

PROCUREMENT STRATEGIES – ONE SIZE FITS ALL?

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ABSTRACT

The Local Government Act 2002 requires all Councils to provide good quality local infrastructure and perform regulatory functions in a way that is most-cost effective, efficient, and appropriate. Many local Councils develop guidelines and strategies to provide direction for procuring goods, services or works. These procurement guidelines usually incorporate a number of intangible aspirations such as cultural value, fair operation and sustainability. Balancing these intangible aspirations against the ratepayers concerns regarding cost can be difficult, particularly when trying to justify short term “pain” for long term gain.

Even with a procurement policy that requires consideration of intangible aspirations it can be difficult to truly give fair weighting to these factors. Typical methods such as lowest priced conforming tender or weighted attributes are heavily swayed by the weighting placed on price. There is a risk that this focus on lowest price can be at odds with the ‘good quality’ requirement of local infrastructure.

This focus on upfront cost can drive the procurement pathway to the tried and tested “open tender” method based on client specifications. This paper will examine whether this is the most appropriate procurement method, given that the cost of bidding for each supplier is incorporated in the final price. It will also explore different methods used in recent projects and whether these can provide added benefit to the Council.

Procurement options tend to fall under the four main categories: specifications, nominated suppliers, free issue and novation. Each of these options can be used separately or in combinations to provide procurement that meets the intangible and tangible aspirations of the procurer.

During a recent upgrade at the Waihi and Paeroa Water Treatment Plants a mixture of procurement methods were used to balance the desire for consistency of equipment throughout the district with the need to deliver the project for the lowest cost. In particular the award of a large portion of the contract was by closed Tender with one supplier only.

This paper will examine procurement methods used in upgrading water and wastewater infrastructure using the Waihi and Paeroa Water Treatment plants as a case study and how the overarching goal of affordability was balanced against the intangible aspirations of the council.

KEYWORDS (ARIAL, 11)

Procurement, Single Source, Project Delivery,

1 INTRODUCTION

Upgrade and renewal of assets such as water and wastewater treatment plants forms a key part of local government (Council’s) activities. In 2012 a survey of projects in New Zealand found that only 33% were consistently on budget, 29% were consistently on time and 35% consistently delivered to the stated objectives. This low success rate on the three typical key targets - cost, time and quality - drives home the importance of using the most appropriate procurement method.

Procurement in the public sector is guided primarily by the principles and aims of the Local Government Act, then any Department/Council procurement policies. The Local Government Act section 10 states that:

“The purpose of local government is—

(a) to enable democratic local decision-making and action by, and on behalf of, communities; and

(b) to meet the current and future needs of communities for good-quality local infrastructure, local public services, and performance of regulatory functions in a way that is most cost-effective for households and businesses.

In this Act, good-quality, in relation to local infrastructure, local public services, and performance of regulatory functions, means infrastructure, services, and performance that are—

(a) efficient; and

(b) effective; and

(c) appropriate to present and anticipated future circumstances”

The Local Government Act requires Council to provide services in the most cost effective way possible, which has led to the interpretation that contracts must let via open tender or selected tender and be awarded on a lowest cost conforming basis. While this can be appropriate for some contracts, it can also have the effect of raising the price of the project as the cost of tendering, while not directly paid for by Council, will be included in the winning Tender's cost. Councils have found that with the changes to the health and safety act coming into force smaller contractors are only engaging in contractors as a subcontractor as opposed to a standalone operator. The main contractor in turn then adds a mark up to their costs, leading to increases of 15 to 30%.

Some Councils take this requirement to heart so much that their procurement policies begin to have a significant negative impact on the projects budget. Councils requiring multiple prices, full tenders or even open tenders on very low value capital or service fee projects drive the cost of winning projects up, which in turn drives up the prices presented in the tender. The limits on procurement values appear to be driven by external agencies advising Council's to provide transparency and accountability, but don't take into account the cost impacts that this can have on projects.

Tenders may not think it financially viable to prepare full tenders on small capital value projects and the price tension between multiple bidders may be lost.

Procurement methods evaluated and discussed by this paper are as follows:

- Traditional Client design – Contractor build
- Design & Build for selected portions of plant
- Early Contractor involvement during Client design
- Alliancing
- Free issue of critical plant items
- Novation
- Nominated suppliers

This paper will examine procurement methods used in upgrading water and wastewater infrastructure using the Waihi and Paeroa Water Treatment plants as a case study and how the overarching goal of affordability was balanced against the intangible aspirations of the Council.

