

Chapter 4. Shifting IMSS contract management from supplier compliance to performance

The satisfactory delivery of some of the most critical health services such as the provision of medicines largely depend on the capacity of suppliers to provide to the buying organisation the required products and services in a timely and effective manner. Yet, beyond the strict compliance with contractual commitments, performing suppliers could also impact more broadly the provision of health services and participate to the achievement of IMSS' objectives. This Chapter discusses the recent efforts carried out by the Institute to ensure greater compliance of suppliers with their contractual commitments. It also suggests means to revisit the Institute's relationship with its suppliers by developing a sound and comprehensive contract management framework.

Alongside thorough procurement strategies and complex assessment mechanisms to evaluate bids, effective contract management is a decisive factor in ensuring suppliers contribute to IMSS's high-quality health services. In addition, optimising co-operation, co-ordination, and communication – particularly with regard to the supplier base – has been found to have a profound impact on cost reductions while improving service delivery (Rajagopal, 2009^[1]).

The previous OECD review identified several inefficiencies in IMSS's procurement management system (OECD, 2013^[2]). This chapter assesses IMSS's progress since then in managing its pool of suppliers. It discusses suppliers' compliance with contractual terms and conditions, and sheds light on potential avenues for improving suppliers' performance further.

The OECD Recommendation on Public Procurement highlights the importance of adequate resources and expertise in contract management for ensuring efficiency throughout the public procurement cycle Box 4.1. It also insists on the benefits of a comprehensive evaluation of procurement operations to inform future procurement decisions.

Box 4.1. Principles of the OECD Recommendation relating to performance management

The OECD Council notably:

VII. RECOMMENDS that Adherents develop processes to drive Efficiency throughout the public procurement cycle in satisfying the needs of the government and its citizens.

To this end, Adherents should:

i) Streamline the public procurement system and its institutional frameworks. Adherents should evaluate existing processes and institutions to identify functional overlap, inefficient silos and other causes of waste. Where possible, a more service-oriented public procurement system should then be built around efficient and effective procurement processes and workflows to reduce administrative red tape and costs, for example through shared services.

ii) Implement sound technical processes to satisfy customer needs efficiently. Adherents should take steps to ensure that procurement outcomes meet the needs of customers, for instance by developing appropriate technical specifications, identifying appropriate award criteria, ensuring adequate technical expertise among proposal evaluators, and ensuring adequate resources and expertise are available for contract management following the award of a contract.

iii) Develop and use tools to improve procurement procedures, reduce duplication and achieve greater value for money, including centralised purchasing, framework agreements, e-catalogues, dynamic purchasing, e-auctions, joint procurements and contracts with options. Application of such tools across sub-national levels of government, where appropriate and feasible, could further drive efficiency.

X. RECOMMENDS that Adherents drive performance improvements through Evaluation of the effectiveness of the public procurement system from individual procurements to the system as a whole, at all levels of government where feasible and appropriate.

To this end, Adherents should:

i) Assess periodically and consistently the results of the procurement process. Public procurement systems should collect consistent, up-to-date and reliable information and use data on prior procurements, particularly regarding price and overall costs, in structuring new needs assessments, as they provide a valuable source of insight and could guide future procurement decisions.

ii) Develop indicators to measure performance, effectiveness and savings of the public procurement system for benchmarking and to support strategic policy making on public procurement.

Source: (OECD, 2015_[3]).

Reinforcing accountability to ensure well-executed contracts

IMSS has welcome flexibility in developing contract management principles that are adapted to its structure and procurement strategies. Aside from legal provisions and the normative framework, the assessment of contract execution is largely left to IMSS's discretionary policies. This section discusses efforts by IMSS to ensure suppliers' compliance with contractual terms.

Overarching principles for contract management in the Mexican public procurement system are defined in the legislative and regulatory provisions of the Public Procurement Law for Goods, Leases and Services (*Ley de Adquisiciones, Arrendamientos y Servicios del Sector Público*, LAASP) and the Public Procurement Law for Public Works and Associated Services (*Ley de Obras Publicas y servicios relacionando con la misma*, LOPSRM).

While the LOPSRM dedicates a whole chapter to contract execution, the LAASP provides far less information. It merely includes provisions on payments to suppliers, penalties applied in case of unsatisfactory performance or delays, and options for terminating contracts. Neither do bylaws (*Reglamento de la Ley de Adquisiciones, Arrendamientos y Servicios del Sector Público* - RLAASSP and *Reglamento de la Ley de Obras Publicas y servicios relacionando con la misma* - ROPSRM) provide a more complete framework of what a structured contract management process should look like.

While the Procurement Manual (*Manual Administrativo de Aplicación General en Materia de Adquisiciones, Arrendamientos y Servicios del Sector Público*, MAAGMAASSP) includes a specific section on contract execution, it mostly deals with the administrative steps, such as verification and inspection, which trigger payments to suppliers. All these normative provisions remain silent on how IMSS should structure its relationships with its suppliers, leaving the institute with the discretionary power to develop its own contract management framework.

Reducing the default rate: an effective sanction mechanism led to MXN 250 million of cost avoidance in 2016, yet, IMSS could ensure that its strategic objectives are not hindered by the share of defaults.

The Policies and Guidelines for the Procurement of Goods, Leases and Services (*Políticas, bases y lineamientos en materia de adquisiciones, arrendamientos y servicios*) list the steps for controlling and inspecting the goods and services procured. They also define the termination of contracts and the main sanctions applicable in case of unsatisfactory performance:

- Conventional penalties: in the case of delays in delivering goods or services, IMSS can apply the penalties agreed in the contract. IMSS's internal guidelines set daily penalties at 2.5% of the value of the good or services, up to a maximum of 10%. This ceiling corresponds to the performance bond required from the winning bidder upon signature of the contract. Penalties can be raised to up to 20% of the total value of the good or services if the winning bidder has been exempted from providing this performance bond.
- Pre-established deductions for specific types of non-compliance with obligations in the contract.

Internal manuals identify who is responsible for the administrative management of contracts:

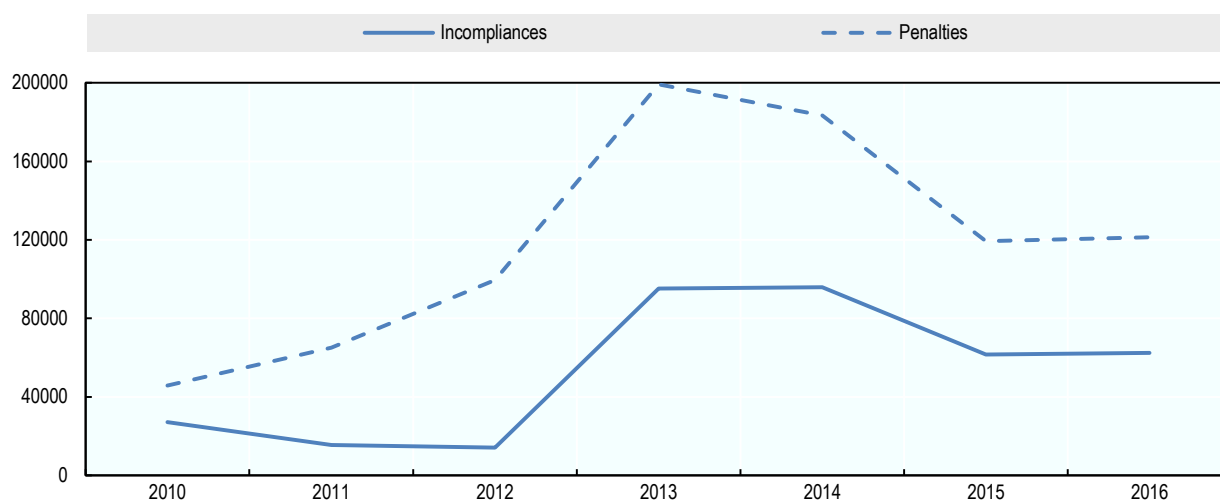
- The Technical Co-ordination of Planning and Contracts, through its Contracts Division, is in charge of contract management at the central level.
- The co-ordinator of supplies and equipment in the delegations.
- The co-ordinator of supplies in the highly specialised medical units (UMAEs).

