



# **How Can Public Procurement Influence Business and Social Development?**

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Public procurement is a large part of any country's economy, independently of its geographical location, political inclination or level of development. On average, public procurements amount to 17% of GDP among the EU countries (Bolkenstein, Frits, 2004).

Public procurement can be considered as a special case of business transactions between organizations. Public procurement is based on a different and stricter jurisdiction than transactions between private companies.

Just as in the private sector, the public sector strives to get the best possible deal. However, profit is not the driving force in the public sector, which means that public procurements have other and broader consequences than the private sector's purchasing activities.

## **Purpose**

This paper explores, investigates and analyses positive and negative consequences of different aspects of public procurement and its influence on the market and as a tool to achieve political goals.

## Public and Private Sector Purchasing

One of the most important roles of the public sector is dealing with service delivery to citizens and organizations. Private companies in general dominate production of goods. However, a growing number of private companies are moving towards both production and selling of services as part of their offerings. Hence, they are acting more and more similar to that of the public sector (Vargo and Lusch, 2004). Furthermore, a growing part of services that was earlier provided by the public sector is now wholly or partly outsourced and provided by the private sector.

### *Public and Private Sectors*

The public sector organizations as well as private companies can range from one person to several thousands of employees. Public organizations can be very local, like kindergartens, or with the responsibility to cover the whole nation, like ministries.

Similarities and differences between private and public sectors' organizations are summarized in Table 1 below.

**Table 1.** *Comparison Between Public and Private Sectors' Characteristics (After Lindskog, 2004)*

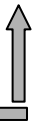
	<i>Private</i>	<i>Public</i>
Competition	Yes	No
Size of organizations	1-10,000+	1-10,000+
Geographical dispersion		
- Local	Yes	Yes
- Regional	Yes	Yes
- National	Yes	Yes
- International	Yes	Yes (limited number)
Production		
- Goods	Yes	No
- Services	Yes	Yes
Profit driven	Yes	No
Openness/transparency	No (limited)	Yes
Contacts with customers	Vary	Many

Public procurement can have different roles in addition to getting the best deal, including the achievement of economic, societal or political objectives.

### *Private and Public Sectors Business Relationships*

Public procurement (B2G) in Fig. 1 is put in a broader context of business and businesslike contacts between different parties. It shows the relationships between the main organizational and economic entities that are directly and/or indirectly involved or dependent on B2G. The main bodies are: companies/businesses (B), public agencies/government (G), citizens (Ci) and consumers (Co).

**Figure 1.** Private And Private Sectors' Business and Businesslike Relationships (After Lindskog, Brege & Brehmer, 2008) The Relation between Companies – Business-to-Business (B2B) – Has Also often been Compared with the Relation between Government and Companies – Government-to-Business (G2B) or Business-to-Government (B2G). (Lindskog, Brege & Brehmer, 2008)

	Agency G	Business B	Citizen Ci	Consumer Co
Agency G		G2B Service delivery to companies	G2Ci Service delivery to citizens	
Business B	<b>B2G</b> B – selling G – buying	 B2B B – selling B – buying		B2Co B – selling C – buying
Citizen Ci				
Consumer Co				Co2Co Co – selling Co – buying

The essential point for all B2B transactions is to get the best possible deal. A win-win situation is preferred in order to avoid an unbalanced contract that for the seller can result in either the winner's curse<sup>1</sup> or too high profits with dissatisfaction on the buyer's side from the feeling of being cheated.

A company purchases in order to produce goods and services and afterwards sell its products for a profit and their decision is mainly based on two criteria: price and quality. A public agency procures in order to produce and deliver services to citizens, companies and fellow agencies and is in most cases financed by taxes.

