

Annex

NGET_A14.06_Delivering competitive value through Procurement

December 2019

As a part of the NGET Business Plan Submission

nationalgrid

RIIO-T2

nationalgrid
Electricity Transmission

NGET_A14.06_Delivering competitive value through Procurement

Value for money (December 2019)

Submission annex

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1. Context and background

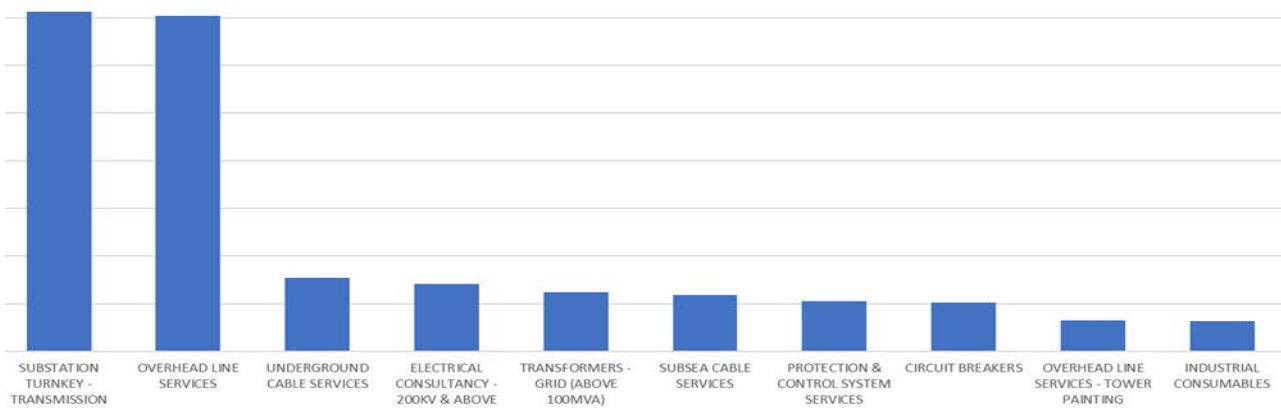
Procurement’s role is to build value-adding strategies for all areas of National Grid’s spend, to go to market and competitively source the purchase of all goods, services and works that are required, and to put in place the appropriate contracts for business entities to then deliver through. As a Group function, we work closely with each part of the business to ensure we are aligned on objectives and requirements.

The purpose of this document is to provide insight into how Procurement delivers competitive value through these processes to help achieve whole-life value for our customers and end consumers.

In the UK, an annual total spend of approximately £1.8bn passes through Procurement for all business entities. This covers the external purchase of goods, services and works, which include not only network capital investments in transmission equipment, but a diverse range of goods and services ranging from travel to IT, temporary labour and stationery. Figure 1 shows the top 10 areas of spend for Electricity Transmission, based on the financial year 2018/19.

Our procurement approach considers opportunities to leverage value on a regional (UK) and Global basis. As well as ensuring value for the products and services, we work with the business entities to provide insight and early visibility of both opportunities and risks and work to maximise/ minimise as appropriate.

Figure 1: Top 10 Categories of Spend



Overall, our spend is categorised into the following three ranges:

- Individual spend items/contracts <£[redacted] = ~2% of spend
- Individual spend items/contracts >£[redacted] = ~17% of spend
- Individual spend items/contracts >£[redacted] = ~81% of spend

The above categories are used as ‘monetary thresholds’, which have been established to ensure there are proportionate definitions and process, systems and governance for each individual item. A competitive process is followed for any purchase over £[redacted], with any exceptions to be authorised through the appropriate delegations of authority. For all purchases that are greater than £[redacted], National Grid follows a more defined sourcing and tendering process (this is lower than the legal threshold set by the European Utilities Contract Regulations 2016, UCR, which are currently ~£363k for Goods and Services and ~£4.55m for Works), we choose to do this because we believe we can drive more value this way. Both processes

ensure we deliver the most competitive outcome and overall our approach means that we drive competition into 98% of the outsourced spend that passes through Procurement.

These competitive processes are equivalent to 'Native Competition' as defined by Ofgem.

