
WHAT CAN PUBLIC PROCURERS LEARN FROM PRIVATE?

AN EXPLORATIVE STUDY OF SWEDEN | 10 FEBRUARY 2008

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| PREFACE

The Swedish Competition Authority has asked Copenhagen Economics to conduct a short exploratory study on what public procurers can learn from private.

The importance and relevance for reforms of public procurement strategies in Sweden cannot be underestimated. The recent developments in Sweden include new legislation, organisational change of regulators and an increased focus on alternative forms of procurement such as public private partnership. Public procurement in Sweden is a field that is likely to be subject to further scrutiny, debate and reforms in the near future. It is the ambition that this study will provide a constructive input to the discussion.

The present study is based on a brief survey on research, policy statements and interviews with individuals engaged and experienced in public as well as private procurement. The responses have been very positive and many interviewees have underlined the tremendous savings potential by making procurement more efficient given that its size of approximately SEK 400 billion annually (approx € 38 billion).

The input provided by the interviewees has substantially complemented the initial perspective and enriched the conclusions.

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Chapter 1 | MAIN FINDINGS

What can public procurers learn from private companies regarding stimulating competition among suppliers? Given the approximately SEK 400 billion (approx € 38 billion) spent annually in public procurement in Sweden, the savings potential arising from more competitive supplier markets is massive.

Supplier competition largely depends on the number and size of tenders. Large-scale procurements can be cost-saving in the short run, but not necessarily so in the long run. If contracts are very large, they will also be few. As a consequence, we would expect higher concentration in supplier markets, scale-driven entry barriers for small and medium-sized enterprises (SMEs), and reduced flexibility for the public users. Over time, costs may rise due to fewer alternatives and less competition.

An adequate public procurement policy therefore needs to strike a balance between benefiting from economies of scale among suppliers and fostering competition among them. For this purpose, we propose a simple conceptual model that identifies a number of factors that are external and internal from the public procurer's horizon. Based on interviews, the literature, and our own experience we conclude the following:

- The size and length of procurement contracts matters. Few and large contracts lead to concentrated markets whereas a mix of contracts in various sizes foster a more varied market structure.
- Claimed economies of scale and scope are often exaggerated and sometimes even non-existent. Too large and/or too complex tenders precludes many SMEs from participation in tenders.
- Purchasing strategies of private firms are primarily focussed on stimulating supplier competition through performance monitoring and communication, and only to a limited extent by carefully setting contract size and length.
- An SME-friendly public procurement policy need to systematically balance various factors and then make an informed decision on the adequate tender size.

The results strongly indicated that the greatest learning potential for public procurers were not on how to find the best size of tenders, but rather on other skills. We identify *four* lessons for public procurers based on the experiences from the private sector:

1. Communication between procurers and suppliers is seldom satisfactory. As a consequence, suppliers have often experienced that public procurers sometimes ask for products or services that are not first-best to satisfy actual needs (e.g. because it does not reflect the current level of technology in the market). This can be seen as a failure in communication between the parties, which need to be addressed in a proper way. Better communication enables suppliers to better understand what products are the most appro-

private to satisfy the needs as efficiently as possible. Various proposals were advanced by respondents, including annual forums, fairs and capacity building schemes of public procurers administered by government agencies. We believe such initiatives may prove useful, provided they do not compromise fairness and competitiveness in the tender process.

2. *The flexibility* for suppliers to propose alternative products is often unduly restricted in tender specifications. Some interviewees sense that public procurers often put an improper weight on conditional requirements in relation to flexible award criteria. Others stress the importance of conditional requirements but agree that public procurers are too restrictive in setting the general frames for the tender. The restrictiveness may take the form of too much emphasis on how a project should be conducted in relation to what it is supposed to achieve. This hampers innovation, limits the quest for cost-efficient solutions and complicates procurement processes as well as worsens conditions for SMEs. Private companies are generally better at allowing suppliers sufficient manoeuvring space for innovation and new solutions.

3. *Predictability* regarding what future tenders will require is considered as poor. In some industries and for some activities, firms may need to invest in research and development long before the actual tendering procedure is started in order to meet these demands. If firms are uncertain on tomorrow's demands in public procurement, they may find it too risky to do so. Hence, better predictability may stimulate innovation in the right direction. This argument has been stressed by interviewees in particular with relation to environmental performance. Predictability is also warranted on when tenders can be expected to be announced which would enable firms to be better prepared. Sufficient time between the tender phases (announcement, time limit of tender, decision, start of delivery) is often a prerequisite for the participation of SMEs in public procurement.

4. *Learning*. It is paramount to carefully evaluate procurements through its entire life cycle and feed-back the lessons learnt into future procurements. This aspect has a strong dynamic implication – private companies are generally felt to be far better than public at evaluating supplier contracting processes and learning. Also, thorough monitoring during the contract life may provide strong incentives for the supplier to maximise performance in the delivery phase. For public procurers, such learning and monitoring is generally perceived by interviewees as being underdeveloped and not prioritised. It is, however, but greatly needed.

Chapter 2 THE OUTSET

2.1. BACKGROUND

Public procurement by national and local governments in Sweden amounts to considerable amounts annually. Although no clear figures exist due to inadequate statistical coverage, most estimates today reach around SEK 400 billion per year (Konkurrensverket 2007, p 60), which represents about a third of total government (central and local) spending or around 15% of GDP. It is natural to expect that even small improvements in efficiency have the potential of significant budget savings.

The area is subject to some, but perhaps not overwhelming, interest from politicians, government agencies and trade associations. There have been a number of state-commissioned enquiries and other studies on the subject. Criticisms of the current practise and proposals for higher efficiency in procurement have been a common theme. Typically, trade associations stress various bureaucratic obstacles and unfairness as the major problem. A common area for complaints is markets where public bodies directly or indirectly compete with the private sector. National authorities complain about weak coordination and inefficiency among public procurers, poor incentives of public buyers to obey existing rules and weak sanctions available for courts and regulators in their enforcement role.

The purpose of the new legislation that was enacted on 1 Jan 2008 was to address some of these shortcomings. The Swedish Competition Authority is since 1 September 2007 assigned the task of monitoring compliance with the Public Procurement Act. On the same date, the Authority established following a Government Instruction a Council for Public Procurement consisting of a mix of academia and representatives from the private sector and trade associations. The role of the council is to advise the Authority on how to perform its regulatory responsibilities.

Part of the mission is to stimulate research and competence formation regarding efficiency in public procurement. Perhaps surprisingly, academic research on public procurement efficiency is rather thin, both in Sweden and internationally. Also, there has been little in terms of drawing on the results from the neighbouring research area of private purchasing. Indeed, private companies are in many ways confronted with similar challenges when it comes to establishing efficient sources of supply.

A troubling observation is that many public tenders render meagre responses in terms of bidders – especially so when the public sector represents a significant part of total demand (Konkurrensverket 2008, chapter 5). So, it is natural to expect that procurement policies, in particular the sizing of contracts, have a direct impact on market structure and competitive conditions in the market.

2.2. THIS STUDY

The purpose for this study is to draw lessons from private purchasing strategies which can be relevant for public procurement.

