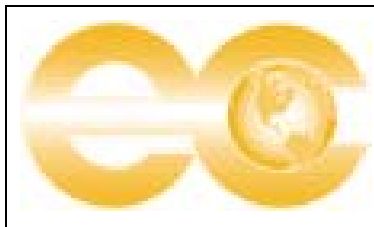


Funding E-Procurement System Acquisition

NECCC
December, 2000



National Electronic Commerce Coordinating Council

The National Electronic Commerce Coordinating Council (NECCC) is an alliance of national state government associations dedicated to the advancement of electronic government within the states. The Council is comprised of **NASIRE** (a group representing the chief information officers of the states), the National Association of State Purchasing Officials (**NASPO**), the National Association of State Auditors, Comptrollers and Treasurers (**NASACT**) and the National Association of Secretaries of State (**NASS**). In addition to these voting members, other governmental and private organizations participate in an advisory capacity. These associations include the National Governors Association (**NGA**), the National Association of State Chief Administrators (**NASCA**), the Information Technology Association of America (**ITAA**) and the National Automated Clearing House (**NACHA**). The ITAA and the NACHA specifically represent private information technology companies and the financial services and technology industries.

EXECUTIVE BOARD

Chair: **Hon. J.D. Williams**, NASACT, Idaho State Controller

Vice Chair: **Richard B. Thompson**, NASPO, Maine Director of State Purchasing

Secretary/Treasurer: **Carolyn Purcell**, NASIRE, Executive Director, Texas Department of Information Resources

NECCC BOARD

NASIRE	George Boersma , CIO & Deputy Director, Michigan Department of Management & Budget Steve Kolodney , Director, Washington Department of Information Services
NASPO	Dave Ancell , Director, Office of Purchasing, Michigan Department of Management & Budget Joyce Murphy , Director, Division of Purchasing & Materials Management, Missouri Department of Administration,
NASS	Hon. J. Kenneth Blackwell , Ohio Secretary of State, Hon. Elaine Marshall , North Carolina Secretary of State Hon. Ron Thornburgh , Kansas Secretary of State
NASACT	Hon. David Heineman , Nebraska State Treasurer Hon. Thomas Wagner , Delaware Auditor of Accounts
NGA:	Thom Rubel , National Governors Association
NASCA	Pam Ahrens , Director, Idaho Department of Administration
ITAA	Basil Nikas , CEO, iNetPurchasing.Com
NACHA	William Kilmartin , Vice President, American Management Systems - AMS

NECCC STAFF

Brandon W. Lenoir, Director • 202-624-5451 • e-mail: blenoir@nasact.org • web: www.ec3.org

ACKNOWLEDGEMENTS

This White Paper is prepared by the e-procurement and funding workgroup of the NECCC.

AUTHORS AND CONTRIBUTORS:

Dave Ancell	State Purchasing Director	Michigan
Ron Bell	State Purchasing Director	Virginia
Marv Eicholtz	State Purchasing Director	Montana
Richard Pennington	State Purchasing Director	Colorado
Dick Ross	Assistant Director of the Procurement Services Group	New York

Table of Contents

Page

4.	INTRODUCTION
4.	Scope of This White Paper
4.	Survey Method
5.	SURVEY RESULTS
5.	Scope of E-Procurement Projects
5.	Funding Approaches
6.	Legal and Policy Constraints
7.	Cost Estimates and the Business Case
9.	State-Funding of an E-Procurement System
9.	"Reverse Revenue" or Self-Funded Models
12.	Considerations for Fee-supported Procurement Offices
12.	Other Stakeholder Issues: Identifying the "Team"
13.	State Resource Requirements
14.	Other Issues/Considerations
15.	SUMMARY AND CONCLUSIONS
17.	APPENDIX A: Funding Issues/Survey Worksheet
22.	Workgroup Member List
23.	APPENDIX B:
	Surveyed States - E-Procurement Project and Funding Summaries

Introduction

Twenty-six states who reported current e-procurement initiatives were surveyed for this report. Many states have developed or acquired solicitation publication systems that they develop and maintain in-house. Many also have a requisition and purchasing module as part of an existing ERP system. Discussion in this paper, however, has been limited to systems that provide functionality beyond web-based solicitation publication systems and requisition and purchasing functionality in previously existing ERP systems. The primary funding challenges involve acquisition of catalog systems (with various combinations of online requisition, ordering, receiving, and payment) or bidding systems that provide more than publication of the solicitation on a web site.

Some issues have been noted but not covered in detail. Among them is the critical, threshold decision about whether a state should choose a state-hosted or application service provider (ASP) hosted solution. The relationship of that decision to available funding models is noted.

SURVEY METHOD

In May 2000 a request was sent out to all 50 states via the National Association of State Procurement Officials (NASPO) e-mail list serve. The e-mail asked that states identify a contact person who could discuss funding issues with members of the NECCC e-procurement and funding workgroup.

Because the inquiry focus changed depending on the exact e-procurement system and specific funding model used, some flexibility in the survey was needed. Using an issues outline and conducting the survey orally was considered preferable to relying on a written survey. The issues outline is at *Appendix A*. It should be noted that within their individual state procurement guidelines, Colorado and Utah worked cooperatively on an e-procurement system.

Survey Results

SCOPE OF E-PROCUREMENT PROJECTS

The e-procurement systems under use or in development are:

- Passive bid solicitation systems, where vendors are responsible for checking web sites and downloading solicitations.
- Web-based publication of state contracts and price agreements.
- Bid solicitation distribution systems that “push” solicitation notices to registered vendors, with or without a capability to submit bids electronically.
- Catalog system only, without bidding capability, where orders could be placed for items on the catalog system.
- Catalog systems, with internal quote and bidding capability, with requests for quotes or invitations for bids distributed to registered vendors on the system.
- Catalog systems with integration to the state’s accounting system.

