JIGSAW TALENT MANAGEMENT

MONTHLY MARKET REPORT

NOVEMBER 2020

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NOVEMBER 2020

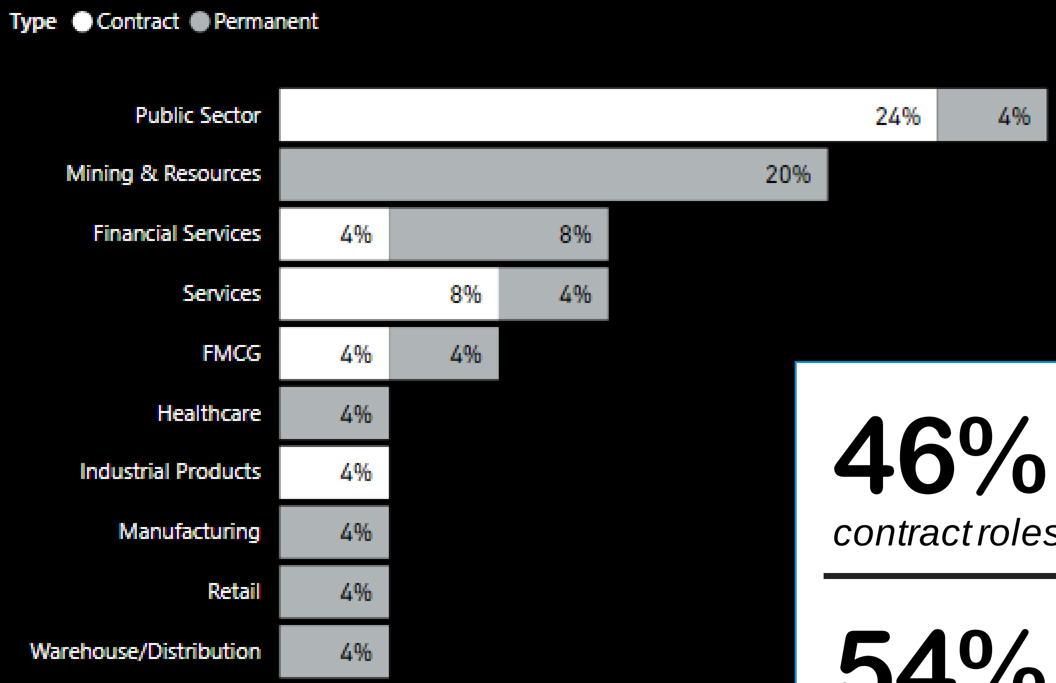
In this report:

JIGSAW JOB STATS

CURRENT MARKET DEMAND

NOVEMBER 2020

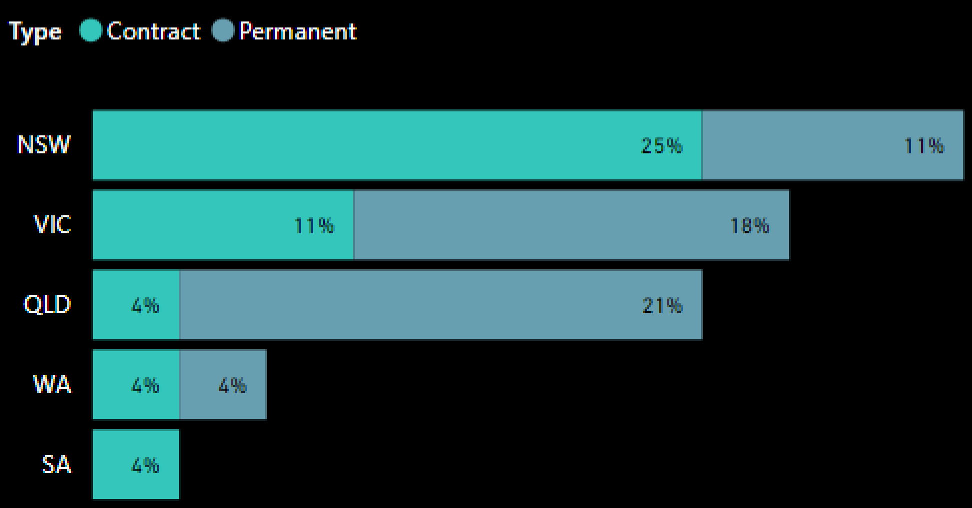
Live Roles by Industry



46%
contract roles

54%
permanent roles

Live Roles by State & Job Type



Many of us will be happy to see the back of 2020.

Australians seem to be swapping one disaster for another. From the bush fires, the pandemic and now the economic crisis, it seems we are being challenged on many fronts and without being too sentimental, we hope that these trials bring people closer.

So, as of the end of October, what can we summarise? The US election is the big one. It seems bipartisan government is a thing of the past and never before has a country been so divided. The gap between Republicans and Democrats is so vast that it may not matter who wins the polls, the other side of the coin will likely not accept the result. As Jigsaw see it, neither party stands for a free market and no matter who is nominated one thing is guaranteed - more stimulus. Whether it be $1.5 trillion or $3 trillion, the US currency will be at risk of further debasement and the country will be lucky not to stir itself into a civil war if radical measures are not taken.

History teaches us that the fall of empires is a certainty. Just because we now have planes, trains and blockchain, this does not alter the fundamentals of society and economics. If we look at the fall of Rome, it was due to leaders who were more interested in themselves than that of the public good. Key affairs were not attended to, provisional armies were neglected, shrinking Rome's influence as it lost out to foreign invasion. Debt and currency debasement occurred as the people lost faith in the ruling party (reducing silver content of coins) causing hyperinflation 200X in 40 or so years. Rome went downhill from circa 180AD to 280AD, about a 100-year timeline. The final attempt at reform involved centrally planned communism to stabilise prices and create stimulus for the regions left under Roman control. This central control created an ever-expanding governance, which in turn created an increase in taxes (25% - compare that with what we pay today and what Mr Biden is proposing, which is 60%+). These high taxes disincentivised the labour force and many turned to slavery instead (slaves paid zero tax and they had more prosperous existence than workers).