The public servants designated as contract administrators are responsible for applying penalties and deducting payments. However, the previous OECD review found that the sanction mechanisms foreseen in the law and detailed in IMSS guidelines were inconsistently applied, if applied at all. It recommended that they should be applied systematically. This issue has also been regularly stressed by the Mexican Supreme Audit Institution (*Auditoría Superior de la Federación*, ASF) in audit reports (ASF, 2013^[4]).

Greater enforcement of penalties for unsatisfactory performance by suppliers could discourage them from habitual non-compliance. As noted in the previous review, suppliers, especially those of medicines to remote regions, found it financially more advantageous to pay the conventional penalties under centralised contracts than to meet all the requirements, since deliveries to remote regions often involve low quantities and high delivery costs.

Analysis of trends in IMSS's application of sanction mechanisms provides different but complementary conclusions. Figure 4.1 shows that since the OECD recommendations to strengthen its sanctions mechanisms, IMSS has enforced cases of contractual breaches by suppliers more consistently. Following the previous review, the number of incompliances and penalties dramatically increased in 2013 and 2014 while stabilising in 2015 and 2016 at levels still illustrating a greater enforcement of sanctions mechanisms. This has allowed it to avoid incurring costs for the unsatisfactory execution of contracts. As an example, in 2016 it avoided more than MXN 251 million in costs, representing a 275% increase over 2010 and a large reduction in the waste of public money.

Figure 4.1. Evolution of incompliances and penalties, 2010-2016



Note: the right axis represents the number of incompliances and penalties reported in a given year

Source: OECD calculations based on data provided by IMSS

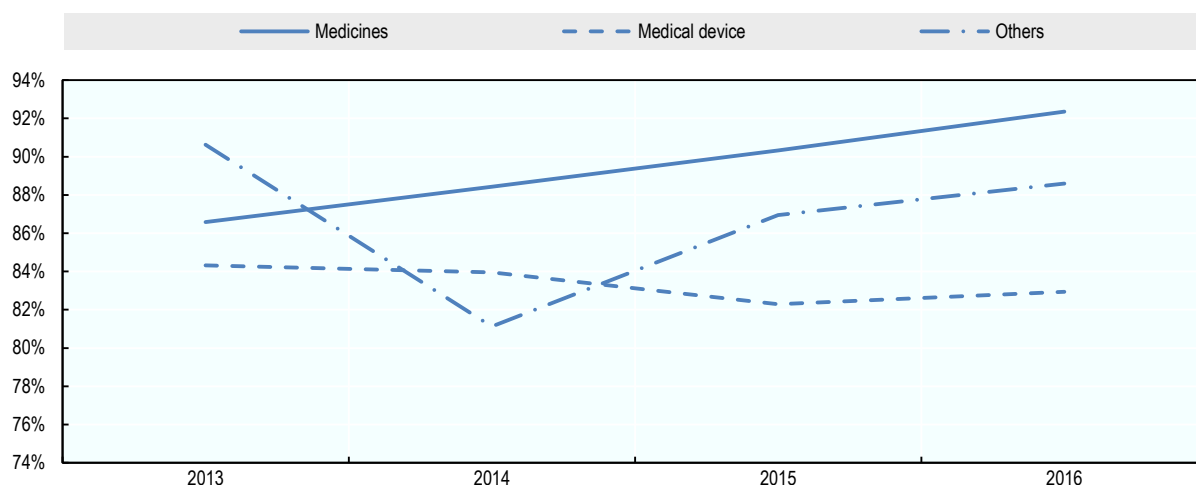
While enforcing sanctions is allowing IMSS to avoid incurring costs for the unsatisfactory execution of contracts, the share of non-compliant contracts is still high, which could also harm the efficiency of the system. In 2016, 17% of orders were sub-optimal either because of delays, or partial or non-execution of contractual obligations.

Efficient contract execution is of major importance in all procurement systems. At the time of contract award, the commitments put forward by the successful bidder are hypotheses only – these need to be delivered during the execution phase. Choosing suppliers with the capacities to execute the contract according to the agreed terms and conditions is therefore central in the market analysis supporting the choice of a procurement strategy (see later sections in this chapter).

This exercise is also instrumental in ensuring that awarded suppliers in consolidated tenders are able to meet large-scale nationwide delivery of medicines or medical devices. The 2014 annual audit report on public accounts of the Mexican Supreme Audit Institution highlighted that failure to execute a contract could severely impede the benefits attained in this type of tender process (ASF, 2014_[5]). For example, in a sample of audited consolidated tenders, the report found that 123 references in three contracts were meant to produce savings of more than MXN 221 million. However, these savings were not realised due to non-compliance by suppliers, which represented 77.4% of the total awarded amount and forced delegations to use alternative, more expensive, providers outside the consolidated tender.

Figure 4.2 suggests that specific product categories, such as “medical devices” and “non-medicine products and services”, are more prone to non-compliance than others. For these categories the share of non-compliant purchase orders can reach levels as high as almost 20% of the total number of products ordered. A cautious review of the underlying reasons for non-compliance could therefore be carried out to assess whether the requirements put to tenders need to be revisited.

Figure 4.2. Share of compliant suppliers by year and product types, 2013-2016



Source: OECD calculations based on IMSS data

Identifying mechanisms and strategies which ensure that suppliers abide by their initial commitments and value propositions is therefore crucial to secure the benefits that were promised in the tendering phase.

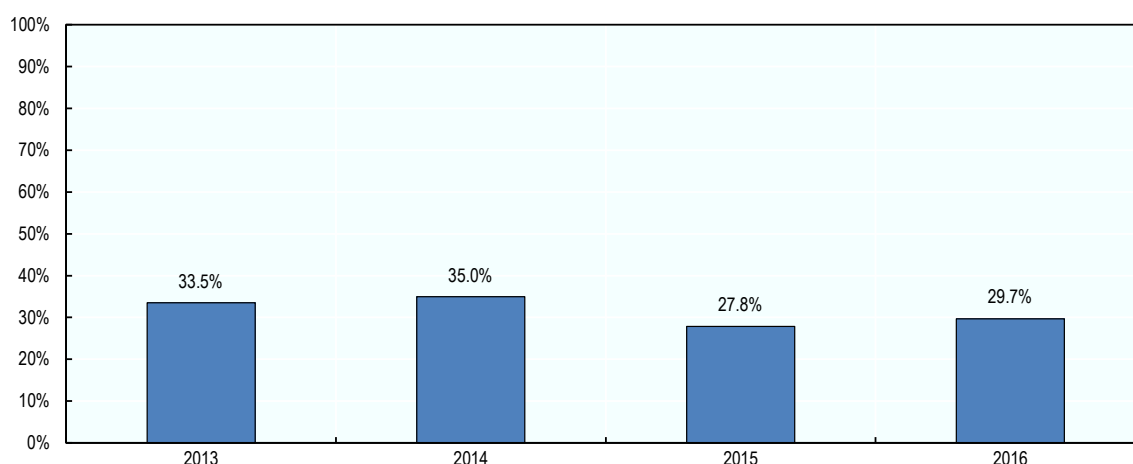
Making suppliers accountable not only for inputs, but also for procurement outcomes: IMSS could assess their past performance according to previously agreed and objectively defined criteria

The large share of purchase orders being subject to sanctions calls for tools and strategies which could help to decrease the share of defaulting suppliers. The previous review recommended, among other strategies, grouping the smallest purchase orders which would not otherwise provide sufficient financial interest to suppliers facing fixed transportation and logistics costs. It also recommended assessing the relevance of using past performance evaluation in tender processes.

By comprehensively monitoring and documenting suppliers' performance, public officials can require corrective actions when performance fails to meet the contract requirements. Performance monitoring can also inform future procurement strategies and the selection of suppliers, when their past performance is assessed for award of contracts (OECD, 2016^[6]).

