

Authority to enter into a non-competitive contract with Ernst & Young to support Category Management and Strategic Sourcing

Date: November 16, 2020
To: General Government and Licensing Committee
From: Controller and Chief Procurement Officer
Wards: All

SUMMARY

This supplementary report is to support the request for the approval of a non-competitive contract with Ernst and Young LLP (EY) for continued support of Purchasing and Materials Management Division's (PMMD). This contract will enable PMMD to accelerate the adoption of Category Management and Strategic Sourcing strategy which was successfully piloted through the original competitive contract with EY.

This report also considers other staffing options to deliver the proposed strategy using some combination of reorganization, contract or permanent staffing decisions.

This proposed non-competitive contract will deliver up to \$110M in annual benefits with an investment of up to \$8.9M all while enabling PMMD and the City to continue our transition to be a self-sufficient best in class procurement organization. This represents a return on investment of over \$100M in less than 18 months. A significant portion of the investment is tied to the achievement of results through a success fee model. Success fee is intended to ensure that EY is incentivized to help the City maximize the benefits. EY will only be compensated for the success fee if the benefits identified are realized by the City. Also, the rationale for undergoing this transformation include recommendations from past reports, Auditor General Findings, value for taxpayer's dollars and to ensure that we are paying fair market value for the goods and services the City procures.

To date, EY has helped us achieving \$41M in annual benefits with an investment of \$4.5M, for a return of \$36.5M in the first 2 years. For clarity purposes, the report on GL16.4, indicated \$41M in annual savings but should have said annual benefits, as the benefits achieved can be a combination of cost avoidance and cost reduction plus other qualitative benefits. In addition the realization of these benefits will occur over the life of the contract and may change depending on how the contract is utilized.

The City is still in the midst of developing its capability to execute on procurement more strategically. The proposed contract is intended to deliver significant additional benefits

and build further knowledge and capability in the City. Furthermore, their support is critical to expand existing PMMD resource capacity to operationalize key elements of the procurement transformation that will help unlock further value and sustain the benefits achieved in the process.

Core components of the transformation include the continued standing up of the CMSS Unit, creation of processes for Category Management, Supplier Relationship Management and Contract Management as well as the development of all the training material and the delivery of the training, the governance framework and approval processes to ensure visibility and oversight at the right levels of leadership are maintained with respect to categories and the sourcing opportunities and reporting on the benefits of the sourcing projects and category performance. This occurs while PMMD continues recruiting for both CMSS and PMMD's new Program Support unit.

EY provides access to expertise and resources that the internal City staff does not possess or have access to at this time. Some of the key attributes of EY's value for the City are the following:

- Local and global resources with subject matter knowledge
- Subject matter experience on various spend categories, some of which is not readily available in the marketplace
- Proprietary tools and templates (e.g. Compliance IQ, EY Process Benchmarks etc.)
- Advanced data analytics tools and expertise (e.g. Alteryx modelling and Power BI visualization)
- Market intelligence (e.g. leading practice commercial constructs and supplier capability information through EY's global network)

EY will help us in two key areas:

1. Complete the procurement transformation journey to make the City self-sustainable and best in class procurement organization. This will include developing and implementing processes and strategies that directly relate to the key components of the procurement transformation.
2. Deploy a team of resources on the ground and from around the globe (subject matter specialists) to help complete some of the largest and most complicated procurements at the City that will deliver an annual benefits of \$110M. This includes a success fee component such that part of EY fees are held back until benefits are confirmed by the City staff. This will help incentivize EY to generate higher benefits for the City as noted above, PMMD will continue to recruit for positions as part of the overall reorganization journey PMMD has been on. It is not possible, however, to recruit fast enough, be able to create the deliverables and work with the Divisions on strategic sourcing events in a way that would achieve the benefits within 17 months as it would be to work with EY.