2 PROCUREMENT METHODS

There are a variety of procurement methods commonly used in public and private industry. These methods can all achieve project success in terms of cost, time and quality in different situations. In determining which

method is most appropriate for any project, it is important to think about the project objectives, requirements, characteristics (i.e. location, value, and size), risks, market trends, capacity and timeframe.

2.1 TRADITIONAL CLIENT DESIGN

Traditional client design typically involves the client engaging a Consultant to undertake the design of the plant from concept through to detailed design. This is a well-used procurement method, for a number of large water and wastewater infrastructure projects in New Zealand. This can involve the consultant gaining appropriate permits and consents, and preparing the Tender documents for a Contractor. Then depending on the size and typical procurement limits the Tender can be let fully open or restricted to a smaller number of Client selected Tenderers.

Advantages of the traditional Client Design is the large input the Client can have into the design process, which can have a beneficial impact on the final capital costs of the works. However this high level of involvement can have design cost implications and may also increase capital costs above original budgets due to wish list inclusions.

2.2 DESIGN BUILD

The design build approach requires first the writing of performance and/or equipment specifications. These specifications are then used by the Contractor to source and procure equipment that meets the project/client requirements. This ensures that a fit for purpose item of equipment is procured while allowing the Contractor flexibility to approach the suppliers and negotiate the best price. All responsibility for establishing an adequate supplier/design lies with the Contractor.

This procurement method is typically used where there is a tight capital budget and little client input requirements. Advantages of this method are as follows:

- Competitive pricing.
- Design/equipment complies with requirements – it is “fit for purpose”.
- Contractor can add their mark-up to the equipment purchase price and this is likely to attract more contractors to tender.
- Minimal time spent investigating models of equipment and their suppliers during the design stage.
- Ability for the Council to request a process guarantee from the Contractor.

Disadvantages of this method are that the Contractor could add significant mark up to large items of equipment, thus increasing the overall project costs. The design specifications for this type of contract need to be very robust, as you get what you pay for. Additionally each item must be checked to ensure it conforms to the specifications, potentially adding significant time during Tender evaluation. Some councils see design build as a way to avoid paying design costs. This can be misleading as the Council is still paying design costs in the tenderers price, however they have given away control over this design.

Scenarios where design build is effective is where the Tenderer can leverage off their specialist experience and develop and innovative cost effective solution, these cost savings are then passed onto Council in the Tender price.

2.3 EARLY CONTRACTOR INVOLVEMENT

Early Contractor involvement seeks to draw on the agility of a design build contract while still having high levels of client input. It utilizes the strengths of the Contractor for review of the client design, providing input on constructability, adequacy of information supplied and solutions that will be the most cost effective to construct. This early involvement can lead to significant time saved in design and savings in capital expenditure. However the early sign up of the Contractor prior to preparing the design also has its disadvantages and it may not procure the appropriate Contractor and/or the cheapest capital works cost. The Contractor may also steer the design in a direction which advantages them over other Contractors.

2.4 ALLIANCING

Alliancing seeks to bring the best parts of traditional procurement methods with design build. The Principal, Contractor and consultant form an Alliance to manage the design and construction of the works. This method relies on the parties to work collaboratively to deliver the project, sharing project risk and reward. It is often used for highly complex projects with high levels of uncertain and significant risk elements. These projects are often difficult to effectively cost, scope and/or deliver under a more traditional method. Alliancing is typically used for large infrastructure projects to share the high risk with large contractors and consultants by providing the potential for high reward. This procurement strategy could be difficult for smaller Council's to implement given the shared reward incentives which lead to the potential for large bonuses for the Contractor/Consultants. This is something that small Councils can not necessarily afford.

2.5 FREE ISSUE

Free issuing equipment is a procurement strategy used to prevent expensive items incurring Contractor mark-up or where equipment has a longer lead time than the duration of the contract. The item of equipment is purchased by the Principal and provided to the main Contractor to install.

Details of the items of free-issued equipment are included in the tender document. Therefore, the Contractor does not add a purchase price, but only costs associated with installation.

Advantages of this method are as follows:

- Pricing can be competitive if the Principal requests a number of quotes from suppliers.
- The exact model of equipment that is required is procured for the project.
- The item of equipment procured can be selected so that it is serviceable in the local area.
- No Contractor mark-up on capital cost of equipment.

Disadvantages of this method are that time must be spent during design to select and purchase equipment prior to letting the contract. Additionally, the client takes on the risk of the correct model selection. Also, under this method, delay in the supply chain of the equipment can lead to significant Contractor costs being passed onto the Client for delay to the program.

