IRRECONCILABLE DIFFERENCES OR THE BEST OF TWO WORLDS: ANALYSING THE SIMILARITIES AND THE DIFFERENCES BETWEEN PRIVATE AND PUBLIC PROCUREMENT RULES AND PRACTICES

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ABSTRACT. As a result of harmonizing legal regulations in relation to the accession of Hungary to the European Union May 1, 2004, certain private companies operating in the energy and utility sectors fell under the scope of the Public Procurement Directives and corresponding national Act. A qualitative research study was initiated to compare the decision making processes of private organizations before and after the regulatory changes and to observe how public procurement requirements would affect supplier relationships. The restricted set of selection and evaluation tools allowed by the Act has resulted in ruthless supplier behaviour and led to tactics not used on the commercial side. It seems that the strategic nature of those relationships may dynamically change from relational to transactional depending on the means available to the purchaser to make contract choices.

INTRODUCTION

Procurement is the process of acquiring goods, works and services. Selecting suppliers is key to any business. It is also recognized that success of organizations does not depend on their own operations only, but they work as part of a value chain connecting together a network of suppliers and customers (Porter and Millar, 1985). The purchasing function has developed from 'buying' to 'supply chain management':

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from purchasing goods at lowest price to managing supplier relations in order to enhance the creation of value (van Weele, 2001).

Public Procurement (PP) as a function of government is utilized not only to secure goods and services required by public sector organizations for their missions and to support services provided to taxpayers, but it may also be used to implement national policies and to achieve social and other objectives (Thai, 2005, Harland et al., 2005).

European Union (EU) has two separate sets of PP rules: one for coordinating the award procedures for public works contracts, public supply contracts, and public service contracts (European Commission, 2004b), and another guiding the purchasing activities of entities operating in the water, energy, transportation, and telecommunications sectors be they public or private owned (EC, 2004a).

As Hungary joined the EU May 1, 2004, the national Act on Public Procurement (2003) had to line up with EU Directives. Similarly to the EU approach, the Act differentiates between "general" rules aimed at all public entities and "special" rules for "utilities" companies. As a result, starting the day of the accession privately owned companies in the utilities sector had to follow the special Public Procurement regulations with respect to purchases related to their activities serving public purpose. Their suppliers were affected as well. Economic operators who wished to respond to purchase calls under PP also had to make sure that their proposals adhere to related requirements of the new law.

This situation presented a unique opportunity to investigate the reaction and response of private entities – accustomed to their own purchasing processes – to the requirement of following procedures administratively controlled by the regulatory environment. As a key advantage to research, the two types of procurement philosophy and practice may be investigated within the very same organization.

To understand the mechanism at play, a qualitative research study had been initiated to analyze purchasing as a decision making (DM) process and to observe how private purchasers and their suppliers react to the decision space created by the PP law. The collision of the two procurement "mindsets" led to characteristic decision making behaviour on the part of the purchaser aimed at simplifying the situation. Although the EU rules did open up the market as intended, the resulting competition also seemed to bring on heightened risk and lessened power

for the purchaser to achieve quality goals. The perception was that suppliers ruthlessly took advantage of the changed rules.

The paper is organized as follows. First it reviews the problems of procurement and public procurement as decision making exercises followed by a summary of key theories on organizational decision making. After stating the research questions it describes the selected research approach. The paper then presents the rich description of a case as an example how one corporation responded to the challenges of the regulatory environment. A discussion and generalization of the findings concludes the paper.

PUBLIC PROCUREMENT AND ORGANIZATONAL DECISION MAKING

Public Procurement as Organizational Decision Making Problem

Procurement as a process spans from the identification of needs through to the end of a services contract or even to the end of the useful life of an asset. It includes the design and delivery of those works, products or services, the assessment of their quality, and the evaluations and reviews that will lead to further procurement (Hughes, 2005). The whole process contains several decisions about the services that will be delivered to its users. Public Procurement as a state function includes decisions about the products and services that will be delivered to public authorities or to the communities they serve (Hughes, 2005).