Eventually, the people who were left in serfdom abandoned their duties and fled to the barbarian lands to escape. If you have time, the breakdown of Rome is fascinating, and the dynamics mirror the present day. The problem is world leaders either believe they can outsmart the issues that created such turmoil in the past or they simply have never explored the past.

This month, Jigsaw have focussed most of our content on procurement, which with Melbourne's lack of procurement process seeming to be a key theme resulting in the failure to contain the initial outbreak of Covid-19, and the debacle of the land purchase for Western Sydney Airport costing 10X its real market value, procurement's lack of respect and the costs associated with its abandonment seem on point. What is interesting re the two events that seemed to neglect the fundamentals of procurement rigor is in both scenarios, Sydney airport and Melbourne's lockdown security have entirely different issues that have resulted in a cost. These costs were wide. From potential corruption leading to a lack of public confidence in our nominated parties to compounded economic destruction, if procurement was engaged and respected, even without a mandate for savings, the outcomes may have been much more favourable.

The theme of the central article "Procurement – Economic Lever" is attempting to answer key questions on procurement's real value and purpose, with value being a key theme. Other segments focus on how procurement will be diminished or enhanced re geopolitics and how passive procurement is a worrying and self-cannibalising trend for the profession as a whole.

As a market snapshot, Jigsaw are seeing increased demand for procurement across all industry sectors. Jigsaw are working with retail, consumer manufacturing, mining, finance and public sector as businesses are realising a V shaped recovery is off the table. Category management is still the key theme for many businesses as they seek to better integrate market knowledge and demand to create value.

It is Jigsaw's view that for category management to flourish, central models will need to be abandoned and individual functions within the business will have to drive the demand for the skillset outside of the CFO. This means a business could have zero category management for ICT but have a world class category management in play for marketing. This shift in thinking, from centrally planned and governed procurement departments to de-centralised, cost centre focussed capability is a key change that may solve the transformational nature of construct to de-construct dynamics that are occurring. When procurement exists as a separate entity, as a function not a skill set, its existence and value needs to be measured. In business, performance can be measured re the front end via sales or the back end re savings. Anything that falls outside of this is often classified as a soft value. Jigsaw have indicated time and time again, that measurement at the head of the beast is endless and value can stay consistent or be improved, yet this luxury does not exist at the tail. This is one of the key issues facing procurement. Procurement is possibly a capability more than it is a department. Businesses do not have a stakeholder management department or a leadership department as dealing with people is inherent in people's everyday lives which many transfer to the business environment. Like many things, the capability of dealing and influencing people varies and some people are very good at it while others struggle with it. Procurement is similar. Some people are naturally strong negotiators and have a deep sense of commercial value. Each department needs strong leadership and stakeholder management, whether it be marketing or technology. Departments also need good procurement skills, and many believe they have it and if they don't, they can go to market to appoint it. When procurement is appointed as a capability within a function and is not a function in its own right, it will have more value.

Its key sponsor will be the head of the actual function, removing the need to influence the value internally. Procurement will be part of the fabric of a department, constantly learning more about the subject matter, in real time. Relationships will be cemented in the core business, likely removing the transformational dynamic that sees procurement last 3- 5 years and then get dismantled.

The promotional arc for procurement will shift from increasing ownership of ever bigger functions in procurement to progressing to be the head of marketing, technology or logistics. If the market is telling us the long term expense and value of large procurement departments leads to a future decrease in value, then maybe a shift in thinking is required, where procurement is more cost effective and is seen as a middle management function and a stepping stone to progression in alternative departments, not as a marker in its own right. This change would certainly shrink the marketplace, increase the cost of hire and the capability required, yet this contraction in the market size would benefit the best players in the space. Purchasing, legal and processes would exist as separate skill sets. Procurement would not exist to be a hybrid of all things, a bit of legal, a bit of process and bit of purchasing. It would exist to simply manage suppliers, look at future department demand, drive innovation and unlock the desired value of the function head.

We hope you find these segments of interest. Stay Safe!

The Rise of Nationalism and its impact on Procurement

Globalisation. In the 80's through to today, it was fairly easy for companies to expand into other nations and trade. Geopolitics has always existed, but in recent times, no matter which nation was the founder of a given enterprise, its success was weighted on its product and backed by business fundamentals or creditors. For procurement, globalisation offered economies of scale, global category strategies and global teams, all pulling together to achieve value for a global leadership team that were aligned and had the world as an opportunity for growth. This has resulted in record profits and trillion-dollar enterprises.

As we rapidly head towards 2021, this could change. As examples of potential future issues re global businesses that operate in different countries and the impacts of geopolitical issues, we can look at TikTok, a Chinese global tech business that was forced by the US government to find a US buyer for its US operations, that selected buyer being Oracle. With over 100m users, many in the US and increasing at over 400k per day, investor value would be destroyed if the global business was to be divested into smaller parts. As of today, a partner model is in the background, and no decision is clear to the outcome of a deal, but if this is a trend, it means business profits will contract across global enterprises as geopolitical tensions impede capitalism. Other companies who are in the line of fire include Arm Holdings, a British semi-conductor business with interests in China, who according to the Economist, were approached by Nvidia via $40bn bid to acquire the business. This US takeover bid was of course a concern for a British business that did not want to get dragged into a US/China trade war. Huawei too, has been impacted by having its operations put on notice in the UK and has had sanctions placed on it in the US. Huawei is now waiting on Germany to decide if it will be a key player in rolling out 5G as Angela Merkel set out a draft on ICT security.

In this instance, Huawei have some leverage as the German economy is very reliant on China re its exports, as Germany is one of the few western countries that retained is capital and manufacturing sector and this may assist its eventual recovery, depending on outside influences across the Euro region. Still, Germany desperately needs advancements of 5G to stay economically competitive and China will use this and the trade dynamic as leverage.

It seems global businesses face an uncertain future, especially those with large scale operations across both China and the US. If geopolitical issues increase in line with trade and security, there is a very real threat to global businesses being divested, running independent operations and cultures under one global brand. M&A deals will be more complex, as deals will likely focus on country operations not the entire business causing huge issues re divestment of P&L's and global integrated systems. Entering new markets will prove more challenging and business costs will escalate as management teams fragment, economies of scale are lost and profits contract. This will have a follow on impact to equities. Jigsaw have been indicating for some time that we have likely hit peak value across global large cap stocks with future profits and growth likely to contract and right size over the next 3 years. If this dynamic is not yet priced into equities, many investors are going to be left holding the bag as forecasted revenues are not realised.