RECOMMENDATIONS

The Controller and the Chief Procurement Officer recommend that:

1. City Council authorize the Controller to negotiate and enter into an amending agreement with Ernst & Young LLP to continue supporting Purchasing and Materials Management Division's Category Management and Strategic Sourcing initiative by increasing the value of the contract from \$1.0 million gross (\$1.018 million net of HST recoveries) by an additional \$8.985 million gross (\$9.143 million net of HST recoveries) to a potential upset limit of \$9.985 million gross (\$10.161 million net of HST recoveries) broken down by:
 - a. adding \$3.485 million gross (\$3.546 million net of HST recoveries) for consulting services related to developing category governance, improving reporting, strategic sourcing support and the development of a supplier relationship and contract management framework;
 - b. including a 5% success fee for EY's support in obtaining an estimated 110 million in benefits from category management and strategic sourcing events for an upset limit for a success fee of \$5.5 million (\$5.597 million net of HST); and
 - c. extending the term of the agreement to May 31, 2022

FINANCIAL IMPACT

The financial impact is overall set out in GL16.4. With the deferral, the cash flow for this contract is expected to shift from November 2020 to March 2022 to now effectively January 2021 to May 2022.

The Chief Financial Officer and Treasurer has reviewed this report and agrees with the financial implications as identified in the Financial Impact section.

DECISION HISTORY

At its meeting on October 5, 2020, General Government and Licensing Committee deferred GL16.4 - "Authority to Enter into a Non-competitive Contract with Ernst and Young to Support Category Management and Strategic Sourcing" to the November 30, 2020 meeting and requested the City Manager to report to the November 30, 2020 General Government and Licensing Committee on options to achieve the desired savings through some combination of reorganization, the hiring on permanent staff and the hiring of contract staff.

<http://app.toronto.ca/tmmis/viewAgendaItemHistory.do?item=2020.GL16.4>

COMMENTS

Category Management and Strategic sourcing was introduced in 2018 as a piloted approach to change the manner in which the City procures goods and services in a more strategic forward-looking approach from the more traditional procurement processes and techniques in place at the time. It reflects a growing desire to establish a more proactive and value driven relationship with the City's vendors. As was mentioned in GL16.4, this strategic approach was stood up from nothing over the past 2 years with the creation of a team within PMMD which, with the support of EY and PMMD's divisional partners, generated \$41M of benefits for the City at a cost of \$4.5M. It is PMMD's plan to learn from the results of this very successful pilot and accelerate the City's acceptance of the Category Management and Strategic Sourcing approach to procurement across all the City's Divisions. In order to achieve this objective, PMMD will be required to develop certain specialized tools and training materials, will have to obtain resources and skills to work through the pipeline of opportunities and develop new opportunities. The remainder of this report considers the two options (Option 1- Continue with support from EY. Option 2- Build this ourselves) to achieve this goal.

Option 1. Extending EY contract to support Category Management and Strategic Sourcing and to continue to assist in the modernization of Purchasing and Materials Management Division

As explained in GL16.4, EY was retained to support the implementation of Category Management and Strategic Sourcing in PMMD, as a means to become a strategic partner for City Divisions to be able to drive benefits through managing categories of goods and services the City purchases (such as Construction or I&T) and to approach sourcing events in a strategic way to achieve cost benefits in the form of cost savings or cost avoidance. During the initial contract which was valued at \$4.5 million, EY was able to help the City achieve \$41 million in benefits from strategic sourcing events, an overall net benefit of \$36.5 million.

Given the City's current financial situation and the success that has been achieved to date, Staff are recommending that we continue to have EY continue to support PMMD in two ways. First, through the development of key deliverables to support the governance and reporting on Category Management and Strategic Sourcing, Contract Management and Supplier Relationship Management, as well as developing specific Category Strategies for the City's largest categories of spend.

And second, through the continued support of Category Management and Strategic Sourcing by as together working with the City Divisions on further strategic sourcing opportunities in order to achieve an additional \$110 million in benefits over a 17 month period. This work will continue as Purchasing and Materials Management continues the recruitment and onboarding of procurement professionals for the CMSS Unit and the development of the Program Support Unit. This is part of PMMD's overall strategy to move from taking a transactional and reactive approach to procurement to become a strategic value added partner to the City Divisions in both how we approach procurement as well as supporting Divisions in how they manage contracts and

important Supplier relationships. We note that the Auditor General considers the ability of the City to better manage its procurement contracts as a key theme in a number of Auditor General reports.

Deliverables

As part of the extension EY will deliver the following 5 deliverables:

- Establish Category Governance Process and Roadmap - Setting the proper process between PMMD and the Divisions to ensure target benefits are achieved from Category Strategies;
- Reporting Tools- Develop reporting on benefits tracking with associated dashboards;
- Develop Supplier Relationship Management Playbook - Designing and implementing supplier relationship management processes to help achieve full value from key supplier relationships, and developing the training material for the City to use moving forward;
- Developing Contract Management Playbook - Designing and implementing contract management processes to help sustain value from strategic sourcing, developing the training material for the City to use moving forward and piloting three contracts using modelling data to ensure that benefits are achieved; and
- Developing Category Management strategies for the top three categories of spend (Construction, I&T and Facilities Management) to drive longer term benefits.

