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| **Subject** |  | Good practice when using the Price quality method of supplier selection |

## Introduction

The price quality method of supplier select (PQM) is described in the NZ Transport Agency’s [Procurement manual](https://www.nzta.govt.nz/assets/resources/procurement-manual/docs/procurement-manual-amendment-4.pdf) in Appendix C. This note presents additional advice on the use of PQM, focussing on issues that commonly arise and need to be addressed by a tender evaluation team. This note does not repeat the advice that is already included in Appendix C.

Much of what is discussed in this practice note applies to other supplier selection methods – not just PQM.

This note:

1. Offers advice to guide practice when replacing supplier quality premium (SQP) values – as permitted under PQM.
2. Advises against one particularly undesirable practice that is occasionally adopted when replacing SQP values – a practice that can produce a perverse result.
3. Provides advice on a number of other tools that can be used with PQM.
4. Reminds purchasers that the circumstances under which a tenderer’s proposal may be rejected / failed must be spelt out in the request for proposals (RFP), because the Procurement manual does not define the criteria for rejection.

## Summary

The points made in this note include:

1. The procurement manual offers a range of methods that allow selection on price alone (providing minimum criteria are met), selection on supplier quality alone (price to be negotiated) and on both price quality - PQM trades price and quality – refer Procurement manual Appendix C and Chapter 5.
2. Under PQM the amount more that the approved organisation is prepared to pay for a higher quality supplier (the SQP) is determined by a formula – refer Procurement manual Appendices C and H
3. Sometimes the SQP values will be very large – this is seen as a problem by many but it is no more than a consequence of the method (including its detailed design by the purchaser) and the range in ‘quality’ of the proposals received.
4. SQP values must be reviewed and can be replaced – refer Procurement manual Appendix C – Step 4 in the process.
5. Replacement will likely cause tenderers to doubt the integrity of the supplier selection process and will increase the probability that it will be questioned.
6. Replacement needs to be done with care to ensure that it is legally acceptable.
7. Careful design of the supplier selection process, using the tools discussed below, will help to avoid any need to replace SQP values.
8. Replacing by scaling SQP values has been used and may be acceptable in exceptional circumstances.
9. Fail criteria must be set out in the RFP
10. The estimate must be included in the RFP when using PQM – refer Procurement manual page C-7.
11. As is the case with all procurement practice, approved organisations must comply with their administrative law obligations including the obligation to be fair and reasonable in their dealings with all tenderers. They must also be prepared to give reasons for decisions made. The Transport Agency considers that it is good practice to offer, through the RFP, to give feedback to unsuccessful tenderers and to do so promptly when asked.

## SQP values may be replaced under exceptional circumstances

SQP values, as calculated at Step 3 in the PQM process, may be ‘replaced’ following ‘review’. This is permitted at Step 4. However, replacement should only be resorted to under exceptional circumstances. Legal advice would normally be sought because replacement presents a high risk of legal challenge. The purchaser must be able to give good reasons for replacement and good reasons to support the new values. Refer Procurement Manual Appendix C part C.5 *Price quality* under the heading *Confirming the supplier quality premium*.

## Do not arbitrarily cap the maximum SQP value

Large SQP values are sometimes replaced by a cap – a maximum value. Such an approach is irrational because the size of the largest SQP value calculated in a PQM evaluation is a function of the relative quality of the suppliers that submit proposals.

The following example demonstrates the type of problem that can arise when a cap is applied. If all proposals received are of a similarly exceptional quality and consequently are all given scores in the range 80 to 90 on all non-price attributes the SQP values will be small. If on the other hand one of the tenders is of low quality and has a very high tender price - receiving scores around 40 for all non-price attributes - the SQP values for all the exceptional quality tenders will become relatively large numbers.

Replacement of the calculated SQP values for the high quality suppliers with a lower ‘cap’ will simply ensure that the lowest priced tender becomes the preferred tender. The introduction of an irrelevant factor – a low quality high priced tender – has eliminated the purchaser’s original intent to trade price and quality.

Replacing high SQP values with a maximum or ‘cap’ value is probably illegal given its arbitrary nature and its ability to produce a perverse result.