However, this volatility across global markets should be welcome news for procurement professionals who over the past 15 years, have lost out on career growth and strategic accountability as a result of globalisation. In October, Jigsaw highlighted how globalisation, although good for companies, is actually not so good for domestic economies. If we have a swing back to more regionally focused operations and strategies, then we will likely see increased demand for jobs in domestic markets, and procurement, with a backdrop of decreasing sales and scale, could benefit as the importance of domestic P&L's comes more into focus.

The hocus pocus of global category management, will be forever left on the white board, not just because it does not really work for 80% of goods and services, but the structure of capital will change and dictate regional strategies are more critical in line with domestic supply and demand. Maximising a domestic footprint will be a key agenda for global business, rather than emerging market expansion being the path of least resistance. As brands and operations are forced to service fragmented markets, the result will have to be a fragmented cost base, increasing the cost of supply chain and placing procurement on the agenda to create tail end value. This may also prove good news for National enterprises. As global businesses fragment into domestic autonomous operations, they may compete more fairly with national players, who previously lost out re economies of scale or via diversified P&L's.

The Rise of Passive Procurement

Procurement. It sets out to drive value for organisations, yet the value it creates to businesses often seems to have an inverse relationship to the value it holds within businesses. It seems the more savings the function generates, the more it creates downward pressure on its future value to an enterprise. This is the issue with savings being a key metric for the function's existence and why the procurement function is so volatile and cyclical. It seems to be an existence of ever decreasing circles. Procurements stock rises and falls in a cyclical pattern, which over the long term damages the sophistication of what can be achieved. It is the equivalent of China vs the US. The US votes in a new leadership every 4 years, with a turning point after two years where all energy and attention is focused on retaining power and not focusing on the job at hand. China does not have this issue and drives agenda's over the long term without the distraction of retaining power. This long-term view allows true strategic objectives to be realised. The results of both models are obvious in today's geopolitical events. The synergy of course with procurement and US politics is the focus on short term value to retain its equity rather than investing in sophisticated long-term strategies.

Over the past 20 years, many articles have surfaced, including Jigsaw's, covering many elements of the procurement spectrum including e-procurement, sourcing, risk, open book pricing, supplier management, customer centric models etc. The list is endless, yet if we are brutally honest, nothing really changes in Australian procurement and even for what change there is, procurement is still tasked with contracting demand, reducing the unit price or transaction price whilst attempting to optimise value via SLA's and KPI's, that are often impossible to achieve or commercially suicidal for the suppliers to agree to. Yet, even as these trends persist the key issue for procurement is zero voice. In many businesses, procurement makes few decisions re supplier selection as it does not own the relationship with the supplier or a P&L. It likely never will unless procurement de-centralises and becomes vertically aligned with functions. This raises questions to the ability for procurement to strategically impact business outcomes and also raises doubts on how procurement can impact supplier relations to unlock value, especially when the value of scale via P2P and systems conflicts with the value of subject depth, traction and engagement with departments. That is why procurement needs to be separated from systems, process and governance. As it stands, procurement is a dumping ground for any shared service admin. If this does not stop, it will have no future.

In fairness to procurement, it is not the short comings of procurement executives. In Jigsaw we have met thousands, from all over the world, and the best of breed could unlock huge value to a business, if they were given the right mandate. Thing is, in a social-capitalist system, where companies understand the central bank put, and where debt and equities are more important than genuine profits, and risk is not understood, procurement is a function who's value and purpose as a strategic lever could be under threat. With the cost of capital so cheap, it is likely more cost effective to borrow than to save, as has been the case since 2008.

Procurement has other issues too. As procurement platforms become more standardised, tenders are turning sectors of industry into ETF like baskets. Index trading (passive trading) is viewed as low risk, and a way of positioning your capital to track a basket of securities tracking the underlying index. It removes price discovery of stocks and allows financial planners a low risk cookie cutter model to manage large portfolios. To customise a portfolio per user would simply be impossible and the work associated with the research and the carry risk for investors would be too high. Still, this does not stop financial managers charging $30k per annum to passively manage a fund and charge you a price for pro-active expertise. Companies linked to the index go up and down as funds are introduced or withdrawn in aggregate. Reviewing the quality of each company, the management, past earnings, future earnings, ROCE, ROE etc are not part of this parcel and this trend is a key reason for certain equities outperforming and displaying an over contribution in the stock market.

Procurement, or the wider stakeholder group who make the call on suppliers and terms are now attempting to do the same, with the agenda having an inverse effect to stocks in that is contracts market pricing. Pre-written terms are commonly being sent to suppliers requesting agreement or no trade. This passive and let's be clear, unsophisticated technique, substitutes procurement research and sector understanding which is a high skilled component of the best procurement practitioners with a document and a mandate to select who will accept terms. Over time, overall capability of the procurement workforce will retard as the function continues on its logical path to be disrupted by technologies that can do the same at 75% less cost. Afterall, if the stance is to send out non-negotiable requests, a person is not required, just an algorithm. Just like passive trading, the supplier market is condensed into vertical parcels (sausages), with multiple companies lumped into the same basket. It is turn key, un-sophisticated and has nothing to do with value or risk.

Procurement – Economic Lever?

For this article, Jigsaw want to explore procurement's mandate. We believe this economic crisis is the catalyst for procurement to step up and show its mettle in Australia. So far, it seems this is not the case as demand for capability has not met Jigsaw's prediction. Although this is a concern, it could still happen as stimulus subsides and businesses realise that investment and a change of mindset are required.

The question we want to answer is if public sector procurement has the wrong mandate and as a result, the government has missed a golden opportunity re the economy. Jigsaw are going to explore two opposing procurement strategies and challenge common thinking of what procurement exists to achieve. Jigsaw know that procurement can generate revenue and be a force for economic inflation, but it has to have the right sponsorship and mandate to achieve this. Without the right mandate, no amount of tactical tweaking via systems, technology or concepts will help procurements long term branding, value and development as a function. As indicated earlier in this thread, retardation of skill set and accountability is the last thing procurement needs if it wants to be more relevant within the corporate frame.

