

# CHAPTER 1

## PROCUREMENT

### 1.1 INTRODUCTION

At the time of the inquiry, procurement was defined by the Department of Public Works and Services, as “a process which includes all the activities involved in providing a government service, from the initial decision that a service is needed, through administration, management and evaluation to discontinuance of the service” (S15, 1)<sup>1</sup>.

In many ways, then, procurement is the core function of the public sector. It is the provision of a specific service to the public.

Currently the New South Wales Government expends a total of about \$10 billion per annum on procurement, including the procurement of construction services for the provision of capital works.

The Industry Commission’s definition of procurement is a little more narrow, reflecting the more contemporary approach of outsourcing the procurement of goods and services:

An arrangement whereby a contracting agency enters into a contract with a supplier from outside that agency for the provision of goods and/or services which typically have previously been provided internally — not necessarily involving competitive tendering. Also called ‘outsourcing’.<sup>2</sup>

Given the importance and magnitude of procurement, it is critical that it is carried out in as efficient a manner as possible. It should also go without saying that the maintenance of high quality of service is just as important as efficiency in the procurement process.

One means by which governments are seeking to increase the efficiency and cost effectiveness of service provision is through outsourcing (also known as contracting out) via competitive tendering and contracting.

### 1.2 OUTSOURCING - A NEW CONCEPT?

Outsourcing and competitive tendering have received considerable attention in recent times. However, the notion is by no means new even though “the view that contracting out is an invention of the recent reform period is held fairly widely. In fact, “it is beyond question that many involved in implementing the reform program are ignorant about past administrative practices” (McIntosh et al, 1997, 13).

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<sup>1</sup> This was redefined this year to be “the process involving all activities following the decision that a good or service is required. It involves the acquisition and disposal of goods and services” (NSW Government White Paper 1999).

<sup>2</sup> Industry Commission, *Competitive Tendering and Contracting by Public Sector Agencies*, January 1996. Quoted in NSW Parliamentary LRS Briefing Paper No 22/97.

As the Auditor-General put it to the Committee in his submission to the inquiry:

At its simplest level, agencies have long purchased-in a range of goods and services because it is manifestly more efficient than in-house production. Thus the Audit Office procures motor vehicles, computers and software and a range of stationery items for which internal supply would be unthinkable. (A-G sub, 1)

The notion of contracting out has indeed been around for some time, as Reilly and Tamkin have argued:

The idea that organisations will not carry out all the activities which relate to the provisions of goods and services has a long history and the public sector itself has used some form of contracting out for a long time. Indeed, in the nineteenth century, before the advent of the big integrated firm, outsourcing was the norm. (1)

However, this picture gradually began to change this century, accelerating after the war with the arrival of “mass markets and volume production [which] allowed companies to grow ... until they became vertically integrated in terms of process, and self sufficient too in support services” (Reilly and Tamkin, 1). Of course, this did not occur across the board; a good example being the car industry.

Thus the long term pattern of outsourcing was reversed for a time in the latter part of this century.

So while there is nothing new about ‘outsourcing’ or ‘contracting out’ in the public sector, there is not only a renewed interest in the process but a considerable change in emphasis. What is new is that more complex public sector services, which might once have been considered core services, are in some cases being given over to private sector interests. For instance, New South Wales has contracted out the construction and management of public hospital services and, on the Federal level, the Commonwealth Employment Service has been wound up and employment services handed over to a myriad of private and community sector operators.