As shown in Figure 4.3, repeated non-compliance by suppliers with contractual terms might indeed encourage IMSS to consider assessing their past performance before deciding to award a contract.

**Figure 4.3. Share of suppliers that are less than 75% compliant
(in terms of number of orders)**



Source: Based on data provided by IMSS

Articles 54 to 61 of the LAASP allow for sanctioning suppliers in case of serious and repeated contractual breaches. The list of sanctioned suppliers is co-ordinated by the SFP and accessible online. It provides contracting entities with the opportunity to verify whether participating bidders have been sanctioned in the past (OECD, 2017^[7]).

Sanctions range from a simple fine to a temporary exclusion from future tender processes up to a maximum of five years. While the Mexican normative framework introduces a sort of temporary debarment procedure for suppliers whose performance is repeatedly

unsatisfactory, IMSS has not developed a more systemic and structured system to factor in the assessment of bidders the question of past performance.

Other OECD countries take into account suppliers' past performance in tenders in two different ways. The first mechanism is somewhat similar to Mexico's debarment mechanism and integrates this component at the selection stage. In other procurement systems, such as Korea's, past performance is used as a selection criterion (OECD, 2016^[6]). To be part of Multiple Award Schedules (Korean framework agreements), suppliers must prove that at least three previous contracts were executed satisfactorily. With the introduction of the EU Directives in 2014 reforming public procurement, past performance, when it relates to the subject matter of the contract, is being introduced in EU countries as a mechanism to screen bidders and exclude those whose past performance has been poor.

The US takes a different approach (Box 4.2). It imposes the use of past performance as an award criterion in tenders exceeding a certain amount. The fundamental difference with this approach is that past performance becomes a component of the relative merits of the bids, rather than a factor excluding suppliers from competing. In this way, suppliers' past performance is taken into account in the comprehensive assessment of their offers.

Box 4.2. Past performance as an award criterion in the US

Federal law generally requires agencies to evaluate and document contractor performance on contracts or orders whose value exceeds the simplified acquisition threshold (generally USD 150 000). The evaluation must generally address the quality of the product or service supplied by the contractor, its efforts to control costs, its timeliness and compliance with schedules, its conduct of management or business relations, its performance in subcontracting with small businesses, and other applicable factors (e.g., tax delinquency). The evaluation and any contractor response comprise the past performance information that is stored in government databases (e.g., Past Performance Information Retrieval System and the Federal Awardee Performance and Integrity Information System), and may be used in future source selection decisions.

Federal law also generally requires agencies to consider contractors' past performance when making source selection decisions in negotiated procurements whose value exceeds the simplified acquisition threshold. In a negotiated procurement, the contract is awarded to the bidder whose proposal represents the "best value" for the government based on various factors identified in the solicitation. These factors typically must include price and past performance. However, other factors may be considered, and procuring agencies determine the weight given to various factors.

Additionally, agencies are required by law to consider whether the contractor has a "satisfactory performance record" when determining whether the contractor is sufficiently "responsible" to be awarded a federal contract. Agencies generally cannot award a contract without determining that the contractor is "responsible." While agencies are generally prohibited from repeatedly finding a contractor non-responsible based upon the same deficient past performance, they may debar or suspend contractors for wilful failure to perform under a contract or contracts, or for a history of failure to perform or of unsatisfactory performance of a contract or contracts.

Source: Adapted from (Manuel, 2015^[8]).

Using past performance as a selection or evaluation tool in procurement process sparks debate worldwide, notably over the objectivity of performance assessment, barriers to entry for new suppliers and whether it prevents companies from correcting deficient relationships with the public sector.

However, research assessing the outcomes of recurrent tenders in a specific setting demonstrated that evaluating suppliers' past performance could have positive effects on their future performance. Based on an experiment carried out by an Italian public utility company that introduced a new rating system, the research found that reputational incentives could be a powerful mechanism for improving supplier performance (Decarolis, Pacini and Spagnolo, 2016^[9]). The analysis showed that across the 136 parameters scored to assess the satisfactory execution of contracts by suppliers, overall compliance increased from 25% to 80% without a major impact on prices. As critics feared that this evaluation mechanism could create a potential barrier to new entrants, the contracting authority assigned the average ranking to new suppliers by default. This would then be reviewed according to future contract performance.

Besides informing procurement decisions, these efforts can help to define a broader performance assessment framework which could also reshape the relationship between IMSS and its suppliers.

Taking into account its centre-led procurement structure, IMSS could maximise the use of information to monitor suppliers' performance

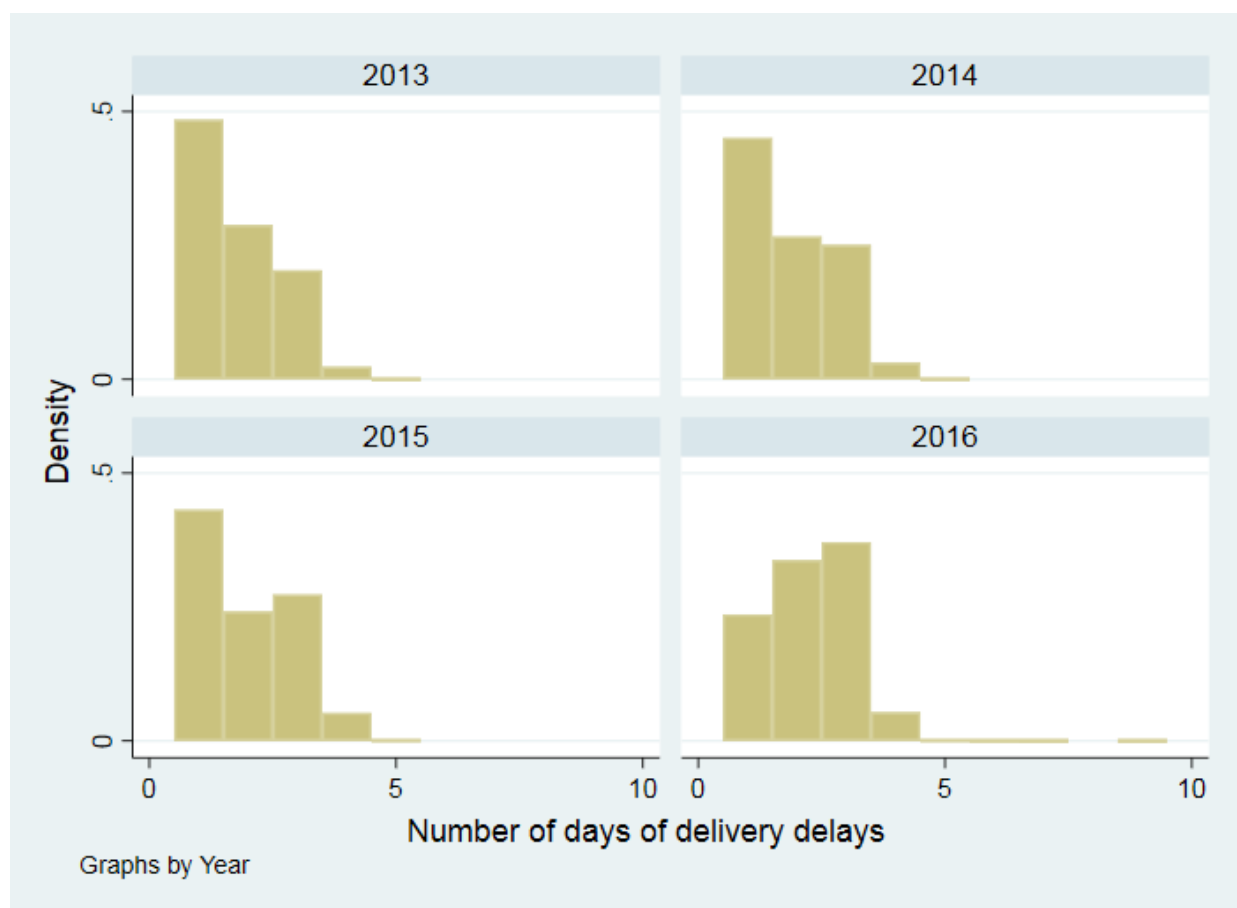
Being the primary users of procured goods or services, decentralised units can feed suppliers' performance back into defining their next procurement strategy. However, to do so, the central unit should identify those aspects of contract execution on which information should be reported to assess suppliers' performance. As an example, in the case of the procurement of medicines, supplier performance will not only depend on timely delivery, but also on the quality of the product delivered, its traceability or its expiry date.