As the economy comes under strain, the LNP has pulled many levers to try and create inflation and reduce unemployment. Open market operations, interest rate manipulation, tax cuts, stimulus checks etc are all being used as levers to create economic growth. The problem with these levers is they rarely work and once a debt to GDP ratio hits above 60%, they never work (Multiplier effect becomes redundant). In our October report we highlighted that we are in a deflation phase, which will over time swing into a stagflation or hyperinflation phase that the central banks will have zero control over. Until then, we have macro deflation, so any market liquidity will quickly be used to pay off debt and enable basic consumption.

This does not create employment or productivity; it simply creates a larger debt problem for the government. Jigsaw are of the opinion that government procurement could be a powerful lever for influencing the real economy, and we will go into detail as to why and how it can do this.

We will explore two models:

(S = savings & E = expansion)

The one model will focus on savings (S) and the second will be a non-traditional model focussing on expansion (E).

Traditionally, government procurement exists to extend the tax dollar. Procurement in public sector nobly believes that by negotiating terms with suppliers across the private sector it is getting better value for the taxpayers and stretching government budgets to buy more goods and services per dollar. Now, we know what you are thinking as you read this sentence. You are likely thinking of the recent press coverage of the land acquisition for the Western Sydney Airport (market value $3m and yet procurement paid $30m) or maybe the $30m that Dan Andrews paid for the security firm to manage the Covid-19 quarantine. These two examples are obviously not going to be presented at CIPS conferences as cases for either value or process, but we have to assume that most procurement in the government is regulated, processed and with the agenda to achieve value via savings. We also have to assume that procurement was likely not even engaged and this is why the government is on the news attempting to shield itself of corruption.

The question is, is this really how procurement should be valued in the government?

This agreed upon mandate which copies the private sector blueprint is mirrored across all agents across all states. The problem is, the public sector is not a private company, and has very different intent to a private sector enterprise. Public sector should have a macro aggregate strategy which is to create value to taxpayers which seems to align to the same strategy as a private sector enterprise attempting to drive EBIT improvement. Thing is, if this value is focussed at the consumer end (income/tax payer focussed), we will get little in the way of sustained economic benefit aside from improved infrastructure (if central planning can align spending to where it is required, which is mostly not the case), which although can optimise industry and commerce, is potentially not optimal as a single value proposition. Jigsaw are of the opinion that the government could be pulling on the wrong side of the rope and should be thinking about capital allocation to indirectly benefit the consumer. At least as a portion of the agenda under certain conditions. So, Jigsaw are going to explore two opposing procurement models in the government to see if our theory makes a case for itself. (S = Savings model) and (E = Expansion).

Model S (Diagram 2) is the typical savings model of a government agent setting up a commercial relationship with a supplier (A). For a fair comparison, both procurement models explored (S & E) will have the same basic market inputs re salary, credit card debt, income tax, car prices, rentals and house prices; see index – Diagram 1. We have kept the nominal figures as simple as possible for ease. What we at Jigsaw will be exploring is how procurement influences a butterfly effect to the wider economy.

We apologise in advance if our total analysis is in anyway flawed. In fact, we welcome opinions and comments of anything we have not considered, and if anybody in our network who is far smarter wants to create a better model for discussion, please do. We will credit you with synopsis and distribute it across the network. Afterall, this is not an exercise of ego, we just like the truth. In example S and E we have only used two phases of engagement.

To take the process further than two phases of the business chain would take too long and the variables expand further, so the assumptions that need to be made make the exercise too complex. As indicated, this is just a thought experiment.

Diagram 1 – Index Guide

Index Guide	Average ($)
Credit Card (Private Debt)	$3,258
Car Sales	$58,000
House Prices	$420,000
Income	$90,000
Holiday Expenses per annum	$4,750
Restaurant spend per head (weekly)	$520
Rental per head (weekly)	$525
Social Security (weekly)	$277.85
Stamp Duty on $840k house	$33,135
Payroll Tax	$4,360

*All tax is associated with NSW

Procurement Breakdown – Savings for Value (Model S)

In the savings example (Model S), the government agency is engaging Supplier A for a deal worth $200,000,000 and have negotiated a 25% saving on the contract, reducing the cost to $150,000,000, so saving $50,000,000. This saving is then used to engage another supplier (B) to deliver further services for the government, and the government procurement department again negotiate a further 25% discount of standard terms achieving a net saving of $12,500,000 from the initial $200,000,000.

In model S, we can see that government procurement perceives it has improved the total economic impact using traditional procurement techniques, avoiding supplier A standard terms and saving $50,000,000 through bench marking and negotiation. In model S, government funds have spread across two suppliers, A and B, extending the purchasing power of the $200m. Total tax generated in the negotiated model from the two suppliers is slightly less than if terms were left as standard by $32,0689, but this small deficit is more than compensated by the $12,500,000 savings achieved via negotiations and the $6,575,850 economic benefits

Procurement Breakdown – Savings for Value (Model S)

Diagram 2 – Savings for Value (Model S)

