Transfund General Circular No. 03/06 (web version)

Price Quality Method CPP for Professional Services

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Purpose

Transfund New Zealand has approved a new competitive pricing procedure (CPP) for purchasing physical works and professional services.

This circular gives tendering authorities the information they need to use the new CPP for professional services before it is formally incorporated into the *Competitive Pricing Procedures Manual: Volume 1, Physical Works & Professional Services* (CPP Manual). It also:

- summarises the main features of the new CPP, called the price quality method (PQM)
- tells you how to use PQM to evaluate tenders for professional services contracts
- outlines the changes we will make to the CPP Manual to incorporate PQM.

This circular refers to two documents:

- The attached text of the formal amendment that we will make to the CPP Manual. This attachment sets out the mandatory procedures and guidelines for using PQM.
- The spreadsheet that we have developed to perform the calculations for PQM and show how the process works. The spreadsheet is on the Transfund website (click here to go to the download).

An earlier circular (No 02/09 *Price Quality Method CPP for Physical Works*), issued on 19 September 2002, gave similar detail to this circular on using PQM for physical works contracts. We had intended to incorporate all the changes necessary to introduce PQM for physical works and professional services in an amendment to the CPP manual before now but publication of that amendment has been delayed. The amendment will be published on the Transfund web site in September.

Summary of PQM

PQM is designed for you to evaluate tenders when the quality of the supplier is very important, and you are prepared to pay more for that quality.

We have approved PQM because it is simple and transparent. It is almost identical to the weighted attribute method, and will result in the same decision in practically all situations. However, PQM is significantly better because it gives you a clear and consistent process for deciding the supplier quality premium (SQP) (the amount more you are prepared to pay for a better supplier) for each tenderer, and you see those dollar values. It also enables tenderers who don't win the contract to learn the difference between their SQP and the winning tenderer's SQP.

The added transparency in PQM means that you will need a well-managed process for using it. We recommend that before using PQM you:

- **become very familiar with the attachment to this circular, which sets out the mandatory procedures and guidelines for using PQM for professional services**
- **test PQM on recent tender evaluations that used the weighted attributes method**
- **decide how you will report the results of the tender evaluation, both within your organisation and to the tenderers**
- **ensure that everyone within your organisation involved in the purchasing decision making process knows and understands that process.**

The weighted attribute method and the quality-price trade off method (QPTO) are still available for you to use. In approximately 12 months we will review use of all three CPPs (for physical works and professional services) and decide which ones we will continue to approve. This review will include a survey of tendering authorities. We recommend that you start gathering information for this survey now.

The amendments that we will make to the CPP Manual affect mandatory procedures and guidelines in Chapters 1, 2, 3 and 4.

Key points

This circular gives you all you need to start using PQM now for professional services contracts.

We recommend that you test PQM before you use it, and establish a process for reporting results.

The PQM for professional services spreadsheet on the Transfund web site (click here to go to the download) will perform the PQM calculations.

In approximately 12 months we will review all the CPPs for physical works and professional services contracts, including PQM.

Using PQM: an overview

If you use PQM before we make the formal amendments to the CPP Manual, you must advise tenderers how tenders will be evaluated, possibly by reference to this circular in the request for tenders (RFT).

In addition to the usual requirements, all RFTs for contracts that will use PQM should state that tenderers who do not win the contract will be told the difference between their SQP and the winning tender's SQP. Tenderers need to know that if they win, other tenderers will be told how they fared in comparison.

Calculating the weighted sum of the non-price attribute grades

The process for calculating each tenderer's weighted sum of the non-price attribute grades is exactly the same under PQM as under the weighted attributes method. It is the next stage, deciding the SQP, that differs.

Deciding the SQP

The SQP is the amount more that you are prepared to pay for a better supplier.

PQM provides a step-by-step, transparent method for deciding the SQP for each tender. The SQP formula involves dividing the weighted sum margin (the difference between the tender's weighted sum and the lowest weighted sum) by the price weight, and then multiplying the result by the estimate (less any amount fixed by the tendering authority).

Evaluating alternative tenders

PQM makes evaluating alternative tenders simpler. It makes a clear distinction between the characteristics of the supplier and the qualities of the product to be supplied. If an alternative tender (an offer to supply a product that is different to that envisaged in the RFT) is received then an alternative tender premium (ATP) must be calculated, in addition to deciding the SQP for each tender.

With professional services it is often difficult to distinguish between the quality of the product (the professional service) and the characteristics of the supplier (the professional service provider). For this reason the current CPP manual includes mandatory requirements and

guidelines for analysing alternative tenders for physical works but not for professional services. The attached CPP mandatory requirements for PQM for professional services similarly make no reference to alternative tenders. They are otherwise identical to the requirements published for PQM for physical works (in general circular No. 02/09).