Decentralised entities provide the central procurement unit with weekly updates of suppliers' non-compliance in terms of instances where breaches have been reported. However, reporting is limited to the identification of a breach and, in case of delays, the amount of undelivered medicines and the number of days the supplier has been subject to penalties.

While providing information on sanctions imposed on suppliers is a first step to assess contractors' compliance, the reported information cannot in itself capture all dimensions of suppliers' performance.

The IT systems in which this information is entered also include the effective dates on which goods or services have been delivered. This information could be used to analyse late delivery, which is one dimension of supplier performance. It could also provide IMSS with further insights into delivery trends for specific product categories and could help to define future delivery timeframes.

As Figure 4.4 shows, an analysis of the average delays in purchase orders subject to penalties suggest an increased tendency for delivery delays to increase on average. While this could be explained by a number of factors specific to some product categories or some delegations, this could also imply weaknesses in the current penalty scheme, as penalties are limited to a maximum of four days of delays.

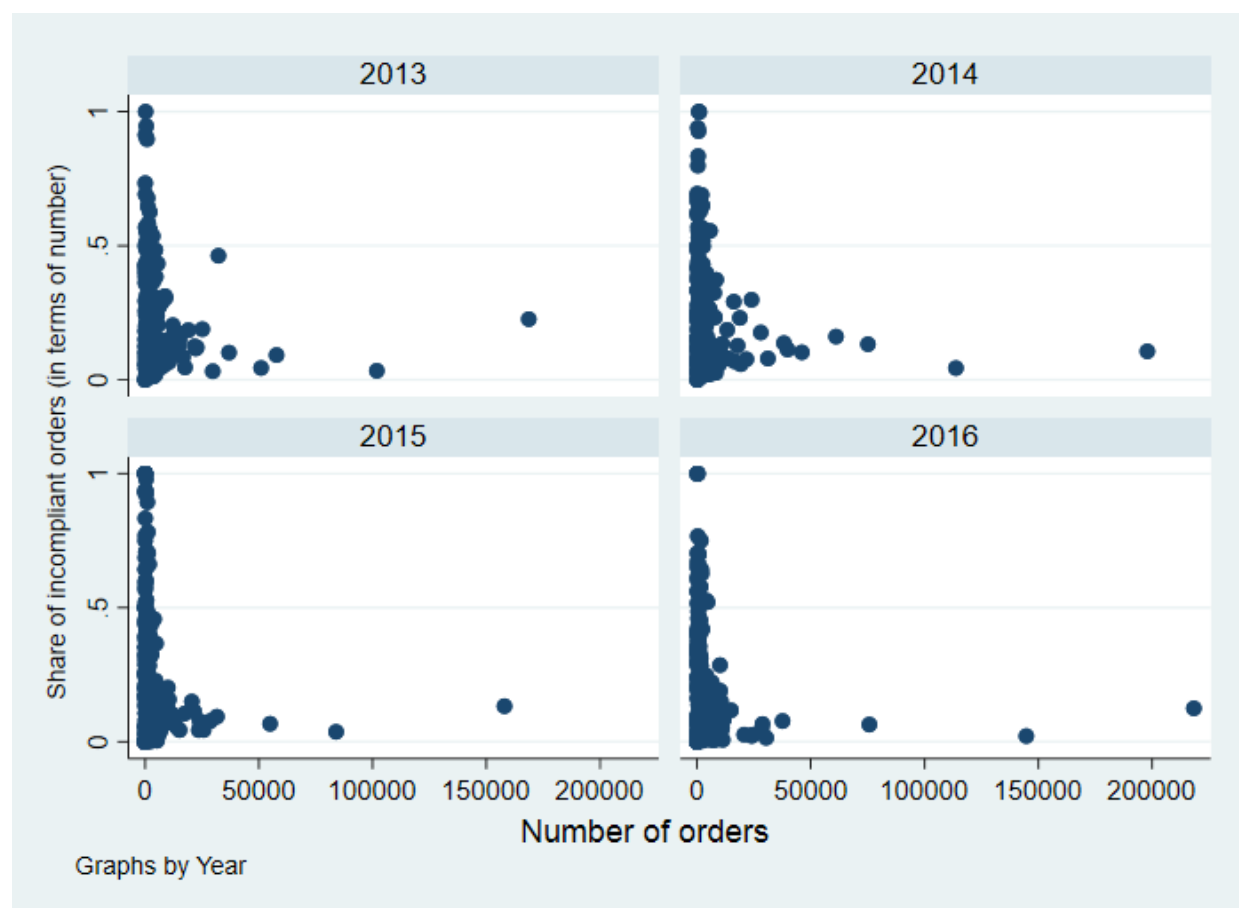
Figure 4.4. Average delivery delay for IMSS procured products, 2013-2016

Source: OECD calculations based on data provided by IMSS.

In addition, although IMSS monitors the share of non-compliant products by suppliers, by product references or by delegations both for central and decentralised procurement, this analysis could usefully be complemented by an analysis of the number of non-compliant purchase orders using the same parameters. While the total number of non-compliant products provides an initial overview of overall suppliers' adherence to contractual terms and conditions, it only partially captures the economic impact of these defaults.

Assessing the share of purchase orders that suffers from contractual breaches could provide additional evidence of suppliers' performance and be used as a proxy for the indirect costs linked to these defaults (see Figure 4.5 for an example).

Figure 4.5. Share of non-compliant purchase orders, 2013-2016



Source: OECD calculations based on data provided by IMSS

Figure 4.5 shows that non-compliance rates for purchase orders are increasing among suppliers receiving few purchase orders. On the other hand, the largest suppliers, those receiving more than 25 000 purchase orders per year as shown in the figure above, have low rates of non-compliance, suggesting that contract management for those suppliers could focus on other aspects of contract execution.

The strategies adopted in certain tenders also provide opportunities to increase the scope for gathering information on contract execution. In specific procurement strategies such as consolidated tenders, this feedback mechanism could be extended to collect information from the contract managers of the other entities participating to those tenders. IMSS can already benefit from additional quantitative and qualitative information gathered through contract management processes developed by other institutions, such as PEMEX, the Mexican state-owned oil company (Box 4.3).

Box 4.3. Contract management processes in PEMEX

The PEMEX directorate which defines the company's procurement methodologies and sourcing strategies has a sub-directorate responsible for relations with suppliers and contractors (*Subdirección de Desarrollo y Relación con Proveedores y Contratistas*, SDRPC).

The centre-led procurement function poses some challenges in objectively assessing suppliers' performance. SDRPC is responsible for the overall oversight of suppliers, and liaises with business units to collect information on suppliers' performance. It uses several IT systems to gather information from the following sources:

- Suppliers registration system: as well as being used to reference bidders and contractors, this tool is also used to implement commercial and financial risk assessments of bidders. Depending on the strategic importance or risk profile of the company, and the amount of contracts they hold with PEMEX, suppliers and contractors may be invited to subscribe to an extended registration. In this case, they are asked to provide additional information and documentation on a wide range of business aspects, including financial, product and service quality certifications, health and safety, and corporate social responsibility policies.
- Transactional information: This information is gathered from PEMEX Enterprise Resource Planning System. This tool, coupled with the system for electronic invoicing, is central to contract administration and includes information which can provide insights into suppliers' performance. An approval workflow tracks the submission of invoices, their validation by business units, and corresponding payments processed by the Finance Corporate Directorate. However, this transactional information only partially and indirectly depicts suppliers' performance on contracts signed with PEMEX.
- Surveys: To address the above information gap and considering PEMEX's centre-led procurement function, additional information is gathered from project managers through periodic surveys. These ask them for feedback on suppliers in the following areas:
 - Understanding the business and client service
 - Innovation and technology
 - Quality
 - Contract management and compliance
 - Human resources
 - Security and social responsibility

Source: Adapted from (OECD, 2017^[10])

While these additional analyses could maximise the use of existing information to monitor suppliers' performance, developing a stronger contract management framework will require additional efforts, such as categorising the supplier base against their relative roles in contributing to the delivery of high quality healthcare services. For example, information reported to the central procurement unit does not capture certain perspectives that are essential for implementing strategic contract management such as the quality of after-sales services provided by suppliers or their capacities to develop client relationships.

