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Public Procurement Strategy for Accelerating the Economic Recovery

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Abstract

The current global economic downturn represents a major challenge to public sector organisations, yet there remains an assumption that English local government procurement strategy developed during a period of economic boom, is appropriate during the recession. This paper challenges that assumption and sets out a procurement strategy which could accelerate economic recovery. The strategy advocated can be tested and the lessons learnt utilized in other countries or during future periods of economic downturn.

Keywords: Economic Recovery, Public Procurement Strategy

1.0 INTRODUCTION

Predictions are that the UK economy will contract by between 25% and 30% during 2009 (Smith and Oakeshott, 2009, pp.1-2; Tobin, 2009, p.22; Webster, 2009, p.13.); the worst since the second world war and possibly the worst recession in 100 years (Prowle, 2009, p.18). Businesses are reported to be experiencing difficulty in accessing loans and as a result encountering cash flow crisis and indeed collapse. Managing cash flow is currently considered the most urgent concern for businesses. (BCC/LGA, 2009, p10). It is for others to predict the economic and social consequences but one could hypothesise as to the potential long-term impact on local communities if the scenario is manifested. Namely, higher business failure with consequential loss of revenue to councils; higher unemployment leading to greater demand on public services and potential decline in community cohesion; decline in third sector funding paralleled with a greater need for the services they provide; a decline in thriving business environments which in turn leads to skills migration and reduced attraction of inward investment. Any or all of the above can be expected to have a long-term detrimental community impact and in turn greater demand on the resources of local government. Such an environment justifies asking 'is public procurement strategy making the best possible strategic contribution in accelerating an economic recovery?'. Procurement could focus, opportunistically, on the short-term superiority of bargaining power and extract maximum cost reductions. Alternatively, local government procurement could take a more strategic perspective, reflecting its uniqueness from the private sector (Murray, 1999; 2001), improving its strategic contribution (Murray, 2001) and meaningful involvement (Johnson and Leenders, 2003) through accelerating the economic recovery. A spectrum of potential strategic local government procurement responses therefore exists, at one extreme the need to help councils weather the storm through reducing costs, and, at the other, the potential of achieving long-term community resilience, not necessarily at an additional cost to the council. It is not for public procurement managers but local political leaders to make the choice regarding the council's specific objectives, but it is public procurement managers' professional duty to develop and present options (Murray, 2007 and 2009). However, should a council choose to prioritise accelerating and economic recovery, then there is a need to consider what such a procurement strategy would look like.

2.0 LITERATURE REVIEW

Research has yet to reflect on public procurement's contribution in moving from the current global economic downturn; this paper, set within the context of English local government, provides a primer for that discussion. Secondary research is drawn upon to indicate the strategy currently being pursued by English councils and perceived procurement best practice is critiqued. The argument is presented that perceived best public procurement practice may well, in the short-term, be inappropriate and perhaps delay economic recovery.

Suggestions for more radical short-term procurement strategic interventions are set out and justified. Given that the economic crisis is a recent phenomenon it is not possible to compare empirical research on what works and is appropriate for use as strategies in future downturns. However, it is hoped that the components of the procurement strategy proposed may provide a useful basis future comparative analysis.

2.1 Perceived English Local Government Best Procurement Practice

A detailed review and statement of perceived best practice is beyond the scope of this paper but there are a number of generalisations which could be made based on academic literature and a review of key policy documents relating to English local government procurement.

Academic literature: Perceived private sector best practice can be generalized under the banner of 'lean supply' (Lamming (1993)). 'Lean' as a concept has now been espoused by the NHS Institute for Innovation and Improvement (2009) but its successful application in UK local government was tested and reported on by Erridge and Murray (1998a and 1998b). The local government lean supply model set out by Erridge and Murray suggests good practice includes long-term contracts, single-sourcing, two-stage tendering and the use of e-procurement to reduce transaction costs. Lean supply was not viewed as an obstacle in achieving socio-economic goals although that research considerably pre-dated the current economic downturn. Thai (2007, p.3) reviewing papers presented at the 2nd International Public Procurement Conference, concluded that cooperative purchasing is considered good practice in reducing costs and risk, minimizing 'red tape' and maximizing economies of scale. Similarly, Knight, *et al.* (2007, p.7) summarizing the findings of the International Research Study of Public Procurement stated that "... clearly [joint purchasing] is a key theme in public procurement today". While Caldwell, *et al.* (2007, p.152) observed that "... if the policy aim is to stimulate local SMEs, but the value of the contract is high or would impose distress upon a single supplier's or subcontractor's productive capacity, this could force the government agency to use multiple suppliers, although single sourcing would be preferred for efficiency reasons".

