

**Bounded rationality, negligence or corruption: The effect of emergent malfeasance in procurement practice.**

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## Reinventing Public and Non Profit Governance

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### Bounded rationality, negligence or corruption: The effect of emergent malfeasance in procurement practice.

Emergent procurement malfeasance

John Hargreaves & Ifryn Price

## Abstract

A recent European Commission (EC) report highlighted widespread perceptions of corruption in public sector procurement (Anon 2014). The report identified that given the level of financial flows generated, public sector procurement is an area prone to overt and covert corrupt practices which are exacerbated by “weak governance which hinders market competition and raises the price paid by the administration for goods and services, directly impacting public expenditure and therefore tax payers resources. The financial interests at stake and the close interaction between public and private sectors make public procurement a major risk” (p21). We report a specific investigation, which bears out that conclusion.

In UK Public Sector procurement the acronym OJEU, strictly speaking the Official Journal of the European Union has become short hand for the overall legal framework governing public procurement. The framework and its processes aim to increase transparency and eliminate trade barriers arising from discriminatory procurement. *Ex ante* transaction costs are, it is assumed, justified by *ex post* benefits. We test that assumption in one market sector and find the opposite. In a silent conspiracy those who benefit from the *ex ante* stages of the process do not enhance the *ex post* value-in-use for the intended beneficiaries. While not corruption per se, the outcome can be seen as emergent, or complicit, malfeasance.

The specific research sought to identify the real and possible impacts of short-term duration contracts on stakeholders engaged in a sector of the Facilities Management (FM) market place. It focused on the trading relationships between private sector “suppliers” and public sector “buyers” providing Repairs and Maintenance (R&M) services to the Social Housing sector. As this channel has specific operational traits, legal obligations and common social,

political and cultural dimensions it provided a controlled opportunity to identify issues that potentially emerge out of short-term contracts.

Our review of the market identified a number of trends that, whilst pertinent to the supplier organisations, were also a feature of the industry. These were related to the procurement process, and how it influenced the structure of the businesses operating within the industry; the contract, which defines and shapes the business relationships; and additionally the management of the procurement and award process<sup>1</sup>.

Short-termism in outsourced R&M contracting has a potential negative cost, for both “buyer” and “supplier”, in terms of increased *ex ante* and *ex post* transaction costs. The process operates to the benefit of those involved in doing or advising on the procurement and contract management to the detriment of the supposed beneficiaries, the tenants of the Social Housing stock. We cannot call the process deliberate corruption. We do though argue that the term 'emergent malfeasance' is justified.

### **Key Words**

Transaction costs, Adverse selection, Value, Procurement, OJEU, Facilities Management.

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<sup>1</sup> One of us held a board level position in the industry with extensive contacts

## Introduction

A recent European Commission (EC) report highlighted widespread perceptions of corruption in public sector procurement (Anon 2014). The report identified that given the level of financial flows generated, public sector procurement is an area prone to overt and covert corrupt practices which are exacerbated by “weak governance which hinders market competition and raises the price paid by the administration for goods and services, directly impacting public expenditure and therefore tax payers resources. The financial interests at stake and the close interaction between public and private sectors make public procurement a major risk” (p21). We report a specific investigation, which bears out that conclusion.

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The specific research sought to identify the real and possible impacts of short-term duration contracts on stakeholders engaged in a sector of the Facilities Management (FM) market place. It focused on the trading relationships between private sector “suppliers” and public sector “buyers” providing Repairs and Maintenance (R&M) services to the Social Housing sector. As this channel has specific operational traits, legal obligations and common social,

political and cultural dimensions it provided a controlled opportunity to identify issues that potentially emerge out of short-term contracts.

The UK Social Housing sector manages in excess of 5.5 million properties, has a rental turnover of £12.bn. per annum<sup>2</sup> and directly employees over 250,000 people. The housing stock is managed by several thousand organisations, which range from Local Authorities (LA) and Registered Social Landlords (RSLs) to Housing Associations (HAs). The sector is highly regulated and controlled, with considerable polarisation in the market place.

