-style-type: none"> • Engineering and management support • High-end consulting • Intelligence • Research and development • Specialty legal • Specialty training
Many suppliers	<ul style="list-style-type: none"> • Administrative support • Automated data processing • Contract and contingent labor • Facilities construction and operations • General maintenance and repair • Housekeeping and janitorial • Landscaping • Telecommunications • Travel and transportation 	<ul style="list-style-type: none"> • Advertising and marketing • Education and training • Financial • Health care • Human resources • Information technology • Legal • Public relations

Source: GAO analysis based on company interviews.

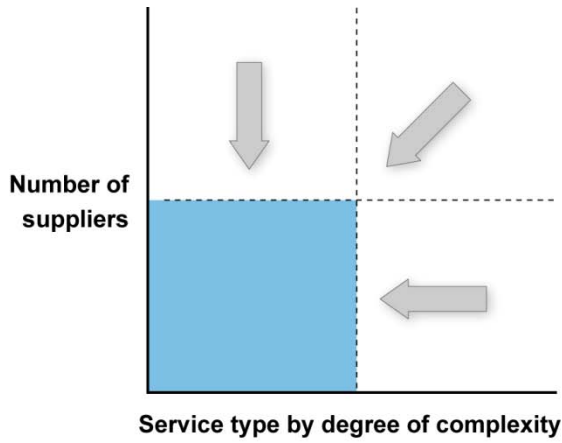
Long-Term Goal Is to Commoditize All Services

Companies we reviewed are not content to remain limited by their environment; over the long term, they generally seek to reduce the complexity of requirements and bring additional suppliers into the mix in order to commoditize services and leverage competition. This dynamic, strategic approach has helped companies demonstrate annual, sustained savings. Companies generally aim to commoditize services over the long term as much as possible because, according to them, the level of complexity directly correlates with cost. Companies also aim to increase competition, whether by developing new suppliers or reducing requirements complexity, which could allow more suppliers to compete. In doing so, companies can leverage scale and competition to lower costs.

“Complexity drives cost.”

Figure 3 below depicts most companies’ overall goal of commoditizing services over the long term, as depicted by the goal of moving services to the lower-left quadrant of companies’ transactional framework shown earlier.

Figure 3: Companies' Long-Term Goal Is to Commoditize Services to the Extent Possible



Source: GAO analysis.

**Choice of Procurement Tactics
Varies Based on Complexity
and Supplier Availability**

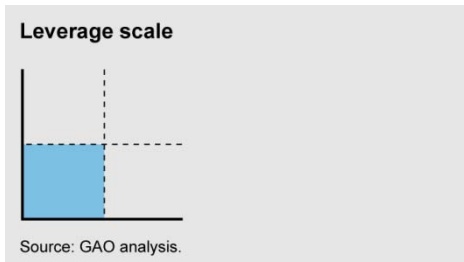
The two factors—complexity and supplier availability—influence what tactics are best suited to each quadrant of services as shown in table 4 below.

Table 4: Key Tactics by Quadrant

	Commodity services	Knowledge-based services
Few suppliers	<ul style="list-style-type: none"> Look for the “90 percent” solution Standardize requirements in line with commercial specifications Temporarily dual-source to maintain competitive industrial base Develop new suppliers 	<ul style="list-style-type: none"> Understand individual element cost drivers to negotiate better rates Streamline requirements to reduce complexity Recruit skilled procurement talent Increase senior management visibility to ensure progress against goals and metrics Target executive-level relationships with suppliers to improve influence and collaboration Develop new suppliers Utilize third-parties to benchmark supplier rates against comparable suppliers
Many suppliers	<ul style="list-style-type: none"> Leverage scale and volume across organization Develop procurement catalog with pre-negotiated prices Use fixed price contracts Retain some expert staff to minimize future risk of changing suppliers Identify market trends to target savings opportunities Utilize a variety of bidding methods to find ways to lower cost Determine near term savings opportunities to gain organizational buy-in 	<ul style="list-style-type: none"> Prequalify suppliers by skill-level, risk, and rates to eliminate non-competitive companies Prioritize suppliers based on effectiveness and efficiency to maintain informed database and obtain better rates Collaboratively determine point at which reduction in price may diminish quality of performance Continually measure, track, and manage suppliers to ensure optimal performance

Source: GAO analysis based on company interviews.

Note: Some tactics may be used across multiple categories.

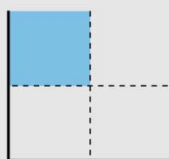


Source: GAO analysis.

