

Price vs Cost? A UK Perspective on Public Procurement Practices

18th November 2015

Professor David J. Edwards

BSc, PhD, MABS, MCMPE, Assoc.HM.RE, FIoQ

Birmingham City
Business School

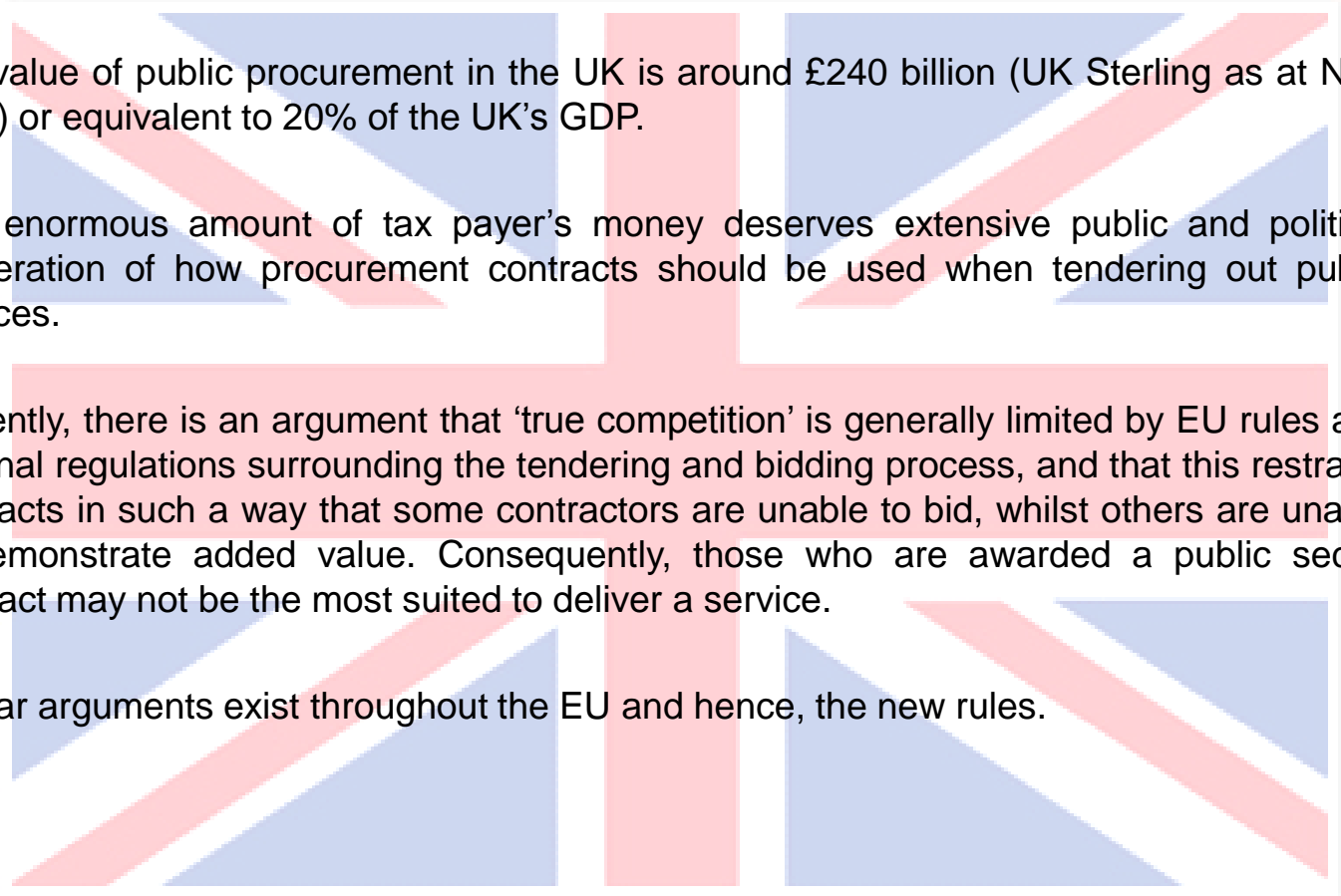


It's Not My Money! – Perception or Misperception?

