Buying Support Agency

Topic Guide: Value for Money (VFM)

Introduction

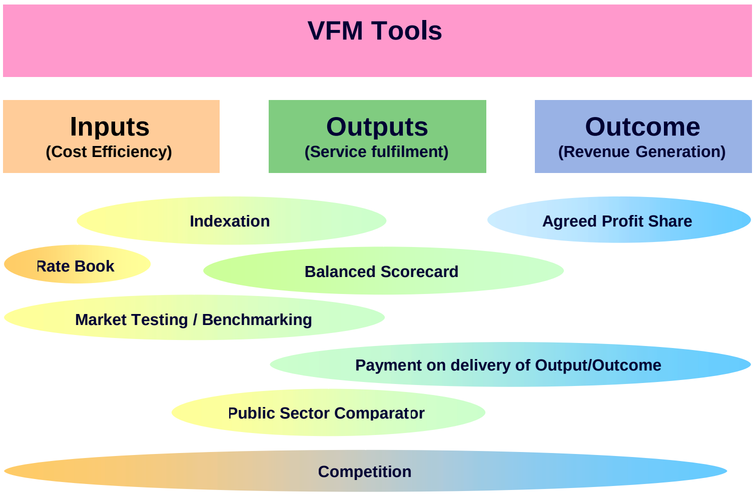
Value for money (VFM) can be defined as the optimum combination of **cost**, **quality** and **service** to meet the Customer's requirement. This section is split into two distinct areas:

- VFM Tools - these enable the supplier or the Customer to demonstrate that VFM is being delivered;
- Innovative Commercial Arrangements.

VFM Tools

It is usually easier to compare the cost of a bid or project than to assess the quality and value offered. In carrying out VFM comparisons, organisations have often placed undue emphasis on comparing the cost of the bid or project without considering the overall value offered.

The diagram below details the VFM controls that can be employed to demonstrate VFM both at the outset, and during the lifetime of the programme, for each of the three contracting styles. In relation to the Customer, the example being used is an Outputs-based contract.



VFM Tools
Inputs
(Cost Efficiency)
Outputs
(Service fulfilment)
Outcome
(Revenue Generation)
Indexation
Agreed Profit Share
Rate Book
Balanced Scorecard
Market Testing / Benchmarking
Payment on delivery of Output/Outcome
Public Sector Comparator
Competition

Broadly speaking, Input-based contracts should be assessed against cost efficiencies since the level of quality should be defined by the Customer in the requirements specification. The calibration for VFM on an Output-based contract would be whether the Service has met the required output parameters defined by the Customer. With Outcome-based contracts typically you would look to the level of revenue generation or meeting other desired Outcomes.

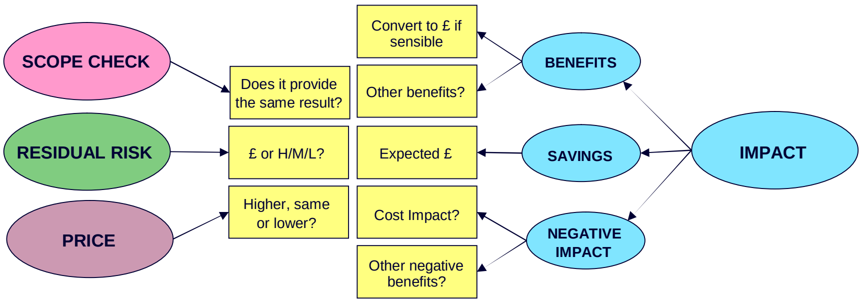
In relation to Output-based contracts, the following tools could be applied:

Competition

The best test of demonstrating value for money is competition. For an output-based contract where the term of the resultant agreement typically last for between 5 and 10 years, competition should confirm value for money for a significant period of this term (c. 2 to 3 years) and it is often unnecessary to test value for money in these early stages unless there is significant change to a contract scope in these early years.