Appendix B has a brief summary of the project scopes and current status of the projects in states who were surveyed.

FUNDING APPROACHES

The basic funding approaches in use by the states surveyed are:

- State-funded, where payments are made by the state to the vendor, with funding from state-generated revenues, e.g. a cash fund or fees collected from governmental entities using the system. Tennessee plans to fund its system through assessment of agency use fees.
- Self-funded or reverse revenue models where the vendor retains transaction or bidding fees to recapture the implementation, operation and maintenance costs. For example, the Connecticut, Colorado and Utah e-procurement systems will be financed through a self-funded model, with the ASP vendor recovering its development and operations costs through fees charged to vendors for transactions, i.e. catalog orders and bids awarded.
- Some combination the above. For example, in the Washington e-procurement system, there was a one-time charge for integration to the financial system. Washington contractually committed to pay the vendor a portion of the development and implementation costs, with that investment recaptured by charging user fees (to state agencies, higher education institutions, and political subdivisions). The e-procurement vendor will also be permitted to charge a transaction fee to suppliers. Texas similarly has a fee structure that contemplates payment of transaction fees by suppliers and using agencies.

LEGAL AND POLICY CONSTRAINTS

Revenue Limitations A fundamental issue in choosing between a state-funded model and self-funded model is the treatment under state law of the supplier fees charged in a

self-funded model. Both Washington and Colorado, for example, are revenue limited. However, in neither state was the fee charged to the supplier (and likely passed on at least in part to governmental agencies) considered revenue for purposes of revenue limitations. States having constitutional or statutory revenue and spending limits must resolve this issue concerning treatment of supplier fees.

Need for Legislative Authority Most states reported no real concern with finding requisite authority for e-procurement system acquisition. Both Colorado and Washington could point to statutes that granted “authorization” for soliciting and implementing the system. In the case of Washington, its statutes were changed several years ago to make state procurement cash funded, or self-sufficient in that the costs of operation are covered in fees charged to agencies for procurement services. This granted sufficient flexibility to solicit and implement the e-procurement system.

In Colorado, a 1999 statute creating the Governor’s Office of Innovation and Technology provided the statutory authority to acquire the e-procurement system. Connecticut reported that no specific statutory language existed to authorize its procurement of the self-funded system.

Contractors as “Fiscal Agents” One state whose central procurement office was supported through user fees and revolving funds thought that third party collection of fees could violate legal limitations on a commercial entity’s operating as a fiscal agent of the state.

Charging Suppliers Transaction Fees The self-funded model requires assessment of fees against suppliers. Some states reported a basic policy objection to this model. The primary concern was impact on small businesses doing business in those states.

Integration to Back-End Accounting Systems One of the major cost drivers in e-procurement systems is integration to existing accounting systems, where the e-procurement system is not part of a more comprehensive ERP system. The fundamental decision about whether to require integration must be made at the time of solicitation development, unless a decision is made to make a selection and then negotiate changes as integration is desired. A state’s fiscal control model may require encumbrance at the time of placement of large dollar orders. The Connecticut, Washington, Utah and Colorado systems all require integration to existing accounting systems.

Choosing to Await a Full ERP Solution At least two states have chosen to await an appropriation for a full ERP solution, instead of attempting a piecemeal solicitation of an e-procurement system. Since the survey did not target states without a present e-procurement initiative underway, it is possible more states have chosen to await an integrated ERP solution.

COST ESTIMATES AND THE BUSINESS CASE

Need for Cost Estimate/Business Case or Model There was general agreement that a business model or cost estimate had to be developed. For state-funded systems, states

have established processes (such as a feasibility study) for submitting appropriation requests or requests for approval.

For any system involving either self-funding or recapture of costs through user fees, success of the funding model depends on sufficient expenditures through the system. All of these systems require significant investment in time and resources to implement the system, train users and vendors, and adapt business processes to the systems. There is also a considerable investment of time and effort to encourage agencies to participate in requirements definition, source selection and implementation of the systems.

A business model that shows expected transaction efficiencies and savings from dynamic pricing is key to convincing agencies and institutions that the system is beneficial. Washington considered development of a business case in advance of the solicitation to be critical. Colorado and Utah did not have a formal business model or plan developed, although the New Century Colorado initiative had the governor's support and developed an early estimate of savings from the e-procurement system. A business model would also be useful to encourage other institutions and political subdivisions to join the system during implementation.

Development of the Business Case or Model Vendors are more than willing to participate in market research meetings and demonstrations. Michigan, for example, used a private consulting group to prepare its strategic plan and business case.

Most states developed their business models and feasibility studies in-house.

Washington spent an estimated of 200 hours of internal time prior to and during the RFP process analyzing procurement workflow, and developing specific time and dollar estimates for procurement workflow steps. This business model was used for justifying a \$3 million request for spending authority from the procurement cash fund. The business model was also invaluable in approaching governmental entities about the advantages in joining the system. Washington found its business model accurately predicted the system costs. Washington reports that the information available through the Internet and in vendor market research meetings was adequate for its estimates of expected system costs and capabilities.

Issues in Market Research and Development of the Business Model While vendors cannot provide specific pricing for a project, they should at least be able to explain how the pricing essentially is broken down. For example, software licensing costs may vary for catalog software, a quote and bidding functionality, and payment and invoicing features.

Some issues to be considered:

- If a state is considering state payment for ownership of the system, seek to understand what the basic software cost will provide, and what maintenance and upgrade services are included. Determine what support is available for a software product without payment of annual maintenance fees. Expect recurring annual fees for maintenance and upgrades.
- Ask how software support is available and priced if the software is customized.