Despite the perception that good practice equates with aggregated single sourcing, Lindhorst and Telgen (2007, pp. 471-482) hypothesised that single sourcing may not be a 'silver bullet' and argued that the use of multiple-sourcing: gives a wide access to markets and technologies. The application of this strategy could stimulate the innovation of products and services by keeping more access to the markets. By offering smaller orders to a wider market with multiple sourcing strategy SMEs have more chances to win business (p. 475). The academic literature, although pre-dating the recession, therefore can be generalised as consortium single-sourcing, long-term contracts, with two-stage tendering and the use of e-procurement as a transaction cost reduction tool.

English Local Government Procurement Policy Literature: Key local government policy documents which articulate best practice procurement are the National Procurement Strategy for local government (NPS) (ODPM/LGA, 2003). The Small Business Friendly Concordat (ODPM, 2005) and the Roots Review (2009).

The National Procurement Strategy for local government: The National Procurement Strategy for local government covered the period 2003-2006, but is still recognized as a statement of good practice. The Strategy had four themes, namely, providing leadership and building capacity; Partnering and collaboration; Doing business electronically; and, stimulating markets and achieving community benefits. The key aspects of the Strategy can be viewed as an echo of Erridge and Murray's (1998a and 1998b) Local Government Lean Supply Model with the exception of the emphasis on collaborative procurement, although collaborative procurement is really a variation on the theme of single sourcing on a much grander scale. Significantly relevant aspects of the NPS are set out within the theme of 'Achieving community benefits', there we find the need for the corporate procurement strategy to reflect the linkage with the community plan and its priorities (p.47) and 'easing access' to SMEs (p.49). Nevertheless, the underlying mantra is that good practice includes collaborative procurement and the use of e-procurement to reduce transaction costs.

2.2 The Small Business Friendly Concordat

In 2005 the Small Business Friendly Concordat (ODPM, 2005) was published. It is reported that 65% of English councils have subsequently adopted the Concordat (CLG,2008, p. 6). Directly relevant commitments include:

- That the approach to individual contracts, including large contracts and framework arrangements, etc., is supported by a sound business case and options appraisal;
- Keeping the tender process as simple as possible in order to help minimize the costs to suppliers;
- Paying suppliers on time - no more than 30 days from receipt of an undisputed invoice;
- Ensuring all contracts require the council's suppliers to pay their subcontractors, throughout the supply chain, within 30 days from receipt of an undisputed invoice.

Having said that, the NPS and Concordat pre-date the current economic downturn and were first developed against the background of a thriving economy (Cable, 2009, p.1; Prowle, 2009, p.18). To look to espoused best practice in the current environment we need to consider the Roots Review (2009).

2.3 The Roots Review

Subsequent to the NPS, the Gershon review (2004) placed a considerable responsibility on procurement to achieve cost reductions. The theme of cost reduction as a procurement priority has continued with the most recent iteration being the Roots Review (2009). The Roots Review had a very narrowly defined objective, namely, "*... the contribution to the savings target which is expected to arise from improved procurement*", in the context of an expectation of £2.8bn cash-releasing gains through smarter procurement. It is therefore understandable that the priority is to reduce council costs as opposed to accelerate the economic recovery; had that not been the case perhaps a different interpretation of best practice would have been articulated. However, it is explicitly stated that "*... best practice would argue for greater collaboration*" (paragraph 6.17) to yield 'best deals' in the sense of cost reduction (for example, Recommendations 2, 4, 11, 23 and 25). Even when SMEs are referred to (for example paragraph 6.19) it is in the context of enabling "*them to respond to procurement*" or indeed "*... electronic advertising of contracts to broaden the range of SME suppliers leads to better prices*" (paragraph 6.22) as opposed to helping them navigate the economic downturn and ensuring long-term contestable markets.

We therefore are forced to conclude that best practice local government procurement, in its more recent manifestation, is greater collaborative procurement and the threat ... where individual authorities consistently act alone and forestall [pan-public sector] partnership working in procurement, and this demonstrates poor Value for Money, this should be taken into account by the Audit Commission in assessing the Authority's Use of Resources score (Recommendation 23). It can therefore be concluded that the prevailing mantra of local government procurement best practice is cost reduction, through aggregated collaborative procurement, making use of e-procurement to reduce transaction costs and paying within 30 days. The paper now considers local government procurement's response to the economic downturn prior to considering could more be done.