According to McIntosh, what has changed significantly is that both processes are now attracting much wider interest and that outsourcing has become a policy objective in its own right:

Contracting out has always been recognised as one of the options available to governments and their instrumentalities as they consider how to implement public policies. But thinking about it has, until the recent period, always been secondary to thinking about the particular service involved, be it public works, transport, health, education, the delivery of international aid or the management of the public finances. These services have been the policy agenda items; contracting out has simply been an implementing tool that might be used. Now contracting out has become an agenda item in its own right, as governments have elevated it to become a subject of first-order policy making... It is scarcely too much to suggest that what was once merely a means for achieving other ends has become an end

in itself, as governments have come to see it as a major factor in reducing the size of the public sector. (11)

Renewed interest in contracting out in recent years has been driven by a fundamental re-evaluation of the relationship between the public and private sectors, epitomised by a belief in political, business and certain academic circles that governments should reduce their involvement in non-core activities so as to optimise efficient delivery of core services. This whole reassessment has been encouraged by:

... generating questions about structures, costs and efficiency. The move away from the command and control philosophy to one that accepts looser relationships is conducive to transferring work to third parties. The same conclusion is reached by the realisation that the benefits of carrying out work internally may not be sufficient to outweigh the cost savings to be obtained by outsourcing. (Reilly & Tamkin, 4)

To lift their performance, governments around the world are having to confront two major issues:

- Do they still need to be involved in some activities or can these be better provided by others?
- Are there better ways of providing the services demanded of government?

The political interest in the process, reflected in “organisational imperatives”, has been driven by governments seeking to cut costs and improve efficiency as management has endeavoured to optimise organisation size and structure in response to numerous pressures, including increased intensity and breadth of competition, technological change and the demands of customers (see Reilly & Tamkin, 4).

Competition for the delivery of goods and services in the public sector seems to have been accepted by both of the nation’s major political parties, and there would appear to be no going back.

In reforming the procurement of goods and services, governments have sought to lay greater emphasis on the importance of introducing and maintaining competition in the supply of goods and services to the public sector.

The cornerstone of these policies is the contracting out of the delivery of goods and services to either in-house or private players who compete to win contracts. Efficiency is a major objective (see Administrative Review Council, 1997, 2).

Governments in Australia have enthusiastically followed these trends. While it has now been going on for some years, the most recent and probably the most formal manifestation of the process has been the adoption by state and federal governments of a National Competition Policy, following on from the Hilmer Report.

Like their counterparts in other jurisdictions throughout Australia, successive New South Wales

governments have reformed the way they procure goods and services in recent years.

The Auditor-General has suggested some caution on the issue, noting that the principle that the existence of a competitive market for the supply of goods or services will “always provide the more efficient goods or service compared to an in-house monopoly supplier [is not] universal” (A-G sub, 1).

Acknowledging the resurgence of contracting out, the Auditor-General notes:

This new phase is significantly more complex than purchasing in products or ancillary services. The complexity arises because the importance of transaction and communication costs can be underestimated; because the Government can under certain circumstances effectively retain the responsibility and accountability for the service; and because contracting out might involve an inappropriate transfer of risk which would be better (more efficiently) maintained by the Government. (A-G sub, 1)

Competitive tendering is an important part of this process, particularly the contemporary revival of outsourcing.

### **1.3 TENDERING**

Tendering and contracting are parts of a single process for obtaining the supply of goods and services, and for the construction of capital works.

A tender is simply an offer in monetary terms to execute a task as defined. It is part of a process to obtain competitive offers from which one will be chosen as the basis of a subsequent contract.

Tendering can take a number of forms:

- Public
- Selected
- Negotiated
- Registered.

The reasons for tendering are to ensure probity, guarantee fairness, and gain value for money through competition. In order to construct a project, its cost or price must be established. This is usually done through the tendering process, which is used to select the constructor.

Tendering also plays a very important role in testing the benefits and costs of substituting one source of supply for another.

The full benefits of outsourcing will only be achieved through effective and efficient tender processes. Poor tendering practices impose costs on both agencies and contractors with substantial reductions in benefits and, ultimately, quality of service.

As the Industry Commission stated:

In specifying service requirements, preparing contracts and developing and managing tender practices, agencies should take into consideration the relevant service, agency and market-specific characteristics, together with ... ‘best practice’ guidelines... This will ensure that the tender processes adopted are appropriate to the individual circumstances of the agency and enhance the benefits to the agency, its clients and the community as a whole. (Industry Commission, 350)

With this brief general overview in mind, the Committee looks more specifically at aspects of capital works procurement in the next chapter.