- Hardware costs are a significant part of the implementation. IT personnel will have to be involved in estimating whether equipment exists for state-hosted solutions.
- Find out what ancillary services are available with respect to supplier catalog enablement and catalog content management. An existing fee structure for these features may be some indication of the amount of state resources needed to maintain the catalog system, particularly if catalog software will be purchased by the state.
- Some vendors claim full “catalog content management” services. Clarify how the content management service (and payment for them) is related to the funding model being chosen. Learn as much as possible about the support needed by the supplier community on these types of systems, and who provides it.
- Even among states who have completed solicitations, getting a firm estimate about state resource requirements remains a challenge. The roles that are commonly outlined for state performance are: project management, system administrator, catalog approver, supplier outreach and training, and user outreach and training. Try to reach an understanding about who (vendor or state) would be responsible for which role, and the extent of likely state resource requirements. Estimates so far have ranged between 2 and 6 full-time-equivalent personnel for these roles, not including the individual agency or institution “super user” or administrator.
- Discuss the possibility of an option for state ownership of an ASP system. So far, there is insufficient experience to know whether any kind of ASP purchase option (for state-hosting) is feasible or really desired.
- Find out what ERP systems can be interfaced, and how the accounting systems integration work would be priced.
- Find out whether a trading community exists that is using the system, and what is required (e.g. payment of fees) to start using those suppliers.
- Get a clear understanding about what commodity code “engine” lies behind the workflow and line item catalog loads, that will permit hierarchical commodity and service reporting and workflow controls. Find out if there would be extra costs associated with implementing a state-specific commodity code structure.

Return on Investment (ROI) Although “return on investment” is commonly used by vendors to advocate investment in e-procurement systems, there are no studies targeting specific e-procurement systems and analyzing their probable ROI. Colorado and Utah, for example, invited submission of independent studies that analyzed specific systems. Although there is general information available that estimates efficiencies and cost reductions from use of these systems (in the range of 20-30%), no third-party analysis of specific systems so far exists. Independent ROI analysis was not used in any state e-procurement acquisition to justify appropriations requests or fee structures.

The survey asked about the use of ROI or other efficiency savings as performance or incentive triggers in contracts, but none were found to have been used.

STATE-FUNDING OF AN E-PROCUREMENT SYSTEM

The survey found the following with respect to the use of traditional state-funded projects.

- States which embarked on a state-funded solution have reconsidered the funding strategy and are considering at least partial use of a supplier transaction fee model.
- No lease-purchase or other traditional financing method is currently in use.
- Expect the contract to include the following fee/payment structure in a state-funded model:
 - A basic license fee for a perpetual license to use the system
 - An annual fee for software maintenance and upgrades
 - Possible separate fees for bidding and quote functionality and payment and invoicing services
 - Hourly-priced integration services for legacy accounting systems integration
 - Responsibility of the state to provide some ancillary services for catalog content management and support, unless fees are separately paid

States having a revolving fund or other substantial cash fund for support of the central procurement office are more likely to be able to use a state-funded model. Most states simply report no available funds. The Washington e-procurement system was one example of the flexible use of available cash funding to partially pay for the system development costs and achieve reduced supplier transaction fees.

Colorado and Utah, on the other hand, had no such funding source available. Texas was statutorily required to use a self-funded model.

“REVERSE REVENUE” OR SELF-FUNDED MODELS

Description

In a self-funded model, a third party vendor typically hosts the system and charges suppliers transaction fees and bidding fees to recoup the costs of development and system operation. In the self-funded model, ancillary services such as catalog enablement and maintenance are typically defined as part of the solicitation requirement.

States using this model have chosen to use an ASP deployment and not state-host the equipment and software. There is no example yet of the use of a self-funded model for a state-hosted system.

Achieving “Spend” Targets: The Importance of Supplier and User Support The key to success of this model is moving sufficient transactions (i.e. orders and bids) through the system and generating the revenues to support the costs. There are two key challenges:

Suppliers must use the system. States are learning that suppliers must conclude that the time and resource investment – as well as the fee – are offset by the efficiencies and other market advantages in being on the catalog.

Further, there is a challenge in overcoming “inertia” in achieving state implementation of these systems. Even though there is no overt payment required for the system, users will have a significant investment in terms of time and training.

The Types of Fees Much of the evaluation of relative merits of systems, and likely impact on the state and its suppliers, revolves around a clear understanding of just how fees operate. A clear description of these fees must be required as part of the proposals. These are the types of fees states will encounter:

Registration/Subscription Fees: A fee paid one time or periodically (e.g. monthly or annually) by a supplier to be hosted on the catalog, to receive solicitations or requests for quotes, or both;

Ordering Transaction Fees: A percentage (with or without a fee ceiling) applied against the amount of the order. The agreement should define the handling of fees if orders are changed or rescinded. An example would be 1% per order (not to exceed \$50 per order).

Bidding Transaction Fees: A percentage (with or without a fee ceiling) assessed against the successful bidder based on the amount of the award. An example would be 1% of the award not to exceed \$100.

Catalog Service Fees: The structure of these fees varies widely. Some are a straight monthly fee with tiered pricing based on the number of lines of catalog SKU. Other fees are based on the amount of orders.

The Importance of Expenditure or “Spend” Estimates Transaction fees operate against expenditures through the system. Vendors typically will ask for warranties of expenditure levels or detailed expenditure data from which they can draw inferences about anticipated expenditures.

The challenge of coming up with expenditure information was one reason that Colorado and Utah decided to work cooperatively on the e-procurement system. While detailed commodity and service expenditure generally was not available, the total expenditures from both states may have provided some additional assurance to vendors that their costs could be recovered within a reasonable fee structure.