Given the resource limitations, we have adopted an explorative and qualitative approach. The international literature on public procurement and private purchasing provide our point of departure and set the frames for our reasoning. Based on this, we develop a simple conceptual model regarding relevant considerations for identifying an optimal size-competition balance in public procurement.

The model provided the point of departure for nine long interviews with representatives of private companies with experiences from both public and private customers and representatives of trade associations of sectors where public procurement is a significant source of contracts. The results of the interviews are compiled and systematised into categories according to identified themes.

The scope of this methodological approach is to capture a plethora of reflections and interpretations of potential lessons for public procurers. Hence, the nature of empirical evidence is inclusive and fairly rich. The limitations are the obvious ones that are typical to all qualitative studies: generalisations are weaker than for quantitative studies due to a small number of observations; respondents' judgements may be subject to bias and our own interpretation; and analysis of the responses may be sensitive to outliers. For this reason, the results and tentative list of lessons should be regarded with some caution. In any case, it is our ambition that this explorative report will stimulate further research initiatives in this scarcely researched area.

The next chapter summarises the literature on the scale-efficiency trade-off in public procurement along with our conceptual model. Chapter 4 summarises the interview results and identifies three conclusions. We believe that a sizing strategy in line with our model is an appropriate venue for the public sector, but the evidence suggests that there is little to learn from private sector in this respect. In contrast, there are important lessons to be drawn in four other areas. These are outlined and motivated in Chapter 5. The appendices include a list of interviewees, the interview guide and references.

Chapter 3 SCALE AND EFFICIENCY IN PROCUREMENT

In this chapter, we first consider the different roles and objectives for public and private procurers. Although the objectives in the public and in the private sector exhibit important differences, they nevertheless share the objective of achieving efficiency. Relevant research on this, which primarily is found within business administration and marketing research traditions, are shortly reviewed in sections 3.2 and 3.3. It is evident that academic research on public procurement often is distinct from that of private purchasing strategies. Although journals such as the *European Journal of Purchasing and Supply Management* and *Journal of Public Procurement* publish articles on both subjects, there is very little in terms of applying reasoning or findings across these two areas.

Another observation is that research on public procurement, despite its potential significance for budget savings and SME promotion policies, is indeed meagre. Some contributions do exist on the scale-competition perspective. A significant share of research in this area has adopted other perspectives, such as risk sharing (public private partnerships) and, probably inspired by the literature on private purchasing, the roles of relationships and trust.

On the other hand, the research on private purchasing is richer and largely distinct from that of public purchasing. There is little in terms of cross-referencing. In the private sector, purchasing strategies have grown in importance over recent years and successful companies invest heavily in efficient ways to manage and monitor suppliers. Professionalism is a key focus area and a prerequisite for being able to continually exert pressure on suppliers to perform.

Based on these findings and our own reasoning, we develop a conceptual model including a list of important considerations for public procurement officials in section 3.4. We argue the model would provide useful input when designing optimal procurement designs with respect to size and centralisation. In markets where public buyers constitute a significant player on the market, sizing of tenders may in itself constitute a powerful policy tool to achieve public policy goals such as SME promotion. The appropriate sizing of public tenders should consider external factors that relates to market structure as well as internal factors which refer to the abilities and conditions within the procuring body.

3.1. PUBLIC VS. PRIVATE PROCUREMENT

The objectives of private and public procurement are very different. Private companies are exposed to the harsh and tumbling realities of market competition. The management is assigned with the simple task imposed by their owners to deliver profits today and tomorrow. Since such a goal is easily monitored, one can expect that the approaches devel-

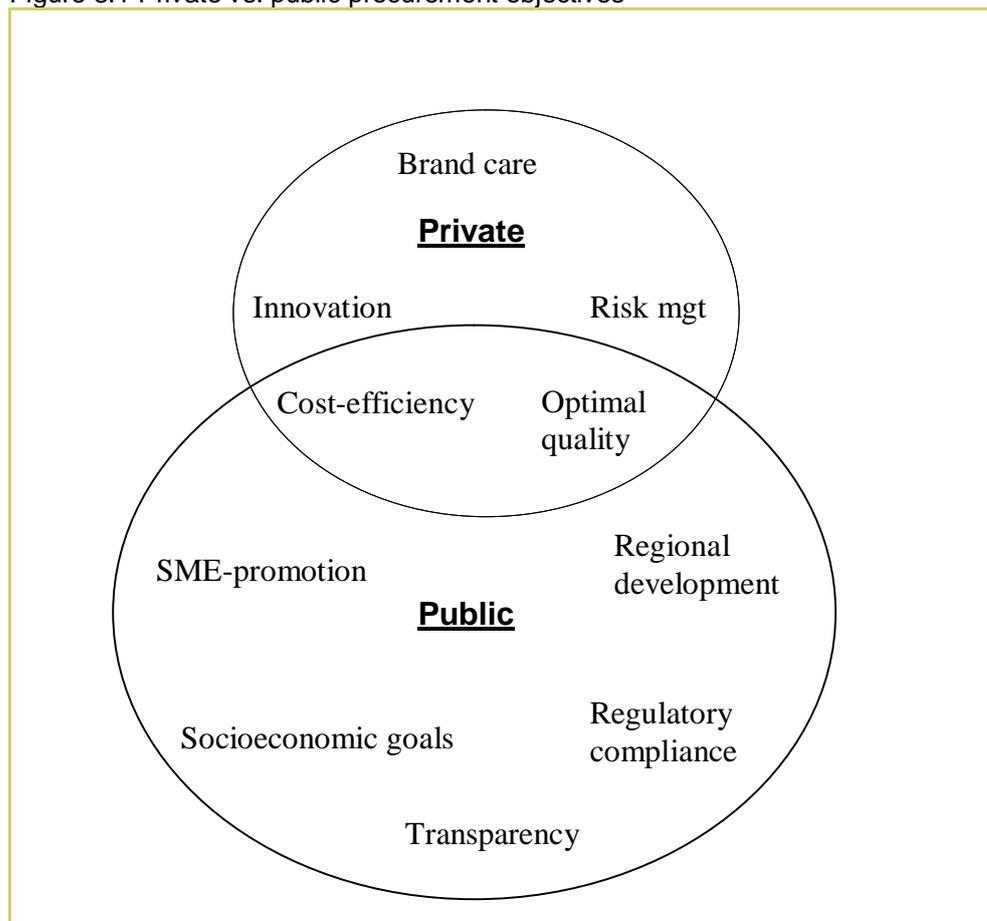
oped by successful companies to procure is better suited to minimise costs compared to public procurers.

Public procurers operate under very different conditions in which the threat of bankruptcy is absent, objectives diverse, rigorous evaluation hard to perform, and the prospect of being part of a lawsuit very possible. Drawing on Andersson (2002), one could depict the typical public procurer as operating according to a logic defined by hierarchies, whereas the private purchaser acts according to market logic. In hierarchies, political influence coexist with the economic incentives of cost-minimisation. Two sets of principles are sometimes not compatible. The rights and wrongs are defined within the hierarchy according to its own agenda, which may be partly hidden for outsiders. Market logic is simpler and the private purchaser would have sufficient degrees of freedom to design efficient purchasing arrangements. Profitability is the overriding benchmark against which the performance of the purchaser is evaluated.