Model S								
Summary	**Supplier A Standard**	**Supplier A Negotiated (25%)**	**Impacts A**	**Supplier B Standard**	**Supplier B Negotiated (25%)**	**Impacts B**	**Impacts of Negotiation**	**Variance vs Standard Terms**
Government Spend 100%	**$200,000,000**	**$150,000,000**	**$50,000,000**	$50,000,000	**$37,500,000**	**$12,500,000**	**$187,500,000**	$12,500,000
Employment Generated	100	75	**25**	50	37.5	**12.5**	112.5 FTE	12.5FTE
Tax Generated								
Corporate Tax	$9,000,000	$6,750,000	**$2,250,000**	$2,250,000	$1,687,500	**$562,500**	$8,437,500	$562,500
Payroll Tax	$436,000	$313,375	**$122,625**	$218,000	$163,500	**$54,500**	$476,875	-$40,875
Income Tax	$2,259,700	$1,694,775	**$564,925**	$1,129,550	$847,388	**$282,163**	$2,542,163	-$282,463
Stamp Duty	$1,656,750	$1,242,563	**$414,188**	$828,375	$621,281	**$207,094**	$1,863,844	-$207,094
Total Tax	**$13,352,450**	**$10,000,713**	**$3,351,738**	**$4,425,925**	**$3,319,669**	**$1,106,256**	$13,320,381	$32,069
Increased Government Cost								
Unemployment Benefits		$367,705	**$367,705**		$183,853	**$183,853**	$551,558	-$551,558
Credit Expansion								
Credit Card	$325,800	$244,350	**$81,450**	$162,900	$122,175	**$40,725**	$366,525	-$40,725
Car Sales	$5,850,000	$4,387,500	**$1,462,500**	$2,925,000	$2,193,750	**$731,250**	$6,581,250	-$731,250
Rent ($525 per week per cap)	$1,260,000	$945,000	**$315,000**	$630,000	$472,500	**$157,500**	$1,417,500	-$157,500
Retail (clothes $2000)	$200,000	$150,000	**$50,000**	$100,000	$75,000	**$25,000**	$225,000	-$25,000
Holiday ($4750)	$475,000	$356,250	**$118,750**	$237,500	$178,125	**$59,375**	$534,375	-$59,375
Restauraunt	$2,496,000	$1,872,000	**$624,000**	$1,248,000	$936,000	**$312,000**	$2,808,000	-$312,000
Mortgages	$42,000,000	$31,500,000	**$10,500,000**	$21,000,000	$15,750,000	**$5,250,000**	$47,250,000	-$5,250,000
Total Expansion	**$52,606,800**	**$39,455,100**	**$13,151,700**	**$26,303,400**	**$19,727,550**	**$6,575,850**	**$59,182,650**	**$6,575,850**

Net Benefit of S model	**$19,627,408**

In addition, aggregate employment contribution is increased from 100 to 112.5 (12.5%), even though both businesses have to lay off staff due to reduced income via the negotiated deals, which does incur a government cost of $551,558 per annum re social welfare.

So, it seems in example (S = savings) government procurement existing to drive better value for tax payer dollars is absolutely the right thing to do. So far, the data indicates it not only makes the tax dollars stretch further but also expands the economy, increasing employment and expanding the velocity of money.

The question is, what are the impacts we cannot see? What if the $50m was not saved and instead allocated to Supplier A in full? Does 25% make a difference in the longer term and if multiplied a thousand times, would the private sector be in better shape?

Procurement Breakdown – Economic Value Model E

In the 2nd model (E) procurement does not exist to drive any savings at all. In fact, procurement is positioned as an economic lever for governments to compliment the tools already in existence to manage the economy, which are monetary and fiscal. As both fiscal and monetary policy are central, they are not too effective in driving economic growth. Stimulus has the best chance of working if it goes to where the economy requires it (BAU), to where demand for dollars gives a return to economic growth, which means increasing the expansion of credit, employment, investments and stimulating the private sector. Government procurement has a huge advantage as a lever over central banks. It interacts with the real economy, engages real businesses and is in a superior position to allocate funds to where the real economy needs them, ideally in normal conditions. If this was a government mind set prior to a downturn, we may not be in such a dire situation.

Procurement as it is executed today is deflationary. Its existence is not optimum for a thriving economy. It is however optimum for a single business seeking to gain competitive advantage in the private sector. Problem is, if the government procurement is acting as a deflationary force in sync with the private sector acting as a deflationary force, the economy has no choice but to contract. Government and Private Sectors have an inverse relationship re economic impacts and as such, should have opposing procurement agendas to achieve balance. Government expansion is deflationary and private sector expansion is inflationary. As procurement increases processes, systems and requirements for engagement, the velocity of trade is retarded. So, procurement is not just slowing down the velocity of market transactions, it is reducing the value of market transactions and the total supply of products and services being produced and channelled through the market. Again, for a private business this makes sense, as profit is the key driver. Private sector wants to inflate market share and profits, whilst deflating its cost to serve and overall operations.

Procurement Breakdown – Economic Value (Model E)

Diagram 3 – Economic Value Model E

Model E					
Summary	Supplier A Standard Terms	Supplier C Standard Terms	Impacts of Non-Negotiation (E)	Impacts of Negotiation (Model S)	Variance S & E
Government Spend 100%	$200,000,000	$10,000,000	$200,000,000	$187,500,000	$12,500,000
Employment Generated	100	25	125	112.5	12.5
Tax Generated					
Corporate Tax	$9,000,000	$450,000	$9,450,000	$8,437,500	$1,012,500
Payroll Tax	$436,000	$109,000	$545,000	$476,875	$68,125
Income Tax	$2,259,700	$564,675	$2,824,375	$2,542,163	$282,213
Stamp Duty	$1,656,750	$414,188	$2,070,938	$1,863,844	$207,094
Total Tax	$13,352,450	$1,537,863	$14,890,313	$13,320,381	$1,569,931
Increased Government Cost					
Unemployment Benefits				$551,558	-$551,558
Credit Expansion					
Credit Card	$325,800	$81,450	$407,250	$366,525	$40,725
Car Sales	$5,850,000	$1,462,500	$7,312,500	$6,581,250	$731,250
Rent ($525 per week per cap)	$1,260,000	$315,000	$1,575,000	$1,417,500	$157,500
Retail (clothes $2000)	$200,000	$50,000	$250,000	$225,000	$25,000
Holiday ($4750)	$475,000	$100,000	$575,000	$534,375	$40,625
Restauraunt	$2,496,000	$130,000	$2,626,000	$2,808,000	-$182,000
Mortgages	$42,000,000	$10,500,000	$52,500,000	$47,250,000	$5,250,000
Total Expansion	$52,606,800	$12,638,950	$65,245,750	$59,182,650	$6,063,100

Future Benefits re Full Terms	
Increased EBIT Benefits of $7.5m	
Surplus for Dividend contribution	$1,000,000
Issuance of new credit (Expansion)	$25,000,000
New Employment re expansion	50
Predicted ROI on Expansion (25%)	
Added Employment Generated	50