Re-engineering the relationship between IMSS and its suppliers

While efforts by IMSS to enforce contract terms and conditions have led to greater supplier compliance with their contractual commitments, the high rate of defaults – along with the absence of a comprehensive performance assessment – pose questions about the efficiency of the existing contract management framework. As well as an effective contract management framework, IMSS's commitments to abide by its own obligations also have an impact on its relationships with suppliers.

IMSS's existing guidelines and processes set out similar general contract management principles to those found in other Mexican public institutions. However, the provision of health services puts a greater emphasis on the satisfactory execution of contracts by suppliers.

The direct link between the quality of inputs provided by suppliers such as medicines and equipment, and the output delivered by the public institution responsible for health services, reinforces the centrality of contract execution in health-related procurement. Health providers need to be able to rely not only on compliant, but also well-performing, suppliers.

Supplier relationship management is an approach to managing an organisation's interactions with the companies that supply it with products and services. It can help to reduce costs and enhance the quality of service delivery (Mettler and Rohner, 2008^[11]). Going beyond contractual compliance, it defines the processes and relationships for developing an environment conducive to good performance.

A successful contract management strategy can achieve positive results by:

- managing the organisation's own responsibilities during the contract
- ensuring the supplier meets the minimum performance criteria, such as compliance
- allowing supplier performance to improve, both in the short and long term, by developing effective supplier relationships.

While compliance has already been discussed above, the other two points are the subject of the rest of this chapter.

Strengthening supplier performance

Managing the organisation's own responsibilities during the contract: IMSS should consider using not only sticks but also carrots, such as timely payments, to incentivise suppliers' performance

Aside from penalties and additional sanctions, a contract management system that provides suppliers with stable and fair contractual frameworks can improve their performance. Failure to do so not only generates breaches and failures, it also increases the likelihood that premiums will be added to unit prices, thus harming the overall value for money of bidders' financial conditions.

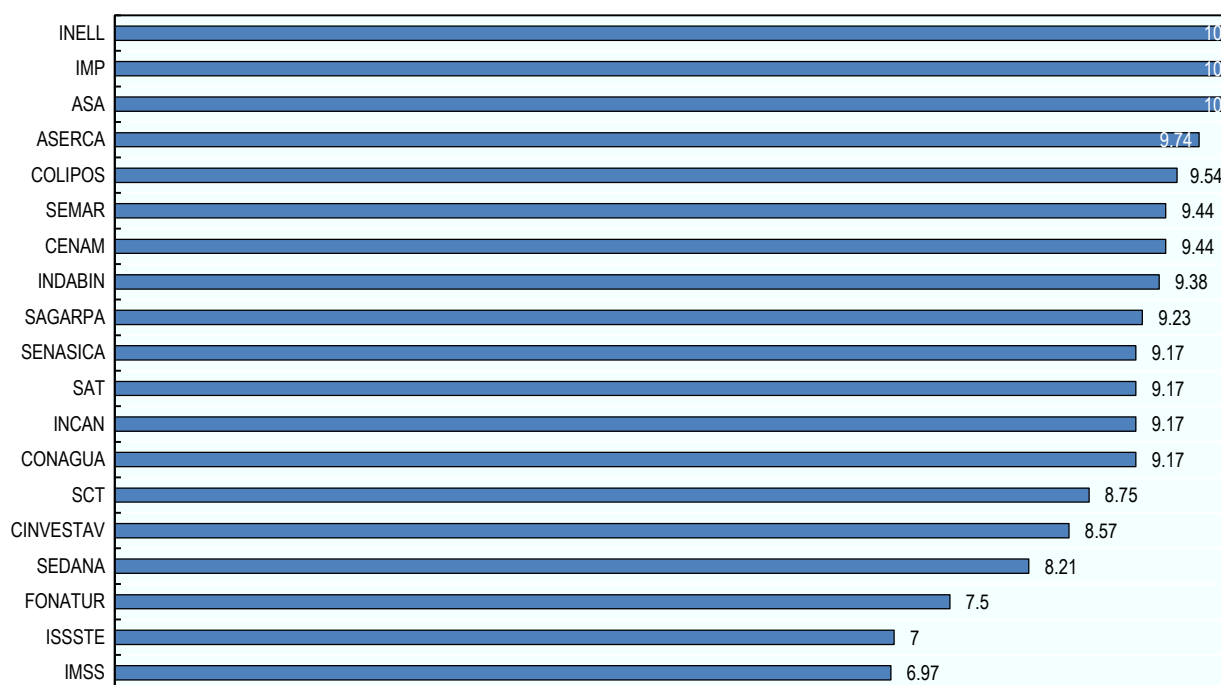
For example, a study of Brazilian pooled procurement experience in the pharmaceutical sector found that failures by some members of the pool to abide by their contractual obligations – notably timely payment – adversely affected the financial conditions granted by suppliers in subsequent tenders (Barbosa and Fiuza, 2011^[12]).

Similarly, the previous OECD review found that suppliers' understanding of IMSS procurement strategies could lead to undesirable effects and produce harmful consequences during contract execution. For example, discussions with suppliers clearly revealed that procurement strategies such as subsequent reverse auctions led them to believe that IMSS's overarching objective is to procure specific items at the lowest possible price (OECD, 2013_[2]). Indeed in this procurement strategy, bidders are asked to lower their initial proposed price throughout negotiation rounds, and the bidder proposing the lowest price is awarded the contract. This procurement strategy entails that bidders are being asked to compete on price only and to further reduce their margins which could have ultimately an impact on or the willingness of suppliers to abide later in contract execution by costly obligations, such as delivery to remote locations.

IMSS's main obligation to its suppliers, as for all public entities subject to public procurement laws, is to pay promptly for goods and services delivered effectively. Aside from the fact that late payment might be factored in by suppliers in their financial proposal and generate a premium in addition to unit prices offered, payments on time can act as a positive incentive for suppliers to abide by their contractual obligations.

Regular surveys carried out by SFP show that suppliers' perceptions of the timeliness of IMSS's payment – and more generally on the management of payment processes – rank the lowest across Mexican federal public administrations (Figure 4.6).