2. Our Native Competition Plan

We utilise competitive processes for all procurements and projects, except where the potential benefits of doing so are outweighed by the costs

- We comply with the European Utilities Contracts Regulations 2016 (UCR) which require the use of competitive processes for the purchase of goods and services above a financial threshold (currently ~£363k for Goods and Services and ~£4.55m for Works).
- A competitive process is followed for purchases over £█, with any exceptions to be authorised through appropriate delegations of authority. For all purchases greater than £█, we follow a more defined sourcing and tendering process. This is lower than the legal threshold set by the UCR; we choose to do this because we believe we can drive more value.

Our competitive process is robust, transparent and provides equal treatment of potential bidders and protects information appropriately

- We treat all bidders fairly and with the appropriate level of transparency. Bidders need to trust us not to reveal confidential information to the market before they make their best submission and share innovations.
- We ensure confidential information is handled appropriately.
- We offer fair payment terms and participate in the Prompt Payment Code, encouraging our direct contractors to cascade these principles through all levels of the supply chain. This protects the cash flow of all parties, but particularly helps smaller businesses.
- We drive performance in our contracts by ensuring they contain appropriate measures (Key Performance Indicators) to incentivise suppliers. We measure supplier performance on a quarterly basis and the outcomes affect future workload allocation.

The complexity of the competitive process used is proportionate to the value and time-sensitivity of the project or system need in question

- Our Strategic Sourcing Process enables us to identify the optimum way to contract work taking into account the value, risk and urgency of the work. We seek opportunities to benefit from our global buying power.
- We have set up frameworks to speed up the commercial process, reduce tendering costs, drive optimal designs, leverage volume and introduce innovation. Our framework agreements allow enough flexibility to ensure that suppliers are able to introduce innovation and optimise designs whilst we remain able to leverage our volume through the workload allocation processes.
- For complex, high-value, bespoke or unusual projects where we believe we can drive additional value, we retain the option to spot tender and can allow a longer period for tender receipt than the legal minimum.

Information is provided equally to all parties, and any conflicts of interest are managed

- We will continue to provide early visibility of the work plan through quarterly webinars and issuing project briefs to enable our supply chain partners to plan more effectively. We have already shared our T2 plan through our ongoing six-monthly senior engagement forums with our key framework suppliers.

- We have appropriate checks in place to identify and manage any conflicts of interest.

We are agnostic to technology and bidder type

- We continue to drive competition into our supply chain by introducing new suppliers. We are open to innovative solutions and remain technology agnostic (where practicable).
- Our frameworks are expanding to include more options for installation-only contractors, to increase technology agnosticism by decreasing our reliance on equipment manufacturers.

Competition is structured to generate outcomes in the interests of current and future consumers

- We constantly work to increase efficiency, mitigate risks and optimise whole-life costs. We have a lead role in the Institution of Civil Engineers Infrastructure Client Group; as part of this, we are an early adopter of Project 13 principles for our LPT2 project which emphasises the importance of delivering broader outcomes to benefit the local community and consumers.
- We leverage value by being a better client, regularly seeking feedback from our supply chain as to how we can help them be more efficient, which in turn leads to lower costs and better outcomes for customers and consumers.

3. How do we deliver value?

Our procurement lifecycle has three parts: our Category Strategy Framework which identifies our requirements and spend in the UK and US (for combined consideration if appropriate) and opportunities to deliver value and mitigate risks; our Strategic Sourcing Process the internal procurement process which is used to ensure we undertake best practice sourcing to deliver value; and our Contract Management Process which ensures we manage contracts with third parties to ensure we receive the goods and services expected and maximise commercial benefit.

Figure 2: Procurement lifecycle



To ensure we remain efficient in what and how we deliver as a Procurement function, we utilise externally recognised benchmarks to assure ourselves that the value being delivered, and the size of the Procurement function is in line with and proportionate to the spend being managed. As a shared function, a portion of Procurement’s costs are allocated to NGET; these costs are categorised as Business Support costs. We have benchmarked the cost of our Procurement function, as detailed in our Value for Money chapter. Hackett found that our UK shared services Procurement function costs were in line with the top 25% most efficient peer companies (i.e. were upper quartile efficient).