It is an obvious and probably uncontroversial observation that the objectives are largely diverging between private and public procurers although they may be somewhat overlapping. Indeed, sometimes the full list of objectives for public procurement may be hard to identify. Firstly, public objectives in procurement are, and certainly should be, wider and more numerous than private ones. Sometimes different public objectives may clash - a recent example highlighted by Loader (2007) is cost-efficiency versus SME-promotion in the UK. Secondly, there are some objectives that are truly distinct between the public and the private sphere. For instance, we may include regional development, socioeconomic aspects and SME-promotion in the public set of goals which typically are not mirrored in the private firm. On the other hand, caring for the brand, managing risk and spurring innovation among suppliers, are naturally important considerations in private purchasing. Finally, and most importantly, there is an important overlap in the objectives of cost-minimisation and quality optimisation. Clearly, this is the area in which sharing of experiences among sectors may be worthwhile. An illustration of the reasoning is provided in figure 3.1 below.

It is clear that the two overlapping objectives in the figure below, cost-efficiency and quality, hinges upon sound and competitive markets. Hence, both private and public procurers have typically the interest in common to foster competitive markets. Few would dispute that procurement policies of both private firms and public bodies affect the evolution of market structure. Large, few and complex contracts may be too costly or complicated for SMEs, leaving the market for larger firms. Such an increased market concentration would increase market power of a handful of large suppliers, possibly resulting in higher prices and a deteriorated performance.

Figure 3.1 Private vs. public procurement objectives



Source: Copenhagen Economics

Foreseeing this, one would expect that an efficient firm would adopt a procurement policy so as to safeguard competition among actual and prospective suppliers. In practise, this would probably involve designing contracts with an appropriate life span and size that would allow a number of suppliers to survive.

Such strategic considerations are, however, only relevant when the purchasing party represents a significant share of total demand in the relevant market in which the suppliers operate. Examples would include many public procurers, and some of the larger private ones as well in Sweden.

Conceptually, public procurers would have stronger incentives for sound and efficient competition among suppliers than private enterprises. The reason is that a unilateral pro-

competitive action is likely to incur costs for the procuring party, either in the form of foregone scale efficiencies or increased transactions costs. The cost is borne by the individual purchasing party whereas the benefits are shared with other firms and procurers, and possibly also ultimately with consumers. For a public procurer, all these positive effects are part of the public interest. In contrast, for a private firm, these positive effects that accrue to others do not contribute to the profits of the firm. Hence, competition in supplier markets should merit higher priority when the procurer pursues public interests rather than the interests of a private firm. In academic research, Caldwell et al (2005) consider the area to be sadly neglected and argue for more research on supplier incentives and management of supplier relations.

3.2. RESEARCH ON PUBLIC PROCUREMENT

There is comparatively little available theoretical and empirical research in economics on public procurement. Given the scale of this activity, it is rather surprising. Even very moderate gains in efficiency would result in significant savings for governments. In spite of this, academic research is still in its infancy.

We conclude that the scale-competition-problem is acknowledged, but not analysed in depth in the literature. A possible exception is the case of monopsony (Keisler and Buehring, 2005). The focus is on short-run rather than long-run cost savings. The specific issue of how to balance the benefits from economies of scale and supplier competition is scarcely discussed. Other related issues, such as the optimal number of suppliers, have attracted more interest and the conclusions from those studies have some relevance also here (Segal, 1989; Cousins, 2002).

On possible lessons for public procurers from private purchasing, the literature is more or less silent. One notable exception being Prager (1994) which provides a colourful exposé of US experiences concluding that contracting out of government services is far from a 'silver bullet' or a panacea for improving efficiency in the public sector. Long term gains critically depends on a number of conditions, such as: when the public body cannot take advantage of optimal scale or reap benefits of economies of scope; when contracting out is a solution to a public organisational failure; when supplier competition is satisfactory and; when management costs of the outsourcing process are not prohibitive. Public bodies should, Prager concludes, approach the outsourcing decision just as private firms do, pragmatically (and not ideologically).

More recently, Linthorst and Telgen (2006) considers the pros and cons of using multiple suppliers in public procurement in the Netherlands. The pros include, for example, lower costs through harsher competition, relative 'independence' from individual suppliers, less

risk for supplier disruption and wide market access. The disadvantages involve higher administrative costs, less loyalty among suppliers and less scale returns. After reviewing the specific public policy goals for procurement, which are of either regulatory, commercial or socioeconomic nature, they conclude that multiple sourcing can help governments reach some of these goals, as illustrated in table 3.1 below.

Table 3.1 Procurement goals and its fit with multiple sourcing

Procurement goal	Description	Fit of multiple sourcing
Regulatory goals	1. More Compliance	Neutral
	2. More transparency	Neutral
Commercial goals	3. Reduction in costs	Unclear
	4. Stimulation of innovation	Positive
	5. Stimulation of competition	Positive
Socio-economic	6. More sustainable purchasing	Unclear
	7. More buying from SMEs	Positive

Source: Linthorst and Telgen (2006), derived from table 5

Although they do recognise the cost disadvantages associated with multiple sourcing, such as higher administrative costs of procurement and probably less scale-efficiency, the combined effect is deemed unclear and has to be judged case by case. Hence, multiple sourcing is more likely to be beneficial in cases where both economies of scale and administrative cost savings are limited.

A more formalised examination of the scale-efficiency trade-off is provided by Keisler and Buehring (2005). They consider a case where the government is the only customer and all goods on the market are acquired through public procurement. In such a case the procurer has tremendous influence on market structure. For instance, using a single supplier for some time would, depending on the financial strength of the others, result in a de facto monopoly and elimination of supplier competition. On the other hand, competition between multiple suppliers necessitates some degree of excess capacity and may also result in foregone positive scale effects. In their model, competition is significantly increased as the number of suppliers rises to four, thereafter these benign effects become less important and the scale disadvantages more costly. In addition, these effects are highly dependent on the assumed price elasticity¹ but less sensitive to the ratio of variable to fixed costs.

Keisler *et al* conclude that competition cannot work unless suppliers jointly possess some degree of excess capacity. Also, reasonable profits among successful suppliers are consistent with sound competition in procurement markets.

¹ The model is sensitive to the degree of price elasticity – the positive effects of competition rises with higher elasticity.

In a way, these observations are pretty well mirrored by the main arguments presented by Caldwell *et al* (2005) whose paper identifies supplier incentives and post contract management as key areas for research. The study is based on three in-depth case studies. One key finding is that there is a need to incentivise suppliers to suit broader public sector requirements: public contractual forms should be able to reward suppliers for excellence rather than for volume. The authors also advance the argument that supplier dominance is best handled through managing a selection of suppliers within a ‘portfolio’ in order to maintain an element of disciplining rivalry. Certainly, this critically hinges upon procurement officials’ skills. Accordingly, Caldwell *et al* lastly conclude that procurement competence need be strengthened around ‘post-contract award management’ to ascertain that suppliers deliver as promised.