Figure 4.6. Supplier satisfaction index for management of payments by Federal public entities

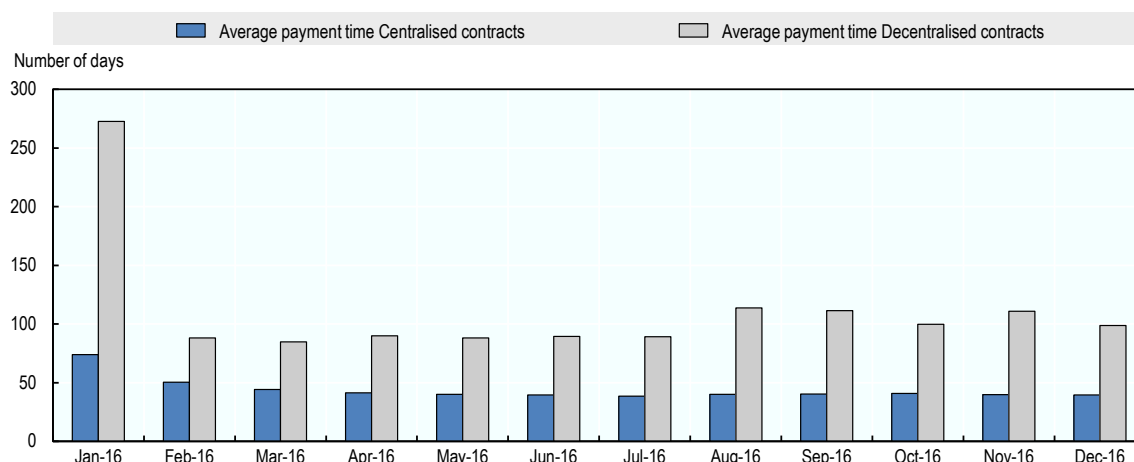


Source: Information provided by SFP

According to the public procurement law (art. 51), payment terms should not exceed 20 days following the receipt of the invoice. However, IMSS recognises that in practice payment significantly exceeds this timeframe, either because of the absence of validation by the technical area or because of material errors on the invoices. As shown in

Figure 4.7, significant payment delays occur at both central and local levels, with the average payment timeframe almost amounting to 10 months.

Figure 4.7. Average IMSS payment timeframe for procurement of medicines (2016)



Source: Data provided by IMSS

While this harms suppliers of all sizes and their relationships with IMSS, international experiences suggest that late payments by the public sector affect small and medium-sized enterprises significantly, harming their ability or willingness to participate in public tenders.

However, this issue is not exclusive to IMSS – it is widespread in the Mexican public sector. According to the Ministry of Finance and Public Credit (*Secretaria de Hacienda y Crédito Público*, SHCP), the amount owed by all the public entities in Mexican states to their suppliers and contractors equalled MXN 49 billion at the end of 2016 (Valdelamar, 2016^[13]).

Payment delays not only affect the buyer-supplier relationship, they also increase IMSS's liabilities. Article 51 of the RAASP mentions that unpaid pecuniary amounts can generate interest. Therefore, in contracts which are satisfactorily executed the initial estimated savings are put at risk by delayed payments and potential claims from suppliers. By improving payment timeframes IMSS would therefore not only encourage suppliers to fulfil their contractual obligations, but also protect itself better against future financial liabilities.

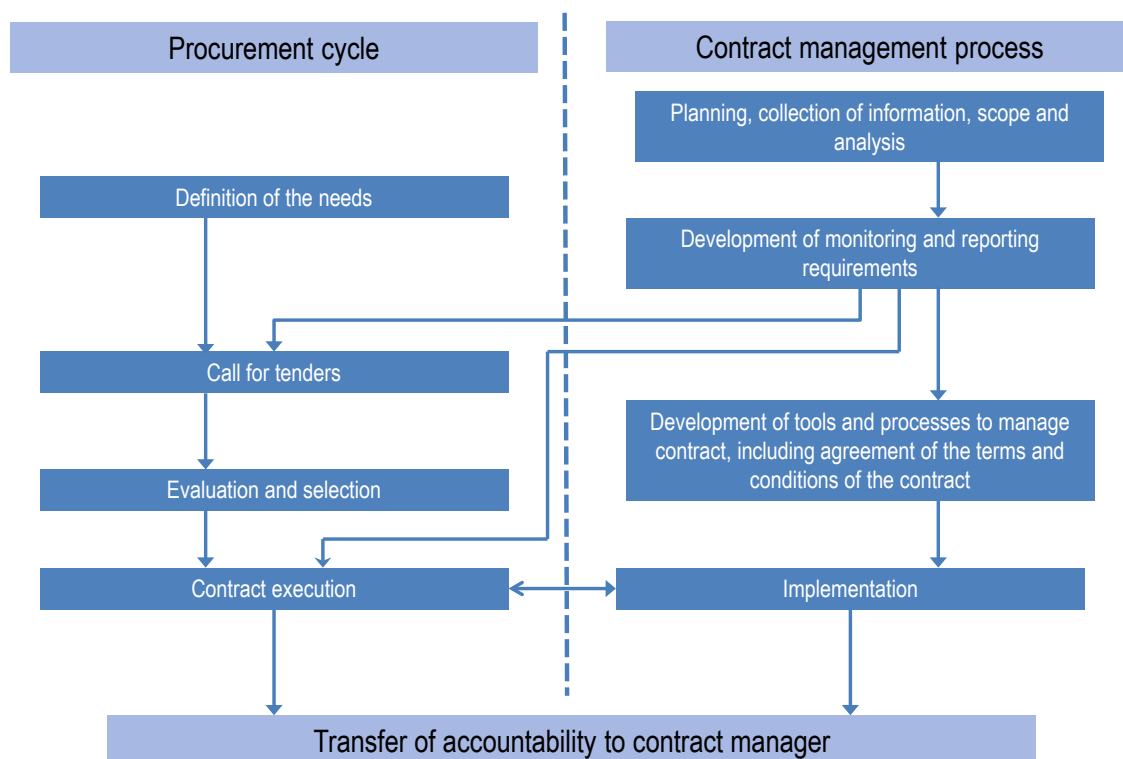
Building alignment between IMSS and its suppliers: IMSS could ground suppliers' performance in procurement strategies and selection process

A number of studies stress the benefits of a strategic alignment between buyers and suppliers (see for example (Barratt, 2004^[14])). Better supply chain integration can indeed be a strong lever to improve organisational performance. Across different industries, the notion of integration is generally discussed with reference to aligning general corporate strategies and priorities among different organisations within a supply chain. Measures of success include enhanced profitability and customer satisfaction.

Building alignment between IMSS and its suppliers needs to start early in the procurement process, as shown in Figure 4.8. It cannot be achieved after procurement

strategies have been implemented and suppliers selected. It requires early communication between IMSS and its suppliers, and the tender process needs to be able to identify companies that are best aligned with its priorities.

Figure 4.8. Development of contract management strategies



Source: Produced by OECD Secretariat

One crucial feature of contract management in IMSS is medicine procurement, which represents almost 60% of IMSS's total procurement expenditures. Medicines have to be delivered across the country, and sometimes to remote locations. This process is highly dependent on suppliers' ability to respond to emerging needs, such as unpredictable levels of demand, which cannot always be anticipated. The importance of a responsive supply chain has been acknowledged for a long time in the literature as a means of responding quickly to unpredictable demand; and to minimise stock outs, forced markdowns and obsolete inventory (Fisher, 1997_[15]).

The previous OECD review identified weaknesses in the management of medicine stocks by the decentralised entities, mostly delegations (OECD, 2013_[2]). In response, IMSS defined a process to measure average medicine consumption and to issue replenishment orders as soon as levels dropped below optimal. IMSS also developed processes whereby delegations in the vicinity could provide needed medicines to other locations in an emergency. This process has had the benefit of limiting emergency purchase orders.

Other contracting relationships exist which can respond to the specificities of medicine procurement. For example, on-demand consumption or just-in-time delivery are delivery mechanisms which could provide several advantages to buying organisations, such as limiting stock management costs. Imported from procurement practices in the

manufacturing and automotive industries, these approaches require suppliers with extended delivery capacity in order to effectively perform their obligations. IMSS has decided to develop a consumption-on-demand strategy for a selected number of low-cost medicines that are purchased in large volumes. Through this strategy, levels of stocks are monitored and replenishment orders are issued to suppliers as soon as stocks in pharmacies reach a minimum threshold. Applied to 25 drug references, this strategy provides IMSS pharmacies with greater stock flexibility. According to the terms and conditions of the corresponding tenders, bidders are requested to provide the pharmacies directly with the selected medicines within three calendar days of stocks falling below the minimum levels. This specific delivery scheme therefore calls for a thorough assessment of suppliers' capabilities. In addition, under these operating conditions, relations with the supplier should be built on a high degree of mutual trust and openness to increase operational efficiency. When entering into this type of more responsive relationship, it is important that the buyer selects suppliers that have consistently exhibited high levels of quality and delivery reliability.