There are several issues recurring in the PP literature that relate to the decision making aspect of public purchasing. Lot of discussions concern strategic issues of governing such as the possible support of high-level policy goals (Erridge, 2005), emerging practices involving private financing (Lawther and Martin, 2005), questions surrounding the development of long-term supplier relationships (Hartley et al., 2007), or investigation of the effect of strategic procurement decisions on particular sector markets (Knight et al., 2003). Relatively less attention is paid to how the available regulatory framework is actually able to deliver when it comes to the execution of set strategies. As for a decision making process, Hughes (2005) considers five main steps: Assessing needs, Service design, Supplier short-listing, Supplier selection, and Supplier performance evaluation.

In terms of everyday procurement activities Krüger (2004) investigates the issues of banning negotiations for public entities as a

vehicle for resolving certain purchasing issues. The assumption about open procedure is that competition among potential suppliers of exchangeable goods and services in general tends to lead to better quality over price (Axelsson and Lindberg, 2005). It is the intention of the European Council as expressed through the introduction of the new PP Directives (EC, 2003b), to use open procedures to guarantee the opening-up of public procurement to competition within community states in order to lower prices. Publication of all tenders above the EU threshold has to be advertised in the Official European Journal[1].

Erridge, (1999) presents transaction cost based arguments to prove the necessity of better defined specifications. Although the importance of using evaluation criteria as a vehicle to lead and control the supplier is well recognized in the literature (Axelsson and Lindberg, 2005), there seems to be limited research reported on the methodological aspects of actually *developing* contract award criteria. Discussions about how to set up the whole interrelated system of technical, capability, and suitability requirements as required by the law are fairly simple. Piga and Zanza (2004) do touch on the problem but only lists a few typical solutions applied in practice without any discussion of their applicability or related issues. De Boer et al. (2001) provide a framework to compare methods supporting supplier selection and critically review known methods but it stays at a very high theoretical level. Holt (1998) also looks at the question of which methodology is suitable for construction contractor selection but stays with comparing mathematical models only and does not consider related organizational issues. The role and mechanism of eAuction is also well discussed (see for example, Soudry, 2004). Tátrai (2007) presents a comprehensive overview of the use of eAuction in Hungary only to conclude the need for major improvement.

There is discussion concerning the higher efficiency of private procurement procedures compared to their public counterpart (Tátrai, 2007). Lian and Laing (2004) is a rare in-depth comparison of public and private purchasing practices. It focuses on the Health sector, but understandably, organizations compared follow either public or private rules.

Each of the above investigations only describes one angle of the whole picture. Although some interesting preliminary case study results are reported by Caldwell et al., (2005), there seems to be no research

reported on the overall effect of all the various aspects and how they influence the relationship between the buyer and the seller.

Theoretical Views on Organizational Decision Making

Most decisions involve conflicts. The solution, especially in terms of economic arguments, essentially involves making trade-offs among potential outcomes. Baron (1995) identifies three sources of conflicts and corresponding trade-offs. The *conflict of risk* means making trade-offs between the probability and expected value of choices. The *conflict of goals* means making trade-offs among various (sometimes interrelated or even contradictory) goals. The *conflict of stakeholders* means making trade-offs between goals of different people involved.

Most of the literature related to the decision making aspect of public purchasing assumes an economically rational decision maker when it comes to resolving above conflicts. This traditional view is rooted in expected utility theory (von Neumann & Morgenstern, 1947). A *rational decision maker* is assumed to be armed with complete information about alternatives and their consequences, is able to compare those alternatives, and simply selects the one that maximizes his utility (Langley et al., 1995).

The first serious challenge of above mathematical or economical notion of rationality was raised by the work of Simon (1957) and, as a result, the notion of "bounded rationality" was born. Simon's "administrative man" works under the condition of limited capabilities. This decision maker is committed to a midcourse between omniscient rationality and intuition. He or she follows a cognitive process that consists of a simple sequence of programmed steps and does not go for the best possible solution. This process is led by heuristics, thus procedures developed by the organization or by individual managers through the experience of making decisions to economize on cognitive resources, time, and attention processes without necessarily jeopardizing the quality of decisions (Aumann and Sorin, 1989). Heuristics might be about satisficing goals (searching for an acceptable solution instead of the optimal one), simplification (intentionally ignoring certain aspects of the decision process in order to reduce the cognitive load), and reference to past cases (identifying similar past cases and their decisions for guidance). In addition, there were decision maker biases identified that concern the availability of information, the judgment of risk, or the need to feel protected from negative outcomes (Kahneman et al., 1982). For

