
5.0 Supplier selection process

5.1 Overview

Introduction

This chapter sets out general guidelines on the supplier selection process. All of the supplier selection methods that are available for use by approved organisations are defined in appendix C *Supplier selection methods*.

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5.2 Approach to supplier selection

Introduction

Once an approved organisation has selected an appropriate delivery model and decided how it will be used, it must design the supplier selection process. This chapter sets out general guidelines on the supplier selection process.

This manual describes five supplier selection methods and requires that approved organisations use one of these methods in the supplier selection process. Refer to section 10.13 *Using an available supplier selection method*.

In some approaches to supplier selection, including where a supplier panel delivery model has been adopted, more than one supplier will be selected. This chapter assumes the more common situation, where a single supplier is appointed. However, it should be read to accommodate the plural, where appropriate.

The following sections describe the three approaches that approved organisations can take to competition in the supplier selection process. They are open, closed and direct.

Form of competition

Open

Section 25 of the LTMA establishes that competition is desirable. An open supplier selection process is the 'default' position taken in this manual.

Section 10.8 *Competition for supply* requires that every supplier selection process commences as an open competitive process in which all potential suppliers are invited to engage. The rule then establishes a limited number of exceptions, which are discussed below.

The rule only requires that the process commences as an open competitive process. Where appropriate, the process may be staged, with the initial open competitive process followed by, for example, a shortlisting process. In this situation, the number of potential suppliers remaining in the competition may be reduced to three or four.

Closed

Where the estimated value of the contract is below the prescribed limit for a closed contest, approved organisations can dispense with the requirement for open competition. Refer to section 10.9 *Direct appointment and closed contest for low dollar value contracts*.

Where a closed contest is used, the approved organisation commences the supplier selection process by selecting a minimum of three willing and able suppliers to participate in the competition. The suppliers may be chosen through any appropriate means, although approved organisations are encouraged to use a form of register to identify suitable suppliers to approach. Once three or more suppliers have been selected, the supplier selection process proceeds in the same way as an open competitive process, using an available supplier selection method.

5.2 Approach to supplier selection continued

Form of competition continued

Direct

Approved organisations may directly appoint a supplier in the following situations:

1. The contract is a low dollar value contract (refer to section 10.9 *Direct appointment and closed contest for low dollar value contracts*).
2. The contract is a low dollar value contract and the supplier selection process commences as a closed contest, but only one potential supplier is identified (refer to section 10.9 *Direct appointment and closed contest for low dollar value contracts*).
3. The supplier selection process commences as an open competition, but only one potential supplier is identified (refer to section 10.8 *Competition for supply*).
4. A monopoly supplier situation exists (refer to section 10.10 *Direct appointment of a monopoly supplier*).
5. The requirements for direct appointment are met (refer to section 10.11 *Direct appointment where competition reduces value for money*).

Where direct appointment is used, all contract terms and conditions, including price, will be negotiated with the selected supplier in accordance with the direct appointment supplier selection method.

Use of supplier registers

Approved organisations are encouraged to use a register as a source of names from which to identify a potential supplier(s) when the contract value is within the limits specified in section 10.9 *Direct appointment and closed contest for low dollar value contracts*.

A number of registers are currently available, including ones maintained by industry associations.

A register gives all suppliers the opportunity to indicate their interest and availability to potential purchasers. This mitigates some of the negative effects that closed contests or direct appointments have on open and competitive markets.

Prequalification systems

A prequalification system uses a form of supplier register owned and maintained by an approved organisation or group of approved organisations. Suppliers on a prequalification register must have met the criteria specified by the approved organisation. Suppliers on the register are prequalified for particular types of work or services and are not required to resubmit generic information with every proposal they submit in response to a Request for Proposal (RFP).

A well-designed and well-administered system that is used appropriately can reduce the costs incurred by suppliers and the approved organisation. The number of contracts being let under a prequalification system needs to be significant to justify the cost of establishing and maintaining it. Any approved organisation considering a prequalification system should think about collaborating with neighbouring or otherwise similar approved organisations.

Prequalification systems are usually only used for routine works and services. The supplier selection process for large or complex contracts will usually be managed outside of such a system.