For commodity services with many suppliers, such as administrative support, facilities maintenance, and housekeeping, companies generally focus on leveraging scale and competition to lower cost. The figure on the left shows the companies’ transactional framework discussed earlier and highlights the quadrant represented by commodity services that are served by many suppliers. Typical tactics applicable to this quadrant of services include consolidating purchases across the organization; using fixed price contracts; developing procurement catalogs with pre-negotiated prices for some services; and varying bidding parameters such as volume and scale in order to find new ways to reduce costs. For example, Walmart continually lowers costs on store maintenance services such as parking lot maintenance by inviting bids on a regional or national basis. Bidders are required to submit quotes based on a variety of options

that are thoroughly discussed ahead of time, such as the number of stores or regions and contract length. This helps Walmart identify new contract parameters by which to reduce costs. Boeing has begun developing procurement catalogs for commonly acquired routine and low-dollar services. The catalogs list approved suppliers and negotiated prices to allow users to directly execute contracts up to a certain amount.

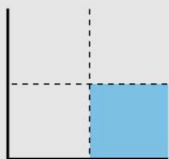
Standardize requirements



Source: GAO analysis.

For commodity services with few suppliers, such as specialized logistics and utilities, companies focus on standardizing requirements. Typical tactics applicable to this quadrant of services include paring back requirements in order to bring them more in line with standard industry offerings, and developing new suppliers to maintain a competitive industrial base. For example, Walmart holds pre-bid conferences with suppliers such as those supplying store security for “Black Friday”—the major shopping event on the day after Thanksgiving—to discuss requirements and what suppliers can provide. Delphi makes an effort to maintain a competitive industrial base by dual-sourcing certain services in order to minimize future risk—a cost trade-off.

Prequalify suppliers



Source: GAO analysis.

For knowledge-based services with many suppliers, such as information technology, legal, and financial services, companies prequalify and prioritize suppliers to highlight the most competent and reasonable suppliers. Typical tactics applicable to this quadrant of services include prequalifying suppliers by skill level and labor hour rates; and tracking supplier performance over time in order to inform companies’ prioritization of suppliers based on efficiency. For example, Pfizer Legal Alliance was created to channel the majority of legal services to pre-selected firms. Delphi only awards contracts to companies on their Category Approved Supplier List. The list is approved by Delphi leadership and is reviewed annually.

Understand cost drivers



Source: GAO analysis.

For knowledge-based services with few suppliers, such as engineering and management support and research and development services, companies aim to maximize value by better understanding and negotiating individual components that drive cost. Typical tactics applicable to this quadrant of services include negotiating better rates on the cost drivers for a given service; closely monitoring supplier performance against pre-defined standards; benchmarking supplier rates against industry averages in order to identify excess costs; and improving collaboration with suppliers. Some companies leverage their knowledge of cost drivers in order to use time and materials contracts—a contract type that we have reported as high-risk, mainly because of inadequate oversight—because that allows them to negotiate individual rates. For

example, Dell's forensic costing process breaks down service costs to the smallest component—for example, labor rates and even raw materials such as fuel. Cost knowledge is shared throughout Dell's procurement organization, providing an advantage in negotiating contracts. Boeing uses benchmark clauses in some contracts, requiring that supplier rates be within a specified percentage of the benchmarked average as determined by third-party research firms such as Gartner Group. To improve collaboration with suppliers, Pfizer aims to build a single global account management team in order to have one point of contact globally that can solve issues and manage the Pfizer relationship holistically.

Opportunities Exist for Federal Agencies to Adopt Commercial Practices

Federal agencies have opportunities to leverage leading companies' practices for purchasing services in order to lower costs and maximize the value of the services they buy. In our September 2012 report on strategic sourcing, we found that most of the agencies we reviewed leveraged only a fraction of their buying power. Specifically, we found that four agencies—DOD, Department of Homeland Security (DHS), Department of Energy (Energy), and Department of Veterans Affairs (VA)—accounted for 80 percent of federal procurement spending in fiscal year 2011, but managed only 5 percent, or \$25.8 billion, of the \$537 billion spent on federal procurement through strategic sourcing contracts. Their strategic sourcing efforts resulted in \$1.8 billion in savings. When strategic sourcing contracts were used, selected federal agencies generally reported achieving savings between 5 and 20 percent. However, we reported that many agencies did not address the categories that represented their highest spending, the majority of which exceeded \$1 billion and most of which were services. Agencies also continued to face challenges in obtaining and analyzing reliable and detailed data on spending, securing leadership support, and acquiring services through strategic sourcing.¹⁰ Adoption of leading companies' practices could help agencies increase the portion of and types of services they strategically source. For example, leading company practices show how agencies could adopt tailored tactics to better target services that have been considered too difficult to strategically source, such as professional services. Moreover, leading companies have saved between 4 and 15 percent annually—over prior year spending—on services using these

¹⁰GAO, *Strategic Sourcing: Improved and Expanded Use Could Save Billions in Annual Procurement Costs*, [GAO-12-919](#) (Washington, D.C.: Sept. 20, 2012).

practices. A savings rate of 4 percent applied to the \$307 billion spent by federal agencies on services in fiscal year 2012 would equate to \$12 billion in savings. In December 2012, OMB directed agencies to take actions to better coordinate and gain more visibility into spending to overcome these challenges.