Services expenditures appear to be one of the most difficult to forecast as possible candidates for the system. Connecticut reported that vendors expected the state to estimate the amount of expenditures that would likely traverse the system. States probably should avoid creating any warranties about specific expenditures through the e-procurement system. The Colorado/Utah experience was that most vendors at least used price agreement and state contract volumes to forecast their expected expenses through the system.

State Price Agreement and State Contracts Price Adjustments State contracts or price agreements appear to be the focus of the catalog systems. Those contracts are normally unit priced and may be good candidates for catalog solutions.

Once the system is mature and the agreement or contract is re-sourced, the fee structure will have been disclosed and included in the unit pricing. Vendors are likely to ask about renegotiation of state contract rates during the transition onto the system. Colorado/Utah said they would be willing to negotiate equitable adjustments to unit prices as a result of the fees.

The expectation is that the states will not see a “dollar-for-dollar” pass through of all the fee costs. The expected transaction efficiencies for suppliers from a catalog and ordering system should at least partially offset the amount of the transaction fee. Further, with multiple state contract and price agreement awards on catalogs, suppliers may decide to limit upward price adjustments in unit prices (as a result of transaction fees) to improve their competitive positions. It is too early to tell how much of the transaction fee will equate to dollar-for-dollar increases in unit prices on state contracts and price agreements.

Fee Re-negotiation Provisions and Revenue Caps Unless there is reasonable certainty about the expenditure detail and the scope of agencies that will use the system, expect considerable contingency. Colorado and Utah were not able to commit to specific ordering data accuracy. Nor were they able to commit to making the system mandatory without a better feel for the capabilities of the system. Instead, the contract included a two year re-negotiation provision that established criteria for fee re-negotiation. The re-negotiation can be invoked by either party.

In order to effect this type of provision, more detailed disclosure of costs, unit labor rates, and revenue projections is required. Those disclosures may also facilitate the initial evaluations by providing some insight into implementation, manpower loading, and timing of expected expenditures.

The fee structure is limited contractually. One concern is that the fees continue to operate after the costs of development and implementation (and a reasonable profit) are achieved. Vendors argue that they are at greater risk in these models, and do not achieve a positive cash flow until 18 months to 3 years into the contract. One approach is to permit vendors to propose a reasonable cap on their revenues that will be evaluated as part of the RFP. Once that revenue is reached, fees will be adjusted to account only for operating cost (plus reasonable profit), or some part of the revenue stream will be diverted to the state.

While this technique was used in the Colorado/Utah RFP, the effectiveness of the provision will not be known until the two-year re-negotiation.

“Leakage” From the System Vendors will want to know whether the system will be mandatory, for which agencies and institutions, and for which types of supplies and services.

The states generally have been unwilling to make such assurances without knowing how the system will work. Texas statutorily mandated use of the system by state agencies.

Colorado and Utah stated an objective to get all high-volume purchases which are good candidates on the catalog.

Fee Enforcement One issue involves failure of suppliers to pay the fee. This can be a problem, because fee assessment commonly is done periodically based on a previous month's orders or awards. E-procurement system vendors want to know what steps the state will take if fees are not paid. Colorado and Utah took the position that state contract vendors would sign an agreement to pay fees and they would be removed from the system upon a finding that fees were not paid (other than in a dispute based on performance of the e-procurement system itself).

CONSIDERATIONS FOR FEE-SUPPORTED PROCUREMENT OFFICES

About half of the responding states are substantially supported by fees, normally assessed against governmental entities who buy from state contracts.

The States of Washington and Texas were the only responding states that use both supplier transaction fees and user fees on the e-procurement system. Washington charges a \$4-\$4.50 straight user fee per order. The Texas fee structure includes a combination of transaction fees and subscription fees.

There is general agreement that e-procurement systems facilitate collection of ordering data necessary to collect fees from governmental users. In any funding model that has a self-funded component, "off contract" spending becomes an issue, not only for the e-procurement vendor that is trying to recover implementation costs, but also for the state office that is trying to recapture investment costs. It still is too early to determine the effect that supplier transaction fees and user fees have on system use.

States using a self-funded transaction fee model were asked whether they saw an issue with "competing fees." In some cases, a surcharge is added to state contract orders and remitted by the supplier to the state. In other cases, the state administers a user fee, which is assessed against governmental ordering entities on a transaction basis. Where success of the funding model is based on achieving expected spend volumes through the system, there may be an issue when aggregated fees are perceived by users to make the system unattractive from an overall pricing perspective. Although identified as an issue, so far there has been insufficient experience to reach a judgment about the effect of competing fees on success of the self-funded e-procurement system and its implementation.

OTHER STAKEHOLDER ISSUES: IDENTIFYING THE "TEAM"

Sponsorship Level This kind of effort will not be successful without cabinet level commitment to the project. Efforts that have stalled have been hampered by absence of governor or cabinet-level promotion.

- The Washington effort was boosted by placement of the e-procurement system on the Governor's "top five" list of high priority projects.

- The Colorado/Utah effort was promoted by the Colorado Governor's Office of Innovation and Technology. Utah similarly had governor cabinet-level support for the effort, as did Connecticut.
- Virginia's Governor issued an executive order that required acquisition of the e-procurement system. Michigan and Tennessee similarly had governor support.
- Texas had a 1997 legislative mandate to acquire a self-funded e-procurement system.

Budget Office Support Budget personnel obviously will have to be involved in any appropriation requests necessary to support the system. Even on self-funded models, because there is at least indirect budget impact, consider budget office involvement in the development of any business case and in writing the requirement.

Accounting/Controller In a self-funded model, the state controller or chief financial officer must be involved if there are issues involving revenue limits. Because the system likely will involve integration with the accounting system, state accounting or the state controller must be involved on the team.