The current market potential for R&M suppliers to the Sector exceeds £14.0bn per annum<sup>3</sup>. In recent years, several of the major construction companies have sought to enter the market due to economic down turn or competitor pressure within their core markets. Their entry routes have been either aggressive pricing or acquisition of niche market property services / FM organisations. The supply chain of main contractors and subcontractors employs over 65,000 FTE's.

Our review of the market in 2011 identified a number of trends that, whilst pertinent to the supplier organisations, were also a feature of the industry. These were related to the procurement process, and how it influenced the structure of the businesses operating within the industry; the contract, which defines and shapes the business relationships; and additionally the management of the procurement and award process<sup>4</sup>.

Our research suggested that short-termism in outsourced R&M contracting does have a potential negative cost, for both “buyer” and “supplier”, in terms of increased *ex ante* and *ex*

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<sup>2</sup>This is based on the average weekly rental income per property. It should be noted that 70% of this figure is provided by the State in the form of Housing and other benefits.

<sup>3</sup> An element of the research project was to gather information on a daily basis from the Official Journal of the European Union - TED website regarding government and NGO tenders, their contract term value and the period and specific contract details. Inside Housing published the value of R&M as £14.0bn for 2010.

<sup>4</sup> One of us held a board level position in the industry with extensive contacts

*post* transaction costs. However, short-termism may be desired position for elements of the supply chain due to increased buying opportunities and hence profit potential. Does it allow the “buyer” to reduce risk due to poor procurement practice and an inability to effectively contract manage their “suppliers” performance due to asset management not being their core competency ? Are the levels of transaction costs and inefficient service a price worth paying? - Alternatively does the process operate to the benefit of those involved in doing or advising on the procurement and contract management to the detriment of the supposed beneficiaries; the tenants of the Social Housing stock? Our argument after the research is that it does. We cannot call the process deliberate corruption. We do though argue that the term 'emergent malfeasance' is justified.

### **Literature**

Today's purchasing practices are assumed by academics to have evolved in an orderly manner from past practice. Emiliani (2010 116) suggests that practitioners of modern industrial purchasing and supply chain management lack a historical perspective in the execution of their strategic and day-to-day procurement practices. By assuming that current practices are favourably grounded in past practice they avoid questioning their own practices in respect of ethics, effectiveness or corporate responsibility. Emiliani goes on to argue that current practices have ignored history and the hard won lessons and that subsequently procurement practice has become internally focused and standardised for both the “buyer” and the “supplier” organisations. The result is tensions between the parties whose interests should ideally at least, - be fundamentally similar, i.e. the supply of R&M services to the Residents.

At the heart of the debate is a mathematical equation. The optimum design would be a non – zero-sum (win-win) outcome, whereas in practice buyers seek to realise zero-sum outcomes

(Emiliani 2004, 2010). The value network for R&M (Figure 1) operates within a volatile and highly regulated environment with polarisation of “buyers” and “suppliers”, exacerbated by a fixed market in terms of stock volume. Given this position, are the unintended consequences of aggressive procurement practice opportunistic behaviour as the suppliers within the value network seek to redress the position?

Procurement process design is limited and outlined specifically by OJEU<sup>5</sup>, but crucially the procurement process design, content and evaluation criteria rest with the “buyer”. New public management (Horton 2003) and the desire to adopt the practices of the market increase the desire to emphasise a price reduction strategy despite what the purchasing media have long said about the shortcomings of “price beating” and the use of finance based performance based metrics as a measure of success.

Academically the effects of polarisation or “buyer” / “supplier” consolidation in a market is not widely covered within the context of the development of procurement and supply networks, although the fixation with price beating also the adoption of sharp practice and coercive practice within the product and services industries is widespread. Additionally studies show the consequences of such actions; i.e. poor supplier relationships (Hannon, 2003), loss of supplier technology, bankrupt suppliers (McCracken & Glader, 2007) and supplier retaliation (Emiliani and Stec, 2004; 2005), in the form of agency, price fixing and bid rigging<sup>6</sup> and an unwillingness to succumb to “buyers” requests.