organizations, the argument is that decisions are characterized by organizational routines and influenced by individual biases. Another school of thought emphasizes the power and politics of decision making (Pfeffer, 1992). Those with power in organizations often prevail in decisions, regardless of whether the resulting decisions are rational or in the best interest of the organization. Decision-making often follows informal processes of negotiation, bargaining, trade-offs, and other political activities, and serves the self-interests of those involved. Simon (1997) later showed how the objectives and the constraints are interchangeable in the role they play in defining problems. Some constraints can become objectives at a given time in the management process and return to being constraints at other times depending on the focus of the decision maker. In an organization, an intermediate objective often becomes a means. The result is the organizational chains of means and objectives (Simon, 1997, p. 83), which further complicates the evaluation of decisions. Simon concluded (1997, pp. 161-162) that the multilayered aspect of most decisions rules out optimization as a practical model for decision making. Furthermore, the model or method used in supporting decisions becomes a constraint. Techniques and solutions selected restrict what might be expressed using them (Pomerol and Adam, 2008).

During individual procurement procedures there are a series of delicate moments that could be looked at as a series of more granular ‘sub-decisions’ leading to the complex decision of purchasing. Decision is not a single point in time, e.g. when the supplier is actually selected. It is composed of several partial decisions which, once made, become constraints and allow the decision maker to limit the search space. One option, once committed, becomes a restriction. As partial goals, means, and constraints are interchangeable, evaluation criteria, for example, might be turned into a constraint expressed in the form of concrete specification requirements and vice-versa.

RESEARCH QUESTIONS, METHOD, AND CASE SELECTION

The situation in Hungary after the accession to the EU presented a unique opportunity to investigate the reaction and response of private entities – accustomed to their own purchasing processes – to follow procurement rules set by the regulatory environment.

Comparing public and private processes within the same organization allows the research to close out all other factors: the same organization, the same people, the same procurement culture as well as the same political and psychological setting. The same products are required by both business streams, by the part that caters to the commercial market and by the part that provides public service or operates under public license. The same set of potential suppliers may be assumed as well.

The overall research objective was concerned with the decision making practice of public procurement professionals and how this practice may be supported by direct involvement of outside expertise. Within the main theme this paper reports on results related to the research question *of how private purchasers and suppliers view the decision space created by the PP law*.

The research followed a qualitative methodology (Miles and Huberman, 1994) based on in-depth case studies. The design was primarily based on the inductive, case-study oriented approach as presented by Yin (1981) and further refined by the replication logic discussed by Eisenhardt (1991).

Cases were selected to represent the spectrum of organizations affected by the changes in Hungary but it was limited by several factors. Based on the official list of PP subjects[2] there appeared to be no more than three dozen private companies affected. With the intent of comparing private and public procurement procedures within the same organization this group became the basis for sampling. Despite availability, case selection was fairly limited by accessibility: several candidate organizations approached declined participation. Nevertheless, there were three organizations fully studied: one utility organization with the majority of its procurement falling under PP (case is under publication), another public service provider company with appr. 25-30% of its purchases being affected (case presented in this paper). A third organization was also chosen as a pilot study, which was not a utility company, rather a grant beneficiary running only one major project involving PP (reported in Csáki and Habi, 2007). All three organizations selected are key players in their respective businesses with well over 1000 employees each. They are large enough to be efficient in their negotiation with suppliers yet do not dominate neither the market nor all their supply chain partners.

The case we primarily focus on in this paper is about an important player in the energy business with three main production units, South, West, and Central, each with specific tasks, with corresponding purchasing pattern and supply market characteristics. They are under heavy scrutiny from industrial regulatory and safety bodies. Maintenance and replacement of equipment forms a large part of their work and needs.

Data collection comprised of four parts to ensure triangulation. Interviews with employees served as the main research instrument augmented with collection of relevant documents. In addition, interviews were conducted with outside experts and representatives of suppliers.