Naturally, such changes require that relationships between suppliers and public procurers are more flexible. Evidence from the US suggests that such reforms can improve the effectiveness of public procurement. Clearly, they also provide new challenges to public managers, but can be sensible strategies when the tender involves complicated and non-standard products. Lawther (2007), drawing on the experiences of the Invitation to Negotiate approach adopted by the State of Florida, designs a conceptual model for when more flexible relationships and increased space for negotiations between procurers and suppliers are warranted. Two dimensions are highly relevant when assessing these needs – the complexity of the product and the required degree of customisation. Depending on the nature the intended procurement, an efficient procurer would need to adopt his policy accordingly. Lawther outlines his model in the following matrix, see table 3.2.

Table 3.2 Lawther’s model for assessing need for flexibility and negotiation

	Low complexity	High complexity
High customisation	1. High/medium flexibility, little negotiation	2. High flexibility, much negotiation
Low customisation	3. Low flexibility, no negotiation	4. Low flexibility, low negotiation

Source: Lawther, (2007), Figure 1 (somewhat simplified)

Waste management service is an example of low complexity and little need for customisation – hence procurers may not need to allow much flexibility or room for negotiation with suppliers (case 3). The opposite situation can be illustrated with e-government or IT-systems where products must be adapted to the specific needs of the public administrative body in question (case 2). Case 1 may be exemplified with leases of office space – substantial flexibility is probably necessary in the tender specifications but there is little need for extensive negotiations with potential vendors. Case 4 would refer to cases where

complex but already existing off-the-shelf products are to be procured and where the need for flexibility and negotiation is limited.

Recently there has been a surge in the interest for procurement arrangements which involve alternative ways of distributing risks between the procurer and the supplier. The predominant alternative contractual forms are the public private partnership models that have been employed in Sweden and elsewhere. Although such projects are more demanding in terms of planning, normally require commitments over long time and are better suited to large-scale infrastructure investments, the model certainly has a potential to improve efficiency (Konkurrensverket 2008). Public private partnership projects are clearly a step towards public contracts which incentivise suppliers to suit broader public sector objectives and make it simpler to reward suppliers for excellence rather than for volume.

In sum, we have seen fairly little in terms of economic research on the optimal balance between ensuring competition among suppliers and to benefits from economies of scale. Nevertheless, the basic trade-off is identified, and we conclude that the literature provide some support for the relevance of including the scale-competition trade-off in an efficient public procurement strategy.

3.3. RESEARCH ON PRIVATE PURCHASING

The literature on private purchasing is richer than that of public procurement. The main thrust of this literature, however, is not on the scale-competition trade-off, but rather on the management of risks, relationships and costs. Recently, the interest has grown, primarily driven by the potential for cost savings. Our general impression is that purchasing within private corporations is a more prioritised activity compared to procurement in public bodies. Europe Economics conclude in their 15 country study conducted for the Commission that private purchasing is “an integral part of strategy and - - - subject to audit” (Europe Economics 2006, para 4.71).

A good and concise example of these developments is provided by Niezen *et al* (2007) who observe that more than half of the cost reductions in successful corporations arise from supply management activities. Three main sources for these savings are identified. Firstly, leading companies manage to create supplier competition by continually searching for new suppliers and developing alternatives such as ‘insourcing’. The potential competitive threat to suppliers ensures cost efficiency. The question of sole or multiple sourcing is part of the strategic behaviour - important considerations in addition to prices include delivery speed, quality, flexibility and assured supply. Secondly, efficient purchasing divisions within successful corporations continually seek to tap knowledge from

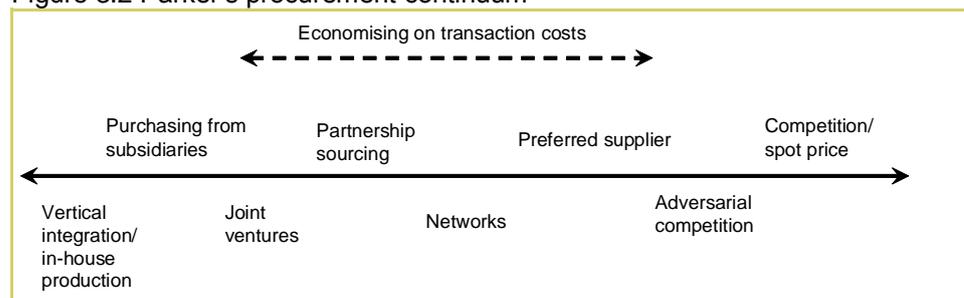
suppliers and feed it into their own organisation. The increased knowledge improves the abilities of corporations to negotiate with new suppliers and to develop alternatives. The third source includes direct initiatives to ‘expand the supplier universe’ – i.e. to stimulate firms to engage in the kind of operations that would make them eligible as suppliers.

Slightly from a different angle, Ogden et al (2007) identifies three main elements in the purchasing strategies of successful corporations: *professionalism*; *status* of the purchasing section within the organisation of the firm; and *active supply management*. Successful firms often perform well on all these aspects and have seen clearly visible effects on overall financial performance. Previous research have associated such strategic thinking mostly with North American large corporations. However, the results seem to indicate that there is a general recognition across countries and firms in Europe that there exists a gap between desired and actual levels of strategic thinking in purchasing. The purchasing activity is strengthened throughout most industries today.

Niezen *et al* and Ogden *et al* adopt different perspectives, but share a clear focus on active management of suppliers as a key to achieve efficiency. Purchasing managers in successful corporations are knowledgeable, continually monitor performance of suppliers, and seek alternatives. Prager (1994) observes that “[the] private sector not only undertakes outsourcing but manages it”, which captures the core of what lies behind both efficient private purchasing and the research efforts devoted to it.

Purchasing management can be organised in different ways. Parker (1997) identifies that most supplier relationships can be described along a continuum between pure competition or spot price market sourcing, in which little negotiating or interaction takes place, to full in-house production. In between these extremes, purchasing managers may strategically choose a suitable degree of ‘closeness’ with its suppliers. This is illustrated in figure 3.2.

Figure 3.2 Parker’s procurement continuum



Source: Parker (1997), Figure 1, slightly modified

Both extremes represent low transactions costs – either because production takes place within the firm, or because the spot market is used. In between, transaction costs are higher because of the need to regulate cases of potential opportunism.

A possible path to minimize such transactions costs is to substitute some of the contractual arrangements with an element of trust. Such relationships are more subtle but appear to be an important aspect in private purchasing. Trust can be consistent with profit-maximisation behaviour if the actors are long-term and have repeated encounters in the market. Trust, or ‘collaborative relationships’, can also be regarded as a process between the parties to achieve a mutually benign objective. As long as trusting each other is valuable, firms are willing to continue and deepen such relationship.

Nevertheless, as underlined by Cousins (2002), one should not forget that “all firms are ‘snakes’[, obsessed] “with their own survival and self-interest”. Also, “when that interest is no longer served, rest assured, they will bite you!” (*op cit*, p 81). Further, transparency is generally regarded as a prerequisite for trust between the parties, although it also may have some negative effects (Hultman *et al* 2007).

3.4. THE SCALE-COMPETITION TRADE-OFF

There are a number of considerations that can be justified when finding the optimal scale of procurement. In what follows below, we will organise these into factors that are *external* and *internal* to the procurer, respectively. By external factors, we refer mainly to market characteristics such as concentration on the buyer and the seller side. Internal factors include aspects such as competence within the procuring organisation, technology and organisational set-up. Depending on the nature of these factors, public procurers may either wish to conduct large and centralised tenders or, alternatively, smaller and decentralised ones.