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<sup>5</sup> Directive 2004/18/EC of the European Parliament and of the Council of 31/03/2004 on the coordination of procedures for the award of public works contracts, public supply contracts and public service contracts

<sup>6</sup> In 2009, the OFT imposed fines totalling £129.0m on 103 construction firms, which it had found, had colluded with competitors on building contracts. These activities were mostly in the form of “cover pricing”. This total was reduced on appeal.



The available academic literature available tends to assume the procurement professional. A feature identified in this research was that well-intentioned amateurs are prevalent in R&M service procurement design and process in all but the largest of the “buyer” organisations. They predominately have a skill bias in finance or operational practice (either housing or maintenance). Keasey *et al* (2000) suggest several dysfunctional consequences of such practice: specifically misinterpretation, ossification and sub optimisation. Bouwman (1984) compares the decision making process of what are deemed “Experts” and “Novices”, saying that it was “Experts” who typically transferred reason into recognition, a position supported by Dreyfus & Dreyfus (1986 30), espousing that “...experts don’t solve problems and don’t make decisions; they do what normally works”. In summary, finance and operations may not be good surrogates for professionals in purchasing.

However, even an all-embracing contract cannot protect against a lack of economic trust and *ex ante* opportunism due to poor assessment capability (Rickts, 2001). Additionally internal toxic incentives encourage goal distortion (Chapman, 2005), a “milk and move” culture (Jackall, 1983) and the implications for service delivery when managers “hit the target” from the perception of securing works for a budget, but “miss the point - fixated on targets without appreciating the impact on quality of service (Bevan & Hood, 2006). A point infrequently considered within the sphere of procurement literature is service delivery and *ex post* transaction costs generated by adverse selection, in particular the cost of measurement, contract management and opportunism through bounded rationality and imperfect commitment.

A major problem that economics associates with the “commons” is that its benefits are readily accessible to all, that it is generally seen to have few barriers to entry and as a consequence is prone to misuse, resulting in the well-known “tragedy of the

commons”(TOC) (Harding, 1968). Economic convention presents arguments about the commons, premised on methodological individualism and rational choice presenting a model that conceptualises the commons as being (1) owned by a collective of actors and (2) objectively given, where the pursuit of self-interest can lead to the degradation of the said commons. The basically essentialist model make an assumption that the actors are norm – free and opportunistic maximisers of short–term interests whose actions, in the absence of restrictions to access, tend not to contribute to the long-term interests of the collective. Additionally the collective action of the group has the potential to lead to sub–optimal outcomes for all actors. Consequently, it creates collective misuse and a “degradation” of the commons. Ostrom (1999) describes the TOC as a metaphor for the problems of overuse, citing that resource users are norm free maximisers of immediate gains, who will not cooperate to overcome the common dilemmas that they face.

The TOC is frequently argued as an example of market failure, where organisations using the commons impose external costs on their rivals. Mason & Phillips (1997) suggest, “this externality can be both static and dynamic”. Static externality reflects the “crowding” problem where each firm's costs rise with industry output as the number of players in the market increases. *Ex ante* transaction costs linked to procurement, are a significant portion of all firms’ costs and must be recovered from the market if firms are to continue to trade. Additionally a larger number of firms increases competition, potentially leading to lower “output” prices and a squeeze on margin. The dynamic externality exists if current actions lead to higher future costs (op.cit 148); i.e. cost will change from one period to the next when access to “stock” changes.

The Social Housing R&M market is dynamic in terms of competitive procurement practices, which are highly regulated via OJEU. Al-Fattal (2009), suggests that the TOC has proved to

be an important political economic concept as it has the capability to determine cooperation between actors to “conserve the common good and to lessen the transaction costs of negotiation and enforcement”. However, within OJEU practice co-operation is seen as a major source of post award legal challenge with charges of opportunist behaviour and profit maximisation.

Given then that liberalisation of trade is a pre-requisite, and desirous on the part of the “buyers”; what is the impact of suppliers seeking to win greater market share within a cyclical, pre defined market? Mason & Phillips (1997) outline the non-cooperative equilibrium, setting out that a dash for growth by suppliers reduces their short-term profitability. *“Construction firm profits slump due to high competition”*. (Inside Housing 18/2/2014) This market position is further exacerbated over time as the size of the cyclical market alters, as there may not be sufficient work available to win in the medium-term. Should this reduce the numbers of actors competing either through polarisation (the financially / operationally stronger – buying the weaker) or administration / liquidation, the long - term position would be increased negatively for buyers.