Interviewee selection for one-on-one interviews tried to reflect the roles identified during the pilot (see 0): at least one person was reached from each functional area involved. Expert interviews were conducted with people from the consultant company selected to guide the transition, PP experts, and academics involved in research of Hungarian

TABLE 1
Summary of interviews conducted (by case and by interviewee role)

Interviewee group	Pilot	Case 1 (this paper)	Case 2
Academics, experts	4 + 3	N/A	N/A
Outside Consultants involved	4 (2 PP legal, 1 Decision Support, 1 domain)	1	1
Executive level (involved in transition)	N/A	3	1
Procurement people	1 (non-PP)	9 non-PP + 5 PP	1 non-PP + 1 PP
Legal	1 (non-PP)	1 PP	1 (involved in both)
Finance	1	0 (restricted by availability)	1
Domain experts	1	3 (overlap w/ procurement)	3 (overlap w/ recipients)
Recipient of services	1	3	3
Suppliers	2	1	1

management practice. Wherever it was possible, suppliers were approached as well.

Documents analyzed included corporate web pages, minutes of transition planning meetings, work-products of transition task forces, description of the official corporate procedure developed, and documents related to individual PP procedures conducted.

RESULTS: DETAILED PROCESSES OF PUBLIC PROCUREMENT DECISION MAKING

Constraints and Requirements Resulting from EU and Hungarian PP Law

The EU PP Directives and the corresponding national Act set limits and conditions for the preparation, advertisement, and submission of tenders. The law requires that procuring entities follow an elaborate process of preparation, evaluation, and documentation when executing individual procedures. Corporate regulations have to establish rules how the final decision maker is determined and how members of the jury are selected. The law specifically requires the presence of public procurement, financial, and legal expertise in each evaluation committee. The committee prepares recommendation for the decision maker, but the outcome of their proposal depends on the selection and evaluation criteria preset in the advertisement and specification documents.

For general procurement the default procedure type is the open procedure, while for special procurement negotiated procedure may also be chosen. There are strict restrictions on the use of procurement without notice. Additional procedure types such as restricted, framework agreements, prequalification system, or competitive dialogue, or eAuction have specific conditions.

The law requires market and product knowledge, but it does restrict the applicability of RFI-type requests. There are strict timelines to observe. For example, there is a minimum limit set to give enough time for suppliers to prepare their proposal. This means that there is a minimum length any procedure of a certain type might last. There are rules how preset deadlines may be delayed or modified, or under what conditions a tender may be revoked. The law determines in considerable details the steps of the process. It also standardizes and restricts the methods to be used for selection of the winning proposal and the means

how to collect information that may be used as proof for suitability (financial and reference type information are the most commonly used in PP). It limits the means of evaluating the ability and past performance of potential suppliers. Disqualification may only be based upon certain type of documentation and references. Criteria related to the supplier itself may not be used as part of the awarding. Restricted procedures may use scoring of ability to sort suppliers, however. The Act allows for the possibility to subsequently attach certifications and declarations related to grounds for exclusion and suitability but the scope of rectification has to be announced in the invitation in advance.

The CA may not learn during the process or may not make a mistake: if the contract notice or the technical documentation is faulty or contains errors those may not be corrected. The last resort may be to recall the procedure, but not without legal consequences. Furthermore, changes to certain peculiarities of the Hungarian Act on PP turned out to be frequent creating considerable uncertainties.

Commercial Procurement Decision Making Process And Structure

In the company investigated purchasing needs are typically initiated by the recipient unit. There are strict corporate rules established determining the level of signing authority required depending on the value of the item or project. Once an internal request is approved or sometimes even during the approval process, procurement officials are informed. Future recipients not only provide specifications but usually recommend two to five potential suppliers they wish to be considered. They might also prepare a "black-list" of unwanted entities. The corresponding sourcing group assesses the market and is required to identify additional suppliers if possible, typically bringing the tally to at least 5, depending on asset type and assuming the market has that many (pre)qualified suppliers. If the size of the project warrants, a procurement team is set up to define precise requirements, create the evaluation criteria system, solicit proposals and evaluate offers.

There is a prequalification system in place. In fact, no supplier may place an offer or even be invited without going through the prequalification process consisting of filling out a large survey and providing proof of claims made in the response. Corporate ability is first assessed based on references. Prequalification data is then updated by evidenced performance (positive and negative experiences alike) contributing to the overall judgement of the ability of the supplier to

perform. This data becomes part of the long term strategy. All this is done in the name of reducing risks, thereby leading to reduced cost.

