Is negotiation underutilized in public procurement?

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TIMES ARE HARD. Our cities deliver approximately 60 percent of public services but enjoy only 8 cents out of every tax dollar. Several major cities are projecting budget shortfalls of several millions of dollars leading to fairly predictable results – staff reduction; eliminated or declining service levels; increased pressure to replace worn-out infrastructure; under-maintenance of existing infrastructure; and difficulty meeting rising standards for capital-intensive municipal services such as drinking water, solid waste and waste water.

This funding gap drives the effort to derive the maximum benefit from every dollar. However, studies of public procurement in North America consistently show that public authorities pay roughly 10-15 percent more than their private sector counterparts – the largest gap occurring in major capital expenditures. Reducing or eliminating this gap would free up money for additional capital expenditure.

From a legal perspective, we think the primary cause of this funding gap is the overall approach. The legal requirements that ensure public sector procurement is conducted in an "open, fair and transparent" manner vary with the level of government, but all result in a system strongly biased towards open competition, particularly through tendering. Negotiating cost savings on capital contracts, the private sector's method of choice, is an entirely different approach – one rarely employed in the public sector.

With profit maximization being the overall corporate goal, the private sector depends on bottom-line driven budgeting and rigorous, critical cost-benefit review of proposed expenditures. At its best, this system delivers both capital projects and routine expenditures on time and within budget.

Section 271 of the new Ontario *Municipal Act* requires virtually every Ontario municipality to reformulate, or in some cases formulate, its procurement policy by January 2005.

Important as this policy development is, it is not likely to lead to substantial improvements in the efficiency of municipal procurement. The Ministry of Municipal Affairs' guidelines, with respect to section 271, seem certain to result in a more formalized, bureaucratic, process-driven system, replicating much of the current practice at the provincial level. We think a blend of both private and public sector practices might work better.

"Open, fair and transparent" public procurement standards smack of motherhood and apple pie, but they have consistently proven to be difficult to apply. For whom is the process fair – the taxpayer after we accept the lowest bid when it might have been negotiated to an even lower price; proven suppliers being excluded from tendering because their bids arrived a few moments late? Everyone knows the rules, but when procedural compliance takes priority over the objective of getting best value for money, the entire process becomes misdirected and not always fair.

Private sector procurement departments control the costs of production and take pride in negotiating cost-saving contracts with vendors. Purchasing directors with negotiation skills are sought after. In contrast, the skill set of the public sector purchasing manager is geared more toward supervising the procurement process and preparing reports than negotiating the best deal.

From supplier complaints, we have considerable reason to believe that many suppliers avoid public contracts because of the "openness" of the contract award system. A private sector company might seek competitive bids from a few potential contractors, resulting in each supplier having a good chance of being awarded the contract – making it worth their while to participate. However, contractors bidding on a public works contract might find themselves competing against 10 or 20 others, reducing the chance of success to where they can't justify the time required to submit a bid or proposal.

Also, is the current process conducive to good long-term supplier and customer relationships? Although there is hard data available on the cost of government procurement, we're not aware of any systematic study on whether public procurement contracts lead to a higher level of supplier-customer disputes than other forms of contracting. But, since the decision in *Ron Engineering* (Supreme Court, 1981), there have been more than 500 Canadian court judgments involving complaints about tenders, RFPs and the like – representing only a fraction of disputes that have arisen – leading to tendering becoming a ritualized, wholly artificial approach to contracting, superintended by lawyers and judges.

As well, our own experience leads us to believe that public sector arrangements could suffer a higher level of difficulty with respect to quality and service. The following are among the numerous reasons that might explain why:

- The tender process makes it difficult to develop long-term supplier relationships. It also complicates factoring past vendor performance into purchase decisions.
- The mandatory award of a tender to the lowest qualified bid sometimes encourages low-ball offers from suppliers – perhaps intentional; perhaps lack of experience. When work cannot be done to a satisfactory standard for the price quoted, dispute is inevitable.

We aren't suggesting the entire public sector approach be abandoned, or anything radical be put into place overnight. However, *in our opinion*, it is essential to critically review the public contracting process. Perhaps an organization such as the Ontario Public Buyers Association could commission a thorough, comparative study of the public and private procurement process, to identify private sector approaches that could be modified for the public sector. We also suggest that public sector purchasers revise their front-end documentation in an effort to contain the threat of litigation. To improve procurement efficiency, flexibility rather than formality is the order of the day.

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