## **Methodology**

### **Design**

To investigate these hypothetical effects in one particular market segment we adopted a pluralist “mixed methods” design. Triangulating quantitative and qualitative data allowed comparison, validation or corroboration of the results and was grounded in a theoretical objection to the increasing polarisation found in current methodological orthodoxy (Anon1 for review). The two forms of data bring a greater insight into the problem than would be obtained by using only a single method. Organisations are often intensely political arenas. Researchers relying on documentary evidence are advised to use triangulation to enhance

validity and reliability (Saunders *et al*, 2000). We utilised document analysis, data charting, and qualitative, but realist, ethnography (Sanday, 1979; Anon2 for review) via semi-structured interviews, a time lapsed study of an HA SBU and netnography within industry sector blog sites.

Triangulated or mixed method design should emphasise a study's particular purpose, (Morse & Neihaus, 2009). Questions and source of can be fixed or emergent (Creswell & Plano Clarke 2011 55), albeit these two positions should be considered as ends on a continuum and not as a clear dichotomy. We implemented the qualitative and qualitative strands concurrently and gave them equal priority. The strands were independently analysed before the results were combined during the overall interpretation of the findings.

### **Interviews**

We interviewed senior managers, directors and partners of organisations operating within the value network to identify the rhetoric and the reality of short-termism for all stakeholders engaged in the procurement, delivery and management of R&M services. Our objective was to obtain conflict or consensus and emergent themes from the qualitative research data, which could be compared and contrasted to data obtained from document analysis and customer satisfaction surveys. We had a privileged level of access to interview targets within the industry and value network (Figure 1) and therefore believe our sample was representative of the sector.

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TAKE IN FIGURE 1

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## **Realist Ethnography**

Anon2 for review, building on the work of Scott-Morgan (1994) and reverting to the position of Sanday (1979) suggest that ethnography should unearth the rules for proper and predictable conduct as judged by the people studied. Their challenge is that ethnography as inductive can be realist and “in this view uncover real unwritten rules of the game in such a manner that enables diagnosis”. Scott-Morgan (1994) argues that analysing ethnographic data for common motivators, enablers and “triggers reveals unwritten rules as routines of organisational behaviour. His pragmatic stance “against necessary immersion” is that a combination of internal and external research can assist with the speedy elucidation of a particular set of unwritten rules. Our pragmatic approach was broadly ethnographic but prioritised Sanday's (1979) successful outcome.

## **Documentation Analysis**

The emphasis was on reviewing documents that provided an insight into operational capability and performance. In terms of relevance and materiality, the documents were gauged against a rigorous set of criteria Scott's (2004) *Authenticity, Representativeness, Meaning* and *Credibility*. Documents analysed were audited financial accounts and board reports, Audit Commission reports, Housing Corporation and Tennant Services Authority<sup>7</sup> surveys: quality control and audit reports, OJEU reports and official EU “White papers”.

## **Results**

Our research focused on public sector procurement and considered the procurement process, the contract and management capability of the process. The primary objectives of European procurement legislation are the creation of competition within the supply of services to

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<sup>77</sup> <http://www.homesandcommunities.co.uk/tsa-archive>

Government bodies, the delivery of the best value for money by generating the lowest transaction costs to achieve the best procurement outcomes and to aid the fight against corruption. Anon (2014) nevertheless identifies the issue of corruption in the process as a complex phenomenon, with 64% of UK companies surveyed responding that overt corruption was wide spread, (p6) with the construction sector being deemed to being particularly vulnerable to corrupt public practice. (p17 & p27). The report did not comment on covert corruption but acknowledged that further strengthening in the integrity in standards and practice is called for. (p34)

We believe the process in practice displays bounded rationality. Negligence and opportunism have created interrelatedness within the value network, adding concentration via “supplier: buyer” polarisation. The unintelligent design and inconsistent management of the process has not delivered uniform value in use for the resident whilst creating quasi rents for elements within the supply chain.

