

Competitive contracting

Comparing public and private approaches



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NO ONE DENIES THAT there are benefits in competition. The goal of competitive procurement is to create a “pool” of qualified bidders who can provide satisfactory quality goods and services. An open and competitive process reduces perceptions of favoritism, and gives all suppliers (all being taxpayers) a fair chance to bid for the government contracts that their taxes fund.

However, numerous studies have shown that governments around the world pay more than the private sector — perhaps because the private sector drives down costs to maximize profits. The fact that competitive contracting is less used in the private sector than in the public leads one to question whether it is necessarily the most cost-effective method of meeting government procurement needs. This article considers some of the factors that prompt the private sector to employ a procurement process that is neither open nor competitive.

In private sector procurement, there is a range of non-ticket price ends that can be served through techniques other than competitive contracting. Most of the considerations that motivate private sector practices are geared towards the superior ability of the private sector to employ full life cycle costing, in which the ticket price is of far less importance. Such concerns include the following:

- *Developing relationships:* The supply of goods and services is an interactive process, and purchasing involves more than buying to meet an immediate need. Many private sector customers prefer using suppliers with which they have a strong established relationship. The supplier’s superior knowledge of the customer’s needs allows it to better serve those needs. Established suppliers usually are more reliable. In addition, by developing a relationship with the supplier, the customer is better able to coordinate in arranging a supply that fits with its purchasing strategy. These relationships may also discourage fraud and other abusive practices. There are also benefits in selecting suppliers that have the financial strength to remain in business despite downturns in economic conditions, rather than to seek only the best “spot” price for individual supplies.
- *Quality control:* Since their purchasing departments are generally better resourced, private sector customers are far more oriented to monitoring performance and the quality of supply than their public sector counterparts. As a result, they are more inclined to place an emphasis on demonstrated quality control. Good quality suppliers may charge a higher ticket price but, if their products are more reliable, it is worth it. For instance, just in time manufacturing is based on the total elimination of waste, and depends upon a supply of reliable quality that is delivered on time. Paradoxically, governments contribute to their own higher cost, by being more tolerant of delay and poor performance than the private sector.
- *The private sector benefits from the narrower focus of its activity:* In the private sector, purchasing tends to be commodity based,

allowing buyers to acquire solid knowledge regarding the materials and services they are purchasing. Such knowledge is harder to acquire in the public sector, since governments engage in a more diverse range of operations: at the municipal level, the same buyer may be working on the purchase of park equipment one day, the construction of a municipal swimming pool the next, and a police mobile operations center on Wednesday. Clearly this buyer would have difficulty in acquiring the same level of trade knowledge that a private sector counterpart would acquire who only worked in one particular commodity area. The result is that the private sector buyer is almost certainly better placed to compare the quality of products. This has a number of follow-on effects.

- *The private sector stresses the development of a buyer’s ability to negotiate.* For instance, a longer term commitment can be used as an incentive for cheaper supply, since it reduces the cost of contracting to the vendor. That option is denied to the public sector buyer, since the competitive process affords no assurance of a long term relationship. Too often public procurement seeks to obtain an unlikely blend of the best of all possible worlds – the lowest price, the most flexibility and the best service. No supplier can afford to make across the board concessions. The private sector is more attuned to the need for compromise and balance.
- *Long term contracting can generate economies of scale:* A negotiated long-term contract with a single supplier can lead to improved delivery of products and services, enhanced responsiveness, and deeper knowledge of the government program requirements. The possibility of long term relationships encourages suppliers to invest in better understanding customer needs and in providing superior service.
- *Drawing on the cost efficiencies of negotiation:* Large companies tend to set up blanket orders with suppliers that are quoted every three years. They build up relationships with these suppliers that last sometimes for decades. This different concept of doing business cuts down on the overall procurement process.
- *Comprehensive supply arrangements can generate economies of scope:* The blanket order system is sufficiently flexible to cover new needs. When a new item is added to the blanket order, a price will be negotiated with the vendor, so that orders can be placed within the existing purchasing scheme. This cuts down on the cost of individual purchase orders, estimated to be between \$55 and \$85 each, depending on the size of the company. ♣

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