The side-effects of this rule is twofold: on the one hand smaller organizations rarely invest the effort to jump this hurdle leaving the company with untapped supplier potentials, while prequalification sometimes needs to be done urgently if a new supplier is identified for a much needed product or service on the other. Since it is difficult for a new supplier to earn points based on past performance, it is customary to offer them smaller contracts first to test their abilities. This also keeps established suppliers somewhat under pressure as they realize that the purchaser is constantly looking for new opportunities[3]. On the other hand, it would be against the rules and, therefore, almost unimaginable to offer a large contract to an untried supplier. Transitioning to a new supplier requires time and effort and always involves risks.

There are three main types of procedures: Request For Information (RFI), Competitive Tendering, and negotiations. RFI is one form of approaching potential suppliers. It is the standard procedure to discover latest advances in technology, understand requirements, and clarify possibilities. Theoretically, the choice of procedure type and solution depends on market features, including the product in question. However, although no internal statistics were available, none of the interviewees at the company managed to recall more than a few open procedures per sourcing group during the last few years prior to this study. Some sourcing groups have never run competitive tendering. The argument used against selecting open procedures was that most markets are "supplier markets" with only a few specialized suppliers in each particular core-business related supply arena. Thus almost all of the large purchases use negotiated procedure with restricted invitation.

The company has an elaborate eProcurement system installed as part of an Enterprise Resource Planning solution. Suppliers are required to use the eProcurement portal. At the time of this research, the company was in the process of implementing a new Supplier Relationship Management module as part of the ERP initiative. This would require all purchase requests to be initiated online.

Criteria for individual purchases are composed of two parts: the ability and readiness of the supplier and the quality and basic characteristics of the proposal. Both parts may earn points towards a final score using a weighted structure. Supplier assessment data is drawn from

the prequalification system as well as from the proposal, but relies heavily on past performance. Evaluation of the proposal itself considers commercial (e.g. delivery and payment conditions) and technical factors as well as price. If the number of actual proposals is above 3 or 5, a shortlist is created, based on parts of the above criteria. Those on the shortlist are invited to negotiate and an attempt is made to bring all proposals to "level" regarding technical content (especially in case of new technologies). The best offer is selected using the scoring system established as above. (This raised a concern regarding repeated application of the same criteria for both short-listing and final scoring.) However, before the winner is actually identified, an additional round of price talks is initiated with the leading supplier. Selection and award criteria, as by corporate rule, are *never* publicized, neither is the final winning price. Occasionally eAuction is utilized, but only if the range of initial offer-prices is no wider than 15%.

The purchasing function is organized mostly around material groups. Where it makes sense based on supply market characteristics, such as in case of stationery or certain common materials, e-Auction is used as the main vehicle for sourcing. Framework contracts are typical for production materials or certain development work subtasks (e.g. digging ditches on site is purchased in "bulk"). As a result of strategic decisions, maintenance is almost fully outsourced using a so-called Single Service Company solution, where one main contractor looks after both material and services related to core maintenance tasks. The SSC company manages a pool of subcontractors for an agreed management fee. The type of procedure, approach, and evaluation vehicle used thus mainly depend on the product type and market conditions.

The procurement decision making process is complex: many factors are at play and several sub-goals may be established. The choice of transactional or strategic approach or a combination of the two is considered carefully. Changing high level executive goals and objectives influence the actual process and decisions. Purchasers need to assess the risk associated with new suppliers and new technologies. They consider the time available, the complexity of the project as well as the ease of communication, flexibility, response time and reliability of potential suppliers, or how they react in case of urgency. There are contract templates prepared and the legal department rarely gets deeply involved in a process. The financial department typically helps out with setting suitability criteria beyond prequalification. There is internal audit in

place to review procedures and to ensure compliance with corporate policies on how to conduct business. With the expanding use of ERP, formalities are more and more controlled.

As for the daily practice, projects are often started in a hurry with short delivery dates. This leaves procurement people little room to manoeuvre: as a result, specifications are often unfinished when published and the negotiation process is actually used to firm up requirements. Obviously, entering negotiations without a well defined set of goals in mind also means that it is not clear *what the best solution for the corporation is*. In fact, it is not uncommon for recipients to change specifications when negotiations with potential suppliers are well underway.