### **Delivery of value for money**

The ultimate effectiveness of the procurement process can be gauged from the responses to customer satisfaction surveys and organisational reviews undertaken by the Tenants Services Authority (TSA) and Housing Corporation (HC). The output of HAs service to their residents was defined in terms of “*value for money*” (as defined by the TSA within its 2010 regulatory framework and assessed by the Audit Commission<sup>8</sup>). Analysis of R&M services delivered at a macro level to the Social Housing sector identifies several trends (Tenants Services

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<sup>8</sup> The Role of the Audit Commission has been redefined following the “bonfire of quangos”

Authority, Existing Tenants Survey 2008<sup>9</sup> ; Housing Corporations Survey of existing Housing Association Tenants, 2006<sup>10</sup>).

The HC 2006 report cited that *“There was a clear link between the repairs service provided by the HA and the HAs overall satisfaction level”* (p64). Tenants who were satisfied with the repairs service were also satisfied with the overall services of the Landlord (91%) and only 28% of tenants who were dissatisfied with the repairs service were satisfied with the overall performance of the Landlord. Only 78% of respondents thought that their rent provided value for money (p7).

All respondents were asked to rate their satisfaction with the way in which their Landlord deals with day-to-day R&M. A majority (71%) were satisfied with this aspect of service delivery. There was an improvement in these figures where tenants had direct experience of the R&M service (75%). However, where tenants had reported a repair but had had no work completed the overall Landlord satisfaction falls to 42%. with those “totally dissatisfied” rising threefold to 37%. Of those surveyed who had reported a repair and this “had not been completed”, 54% expressed satisfaction with overall service of their Landlord. The HC 2006 report concludes, *“...which suggests that between 200,000 and 250,000 tenants had reported a repair across the UK social housing estate and that no repair works had been completed”* (p66).

The key elements relating to resident satisfaction with the R&M works were:

- the time it took for the works to commence from initial reporting,
- the slow speed with which the work was completed and

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<sup>9</sup> D 19307 successful interviews undertaken by Ipsos Mori

<sup>10</sup> 9184 successful interviews were conducted with tenants from 97 HAs based in the UK

- the repair being completed first time.

Drawing on the trends identified in these two surveys and the numbers of properties in the HA estate, it would be reasonable to postulate that there would be approximately 15,000,000 R&M activities per annum and that potentially 3,000,000 of these activities would leave the tenants dissatisfied with the service that they have received. Given the importance of R&M to the tenants in the surveys, and the clarity provided by the Key Lines of Enquiry (KLoE's)<sup>11</sup> to the HAs, and through them to the supply chain, it seems that despite the time, effort and cost spent the procurement process adopted within the value network, and its management, does not facilitate a consistent R&M service delivery. The regulation of the process and the revenue spend on establishing the contract does not appear to achieve its notional objective of achieving the desired results for the intended beneficiaries raising the question of why not.

### **The procurement process**

We found that the design and management of the procurement process had increased fragility, created contradicting objectives and lead to mal distribution within the market. The finding is consistent with the recent report on the EU as a whole. Anon (2014 25) found that 40% of respondents were not participating in public sector procurement as they believed that, specifications were “tailor made” for specific companies, there were conflicts of interests created and unclear selection or evaluation criteria.

The procurement process should be designed to achieve the most competitive price that the services could be delivered for, and to achieve the strategic criteria of the KLoE's i.e.

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<sup>11</sup> Key Lines of Enquiry are the levels of performance expected by the Audit Commission in its inspections of the strategic approach to housing within a HA and local authority area(s)  
[www.auditcommission.gov.uk/housing/inspection/Keylinesofenquiry/Pages](http://www.auditcommission.gov.uk/housing/inspection/Keylinesofenquiry/Pages)



“capacity to deliver” and “value for money”, via “value in exchange”. However, in outsourced R&M service supply, “value in exchange” for the buyer may not equate to “value in use” for the Resident. The highly competitive nature of the procurement process destroys value creation and service quality. (c.f. Gummesson, 1998). Either the sector lacks a consistent understanding of the concept of service quality or it is ignored within the design of the procurement process.

