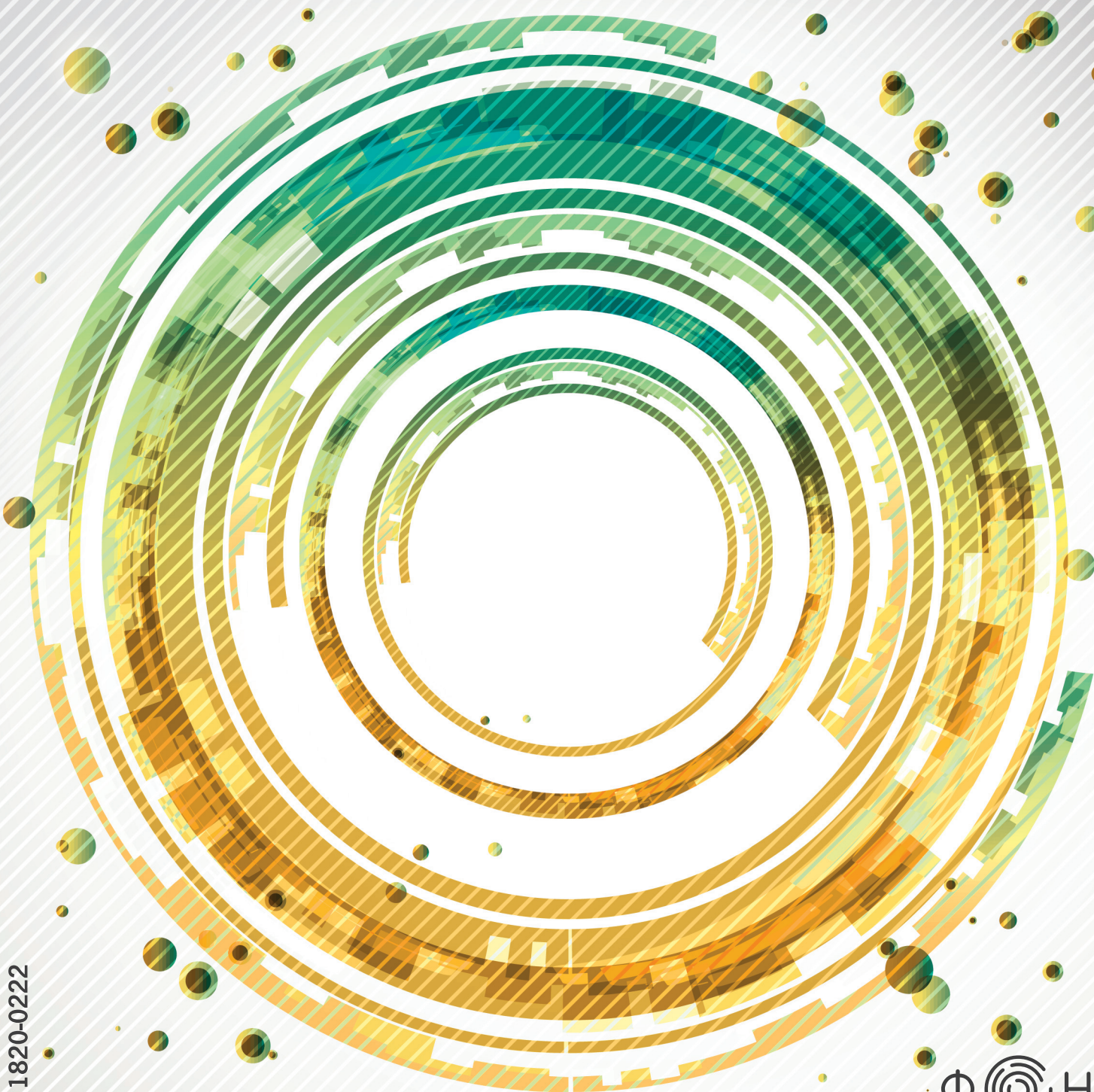


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УНИВЕРЗИТЕТ У БЕОГРАДУ
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Improvements in Organizing Public Procurement at the Local Self-Government Level in Serbia

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The issue of establishing offices for public procurement is very topical in Serbia, having in mind that 1,200 public procurement officers have been certified so far, entailing the need to set up an adequate structure as the operating field. It is also important to determine a correlation between public procurement offices and other organizational units within contracting authority. Further, it is necessary to determine how the public procurement offices at the local self-government level can help contracting authorities in a city/municipality, and in particular the scope of centralization of public procurement that public procurement offices in the city/municipality could conduct in the name and on behalf of local contracting authorities.