Future Tax Generated		Supplier A	Supplier C	Impacts of Future Standard Terms	Impacts of Negotiation (Model S)	Variance Future E vs S
Corporate Tax	Based on EBIT of $37.5m	$11,250,000	$450,000	$11,700,000	$8,437,500	$3,262,500
Payroll Tax	Based on 150 FTE's	$654,000	$109,000	$763,000	$476,875	$286,125
Income Tax	Based on 150 FTE's	$3,389,550	$564,675	$3,954,225	$2,542,163	$1,412,063
Stamp Duty	Based on 150 FTE's	$2,485,125	$414,188	$2,899,313	$1,863,844	$1,035,469
Total Tax		$17,778,675	$1,537,863	$19,316,538	$13,320,381	$5,996,156
Increased Government Cost						
Unemployment Benefits					$551,558	-$551,558
Future Credit Expansion						
Credit Card	Based on 150 FTE's	$488,700	$81,450	$570,150	$366,525	$203,625
Car Sales	Based on 150 FTE's	$8,775,000	$1,462,500	$10,237,500	$6,581,250	$3,656,250
Rent ($525 per week per cap)	Based on 150 FTE's	$1,890,000	$315,000	$2,205,000	$1,417,500	$787,500
Retail (clothes $2000)	Based on 150 FTE's	$300,000	$50,000	$350,000	$225,000	$125,000
Holiday ($4750)	Based on 150 FTE's	$600,000	$100,000	$700,000	$534,375	$165,625
Restauraunt	Based on 150 FTE's	$3,780,000	$130,000	$3,910,000	$2,808,000	$1,102,000
Mortgages	Based on 150 FTE's	$63,000,000	$10,500,000	$73,500,000	$47,250,000	$26,250,000
Business Credit for Expansion		$25,000,000		$25,000,000		$25,000,000
Future Total Expansion		$103,833,700	$12,638,950	$116,472,650	$59,182,650	$57,290,000

The government has no such agenda. It is clear re any statistics you choose to look at, that procurement does zero to curb government debt, as debt to GDP has steadily risen over the past decade in spite of heavily invested government procurement departments and will no doubt further expand in the future. So, procurement is not adding value to curbing the government deficits, the savings generated seem to be used to expand government resources or stretch the tax dollar to create a perceived value, that although arguably exists, is also arguably not optimum. This dynamic of value creation is intent for good, but logic could suggest it is simply at odds with the governments mandate of economic growth.

Take labour as an example. The term human capital does not exist in reality or in the minds of capitalists. Labour sits on the P&L and not the balance sheet, so labour is and always will be an unwanted expense. For the public sector, labour is a value, for the higher the employment numbers the more chance of obtaining favourable votes for your party. The lower unemployment is, the more chance of staying in power. In fact, employment is so important to the government that it will get into debt to create jobs so that the figures are improved. This method however is short sighted and has consequences. This is just one area of opposing views between private and public sector, yet the procurement departments are identical in mandate. Why?

In the expansion model (E), Jigsaw have explored a different agenda for government procurement and one which is in line with government purpose. For procurement to be strategic, it has to sync with the agenda of upstream leadership. The government are struggling to drive sustained economic expansion and influence private sector employment. At this stage, this agenda is weighted with the banks to loan businesses, yet banks would rather loan to less risky asset classes such as housing or invest in derivatives. In addition, government jobs are not economically beneficial to the economy, as we explored in our October report.

What the market requires is private sector expansion and a vehicle of migrating jobs from the public sector, which are a liability on tax and debt, to the private sector, which drive output and enable the country to pay off debt. As the government has no commercial agenda in the form of sales, its commercial agenda is in the form of taxes and employment.

The key difference between the two models (S and E) is how the $50m is utilised. In model (S) it is saved and re allocated to a new supplier, and further savings (ever decreasing circles) can be allocated to further suppliers etc. This spreads the tax dollars across the economic fabric to government requirements, but does not allow for enough profit across these suppliers to expand and grow. In model (E), the $50m is allocated in full to Supplier A, which allows supplier A to not just service government requirements, but expand its own enterprise and the wider economy indirectly outside of government demand.

In model (E), the government procurement spend the full $200,000,000 with supplier A and do not negotiate. Instead, procurement spent time understanding the management team of supplier A, explored their intentions for growth and instead of a tender requesting savings, the tender requested a detailed outline of proposed expansion and future investment, which is to be reviewed in future to retain ongoing government interest. Supplier A was selected in a typical process, and was selected for the commercial arrangement with the government as it was a company that was recognised as having strong growth prospects both domestically and overseas, a good balance sheet, a diverse management team of females and males and was active in environmental projects. It would create both employment opportunities in the local economy and drive exports in the future to help generate a trade surplus.