Our interviews included senior members of the “buyers” and “suppliers” within the value network; and to gain an insight into the causes and consequences of short-term trading. To interpret our findings we developed a framework within the context of the EU directive 2004/18/EC and drawing on the work of Walker and Brammer (2009) and Gelderman *et al* (2006). The framework considered:

- Buyer /supplier familiarity with EU policy and process
- The perceived inefficiencies of the EU policy
- Organisational incentives
- Intelligent client/ Intelligent supplier selection

For the “buyers” the principle issues identified related to process capability: the content and design of the contract notice, the evaluation process and the context management of the contract award.

The responses from the market seem atypical. The EU evaluation report, *Impact and effectiveness of EU public procurement legislation* (Anon 2011) identifies that on average an OJEU Contract notice receives 7.8 bids for the “Open” procedure<sup>12</sup> and 5.5 bids for the “Restricted” procedure for property services within the UK. Our interview data suggest this

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<sup>12</sup> Construction/ service sector

figure is “light”. For example, an internal document provided by an interviewee advised that it had taken the strategic decision to fully outsource R&M delivery across the nationally structured group. It reported, *“The contract notice was published on - a given date - and within 7 days of the notice being published 90 statements of interest had been received”*. The market seems crowded: an obvious influence on static externalities and (Mason & Phillips, 1997) an economic condition conducive to a tragedy of the commons.

### **The procurement decision**

In practice cost dominates procurement decisions. Over 95% of the contract notices we read were based on the “restricted” procedure Twenty five percent% of the awarded contracts were to be on a framework basis<sup>13</sup> and that the predominant evaluation criteria was the “most economic and advantageous tender” (MEAT). This in turn was heavily biased in terms of price over quality, with 94% of notices weighting price at 70% or higher.

*“The weightings are reflecting the economic squeeze. Quality and specifically capability are of paramount importance, but these are a secondary consideration.”* MLD (Litigation lawyer

The critical element of procurement process is the design of the published contract notice. Anon (2014 27) notes “that public procurement at regional and local levels raises particular issues where discretionary powers are not matched with sufficient checks and balances..... at the same time internal control mechanisms are weak” a position supported by one NGO interviewee who expresses a negative opinion on the procurement capability within HAs.

*“We have questioned the procurement capability “in house” to successfully scope the process, and they have frequently bought in advice which they did not know how to manage.*

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<sup>13</sup> The UK is the largest user of Framework contracts with over 40% of all OJEU notices being posted by UK authorities.

*If public bodies coordinated procurement more effectively it would significantly reduce their tendering costs.”* ANGO1 (Senior manager in HCA)

The Housing Associations (HA) interviewed had a procurement policy that was usually based on organisational mass. The larger HAs had their own procurement departments and engaged procurement professionals. The smaller HAs either undertook the work themselves or engaged with “procurement clubs”, buying consortia or consultants. This itself potentially increased transaction costs.

*“External commissioning is beset by barriers. The cost of procurement is stated as a substantial concern. Money is considered “wasted”. Technical barriers are cited as relating to staff, due diligence and cost, but there is an acknowledgement of the inevitability of consultancy fees.”* TSA 2009

## **Responses**

Irrespective of organisational size, the commoditisation of the content of the contract notice created several issues. Only, the larger contractors could fulfil elements of the evaluation criteria<sup>14</sup>. They then sub-contracted service delivery to Tier 2 and Tier 3 sub-contractors. (Anon 2014 26) identifies a risk due to “....the frequently occurring problem relating to the drafting of tailor-made specifications to favour certain bidders and splitting tenders into smaller bids”<sup>15</sup>. Our findings are rather that the complexity of the regulated procurement process creates a commercial environment that favours sub-contracting.

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<sup>14</sup> These being driven by organisational sales revenues and the percentage of individual contract spend relative to the revenue stream of the organisation. The SME share of contract wins is the lowest in the EU

<sup>15</sup> The previous example cited where there were 90 expressions of interest, whilst contradicting the preferred used of main contractors, identifies poor design of the content of the contract notice, hence the volume of interest.