In the attached CPP guidelines we suggest that if you want to use PQM to evaluate tenders for professional services and also want to consider alternative tenders then the PQM evaluation process described for physical works contracts (refer general circular No. 02/09) should be used. You need to explain in the RFT that alternative professional services will be considered and explain how tenders will be evaluated. We do not anticipate that PQM will often be used in this way.

We anticipate that PQM will only be used when the professional service required is reasonably well defined. If a tendering authority cannot closely define the professional service required and wants to consider alternative services, then the Brook's Law or Target Price tender evaluation methods may be better than PQM.

Changes to the CPP Manual

By the end of September 2003 we will have made a number of changes and additions to the CPP Manual.

- We will make formal amendments to Chapters 1, 2, 3 and 4 to incorporate PQM for both physical works and professional services.
- We will move the current parts of Chapters 1, 2, 3 and 4 which set out the weighted attributes method to an appendix.
- We will change the manual's overall structure, so guidelines come immediately after the section they refer to.

Once these changes are complete we will reissue the CPP Manual volume 1 and place an electronic version of the manual on the Transfund website.

Review of competitive pricing procedures

In approximately 12 months we will review the use of all CPPs for physical works and professional services contracts, including PQM. The Transfund Board will use the results of this review to decide which procedures it will continue to approve.

The review will start with a survey of tendering authorities about contracts that Transfund funded and were:

- physical works contracts let after 30 September 2002 or professional services contracts let after 31 July 2003
- for a sum not less than $50,000.

The survey will ask these three questions for each contract let:

- Which CPP was used?
- Were alternative tenders received and evaluated?
- If PQM was used, were any of the SQP figures 'replaced' rather than simply 'reviewed and confirmed'?

We recommend that, to save time and money when the survey is formally underway, you start noting this extra information now.

In addition to this survey, we will interview purchasers and suppliers who have been involved in tendering and evaluating tenders under PQM.

Attachment

The attachment is written in a plain language style. We are interested in your views on this plain language style. If you find it helpful we will write all future amendments to the manual in a plain language style.

Enquiries

For further information contact Bernard Cuttance at Transfund's National Office in Wellington, Ph (04) 916 4273 or email bernie.cuttance@transfund.govt.nz.

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Attachment to General Circular 03/06 — price quality method CPP for professional services

This attachment sets out the changes that Transfund will make to Chapters 1 and 4 of the *Competitive Pricing Procedures Manual: Volume 1, Physical Works & Professional Services* (CPP Manual). These changes concern the Transfund mandatory procedures, and guidelines for using the price quality method (PQM). They will involve the following changes:

References to weighted attribute method

Throughout Chapters 1 and 4, references to the weighted attribute method will be replaced with references to the price quality method, or PQM.

Chapter 1: Introduction and definitions

A new definition will be added to Section 1.4.

Chapter 4: Tendering procedures—Professional Services

Section 4.3.5 mandatory procedures will be replaced.
Section 4.8 mandatory procedures and guidelines will be replaced.

Chapters 1 and 4 of the CPP Manual currently include the mandatory procedures and guidelines for using the weighted attribute method. This information will be moved to an appendix.

Section 1.4: Definitions

The following amendment will be made to Section 1.4, Definitions:

• A new definition, of a supplier quality premium, will be added.

Supplier quality premium (SQP)

The amount more that the tendering authority is prepared to pay for a higher-quality supplier.

Section 4.3.5: Price quality method

1 Tendering authorities must follow the five steps set out below to evaluate the tenders.

2 Tendering authorities can only contract for the preferred tender.

Using price quality method

Step 1: Grade the non-price attributes

• Grade each non-price attribute for each tender from 0-100.
• Reject any tender that scores 35 or less on any single non-price attribute.

Step 2: Calculate the weighted sum margin

- Multiply the weight (specified in the RFT) by the grade for each non-price attribute and divide by 100. The result is the index for each non-price attribute.
- Add all the indices for each tender. The result is the weighted sum of the non-price attribute grades.
- Deduct the lowest weighted sum from each tender's weighted sum. The result is the weighted sum margin for each tender.

Step 3: Calculate the supplier quality premium (SQP)

- Calculate the SQP for each tender using the following formula:

- SQP = Estimate x (weighted sum margin / price weight)

- The estimate used in the formula must exclude any amount fixed by the tendering authority.

Step 4: Confirm the SQP

- Review the SQP calculated for each tender.
- Confirm that the SQP for each tender represents the amount more that the tendering authority is prepared to pay for a higher-quality supplier.
- Replace any SQP with an acceptable figure if the review shows that any SQP does not represent the amount more that the tendering authority is prepared to pay.
- Confirm the new figure with those responsible for determining the preferred tender.