2.6 NOVATION

Novation is a strategy where one party transfers all its obligations and benefits under a contract to a third party. The third party effectively replaces the original party as a party to the contract. When a contract is novated the other contracting party is left in the same position as they were in prior to the Novation being made. A Novation requires the agreement of all three parties.

This strategy can be used when long lead items of equipment are required and to meet the program these must be ordered before the tendering for the construction contract takes place. In this case, the Principal can let a contract with a supplier for the procurement of this equipment. Then, once the main contract for construction is let, the contract between the Principal and the supplier will be novated from the Principal to the Main Contractor. The tender document for the main contract must state that a Novation will be required as part of the contract.

Using Novation can bring the advantages of free issued equipment into the procurement strategy, while still ensuring the Main Contractor is ultimately responsible for the full scope of works.

2.7 NOMINATED SUPPLIERS

Nominating suppliers is a procurement strategy where a number of models and suppliers of the required item of equipment are considered prior to tendering. Each item of equipment is checked to ensure that it complies with specifications that are important to the Principal. One or more suppliers' or models of equipment are nominated as conforming to the Principal's requirements and this list is provided to the contractor.

This strategy can be used to maintain commonality of equipment on the Principal's site, to procure from reputable suppliers or to procure a product with a specific specification. Commonality of equipment potentially reduces the numbers of spares carried by the client. For example, if an item of equipment is purchased and it is the same model as other equipment already on site, it will be possible to carry one set of spares for the two items. If the item of equipment is procured from a different supplier, then it will require its own set of spare parts on site and the maintenance and operation teams will need to be familiar with both items.

Advantages of this method are as follows:

- A choice of two or three suppliers allows reasonably competitive pricing.
- Equipment can be the exact model required.
- The nominated suppliers can be selected so that the equipment is serviceable in the local area.
- Contractor can add their mark-up to the equipment purchase price and this is likely to attract more contractors to tender.

Disadvantages of this method are that the Contractor can add significant mark up to large items of equipment, thus increasing the overall project costs. Time must be spent during preparation of the nominated suppliers list to confirm exact models required. Selecting suppliers and/models can also reduce the price tension of the tender.

2.8 SUMMARY OF PROCUREMENT OPTIONS

As the location, design and risks of each individual infrastructure project are distinctly different it is appropriate to consider the use of alternative procurement methods. Careful consideration can help the client to meet the requirements of efficient, effective, appropriate, good quality infrastructure that is cost effective for households and businesses. Each of the procurement methods discussed above have differing advantages and place the cost and risk differently throughout the project lifecycle.

The sections following will discuss procurement policies within the industry, both private and public and specifically discuss Waihi and Paeroa WTP's upgrades where a multitude of procurement methods were used.

3 COMPARISON OF PROCUREMENT STRATEGIES ACROSS INDUSTRY

The three areas that the water and wastewater consultants and contractors typically service are Central Government, Local Government and Industry. Central Government is typically highly controlled in their procurement policies, and have guidelines and rules for the procurement of any services. Local Government tends to be similar to Central government in terms of procurement policies. However, given the less glamorous nature of water and wastewater in comparison to other Council functions, focus tends to strongly be on price. Industry/private procurement methods also focus on price, but depending on the industry there can be the ability to drive for quality over cost. These three sections and their typical procurement methods are discussed below.

3.1 GOVERNMENT PROCUREMENT POLICY

The New Zealand government has put out a procurement document outlining the rules and processes that government agencies must follow when buying goods or services. The guide outlines five core principles for procurement:

1. Plan and Manage for Great Results
2. Be Fair to All Suppliers
3. Get the Right Supplier
4. Get the Best Deal for Everyone
5. Play by the Rules

Within these principles there is still a strong focus on affordability, but balanced against fairness. Older versions of the policy included requirements for Government agencies to improve business capabilities in e-commerce and consider sustainability, but these have been removed from the 2015 update.

In addition to these general procurement policies, some Government agencies have development procurement policies which go into further detail. In particular New Zealand Transport Agency (NZTA) has development procurement methodologies which detail in depth a number of procurement methodologies and evaluations. One typically applied by Local Government is the “Open Tender Lowest Price Conforming” evaluation method. This evaluation method requires the Tender documentation to clearly define what constitutes a “pass” or a “fail”. The evaluation simply takes the lowest price Tender and assesses whether this passes or fails. This methodology leaves very little room for considerations other than price, and/or innovative design. Once the Tender is awarded any change in the construction methodology requested from the client is effectively a variation.