The critical elements for the suppliers were contract mobilisation and the absorption of the costs related to it, and additionally, the invoice settlement terms and its impact on their debtor/ creditor days ratios. The impact of contract duration and cash flow was not recognised or “surfaced” by the “buyer” interviewees, and was not considered as part of the procurement process selection or evaluation criteria. Equally unconsidered are the financial aspects of profitability and liquidity within the suppliers sub-contract supply chain, either at the point of award or indeed throughout the “life” of the contract. Increased levels or shortfalls of works against the tendered budget or, peculiar to this market place, the number of contracts that commence simultaneously for the supply network, both contribute to a classic over-trading situation.

Meanwhile the buyers, via their procurement processes are simply following a process without concern as to its impact or relevance, either on the market they are procuring from or on the value in use of the services for residents. Our interpretation of the “buyers” contract notices is that they lack an understanding of the R&M services delivery, which they were seeking to procure. A commoditised process renders evaluation easier but encourages contract pricing that bears no relevance to the actual works to be undertaken to maintain the asset stock. Ultimately the result is either achieving an overspend for the HA or non-delivery or services for the resident. (TSA 2008)

Pricing of R&M services was commoditised to assist in the tender evaluation process, with the frequent use of Schedules of Rates (SOR) or price per property schemes. These impact on the services especially where Tier 2 and Tier 3 contractors are utilised and their cost of operation is unknown by the sub contractor management. The pricing methodology and a poor understanding of contract pricing creates an environment of opportunism for the

supplier in the guise of non-delivery, job building and value engineering. (HC 2006) as they seek to recover trading margin.

Within the Larger HA's, who engaged procurement professionals, it was frequently identified that the procurement team did not know if the contract could be delivered for price submitted by the supplier, or what impact that sub-optimal pricing would have within the value network<sup>16</sup>. The design and content of the contract notice did not consider supply chain delivery. The professionals' sole aim for a successful procurement exercise was to achieve "value in exchange" for the HA which was frequently driven by individual incentive schemes. Where a budget was set the procurement team might be personally financially rewarded for securing the contracts under that budget. There was no consideration of whether the service could actually be delivered for the tendered price.

The commoditisation of the process additionally created issues of duplication due to the use of frameworks and buying consortia. Anon, 2001, an EU review identified that 20% of advertised contracts were potentially covered within existing contract awards, concluding that 2500 public tendering exercises undertaken during 2008 were unnecessary. We suggest that commoditisation is driving a "one size fits all" approach, which benefits elements of the "buyer" community and Main contractors, and which contradicts effective procurement practice as outlined in the EU directive. *"There is always a problem when you are pricing from a larger framework. The Buyer is not going to select a contractor who has bid in a process and who you know has forensically examined their stock and their business, additionally buyers would have to accept a standardised method of delivery, which may not be relevant"* PBD (Public sector procurement lawyer)

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<sup>16</sup> There being a step back from the main contractor pricing within the tiers of sub-contractors.

## **Contractual relationship**

The procurement and the award process is the preamble to the contractual relationship. The rationale for a contract is to specify the rights and obligations of parties within a business relationship and to serve as a communication tool and reduce risk. Within the context of governance, the form of contract should demonstrate a commitment to fulfilling strategic intent and providing structure and management to business operations, but it should not govern how businesses operate. Our research identified that standard forms of contract were predominantly used in the relational exchange because the “buyer's” procurement team were familiar with them rather because of their suitability for service delivery. The contracts can be considered incomplete relative to the level of *ex ante* activity within the procurement process. They did not reflect the heterogeneous nature or the future requirements of the HA and were static relative to the asset and levels of performance over the contract life.

The central consideration for this relational exchange is that it is “outsourced”. The Social Housing market place operates within a value network and the divergent constructs and interests of “buyers” and “suppliers” only increase with the introduction of additional parties to the equation. The need for regulation of relationships between more than just “buyer” and “supplier” is arguably critical to multi-contractual relationships. (Cardellino and Finch, 2006). All the “suppliers” confirmed that they sub-contracted works, based on either a geographical location or the requirement to supply specialist services. The main contractors self-deliver no more than 85% of their contracted services. In most cases, the figure was substantially less. The majority of the sub-contracted 2<sup>nd</sup> tier and 3<sup>rd</sup> tier suppliers are not engaged on back-to-back contracts with the “suppliers” potentially exposing both the “suppliers” and “buyers” to financial and regulatory risk which may not have been envisaged by the “buyers” when the decision to outsource was made or the procurement process of to appoint a contractor was designed. Additionally patronage and nepotism to the sub-

contractors benefit if not consistent were insufficiently challenged within the processes to appoint them. In the supply chain the main contract is frequently ignored in preference to a construction based standard contract, with which a quantity surveyor or contract manager may be familiar, but which does not reflect the desire of the “buyers” contract notice or the stated intent of the KLoEs.