5.2 Approach to supplier selection continued

Prequalification systems continued

The criteria for inclusion on a prequalification register for a particular class of work or service will usually include achieving a 'pass' on a number of the non-price attributes. When the approved organisation issues an RFP for works or services covered by a prequalification system, all prequalified suppliers will be invited to submit a proposal. Such a proposal will be limited to price plus non-price attribute information specific to the proposed engagement and not already assessed and 'passed' by the approved organisation when the supplier 'prequalified'. For example, the RFP may be limited to:

- supplementary resources required for the contract
- work-specific or service-specific methodology
- confirmation of ability to secure a bond if the bond is unique to the work or service
- price.

Using a prequalification system does not fundamentally change the supplier selection process. Rather, it divides the process into two stages. First, suppliers are assessed on limited, generic non-price attribute information and prequalified. Later, when the approved organisation wishes to receive proposals for a particular work or service, an RFP is issued seeking the remaining, engagement-specific, non-price information and price.

The requirement for supplier selection processes to begin as an open competitive process (refer to section 10.8 *Competition for supply*) is met by regularly advertising the existence of the system and inviting suppliers to apply to be prequalified. Advertising every quarter is recommended.

Prequalification systems are typically used with the lowest price conforming supplier selection method and these guidelines have been written on this basis. However, it is possible to use other supplier selection methods with a prequalification system.

The NZTA's Highways and Networks Operations group's prequalification system has been used to achieve benefits beyond process cost reduction, including simplifying the process, achieving more consistency in evaluations and improving supplier performance.

Establishing a prequalification system is a significant step for an approved organisation. The benefits and costs need to be carefully considered. Any approved organisation contemplating such an approach should treat the decision as a strategic procurement decision. As such, the NZTA would expect the approved organisation to address the introduction of such a system in its procurement strategy.

Note that a supplier prequalification system and a supplier panel delivery model are sometimes confused. The fundamental difference relates to the way in which suppliers are placed on a panel as opposed to a prequalification register. To be on a panel, a supplier must compete against others and win a place; to be on a prequalification register, a supplier only has to meet the specified criteria.

5.3 Staged supplier selection processes

Introduction

Staged supplier selection processes separate the process into two or more stages. Providing the process remains fair to all and transparent, adding stages can help deliver better value for money by reducing administration costs. Approved organisations should consider using a staged supplier selection process if it is likely to deliver better value for money.

Shortlisting is one example of a staged process (see further discussion below).

A request for an expression of interest (EOI) or a request for information (RFI) stage (or both) can be used to improve the supplier selection process.

An EOI stage may be used to simply gather names and contact details to speed later stages or to gauge the level of interest in supplying. High-level information may be sought to help design the later stages of the supplier selection process. The approved organisation may also choose to consult, either individually or collectively, with those who have expressed an interest to help refine the subsequent process stages. Adding consultation with potential suppliers to the process is commonly referred to as 'interactive tendering'.

An RFI stage may be the first stage in a supplier selection process or may follow an EOI stage. Information gathered may be used to help design the later stages of the supplier selection process as described above, or more commonly to establish a shortlist of suppliers to participate in an RFP stage.

Shortlisting

Consider shortlisting if it will reduce the total cost of the supplier selection process. However, before deciding to shortlist, take into account:

- cost to potential suppliers and the approved organisation
- time savings (urgency)
- the features of the output to be purchased and the supply market (ie consider differences in quality and in the price of the outputs between suppliers).

Reducing the total process cost to suppliers (by excluding some from the competition by shortlisting) is not a sufficient reason to shortlist. If the cost to the approved organisation of including another supplier on the shortlist is marginal, then that supplier should generally be included. The LTMA establishes that it is desirable to encourage competition and therefore exclusion (by shortlisting) must be justified. The interests of suppliers who are unlikely to meet the purchaser's criteria are best served by designing the supplier selection process to provide them with the information they need to decide whether or not to stay in the competition.

Notwithstanding the above, reducing the administrative cost to the approved organisation of evaluating more proposals is a sufficient reason to shortlist if the cost outweighs the anticipated benefit of receiving more proposals.

The number of potential suppliers to be shortlisted must be sufficient to maintain competitive tension. Good practice suggests that three is a sensible minimum for a shortlist, although sometimes (eg when using a competitive alliance) two adequately incentivised suppliers will be sufficient.

5.3 Staged supplier selection processes continued

Shortlisting continued

Non-price information only will be used to determine which suppliers should be included on the shortlist. The usual method employed to do this is in effect a partial use of the chosen supplier selection method.