External factors

When supplier markets are characterised by a national monopoly, there is little point in making tender contracts small or to decentralise the procurement function. Decentralisation in such a context may even lead to inefficiencies since it would probably reduce the likely positive effects of buyer power. Also, the beneficial effects of decentralisation may be limited if, initially, the number of suppliers is no larger than the number of procurers.

The size of the relevant geographic market is also a pertinent element. For local markets, decentralisation is probably more warranted compared to a situation of national or larger markets. In contrast, for products which enjoy national or even international coverage, such as IT hardware, there may be little point in decentralising, since the coverage in it-

self represents a certain degree of seller power. The opposite would constitute a sensible strategy if the products were only offered locally, which often is the case with training or cleaning services.

Economies of scale and scope are perhaps the strongest rationale for large and long contracts. The degree of these benefits naturally depends on the kind of product to be procured. IT hardware is typically regarded as an example when large procurements may result in more favourable prices, whereas these effects are considerably weaker for IT support services which usually require local presence.

When products are highly specialised to fit certain needs, decentralised and small-scale procurements may be preferred to avoid 'one-size-fits-all' concerns. For example, certain products may be developed to address local needs and conditions, and may not be appropriate elsewhere. In contrast, when products are standardised and similar across regions, these arguments do not hold.

In industries where innovation is intense among firms it may be motivated to allow a multitude of contracts and to decentralise public procurements. In this way, more innovations and ideas are tested on the market and technological development is stimulated. In essence, the underlying rationale is the seedbed argument – the greater the diversity of products circulated in the market, the better will the selection process work in which the most economically efficient solutions will prevail. Too large and centralised procurement contracts may produce opposite results. On the other hand, when industries are mature and less innovative, the case for decentralisations and small-scale is not as strong.

If public procurement does not constitute a significant share of the market, the relative influence on the market development is probably small. Transactions costs arising from decentralised and small-scale procurements may then constitute an argument for making procurements fairly large. If, on the other hand, public procurement dominates the market, the most extreme example being defence contracts, the benefits of a pro-competitive small-scale procurement design probably outweigh the transactions costs it incurs.

These factors, external to the firm, are held as relevant considerations for public procurers when designing tenders and are listed in table 3.3 below. Each line corresponds to a factor and the entries in the table represent opposing extremes, such as monopoly vs. many small companies. These extremes correspond to examples where an appropriate public procurement policy would be characterised with either large-scale and centralisation, or small-scale and decentralisation.

Table 3.3 External factors relevant for procurement design

Large/Centralised	Small/Decentralised
Monopoly	Many small companies
National or larger geographical markets	Local markets
Significant economies of scale and/or scope	Limited economies of scale and/or scope
Standardised products	Specialised products
Mature industries	Innovative industries
Public procurement a small market player	Public procurement a large market player

Source: *Copenhagen Economics*

In addition, there are also good reasons to think about a range of factors internal to the firm as further explored below.

Internal factors

The factors inside the realm of the procuring organisation are also important to consider. These factors concern both the skills and experiences of the individual procurers and the organisational structure in which they function.

Firstly, they needs to be satisfied may not be the same for all end-users. If preferences differ significantly among the actual recipients of the purchased products within the purchasing entity, it is probably worthwhile to decentralise which gives better opportunities to adapt procurement to actual needs, which, for example, may differ between localities.

Yet, one of the drawbacks of such decentralisation is its dependence on high procurement skills in several parts of the public organisation. Crucially, efficient decentralised procurement hinges upon access to relevant market information. If the understanding of what constitutes a fair price is lacking within the procuring organisation, centralisation and pooling of purchasing competence can be efficient. Centralisation also has the additional advantage of simplifying an appropriate sequencing of contracts to make it easier for SMEs to participate. A SME-friendly time profile of tenders includes contract length and the period between announcement, decision and commencement.

These internal factors are summarised in table 3.4 below.

Table 3.4 Internal factors relevant for procurement design

Large/Centralised	Small/Decentralised
Similar preferences across the organisation	Heterogeneous preferences
Little understanding of a fair price	Great understanding of a fair price
Great understanding of future needs	Future uncertainty

Source: *Copenhagen Economics*

Taken together, the external and internal factors outlined above are meant as a non-exhaustive list of important considerations for a public procurer with the objective of fostering competition among suppliers, minimizing procurement costs, stimulating innovation and supporting SMEs. They are all derived from a theoretical viewpoint - the factors are relevant in designing an optimal size (and length) of procurement contracts. The meaning of “optimal” in this regard refers to striking a balance between making cost-efficient procurement contracts and fostering competition in supplier markets today and in the future.

Chapter 4 HOW LARGE AND LONG SHOULD TENDERS BE?

In this and the next chapter, the results from nine long interviews with experts on public procurement are presented. The initial focus was on what public procurement officials can learn from private purchasers in finding an optimal trade-off between scale returns and competition among suppliers. An interview guide was derived from the conceptual model presented above. Most interviews lasted for about one hour. The interviewees² are not anonymous, but their individual answers are. For this reason, industry characteristics below have intentionally been kept vague. The interview results are interpreted by Copenhagen Economics in light of other relevant empirical evidence. It should be underlined that the conclusions not necessarily correspond to those of the respondents.

Section 4.1 below outlines the experiences of practitioners with respect to whether procurement size affects market structure in any noticeable way. Even though this is kept as a maintained hypothesis by a number of experts, there is little available recognized evidence to support or reject the existence of such effects. Section 4.2 deals with anticipated positive and negative consequences of large tenders. In section 4.3 we draw conclusions in light of these findings with reference on our conceptual model presented above.

4.1. DOES PROCUREMENT SIZE MATTER?

Our overall conclusion is that size indeed matters. Not only tender size, but also geographical reach, and to some extent contract length, has a clear and direct effect on market structure. Few and large (and long) contracts lead to concentrated markets, whereas an appropriate mix of procurement contracts of various sizes foster a more varied market structure. As a consequence, setting the right size of procurement contracts is a highly relevant policy tool for promoting SMEs.

Some respondents acknowledged that in some service markets each tender was a matter of surviving for most firms. This was taken as a clear indication that procurement size affected the number of firms in the market.

Another group of respondents felt reasonably certain that large procurements affected market structure. The effects were not only making life hard for SMEs because of their sheer smallness, but were also having the effect of dampening the willingness among procurers to adopt new and innovative solutions. Since innovations and product differentiation often are the *modus operandi* of SMEs, large tenders restricted the growth prospects even further. In this way, large procurements reduce the market share for SMEs and eases competitive pressure for incumbent large-scale firms.

² Listed in the appendix.

A few interviewees discussed the possibility of SMEs to team up and submit joint bids. Often, the effort was seldom considered worthwhile given the costs and uncertainties involved.

There was one counterargument presented to the view outlined above – large procurements in a particular heavy industry would normally result in extensive subcontracting from the firm winning the tender, sometimes amounting to three quarters of the contract value. In a way, the larger firms that participated in such tenders performed the role of a ‘broker’, providing the link between the procurer and the efficient SMEs that were not in the tender process. Such situations may neutralise some of the negative effects of large tenders but hardly eliminate them altogether.