Federal Strategic Sourcing Efforts for Services Have Been Limited, but Results Show Potential for Additional Savings

In September 2012, GAO reported that many large procurement agencies were in the early stages of implementing strategic sourcing and had achieved limited results. For example, in fiscal year 2011, DOD, DHS, Energy, and VA accounted for 80 percent of the \$537 billion in federal procurement spending, but reported managing only about 5 percent of that spending, or \$25.8 billion, through strategic sourcing efforts. These agencies reported savings of \$1.8 billion—less than one-half of 1 percent of federal procurement spending.¹¹

Further, most of these agencies' strategic sourcing efforts did not address their highest spending areas—including services—which may have provided opportunities for additional savings. For example, we reported that VA had efforts underway to address only 3 of its top 10 spending categories as of September 2012. As discussed later in this report, we recommended that selected agencies identify strategic sourcing opportunities for their highest spending categories, and agencies concurred. By contrast, DHS reported that nearly 20 percent of its fiscal year 2011 procurement spending was directed through strategically sourced contracts which included the majority of its top ten products and services. While strategic sourcing may not be suitable for all procurements, industry groups have reported that leading companies they surveyed strategically manage about 90 percent of their procurements.¹² Moreover, officials from leading companies we spoke with reported that their annual savings for services are between 4 and 15 percent.

When strategic sourcing contracts were used, federal agencies generally reported achieving savings between 5 and 20 percent. For example, at the government-wide level, the Federal Strategic Sourcing Initiative (FSSI) program reported managing \$339 million through several government-wide initiatives in fiscal year 2011 and achieving \$60 million in savings, or almost 18 percent of the procurement spending it managed

¹¹GAO-12-919.

¹²GAO-12-919.

through these initiatives. The FSSI mission is to encourage agencies to aggregate requirements, streamline processes, and coordinate purchases of like products and services in order to leverage spending to the maximum extent possible. Additionally, the Navy reported spending \$145 million and achieving savings of \$30 million through its strategic sourcing efforts in fiscal year 2011; the reported savings was almost 21 percent of the spending that went through strategic sourcing vehicles.¹³

Agencies Need to Overcome Key Challenges to Improve Strategic Sourcing Efforts

Agencies also continued to face challenges in obtaining and analyzing reliable and detailed data on spending, securing leadership support for strategic sourcing, and applying this approach to acquiring services. In 2012, we reviewed the use of strategic sourcing across agencies with the largest procurement budgets in fiscal year 2011 and found that they were reluctant to apply strategic sourcing techniques to services, especially more complex ones. Additionally, these agencies did not sufficiently support strategic sourcing efforts with staff and other resources. These challenges make it difficult for agencies to identify opportunities for strategic sourcing or measure the success of ongoing initiatives.

Spending Data

In our strategic sourcing report, we found that agencies and federal strategic sourcing programs generally continued to rely on the government's current system for tracking contracting information data, and noted numerous deficiencies with this data for the purposes of conducting strategic sourcing research.¹⁴ Conducting spend analysis to obtain knowledge of procurement spending is a foundational component of an effective strategic approach. The analysis reveals how much is spent each year, what was bought, from whom it was bought, and who was purchasing it. The analysis also identifies where numerous suppliers are providing similar goods and services—often at varying prices—and where purchasing costs can be reduced and performance improved by better leveraging buying power and streamlining the number of suppliers to meet needs. For example, in a report on the use of strategic sourcing for office supplies, we reported that the General Services Administration (GSA) estimated federal agencies spent about \$1.6 billion during fiscal year 2009 purchasing office supplies from more than 239,000 vendors. GSA used available data on spending to support development of the Office Supplies Second Generation FSSI, which focuses office supply

¹³[GAO-12-919](#).

¹⁴[GAO-12-919](#).

spending to 15 strategically sourced contracts. Agencies and the federal strategic sourcing program generally continued to rely on the government's current system for tracking contracting information data, FPDS-NG, and noted numerous deficiencies with this data for the purposes of conducting strategic sourcing research. Although we noted that some agencies had been able to identify some strategic sourcing opportunities despite flaws in the available data, the difficulty of obtaining reliable and detailed data on spending hindered their ability to assess which strategic sourcing opportunities offered the most potential benefits.¹⁵ Additionally, we have made recommendations in the past to improve government-wide contracting data systems, such as electronic submission of data and greater controls to help improve the accuracy and completeness of FPDS-NG. Agencies generally concurred with these recommendations and have taken actions to improve the system.¹⁶