The Transition to a New Structure

Company officials only learned early 2004 that the new EU-conform law would move them under the umbrella of the PP Act. They hired an external consultant to guide the organizational transition. It turned out that for certain key parts and materials used there would be different treatment of PP or not-PP required depending on which activity any given individual purchase of the same item was serving. The consultant also provided decision making support to run a few processes.

The PP process created relied on the existing signing authority schema when deciding about the official decision maker to be identified as required by the law. As executives were concerned about the consequences of potential legal issues and challenges – based on the negative view PP had been receiving – they decided to hire a key PP legal expert with considerable reputation and background. This person, as the head of a new PP office, was to be the secretary on every PP evaluation committee representing PP legal knowledge. The office controlled every aspect of PP: deciding if PP was required, making decisions about aggregation of purchase values, creating invitation documents, posting advertisement to both EU and National official Journals, and handling all administration related to any aspect of the procedure.

The Clash of Two Worlds: Private Mindset vs. Public Rules

The emergent PP practice was shaped by the consequences of a constant collision of the two worlds. The very first PP procedure run resulted in a real surprise: there was not a single proposal submitted. The

next few that followed resulted in similar lessons: one had been called back and reissued several times as there was no agreement whether it should have been PP or not, another had several suppliers but all had to be excluded on various grounds, yet another saw no suppliers being interested, and so on. As turned out, suppliers were not aware of the upcoming changes and were not prepared at all. It took almost two years of experience for the PP supplier base to change and settle to its own pattern.

> "… well, depending on the actual subject, one or two of our regular suppliers did not wish to bother with the issue of how to submit a PP-compliant offer. But there, of course, were new arrivals" (Sourcing group leader, West).[5]

Also, the need to change planning procedures became evident during the first year. The practice of placing major requests to be completed within a month did raise issues related to required value aggregation. Most importantly, however, the time required to run a PP procedure prohibited the fulfilment of requests on short notice. Choosing accelerated procedures or ones without a notice to speed up the process would raise the risk of legal challenges.

Procurement and technical professionals who became involved in PP constantly nagged about the administrative overhead: their perception was that they spent twice as much time and effort preparing the same project under PP. They felt time requirements just exploded. Minimal time limits set by the law slowed projects down and put pressure on recipients of goods and services. People were used to having incomplete requirements which could be refined once shortlisted suppliers were known. For open procedures this was prohibited by the law: criteria had to be defined in advance fully. The new process forced certain decisions to be made earlier then usual.

The biggest issue is related to the prequalification of suppliers as using previous performance became a thing of the past. The kind of evidence allowed by PP was inadequate to express corporate expectations against new suppliers.

> "Occasionally we had to deal with contractors who would have never won even a minor deal [under non-PP]. Even worst, after performing below standard, we could not lock them out from the

> next PP tender. We would have needed to sue them and win to use that as grounds for exclusion." (Sourcing manager, West).

Even old suppliers took advantage of the weakened criteria:

> "Imagine: the same company offered different quality for the exact same tender depending on if it was PP or not. The offer met the specifications, but if there was just one parameter they could lessen, they took advantage of it. … worse yet, sometimes they delivered the exact same product but manufactured at different plants [e.g. in Asia] where it was known to have quality issues with materials or assembly. This actually put a strain on the commercial side relationship as well." (Sourcing manager, South)

The type of prequalification allowed by the law did not meet the requirements of private procurement: the company did not use that vehicle at all. The system offered by the Act simple had no power to reduce risk.

> Entry level thresholds exist for first time contract seekers [in a commercial case]. [In PP] just about anyone could come out of the blue and win a contract. In one occasion we did not set the financial requirement high enough and some small company won a reasonable construction job. Boy, they had almost a dozen small sub-contractors all below the 10% threshold: if there was a repair issue we had no idea who might show up and with what kind of background. Asking for the qualification of their lead engineer does not help either (Sourcing group leader, West).