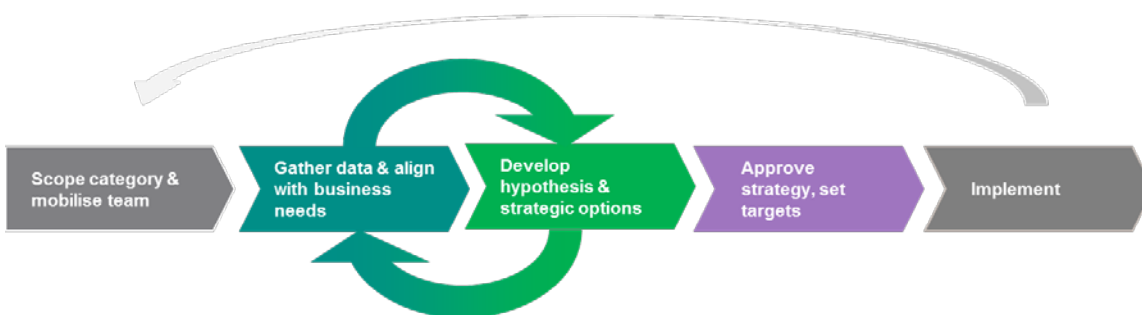
Category Strategy Framework

During the T1 period, the Procurement function adopted a more strategic approach and has since developed category strategies for the majority of National Grid’s spend (currently >80% of annual spend

passing through Procurement). These category strategies look to consolidate the spend on goods, services and works across the businesses (including those parts of the National Grid Group that operate in the US) where appropriate and identify opportunities that can be used to leverage this volume, drive native competition and deliver more efficient outcomes. This is a more strategic approach than simply driving value on each procurement and tender event in isolation. For example, in the areas of Substation Construction and Overhead Line (OHL) works, category strategies have been developed that leverage scope across the National Grid Group portfolio.

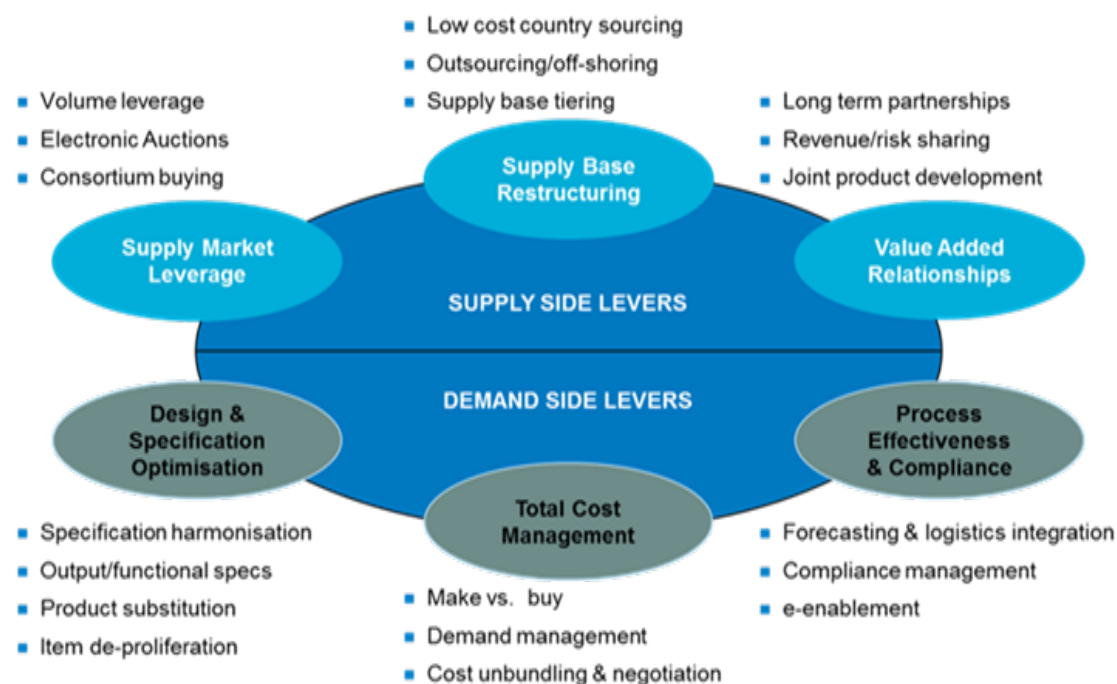
The category strategy framework commences with scoping the opportunity and is monitored through to its implementation in a series of stages. These stages ensure all the value opportunities are sufficiently considered and executed through the Strategic Sourcing Process and Contract Management Process.

Figure 3: Category Strategy Framework



The development of strategies includes reviewing business needs and the key features of the supply market and future trends. The outcome of this process is a plan to deliver value through a series of initiatives or levers. We focus on six value levers which are based on supply and demand. Figure 4 details the six levers and provides an indication of the factors considered within each.