Leadership Commitment

We reported in our strategic sourcing report that most of the agencies we reviewed were challenged by a lack of leadership commitment to strategic sourcing, though improvements were under way. Leading companies we previously spoke with stated that the support and commitment of senior management is essential to facilitating companies' efforts to re-engineer their approaches to acquisitions as well as to ensuring follow through with the strategic sourcing approach. However, we have found that leaders at some agencies were not dedicating the resources and providing the incentives that were necessary to build a strong foundation for strategic sourcing. In addition, a lack of clear guidance on metrics for measuring success had also impacted the management of ongoing FSSI efforts as well as most selected agencies' efforts. For example, we found that agencies were challenged to produce utilization rates and other metrics—such as spending through strategic sourcing contracts and savings achieved—that could be used to monitor progress. Several agencies also mentioned a need for sustained leadership support and additional resources in order to more effectively monitor their ongoing initiatives. We recommended that the Secretaries of Defense and VA evaluate whether

¹⁵GAO, *Strategic Sourcing: Office Supplies Pricing Study Had Limitations, but New Initiative Shows Potential for Savings*, [GAO-12-178](#) (Washington, D.C.: Dec. 20, 2011).

¹⁶GAO, *Federal Contracting: Slow Start to Implementation of Justifications for 8(a) Sole-Source Contracts*, [GAO-13-118](#) (Washington, D. C.: Dec. 12, 2012); and *Federal Contracting: Observations on the Government's Contracting Data Systems*, [GAO-09-1032T](#) (Washington, D.C.: Sept. 29, 2009).

there are sufficient resources to fulfill strategic sourcing missions and develop metrics; the agencies concurred.¹⁷

Purchasing Services

Additionally, as we previously reported, agency officials noted that they have been reluctant to strategically source services (as opposed to goods) for a variety of reasons, such as difficulty in standardizing requirements or a decision to focus on less complex commodities that can demonstrate success. Agency officials also stated several disincentives that can discourage strategic sourcing efforts, such as a perception that reporting savings due to strategic sourcing could lead to program budgets being cut in subsequent years.¹⁸ However, officials from leading companies stated they have focused their efforts on services, such as telecommunications and information technology services, over the past 5-7 years because of the growth in spending in that area, and have achieved significant savings. Leading companies employ more sophisticated strategic sourcing techniques, using spend analyses and in-depth market research to tailor their acquisition approaches to the complexity and availability of the particular good or service they are acquiring.

An industry group surveyed companies and reported that companies are able to strategically buy the majority of their procurements, including services, in part because they targeted services that have been off-limits or controversial for most organizations, such as professional services. Professional services represented the federal government's highest-spend service category and accounted for almost \$50 billion of the federal procurement obligations in fiscal year 2012. For complex services, such as professional services, engineering, and research and development, agencies could apply company tactics to understand cost drivers and prequalify suppliers. Specifically, agencies could address knowledge-based services by using third-parties to benchmark supplier rates against comparable suppliers to ensure best price, develop new suppliers, and prioritize suppliers based on effectiveness and efficiency in order to ensure they are getting the best value. For less complex services, such as housekeeping and telecommunications, agencies could consolidate purchases to leverage buying power. Standardizing requirements could also help drive down costs. Leading companies reported that they applied

¹⁷[GAO-12-919](#).

¹⁸[GAO-12-919](#).

this type of tactic for specialized maintenance and repair, specialized logistics, utilities, and certain types of security.

Officials from leading companies also stated that there is not one right path for developing a strategic approach. However, as we previously discussed, leading companies' foundational principles show that leveraging knowledge, developing services category strategies, and measuring success based on reducing costs and maximizing value are necessary steps. For example, leading companies reported beginning with different principles as they adopted a more strategic approach for purchasing services. Some began by conducting a spend analysis, while others began by implementing an enterprise-wide centralized procurement approach and setting savings goals. While their first steps may vary, agencies could gather enough knowledge to allow them to tailor their tactics to different types of services in order to achieve savings and maximize value.

Recent Agency and OMB Actions Could Improve and Expand Strategic Sourcing of Services

We have recommended that selected agencies and OMB take actions to increase the use of strategic sourcing. For example, in our 2012 strategic sourcing report, we recommended that the Secretaries of Defense and VA, and the Director of OMB take a series of detailed steps to improve strategic sourcing efforts. More specifically, we recommended that:

- the Secretary of Defense evaluate the need for additional guidance, resources, and strategies, and focus on DOD's highest spending categories;
- the Secretary of VA evaluate strategic sourcing opportunities, including opportunities for VA's highest spending categories, set goals, and establish metrics; and
- the Director of OMB issue updated government-wide guidance on calculating savings, establish metrics to measure progress towards goals, and identify spending categories most suitable for strategic sourcing.

