

Juggling act

'Weighting' price vs. functionality



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WHEN MAKING A decision on what to buy, professional purchasers are continuously faced with the challenge of juggling price versus functionality/quality. When developing a Request for Proposal (RFP) they develop, both for themselves and vendors, a standard set of criteria against which submitted bids (proposals) will be evaluated.

Not infrequently, when drawing up the RFP documents it will be stated that some evaluation criteria are weighted, in other words they are more important than others. For instance, a 60 percent weighting may be assigned to the price consideration, with 40 percent being devoted to functional considerations. Example 1 below shows how, after evaluation, two final bids score. As a result of the weighting, a 10.6 percent saving on price means a 30 percent loss of functionality.

EXAMPLE 1	Price	Financial	Functional	Overall Score
A	\$104,000,000	90	50	74
B	\$115,000,000	65	80	71
Difference	\$11,000,000	10.6	-30%	

Weightings are inherently risky. As Example 2 reveals, if one moves to a 70-30 weighting of financial criteria, then it is virtually impossible for the lowest price to lose, no matter how badly it does on functionality.

EXAMPLE 2	Price	Financial	Functional	Overall Score
A	\$104,000,000	90	45	76.5
B	\$115,000,000	65	95	74
Difference	\$11,000,000	10.6	-50%	

A variety of devices have been concocted to try to avoid the problems presented by weighting criteria. One is to award the contract on a dollar per point basis. Under this approach, the functional score is divided by the financial score (or a rounded variant of that score), and the contract is awarded to whichever bidder secures the highest score per dollar of cost. Using Example 1, the two scores would be as follows:

$$A = 0.4807 \quad B = 0.6956$$

Since Bid "B" enjoys a higher dollar-per-point score than Bid "A," the contract would be awarded to B. Unfortunately, this approach tends to result in the same award as would generally occur using a straight average of the functional and price score, although (as the scoring in Example 3 indicates), it is possible in some cases to achieve a different award.

EXAMPLE 3	Price	Financial	Functional	Weighted Score	Average	Dollar per point
A	\$104,000,000	90	72	84.6	81	0.6923
B	\$115,000,000	65	95	74	80	0.8261

Many experienced purchasing professionals (particularly those with a strong finance or control inclination) primarily use dollar-per-point evaluation to provide a reality check. While it is foolish to forego a significantly superior level of functionality in order to achieve a small price saving, it is equally foolish to purchase a slightly more functional product when it costs substantially more money. A dollar-per-point comparison puts into its proper context the question of how much more they are prepared to pay to get a higher level of performance.

Another approach is to use a two or three envelope system. In a two-envelope approach, the functional scores of the various bidders are first tabulated to determine whether (and which) bidders satisfy some minimum functional threshold. Once the passing bidders have been determined, the financial scores of the bidders are determined and the contract is awarded to the qualifying bidder who submits the lowest price. A three-envelope system is similar, the significant difference being that the bidders themselves must first demonstrate sufficient experience to be considered for the award of the contract. The bids submitted by bidders who pass this test are then compared to determine which is best overall. Two and three envelope systems presume that the proposals offered will be broadly similar. These systems also ignore the risk that a person may make a substantial sacrifice in terms of performance in order to achieve a slight benefit in terms of price.

All three of these approaches have significant short-comings. Purchasing professionals have been searching with keen interest for a more balanced way of evaluating competing offers. In our next article, we will consider a recent innovation: the common price comparator. ~~~

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