One respondent explained the disappointingly low numbers of bidders in many tenders as an effect of lack of trust among SMEs for the fairness of the tender award process.

4.2. PROS AND CONS OF LARGE TENDERS

The principal advantage of large tenders is the presumed positive economies of scale and scope that are expected to be reflected in more competitive bids. In practise, however, such claimed benefits are often exaggerated and sometimes even non-existent. On the other hand, very large tenders have drawbacks in terms of less competition, less innovation and sometimes also less productivity. Too large and/or too complex tenders are more of a problem for SMEs than their small production capacity. Framework agreements generally fall into this category.

The Pros

One respondent noted the absence of empirical studies on returns to scale and scope in large public procurement markets which make it hard to draw conclusions. As a general observation, however, it can be frequently observed that SMEs compete successfully side by side with considerably larger companies in numerous services markets. If anything, it was argued, this was certainly a strong indication that returns to scale were not overwhelming in those markets.

Another respondent referred to procurements of travel booking services – there was very little indication that unit service prices would fall with increasing volumes. This observation also suggests limited scale benefits. Similar experiences were reported by the remaining respondents.

These views are largely consistent with recent reports. In the survey by Europe Economics (2006) most respondents, consisting of procurement officials in 15 EU member states,

deemed central purchasing bodies to deliver better value for money. Such arrangements can be regarded as a pooling of regional public procurement needs to achieve scale benefits. Interestingly, public officials in Germany felt that procurement through central purchasing bodies was more expensive. Unfortunately, the study does not discriminate whether these effects are a representation of economies of scale in production or savings on administration costs. In a study by the Swedish National Audit Office (Riksrevisionen 2005) on coordinated procurement arrangements within the Swedish government, it is concluded that the main savings potential is on administrative costs.

Clearly, these effects may differ across industries and between services and goods. In sum, the pros are mainly small cost savings. The cons, on the other hand, were felt to be much more diverse.

The Cons

One respondent believed that large procurements are associated with higher risk aversion among public officials. In large-scale procurements, public procurers would be even less prone to try new and innovative solutions simply because the negative consequences of an error also would be large. New solutions may rather be tested in small, but not large, scale. Since SMEs are often innovation-driven, large tenders would thereby limit their niche in the market. As a result the market may become more concentrated and less dynamic.

A related problem is that a company which indirectly participates in a bid via a 'mother' which the official bidder, cannot participate in alternative bids. This limits the supplier universe and reduces competition. In the private sectors, such legally imposed limitations hardly exist. A metaphor depicted the point perhaps in the clearest possible manner: in the private sector you are allowed to pick out a national team using the best players in the best clubs in the country. In the public sector you can only choose one of the club teams: no picking and choosing of individual players is allowed.

Framework purchasing arrangements are often believed to be associated with large procurement size. Several respondents had strong views of these. In some service sectors such as cleaning, real estate maintenance and IT systems, such contracts are clearly the dominating type of tender. Sometimes very large framework arrangements, covering the whole nation, coexist with smaller ones. There was little support among interviewees that framework arrangements would result in lower costs due to economies of scale. On the contrary, since such contracts in general do not specify volume, they may even lead to higher overall costs since suppliers need to maintain idle capacity in order to be prepared for prompt delivery at short notice. Naturally, the approach would most certainly allow authorities to save on administrative costs. Still, these are not likely to be significant. On

the negative side, reduced user flexibility and the limited chance of SMEs to participate were highlighted. Riksrevisionen (2005) concludes that framework agreements probably are more suitable for standardised goods than for services - a view that was shared with several of the interviewees.

A related issue are the centralised purchasing bodies which are given more freedom under the new procurement act in Sweden. The general opinion among respondents was fairly similar to that of framework purchasing arrangements, with the additional concern regarding the jurisdictional freedom of these bodies to act as a competitive player in the market (SOU 2006, p 457-86).

4.3. PRIVATE PURCHASING STRATEGIES AND SIZING

The results of the interviews strongly indicated that the optimal balance between purchasing scale and competition among suppliers is not a central part of purchasing strategies among private firms.³ Purchasing strategies of private firms are primarily focussed on risk management, performance monitoring and nurturing relations to sellers. Supplier competition is stimulated mainly through performance monitoring and communication, and only to a limited extent by carefully setting contract size and length.

The outcome was somewhat contrary to what we had expected, but could possibly be explained by the fact that private firms seldom reach sufficient size to unilaterally be in a position to seriously affect market structure. Hence, their incentives to act strategically in this sense is limited. Moreover, the size-competition balance has received very little attention in the literature in comparison to other aspects of private purchasing, such as the management of supplier relationships and building trust.

In conclusion, public procurers have little to learn from private purchasers regarding sizing of tenders. Nevertheless, we believe there are strong arguments for using considerations such as those in the conceptual model above in public procurement. We have seen above that tender size affects market structure, competition and the growth prospects for SMEs. In addition, there are costs as well as benefits internally for the procuring body following large and centralised procurements. An appropriate policy for public procurement need to carefully balance the various external and internal conditions and then make an informed decision on the adequate tender size. We propose that the framework developed in section 3.4 above be used for this purpose.

³ In addition to the interviews, a scan of publicly available purchasing policies among large corporations in Sweden on the internet has produced virtually nothing regarding the scale-competition balance.

One respondent believed the reason for the non-existence of a clear private strategy was that few corporations were of large enough size to find such an investment worthwhile. Other noted that private purchasers sometimes were less rigorous with details compared to public procurement officials. Someone was of the strong opinion that private purchasing managers were hardly considering supplier competition aspects at all. Most interviewees thought that the size-competition trade-off identified by the conceptual model was a relevant consideration for a proper and SME-friendly policy for public procurement.

In an ambitious study by the Swedish Agency for Economic and Regional growth (Nutek 2006) it was concluded that the public procurement policy has a strong potential role as a driver for change and development. Unfortunately, current public procurement practise largely fall short of this motive.

Chapter 5 FOUR LESSONS FOR PUBLIC PROCURERS

The results of the interviews showed robustly that the greatest learning potential for public procurers were not on how to find the best size of tenders, but rather on other skills. In fact, the interview theme, “what can public procurers learn from private”, typically led the respondents to highlight a range of factors relating to the forming and maintenance of relationships between purchasers and suppliers. The input from the interviewees provided the main basis for these arguments which has been systematised by Copenhagen Economics into four core aspects outlined below.

5.1. COMMUNICATION

Communication between procurers and suppliers is seldom satisfactory. As a consequence, suppliers have often experienced that public procurers ask for products or services that are not first-best to satisfy actual needs or do not reflect the current level of technology in the market. This can be seen as a failure in communication between the parties which need to be addressed in a proper way. Better communication enables suppliers to better understand what products are the most appropriate to satisfy the needs as efficiently as possible.

Various proposals were advanced by respondents, including annual forums, fairs and capacity building schemes of public procurers administered by government agencies. We believe such initiatives may prove useful, provided they do not compromise fairness and competitiveness in the tender process.

Little communication between public procurers and suppliers

Some respondents with hands-on experience with public procurement of complex services bluntly stated that public officials seldom spoke to sellers. At the stage in which the tender requirements were specified, some contacts may occur, but far from always and virtually never after this phase. As a consequence, it becomes very hard for private corporations to fully understand what the tender exactly is about and what needs that are to be fulfilled.

