

# THE GOVERNANCE BRIEF

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## Understanding Public Procurement

Sound public procurement policies and practices are among the essential elements of good governance. Good practices reduce costs and produce timely results; poor practices lead to waste and delays. Procurement is the process by which a government constructs infrastructure, supplies schools and clinics, and contracts professional services. It is at the heart of delivering public services. It also involves the management of large amounts of money and is the largest single cause for allegations of corruption and government inefficiency.

Procurement is central to expenditure management. As Figure 1 illustrates,

### The Changing Public Procurement Environment

Apart from cost savings, new factors are driving interest in public procurement. Once considered the exclusive realm of boring technocrats, it is now not uncommon to read about a contract award in the tabloids. This change in how procurement is perceived and the importance it is being given by the public are driven by three factors.

#### More Players

There are now many more agencies of government involved in procurement. A decade ago, three or four ministries, usually those in charge of public works and key infrastructure (such as telecommunications and energy), undertook most public procurement. With the almost universal trend towards decentralizing government functions, public procurement is being spun-off to other national ministries or departments and to local governments. This is a very positive development. It puts the decision-making on procurement in the hands of those responsible for delivering the services, and puts the delivery closest to the end-user—the public. Accountability is established and, at the same time, public visibility into how public funds are spent is enhanced.

But devolution creates challenges. The most obvious is the shortage of skilled procurement specialists and other resources in local governments. There are a number of ways of dealing with this. In the long term, training of procurement professionals will ease the skills shortage. In the shorter term, procurement agents can play a useful role. If an agency does not have the capability, it can hire a procurement agent, quite likely one

procurement and revenue management make up a large part of the financial management function, structured within a country's medium term expenditure framework (see Governance Brief, Issue 2 for a discussion on the MTEF). Public procurement is interwoven with key development issues—economic growth, poverty reduction, decentralization, and private sector development. It is also closely linked to trade and foreign investment. Weakness in the procurement system adversely affects welfare and prospects for growth.

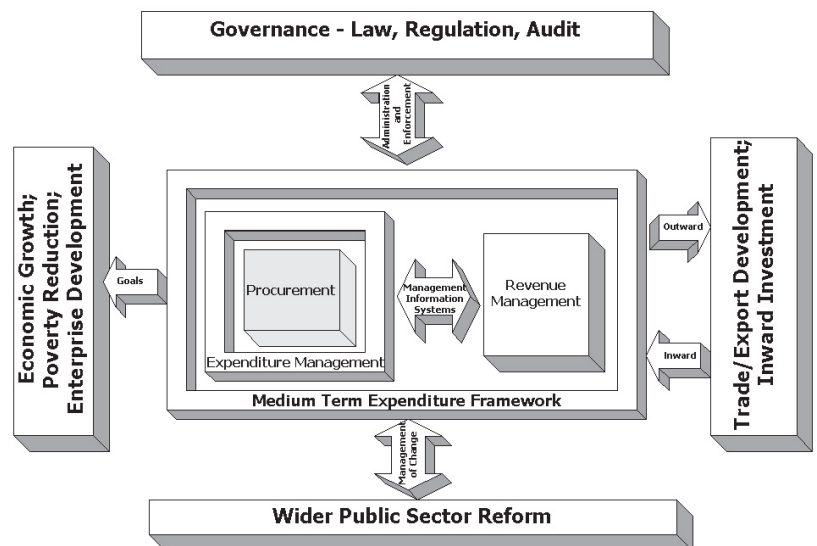
On behalf of its citizens, a government typically spends 10 percent of GDP

on the procurement of goods and services. The difference between doing this well and not doing it well can be enormous. In some countries, reforms to improve the efficiency of public procurement have delivered savings in the order of 10 percent (one percent of GDP). Typically this is equivalent to one-third of a country's health budget. With public procurement so broadly having an impact on development and with such large potential gains, it is little wonder that procurement reform is now a top priority.

of the national ministries that used to handle most procurement. This arrangement, or the greater use of consultants, introduces the professional skills needed, but still allows for devolution of decision-making. The key is to focus on quality decision-making—timely decisions made on the basis of professional analysis, motivated by cost and quality, and minimizing political interference.

In a decentralized environment, there is also a danger that different practices, and possibly different regulations, will proliferate. Ideally, bidders should not face different proce-

Figure 1: Procurement in Wider Public Sector Context



Source: OECD. 15 October 2001. Strengthening Partner Country Procurement Capacities—A Needs Assessment, Paris.

dures when bidding on contracts in different parts of the country, or to different ministries. This argues for consistent national standards and for a central body to set, update, and monitor compliance. The central body can also set policies, audit the performance of implementing agencies, and arbitrate disputes, but under no circumstances should it actually conduct procurement or approve procurement decisions of others.