In commenting on the 2012 strategic sourcing report, DOD, VA, and OMB concurred with the recommendations and stated that they would take action to adopt them.¹⁹

In 2012, as part of establishing crosscutting goals to improve management across the federal government, OMB called for agencies to strategically source at least two new products or services in both 2013 and 2014 that yield at least 10 percent savings. In December 2012, OMB further directed certain agencies to reinforce senior leadership commitment by designating an official responsible for coordinating the agency's strategic sourcing activities. In addition, OMB identified agencies that should take a leadership role on strategic sourcing. OMB called upon these agencies to lead government-wide strategic sourcing efforts by taking steps such as recommending management strategies for specific goods and services to ensure that the federal government receives the most favorable offer possible. Additionally, OMB directed these agencies to promote strategic sourcing practices inside their agencies by taking actions including collecting data on procurement spending. The memo also asks GSA to increase the transparency of prices paid for services that other agencies buy in order to inform market research and contract negotiations.²⁰ This effort has the potential to improve the federal government's access to detailed pricing information and visibility into spending. Improved visibility may also help the federal government better measure the success of its strategic sourcing initiatives. While it is too early to tell whether OMB's actions will result in future savings, this initiative is a step in the right direction.

Concluding Observations

Services, which have traditionally proven difficult for agencies to manage, have quickly become the majority of federal government procurement spending. Making services procurement more efficient is particularly relevant given the current fiscal environment, as any savings from this area can help agencies mitigate the adverse effects of potential budget reductions on their mission. Companies have shown that it is possible to save money by strategically managing services. They have done so not just by consolidating purchases of simple, commodity-like services; they

¹⁹[GAO-12-919](#).

²⁰OMB, *Memorandum M-13-02, Improving Acquisition through Strategic Sourcing*, (Washington, D.C.: Dec. 5, 2012).

have devised strategies and tactics to manage sophisticated services. In addressing these categories, companies have shown that savings in service procurements come over a wide base. Also, such results need not require the creation of monolithic procurement organizations—these results can be achieved with leadership, shared data, and a focus on strategic categories that is dynamic rather than static.

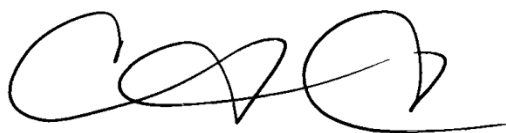
Clearly, the cost culture endemic to leading commercial practices is tied to the private sector's focus on profits. In federal agencies, profit is not a motivator. And there are disincentives to identifying and pursuing new strategic sourcing opportunities, such as the perception that doing so could lead to unanticipated budget cuts. This could contribute to why federal agency efforts to manage the purchase of services strategically are limited to small, commodity-like segments of spending. Similarly, agency tactics tend to be slow-moving and static once put in place. As budgets decline, however, it is important that the cost culture in federal agencies change. The simple dynamic is that adopting leading commercial practices can enable agencies to provide more service for the same budget or the same service with a smaller budget.

Third-Party Comments

Because this report focuses on leading company practices rather than agency operations, we provided relevant sections of a draft of this report to the leading companies we interviewed. They generally agreed with our findings and provided technical comments, which were incorporated as appropriate.

As agreed with your offices, unless you publically announce the contents of this report earlier, we plan no further distribution until 30 days from the report date. At that time, we will send copies to appropriate congressional committees, the Secretary of Defense; the Administrator for GSA; the Administrator for the Office of Federal Procurement Policy; and other interested parties.

This report will also be available at no charge on GAO's website at <http://www.gao.gov>. If you or your staff have any questions about this report or need additional information, please contact me at (202) 512-4841 or chaplainc@gao.gov. Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this report. Staff acknowledgments are provided in appendix III.

A handwritten signature in black ink, appearing to read 'Cristina Chaplain', with a stylized, cursive script.

Cristina Chaplain
Director
Acquisition and Sourcing Management

Appendix I: Objectives, Scope, and Methodology

We were asked to identify practices used by large commercial organizations for purchasing services. Accordingly, we (1) assessed key practices used by leading companies in purchasing services, and (2) examined potential opportunities for federal agencies to incorporate these practices.

To determine leading companies' practices for acquiring services, we selected a nongeneralizable sample of companies based on a literature search and recommendations from experts. We conducted a literature search of industry-recognized companies that have had success with services acquisition practices, including reviewing our prior leading practices reports on services acquisition. We also met with the Defense Business Board, Defense Science Board, and industry experts to discuss their recent studies on services acquisition and to obtain recommendations on which leading companies to contact. Based on this approach, we identified and interviewed the following organizations:

- Seven companies: Boeing, Dell, Delphi, Humana, MasterCard, Pfizer, and Walmart.
- An industry group: Institute for Supply Management.
- A consulting organization: A.T. Kearney.

Based on interviews with these organizations, we identified key practices reported by each company, including procurement organization structures, services procurement history and strategies, initiatives and resultant savings, and contracting methods. To maximize the applicability of our findings to the federal government, we identified top categories of services that the government acquires from the Federal Procurement Data System—Next Generation (FPDS-NG)—the government's system for tracking contracting information—and interviewed companies about their practices in those categories. We compared companies' procurement practices with those identified in our prior work. We identified common themes, including developing a transactional framework depicting our analysis of how companies tailor their procurement tactics, and confirmed with the companies. To assess the reliability of companies' data on acquisition savings, we requested information on data quality control procedures and system safeguards from company officials. In addition we provided relevant sections of a draft of this report to companies for review and comment. We determined that the data were sufficiently reliable for the purposes of this report.