Milton Friedman (the Nobel economist), best described the four ways we spend money:

- "You can spend your own money on yourself. When you do that, why then you really watch out what you're doing, and you try to get the most for your money.
- Then you can spend your own money on somebody else. For example, I buy a birthday present for someone. Well, then I'm not so careful about the content of the present, but I'm very careful about the cost.
- Then, I can spend somebody else's money on myself. And if I spend somebody else's money on myself, then I'm sure going to have a good lunch!
- Finally, I can spend somebody else's money on somebody else. And if I spend somebody else's money on somebody else, I'm not concerned about how much it is, and I'm not concerned about what I get."

Public Procurement Practices: A UK Perspective

- 
- The value of public procurement in the UK is around £240 billion (UK Sterling as at Nov. 2015) or equivalent to 20% of the UK's GDP.
 - This enormous amount of tax payer's money deserves extensive public and political deliberation of how procurement contracts should be used when tendering out public services.
 - Currently, there is an argument that 'true competition' is generally limited by EU rules and national regulations surrounding the tendering and bidding process, and that this restrains contracts in such a way that some contractors are unable to bid, whilst others are unable to demonstrate added value. Consequently, those who are awarded a public sector contract may not be the most suited to deliver a service.
 - Similar arguments exist throughout the EU and hence, the new rules.

Public Procurement Practices: New EU Rules

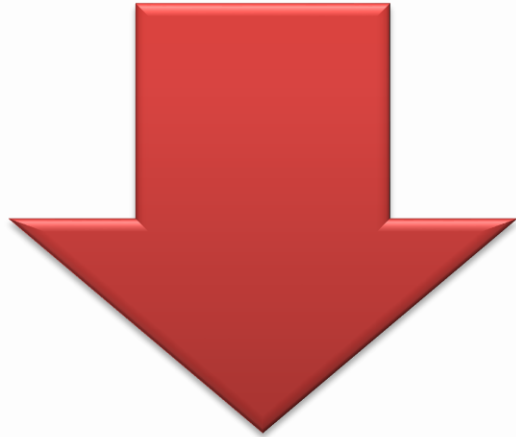
- The Council for the EU explained: *“The new rules seek to ensure greater inclusion of common societal goals in the procurement process. These goals include environmental protection, social responsibility, innovation, combatting climate change, employment, public health and other social and environmental considerations.”*

Source:

http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/intm/140975.pdf

- The rules provide more flexible forms for tendering, including ‘offer negotiated’ and ‘competitive dialogue’ tendering but also offer an ‘innovative partnership’ model – the latter enables a buyer to seek one or more partners to assist in the development of an innovative product or service.
- The rules intend to reduce the cost of tendering, while generating a higher quality/ cost balance and develop relationships/ partnerships that are beneficial for the public sector client.
- All member states have been given two years – until April 2016 – to transpose the Directive into national law.

Public Procurement Practices: Political Extremes



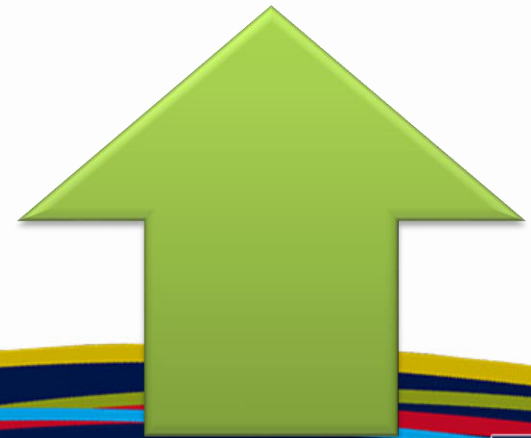
Left wing politicians suggest that: *“It’s clear that the government wants to rush its version of the new procurement rules through, before the General Election, because it cements its narrow obsession with the lowest price to its ideological commitment to privatisation, transferring more and more of our public services into the private sector.”*

Source: <http://leftfootforward.org/2015/02/why-we-must-put-the-new-public-procurement-regulations-on-hold/>



The more conservative right wing position extols the virtues of allowing small-to-medium enterprises more direct access to public procurement contracts, simplifying the procurement process and standardising procurement approaches etc.

Source: <https://www.gov.uk/government/consultations/reforms-to-public-procurement>



Public Procurement Practices: Ancient History

- As long as there have been buildings, there have been cost overruns on public projects.
- The Parthenon spiralled to 469 silver talents in Ancient Greece – the public did not receive this news well.