The five deliverables will be delivered within the term of the contract for the total combined one-time fee of \$1.6 million. The deliverables have a fixed fee, so regardless of the amount of hours it takes, EY will be required to provide the deliverables to the satisfaction of PMMD.

Currently PMMD does not have the right resources in order to be able to complete all of these deliverables within a 17 month period. As part of the Procurement Transformation, PMMD will be building and recruiting for a Program Support unit that will have the appropriate resources to utilize these deliverables to further PMMD's ability to develop, monitor and train staff on new procurement policies and procedures and to be able to assist Divisions with respect to supplier relationship management and contract management.

By having EY work with PMMD to create the above noted deliverables, PMMD will be able to leverage EY to bring leading procurement practices that take into consideration jurisdictional scans and set PMMD up to roll out the deliverables quickly once we have the appropriate resources in place. The deliverables for the Supplier Relationship Management Playbook and the Contract Management Playbook will help PMMD respond to the Auditor General's recommendation from AU3.16 - Audit of Interface Invoice Payments - Improving Contract Management and Payment Processes, and also assist Divisions respond to their own Auditor General recommendations related to contract management. With respect to the Category Management strategies, PMMD has not developed these strategies before, and working with EY will allow the CMSS unit to learn while doing, and set PMMD up to be self-sufficient for further category strategies.

Strategic Sourcing

As noted in GL16.4, PMMD and EY have worked with Divisions to identify additional strategic sourcing opportunities that can be pursued and has the potential to achieve an additional \$110 million in benefits in the form of either cost savings or cost avoidance.

The overall strategy since the beginning of PMMD's transformation was to have EY help develop the appropriate Category Management and Strategic Sourcing procedures and processes with PMMD and to work with PMMD and Divisions to conduct strategic sourcing events in order for PMMD to be able to learn to do it ourselves. As PMMD has grown the CMSS unit, the recruitment of these category management and strategic sourcing professionals has taken longer than expected to have the full team in place. While the recruitments receive high numbers of applicants there are very few in the marketplace who meet the criteria the City requires in particular with the experience in strategic sourcing for the categories. The initial recruitment of the CMSS team started in 2017 with the recruitment of the Project Director, Category Management. This process took three attempts to arrive at a successful candidate in November 2018, which was 7 months after EY initially started. Subsequently the hiring of three Category Managers and 5 Category Leads also took several attempts over the course of 2019 and 2020. While the hiring has been successful for the Category Managers and Category Leads, it did not mean that they were ready to start day one. There was a steep learning curve with respect to learning about how the City operates and how the new procurement process will interface with City Divisions. Hiring in 2020 has also been slowed down due to the City's response to COVID-19 and the associated hiring slow down. There are still 5 positions to hire within the CMSS unit.

The caliber of Category Management and Strategic Sourcing professionals that have been hired all have the experience and background required to execute on the mandates of the role and the objectives established. The current team is working alongside the EY team who has been instrumental in identifying the sourcing opportunities within the categories while the Category Managers and Category Leads carry out the execution with their support. As the Unit matures and continues to hire roles into 2021 the dependency on EY will reduce as we move through Phase 2 of the engagement. The intent is to have the Unit fully trained on all of the functions that EY is currently fulfilling during the Phase 2 period. This will include further training and development of category management strategies, processes, governance and data analytics. Overall the approach is to continue have EY provide knowledge transfer to the existing CMSS staff and to the new staff such that our dependency on EY reduces and we are able to handle all aspects on our own.

When working on strategic sourcing events, often the procurements take longer in the planning stages to work through the proper strategy. With EY's help, PMMD will have more resources to be able to quickly shift to other opportunities if specific opportunities are delayed for various reasons, such as the client Division not being ready. Opportunities need to be assessed and researched and EY, with its global network, will be able to provide the required information quickly to ensure that the \$110 million in benefits is achievable.

As noted above, PMMD will continue to recruit for positions in both the Program Support unit and in the CMSS unit as part of the overall reorganization journey PMMD has been on. It is not possible, however, to recruit fast enough, be able to create the deliverables and work with the Divisions on strategic sourcing events in a way that would achieve the benefits within 17 months as it would be to work with EY.