Information Technology Program/Professionals IT personnel will have to be involved with any integration to existing legacy systems. IT personnel will also be key to making the initial strategic decision about whether to host the equipment at a state site, or to follow the application service provider (ASP) model with equipment hosted by the vendor.

Suppliers Without supplier involvement, evaluators will be challenged in making judgments about the respective merits of different catalog solutions, fee structures, and their impact on suppliers. In the Colorado/Utah project, although supplier support and impact on suppliers was a key factor in the selection, there was insufficient time for formal supplier involvement. Washington found supplier input to be invaluable and formally incorporated a test catalog upload into its evaluation, with supplier input.

Political Subdivisions Local government involvement at the evaluation stage is particularly important if political subdivision spending through the system is expected to help offset system development and implementation costs, e.g. where user fees will be charged to reimburse a revolving fund investment in the system.

STATE RESOURCE REQUIREMENTS

Implementation vs Steady-State State resource requirements is a "total cost" consideration and has been evaluated in some of the e-procurement solicitations. These judgments have been qualitative in nature, based on proposal descriptions of required state support.

In catalog solutions, expect at least a 12-18 month implementation process where the system is deployed, personnel are trained, suppliers are enabled, and the catalogs are populated.

There will be a reduction in central personnel resource requirements after “steady state” is achieved.

States report 4-6 full-time dedicated personnel, including the project director or manager, during implementation. Where there is accounting system integration, add 2 full-time personnel for the interface required.

Central Administration Most states expect to manage the system centrally. After “steady state” is achieved, states estimate 2-3 full-time equivalent employees will be required.

Agency Administration All of the solutions require some individual agency “super user” training and administration requirements. For states with procurement card programs, this administration function is expected to be similar in scope, with more involvement in development of workflow rules. In small agencies, the agency point-of-contact may be able to perform the administration functions as an additional duty.

OTHER ISSUES/CONSIDERATIONS

Procurement and Contracts Issues Related To Funding

Funding Model and Contract Term: In a state-funded system, the use of nontraditional funding models such as lease- purchase may dictate a contract term longer than expected. The survey did not find any example of lease-purchase funding being used for an e-procurement system.

In a self-funded model, the use of a longer contract term will probably be warranted. Based on the scope of business process changes, the inclusion of a fee re-negotiation provision at the two year point, and the time necessary to achieve steady-state operation of the system, a five-year production period, with an option for an additional five years, was used in the Colorado/Utah e-procurement system. Washington also specified a contract term that may reach 10 years in length. Connecticut’s self-funded contract has no expiration period specified.

Evaluation of Proposals: The self-funded model involves supplier impacts and potential costs that are outside the customary price analysis. Some means of evaluating potential costs to the state, supplier impact, offsetting efficiencies, state resource costs, and other impacts should be included.

Change Management: A state-funded model accommodates changes more traditionally. In the Colorado/Utah contract, the change will be handled through fee re-negotiation or through payment of funds, if available.

Anticipate change costs from:

- Required changes to workflow and other system customization;
- Addition of software modules, such as invoicing and payment, bidding functionality (where not included in the basic system), inventory functionality, or procurement card functionality and features;

- Modification of commodity coding structure, such as integration of an unique or modified NIGP commodity code structure;
- Integration of existing accounting systems;
- Integration into a new ERP system;

Additional State or Political Subdivision Integration So far, there is no real information to gauge whether adding political subdivisions results in savings through scaling but the Colorado/Utah experience indicates that savings might accrue as other political subdivisions or states are added to the system.

When Colorado and Utah conducted their procurement, vendors were asked to estimate the savings (if any) from the joint procurement. Estimates ranged from \$3-\$5 million at being able to leverage common ASP hardware. A negotiation trigger was included that requires disclosure of revenue and cost data and permits re-negotiation downward of fees as other governmental entities are added to the system. Another state is defining in advance a tiered fee structure that is tied to expenditure volume through the system.

Summary and Conclusions

SPONSORSHIP LEVEL: ACHIEVING COMMITMENT IN STATE TIME AND RESOURCES

Assessing the level of success in current initiatives is difficult; most are early in implementation. However, those states who have moved the process forward and selected vendors using nontraditional funding models had “sponsorship” at the governor’s level. There is a huge investment in time and resources to define requirements, select a vendor, and get the system implemented. Projects that have languished did so because cabinet level encouragement did not exist. Sponsorship commitment must continue past the procurement phase and through implementation. The work just begins with the selection of the vendor.

UNREALISTIC EXPECTATIONS OF QUANTIFIABLE ROI/EFFICIENCY SAVINGS

Unless a state’s procurement system is highly centralized, it may be difficult to point to reductions in personnel costs from expected gains in efficiencies. Although there appears little doubt that efficiencies will be achieved, expectations of true avoided costs or cost savings from use of these systems may be unrealistic or difficult to quantify.

There is a tangible resource requirement for system administration, both at the centralized and agency level. The real efficiencies are likely to be realized at the user level.

IMPACT ON SUPPLIERS

Broad supplier integration in these systems is probably the most important key to achieving user buy-in. The impact on suppliers from self-funded models is a real concern that must be factored into the business strategy decision, the solicitation, and implementation. In some cases, opposition to this business model in the state precludes its use.

Appendix A

E-Procurement Funding Workgroup Funding Issues/Survey Worksheet

_____ Surveyor	_____ State	_____ Point –of-Contact/Phone
-------------------	----------------	----------------------------------

A. Which best describes your funding approach, e.g.

1. Payments by State to vendor for service/equipment, funding from general/tax fund or special funds, e.g. fees
2. Self-funded or reverse revenue model where vendor retains transaction/bidding fees to recapture implementation/O&M costs
3. Fee paid by State to vendor for service/equipment, funds obtained through treasury loan or other revenue anticipation method
4. Combination of the above?