Public Procurement Practices: Past History

- **The Scottish Parliament 2004...** Original cost £10-40 million – Actual cost £414 million (Overrun of 935% - 4,040%)



A litany of mismanagement and tragic fate were responsible; including:

- Inappropriate brief;
- Poor management/ gross incompetence;
- Changing client demands – indeed a new client(!);
- An architect who was widely known for his wilful experimentalism; and
- Optimism bias.

Public Procurement Practices: Past History

- **The Edinburgh Tram 2003...** Original cost £375 million – Actual cost £1 billion



The 14-kilometre line between the New Town and Edinburgh Airport has 16 stations. Construction began in June 2008, however project delays and contractual disputes delayed its opening by over 3 years until May 2014.

A report issued in August 2011 estimated that the final cost of the truncated network would include £228 million in interest payments on a 30-year loan to cover the funding shortfall.

Reasons for Overruns and a UK Solution?

- Reasons for cost overruns on public procurement projects vary greatly but in our complex and litigious world certain themes are recurrent, namely:

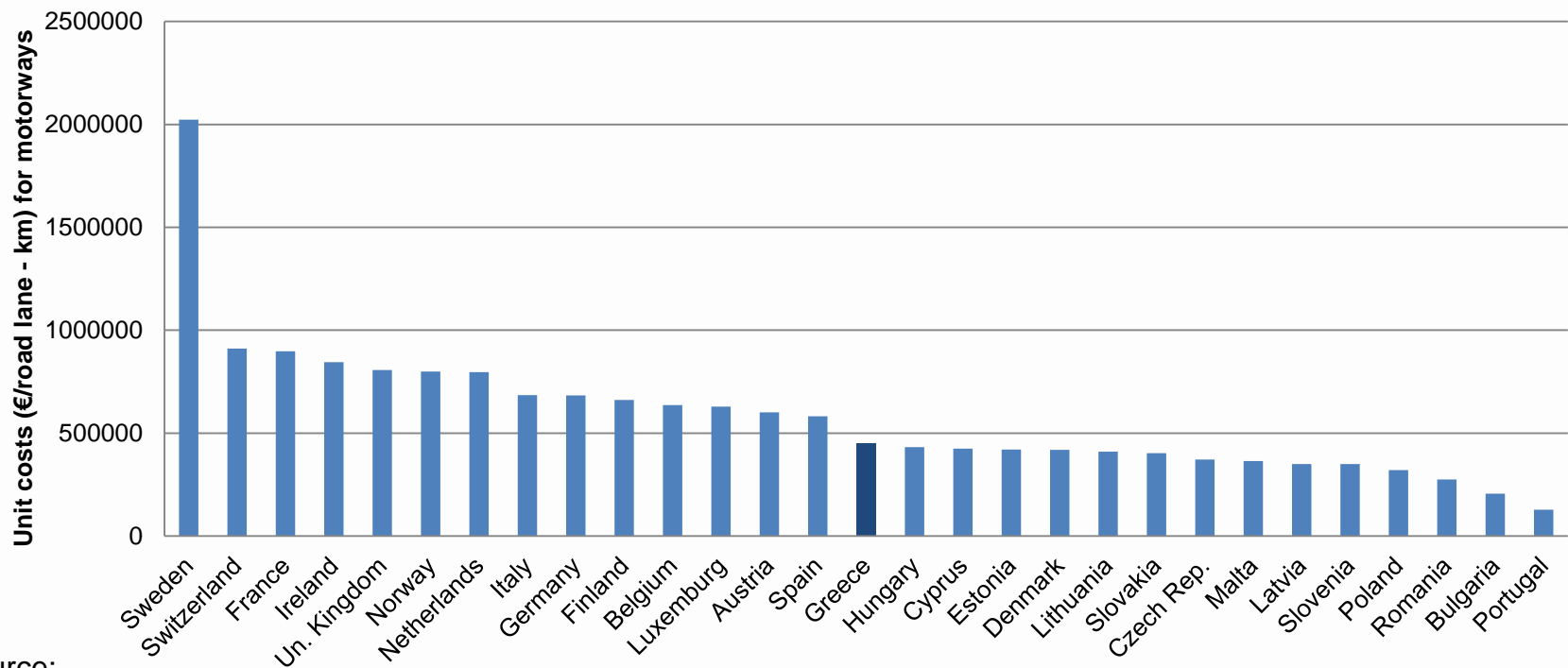


To address many of these issues, UK contractors and clients are increasingly practicing simulation studies to measure (amongst other things):

- how effective project teams are when working together;
- whether organisational cultures are broadly homogenous within the project team;
- How disputes are dealt with; and
- Ultimately, whether the project team will be successful in achieving its objectives.