To identify opportunities for federal agencies to adopt leading company practices, we determined that agencies purchase services similar to those

that the selected leading companies purchase. Specifically, to compare purchased services, we identified the top services leading companies purchase through interviews and reviewed FPDS-NG data from fiscal years 2010 and 2012 to identify the top ten services purchased by the federal government. To assess the reliability of FPDS-NG, we reviewed existing documentation and electronically tested the data to identify obvious problems with completeness or accuracy. We determined that these data were sufficiently reliable for the purpose of reporting government-wide and agency spending on products and services. Additionally, to determine the federal government's spending trend on services since fiscal year 2000, we relied on information we previously reported as well as FPDS-NG data between fiscal years 2008 and 2012. We reported then-year dollars for this analysis.

To determine the extent to which the government plans to target its highest spend service categories, we reviewed Office of Management and Budget strategic sourcing initiatives, but did not assess the results of these initiatives.

We also reviewed our previous reports related to federal strategic sourcing, acquisition, contract management, government streamlining, and duplication, overlap and fragmentation to identify (1) agency efforts to establish a strategic approach that reflected leading companies' foundational principles; (2) procurement tactics that agencies have used to purchase a variety of services; and (3) challenges that agencies face when establishing a strategic approach. We also reviewed the Defense Business Board 2011 Report to the Secretary of Defense on Strategic Sourcing, as well as literature from industry sources on successful strategic sourcing efforts.

We conducted this performance audit from December 2011 to April 2013 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Appendix II: Profiles of Leading Companies

Boeing

- Annual spend: \$7 billion
- Annual savings: 10 percent
- Main services purchased: IT, professional services, contingent labor, site services, travel, manufacturing support, freight and logistics, benefits administration

Source: Boeing.
Note: All figures approximate.

Procurement Organization (Shared Services Group)

Boeing's centralized Shared Services Group is responsible for the global purchase of non-production goods and services. It is organized into Strategic Contracting and Category Management, Procurement Operations, and Procurement Support and Integration components.

Beginning of Focus on Improvement to Services Procurement

Boeing began implementing its current enterprise procurement model in 2006, with its Chief Executive Officer (CEO) subsequently making non-production procurement efficiency a priority.

Visibility into Services Spend

The company has one system that provides visibility into its services spend, called the Shared Service Procurement/Payables Network. The quality and quantity of data provided by this system allows for improved spend analysis.

Overall Procurement Strategy

Boeing's enterprise procurement model aggregates demand by standardizing requirements in order to obtain pricing power. The company is currently implementing a Strategic Contracting and Category Management strategy with a focus on reducing total cost of ownership. This strategy involves category planning, strategic sourcing, contract management, and supplier relationship management.

Examples of Procurement Tactics

Boeing uses a four step process to ensure it is achieving the best value for each service: (1) define requirements; (2) define performance parameters; (3) define minimum acceptable performance standards; and (4) define service level agreements to measure success. Other tactics include standardizing requirements to reduce complexity, including benchmarking clauses in contracts to ensure competitive rates, and conducting business and market intelligence to help formulate future procurement strategies.

Metrics Used to Manage Services

Boeing manages supplier performance by establishing rating criteria with both the business partner and the supplier. An example of an internal metric is percentage goals for unit price reduction.

Dell

- Spend portfolio: \$55 billion (goods and services)
- Annual savings: 10 percent
- Main services purchased: internal and external consulting, third-party customer support, and technicians

Source: Dell.
Note: All figures approximate.

Procurement Organization (Worldwide Procurement)

Dell's procurement operation is structured as a centralized model. They have a Chief Procurement Officer (CPO). Cost knowledge is shared throughout Dell with everyone having access to the same data source. Dell uses Global Category Managers (GCMs), who are responsible for knowing all the requirements, delivery needs, and contracting requirements for each service (or good). Under the GCM are Regional GCMs, responsible for knowing local markets.

Visibility into Services Spend

Dell has a centralized database and reporting process.

Overall Procurement Strategy

Each commodity (good or service) is managed by a unique commodity team that is tasked with developing detailed sourcing strategies. The commodity team conducts research in both the marketplace and the supplier base for a given commodity. Technological issues are considered in order to understand any risks and deficiencies in regards to how the commodity can best be utilized for programs and projects. Procurement scenarios are analyzed so that teams can evaluate how suppliers react to Dell's purchasing needs.