### *Demand for Transparency*

The second factor raising the profile of public procurement is a heightened demand for public scrutiny of the management of taxpayer's money. Contractors and suppliers are also asking for procedures that are fair and unambiguous. In the Philippines, community NGOs monitor implementation of road works, while a recently formed NGO, Procurement Watch, provides input to procurement legislation and national policies.

Transparency is best achieved through clear and consistent regulations, public tendering, widely advertised opportunities, price-based contract award, and full disclosure. Unfortunately, the public spotlight and legal action is sometimes used to coerce officials conducting procurement. To avoid this, evaluation committees should be allowed to carry out their work in confidence and, so long as they work within the terms of the regulations, be protected from unwarranted complaints or legal action.

### *Trade and Investment*

Lastly, public procurement is becoming increasingly linked to trade and foreign investment. A country's procurement system is a statement to its trading partners on how it conducts business. If the national procurement policies are incomplete, contradictory, and not embodied in law, then foreign firms will be less inclined to bid on contracts and invest in production facilities, or, if they do, will seek a price premium to cover the added risk. Policies and laws that explicitly discriminate against foreign firms are also damaging to trade and investment.

Strictly speaking, government procurement agreements are not a prerequisite for membership in the World Trade Organization (WTO). The WTO Government Procurement Agreement (GPA) prescribes equal treatment of foreign and local bidders, but it is not mandatory, and few countries have signed the GPA. Practically though, WTO membership brings with it demands for an open procurement system. China passed its procurement law in 1999, no doubt understanding that an acceptable procurement system was, in effect, a prerequisite for its WTO membership. Similar, non-binding, yet important provisions can be found in the APEC principles on government procurement. For a country to participate fully in international trade organizations, it must signal to the world that its procurement system is based on law and is open to foreign firms.

## **How Procurement Works**

Public sector procurement is commonly, and wrongly, perceived as a downstream clerical function rather than as a strategic component of broader public concerns. As such, it does not command the policy attention needed to realize its contribution to development or to address the systemic costs that arise from weak regimes and poor decisions. In fact, public procurement is a crosscutting process used by government departments to acquire goods and services, and to address several, sometimes conflicting demands (value for money addressing social goals, and fostering competition are examples). As Table 1 illustrates, public procurement encompasses more than the mere act of buying. The nature of the goods and services procured requires additional technical and professional skills. Moreover, the fact that public procurement invests a fiduciary responsibility on public officials means that the system must ensure accountability and transparency.

A distinction is normally made between "procurement" and "purchasing". The former is used for high-value items—contracting for construction-type works, acquiring equipment, and obtaining large quantities of goods. "Purchasing" is used for the ongoing supply of things such as office supplies. Although it may follow a bidding process, purchasing frequently employs the use of standard catalogues, repeat-order, direct purchase, and other methods that do not involve the solicitation of a bid. Procurement on the other hand, especially public procurement, is almost always carried out in discrete packages in which bidders submit sealed bids and compete on price. This bidding system (also commonly called tendering) is described here.

### *Competitive Bidding*

Good procurement follows the principles of economy (best value for money), efficiency (does not delay the project), fairness (does not discriminate against bidders on the basis of nationality, for example) and transparency (what is involved, how it is done, and the results are public). A system that encourages as many qualified firms as possible to compete on the basis of price, while insuring quality objectives are met, is most likely to satisfy these principles.

The multilateral development banks, including ADB, and most governments employ some form of the sealed-bid, competitive procedure for the majority of procurement. To maximize competition, bidding must be adequately advertised, and bidders must be allowed sufficient time to prepare their bids. At ADB, advertisements are posted on our web site and published in *ADB Business Opportunities*. We also require advertising in a newspaper of national circulation in the purchaser's country. Depending on the complexity, minimum bid preparation times are 60 to 90 days, although this can be shortened where bidding is local or under extenuating circumstances such as an emergency.

**Table 1: Components of an Effective Public Procurement System**

<b>Component</b>	<b>Description or Function</b>
Legal Framework	Based on a procurement law that defines responsibility of procuring agencies and suppliers
Policy	Consistent, national policies and standards to be followed by all procuring agencies, including arbitration procedures
Institutional Set-up	Defined structures for conducting procurement that minimize subjective decisions and politicization (including approval mechanisms, authorities, and composition of bid and evaluation committees)
Professional Civil Service	Procuring agencies staffed with procurement professionals, trained and recognized as such under civil service regulations
Resources	Procuring agencies supported with adequate budget, standard documents, and operations manuals
Fraud Prevention	Clear laws applicable to procurement officials and suppliers that increase transparency and encourage inclusion of civil society