For this reason it is recommended that lowest price conforming should only be used for contracts that are low in value; where scope is tightly defined; where the risks are not significant and could not have a material effect on the success of the project; and where there are no opportunities for whole-of-life cost benefits, innovations, or added value alternatives.

3.2 COUNCIL’S PROCUREMENT POLICIES

Councils have historically used an open or invited traditional tender approach with evaluation based on either weighted attributes or lowest price conforming. The limitations of open tender have been set typically based on value of the service fees, or capital works of the project, with smaller projects able to be let to selected providers only. Larger projects typically require open Tenders to ensure transparency around cost effectiveness and fairness.

The open or invited tender model requires multiple prices, full tenders or even open tenders on very low capital projects drive the cost of winning projects up, which in turn drives up the prices presented in the tender. Tenders may not think it financially viable to prepare full tenders on small capital value projects and the price tension between multiple bidders may be lost.

Weighted attributes involves assessment of attributes and price in varying proportions, to come up with a preferred bidder that optimizes price and quality factors. The emphasis that is placed on the varying weighting can easily sway the focus of the information provided by the Contractor for this Tender. For example if the weighting on price is greater than 40% then the Tenderer will naturally focus on the cost of the project over other weighted attributes such as design.

The need for transparency and accountability appears to be driving Council’s to have very low limits on their procurement model and moves a large amount of projects to the open tender approach with lowest price conforming. While this is a very transparent process, it does not always provide the best cost outcome for Council with additional tendering costs added into the project.

3.3 INDUSTRIAL PROCUREMENT

Industrial/private procurement tends to be less focused on the open tender using a traditional approach than Central or Local government is. While industrial procurement does strongly focus on cost, trade secrecy and quality can also affect the selection of the preferred procurement method.

Direct appointment is used frequently in the private sector for the following situations

- low value or specialist projects where there is low risk;
- where you have prequalified suppliers who can do the job;
- where emergency works need doing in a short timeframe; or
- Where it’s valuable to have a long-term relationship with a single supplier.

Most organisations have a dollar cap and some tight rules on the value of contracts that can be procured without competitive processes in place. This is especially important for public sector organizations, where Direct Appointment could lead to a perception of unfair practices.

Typically for industrial/private sector work the water and wastewater infrastructure forms a small part of the capital works and/or upgrade. Therefore the focus of the industrial procurer is typically on either the larger part of the upgrades and/or on shorter term costs.

4 WAIHI AND PAEROA WTP

The design of the Waihi and Paeroa water treatment plants began in November 2012. The aim of the upgrades was eliminate smaller supplies (by connecting areas to main plants), raise the WTP capacity of treated water supplies and to ensure compliance with the Drinking Water Standards for New Zealand 2005 (revised 2008). The upgrade of the plant was selected in the options stage based on the ability to meet upgrade objectives, lowest cost and consideration of ease of independent automation. The selected upgrades involved the installation of a new membrane system and ancillary works at both existing WTP sites. The associated ancillary works including blowers, pre-screening, backwash system, chemical dosing and clean in place system.



Photograph 1: Waihi Hydrocyclones

The WTP plant upgrade contracts involved a number of different but interacting contracts. These were single source membrane contract, free issue equipment and traditional open tender for the bulk of the contract works outside of the membrane contract. The reasons for the selection of these contracts are discussed in the sections following.

4.1 SINGLE SOURCE MEMBRANE CONTRACT

Following the completion of the concept design and selection of the preferred options, consideration was given to what the most appropriate procurement method for the equipment required and the construction of the upgrades. The design of the membrane plant was critical to completing the detailed design of the upgrade and therefore the membrane supplier was engaged prior to completion of preliminary design.

Given that the membranes formed a large part of the upgrade for both plants, and the selection of differing membrane types would change the design around the membranes it was recommended that Council consider procuring this item first. Consideration was given what would be the appropriate method from the following procurement methods Open Tender; Selected Tender; Free Issue; Novation; Single Source. The design was made to procure the membranes using a single source supply contract, due to the following advantages:

1. Commonality of operation, maintenance and spares/consumables between all membrane plants in the district. The Kerepehi WTP had recently been upgraded to a 12.5MLD membrane based treatment.
2. Single contract for membrane service agreement for all three plants.
3. Good relationship with trusted supplier.
4. Reduced costs for bidding/tendering of the membrane package.