Figure 4: Category Management levers



Supply levers:

1. **Supply market leverage** – Ensuring the combined volume across the group is being leveraged and that alternative markets and suppliers are developed to introduce further competition.
2. **Supply base restructuring** – Creation of a competitive framework whilst structuring the supply chain to ensure the right supplier for the job is utilised.
3. **Value-add relationships** – Partner with strategic suppliers to encourage innovation and pursue alternative methods.

Demand levers:

4. **Design and specification optimisation** – Standardise specifications where appropriate to drive down bespoke costs and retain broader supplier base by being Supplier agnostic. Use of functional and output-based specifications to enable innovative solutions and products to be considered.
5. **Total cost management** – Ensure that requirements consider total cost of ownership for overall benefit to the customer, for example, by consideration of long-term maintenance costs and product life.
6. **Process effectiveness and compliance** – Provide accurate demand forecasts, allowing more opportunity to leverage volume and engage suppliers so they are better able to respond to our requirements.

The Transformer and Switchgear category strategies provide recent examples of where we have utilised the Category Strategy Framework to drive competitive value:

1. In 2017, the Global High Voltage Transformers Category Strategy identified an opportunity for a global sourcing event because there was the opportunity to combine the purchase of a number of units across the UK and US businesses. Several levers were utilised within this event to drive value including:
 - Bundling committed global volumes;
 - Inclusion of “best cost” country sources;
 - Deployment of new negotiating approaches.

This resulted in a global award, driving significant benefits to both the UK and US business.

2. In 2018, we undertook a global procurement event for the purchase of Circuit Breakers and Capacitor Voltage Transformers, which resulted in significant savings for the UK business. Levers used in the process included:
 - Bundling committed volumes across the remaining years of the T1 period;
 - Inclusion and use of best cost country sources.

When the decision to go to market is taken, defined as part of our strategy, we use our Strategic Sourcing Process to ensure consistent and effective delivery.

Strategic Sourcing Process

The Strategic Sourcing Process (SSP) has been developed to ensure a robust procurement process is undertaken. This ensures that we deliver competitive value whilst also complying with the requirements of the Utilities Contract Regulations 2016 (UCR) which governs much of our procurement activity. The UCR are designed to prevent contracts being awarded without having gone through a competitive process and to support the free movement of goods, services, people and capital within the EU. The UCR are therefore underpinned by five treaty principles;

- Equal treatment
- Non-discrimination
- Mutual recognition
- Proportionality
- Transparency

The SSP is modular, ensuring that we are able to modify our approach based on the spend, complexity, risk, market place and timescales of the requirement, to ensure that we drive the most effective outcome for the sourcing need. The eight-step process includes four governance gates that allow a steering group (including representatives from the businesses) to challenge outputs and to ensure that the event delivers best practice sourcing, fairness, transparency, value for money and robust contracts. The SSP is designed to be flexible enough for the procurement teams to be able to implement continuous improvement opportunities based on previous experience, best practice and knowledge of the market.

Figure 5: The high-level SSP process



Stages

1. **Event Strategy** – Outlines how the procurement event will be run, including the structure, e.g. set up a new Framework using appropriate procurement procedure available under the UCR or call off an existing Framework agreement , route to market, evaluation strategy, award criteria. Will utilise the relevant learning from the category strategies in place. Identifies what support will be needed from the business, i.e. individuals to be part of the tender team.
2. **Qualification (Optional)** – An option of shortlisting suppliers who meet the selection criteria.
3. **Build Tender** – Development of the tender pack and the evaluation process in line with the award criteria to differentiate tender returns.
4. **Tender** – Effective delivery of the tender in line with the agreed plan (taking account of the complexity of the event and necessary response time from Suppliers which may exceed the minimum UCR requirement), ensuring that business stakeholders and suppliers (including tender queries) are managed and communicated.
5. **Evaluate** – Completion of a thorough and consistent evaluation process, clearly documenting the outcomes to determine the shortlisting of tenderers.
6. **Negotiate (Optional)** – The assessment of tenderers against the contract award criteria, the conducting of negotiations covering both technical and commercial aspects and final evaluation.
7. **Award** – Notification of successful and unsuccessful tenderers and the management of the standstill period.
8. **Handover** – The facilitation of the formal handover from the SSP process to the Contract Management Process (CMP).