B. Describe the basic scope of your e-procurement project:

1. Catalog?
2. Full procurement, e.g. solicitation system, or just small purchases?
3. Accounting system integration?
4. Scope of use: agencies, higher ed institutions, political subdivisions?
5. After implementation, vendor operation responsibilities, e.g. vendor help desk function, catalog maintenance, supplier support?
6. After implementation, continuing "maintenance" by vendor?

C. Clarify definitions of terms

1. General/tax funded
2. Fees, cash funds, etc.
3. Political subdivision
4. Institutions of higher education: are they State agencies or political subdivisions?

D. Cost estimates for States requiring legislative appropriation or other estimates of potential costs

1. Who provided or developed the cost estimate?
2. What data was available?
3. How was the vendor community involved in development of estimates?
4. How has the actual cost performance compared to the estimates?
5. How much did you spend to develop third party estimates?

E. Fee for service model, e.g. general funding appropriation for acquisition of a State-hosted system, or annual charges for an ASP-hosted system

1. State-hosted model (where State owns hardware and software license) or Application Service Provider (ASP) service (vendors owns & maintains)
2. How is the system priced, e.g. per transaction fee paid by State (ASP) vs hardware and software acquisition cost plus maintenance (if applicable)
3. How has the up-front, expected price/fees compared to actual costs/fees?
4. If there has been cost growth beyond that reasonably expected, why?
5. Realistically, will there be recurring software licensing/maintenance costs also? Estimate of how much annually?
6. Was lease-purchase or other financing type of acquisition used?
7. Did you have to overcome any statutory or constitutional hurdles in using this financing method?
8. Was software licensing included in the financing? Or only hardware and integration costs?

F. In a reverse revenue or self-funded model

1. How does the supplier fee operate? By transaction? By bid award? Are there fee ceilings specified?
2. Is there a separate registration fee?
3. Who sets/approves the fee level?
4. What role does the State play in fee establishment and administration?
5. Did your solution have to accommodate legislative approval/establishment of fees or fees set by formal rule-making?
6. What role does the State play, e.g. debarment, in fee enforcement for suppliers on the system who don't pay their fees?
7. Did the State negotiate unit price increases to get existing statewide contract vendors on the system?
8. Were those unit price increases "\$dollar for \$dollar" in terms of passing through the system transaction fees?
9. How has the supplier community responded to this type of model?
10. How is "leakage" controlled, e.g. is use of the system mandatory? By whom?
11. How much State expenditure information was disclosed during solicitation and how was it used by the vendors?
12. Was commodity level expenditure information requested by vendors, and to what extent was it disclosed?
13. Are vendors making independent determinations on amount of "spend" that will go through system, or are they relying on you?
14. To what extent did these fees compete with other fees, e.g. statewide price agreement fees or solicitation information system fees?

15. How was "value" or cost evaluated in selecting the vendor?
16. Were any unique "partnership" approaches, e.g. fee renegotiation, used to monitor the amount of revenue and recapture of costs?

G. Administrative fees charged to users for use of the e-procurement system

1. How are fees assessed against State agencies?
2. How are fees assessed against political subdivisions?
3. Is use of the e-procurement system mandatory?
4. How are fees computed and administered? By whom?
5. How are fees used to offset system acquisition costs?
6. Are fees used to offset system administration costs incurred by your office or another State office administering the system?

H. Fee-supported Procurement Offices

1. To what extent is your purchasing office supported by fees?
2. To what extent are fees charged on existing statewide contracts to support your office administration?
3. To what extent are fee revenues derived from agency or user fees?
4. What problems were there integrating your existing administrative fee/purchasing office funding structure into the e-procurement system?
5. How did the system improve (if at all) your office's ability to track procurement activity and collect fees?

I. Was there a special legislative fund available or established, e.g. technology innovation fund?

1. Is this a one-time expenditure?
2. Is there a payback to fund, with or without interest?
3. How often can funds distributions be authorized? By whom, e.g. legislative appropriation, controller, other department/agency/official?

J. Return of Investment (ROI) or Shared Savings Models

1. Was ROI used to justify appropriation or other program authorization to the legislature?
2. Who conducted the ROI analysis?
3. What data was available or used?
4. Is return on investment being used to "repay" or otherwise fund system costs? How?
5. Is ROI being used as an incentive to the vendor to adjust/establish fees, share in savings, etc.?

6. Are hard dollar savings from use of the system, e.g. through shared savings from the use of auctions, being used to help fund the system? How?
7. Was any other performance-based contract method used for permitting the vendor to share in costs? How was it measured? What was the share?
8. Was specific legislation required to incorporate ROI or shared savings incentives into the contract?
9. What barriers, if any, otherwise existed to use of these types of partnership or innovative funding methods?
10. Has the use of ROI been successful? Why or why not?

K. Other Statutory/Constitutional Barriers and Issues

1. Is your State revenue or spending limited?
2. What problems did constitutional or statutory issues pose for use of self-funded or other unique funding models?
3. Does your State statutory scheme permit the use of a fee-based self-funded model?
4. Did you need specific legislation for this initiative?

L. Other Issues

1. What were the key concerns of the Controller or your State accounting office with respect to these funding issues?
2. For budget requests or other legislative initiatives necessary to your model, who participated in the budget or other development?
3. Who should have participated, but didn't?
4. What other budget office issues existed that have not been already discussed?
5. How high level was the visible "sponsorship" push, e.g. Governor's Office, Secretary level at cabinet meetings, etc.
6. Was the "sponsorship" level high enough? If not, why not?
7. How did the funding model choice influence the contract term?
8. How would additional State or political subdivision integration into the system affect fees or costs?
9. If other entities (e.g. political subdivisions) are added to the system, will the State recapture any of its development costs?
10. How do the different models differ in terms of amount of State resources necessary to implement/operate the system?
11. Do you have estimates in terms of IT and other State personnel required to administer the system?
12. Did you use a "total cost" approach in evaluating the relative merits of the funding and hosting models?