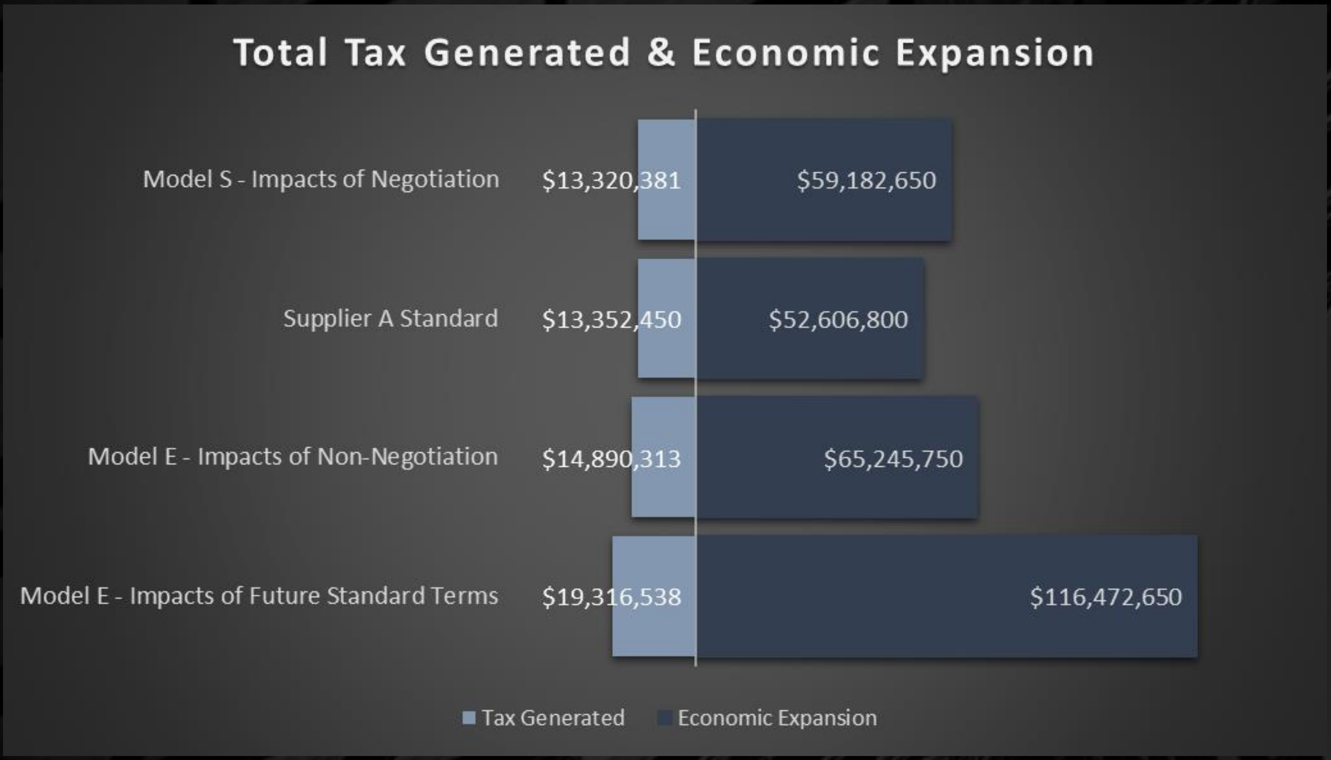
As a result of this strategic understanding to enable economic prosperity, the 100% of terms were traded, procurement did its job in allocating tax funds to the best business in the market that fit the governments mandate of economic growth as well as delivering the key services that were tendered. As a result Supplier A generated a further $7.5m of EBIT per annum re the contract terms, and has both engaged a new supplier downstream (at full terms as mandated by government contract) creating further economic growth to the supplier value chain. Supplier A, as a result, expanded its own operations by taking on further debt, as a result increasing its own workforce/operations and projected future earnings (next year) of 25% increase ($37,500,000).

This news was great for its share price, as its increased turnover, increased profit and business expansion created the confidence required for the market to invest, increasing its market cap and increasing further its viability for credit. Dividends also increased as a result of increased profits ($1m to the dividend allocation), assisting older investors who require income to get a great return on the investment of company A, compensating their lack of interest on savings with the bank. As a result, they are consuming a little more, eating out and planning a holiday.

In the near term, procurement not attempting to save (act as a force of deflation) have enabled $65,245,750 of economic expansion in the same time span as model S, bettering model (S) direct by $6,063,100 and returning $14,890,313 in tax, again bettering model (S) by $1,569,931. Employment has increased in the near term to 125 FTE's, but the real benefit is long term. Next year, the numbers are vastly superior to model (S), with economic expansion of just Supplier A delivering $103,833,700 to the economy and tax benefits of $17,778,675 being generated for the government.

If we include supplier C (keep in mind we have projected zero future growth for supplier C, which is unlikely), the numbers are even greater, with $116,472,650 credit expansion for the economy and $19,316,538 of tax revenue generated for the government. In addition, private sector employment is projected to increase to 175 FTE, an increase of 50 FTE's. Total future economic impact from the government not acting as a deflation is worth a combined tax and velocity for E of $135,789,188 vs $71,951,474 for S.

Diagram 4 – Comparison of Total Economic Value



Summary

So, we have two models. Jigsaw understand that to model such outcomes accurately is almost impossible, but as a thought experiment it raises some interesting questions. Procurement, if it is commercial should not have a set mandate, to do so fly's in the face of what it means to be commercial. Unfortunately, procurements purpose seems to be cemented with the only advancements coming from regurgitated philosophies or advancements in technology, again deflationary. These tools are great for consultancies and private business and also good for public sector if these deflations are countered with private sector liquidity. Many procurement departments believe the short comings of the function are a result of inadequate sophistication. For the private sector, this may hold true across many small to medium enterprises. For public sector, is the reality altogether something different? Is it the mandate for procurements existence in government that is the elephant in the room that needs to be re-defined?

Savings, as indicated can be measured. This means departments believe they are adding value and consultancy firms can charge for services based on this crude metric. However, this dynamic is not working for either the economy or the procurement profession. All that is happening is wave after wave of public sector re-organisation and transformation, all at the taxpayers' expense.

Key thing to note in the two models is the potential ROI on the $50m dollars and how it is allocated into the market. In model S, the total economic impact (tax generated + credit expansion-costs/expenditure) per dollar is 0.38c per $1 spent. In model E, comparing same time current timeline, the total economic impact is favourable at 0.40c per $1 spent. If the government was a private sector business, option S would be favourable, but it is not. Model E really excels in the future return per $ delivering 0.67c return.

If we multiply these transactions by hundreds and thousands it becomes clear that procurement in the government is doing a great deal of damage to the private sector whilst impacting a larger debt deficit and working against the politician's agenda of expansion.

The government is like a company, it has inputs, outputs and exists to have a revenue surplus. Key here is the government exists for a revenue surplus, not the de-centralised agents and procurement departments. The government should not exist to expand itself but indirectly expand its influence on a growing economy. The government should be attempting to improve Australia, the company brand that is Australia, and that means driving economic growth via private sector expansion. Problem is, it is using its own procurement departments as a brake and hindering its own agenda of growth and prosperity. Procurement for government surely should be an investment vehicle, not a function to look at cost (which is a poor metric of return) but look at return on tax dollars spent to private expansion, employment and confidence. Money should freely flow to sound businesses when times are hard, not be contracted via a flawed savings mandate that essentially adds petrol to a fire you are trying to put out. When you run a business, you invest money to grow the business further and create value to the equity owners. If you are holding back on capital and not going full steam for expansion with a mind set on generating future value (profit), you should be replaced as CEO. Procurement in government should be tracking the investment of taxpayer money not just in the infrastructure and assets it purchases but in the actual companies themselves and the wider chain of commerce. Procurement should be tracking the indirect expansion of the businesses it engages with. Supplier Management actually can exist in public sector and the SRM should be tracking growth, increases in employment and generated goods. The dollar should go into the market to multiply, not be contracted and re-allocated in a spiral of ever decreasing value.