Governance gates

- **GATE 0** – Used as a formal gate to ensure the event strategy is agreed by all parties to ensure alignment before launch.

- **GATE 1 (Optional)** – Formal review milestone for qualification shortlisting and Tender documents.
- **GATE 2 (Optional)** – Used as a formal review point to shortlist tenderers for negotiation.
- **GATE 3** – Formal recommendation on selection for contract award.

Determining the event strategy within the SSP process will vary based on factors such as related category strategies, the objectives of the tender, the associated risk, complexity and scope. Based on this, we consider areas such as the agreement options, agreement structure, route to market, qualification strategy/options, native competition and evaluation strategy to determine the appropriate strategy based on the risk associated with, and value of, the opportunity.

- **Agreement structure** – the type of agreement. This could include a framework agreement whereby a closed set of Suppliers are selected to for future requirements. An example of this is the Framework agreements used to facilitate much of NGET's capital works. It takes the form of a one-off/multi-purchase contract or a form of dynamic purchasing system relating to goods, services and works that are more commonly available.
- **Agreement Options** – the options to be considered in the agreement. Examples of this include: lotting to divide a contract into subcategories or geographical regions, the number of suppliers, the contract type (such as New Engineering Contracts (NEC)) and any call-off mechanisms required for a framework, e.g. mini tender and/or direct allocation as a means of awarding work to a supplier. Other items also considered include: Key Performance Indicators, performance bonds, guarantees, Terms & Conditions, and pricing structures.
- **Route to Market** – how the procurement requirement is taken to market. If the activity falls this under the UCR, then we must use one of the procedures defined by the Regulations. We utilise the most appropriate procedure based on our assessment. Our default procedure is a negotiated procedure which calls for competition and allows for both qualification and negotiation to take place. Other procedures provide variations on this, for example the restricted procedure which does not allow the negotiation phase (variations exclude the optional stages of the SSP process). We have also used the Competitive Dialogue and Innovation Partnership procedures.
- **Qualification strategy/options** – the options of engaging the supply base as a way of shortlisting the number of suppliers to be invited to tender based on agreed criteria.
- **Native competition** – through the procurement and negotiation we can ensure that we leverage the competitive nature of the process to maximise the commercial outcome and establish new market benchmarks.
- **Evaluation strategy** – the determination of how the tenderers will be assessed, differentiated and ranked. The evaluation can include the evaluation of commercial and technical aspects, which will also include the evaluation of any innovations offered by Suppliers as part of the Tender.

Whatever the strategy determines is the best route, the SSP process and subsequent alignment to the UCR ensures there is always an equal treatment of bidders and that a fair and competitive outcome is achieved.

A recent example of where the end-to-end SSP process has delivered competitive value is the Dorset Visual Improvement Provision (VIP) project tender which was undertaken with Capital Delivery (CD). Following the SSP, we undertook a competitive tender process for the overhead line and undergrounding elements of the project. This followed detailed development work to ensure that we would have a robust scope for the contractors to tender against. The moderation and negotiation process run in conjunction with CD engineers challenged costs and risks put forward by all the contractors and selected a preferred bidder through the

balance of commercial and technical considerations. This procurement process was reviewed by Ofgem as part our submission for “Reducing the visual amenity impacts in Dorset Area of Outstanding Natural Beauty” and resulted in their agreeing to fund £116m to deliver this project.

Contract Management Process

To minimise value leakage, ensure that the performance of the contract is as expected, and maximise any commercial and innovation opportunities that are identified during the “in-life” operation of the contract, we employ a robust Contract Management Process. Within Procurement, we have established a Contract Management team to manage contracts which are utilised by all business entities, e.g. Travel and Personal Protective Equipment, whilst also managing some specific areas for NGET specifically, e.g. Secondary System Support Contracts. Capital Delivery contract manage capital projects directly, given the scale and nature of the requirement. We work closely with Capital Delivery to share best practice and continue to build on the Chartered Institute of Procurement and Supply award

To ensure effective delivery, the Contract Management team will be involved in category strategy development and the sourcing process to identify opportunities (see figure 6) and ensure that they can be optimised during the operation of the contract.