2.4 Current English Local Government Procurement Initiatives

The British Chambers of Commerce and LGA (2009), and IDeA (2009) carried out research to establish how councils were responding to the economic downturn. The research relied on councils sharing their initiatives and therefore could suffer from self-selection bias. Equally the research did not focus on procurement although procurement featured strongly. Summarized below are the procurement initiatives reported by LGA and IDeA. The examples of procurement's response to the economic downturn appear to be little more than improving on the 30-day payment of invoices to at best seven days, yet it cannot even be asserted that all councils are even aiming for that level of reduction, even though the Chancellor gave an undertaking that central government departments would aim for that standard. Were all to reach the 10 day aspired to by a few then there could be considered a major shift in behaviours in response to the downturn which should in turn be a positive response to the core problem identified by BCC/LGA as SME cash flow. Equally the steps taken in easing access to council business could have been a response to the NPS and Concordat in the absence of the economic downturn. It therefore appears that there has been little change in procurement strategy in spite of one of the worse periods for the economy for many years.

3.0 CRITIQUE OF EXISTING GOOD PRACTICE

This section critiques the current practice and argues it may not be appropriate for the immediate economic environment; indeed, it may hinder a viable economic recovery. Single-sourcing, by definition, reduces the number of suppliers who gain public sector business, and the aggregation of a number of councils business within one framework agreement only exacerbates the adverse impact on the number of contractors. Collaborative, single-sourced contracts may well lead to reduced prices and transaction costs, but in the current environment leads to many losers and few winners at a time when businesses are struggling for their very survival and when bundles of public sector business may make the difference to their survival. Whereas a short-term multi-sourcing strategy, making use of 'lots', could ensure that a wider range of businesses benefited from the security of public sector business. Long-term contestable markets depend on the presence of a range of competing suppliers. In the short-term, the pursuit of single-sourcing collaborative contracts may well mean that there is insufficient alternative business available elsewhere for those who do not win contracts to ensure the survival of a thriving business community. Not only is this likely to lead to greater unemployment and therefore increased demand on other public services, but it may well lead to the creation of monopoly markets, which in turn can be expected to reduce choice and quality, while increasing cost.

Longer-term contracts also bring with them significant responsibilities for suppliers, including the provision of guarantees and liabilities in the event of contract failures. For example, the supplier may be expected to cover the additional costs of the buyer having to source elsewhere for the duration of the contract period. Such a burden on suppliers in the present climate is unlikely to encourage SMEs to bid for longer-term, single-source, multi-council contracts. A parallel shift to greater collaborative single-sourced contracts in a time of increased business failure also increases the dependency of the public sector on a comparatively small supply market. Rather than providing a leverage tool for the public sector to extract better deals, it may actually lead to the public sector accepting a deteriorating level of service rather than no service at all if the supplier subsequently is at risk of failure.

Longer-term contracts make sense in reducing transaction costs but they also increase the exposure to risk for the council in the event of supplier failure. Equally they effectively shutout any opportunity for those who have not won the contracts to revisit their bids in the light of an increasingly competitive marketplace, therefore, it may be possible, not only for councils to gain better prices but also for council contracts to become significantly more attractive than would have been the case prior to the recession. In turn the reality that if the next opportunity to bid for a contract is perhaps four years away, this could be too late for many businesses. The biggest concern facing SMEs at the present time is said to be cashflow, and yet one of the key benefits which public sector contracts provide is the guarantee that invoices will be paid. Therefore, public sector contracts, no matter how small, may provide the oxygen a business needs to survive and the security a potential second tier supplier or financial institution may require to provide credit. This benefit is only restricted to a few suppliers if the public sector uses a single-sourcing strategy. Organisations have long memories, and how much empathy and benevolence the public sector has with the plight of SMEs can be expected to be reciprocated when the economy subsequently recovers. Ultimately this could lead to others achieving preferred customer status in the upturn at the expense of the public sector.