Examples of Procurement Tactics

The ability and will to invest time and effort in capability management—highly trained employees, value creation process, and supplier relationship management—are the primary keys to procurement success. Teams continually aim to reduce costs by reducing complexity through reusing commodities for new products, bringing in outside expertise, and trusting commodity teams.

Metrics Used to Manage Services

Savings goals and metrics for success are determined from the bottom up and evaluated on a quarterly basis. Financial, operational, and organizational aspects of each commodity have their own set of performance metrics and means to measure improvement and success. This allows procurement officials to understand the “what” aspect that drives success.

Delphi

- Annual spend: \$1.2 billion
- Annual savings: 6 percent
- Main services purchased: transportation and logistics, healthcare and benefits, contract labor, engineering, warehousing

Source: Delphi.
Note: All figures approximate.

Procurement Organization (Global Supply Management)

Delphi's procurement organization is centralized, with a Senior Vice President of Global Supply Management as the equivalent of a CPO. For indirect spend, each of Delphi's four global regions has a director with category managers for its major spend areas: Corporate Services, Facilities Management, Information Technology, Industrial Supplies, Materials Management, and Machinery and Equipment.

Beginning of Focus on Improvement to Services Procurement

Delphi centralized indirect procurement between 2005 and 2007 in order to improve efficiency and drive savings.

Visibility into Services Spend

Company tracks spending through a central database integrated with its financial systems, and monitors its savings through a separate, self-developed information technology tool, Indirect Material Cost Improvement Process.

Overall Procurement Strategy

Service categories are overseen by category team managers who utilize a three-level strategy for procurement: industry knowledge strategy, internal corporate strategy, and supply base strategy. These strategies are formally reviewed and documented annually. Decision criteria for determining service providers include price, total cost of ownership, company viability, company maturity, and management structure.

Examples of Procurement Tactics

Delphi maintains a Category Approved Supplier List for primary service suppliers, which is reviewed annually. Companies on this list provide goods and services in accordance with Delphi's respective category strategies. The companies are approved by the Category Managers and Strategy Council of Delphi's Supply Management Leadership. Delphi will also dual source certain services in order to minimize future risk.

Metrics Used to Manage Services

Cost, delivery, technology, quality, optimization of supply base, and localization to the region are the primary metrics used to measure services. Other performance indicators can include on-time delivery, interruptions, and safety. Suppliers are measured weekly or monthly, depending on the service, and review meetings are held at least quarterly. Savings are centrally tracked and only counted after validation by the financial department.

Humana

- Annual spend: not publicly released
- Annual savings: not publicly released
- Main services purchased: Pharmaceutical, claim processing, and clinical

Source: Humana.

Procurement Organization (Corporate Procurement)

Humana's Corporate Procurement department is centralized with a CPO. Within Corporate Procurement category managers coordinate with internal customers to clarify business requirements, engage with suppliers to satisfy business needs, and develop strategic plans across its six procurement categories. While all purchases associated with government-related contracts are managed through Corporate Procurement, there are two additional procurement teams managing certain non-government-related supplier purchases within Humana: Global Sourcing, focused on business process outsourcing; and Information Technology Strategic Vendor Management, dedicated to software, non-commodity hardware, and technical consulting.

Beginning of Focus on Improvement to Services Procurement

In 2004, Humana hired a new CPO tasked with centralizing the overall Corporate Procurement process. The CPO has since developed spend analytics, results and process measures, and worked to value-driven annual goals and objectives. Category teams were introduced in 2004 yet did not mature to the full team structure, as it exists today, until 2007.

Visibility into Services Spend

Humana has an established centralized enterprise business suite, a fully integrated, comprehensive suite of business applications for the enterprise. These tools cover the procure-to-pay activity for supplier-related spend. Additionally, the team has an established centralized data source to capture key results and process measures.

Overall Procurement Strategy

Humana's six-step procurement process is applied to the purchase of both goods and services. The procurement process is focused on obtaining best value for the enterprise through coordinated category planning and supplier relationship management. The six category teams formally review and refresh their category strategic plans annually, at a minimum, with updates through the course of the year in response to material business change.

Examples of Procurement Tactics

Humana conducts make-versus-buy analysis when determining the ideal source for services. If requirements cannot be met in-house, the company leverages purchases across the organization to create a fully informed view of requirements and a competitive, best value award. Humana relies on bench marking studies, past performance data, and prior customer references. Based on this information and approach, Humana is

progressing toward establishing internal rate cards for consulting services to assess the value of proposed hourly rates based on contractor skill level. Humana adjusts the number of suppliers as needed. Humana steadily brought down the number of suppliers between 2004 and 2012. Currently, 4 percent of the supply base claims 80 percent of Humana's spend. Humana is now engaging small, diverse, and emerging suppliers in order to achieve the right balance of supplier to spend.

Metrics Used to Manage Services

Humana is in the process of scoping out requirements to build a scorecard process to standardize the scoring of vendors' performance, including keeping track of past performance. Inflation and deflation are measured based on year-over-year change in price on a per unit basis. Humana currently tracks cost avoidance and productivity—price and usage. Productivity is a key measure for executives and is incorporated into established performance measures.