Figure 6: Contract management opportunities considered pre-contract award

Value Opportunity	Description
Lean Scope (internal)	Review requirements with operational and technical teams to reduce scope and find an optimal solution
Lean Scope (external)	Consider proposals from the supplier base for innovative scope, services and products
Leverage (volume)	Discuss with supplier other services that the supplier may undertake in return for a volume discount
Trend Analysis	To improve on areas such as demand management
Hire vs Buy	Identify usage times to assess when it would be commercially more efficient to buy equipment as opposed to hiring
Leverage (bundling)	Bundling of projects, orders, temporary staff hires, etc.
Rebates/Retention	Apply rebates on spend including off-contract spend
Pain/Gain Contracts	Review mechanism effectiveness
Competitive tension between existing suppliers	Using mini tendering off frameworks
Payment terms	Early payment in return for additional rebate or % discount
Off-contract spend	Review of any off-contract spend with similar or the same supplier to bring the spend into category spend
Service Level Agreement penalty clauses	Add in-service credits for poor performance
Key Performance Indicator penalty clauses	Add in-service credits for poor performance
Opt-out clauses	To support managing poor performance of a supplier, include opt-out clause for early termination of the agreement

During the Strategic Sourcing Process, we will also prepare for a potential change of supplier to ensure continuity of supply because this often involves complex demobilisation of the previous supplier and mobilisation of the new supplier.

Following mobilisation, the contract enters its “in-life” phase. During this period, we will ensure that our suppliers are performing as per the agreement and the Procurement Contract Management team act as a point of escalation between the supplier and user (i.e. another part of National Grid). In addition, our Contract Managers will look to utilise relevant additional opportunities to drive value (see figure 7). In some instances, such as an opportunity to change supplier, this information will be used in the review of a related category strategy.

Figure 7: Additional Contract Management opportunities considered post contract award

Risk mitigation	Description
Dispute	Invoice validation process and disputes from this process
Change of supplier or sub-supplier	Are there any savings to be made from changing supply base?
Invoicing	Using invoicing data to understand buying patterns, e.g. can a supplier be paid once a month rather than weekly using an automated invoice process

Recently, effective contract management on a variety of contracts has enabled us to:

- Claim rebates which had been agreed in the contract when certain thresholds had been met.
- Work with our business stakeholders to review the equipment being used for certain jobs and identify cheaper fit-for-purpose equivalents, saving money whilst achieving the desired outcome. An example of this is lifting equipment.

4. How do we measure the performance of these strategies and processes?

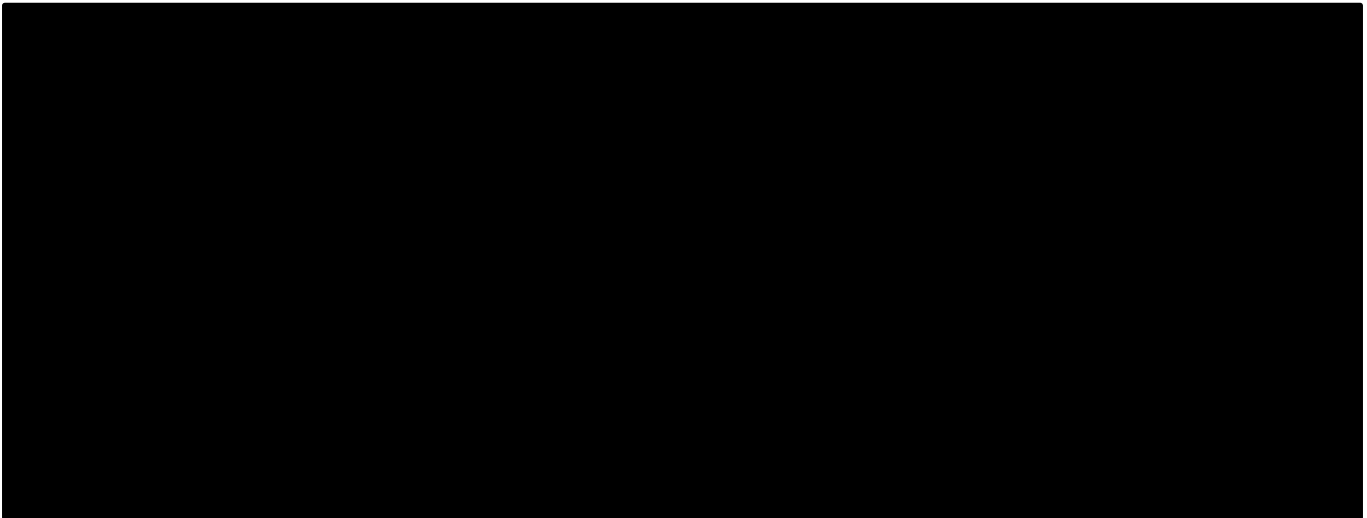
In terms of measuring performance there are some key externally recognised measures that illustrate the effectiveness and overall performance of Procurement. These measures are externally benchmarked, allowing comparison with other organisations and can broadly be viewed as; ‘*how effectively the spend is managed for which they are accountable*’.