#### *Jurisdiction*

Public procurement is in almost all situations and countries regulated by a specific legislation that is stricter than for the private sector's purchasing

<sup>1</sup>The winner's curse - a tendency for the winning bid in an auction to exceed the intrinsic value of the item purchased.

activities. Purchasing is in many ways similar, but the organisation of the private buying process is not stipulated by law, and the suppliers that find themselves unfairly treated in a tender process have no legal jurisdiction to rely on. The closest similarity between public and private purchasing is probably in the acquisition of large investment, often called project purchasing or project marketing/selling (see Ahlström, 2000; Bonnacorsi et al., 1996; Gelderman et al., 2006; Gunther and Bonnacorsi, 1996; Roodhooft and van der Abeelle, 2006).

For members of the European Union, it is mandatory to implement the EC procurement directives (European Commission, 2004). The underlying legal basis for the EC procurement directives is contained in the Treaty of Rome from 1957. The main principles of this Treaty that carry over to the procurement directives aim to:

1. Increase transparency of procurement procedures and practices throughout the community
2. Allow the free movement of goods, services, capital and people between member states
3. Develop effective competition for public contracts
4. Standardize specifications
5. Provide advance information of procurement needs to the marketplace

All public procurements in the European Union (EU) have to follow five fundamental principles:

- *Non-discrimination* – all discrimination based on nationality or by giving preferences to local companies is prohibited.
- *Equal treatment* – all suppliers involved in a procurement procedure must be treated equally.
- *Transparency* – the procurement process must be characterized by predictability and openness.
- *Proportionality* – the qualification requirements must have a natural relation to the supplies, services or works that are being procured.
- *Mutual recognition* – the documents and certificates issued by the appropriate authority in a member state must be accepted in the other member states.

Similar principles for public procurement are also valid in many countries outside EU.

The necessity to follow the national public procurement laws based on EC directives that in their turn are based on the fundamental pillars for public procurement in the European Union, have several implications:

- How the public procurement process is carried out,

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- what the roles of different stakeholders are,
- what the procurers' obligations are
- what the rights of tenderers are
- what risks the procuring organizations can take

### *Public Procurement Process*

The public procurement buying process is in many respects similar to the company buying process. However, the public agencies have to follow the stricter public procurement law. The main differences include that no changes are allowed after the publishing of Request for Proposal (RfP) and that the losing tenderers can appeal [in the court] if they consider themselves being mistreated by the procuring organization or if the procuring organization did not comply with the current national public procurement law or any of the five fundamental public procurement principles for EU countries.

### *Buying Center*

The buying center model (Robinson, Faris and Wind, 1967) can easily be applied in the public procurement context. The main differences are the politicians' and governments' pronounced policy roles, which goes back to the *raison d'être* for the government (serving the citizens) compared with private companies (profit) and smaller number of gatekeepers<sup>2</sup> due to insight and transparency in government dealings. The buying center for the public sector organizations is often more complex than in the private companies due to double responsibilities - political and administrative - especially in the case of big volume or strategic procurements.

## **Stakeholders**

Public procurement not only meets purely utilitarian and economic goals but also political goals that can involve societal, environmental or other political issues. Examples of such goals are new EU directives for the public procurement that impose a procuring organization to specify and take into consideration environmental and social requirements that are harder than the national law and this law need not be followed by private companies. In the domain of telecommunications, campaigns such as "Broadband to every household", deregulation of previous monopolies and forced competition can have a potentially high impact on public procurements. (Lindskog, 2005)

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<sup>2</sup> Typically, the main roles distinguished in the buying center approach are:

- **End-users** for whom goods or services are purchased
  - **Influencers** who try to affect the decision
  - **Deciders** who make the final decision
  - **Buyers** who arrange the transaction and is responsible for the contract
  - **Gatekeepers**, anyone who can control the flow of information.
- These five roles were originally proposed by Webster et al (1972).
- **Initiators** persons that initiate the idea or a purchase added by Bonoma (1982).

The main stakeholders in public procurement (following Lindskog, 2006) are:

Politicians

Politicians are elected by citizens and responsible towards them for their decisions and initiatives. Their voters in the next election evaluate politicians' achievements. The political decisions depend on their party's current policy.

Central government

They formulate visions and take overall responsibility for the whole country. The execution is delegated to the authorities.