Overall, knowing the "tricks of the trade" seemed to be essential: suppliers who decided to learn the law and know how to "play it" have an advantage. For example, a few new suppliers were able to win based on their well established experience with PP in other areas. It does not hurt for the contracting authority either to "learn the tricks".

Technical people originally preferred precisely defined specifications and did not see the point of offering criteria for "extra" performance. Certain quality requirements such as wear of moving parts may not be expressed under evaluation criteria – neither may be the need to minimize risk. These aspects may not be measured objectively in advance: only time tells. With the help of the consultant the company ran quite a few open procedures using elaborated value for money criteria.

As a result, and not having the luxury of relying on negotiations, procurement people learnt the advantages of recognizing differences in performance and also learnt how to use criteria to direct suppliers to submit preferred offers.

When consulting help was used to set up an evaluation system, the average number of criteria was over ten with a considerable room to reward differences in technical performance. However, once no consultant were involved, the local legal PP leader limited the use of technical evaluation. In fact, lowest price rule dominated even negotiated procedures, even though staff claimed to have the knowledge and skills to set up criteria related to more than delivery dates or payment conditions. “Payment schedule is a double edge sword: not all supplier can afford to wait sixty or even more days to be paid. A good supplier may be lost.” (Procurement advisor, Central).

Public procurement is not involved in the eProcurement ERP initiative as most PP suppliers are simply not prepared to use the eProcurement portal and the law does not allow the procuring entity to enforce such a requirement that would “limit” equal access. With the same token, the e-Auction program is not even planned to be extended to include PP.

Once procurement was opened to EU, the West Division reported the arrival of new suppliers. This resulted in a decrease in prices during 2005. However, suppliers seemed to learn: half of the original suppliers were replaced by new arrivals and it became a supplier market again (w.r.t. submitting PP proposals). By the end of 2006 prices hiked back to original levels but not without some quality concerns to be resolved first.

> “Prices went down as much as 20% during 2005. Yet the bottom-line is, after 2 years the supplier pool stabilized and prices went back to the original level by the end of 2006 – if not higher. They all learned the tricks and about each-other. Some informal price-cartels may not be ruled out either. The only time we experience some dip in bidding prices is when one of the suppliers desperately needs a contract.” (Sourcing manager, West).

Change in prices was made possible by the fact that bidders in PP know each others’ prices: data related to evaluation criteria are open. However, lowered prices and the opened up supplier base came not only

with increasing number of quality issues but other burdening side-effects as well. The restrictions of the law to disallow requirements containing references to brands or makes – other than in the context of "equivalency" – led to an increased number of differing machinery and part types. This requires more warehousing, more training, new people with specialty skills to be hired, and more documentation, all leading to increased cost, difficulties in maintenance, and increased risk. Also, transaction costs associated with the higher level of administration and documentation requirements are higher for both sides. This means lesser margins for the winner – sometimes suppliers try to compensate on the commercial side.

> Supplier X submitted an offer of 15M for a commercial side project but they did not win (the actual winning price was 14M). Few months later the same equipment was ordered under PP and this time X offered a bit below 14M (but the winning price this time was 11M). If they could offer lower price for PP the same price would have been enough to win the commercial side. On the other hand, the quality would not have been the same. In fact, we all knew 11M was just plain ludicrous (Sourcing group leader, West).

As a consequence of all above experiences, this private company shied away from open competition unless supported by expert guidance in how to create appropriate criteria system for open invitations. These companies – despite forced to follow public regulations – do spend their own money (as opposed to public entities spending public monies) and they are fully aware of the importance of each decision made. They do have the best interest of their organization in mind. Even if there are fines imposed, actual outcomes are rarely turned over and the amount of the fine is "manageable". Experts judge shrewdly how much risk they take when deciding about no-notice procedures.

DISCUSSION

Expectations were negatively predetermined right at the outset mostly based on the negative milieu surrounding PP in Hungary (Tátrai, 2007). This attitude was partly the result of the perception related to past work of the Arbitration Board. This negative view stayed and was even reinforced after a few procedural problems and resulting fines. It became almost impossible to execute any strategy and the attitude was

determined by the need to survive individual procedures. This *satisficing* approach of corporate decision making thus simplified all issues into a problem of meeting legal expectations on the surface.

> "Survive another day… and just get it out of the door without legal challenge and minimizing potential damage." (PP team member).