Public officials are often not aware of the latest and most appropriate technology. If tenders were more flexible, this would probably not constitute a significant problem. However, given that tender specifications typically are highly detailed, new and innovative solutions may be defined away, which results in frustration among innovative firms engaged in developing new technologies.

One interviewee commented that the public procurer talks a language and uses a logic that differs distinctly from those used among suppliers. Also, tender specifications are often very detailed and hard for suppliers to fully comprehend or understand the underlying

rationales. Quite awkwardly, both sellers and buyers appear to spend much time trying to understand each other but without directly communicating. A general belief among most respondents was that the solution is better and more direct communication between public procurers and sellers. In the private sector, such contacts are commonplace. Suppliers have normally the possibility to present and discuss possible trading arrangements during a series of meetings and subsequent negotiations.

Legal obstacles to more communication

Some respondents noted the public awareness of the problem and that various initiatives have been taken to address them, introducing various forms of direct negotiations between procurers and sellers.

One respondent considered the present legal framework for public procurement as an almost insurmountable obstacle for building the kind of relationships that are commonplace in the private sector. Nevertheless, efficient public procurement necessitates a significant amount of information regarding what the market has to offer. If long-term contractual relationships has adverse effects on market structure one can expect a growing need for the buyer to exert buyer power to replace the eroding competitive pressure. This is indeed a challenge, but is also in part corresponding to how conditions are in the private sector, especially in Japan.

The dominance of ‘price’ as award criteria

Another interviewee, with reference to a service sector, interpreted limited communication as cause for why price dominates as the single most important award criteria. Such price focus carries the risk of down-playing important considerations that relate to flexibility, quality and assured delivery. An exaggerated focus on price together with detailed tender specifications can result in unnecessary costly procurements. Public procurers have mostly little knowledge of what elements in a requested service are the most costly. The point was illustrated with cleaning services: an additional folding may increase costs significantly but only represent a minor value for the recipient of the service. With better information, buyers may be better at matching preferences with actual costs of provision.

Communication initiatives between public procurers and suppliers

It was also reported that some municipalities in Sweden adopted more proactive communicative approaches in the phase preceding the announcement of a tender. Meetings were organised bilaterally between procurement officials and a number of suppliers. The respondent thought these meetings were positive – they were informative for suppliers regarding the actual underlying needs of the municipal and also very useful for procurers in terms of learning about various ways to meet these needs. It was felt that a number of

prospective misunderstandings were removed in this way and that a certain space for entrepreneurship was kept within the boundaries of the tender specification.

In the private sectors, such interaction is commonplace and constitutes the main source of information gathering among private purchasers. In general, however, private purchasers are more knowledgeable than their public counterparts, a difference that most likely is associated with better and more intense buyer-seller interaction. Another reason is that private purchasing is more concentrated towards a particular input. For a smaller municipality, the scope for such specialisation may be severely limited. A noteworthy observation is that private corporations almost never purchase services without physically meeting the supplier. In the public sector, such meetings are much less frequent.

Prospects for better communication

There are important organisational differences between most public procurement officials and private purchasing managers. In private companies, the experts are often different persons compared to the purchasing manager. The two roles are separated but put together in a team. In the public sector, such specialisation is rare. In addition, the public procurer is often organisationally located further away from the end user compared to private purchasers. Taken together, these conditions limits the prospects of reaching the same purchasing skills in the public sector as is seen in some successful private corporations.

Varying forms for improved communication between sellers and buyers were proposed, such as trade association events where public procurement officials are invited. Also, public agencies should take initiatives towards educating SMEs in interpreting tenders and in formulating competitive bids. Larger firms are better at the rules of the game since they often have the strength to designate a certain individual to specialise in public procurements.

Besides these interviews, it is illustrative to shortly refer to published statements and reports. Nutek (2006) devotes considerable attention towards describing the prospects, possibilities and initiatives for more communication between sellers and buyers. Interestingly, the current legal framework, which to an even larger extent would include the recent legislative changes in Sweden, has provisions for increased and improved communication arrangements in place today. Nutek argues these provisions constitute a promising path towards a public procurement policy that better stimulates innovation and choice, not the least through SME-support. The trade associations, Stockholm Chamber of Commerce (Stockholms Handelskammare 2005) and Almega (2006) propose a number of improvements of public procurement ranging from policy issues to stronger enforcement mechanisms. A fundamental problem for their member firms is the contradictory

and unduly restrictive tender requirements. In part, this is explained by dissatisfactory communication between the public procurers and the private suppliers. Indeed, the recommendations by Europe Economics to the European Commission also includes suggested improvements of the information exchange between bidders and procurers (Europe Economics 2006, para 39 (b), p xii).

5.2. FLEXIBILITY

The flexibility for suppliers to propose alternative products is often unduly restricted in tender specifications. Some interviewees sense that public procurers often put an improper weight on conditional requirements in relation to flexible award criteria. Others stress the importance of conditional requirements but agree that public procurers are too restrictive in setting the general frames for the tender. The restrictiveness may take the form of too much emphasis on how a project should be conducted in relation to what it is supposed to achieve. This hampers innovation, limits the quest for cost-efficient solutions and complicates procurement processes as well as worsens conditions for SME. Private companies are generally better at allowing suppliers sufficient manoeuvring space for innovation and new solutions.

Tender specifications often too narrow

Some respondents noted that many tenders involved too many conditional demands in relation to award criteria. As a consequence, the innovative space is limited. Public procurers need to loosen their grip a bit. It was also observed that conditional demands in the private sector often were negotiable. In other words, if a prospective supplier had good reasons, there was always a possibility to contact the private purchaser and argue for a change.

A general concern among SMEs is a low level of trust of the fairness of the procurement process and that the best offer ultimately is selected. The simpleminded price focus contributes to these worries. In contrast, the private sector often considers performance equally or even more important than price. Private purchasers are said to be more interested in the performance than costs. The strong price focus may result in firms, in particular SME, abstaining from bidding. There is also a fear of being subject to some sort of litigation should a bid be successful but legally challenged by a larger competitor.

Another lack of flexibility are the common strict demands of relevant and extensive references. For new firms and especially for SME, references may be poor or non-existent. Overly relying on firm referencing makes entry harder for new firms and for SMEs which may limit competition.

Size and timing of tenders

Also sequencing of contracts is a problem for SMEs. It may be appropriate for public procurers to let the tenders appear with a frequency that make it easier for such firms to participate and submit bids.

Framework agreements are perhaps flexible for the procurer, but is according to some respondents of little value for suppliers since volumes rarely are guaranteed or can be accurately forecasted. Many experienced that framework agreements usually gave disproportionately generous concessions for the public procurers and little flexibility for suppliers.

A critical aspect of the prospects of SMEs to participate in a tender is the time profile of the contract, including the length from sign-on to start of delivery. For a specific medium-advanced service industry, most SME-entrepreneurs would have no problem in meeting most likely procurements, given that sufficient time was given for submitting tenders and, most importantly, for preparation. For example, a 2-year contract to be started in 3 months can constitute an insurmountable obstacle for many SME.