Analysis of several forms of standard contracts identified standardised terms and conditions and key performance indicators, however whilst the archetypes of the asset stock may be standardised, the asset condition would not be. There are 8 basic property types in the sector with a wide variance in the current state of repair. Commoditised pricing methodologies take little or no account of such variation.

*“ They require additional design to the cost models, services specification and performance management criteria to address issues that relate to service delivery. The T&C’s are now so standardised by firms of consultants , they are like finger prints – you can read them and identify who has amended the contract as even the amendments are now becoming standardised !” MLD. (Litigation lawyer)*

There is a clear link to the use standard forms of contract and the concept of Goods-Dominant Logic (Enquist *et al*, 2011) with its emphasis on operand resources and physical output which is driven by the OJEU procurement process and the view that “value in exchange” is the primary requirement for an effective procurement in the “HA world”.

As governance is not evaluated within the award process is contractual governance a procurement consideration? However, with short-term trading cycles, how relevant is the contract? An interviewee outlining the limited number of contract determinations during 2011 for poor service delivery, challenging the concept that service quality is important within the relational exchange. (Yousoff *et al* 2008)

*“..the aim is to get a contractor to deliver the works for a price that the authority is prepared to pay –under a contract that they are prepared to enter into. The contracts must be more dynamic and enable a different relationship between the buyer and the supplier - It must be about outcomes- not price”*. PBD (Public sector procurement lawyer)

### **Discussion**

In summary customer satisfaction survey results (HC 2006) suggest KLoEs of “service quality” and “value” are not being delivered by the complex set of relational exchanges in the R&M value network. The market is crowded. The procurement process is routinized under OJEU, commoditised and detached from service delivery. Procurement specialists are rewarded for beating budgets as ultimately are suppliers and subcontractors if they stay in business. Advisors can thrive on the complexity of the process. The various parties in the network have different and limited perspectives on performance; limits encouraged by the operand reward systems. “Buyers” and “Suppliers” and their supply chain view “performance” from different perspectives neither of which necessarily embraces effective service delivery. The principal beneficiaries of the procurement regulations seem to be the procurers.

The EU procurement regulations, at least as they are interpreted and translated into working practices within value networks introduce, or at least enable, excessive transaction costs without creating value for the residents. Additionally, none of the actors engaged in the exchange actually quantifies the *ex ante* costs, consequently spending millions of pounds per annum on potentially irrelevant and unproductive activities which ultimately fail to consistently deliver a robust R&M service but get recovered from the public purse. The causes of short-term duration trading relationships are known to all within the value network, as are the consequences of adverse selection but generally they remain unaddressed.



We suggest the OJEU process and associated practice supports a tragedy of the commons; a position of emergent malfeasance based on the level *ex ante* transaction costs and subsequent revenue spend to suppliers that delivers poor value in use for the Resident and is financially supported by the State in the form of Housing benefits?

### **Cui bono?**

By observation, short-termism creates rents for certain groups within the relational exchange. The advisors to the “buyers” have an interest in maintaining short duration trading, also acting as advisors to the unsuccessful “suppliers” within legal challenges<sup>17</sup>. Those engaged with “procuring” the works within also benefit when the “buyers” buy the undeliverable deal and then have to re tender within the complexity of the OJEU process. The continuous cycle of short duration contracts enables the large PLC suppliers, who need with the larger “buyers”, to “make” their market. However, as outlined in our introduction, at what cost for the sector? Moreover, is this a price worth paying?

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<sup>17</sup> Running with the fox and hunting with the hounds?

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# Figures

Figure 1 The value network of actors in the R&M sector