These measures include;

- a. Overall cost savings (including reduction and avoidance) as a percentage of total spend
- b. Return on Investment (ROI) based on the cost of procurement

Global Procurement uses these benchmarks as a way of assessing and driving performance.

The latest benchmarking provided by Hackett is illustrated in *Figure 8*. The data identifies world class performance for both overall costs savings and ROI.

Figure 8: Hackett Procurement Benchmark (2018)

In line with the above, National Grid has aligned its procurement objectives to these benchmarks, reinforcing the competitive value required in execution of the SSP process and category management work.

- **Overall cost savings as a percentage of total spend** – ensures savings vs spend is proportionate and in line with benchmarks. Our current performance for cost reduction is in line with our target of being >███%.
- **Return on Investment for Procurement** - ensures overall savings vs the cost of Procurement employees (FTE) is proportionate and in line with benchmarks. We are currently operating in line with our target of a ███ ratio, i.e. at the top end of world class performance.

The ultimate test of whether Procurement is delivering efficiency is demonstrated by the cost of delivered work, whether this be seen through NGET's operating costs or network-related capex projects. Evidence of success can be seen in the TNEI Asset Unit Cost Methodology Review annex [A14.02] which identifies that the majority of installed asset unit costs are lower than the relevant European mean benchmark.

5. The Global Procurement Team

To enable all of the above, in late 2017 we restructured the Global Procurement function to drive additional value. We created:

- A Global team to identify and develop strategies with global synergy and to explore:
 - Market Supplier Development opportunities - to work with the businesses and identify and pursue new supplier opportunities more quickly, enabling us to lower costs whilst ensuring we meet the business needs.
 - Supplier Relationship Management - to use the scale of National Grid's collective spend to leverage greater opportunities from key suppliers, improving access to innovation and BAU innovation or joint development of products and services.
- Category Teams to undertake category strategy and sourcing (SSP) activities, enabling the teams to increase their technical knowledge of specific category areas.

- A Contract Management team

Our people are the key to our success; therefore, we ensure that everyone in the department follows a comprehensive training plan. We participate in a Chartered Institute of Purchasing and Supply (CIPS) corporate award programme (in addition to the individual study route), which has seen 15 of our employees gain CIPS accreditation, with plans for a further 14 employees to commence the programme this year. Additionally, each employee has a bespoke development plan to support their personal development.

Alongside this, we have been working to ensure that our Supply Chain Corporate Social Responsibility objectives are aligned with the wider Group and being adopted by our supply chain. These include requiring all our UK Tier 1 suppliers to pay the real living wage (as defined by the Living Wage Foundation). In addition, we are increasing opportunities for a more diverse range of suppliers to participate in the sourcing process; currently 27% of our spend through Tier 1 suppliers and their subcontractors is with Small or Medium Enterprises (SMEs). We also participate in a number of collaborative opportunities and use our influence in relation to a number of initiatives including the EU Procurement Skills Accord, CDP Supply Chain Climate Change Programme and the UNGC working group to address Modern Slavery. We support our supply chain by participating in the Prompt Payment Code and encourage our direct suppliers to adopt these principles with their suppliers.

6. Summary

The performance of Procurement is benchmarked externally to ensure that our processes and strategies are delivering value. The most recent benchmarks with peers show that our operating costs are in the upper quartile for efficiency. In addition, the value driven through global procurement activities is contributing to the operating costs of NGET's business and network capex unit costs – both of which have been evidenced as efficient (please see Chapter 14 of our T2 plan submission).

We receive regular feedback from our Supply Chain and we have incorporated this into our thinking for future projects which will be delivered in the T2 period. This feedback is driving greater and earlier collaboration with suppliers, use of NEC4 Contract terms, simplified tendering and greater use of outcomes-based incentives through adopting Project 13 principles.

The learnings and best practices from the T1 period will continue to be developed embedded into our processes to ensure we remain efficient throughout the T2 period. In order to maintain our upper quartile performance, we need to build on our learning culture to continuously improve our processes and their application.