The purchaser nominated price, price quality and quality based supplier selection methods can all be used in combination with a shortlisting process. Information for some of the non-price attributes will be sought. Typically, methodology information will not be sought. These non-price attributes will be graded and a weighted sum of the non-price attribute grades determined from this partial evaluation process. The shortlist will be made up of those suppliers with the highest 'partial' weighted sum of the non-price attribute grades.

The shortlisted suppliers will then be asked to prepare a response to the RFP. Non-price information submitted would not normally duplicate what has already been supplied and on which the shortlisting was based. However, the approved organisation may decide to allow suppliers to elaborate on their initial submission. The approved organisation's evaluation team will then complete the evaluation process, only revisiting non-price attributes evaluated in the shortlisting stage if necessary. This second stage of the evaluation will give a final (complete) weighted sum of the non-price attribute grades on which to base selection of the preferred supplier.

Under some circumstances, having established a shortlist by using the early steps in the price quality supplier selection method, the purchaser may choose to complete supplier selection using the lowest price conforming method. Such an approach would need to be described in the RFP.

5.4 Supplier selection methods

Introduction

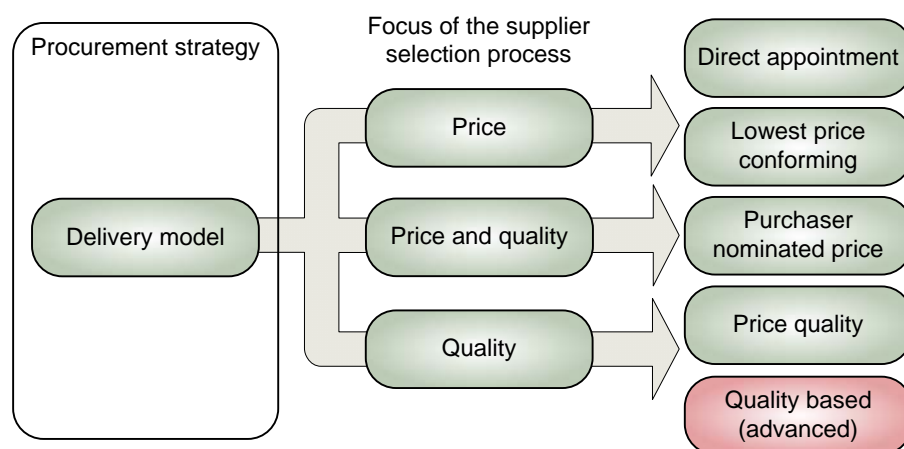
This manual contains the following supplier selection methods:

- direct appointment
- lowest price conforming
- purchaser nominated price
- price quality
- quality based.

Each of these supplier selection methods is defined in appendix C *Supplier selection methods*. An approved organisation must use one of these supplier selection methods when purchasing outputs for activities funded under s20 of the LTMA.

As shown in the following diagram, these supplier selection methods have been grouped to assist approved organisations to assess the relative importance of price and quality:

- Focus on price – all participants must meet quality requirements and the supplier is then chosen on the basis of price.
- Focus on both price and quality – the quality attributes of the suppliers are graded and the preferred supplier is selected by balancing price and quality.
- Focus on quality – the preferred supplier is selected on the basis of quality, with the price being negotiated afterwards.



Competition on price

The lowest price conforming and price quality supplier selection methods include competition on price. To ensure that price competition is fair those outputs which suppliers are asked to price must be very well specified. The risk of claims for works or services that were arguably not required will be high if the outputs that are to be priced are not unambiguously described in the RFP.

5.4 Supplier selection methods continued

Introduction continued

Professional services are often very difficult to precisely describe and therefore any price competition has to be carefully managed. The NZTA expects that use of the lowest price conforming supplier selection method to select a professional services supplier will be rare. The price quality method of supplier selection is better suited to the purchase of professional services because the purchaser can distinguish between suppliers on the basis of their quality attributes, including their experience, skills, track record and their understanding of what the purchaser requires, but again the outputs which suppliers must price have to be specified precisely.

Non-price attributes

Section 10.14 *Non-price proposal evaluation attributes* sets out how an approved organisation must use the defined non-price attributes to evaluate proposals.

Non-price attribute definitions

The non-price attributes defined in section 10.14 *Non-price proposal evaluation attributes* are:

- relevant experience – the supplier’s previous experience in technical areas relevant to the outputs being purchased
- relevant skills – the competence of the personnel that the supplier proposes to use, with particular regard to their skills and experience in areas relevant to the outputs being purchased
- methodology – the procedures the supplier proposes to use to achieve the specified end result
- track record – the supplier’s record of delivering works or services to the quality standards required, on time and within budget
- resources – the equipment, including facilities and intellectual property, that the supplier proposes to use to deliver the outputs
- financial viability – the supplier’s ability to access the financial resources required to deliver the outputs to be purchased.