13. How much flexibility did you permit offerors in proposing funding models or solutions?
14. How did you “compare apples to apples” in evaluating different funding model proposals?
15. What was the key factor in succeeding with the funding model?
16. What was the most significant barrier that had to be solved or overcome?
17. In retrospect, what do you wish you had done differently with respect to the funding approach?
18. Candidly, were there any political realities that got in the way of this project?
19. If your project failed, candidly why did it fail?

M. Vendors (Check Confidentiality Restrictions)

1. Which vendors are you working with?
2. If they are teamed, with whom and for which facets of the system, e.g. catalog, bidding system, accounting system integration, etc.?
3. Which vendors could we talk to that might have constructive ideas on these issues?

N. What other States do you know that are involved in e-commerce and may have good insight into these funding challenges?

[Purpose: To validate our spreadsheet list as complete]

E-Procurement and Funding Workgroup

Alia Mendonsa	Center for Digital Government	Joyce Murphy	Missouri
Ann Orlando	SAIC	Judi Zito	Florida
Bill Keip	Metamore	Kara LaPierre	NIC
Bob Moriarty	SAIC	Karen Helderman	Virginia
Bob Sturm	NIC	Lance Smith	Electro-net
Brandon W. Lenoir	NECCC	Mark Krysiak	Maryland
Brooks Knight	Texas	Marvin Eicholtz	Montana
Chuck Grady	Ariba	Mary Alice Johnson	Digital Commerce Corporation
Dan Moore	CACI	Michael J. Corvino	SAP
David Ancell	Michigan	Michelle Sisler	AMR
David P. Gragan	Oracle	Mike Peterson	CACI
Denise Lea	Louisiana	Miles K. Weigold	EMC2
Dick Ross	New York	Pat Kohler	Washington
Don Griffin	New Jersey	Paul Weber	SAP
Donald R. Greene	New York	Paula Moskowitz	New York
Doug McCoy	EDS	Peggy Fluman	Inacom Corp
Douglas E. Boettner	Nevada	Ron Bell	Virginia
Dugan Petty	Oregon	R. Thomas	Delaware
Fred Norman	NIC Commerce	Wagner Jr.	
Gary Lambert	AMS	Randy Cole	IBM
Helen McCain	Wisconsin	Richard B. Thompson	Maine
Howard Freeman	3M	Richard Pennington	Colorado
Jamie L. Spiegel	Texas	Rick Wheeler	Anderson Consulting
Jan G. Cox	Idaho	Rob Duke	Surety Association
Jan Heckemeyer	Missouri	Robert Attmore	New York
Jane M Wiseman	Anderson Consulting	Robert Kirk	Illinois
Jeannie Wood	Delaware	Robert Smith	Wolfenet
Jeff Holden	South Dakota	Robert Sturm	NIC
Jeremy Starns	AMS	Sandy Wright	Dun & Bradstreet
Jim Passier	Connecticut	Shannon Bisbee	AMS
Jim Tucker	Way2Bid	Stephen Lyon	IBM
Joan Daly	Civic.com	Steve Sorett	Grant Thornton
Joan Sullivan	New York	Theodore F. Winnie	New York
John Bradley	Delaware	Tim Sheehan	Freemarkets
John C. Moore	Virginia	Tom Jaworsky	Oklahoma
John Greaney	Dunn & Bradstreet		
John Kennedy	New Jersey		

Appendix B

Surveyed States: E-Procurement Project and Funding Summaries

State	Project Scope	Funding Model	Fees/Costs	Status/Comments	Vendor(s)
Arizona	Electronic solicitation system development, permitting electronic receipt of RFPs and IFBs	Anticipated assessment of registration fees or award fees charged to vendors	Not known at this time.	Re-evaluating funding model, and seeking appropriation	N/A
California	Catalog system for CMAS and state awards, with some accounting system integration	State-funded	No supplier fees	Being implemented. Pilot complete by early 2001.	Ariba catalog software, with Anderson Consulting integration
Colorado	Catalog system with quote, and integration to executive department legacy accounting system	Supplier Transaction Fee	1% recovers \$12M that includes ASP hosting services, software and maintenance, catalog maintenance, implementation and training, accounting system integration, and 5 years operation. \$25/\$100 bidding fee (not charged to state contract holders). No user fees charged.	Awarded August 2000 (cooperative procurement with Utah)	NIC Commerce
Connecticut	System includes bidding and catalog buying, with accounting system interface.	Reverse revenue self-funded by fees assessed by transaction.	Typically 2% per order plus one time registration fee of \$395.	Vendor Registration has been operational since March, 1999. Catalog buying system now operational.	Digital Commerce Corporation (StateGovCenter.com)
Delaware	ERP system with procurement module for small and large purchase. No electronic catalog system. Only for use by central	State-funded. No supplier fees.		Contract signed 12/98, pilot complete by 7/00, with full implementation by	SAP