On a whole balance of plant over the lifetime, it was evaluated to be most cost effective to have a commonality across the district. However, the difficulty was whether the intangible benefits could be justified to the Council by the project team given that this large value item would normally be selected by Open Tender to provide price competition. The following steps were taken by the Council design team to take convince Council that a single source contract was appropriate:

- 1) Compared with traditional upgrades
- 2) Confirm that membranes were the most appropriate solution.
- 3) Confirm that early procurement had cost/design advantages.
- 4) Confirm that selected supplier was appropriate and that there was sufficient price tension in their quote.

4.1.1 COMPARISON WITH TRADITIONAL UPGRADES

The membranes were compared with the traditional options, to establish the most appropriate upgrade. The options selected for consideration are as follows.

- Option 1 was to install a tube settler clarifier upstream of the filters, upgrade the filter pipework and install UV disinfection units.
- Option 2 was to re-use the existing filters with no modification, install a membrane plant downstream of the existing filters and with final UV disinfection.
- Option 3 was to install a new membrane plant without pre-filtration.
- Option 4 was to install a new membrane plant without pre-filtration or UV Peroxide.

The capital and net present value costs for all the options came out to be within orders of accuracy. The advantages of the membrane options are that these had smaller footprint which assisted due to land constrains on the sites.

4.1.2 MOST APPROPRIATE SOLUTION

While membranes have been used commonly around the world for water treatment since introduction in the 1980's, in New Zealand there has been relatively slow adoption of this technology. For a long time, upgrades involving existing water treatment systems were driven from the drinking water legislation. In order to provide Councillors, who are not all technical people, with certainty that the membranes were the most appropriate solution, a technical paper was presented outlining the advantages and disadvantages of membranes as a whole.

This technical paper supported the assertion that for Waihi and Paeroa WTP's membranes were the most appropriate solutions as they provided the following advantages:

- a) Increased autonomy of plant allowing less operator attendance.
- b) Lower reliance on chemical coagulation for effective solids removal.
- c) Supply and installation of process equipment as a package, making construction simpler.
- d) Lower volumes of chemical held onsite (no bulk storage required).

e) Continuous quality output when inlet quality deteriorates without operator input.

4.1.3 REQUIREMENT TO PROCURE EARLY

Following the concept/options evaluation stage the decision was made to procure the membranes early. This was to ensure that the preliminary and detailed design were based on the correct type of membrane system. Had this decision to select the membrane supplier not been made at this stage, then certain aspects of the design in terms of ancillary interconnections would not have been able to be finalized till after contract award, which would have had impact on the program of works and potentially additional fees for both the Consultants and Contractor.

Additionally a significant objective of the project was to reuse existing infrastructure within both WTPs. Early engagement of the membrane supplier allowed the project team to prepare a design which met with this objective as much as possible. This helped to reduce the costs of the balance of plant contract by reducing the new building construction required. This would not have been possible if the membrane package was procured after detailed design was completed.

4.1.4 SELECTED SUPPLIER APPROPRIATE AND PRICE TENSION

Key driver for the operations staff was the consistency/commonality of membranes across the district. The advantages of this commonality are:

- a) Level of complexity for operations team is reduced, thereby reducing operational risks involved.
- b) Operators can easily move between plants using their understanding of the similar process at each.
- c) Critical spares can be kept at a central location for all plants reducing the cost of spares inventory.

Therefore to justify only going to one supplier, validation of the Tender price was required. This was established by comparing the single source contract price with prices from the recently undertaken open Tender for the membrane installation for the Kerepehi WTP. Other recent membrane projects of similar size were also obtained under confidentiality from other Councils.

Hauraki District Council had recently procured through competitively bid open tender upgrades to the Kerepehi WTP based on membrane treatment. As part of this procurement tenders were request for both a 6MLD and 12.5MLD plant.