Each of these is described in further detail below.

Relevant experience and track record

These two attributes should not be confused.

Track record does not have to be demonstrated in delivering the types of works or services similar to those for which proposals are sought – it is simply about the reputation of the supplier for ‘delivering’. Relevant experience on the other hand is about experience that is ‘relevant’ to the works or services.

There is also a difference in focus on who must have the experience and who must have the track record. For track record, it is the track record of the supplier that is important; with relevant experience, both the supplier and the personnel that will deliver the works or services should be considered. Whether the supplier’s experience or the experience of the personnel is more important will depend on the type of works or services being purchased.

Track record is not one of the three required non-price attributes but, in many instances, it will be an essential attribute and a supplier’s reputation for delivery will effectively be a prerequisite for selection.

5.4 Supplier selection methods continued

Non-price attributes continued

Relevant skills

In some instances, the nature of the works or services to be delivered will suggest that relevant skills should be split into two – technical skills and management skills. Where this is done, the above definition for relevant skills will still apply but the descriptions of the two attributes in the RFP will reflect the purchaser's desire to consider these two skill areas separately.

Methodology

Unlike the other non-price attributes, methodology focuses primarily on the output to be supplied and on how the supplier proposes to deliver that output. Other attributes focus more on the characteristics of the supplier and on the resources (including the human resources) that are to be employed to deliver the output. Methodology can include the way in which the price is calculated.

Where the output is a durable asset (a physical work), methodology can significantly influence its delivered quality, including its whole-of-life cost. This is more true of some delivery models than others – the more room the supplier has to be innovative, the more influence they are likely to have on final output quality. Through the RFP, approved organisations can ask potential suppliers to demonstrate how their proposed methodology minimises whole-of-life costs over the output's life or contributes to value in some other way.

The distinction between the supplier and the output to be delivered is further discussed in section 10.16 *Alternative proposals* and section 10.17 *Added value premium*.

When evaluating aspects of proposals that are related to output rather than a supplier, and an added value for money premium is to be applied, an approved organisation should not 'double count' by also awarding a grade that reflects the added value of the output.

Resources

Given the definition of resources as the equipment that the supplier proposes to use, this non-price attribute is not usually included when proposals for professional services alone are being sought.

Financial viability

Approved organisations may seek information on the financial viability of potential suppliers and reject proposals that fail to meet criteria set out in an RFP.

An approved organisation may review the financial viability of potential suppliers to assess their ability (and the ability of any significant subcontractors) to remain viable through the contract period. The objective is to determine whether a supplier has the financial capability and capacity to establish and manage the contract, including any change requirements.

5.4 Supplier selection methods continued

Non-price attributes continued

The first step in any financial viability review will be to clearly identify who the contracting organisation will be. Any other organisations that will be involved in delivering services under the contract (eg major sub-contractors or other partners) will need to be identified and their financial viability will also need to be considered. The relationship between these organisations and the contracting organisation will need to be assessed, along with any resulting implications for the financial viability of the potential supplier. For example, if the contract is with one organisation, but the work will be performed by two organisations as a joint venture, both organisations should be evaluated and a certain weighting assigned to their scores.

Complete assurance of longevity can never be obtained. There are external factors, such as macroeconomic and industry changes, that will be outside the supplier's control and the scope of the evaluation. Other areas such as strategic and managerial changes are however controllable to a large extent.

An evaluation of financial viability will primarily focus on historical information as a predictor of whether the potential supplier has the resources and funding capability (or borrowing capacity) to manage the contract as well as its current business. Such a financial viability review will concentrate on:

- the strength of the balance sheet
- the profitability of the potential supplier
- the liquidity of the potential supplier
- the gearing (debt to equity ratio) of the potential supplier
- the ability of the potential supplier to provide a bond if required (refer to section 10.22 *Supplier bonds*).

An approved organisation may request financial information from potential suppliers through the RFP, which may then be used to calculate several various financial ratios. Publicly available information may also be used where available.

Where a financial viability non-price attribute is included, it will normally be evaluated on a pass or fail basis against one or more specific criteria set out in the RFP.