State	Project Scope	Funding Model	Fees/Costs	Status/Comments	Vendor(s)
	state procurement organization.			7/02	
Florida	State wide purchasing subsystem part of existing ERP (1987), planned implementation of purchasing system as part of statewide ERP system	State-funded		Legislature has approved phase I, ERP implementation for three agencies by June 2001	ERP vendor not selected
Idaho	Pilot e-procurement (solicitation notification and bidding) system, presently without accounting system integration	State funded plus bid transaction fee; no other bidder or user fees	Estimated 2% transaction fee plus state funds of \$19K + \$1.5K/yr maintenance	In pilot production, integration to be negotiated if full production elected	Syscom
Louisiana	In planning for e-procurement system	N/A	N/A	In planning for integration with AMS system	N/A
Maine	Vendor registration, bidder notification of bid opportunities and online bidding system	Self-funded via supplier fees	Free access via the Internet to bid solicitation documents. Monthly subscription fees based on transaction volume ranging from \$9.95 (for up to 10 transactions) to \$29.95 (for up to 25 transactions) plus a fee of \$1.50 over the minimum.	Functional	SiCommNet
Maryland	E-mall catalog and e-purchasing system provide by ASP	Self-funded	\$150 per supplier for basic services/\$225 for extra services. \$3.50 per purchase order over \$200. Revenues are capped with revenue fee sharing with state when revenue cap achieved. No fees charged to using agencies.	Contract awarded.	SAIC partnering with KPMG.
Massachusetts	Statewide procurement system including bidding, catalog buying and full back office integration. Popularly know as	State-funded	N/A	Catalog buying operational now on phased rollout. Full system under	Metiom (formerly Intelisis)

State	Project Scope	Funding Model	Fees/Costs	Status/Comments	Vendor(s)
	the Massachusetts Multistate EMail			development.	
Michigan	ASP catalog, full procurement system, and accounting system integration to be used by all state agencies, higher education institutions, and political subdivisions choosing to use it.	Anticipated supplier transaction fees and subscription fees by political subdivisions.	No final decision yet on funding model. Vendor is expected to collect user subscription fees (based on state contract orders) and supplier transaction fees.	Andersen Consulting developed strategic plan. In 6-month "proof of concept" pilot.	Epylon, Ariba, and Andersen Consulting
Minnesota	Expanding existing ERP (AMS) with central stores ordering system	State-funded from general fund and revolving fund	State central stores is essentially a supplier, and revenue is generated through orders placed by governmental entities	Incremental development	In-house
Missouri	Online bid notification and bidding system. Online vendor registration.	State-funded, no user or bidder fees	Negotiated fee for development of bidding system to be added to AMS ERP system.	In production at central procurement office	AMS
New York	Planned statewide procurement system including bidding, catalog buying and full back office integration	To be determined	N/A. Expected to be a self-funded model.	Vendor registration to be operational in early 2001	To be determined
Ohio	ERP acquisition planning underway. Ohio has online state contract publication system.	State-funded. Considering changes to user fee structure. Considering supplier-fee system.	N/A. Current online state contract publication system is in-house developed.	ERP project manager RFP has been issued. ERP RFP will then be developed.	N/A
South Carolina	Catalog system. Solicitation notification system for pharmaceuticals. No accounting system integration.	Considering supplier transaction fee for catalog. Solicitation notification system is state-hosted/funded.	Possible transactions fees on tiered basis tied to spend	Awaiting award announcement.	Not announced
South Dakota	In discussions concerning direction of e-procurement			Needs to integrate with GEAC accounting system	N/A

State	Project Scope	Funding Model	Fees/Costs	Status/Comments	Vendor(s)
Tennessee	Catalog and full procurement system, including accounting system integration	Planned funding through graduated agency transaction fees based on number of transactions.	Monthly fee assessment based on volume of agency transactions and type of transaction. Central purchasing office is fully supported by user fees.	Request for Information (RFI) issued.	
Texas	ASP catalog with full procurement system. Accounting system integration. Used by state agencies, higher education, and political subdivisions.	Self-funded system by supplier transaction. 1997 statute required self-funded model. System is mandatory by statute.	\$3 per solicitation, \$1 per transaction paid by supplier and using agency, \$1 per invoice, \$1 per payment. Vendor bid notification subscription \$50. Registration fee negotiated with supplier. \$125 registration fee for political subdivisions.	Proposals under consideration.	N/A
Washington	Catalog system, with integration to executive department legacy accounting systems	Supplier Transaction Fee combined with State funds payment and user fees assessment	.5% supplier transaction fee. No additional catalog fees permitted, vendor responsible for catalog content management. User fees charged based on fixed charge per order.	Awarded June 2000	AMS/Ariba
Wyoming	Web-based Solicitation Notification System	In-house development, State-hosted, State funded	N/A	In process	N/A
Utah	Catalog system with quote, and integration to executive department legacy accounting systems	Supplier Transaction Fee	1% supplier fee recovers \$12M that includes ASP hosting services, software and maintenance, catalog maintenance, implementation and training, accounting system integration, and 5 years operation. \$25/\$100 bidding fee (not charged to	Awarded August 2000 (cooperative procurement with Colorado)	NIC Commerce

State	Project Scope	Funding Model	Fees/Costs	Status/Comments	Vendor(s)
			state contract holders). No user fees charged.		
Vermont	Implementing new ERP system	State-funded	N/A	ERP in implementation, expected to be complete by July 2001	PeopleSoft
Virginia	Full ASP e-procurement solution, including e-mall, e-purchasing and requisitioning, data warehouse, online bidding/negotiation, online auctioning, central vendor registration, surplus property management	Self-funded	1% order transaction fee/\$500 max (with revenue sharing with State), and \$25/\$200 annual registration fee depending on bidding notification features desired by supplier.	Awarded October 30, 2000.	AMS/Ariba
Wisconsin	State-hosted and developed e-mail solicitation notification system with capability to list state contracts. Used by state agencies and local governments.	State-funded with supplier subscription fees. Use of system is voluntary.	\$125,000 initial appropriation from an IT fund.	In production	N/A. State-developed and hosted.