While it is laudable that current best practice espouses the use of e-procurement tools; given the priority of improved cashflow, and that purchase cards can ensure payment within four days at no additional cost to the council, it seems strange that currently local government good practice is for payment within 30 days and those exemplars are aiming for payment within 10 days, as opposed to less through the use of procurement cards. Indeed, perhaps a more radical approach would be to ask why can processes not be put in place to pay suppliers on receipt of acceptable delivery – if such an approach were adopted it would represent a considerable cash injection at little detrimental cost to councils. While the exemplary councils have introduced steps to increase access to council business, this seems to be contradicted by the espoused strategy of moving to greater use of single-source collaborative contracts; the cynic would ask is the publication of procurement opportunities not merely providing a false hope for the business community if it is not paralleled with a strategy of multi-sourcing. Existing UK policy favours the use of two-stage tendering ('Restricted procedure'). Not only is two-stage tendering slower but in such dynamic markets as those of economic recession, circumstances of those bidding can also change rapidly. It therefore, may be more effective, assuming short-term multi-sourcing is used, to make greater use of single stage tendering ('Open procedure'). However, the fundamental problem with two-stage tendering during the recession is that it further delays the time taken in bringing forward new procurements until the cash is placed in the successful suppliers' bank accounts. While the NPS discussed the use of 'social clauses' anecdotal evidence suggests that they have not been widely adopted and to some extent sacrificed in pursuit of short-term cost reduction. Social clauses could provide training opportunities

which would not otherwise exist during the recession. Of course social clauses become problematic when multi-council, single-source contracts are used. In summary it appears that current local government procurement strategy has changed little in response to the recession. Indeed, it is argued that existing good practice appears to act against accelerating the economic recovery and a more radical short-term procurement strategy may be justified. What that strategy could look like is set out in the next section.

3.1 A Procurement Strategy to Accelerate Economic Recovery

Having critiqued the appropriateness of existing local government strategy to make a positive response to the recession, the paper now progresses to suggest what a short term strategy could look like which has the objective of accelerating a viable economic recovery. The strategy needs to be owned and chosen by democratically elected councilors; it needs a democratic mandate for action. The procurement strategy should be to accelerate an economic recovery, considered short-term and not necessarily applicable when recovery has been made. The procurement strategy should not be stand-alone but synergistically linked with a local economic development strategy, including the survival of a thriving competitive business community and manpower skills. Existing good practice of opening up opportunities should be maintained and well communicated. In the short-term the shift towards longer-term multi council collaborative contracts should be set aside in favour of short-term multi-sourcing contracts making use of 'lots'.

In doing so both councils and suppliers have reduced exposure to risk. Plus, the marginal increase in staff through winning of a larger contract is likely to be less than the overall employment provided through shorter-term multi sourcing contracts. The use of social clauses should be embedded in all contracts during a time of recession, so that maximum public value can be achieved. Current good practice of invoice payment within 30 days should be overhauled. Payment by Purchase Cards would facilitate an improvement even on payment within 10 days, but is there really any good reason why invoices couldn't be dispatched on receipt of order, processed and released for payment on acceptance of delivery. Such an approach would make not only make the public sector a very attractive customer but demonstrate a real commitment to respond to the cashflow problems facing SMEs. Given the regular demand of goods and services sourced by the public sector, it would be possible through the placing of standing orders to provide a longer-term commitment to SMEs of security of future business. That security could provide reassurance to potential creditors.

4.0 CONCLUSIONS

The paper has reviewed perceived English local government procurement good practice. The analysis suggests that English local government procurement strategy generally remains unaltered from that adopted prior to the economic recession. Existing procurement strategy, particularly multi-council, single-source, long-term, two-stage tendering is considered inappropriate and possibly delaying an economic recovery.

Equally, some of the initiatives currently being pursued in response to the recession are perhaps to unadventurous. An alternative strategy was then advocated which demonstrates that local government procurement can respond to the external environment and make a strategic contribution in accelerating a viable economic recovery, particularly through use of short-term, multi-source, single-stage tendering and pursuit of payment on delivery.

4.1 Implications for Practice

The paper cautions against following a procurement strategy developed during a period of economic boom; pursuit of such a strategy may well prove to dysfunctional. However, a short-term alternative procurement strategy is set out, the adoption of which could help public procurement managers accelerate a viable economic recovery.

4.2 Implications for theory

The current global economic downturn represents a major challenge to public sector organisations, yet there remains an assumption that English local government procurement strategy developed during a period of economic boom, is appropriate during the recession. This paper challenges that assumption and sets out a procurement strategy which could accelerate economic recovery. The strategy advocated can be tested and the lessons learnt utilized in other countries or during future periods of economic downturn.

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