The importance of relevance

When evaluating proposals, it is important to consider how a potential supplier's proposal is relevant to the nature of the output to be purchased. For example, where an output can be delivered by personnel with a relatively modest level of skills and experience, awarding a higher grade for a non-price attribute because a supplier is offering personnel whose skills significantly exceed the minimum required may not be justified.

Setting non-price attribute weights

Appropriate attention must be given to setting the weights for the non-price attributes. They impact on the outcome of the proposal evaluation process by establishing the relative importance of the non-price attributes that are to be graded. Weights must be advised through the RFP.

5.4 Supplier selection methods continued

Price weight considerations

The price quality method

The price quality method of supplier selection is the one supplier selection method that uses a price weight. It balances (or trades off) price and quality by use of a formula. It enables the purchaser to pay more for a high-quality supplier, and clearly shows the process the purchaser goes through to decide how much more to pay. It is a sensible method to use when the quality of the supplier is important and a trading of price and quality is practically possible through the supplier selection process.

The influence of price weight on supplier quality premium

The formula for calculating the supplier quality premium value for each proposal when using the price quality method of supplier selection is:

Supplier quality premium = estimate * (weighted sum margin / price weight)

The following table shows the relationship between price weight and supplier quality premium. The supplier quality premium (\$s) per grade point figures are based on an estimate of \$100. They are the amount by which the supplier quality premium value (for a particular proposal) will change when the non-price attribute grades, for every non-price attribute to be graded, is increased by 1 grade point.

Price weight	Supplier quality premium (\$s) per grade point
10	9.00
20	4.00
30	2.33
40	1.50
50	1.00
60	0.67
70	0.43

The impact of using a different price weight can be substantial. Supplier quality premium values when using a price weight of 10 are 21 times as large as those calculated when using a price weight of 70 (all other things being equal). Changing the price weight by just 10 (eg from 70 to 60) increases the supplier quality premium values by a factor of 1.55, while using 10 rather than 20 multiplies the values by 2.25.

To illustrate these points by way of example – if two proposals are received and the non-price attributes to be graded are each awarded 75 points for the superior supplier and 70 for the other supplier (a 5 point difference for all graded non-price attributes), the supplier quality premium for the superior supplier will be equal to 2.14 percent of the estimate when a price weight of 70 is used, 20 percent when a price weight of 20 is used and 45 percent when a price weight of 10 is used.

5.4 Supplier selection methods continued

Price weight considerations continued

The effect of price weight on a supplier's decision to enter a competition

A supplier's decision to enter (or not enter) a competition is likely to be strongly influenced by the price weight advised in the RFP. Suppliers who have a higher price structure but offer a higher quality of service will sometimes choose not to compete when the price weight is relatively high, recognising that their chances of winning against a supplier with a lower price structure are small. Conversely, when the price weight is high, suppliers who prefer to compete on price alone (rather than on quality) will be encouraged to enter the competition.

Alternative to a low price weight

If quality is a primary consideration and the proposed price weight is therefore less than 25, an approved organisation should consider using the quality based supplier selection method. There is a risk with a low price weight that an approved organisation will pay more to engage a high-quality supplier than it would if the price were negotiated.

The quality based supplier selection method also gives great flexibility through the negotiation process to tailor the contract, including the price methodology, between the purchaser and the supplier. The resulting contract is therefore more likely to enable the purchaser to obtain best value for money.

Alternatives to a high price weight

If the price is of paramount concern, and the proposed price weight is 60 or 70, an approved organisation should consider using the lowest price conforming supplier selection method. To ensure that the supplier engaged will deliver a quality output and meet the required quality standards, an approved organisation should clearly define in the RFP its minimum quality standards for the supplier and for the output to be delivered.

The purchaser nominated price supplier selection method may also be a suitable alternative to the price quality method in some circumstances. Under this method, price is controlled and quality can be given high importance.

Testing the chosen price weight

Options should be tested before confirming a price weight. This will help a purchaser to avoid an unanticipated range of supplier quality premium values. This can often arise when using the price quality method in unfamiliar circumstances or choosing a price weight with which the purchaser has had no previous experience.

Grades awarded for non-price attributes in previous evaluations (or mock grades for fictional suppliers) can be used to generate supplier quality premiums for the purpose of testing. The purchaser can then assess whether the premiums generated would be acceptable.

The *Attribute weight setting tool* is available to help set the weights for the price and non-price attributes. The *Price quality evaluation tool* will also assist with this testing.