Option 2. Internal reorganization, recruitment of temporary contracts and permanent staff without EY Support

In evaluating this option, staff have noted that the deliverables (tools, processes and materials) identified above in Option 1 are necessary for the prudent management of a Category Management and Strategic Sourcing procurement approach and as such considered how to implement a similar suite of tools, processes and materials in this option. Staff will also consider how to deliver the strategic sourcing effort that EY has committed to provide.

Staff have considered the option of reorganizing from within PMMD and across the various City Divisions that have a significant procurement footprint or sourcing the appropriate skill sets from recruitment together. Staff have also considered a recruitment plan that would provide the necessary skills, experience and time to develop the tools and deliverables that EY will provide and an equivalent amount of support for the strategic sourcing events that the contract anticipates in a manner that is consistent with PMMD's experience in recruiting for these type of skill sets over the last two years..

It should be noted that the current team within PMMD that would be considered competent to lead this type of initiative is currently very small (9) and is fully occupied with in-flight strategic sourcing initiatives. As such recruitment activities and the development of tools, processes and materials would necessarily mean that current in-flight strategic sourcing efforts would be paused or severely curtailed.

Deliverables

In staff's discussions with EY regarding the deliverables, we have noted the content and sophistication of the tools, processes and materials that will be provided and anticipate that a similar suite would require 5 additional Full-time staff resources. These resources would include; 3 financial analysts/modelling specialists (specialized in cost modelling & market intelligence scanning in the supply chain field of expertise and contract negotiations) and at least 2 change management resources to develop processes, procedures, training content and delivery of the training who are specialized in supply chain. This level of staff would additionally require an additional management resource.

The annual cost estimated for this staff would be \$650,000-\$725,000. In addition to the resourcing requirements financial investments in subscriptions to market intelligence tools with global footprint and other supply chain industry memberships will be required. Assuming the recruitment experience that PMMD has had in this area as a guide, these staff are assumed to be in place and functioning as a team within 12-18 months. The development of the tools, processes and materials will take an additional 18 to 24 months.

In summary, it is staff's estimate that to put the tools, processes and materials in place to support an ongoing CMSS strategy, the City would be required to hire staff with an estimated annual cost of at least \$650,000-\$725,000 and delay full implementation of those tools, processes and materials for up to 30-42 months.

Strategic Sourcing

To be comparable to the plan in Option 1, staff will be required to provide an equivalent amount of effort to the 15,500 hours committed by EY. It should be noted that the personnel who are providing the effort committed by EY are experienced in the development of strategic sourcing plans, already have in-depth knowledge of the City's operations and are only utilized specifically on opportunities for which they have expertise (i.e. subject matter experts). We would also note that the City would not be charged for hours that are not directly related to service delivery. To accommodate for this efficient level of effort that the skill set provided by the EY staff, staff estimate that an equivalent number of hours provided internally would be approximately 20% higher which equates to 18,600 hours over 17 months for an approximate annual cost of \$770,000. The 5 resources (3 analysts and 2 change management resources) mentioned under Deliverables is above the 5 full time resources already in plan to recruit for 2021 in the capacity of Category Manager, Category Leads and Sourcing Specialists.

Whereas Option 1 has the resources available to the City immediately, under Option 2, the ability of the City to ramp up its ability to meet the strategic sourcing opportunities is dependent upon the City's ability to recruit individuals with the right experience. As mentioned previously recruitment of this type of individual is difficult to achieve in the marketplace such that the successful recruitment of each employee takes a minimum of six- nine months to recruit and six months to be familiar enough with the City operations to function at the level necessary to be comparable to the effort being provided under Option 1. Further, Option 2 continues to draw management resources away from the Strategic Sourcing events in order to recruit and train new employees. Under this option, the City's ability to respond quickly to Strategic sourcing opportunities would be severely curtailed.

In summary, the option of obtaining the resources necessary to deliver the necessary tools, processes and material to support the ongoing success of Category Management and Strategic Sourcing and deliver the effort necessary to meet the opportunities identified in the pipeline through recruitment would cost the City approximately \$1.5M on an annual basis. This option would also delay the implementation of the Category Management and Strategic Sourcing plans of PMMD until late 2022 or early 2023. The

full implementation of all the aspects of Category Management such as contract management and supplier relationship would not be in place until 2024.

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