Road infrastructure cost in Europe

Indicative total road infrastructure costs



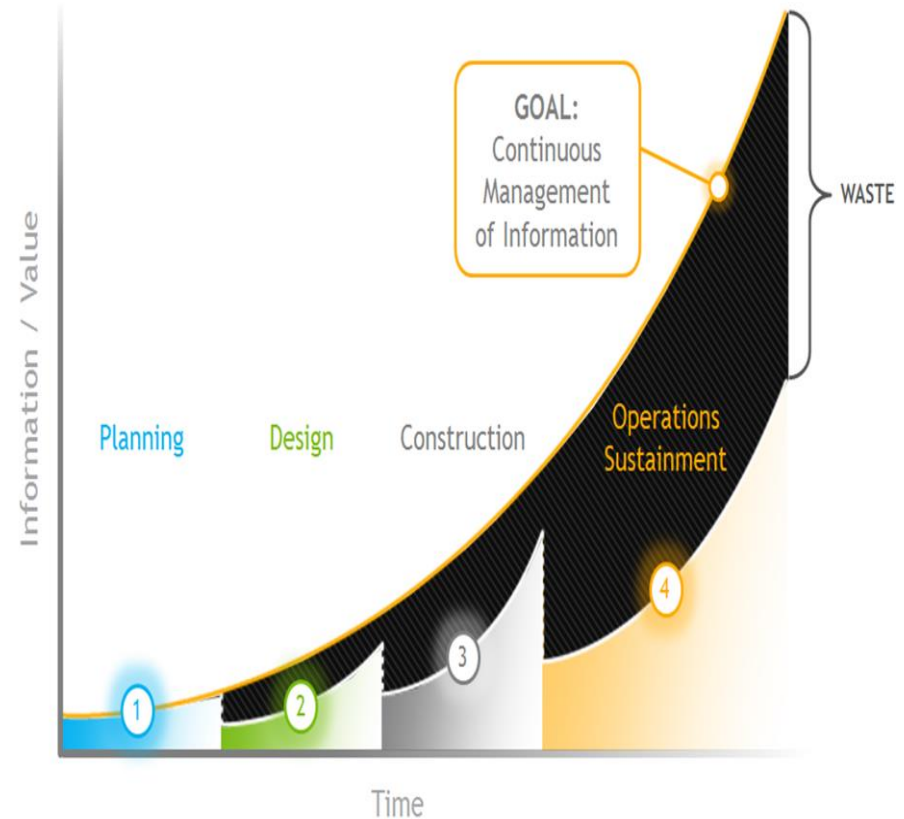
Source:

CE Delft Solutions for environment, economy and technology

Produced within the study “Internalisation Measures and Policies for all external cost of Transport (IMPACT) – Deliverable 2”

Future proofing...an important but often forgotten part of public procurement

- In an age of austerity, eyes must be set firmly on the future.
- As environmental aspects continue to change with increasing speed, the requirements our infrastructure must meet in terms of health and safety, flexibility and cost-effectiveness become ever more demanding.
- The best solution can be built at minimum expense in consideration of a project's life cycle.