Local government

They are responsible for the local authority, community or region. It is also responsible for the geographically limited area including support for locally placed companies that can guarantee employment for their voters. That also guarantee the tax base for local government to make it possible deliver services to citizens and local businesses.

Public agency

designated to procure on behalf of other agencies

Agency that has been assigned by the central government to procure and sign framework contracts for specific functions or equipment on behalf of other agencies.

Public agency

The authority's overall goal is to deliver the best possible service to the lowest cost.

Public agency management

Management is responsible for running and making decision in the agency corresponding to the company management.

Procurement department

The procurement department is responsible for buying activities at the agency.

End-users/employees

End-users are employees that will use the specific function, service or equipment that is procured.

Citizens and businesses

The general public, citizens and businesses are the agencies' customers.

Stakeholders and the buying center roles are interrelated. Different stakeholders can take the buying center's roles.

### **Roles of Purchasing**

In the marketing literature, and in particular within business-to-business marketing, the importance of demanding customers in innovation and product development processes has been widely acknowledged (cf von Hippel, 1985, Hakansson, 1987; Wynstra, 1998; Olson and Bakke, 2001). The probability for success in innovation is much higher if the processes have been inter-organizational in interaction with important and resourceful customers which put focus on the way procurement/purchasing is conducted in innovative industries. Axelsson and Hakansson (1984) define three different roles for purchasing:

- The rationalization role – to buy at very competitive prices which will put pressure on supplier efficiency.
- The developing role – to monitor the technical development (product and process) in different supplier segments and to encourage the suppliers to undertake technical development projects.
- The structuring role – to develop and maintain a supplier structure with a high potential for both development and efficiency.

### **Consequences of Public Procurement**

#### *Outsourcing*

It is difficult to find an all-exclusive definition of outsourcing. Definitions span from almost any type of purchasing through make-or-buy decision to takeover of a function from one organization to another. For the purpose of this paper outsourcing is defined as a one-time event for a specific function that previously has been a part of an organization and afterwards becomes a part of another organization and the relation between these organizations is regulated by a contract. (Lindskog, 2005)

There are two main theoretical approaches to the phenomenon of outsourcing:

#### *Core Competence*

Prahalad and Hamel (1990) define core competence as a combination of production skills and technologies.

#### *Transaction Cost*

Transaction cost theory (TCT), introduced by Coase (1937) and developed principally by Williamson (1975, 1979, 1981, 1985),

maintains that the organization of economic activity depends on balancing production economics, such as scale, against the cost of transacting. Transactions are here the exchanges of goods or services between economic actors, who are technologically separate units, inside and/or outside the organization (Williamson, 1981)

*Positive*

Lower cost for staff through reduction of the number of employees, achieve a clear line of responsibilities through the legal contract, easier administration and evaluation of the contract fulfillment instead of doing the activity internally. Introduction of competition increases the pressure on performance and prices.

*Negative*

The employees have to change status from civil servants to private company employees that can be positive but in most cases makes the future less predictable with a less secure employment situation. Public services and processes that are unique for the sector can be more difficult than the private company without previous experience expects, thus, leading to delays, unexpected cost for the supplier and lower service level to the public agency's customers.

*Social Considerations*

Public procurement has to take social considerations such as inclusiveness, equality, regeneration and integration. Social considerations can be exemplified by employment conditions and welfare of ethnic minorities, women, the elderly etc.

*Positive*

No children workforce, no inhuman working conditions

*Negative*

It can be difficult and costly to control as many of subcontractors can be from distance countries and sometimes even difficult to track down.

*Environmental Considerations*

One of the pillars of the sustainable society is environmental concerns including the approach "green procurement". Among examples are energy saving programs, renewable fuel, paperless offices, non-toxic paints etc.

*Positive*

To be an example for the private sector and a pressure factor for the private sector to implement similar rules



*Negative*

New demands typically drive costs and prices higher, at least initially, and the effect can be limited if only the public sector users adhere to the new considerations. Furthermore, new demands may effect competition in a negative way depending on if the requirements are limited to the national and not the international level.