5.5 Evaluation of proposals

Evaluation process integrity

Proposal evaluators must understand in detail the RFP and other related documents so that they know what the purchaser values and understand the desired outcome. They must also understand and comply with all the obligations that a purchaser has in relation to proposal submitters (refer to section 10.3 *Compliance with legal requirements*).

In the proposal evaluation context, these obligations include:

- acting fairly and reasonably
- using transparent evaluation criteria and processes
- employing fairness and consistency
- only taking into account all relevant factors and not taking into account any irrelevant factors.
- clearly communicating with those who submit proposals about the conclusions of the evaluation process.

These obligations are relevant to the entire evaluation process and to the non-price attribute evaluation process in particular, including judging whether the requirements (or minimum standards) set out in the RFP have been met.

The Official Information Act 1982 and the Local Government Official Information and Meetings Act 1987 require public bodies to provide reasons for their decisions, when asked. A proposal evaluation team may be called on to provide reasons, for example, for failing a proposal on a non-price attribute. A team may also be asked to provide reasons for judging a proposal inferior to the proposal submitted by the preferred supplier.

The Ombudsman has issued practice guidelines that state:

The effect of [the provisions in the official information Acts requiring public bodies to give reasons for decisions when asked is] to ensure that decision-makers avoid arbitrary procedures and make decisions which are fair and reasonable. It therefore serves both to enhance the quality of the decision-making process and to promote the accountability of decision-makers for their decisions ... Statements of reasons protect the integrity of the process and enable persons affected to understand better the basis for the decision or recommendation, even though they may not like it.

Competent people must evaluate the proposals. The NZTA requires that a proposal evaluation team includes at least one appropriately experienced and qualified person (see section 10.19 *Qualifications of proposal evaluators*). Where the chosen supplier selection method is complex or complex requirements are included in the RFP, greater levels of skill and experience will be required. Proposal evaluation teams must be encouraged to seek additional expert assistance whenever issues arise that require greater expertise to resolve.

Approved organisations are encouraged to use referees nominated by suppliers to independently verify the attributes of suppliers. To ensure fairness purchasers must detail, through the RFP, how referees will be used and then act consistently with the RFP.

5.5 Evaluation of proposals continued

Documenting the evaluation process

As stated above, public bodies are required to provide reasons for their decisions, when asked.

Preparing robust documentation as part of the procurement process will enable approved organisations to comply with these provisions and to give feedback to suppliers. Refer to section 10.6 *Documentation and publication requirements*.

Notification of evaluation outcome

The NZTA requires approved organisations to follow best practice and give feedback to all who submit a proposal. Feedback allows suppliers to identify changes that they could make to their business to better align future proposals with an approved organisation's requirements.

All proposal submitters must be advised of the outcome of the evaluation of their proposal and given reasons for their appointment or non-appointment. Section 10.6 *Documentation and publication requirements* requires approved organisations to establish policies for this. An established policy will ensure consistency in the form and content of routine notification.

The following should be provided as a minimum:

- name of the successful supplier
- price of the successful proposal (where the supplier selection method was other than quality based)
- the number of conforming proposals received
- range of grades for each non-price attribute (where attributes are graded) and, for each supplier, their individual non-price attribute grades
- when the price quality supplier selection method is used, the margin between the proposal submitter's supplier quality premium and the supplier quality premium for the preferred supplier.

An approved organisation must be ready, if asked, to make specific observations about an individual proposal and, with appropriate regard for preserving the interests of other suppliers, be able to provide an assessment of the relative merits of a proposal compared with the other proposals submitted.

Advice to those who submit proposals should not extend to disclosure of the opinions etc of individual evaluation team members but should be confined to discussion of the team's collective conclusions.

5.6 Purchaser-supplied inputs

Summary

If an approved organisation wishes to supply inputs to a supplier, it must be fair to all potential suppliers. Refer to section 10.3 *Compliance with legal requirements*.

If an approved organisation wishes to offer inputs, it must advise suppliers through the RFP by outlining the terms, including price, on which the input is offered. There must be no compulsion on the supplier to use the input.

Where a supplier approaches the approved organisation and asks if a particular input will be supplied, either before or after the contract has been let, the input should only be made available on terms that are usual for a contract of that type and at a fair market price.

When a council business unit is to compete for the right to supply minor and ancillary works, and the approved organisation is offering inputs, it must be particularly careful to be fair to all potential suppliers. The approved organisation must manage the supplier selection process in a way that creates no bias in favour of the council business unit.