To summarize the following issues are considered to be the main PP threats by the commercial side of purchasing:

- Not being able to rely on past supply performance of a contractor, especially in relation to the procurer;
- Allowing an unknown, untested company to come "out of the blue" and win a major contract;
- Inability to know and influence (after the signing of the contract) who will actually come and do the work;
- Not to negotiate the price further with the original winner;
- Nhe perception that bidders are too much protected by the law.

However, once practitioners familiarized themselves with the rules they saw advantages in following a stricter procedure as it forces a more conscious preparation. Once timelines are set, officials can not prolong the process at will. PP does not leave room for arbitrarily set deadlines either.

> … What procurement on the private side requires the most is 'common sense'. Public procurement, once you appreciate it, is a profession. You need to learn it. Once you did, you realize the value of well defined [corporate level] goals and matching criteria system (procurement manager, South).

In fact, some learnings were propagated back to influence the commercial side. A program was initiated to clarify steps in the process and standardize their interpretations in the practice of various sourcing groups. Implementation of improvements to the prequalification process is also under way. The confused use of supplier selection criteria was also addressed and it was separated from evaluation including no double use of the same criteria. Interestingly, attempts to influence procedures under PP became almost non-existent. Personal sympathies do not prevail.

Supplier behaviour together with the nature of the market – depending on the type of product – is the most important factor

determining the room available for the purchaser. Private companies build these characteristics into both their supplier relationship strategy and the daily purchasing practice.

> "It is quality and reliability and risk what we are typically worried about – but not when we feel our hands being tied." (procurement manager, Central).

There are well established management techniques to propagate strategy through an organization – irrespective of its size. However, this does not necessarily translate into optimizing over price or even value for money. They consider the process on the one hand, and the overall complexity and contradictions of individual purchases in the context of future operations of the firm on the other. It seems, the EU Directives attempt to achieve strategic goals using means expressed at the level of individual procedures.

Availability of information, thus the enforcement of publication rules seems to have a positive effect: it has an ability to open up the market. New suppliers arrived from abroad, but eventually they have found the PP process too complex and the administration too burdening and for the most part ended up working for Hungarian firms as subcontractors. A few large suppliers with enough future contracts did not even bother to learn the law.

CONCLUSIONS

The procurement decision making process is complex: many factors are at play and several sub-goals may be established. Purchasers need to consider risk, time available, response time and reliability of suppliers, or ease of communication. The constraints and restrictions set out in the law on the means of judging suppliers and their offers did not leave room for the consideration of some of the above. Private companies, who are used to handling such complexity, tend to "play it safe" in the eye of the law which considered to be a nuisance. Their goal with PP related purchases were regularly simplified to achieve legal acceptance and get the project completed. They avoided open procedures and ended up not allowing room for extra technical performance to be recognized and rewarded, not even for more complex subjects.

Greater competition and transparency could result in lowest prices but it has quality issues as a side-effect. In addition, suppliers learn each

other after a while and prices seem to settle back to normal eventually. Both outcomes are alarming: either lowered quality or cartel issues should raise concern about the effectiveness of PP and open procedures. Also, having an up-to-date appraisal of registered providers would reduce the effort – time and costs – involved in applying for individual contracts.

The complexity of rules created and the limited control allowed with regards to supplier relationships make it a liability in the eye of a *procedurally* rational decision maker. The consistency of expectations and available tools and means, as well as preparedness, prestige, and trust need to be considered for a full answer what it takes to achieve effective and efficient public procurement.

Strategic goals for a government should not be mismatched with the goals of a strategic partnership as applied by private organizations. Social, market and other issues as related to PP (Harland et al., 2005) are not at the same level as overall economic value or lowest price which are defined at the level of individual procedures.

NOTES

1. "Tenders Electronic Daily, Supplement to the Official Journal of the European Union" (TED) at http://ted.europa.eu/.
2. The official list of PP Contracting Authorities at http://www.kozbeszerzes.hu/index.php?akt_menu=288 lists more than 8000 organizations.
3. Similar approach has been observed at the two other organizations investigated.
4. It is the experience of procurement professionals that a pride difference more than 15% would lead to no further price bids.
5. All interviews were in Hungarian and are translated by the author.

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