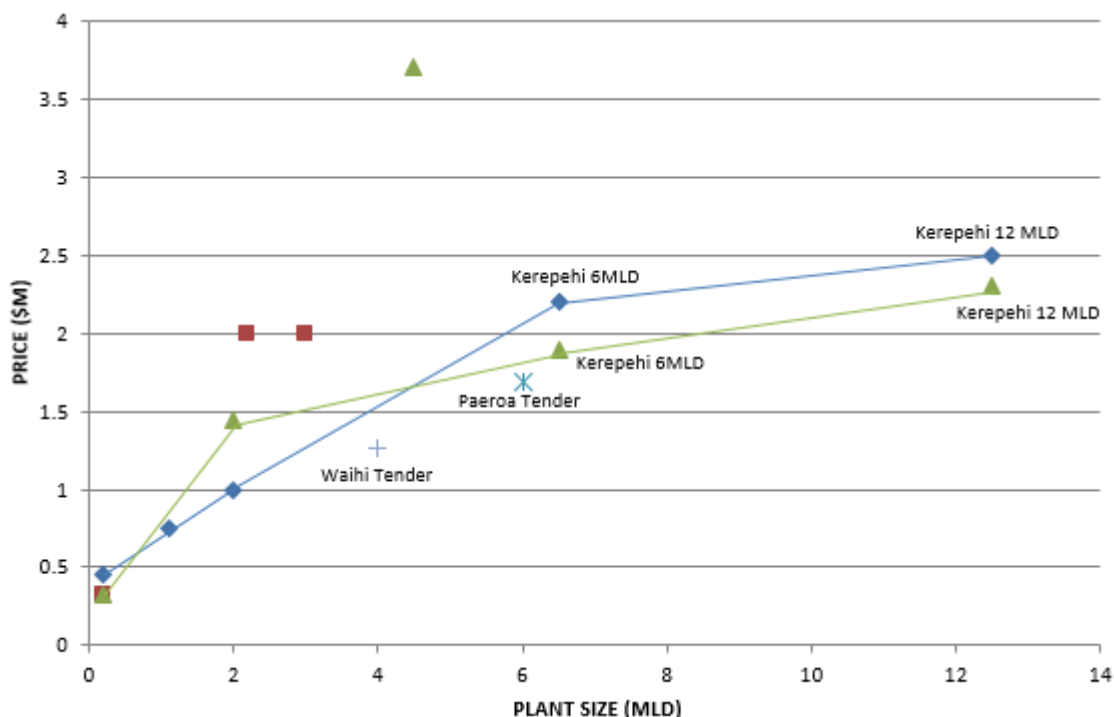


Figure 1: Membrane Costs Compared with Paeroa and Waihi Membrane Tender

As presented in Figure 1 it is clear that the Waihi and Paeroa membrane price was fair and in line with current market prices. Therefore the evaluation found the supplier prices were appropriate and cost effective (likely due to lower bid cost) and on this basis Council were able to award the project as a single source.

4.2 MAIN CONTRACT

The main contract for the upgrades of both the Paeroa and Waihi WTP's covered the package of works outside the membrane contract. This work included installation of hydrocyclones, construction of new buildings, upgrades to existing infrastructure, new chemical dosing, additional instrumentation and ancillary works to support the membranes and the plant as a whole

While the scope of the works covered a number of different areas, there was similarities between the two plants in terms of overall process which made them a good fit to be tendered together. The design had been completed to detailed design stage to enable Council maximum input and to assist in providing a technical solution that provided a pragmatic approach where possible for cost effectiveness.

Due to the fact the design had been fully detailed and no added value was required from innovative approaches, the options for procuring the balance of plant (BOP) package of works were single sourcing, selected tenderers and open tender. Single sourcing the BOP works to the membrane supplier was considered. However, in this case it was deemed that the advantages this would bring to the project were not high value enough to justify this approach.

Lowest price conforming in an open tender format was selected as the most appropriate procurement method to provide price tension. This gave Council the greatest price tension while being in control of the overall design. The lowest priced tender was found to be conforming to the specifications and as such this contractor was selected.

5 CONCLUSIONS

The Local Government Act 2002 requires all Councils to provide good quality local infrastructure and perform regulatory functions in a way that is most-cost effective, efficient, and appropriate. Many local Councils develop guidelines and strategies to provide direction for procuring goods, services or works. Typical methods such as lowest priced conforming tender or weighted attributes are heavily swayed by the weighting placed on price. There is a risk that this focus on lowest price can be at odds with the 'good quality' requirement of local infrastructure.

There are a raft of procurement options available, all with variety of advantages and disadvantages. While there are a number of procurement methods available to infrastructure operators there tends to be a within the industry of low value for open tenders to be required to provide appropriate transparency and accountability.

During a recent upgrade at the Waihi and Paeroa Water Treatment Plants a mixture of procurement methods were used to balance the desire for consistency of equipment throughout the district with the need to deliver the project for the lowest cost. In particular the award of the membrane of the contract was by closed Tender with one supplier only, this negotiation with one supplier outside of a tender process lead to a price below market value which had additional benefits for the district in terms of consistency and commonality for all WTP's in the district.

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