Three measures safeguard against anticompetitive practices such as collusion among bidders, and "wait and see" bids.<sup>1</sup> First, bids must be sealed and remained sealed until the date of bid opening. Second, bids must be guaranteed with a bid security, usually valued at about 2 percent of the value of the contract. If a bidder withdraws or alters its bid after the bid closing date, or if its bid is lowest and the bidder does not sign a contract, the security is forfeited. This penalty dissuades bidders from waiting for the outcome to decide if they in fact want to honor their bids. Lastly, each bidder can submit only one bid and a bidder may be a party to only one bid—it cannot be associated with more than one joint venture. This avoids the situation of a bidder deciding which bid it wants to be associated with after seeing the outcome of the bidding.

### Qualification

A basic principle of procurement is that a contract should only be awarded to a supplier or contractor who is qualified to do the work. It must be able to demonstrate that it has the required experience, technical expertise, and financial capacity. Furthermore, the offered goods must meet minimum requirements. No matter how low the offered price, a contract is not awarded to a bidder who cannot do the job.

Bidders can be qualified before the bidding, in which case bids are invited only from qualified bidders (this is called prequalification). Alternatively, the qualifications of bidders are assessed at the same time as their bids are evaluated (this is called postqualification). Bidders are required to demonstrate that they have adequate financial resources, necessary technical expertise, and prior experience with contracts of a similar size and nature.

For goods to be qualified, they usually must be shown to have been in production for a minimum period of time and in minimum quantities, and to have been produced in factories that meet minimum standards (often an ISO or similar standard). They must also meet minimum technical specifications.

### Selecting the Best Bid

Bids are evaluated in two stages, in public and then in confidence. The public part consists of the bid opening, which must be done in a public meeting with all bidders present (if they choose) and with all bids read out. The objective is to make sure everyone with an interest in the procurement knows who has bid and what were the offered prices. The confidential part is the detailed evaluation of the technical and financial aspects of each bid. This can take place in different ways. Most commonly, the technical and financial offers are evaluated together. Alternatively, the technical offer may be evaluated before the prices are opened.

The objective of the evaluation is to identify the bidder offering the best value for money. The bidding documents provide bidders with the purchaser's minimum requirements. Any offer that exhibits material deviations, omissions or reservations is not acceptable. It is rejected irrespective of how low the price may be. All bids that pass this initial test are assessed to see which offers the best price.

However, it is not just the lowest offered price that the purchaser looks at. Some bidders may offer equipment with

lower operating costs than others. Some may offer longer delivery times or less-than-asked-for terms of payment. To "level the playing field" these differences are given a value and the offered prices are adjusted to arrive at the "evaluated price". The contract is then awarded to the bidder offering the lowest evaluated price.

Arriving at the evaluated price is one of the most difficult parts of the evaluation, and it is here that the process relies most on the judgment of trained, experienced professionals. Key to the evaluation is determining what is a material deviation. Bids with nonmaterial deviations can be accepted and often offer the best value for money, even though not fully complying. So long as these bids are adjusted to compare them fairly with fully compliant bids, they should be considered for award of contract. On the other hand, bids that exceed stated requirements—that offer terms, features, or quality beyond what was asked for—are not given an advantage. The evaluation is made against the minimum acceptable requirements as specified by the purchaser in the bidding documents.

Good specifications are a critical part of the bidding documents, and ultimately impact the quality of the evaluation. Specifications must be generic so as not to favor a specific manufacturer. At the same time they must be detailed and exact. Otherwise it will be impossible to compare the goods offered by different suppliers. Fortunately there are resources available in many sectors. UNDP and WHO, for example, have available specifications for medicines and medical supplies. These can often be used or adapted with minimum modification. Specifications can often be shared between similar projects or updated from earlier projects in the same sector.

### Other Procurement Methods

The competitive tendering system described above is by far the most common. On ADB-financed projects, it accounts for 80 percent of procurement by value. But there are many cases where it is more appropriate to purchase items "off-the-shelf" or through limited tendering, or enter into a negotiated contract. When extending existing works, ordering an additional quantity of goods or purchasing proprietary goods (such as spare parts), a noncompetitive form of procurement may save time and money.

There are a number of other innovative procedures designed to obtain low prices. The "reverse auction" requires all bidders to submit a series of offers, decreasing in value until all but one drops out of the competition. There are various mechanisms to combine competitive tendering with negotiation, negotiating a lower price after bid evaluation. Although the advent of the internet and on-line bidding have made some of these methods more popular, they are not accepted by ADB and the multilateral development banks. Negotiation diminishes transparency and, in the long run, bidders normally inflate initial offers in anticipation of having to negotiate downward. On ADB-financed projects, negotiation is restricted to exceptional circumstances to avoid rebidding where bids substantially exceed the estimate or where only one bid is received.