## Scaling SQP values

Purchasers have been known to address a perceived problem of large SQP value(s) by scaling down the calculated SQP values by multiplying all by a constant less than 1.0. Providing the purchaser has a rational explanation for why the scaled SQP value for the higher quality proposals represent more than they are willing to pay for the additional quality offered by the higher scoring suppliers, compared to the lowest scoring supplier, scaling may be able to be legally defended. However, replacement by scaling will likely cause tenderers to doubt the integrity of the supplier selection process and will increase the probability that it will be questioned.

Scaling has a very similar effect to changing the price weight. Every effort must be made to get the price weight, and the non-price weights, right before publishing the RFP. The Procurement manual provides advice to help set an appropriate price weight before going to the market, refer Procurement Manual section 5.4 *Supplier selection processes*. An[*Attribute weight setting tool*](https://www.nzta.govt.nz/assets/resources/procurement-manual/docs/attribute-weight-setting-tool.xls) is available through the Transport Agency’s website along with other tools and advice around [supplier selection](https://www.nzta.govt.nz/resources/procurement-manual/procurement-tools/#supplier).

## Using a higher ‘fail’ grade

Using a ‘fail’ grade higher than the traditional 35 may reduce the range of SQP values because lower quality suppliers are either discouraged from entering the competition or are ‘failed’.

If a purchaser uses a higher fail grade they need to be sure that they can categorically say “we will not do business with someone who scores under XX on any attribute regardless of the price they tender“. A tenderer who offered a price less than the winning price but was failed on a non-price attribute and consequently rejected, could go public on their price – so the purchaser needs to be confident that you can say that “we will not do business … etc”. ‘Raising the bar’ in this way is nevertheless rational in certain circumstances.

## Note that fail criteria must be advised through the RFP

The fail grade to be used in a proposal evaluation, and more generally the criteria that will be used to establish a fail threshold, must be advised through the RFP. The Procurement manual does not specify a fail grade - it is up to the approved organisation to do that. Refer Procurement manual section 10.14 – in particular part 3 of the rule and the guidelines.

Establishing sound fail criteria is one of the means by which an approved organisation will reserve the right to reject a proposal on the basis that it is low in quality, based on non-price attribute scores. Short listing, discussed below, is another way to help ensure that a low quality tender is not accepted.

## Attributes can be judged on a pass / fail basis only

Purchasers can choose to weight (and grade) some attributes and use a pass / fail test only on others. This will allow greater weight to be given to those attributes that the purchaser wishes to use to differentiate proposals. When designing a PQM evaluation process the option of not weighting some attributes needs to be considered. Refer the [*Attribute weight setting tool*](https://www.nzta.govt.nz/assets/resources/procurement-manual/docs/attribute-weight-setting-tool.xls) on the Transport Agency’s website:

## Price weight is limited to a maximum of 70

Increasing the price weight will reduce the range of SQP values and limit the amount more that could be paid for a higher quality supplier. However, the Procurement manual limits the maximum price weight to 70. An approved organisation that wishes to use a higher price weight, and has a best value for money reason for doing so, can request procurement procedure approval from the Transport Agency. Using a higher price weight may be wise in some circumstances – for example if a pass / fail only test is to be applied to some attributes a total weight of 30 on the remaining attributes may be too large.

Raising the price weight brings PQM closer to the lowest price conforming (LPC) method.

## Short listing

Short listing has a similar effect to raising the fail grade or any other fail threshold.

Procurement manual chapter 5 offers guidance on short listing. Better quality proposals can be encouraged by short listing and the supplier selection process made more efficient. If a limited number of quality suppliers know they are the only ones competing they may make a greater effort when preparing their proposals - leading to better quality proposals and better value for money.

## Testing supplier select process design ideas

As discussed above the Transport Agency’s website offers [tools](http://www.nzta.govt.nz/resources/procurement-manual/procurement-tools.html) for testing supplier selection process design ideas. One very informative way to test such ideas, using the price quality evaluation tool, is to take the tenders previously received for a similar contract and use the prices tendered and scores given for non-price attributes to perform ‘what if’ analyses. Alternative approaches to tender evaluation can be tested - like:

* Short listing to say 3 suppliers based on a limited set of non-price attributes – as if you had used a staged approach to supplier selection, initially requesting information on those non-price attributes alone.
* Using a different price weight – the non-price attribute weights will need to be scaled to ensure that the sum of all weights is still 100.
* Using a pass / fail only test, a ‘nil’ weight, on some attributes – while adjusting the other weights to make sure that the sum of all weights is still 100, possibly by scaling up the weights for the other non-price attributes.