Tailoring the contract management framework to IMSS's decentralised structure and suppliers' portfolio

To maximise the effectiveness of its contract management framework, IMSS could tailor it against its procurement organisation and allocation of responsibilities

Another element to take into consideration for effective and comprehensive contract management is IMSS's organisational structure. While procurement strategies are designed at the central level, most of the follow-up activities during contract execution are left to decentralised units in the delegations and the highly specialised medical units. As it is these entities which are handling the management of stocks and the receipt of goods and services, they are best-placed to bear this responsibility.

Across OECD countries, almost 85% of centralised purchasing bodies are defining and implementing collaborative procurement instruments, such as framework agreements, to delegate contract management activities linked to purchase orders (OECD, 2017^[16]). This relationship resembles the organisational features of IMSS.

To ensure consistent monitoring of contract execution, central purchasing bodies (CPBs) often disseminate to decentralised contract managers best-practice guidelines for sound and robust contract management (GOV U.K. Crown Commercial Service, 2014^[17]). The CPB of New Zealand, for example, has developed a framework to ensure that significant contracts managed by contracting entities are consistently assessed and that reported benefits are harmonised (Box 4.4).

Box 4.4. Implementing strategic contract management in New Zealand

New Zealand's Ministry of Business, Innovation and Employment has recently been directed by ministers to establish a framework for the management of government's significant service contracts with third-party providers. The purpose of the framework is to provide confidence to government and the public that important services are being effectively delivered in New Zealand.

The framework includes agency and system-wide visibility, standardised management, oversight and accountability of agencies' significant service contracts. Through the implementation of the framework, agencies will have visibility of their significant service contracts, be positioned to respond to changes, mitigate risks and have assurance that their significant service contracts achieve their intended outcomes.

The framework for managing significant contracts helps agencies outlines a strategic alignment between the agency's objectives and suppliers' execution of the contracts. To do so, it reinforces the following dimensions:

- Visibility on procurement spend by assessing the criticality of the contracts signed with suppliers to achieve the objectives of the agency
- Clarity on expectations by identifying the critical factors which drive effective management of contracts
- Accountability by understanding how contracts are performing and how this performance contributes to the achievement of the agency's objectives
- Building evidence by assessing the agency's performance against pre-defined standards
- Improved capability in agencies and across the government by developing tools and systems to drive best practice

Agencies are required to report back on their significant service contracts every six months, with a first report due in March 2017.

Source: (MBIE, 2017^[18]).

To delegate these responsibilities effectively and ensure consistent practices, IMSS could define a standardised minimum contract management framework which would be applied to all delegations and UMAEs. Although guidelines have been developed to define requirements for the inspection process for the delivery of therapeutic and non-therapeutic goods, these do not integrate a structured mechanism for identifying products to be inspected. Neither do they indicate how often the evaluation should be conducted.

Some delegations reported during the fact-finding mission that they inspect all medicines received from suppliers. But since delegations receive on average more than 1 600 medicines per purchase order, a comprehensive inspection of all items received does not seem feasible. This therefore suggests that uneven practices are taking place in delegations and UMAEs, thus questioning the comprehensiveness of the breaches reported besides delays in deliveries. Defining the general principles to be applied in contract management activities would provide IMSS with the assurance that reported activities provide a reliable picture of contract execution.

To strategically allocate resources, IMSS could adapt contract management activities to the criticality of the goods or services procured.

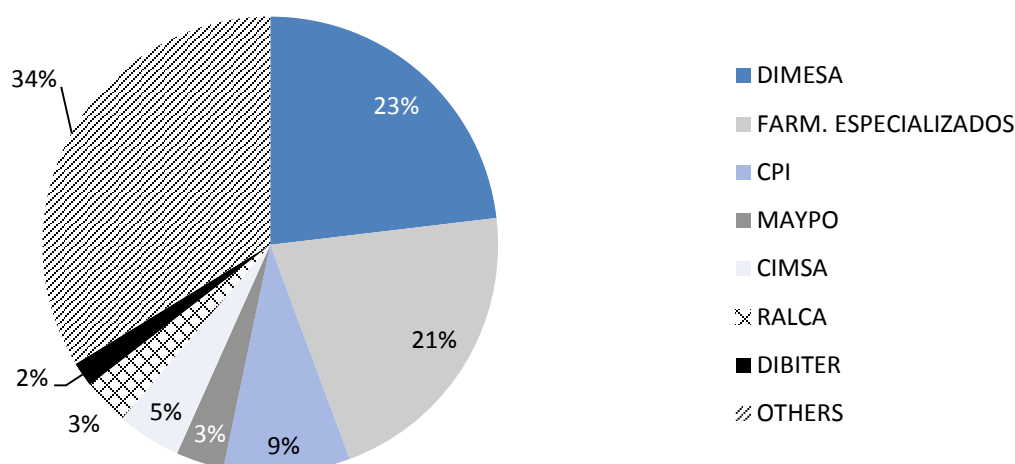
While implementing standardised and robust contract management principles is a prerequisite to ensure that suppliers will deliver the expected value for money promised in their bids, contract management success or failure are also highly dependent on additional factors, such as buyer capabilities and the robustness of IMSS's procurement (NAO, 2016^[19]).

A comprehensive and effective contract management framework typically includes the following items (OECD, 2017^[10]):

- Planning, information collection and analysis, providing a clear understanding of the contract's surrounding environment (regulatory, commercial, etc...) and allowing for the identification of project risks, mitigation measures and potential effects.
- Contract administration which defines roles and responsibilities in managing the contract, allows for responsiveness in mitigating risks, and ensures objectives are achieved.
- Effective performance reporting and monitoring, providing relevant standardised information on which controls could be based and to support informed decisions.
- Efficient relationship management, creating a long-term relationship of mutual benefit between the parties and enabling them to more effectively anticipate risk before it occurs.
- Governance and integrity mechanisms providing an appropriate setting for interactions with suppliers.
- Effective knowledge sharing and information management ensuring that information on the project can be easily retrieved and accessed, and enabling the parties to comply with obligations on information retention, disclosure and protection.
- Change management which ensures that change events are managed smoothly without creating unnecessary risk or the unintended acceptance of risk.
- Contingency plans allowing for prompt and appropriate reactions to unplanned events.
- Ongoing review of the contract management framework and adapting the framework to changes in strategic business orientations.

IMSS's efforts to implement the various areas listed above would depend on the relative importance of the supplier in the execution of IMSS public service delivery. A review of IMSS's procurement portfolio reveals a great heterogeneity of products and services procured under different strategies and at different levels. For example, consolidated tenders reveal considerable market concentration (Figure 4.9).

Figure 4.9. Market concentration in consolidated tenders for medicines and healing materials, 2017



Note: Vaccines and patent/single-source drugs not included

Source: (Investigación Farmacéutica, 2017_[20]).

As IMSS's supply base is so diverse, reflecting the types of goods and services it provides, to maximise the value added by suppliers, contract management activities should be tailored to the main characteristics of the suppliers and to the features of their relationship with IMSS.

The example from New Zealand above (Box 4.4) also highlights the relevance of adapting contract management activities to the nature and the importance of the contract to the buying organisation. This builds on the longstanding literature on product segmentation and notably on the seminal work done by Krajlic (Krajlic, 1983_[21]) on the classification of products or services based on their supply risk and profit impact. Building upon this exercise, IMSS could tailor its contract management strategies to the criticality of the goods or services procured.

In Australia, Health Purchasing Victoria (HPV), an organisation responsible to the Minister of Health, works with public hospitals and health services in the state to support their procurement operations. It has developed a policy framework, known as the HPV Health Purchasing Policies, to cover the health service's internal procurement practices. HPV has designed these policies to ensure consistency and probity in procurement practice within public hospitals and health services. To implement these policies, a contract management strategy aligned with product categorisation has been developed to indicate to individual entities that the extent and nature of contract management activities depends on the nature of the goods or services procured (Annex 4.A). IMSS could build on this example to develop a contract management strategy tailored to its procurement portfolio.