Step 5: Identify the preferred tender

- Deduct each tender's SQP from the tender price.
- Identify the tender with the lowest tender price less SQP. This is the preferred tender.

Section 4.8: Tender evaluation—price quality method

1   Tenderers must submit tenders in two separate envelopes.
- envelope 1 must contain all tender information other than tender price.
- envelope 2 must contain the tender price information.

2   Tendering authorities must follow the five steps set out below to evaluate the tenders.

3   Tendering authorities must complete steps 1–4 before opening envelope 2.

4   Tendering authorities can only contract for the preferred tender.

Using price quality method

Step 1: Grade the non-price attributes

- Open envelope 1.
- Grade each non-price attribute for each tender from 0-100.
- Reject any tender that scores 35 or less on any single non-price attribute.

Step 2: Calculate the weighted sum margin

- Multiply the weight (specified in the RFT) by the grade for each non-price attribute and divide by 100. The result is the index for each non-price attribute.
- Add all the indices for each tender. The result is the weighted sum of the non-price attribute grades.
- Deduct the lowest weighted sum from each tender's weighted sum. The result is the weighted sum margin for each tender.

Step 3: Calculate the supplier quality premium (SQP)

- Calculate the SQP for each tender using the following formula:

- SQP = Estimate x (weighted sum margin / price weight)

- The estimate used in the formula must exclude any amount fixed by the tendering authority.

Step 4: Confirm the SQP

- Review the SQP calculated for each tender.
- Confirm that the SQP for each tender represents the amount more that the tendering authority is prepared to pay for a higher-quality supplier.
- Replace any SQP with an acceptable figure if the review shows that any SQP does not represent the amount more that the tendering authority is prepared to pay.
- Confirm the new figure with those responsible for determining the preferred tender.

    Complete steps 1–4 before opening envelope 2.

Step 5: Identify the preferred tender

- Open envelope 2.
- Deduct each tender's SQP from the tender price.
- Identify the tender with the lowest tender price less SQP. This is the preferred tender.

Guidelines 4.8: Tender evaluation—price quality method

Price quality method (PQM) enables the tendering authority to pay more for a high-quality supplier, and clearly shows the process the tendering authority goes through to decide how much more to pay.

How to test PQM

Before using PQM, tendering authorities should test the method on recent tenders that used the weighted attributes method (which is very similar to PQM). This testing will provide a good understanding of how PQM works and the kind of results it gives.

This testing is also important because best practice use of PQM involves telling tenderers what their SQP was, and how it differed from the winning SQP. Tendering authorities must be able to justify the way they reached the SQP for each tender.

Grading the non-price attributes

Refer to Appendix L ('Non-price attribute grading') for guidance on grading non-price attributes.

An industry working group set the 'fail' threshold of 35 or less.

Calculating the SQP

The estimate should be included in the RFT, to make the process transparent and to let tenderers know how much resource you think will be needed. If it is not included in the RFT, it must be determined before envelope 2 is opened.

An amount fixed by the tendering authority is usually a provisional sum, prime cost sum, or contingency sum.

Provisional sums and so on priced by the tenderer, not fixed by the tendering authority, must be included in the estimate. The estimate is for the part of the work that the tenderer has to price.

Confirming the SQP

The review of each tender's SQP is intended to confirm that no SQP is too high or too low. However, if the review shows that any SQP is not acceptable, you must record this conclusion and its reasons. The reasons for the tendering authority's decision must be clear (see Section 4.11).

Alternative tenders

Section 4.8 is identical to section 2.7 (PQM tender evaluation for physical works - refer general circular No. 02/09) except that it does not refer to alternative tenders. If a tendering authority wants to use PQM, and to consider alternative tenders (offers to supply an alternative professional service) then the PQM evaluation process for physical works tenders in section 2.7 needs to be used instead of this section 4.8. Any ATP must be calculated as described in section 2.8. This approach implies that the tendering authority will pay a premium (an ATP) for a superior service in addition to any SQP.

However, we do not expect that PQM will be regularly used in this way. When purchasing professional services it is not easy to make a distinction between the characteristics of the supplier and the qualities of the product (the professional service) supplied. So in most cases differences in the service offered by different tenders will be valued through the non-price attributes grades, the methodology grade in particular, and will reflect in the SQP.

If a tendering authority is not absolutely clear about the professional service it needs to buy it may be better to evaluate tenders using Brook's Law or Target Price. Methodology would be given a high weight.

Negotiation

Providing the intent of section 4.12.1 is met negotiation with the preferred tenderer is allowed.