Procurement of professional services poses unique requirements. By its nature, selection must be based, to a certain

<sup>1</sup> With "wait-and see" bids, a bidder arranges things such that they make a final decision on their bid after determining the prices of other bidders. This could occur, for example, where a bidder submits more than one bid, one higher than the other. If, after bid opening, both bids are lower than those of the competitors, it abandons the lower bid.

degree, on professional qualifications and experience of firms and key individuals. Selection procedures are therefore only partly based on price, and in some cases price is not a criteria. ADB does not use a separate procedure for procurement of services, except for the recruitment of consultants. A quality and cost-based system (QCBS) has recently been introduced for firms. When evaluating proposals, QCBS assigns a 20 percent weighting to cost and an 80 percent weighting to qualifications. For recruitment of individual consultants, and in exceptional circumstances for recruitment of firms, cost is not a factor in the selection.

## Promoting Other Commercial and Social Policies

Procurement systems are sometimes used to address other commercial and social policy objectives. Measures are commonly incorporated in public procurement regulations to promote local business, develop small enterprises, further labor and environmental standards, and assist disadvantaged groups. In principal, international best practices discourage these measures. It is felt they are best dealt with outside the procurement system, through local labor laws for example. Within the procurement system, collateral objectives are difficult to quantify, sometimes contradictory, and often contrary to the principles of fairness and obtaining best value for money.

Although treated restrictively, collateral issues occupy an expanding place in the procurement system used by ADB and the multilateral development banks. Standard terms for civil works contracts have for several years included clauses on labor standards. Consistent with environmentally-responsible procurement, a "negative list" defines goods that cannot be procured because of their environmental impact. This list is being refined and is soon expected to apply to procurement financed under project loans (it currently only applies to program loans). ADB is also developing guidelines to incorporate environment-related specifications on goods and work methods into bidding documents.

ADB and the multilateral development banks include domestic preference provisions in their procurement systems. The term "preference" is unfortunate as it wrongly suggests foreign bidders are not treated equally with domestic bidders, that in an attempt to promote domestic industry, the domestic firm is given an advantage. In fact, domestic preference is used simply to put domestic manufacturers on an equal footing with their foreign competitors. To avoid the distortions of taxes and duties, prices of imported goods are evaluated excluding import duties, while locally produced goods are evaluated excluding sales tax. To make the comparison fair, a firm that manufactures domestically is given a price preference of up to 15 percent to offset the duties and taxes it must pay on its inputs, and which an importer would not pay. It is the origin of the goods, not the nationality of the supplier that determines domestic preference. A foreign firm that manufactures its goods locally is entitled to a preference, while a domestic firm that

Problem or Issue	Occurrence (%)
<b>Legal:</b>	
No legislation, or laws have gaps or conflicting provisions	67
Inadequate grievance provisions for bidders	67
<b>Institutional:</b>	
Widespread corruption in the procurement process	100
No central policy body	44
Weak enforcement mechanisms	56
<b>Procedural:</b>	
Noncompetitive practices in use	67
Lack of standard procedures	67
Weak contract monitoring systems	56
Inadequate import, export, and transit procedures	44
Poor procurement planning capacity	67
<b>Resources:</b>	
Lack of trained procurement practitioners	100
Low remuneration of procurement professionals	56

Source: OECD. 15 October 2001. Strengthening Partner Country Procurement Capacities - A Needs Assessment, Paris.

imports is not.

Corruption concerns are central to public procurement and can hardly be termed collateral. ADB's procurement system includes a number of measures to combat fraud. Recently, ADB has started screening contract-award decisions to insure its financing is not being used to finance terrorism or is not part of money-laundering operations.

## Looking Forward

One of the better-known tools for assessing a country's procurement capacity is the World Bank's Country Procurement Assessment Review (CPAR). ADB cooperates with the World Bank when conducting CPARs in ADB member countries. An analysis of the findings in 9 countries is summarized in Table 2.

Table 2 clearly demonstrates that procurement capacity must be built on several fronts—laws, institutions, procedures, and human resources all require attention. The essential elements of a good procurement system are known but putting them in place is challenging. Significant resources and a long-term commitment are required. Perhaps the biggest step is to recognize public procurement as a strategic governance issue. Only when so recognized will it command the necessary policy attention and commitment of resources.

Procurement should be regarded as a key part of public expenditure management within a medium-term expenditure framework. Its interface with the legislative and regulatory framework needs to be recognized, as does its importance for the promotion of trade, foreign investment, and the private sector.

*This article was contributed by Robert Rothery of ADB.*

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