Proposals for action

To increase the efficiency of the post-award phase and to ensure that the objectives agreed during the bidding stage actually materialise, IMSS should support its suppliers in transitioning from compliance to performance through the following measures:

Strengthen accountability in IMSS's relations with its suppliers

- Ensure that contractual breaches are enforced, but also kept to a level which would not adversely affect the benefits promised in the tendering phase.
- Decrease significantly the average timeframe for paying suppliers; long delays harm the IMSS/supplier relationship and are likely to lead to bidders adding premiums to their proposed prices.
- Make suppliers accountable for procurement outcomes by assessing their past performance according to previously agreed and objectively defined criteria.
- Use existing information in the IT system to capture additional perspectives of contract execution and gain a better understanding of the impact of suppliers' performance on IMSS.

Revisit IMSS's relationship with suppliers to promote better performance and ultimately better healthcare services

- Define contract management strategies at the early procurement stages and embed related requirements into procurement strategies and the selection of suppliers.
- Design a contract management framework adapted to how IMSS organises procurement, i.e. with decentralised units with diverse experience and heterogeneous needs being responsible for the day-to-day management of contracts.
- Tailor contract management activities according to the relative importance of the products and services procured so that resources are efficiently allocated across IMSS's procurement portfolio.

Annex 4.A. Contract management strategy in Monash Health (Health Purchasing Victoria)

Annex Table 4.A.1. Contract management strategy tool

| Complexity Quadrant | Value for Money (VFM) 1. What are essential set of controls (systems and processes) the organisation needs to have in place to ensure value for money outcomes are achieved? | Risk Management and Contingency Planning 2. What are the minimum controls the organisation requires to determine if the supply is at risk and what back up arrangements could be required to ensure continuity of service? | Capability and Responsibility 3. What are the minimum actions the organisation can take to determine the appropriate capability exists to undertake contract management? | Performance Monitoring 4. What does the organisation need to do to know if suppliers are fulfilling their contract obligations and if expected commitments are being realised? | Continuous Improvement 5. What can the organisation do to improve procurement practice to drive value for money? |
|---|---|---|---|---|--|
| Transactional Low value/low risk, low volume/low frequency of use. Generic or commoditised items | Pricing is relative to industry standards Analysis of TCO in limited circumstances i.e. low initial costs but high ongoing costs | Understanding of market in order to identify other supply points if required By Sourcing Team (buyers) on demand | Level 1 procurement skills | Formal Contract Management Plan Not required / use simple form Delivery In Full, On Time measured by Supply Team Annual review of pricing agreement | Monitor spend by key categories to identify opportunities for aggregation of demand, HPV collective agreements or prequalification arrangements Focus on business improvement via process optimisation |

| | | | | | |
|---|---|---|---|--|---|
| Leveraged High volume / frequency / spread of use. Typically many suppliers | When developing contracts, consider pricing mechanisms such as volume based discounts to enhance VFM Communication and training plan for new contracts to create internal awareness and ensure compliance Develop financial benefits checklist Consider inclusion of non-performance penalties in contract development Aggregation of suppliers considered Assessment of TCO recommended | Use short-form risk assessment and supplier segmentation to understand potential risks Based on market analysis, determine if business continuity plan is required where competitive market does not exist Clear escalation path for issues established and tracking mechanism for all issues Consider Probity Plan. Engage Probity Advisor if indicated (may be internal or external) | Level 1 procurement skills Articulate roles and responsibilities and appoint relationship manager and service delivery manager | Performance management built into contract management framework Implement standard supplier scorecard template and ensure regular benchmark of supplier performance on scorecard Generate standard procurement KPI reporting for management on a regular basis Annual review of pricing agreement and performance against service / delivery KPIs | Processes are in place to monitor variations and extensions of contracts against supplier Implement a supplier relationship management plan, including feedback from supplier and staff performance Engage with contract users to identify opportunities for improvements Establish framework for review of performance and the application of non-performance penalties as required Review financial benefits to monitor achievement of VFM Participate in HPV reference groups |
|---|---|---|---|--|---|

| | | | | | |
|---|--|--|---|--|---|
| <p>Focused Limited suppliers & alternatives, Limited volume/frequency/spread of use, potential high risk to operations Higher level of customisation, scope for innovation, high switching costs</p> | <p>When developing contracts, consider pricing mechanisms such as alliance, penalties/incentives/risk share arrangements, and other pricing models to enhance value Ensure total cost of ownership has been calculated and accounted for including all ongoing service requirements Build service performance KPIs into contract Develop tailored financial benefits checklist to drive VFM Consider inclusion of non- performance penalties in contract development</p> | <p>Undertake long-form risk assessment and supplier segmentation to understand potential risks Require suppliers to submit business continuity plans Detailed contingency planning is undertaken and regularly reviewed Establish a clear escalation path and tracking mechanism for all issues Complete Probity Plan. Engage Probity Advisor if indicated (may be internal or external)</p> | <p>Level 3 procurement skills Articulate roles and responsibilities and appoint a relationship manager and service delivery manager Consider level of involvement required by technical / subject matter expert</p> | <p>Develop KPIs tailored to contract and project outcomes. Ensure these can be efficiently and consistently measured with minimal effort KPIs are included in the ITS Ensure supplier buy-in for performance management program in order to develop the framework of a relationship that works for all parties involved Implement a tailored supplier scorecard (using the template) and ensure regular benchmark of supplier performance on scorecard Reviews conducted quarterly for 1st 12 months, thereafter 6-12 monthly for the term</p> | <p>Processes are in place to monitor variations and extensions of contract against suppliers Implement a supplier relationship management plan, including feedback from both suppliers and staff on contract performance Establish framework for review of performance and the application of non-performance penalties as required Review financial benefits to monitor achievement of VFM and identify areas of improvement Evaluate tender & contract administration performance</p> |
|---|--|--|---|--|---|

| | | | | | |
|--|---|---|--|---|--|
| Strategic High value Competitive market High visibility, affects most areas of business Critically affects operations | When developing contracts, consider pricing mechanisms such as alliance, penalties/incentives/risk share arrangements to enhance value Ensure total cost of ownership has been calculated and accounted for including all ongoing service requirements Build service performance indicators into contract Develop tailored financial benefits checklist to drive VFM Consider inclusion of non-performance penalties in contract development Communication and training plan for new contracts Seek to drive value beyond price | Undertake long-form risk assessment and supplier segmentation to understand potential risks Require suppliers to submit business continuity plan Detailed contingency planning is undertaken and regularly reviewed Establish a clear escalation path and tracking mechanism for all issues Complete Probity Plan Engage Probity Advisor if indicated (may be internal or external) | Level 4 procurement skills Articulate roles and responsibilities, appointing relationship managers and service delivery managers, ensuring a clear escalation path for all issues Consider establishment of project Steering Committee to oversee procurement process and ensure probity and VFM outcomes Consider level of involvement required by technical/subject matter expert where the good or service being procured is highly technical | Develop KPIs tailored to contract and project outcomes. Ensure these can be efficiently and consistently measured Ensure supplier buy-in to performance management program Implement a tailored supplier scorecard template and ensure regular benchmark of supplier performance on scorecard Establish feedback forums to identify performance issues or improvement opportunities Establish regular stakeholder meetings as part of the performance monitoring process to identify and quickly raise any performance issues Reviews conducted quarterly for 1st 12 months, thereafter 6-12 monthly for the term of the contract | Processes are in place to monitor variations and extensions of contract against supplier Regular reviews by senior management of performance reporting Establish framework, including relevant stakeholders, for review of performance and the application of non-performance penalties as required Non-performance penalties are enforced i.e. a case by case basis considering the degree of loss or disruption and/or the availability of alternatives Review financial benefits to monitor performance Identify areas of improvement, and opportunities for innovation (one initiative annually) Evaluate tender & contract administration performance |
| | | | | | |

Source: (Monash Health, 2015_[22]).

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