Benchmarking and Public Sector Comparator

The principles of Benchmarking and Public Sector Comparators are broadly similar in this regard. Care must be taken in ensuring the comparison between different options considers all aspects as the diagram below illustrates:

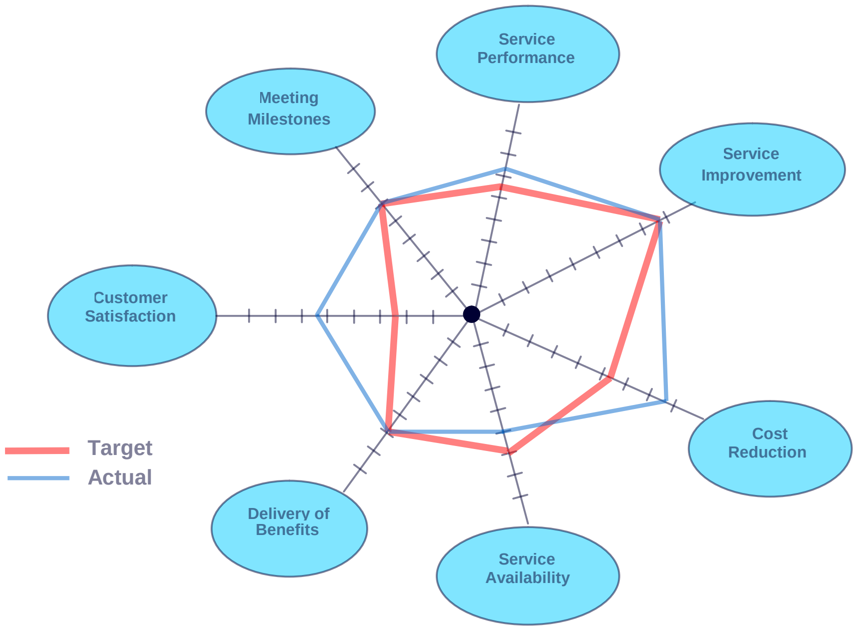

SCOPE CHECK
RESIDUAL RISK
PRICE
Does it provide the same result?
£ or H/M/L?
Higher, same or lower?
Convert to £ if sensible
Other benefits?
Expected £
Cost Impact?
Other negative benefits?
BENEFITS
SAVINGS
NEGATIVE IMPACT
IMPACT

In order for the comparison to be fair, it must take account of the following factors:

- Scope – does the offer deliver the same, better or worse outcome than the comparator?
- Residual Risk – all risks that remain with the customer are compared and a view taken of the value of the risk.
- Price – is the offer higher, the same or lower than the comparator?
- Impact – how does the offer impact on the organisation?
  - Benefits
    - How many of the predicted benefits can realistically be represented in financial terms (e.g. revenue generating opportunities or productivity improvements) and how does this compare with the comparator?
    - How do the remaining benefits that are not easily converted to financial measures compare?
  - Savings
    - How do the savings predicted by the offer compare with the chosen comparator?
  - Negative Impact
    - Are there any cost impacts associated with the offer and the comparator?
    - How do the remaining disbenefits compare?

Balanced Scorecards

Balanced Scorecards are particularly appropriate where there are multiple performance measures. The “spider-web” diagram below shows the graphical representation of how the Supplier has performed against the seven critical success factors agreed between the Supplier and the Customer.



This is typically used in the context of less tangible service measurements such as Customer Satisfaction Surveys.

Indexation

This form of VFM tool is often overlooked. If a customer has demonstrated VFM via competition, one of the most effective and labour un-intensive mechanisms for continuing to demonstrate VFM is via an appropriate indexation clause.

Care should be taken as to which index to choose from, and consideration should also be given to having different indexes for different parts of the service. Computer Economic Limited (CEL) Indexes are usually appropriate for the business environment we operate in.

Payment on Delivery of Output/Outcome

This tool is often underestimated and overlooked. The principle is that the payment plan is linked to the delivery of value. Be that the delivery of a working solution, or the delivery of a service in accordance with service levels. Spending time developing the right Service Level mechanism is critical to engendering the right behaviour from a Supplier and the right focus on Service Delivery, ultimately leading to the delivery of value to the Customer.

General

All too often an inappropriate VFM tool is applied to a particular contracting model (e.g. Balanced Scorecard for an Input based contract), or a VFM tool is used inappropriately (Benchmarking exercise where comparisons have not been made for the residual risk from one offer to the next).

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