Tender specifications are also often considered as inflexible in meeting unforeseen needs or other externalities. If surrounding conditions suddenly change, it is often unclear what kind of operative responses that are expected from the supplier. Further, suspicions are frequent amongst suppliers that tender specifications sometimes are 'tailored' towards a certain company, which is regarded as highly unfair.

Fear of litigation

The main reason behind public procurers' propensity to make tenders inflexible is fear of litigation. If tender specifications are broad, it is perceived that it would increase the chance that unsuccessful bidders would legally challenge the award decision.

Another respondent stated that a potential source of inflexibility arises when consultants which have participated in a pre-study are not be eligible for submitting bids in the subsequent tender. This restricts the supplier universe and competition and may also limit the willingness of competent consultants to conduct pre-studies.

In several aspects, the points raised by the interviewees are confirmed by published reports and statements. The Swedish employers' organisation for service companies, Almega, concludes (Almega 2006) that tender specifications have a tendency to focus on *how* rather than *what* is supposed to be delivered. The organisation concludes such practise largely to be unnecessary and that it ultimately limits entrepreneurship. Europe Economics (2006) considers, from a European perspective, private procurers as more fit for the purpose and flexible, whereas public procurers typically are afraid of litigation. Pub-

lic procurement is often characterised by administrative incompetence coupled with an insistence on unnecessary detailed compliance. Private sourcing, on the other hand, is generally more transparent, more competitive and less bureaucratic. The Swedish Competition Authority (2008) concludes that low price award principles is common in public tenders which may lead to few bidders and less innovation.

5.3. PREDICTABILITY

Predictability regarding what future tenders will require is generally considered as poor. In some industries and for some activities, firms may need to invest in research and development long before the actual tendering procedure is started in order to meet these demands. If firms are uncertain on tomorrow's demands in public procurement, they may find it too risky to do so. Better predictability can hence stimulate innovation in the right direction. This argument has been stressed by interviewees in particular with relation to environmental performance. Improved predictability is also warranted on when tenders can be expected to be announced which would enable firms to be better prepared. Sufficient time between the tender phases (announcement, time limit of tender, decision, start of delivery) is often a prerequisite for the participation of SMEs in public procurement.

Standards and future demands

Some respondents stress that it is difficult to correctly foresee future conditional demands on public procurements. Sometimes, demands come as a surprise when the tender is published and it can be hard for some enterprises to meet them within the postulated time limits. Had the procurement officials declared such goals well in advance, it is likely that more companies would have had time and resources to meet them. A few of the interviewees argue that private firms are better at pursuing such objectives.

The role of standards was advanced as a possible solution to increase more predictability. Standards have the potential to simplify both procurement and bidding. Today many public procurers have developed poor substitutes that may be hard for suppliers to fully grasp. Standard setting processes may also be beneficial through ensuring objectivity, transparency and influence by stakeholders. There is a need for further standardisation and improvements in existing standards. Naturally, it is important to safeguard that such standardisation efforts do not curb or distort innovation.

An area where the informational challenge is paramount is environment conditions. A number of years ago, public procurers more or less defined such criteria afresh with each new tender. The process was utterly cumbersome for both procurers and suppliers. Lately, the industry and the procuring community in Sweden has jointly developed standards for a number of common IT-products which made procurements less time-

consuming, more efficient and also provided much sought-after guidance for the industry regarding public environmental priorities. A similar task force for sustainable procurement exists in the UK. The guidance reduced the uncertainty involved among suppliers and stimulated more focussed research and development agendas.

Framework contracts

Another aspect, raised by most respondents, concern the prevalence and practise of framework contracts. Most companies regard these as highly unpredictable as regards future volumes, especially for large framework contracts that cover the entire nation. Only large firms are really in a position to handle such uncertainty in an efficient manner. A common belief is that the market would be more diversified if framework contracts were less prominent. A sound public procurement policy should try to direct the development path of the industry when it comes to issues such as environmental performance.

5.4. LEARNING

It is paramount to carefully evaluate procurements through its entire life cycle and feed-back the lessons learnt into future procurements. This aspect has a strong dynamic implication – private companies are generally felt to be far better than public at evaluating supplier contracting processes and learning. Also, thorough monitoring during the contract life may provide strong incentives for the supplier to maximise performance in the delivery phase. For public procurers, such learning and monitoring is generally perceived by interviewees as being underdeveloped and not prioritised but greatly needed.

Incentives to perform in private vs. public sectors

One interviewee referred to the Japanese example of private purchasing that has drawn some attention to various business communities over the years. Learning plays a central role and contracts are loose with respect to detail. Instead, the buyer constantly monitors and registers the performance of the suppliers in order to maintain pressure for optimal performance. The supplier knows that dissatisfaction of performance may result in an immediate disruption of order from the client. Long-term relationships are the norm.

In stark contrast, most of the interviewed witnessed a move in the opposite direction in the public sector. As long as delivery is acceptable according to tender specification, the supplier is paid the agreed amount. Performance in excess of what is promised is as a general principle not rewarded. In other words, irrespective if a supplier only barely fulfil the public procurement contract or, fulfil it with outstanding excellence, the termination date and compensation scheme remains unaffected. Hence, during the delivery phase there is virtually no incentive for suppliers to improve performance in excess of the minimum as stipulated in the contract.

In the private sectors, the picture is often the opposite. There are often strong incentives for high performance put in place during the life of the delivery phase. These incentives concern both monetary rewards as well as an increase probability of contract extensions in time or volume. Performance monitoring and learning in the government sector is an area that is regarded as underdeveloped, including both central government agencies as well as municipalities. There is vast scope for improvements in this field.

The challenge for public procurement

The shortcomings of municipals is partly a function of its small size in combination with its wide obligations. A single public procurer may need to have expertise in goods ranging from toilet tissue to IT-services which constitutes a real competence capacity limitation. Another problem is the organisational structure of public procuring bodies – users are not infrequently located very far from the procurers. It is natural to expect that the prospects for efficient learning are constrained as a result.

Some respondents described cases where the user of publicly procured products were not happy with the delivery despite the fact that the supplier fulfilled all its contractual obligations. Such situations are not uncommon in the public sectors, but seldom arise in the private sector. One respondent explained that they always sought to directly measure client satisfaction, an activity that almost never was conducted with public customers given the limited incentives to do so.

The general thrust of these interview results mirror reasonably well what the former Chief Executive of the UK's Office of Government Commerce put forward in his condensed and sharp article: "Procurement isn't just a job: good procurement is a skill, and it needs to be recognised as such" (Oughton 2007). There is probably no other way to obtain such skills else than learning through experience.

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| APPENDIX: INTERVIEWS

1. Olof Erixon, Svenskt Näringsliv, 13 dec, 2007
2. Mats Bergman, Professor in Economics, Uppsala University, 17 dec, 2007
3. Hans Wendschlag, HP, chair Miljöstyrningsrådet, 18 dec, 2007
4. Stefan Holm, Almega, 20 dec, 2007
5. Daniel Kärrholt, Sakab, 28 dec, 2007
6. Anette Berg, Vivaldi, 9 jan, 2008
7. Mikael von Otter, IT-telekomföretagen, 9 jan, 2008
8. Per Hammarstedt, Stockholms Handelskammare, 11 jan, 2008
9. Åke Rådberg, Byggindustrierna, 11 jan, 2008 (through email)