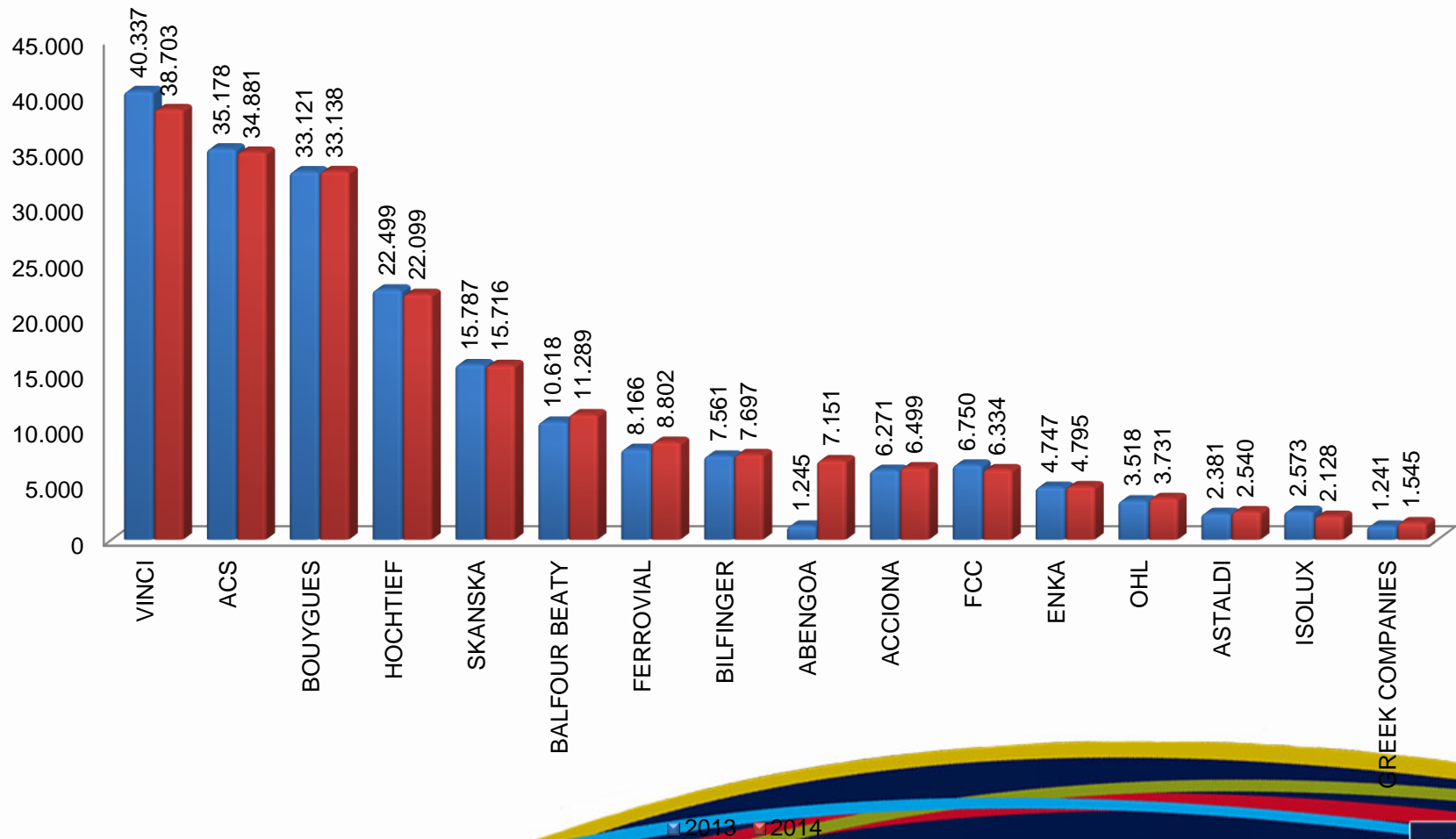


Public Procurement Practices: Conclusions?

- **So is price the same as cost?** No. Time and time again, the lowest price has been historically proven to incur the highest cost. We ignore this at our peril.
- **How to implement EU rules at a national level?** Any decisions taken during the interim period (leading up until April 2016) should be based on robust research facts – trials may be advisable to raise public confidence.
- **Will the new EU legislation be successful?** Success is most likely to be variable, hence great care and attention must be given to implementation at a national level.
- **Are the many problems relating to public procurement set to continue?** Project delays and disputes are almost inevitable and with any new rules introduced, a period of transition is required. The lessons learnt during this transition are perhaps the most important. We can only hope for an overall improvement – the level of improvement to be reached represents a Gordian knot and only time will tell.
- **Philanthropic benevolence?** Ultimately, altruism, transparency and accountability are the keys to successful public project delivery. No matter how good the person – money is corruptible...

An optimistic future?

Income of foreign companies 2013-2014 (in € million).





Thank you for listening!

18th November 2015

Professor David J. Edwards, BSc, PhD, MABS,
MCMPE, Assoc.HM.RE, FIoQ

Birmingham City
Business School