*Competition*

Competition is one of the pillars of public procurement. No competition – no procurement

*Positive*

Better prices and/or better solutions

*Negative*

Possibility of a conflict with goals for regional and/or local development of especially smaller locally based companies in case of local companies going out of business

*Knowledge Management*

Knowledge Management (KM) was developed over the last decades (Nonaka 1991). The main focus of KM is identification, creation, presentation distribution and adoption of insights and experiences through the range of strategies and practices within an organization or business field etc.

*Positive*

Possibility to learn from each other since there is no competition between public agencies, avoid reinvention of the wheel per se, reduce training time for new employees and in general improve efficiency of the procurement process (McAdam&McCreedy, 2000; Thompson&Walsham,2004).

Possibility to concentrate scarce resources in order to analyze already performed procurements and information from other public agencies. This can be achieved through for example framework contracts or a body that concentrates on aggregating knowledge from previous procurements in the specific field.

In particular, electronic procurement enables a more systematic analysis which increases the possibilities to learn from earlier activities.

*Negative*

In case of framework contracts it can be difficult for SMEs to respond to RfPs

*Small and Medium Enterprises (SMEs)*

SMEs are companies with a turnover or number of employees below certain limits. The typical limit is of 250 employees. The companies with ten or fewer employees are called Small Office/Home Office (SOHO). In most

economies, smaller enterprises are in great numbers and accounts for a big part of the economy. They are often the driving force behind innovations.

*Positive*

There is a special focus on SMEs

*Negative*

Still difficult to win not only in case of framework contracts but in almost any public procurement as many SMEs lack references, financial stability and guarantees. It can be too risky for the public agency to choose a company without previous good records. The agency risk being unable to fulfill its service delivery obligations at the same time as the SME cannot pay penalties without going bankrupt.

*End-Users and Clients*

*Positive*

It has always been important in any kind of purchasing to have correct information about end-users and clients needs and requirement. This is especially valid in the case of public administration's purchasing activities due to public procurement jurisdiction that not allow to make any changes in the requirements after the RfP has been published.

*Negative*

If the analysis of needs is not done properly, it is virtually impossible to correct and adapt the RfP to the real needs.

*Risk Taking/Risk Aversion*

The public sector is less inclined to take risks due to the possibility to appeal to the court by a tenderer who is dissatisfied with the treatment or decision, which may prolong or even force a remake of the procurement process.

*Positive*

To avoid risks and choose well known solutions increases stability and less gambling with taxpayers' money

*Negative*

Risk aversion can signify that **how** (to make it correctly) overshadows **what** (to buy the correct and needed services and goods). Too much jurisdiction can lead to too little business. The public sector may fall behind private companies in utilization of new services, ideas etc (Kearney, 2005)

Taking too much risk by procuring innovative solutions or from a new often smaller company can jeopardize service delivery in, for example, the case of bankruptcy.

That can be summarized as shown in the table 2 below:

**Table 2.** *Consequences of Public Procurement for Business and Social Development*

Consequences of public procurement		
	Possible positive	Possible negative
Outsourcing	Decreased number of employees Clear responsibility Easier administration	Changed status for outsourced employees Unexpected costs Lower service level
Social considerations	No children work No inhuman conditions	Difficult and costly to control
Environmental considerations	Example and pressure factor towards the private sector	Cost-driver Effects competition
Competition	Better prices and solutions	Conflicting goals for local development
Knowledge Management	Aggregation of results from previous procurements	More difficult for SMEs (framework contracts)
SMEs	Special focus	Outcome more risky
End-users and clients	Collection of needs	No change after publishing
Risk taking/risk aversion	Increases stability	<b>How</b> overshadows <b>what</b> Jeopardized delivery

## Conclusions

Practically all consequences for different parties and aspects involved in or depending on public procurements can be both positive and negative depending on stakeholder. In addition, political goals can end up being in conflict with economical goals or the public procurement jurisdiction.

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