MasterCard

- Annual spend: not publicly released
- Annual savings: not publicly released
- Main services purchased: legal, IT, HR, advertising/marketing, professional services, facilities management

Source: MasterCard.

Procurement Organization (Global Supply Chain)

The CPO has worked since 2009 to reduce silos within MasterCard's business units, and established a centralized model with a category focus.

Beginning of Focus on Improvement to Services Procurement

Prior to the CPO's arrival in 2009, MasterCard's sourcing organization focused primarily on traditional procurement and tactical sourcing. The company recognized the value of advancing from a tactical procurement approach to a strategic one.

Visibility into Services Spend

MasterCard uses a centralized database for procurement operations, which provides transparency into their global spend. They may use other tools to track supplier performance, risk management, and to conduct e-sourcing.

Overall Procurement Strategy

MasterCard employs a category management strategy that is comprised of a six-step model: (1) analyze internal and external spend; (2) define requirements and develop strategy; (3) execute strategy; (4) negotiate and award contracts; (5) implement and manage contracts; and (6) manage supplier performance.

Examples of Procurement Tactics

MasterCard emphasizes the importance of understanding the nature of requirements. Some categories are more complex than others and the approach for each category differs. Procuring services in the contingent/temporary labor space is driven by competition and achieving process efficiencies; procuring services in the legal services space is driven by custom requirements and increased complexity.

Metrics Used to Manage Services

Cost savings are always important and MasterCard uses standard definitions to measure those savings, such as year-over-year change. Other metrics such as productivity savings and budget savings allow for innovation and investment.

Pfizer

- Annual spend: \$16-17 billion (goods and services)
- Annual savings: 4-6 percent (goods and services)
- Main services purchased: legal, management consulting, IT, HR consulting, research, development and medical, business process outsourcing, fleet, marketing and sales, media, agencies, raw materials, contract manufacturing, capital equipment and construction

Source: Pfizer.
Note: All figures approximate.

Procurement Organization (Global Procurement)

Pfizer has “category teams” with a global reach for broad groupings of services with category managers assigned to each category. The global category zone leads are managed by Vice-Presidents who report directly to the head of the procurement organization and work with internal business partners, who execute contracts on a company-wide basis or locally as needed.

Beginning of Focus on Improvement to Services Procurement

Pfizer undertook a spend analysis effort in 2007, which revealed increased spending on legal, consulting, and financial services, as well as opportunities for improving the efficiency of their processes.

Example of a Procurement Tactic

Pfizer will examine market conditions and unbundle contracts for greater transparency and to bring more suppliers into the mix; later on Pfizer might bundle contracts to gain leverage as part of the strategy.

Compliance

Pfizer has a policy that procurement transactions over \$100,000 must be competitively bid with limited, documented exceptions. Pfizer Procurement monitors compliance with company processes and billing guidelines. The company considers its procurement professionals as essentially risk managers rather than contract managers because they need to consider what is best for the company and how to minimize total cost of ownership while maintaining flexibility.

Walmart

- Annual spend: \$1.5 billion
- Annual savings (since 2009): 12-15 percent
- Main services purchased: Facilities maintenance and capital expenditures

Source: Walmart.
Note: All figures approximate.

Procurement Organization (Realty Procurement Services)

Walmart's procurement function is decentralized. Realty Procurement Services, led by a Realty Vice President, provides sourcing support for facilities maintenance which includes outside services such as snow removal, roofing, and parking lot maintenance. Realty Procurement Services provides complete procurement, project management, and sourcing support for Walmart capital projects.

Beginning of Focus on Improvement to Services Procurement

Focus on procurement improvement began in approximately 2008. However, the services spend is not fully leveraged as different divisions within Walmart procure services such as human resources, information technology, legal, and marketing separately.

Visibility into Services Spend

Walmart does not have one system that provides visibility into the services procurement spend. It utilizes one system as a contract bidding tool and is currently implementing another to provide increased spend visibility into maintenance services.

Overall Procurement Strategy

Walmart's procurement strategy is focused on the reduction of total cost of ownership. While the lowest bidder may often be awarded a contract, it is important to take into account other considerations such as diversity and sustainability.

Examples of Procurement Tactics

Walmart employs craft managers for the major categories of services they acquire. These managers provide expert advice to the procurement organization. Walmart uses a performance management system that includes "score-carding" to rank suppliers based on various criteria. The company also applies a tiered pricing strategy, where a supplier offers different rates depending on the size of the contract.

Metrics Used to Manage Services

Average invoice price, hourly rate, time spent on location, and average time to complete a task are examples of the metrics Walmart uses to evaluate performance.

Appendix III: GAO Contact and Staff Acknowledgments

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Staff Acknowledgments

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