Public sector procurement is the perfect lever to do this having an inverse relationship to the function in the private sector. Via government procurement, the economy can increase private sector employment, increase tax revenues and enable genuine business expansion. The larger the private sector gets the more tax (new revenue, not recycled revenue) gets collected to further develop education, healthcare, aged care and other key projects. The more the private sector expands, the more consumption is achieved, and production generated. The more the private expands, the more genuine profit can be aligned to the share price of a business, the greater the dividends for investors and the greater the confidence for entrepreneurs. As private sector uses procurement for deflation, government procurement counters with inflation. As government procurement invests in private businesses, private businesses use the deflationary elements to be globally competitive, enabling Australian businesses to be world beaters, in turn maximising exports and allowing capital to expand overseas and domestically.

As terms of business are transacted at standard terms, and assuming value is created by selecting good management teams with no moral hazard, strong balance sheets and excellent vision for future growth, procurement is achieving what it preaches, being a true driver of value and revenue generation for the economy. Procurement should be the 1st lever in the governments arsenal of tools to manage the economy, only using monetary and fiscal policy as tools if government procurement fails in its new primary objective. Like interest rate manipulation, procurement can be used to expand or contract an economy. If inflation is too high, the government procurement switch to private sector mandate, and contracts market liquidity via negotiating terms, driving down both turnover and profits and putting a brake on growth re its direct deals. If like now, the market needs a kick start, then procurement eases the market liquidity and drives stimulus to businesses in a tangible way that impacts employment and future returns via capital allocation not consumerism via income allocation (Job Keeper).

This, over time, as a lever protects savers as interest rates are not a primary tool for stimulation and the currency does not get debased via open market operations. Governments can rely on less debt as tax increases and exports are multiplied.

As we have written before, confidence drives an economy, nothing else. That is why a lack of confidence in currency, governments or businesses can be a doom cycle that feeds itself. Contracting revenue and profit releases bad news into the markets, this creates a lack of confidence for investment and consumption and contracts the growth of private enterprise. Savings mandates repeated over time are terrible for an economy as businesses have to keep making ends meet with ever declining turnover and profits. The private sector does this to itself, it does not require public sector to jump on the bandwagon.

A trend that is now happening is the private sector is using public sector terms to further compress terms, so the government is setting commercial precedents that are extremely damaging. As an example, look at the 0007 scheme for contingent labour. For years the government thought it smart to push a 7% margin for agencies to provide contractors, this is a reduction of over 60% of standard terms. Now the private sector is using this as a benchmark and where 15% was a fair negotiation previously, now the private sector is targeting the same rates as the government. Business are transacting, but they are making zero profits. This will get worse unless some common sense is applied.

So, both models have been presented, both will have supporters, but for us in Jigsaw it seems pretty clear. Procurement in the government has the chance to re-brand the function and be a genuine lever in the economy. It can be a tool for driving considered expansion, nurturing future businesses and taking the Australian economy forward. Value is not savings, it never has been and for a government should never have been. The government leaders may not understand, but in our opinion, they are neglecting the greatest lever of all.

Commodity of the Month – Aluminium

Aluminium is a soft white metal used across a number of industries with application covering transport, packaging, engineering and construction. In the 19th century it was used to make jewellery, as it resembled silver. Its industrial utility was not realised until 1867, when it took the form of wire and foil across England and France. This progressed to the 1st smelter being developed in Russia in 1885 and reached the US in 1888, which was the beginning of the business we know globally today as Alcoa based out of Pittsburgh and producing circa 200kg's per day.

Aluminium stems from aluminium oxide and is obtained via a process called electrolysis. It was discovered in 1808 by Sir Humphry Davy, who also used the process of electrolysis to discover other key elements including boron, sodium and magnesium. In relation to extracting aluminium out of mining deposits, the key raw materials is Bauxite, which was 1st discovered by the geologist Pierre Berthier. It took society a further 35 years to yield pure aluminium via the process of electrolysis without other impurities such as mercury, potassium and platinum existing. This process was discovered in 1854. By 1889 the process for extracting alumina evolved to extracting the pure material from alkane solution. The Austrian chemist called Carl Bayer developed the obviously named Bayer process which has lasted to modern times and over 90% of alumina is now produced via this method. From 1890 onwards, aluminium was used across various industries including rail, planes, foils, packaging and automotive. In 1902, Alcoa expanded into Canada under the brand Northern Aluminium Co (Alcan) and eventually divested away from the parent company to an independent company in its own right by 1928.

As a raw material, the consumption of aluminium has been growing steadily and is forecasted to rise from a demand of 62.5 million tonnes today to 71 million tonnes in 2023. China and India will be the main drivers for this demand.

Historically, China, North America and the EU were core consumers, but as we head towards the future, India will increase demand 5-fold and China will nearly double. Most other countries and regions such as Japan, North America and EU will contract demand.

Australia is well positioned to exploit this demand for resources, as alongside Asia and North America, it is one of the largest miners of Bauxite. Aluminium demand is highly correlated to development of transport, and predictions are that China and India will be increasing this demand over the next 10 years. A key trait of aluminium is its sustainable properties. It is one of the most environmentally friendly raw materials as it is recyclable, and the process of recycling uses only about 5% of the energy required to create primary aluminium from bauxite ore. This is good news, as to mine primary aluminium is pretty challenging.

To yield 1 ton of aluminium, you have to find 5 tons of high-grade bauxite ore. That is a lot of energy, pollution and land damage associated with the process. The by products of producing aluminium are also very harmful to the environment and via aside from perfluorocarbons being released into the air, a toxic sludge is also produced called red mud, that in large enough quantities can destroy marine life, or if dried out, morphs into fine particles causing respiratory issues.

So, there is strong future demand for the metal and it is highly recyclable. That is good news and means we can all do our bit by making sure we recycle pots, pans, packaging, cans etc. Key to this is understanding what your waste is made from and where is the best place to take it to ensure it gets properly processed. The recycling process is pretty simple and involves shredding, removing impurities and heating the metal to 600c and then adding material to obtain the alloy specification.