Keywords: public procurement, local Government, centralization, strategy, Serbia

1. Introduction

It is estimated that the share of public procurement in local self-government budgets in Serbia for 2011 was 20-25% on average, indicating the importance of public procurement in managing public finances at the local self-government level (1). Hence, improving the management and organization of public procurement has significant potential for savings and increasing the efficiency of local self-governments. In order to release this potential for savings and increase efficiency of the local self-government, public procurement must reach the quality management standard defined as „collection of good practices“.

A crucial factor in attaining quality management standard is introducing efficient organization of public procurement. According to applicable law, public procurement in Serbia features high level of decentralization (2). This means each direct/indirect budgetary beneficiary is a contracting authority and they make up some 12,000 contracting authorities in Serbia.

The Public Procurement Law (PPL) allows a contracting authority to “authorize another contracting authority to conduct public procurement in its name and on its behalf, or take certain actions in that procedure” (Article 29 of the PPL). The option to integrate public procurements creates a possibility to combine organizational models of decentralization and centralization of procurement in order to set the model best suited to the existing circumstances.

This paper begins with a description of quality management standard that public procurement offices at the local self-government level should attain. The second part focuses on organizing procurement so as to maximize advantages offered by centralization of public procurement in order to reach the quality management standard. In particular, it elaborates cases which do and which do not justify the approach of centralizing public procurement, which is most relevant to local self-governments in defining the concept of organization and operation of public procurement offices, having in mind that public procurement offices are the ones to implement the centralized public procurement. The conclusion summarizes recommendations to local self-governments concerning setting of the quality management standard and organization of public procurement offices.

2. Quality management standard

Quality management standard can be defined as “*collection of good practices*” or “*level of quality management that should be reached or sought*”. As for the organization of public procurement in local self-governments in Serbia, the concept of quality standard should be distinguished from “minimum standard” which is in compliance with the legislation. Quality management standard is a description of good practice in managing public procurements that leads to applying the principles and goals of public procurement (1).

Principles of public procurement are defined by the Public Procurement Law as: 1) principle of cost-effectiveness and efficiency, 2) principle of ensuring competition, 3) principle of transparency and 4) principle of equality of bidders (2).

Given that public procurement goals in Serbia are not specifically defined, we can resort to the definition of the US National Institute of Governmental Purchasing - NIGP:

“to satisfy the needs of contracting authority by the means of market responding to its requests by providing what is needed (i.e., the quality) when is needed (i.e., in a timely fashion) for a fair and reasonable consideration, while at the same time serving the long term state interests by minimizing business and technical risks, achieving socio-economic objectives, maximizing competition and maintaining high level of integrity” (1) Having in mind the stated principles and goals of public procurement, it is possible to define a general model of public procurement organization at the local self-government level in Serbia that enables its implementation. This model is designed on the basis of “good practice” in the EU countries, particularly Denmark, and is the goal that local self-governments in Serbia should strive to reach within the next 5 - 10 years. The Danish experience shows that transition from the level of management and organization featured by the present-day local self-government in Serbia to the level set as the goal, which will be elaborated below, brings huge savings and significantly increases efficiency in the work of local administration (1).

Quality management standard and organization of public procurement has the following traits.

Local self-government has a defined public procurement policy that covers all procurements in a city/municipality. Public procurement policy should be adopted by the city council and posted at the website of the city/municipality.

Public procurement policy has to include these elements: ban on political interference in both public procurement procedures and work of public procurement offices; adopting code of ethics in public procurements by city/municipal assembly; efficient mechanism to sanction the breaches of public procurement rules and code of ethics; clear distinction between procurements conducted by budgetary beneficiaries with or without assistance of public procurement offices and procurements conducted by public procurement service in the name and on behalf of contracting authorities.

Public procurement service at the local self-government level should be designed as a centre of public procurements expertise at the level of city/municipality. This service may be organized as a separate organizational unit reporting to the mayor, or as an organizational unit within a broader segment, such as the sector of finance.

The number, structure and qualification level of employees in this service should be directly dependent on the portfolio of the planned public procurements. It is also important that the city/municipality has its own medium-term strategy for selection, recruitment and training of employees in the public procurement service.

Public procurement service must have clearly defined tasks. The most important ones include: gathering and analyzing data on public procurements conducted on the city/municipality territory, overview of procurement plans for all budgetary beneficiaries, preparing annual procurement plans to be adopted by the city/municipality, regular reporting to relevant assembly on implementation of procurement plans.

Further, public procurement service should maintain standing communication with end users so as to involve them in the process as subjects whose needs are being satisfied by procurement, from the very beginning, including the defining of needs, up to the very last stage of public procurement, which is contract implementation.

An important task of the service is market research, conducted in order to identify relevant bidders and learn market prices of goods, services and works to be procured.

Public procurement service should provide advisory support to contracting authorities at the local self-government level when conducting public procurement procedures, or even engage itself in conducting such public procurement procedures for the sake of contracting authorities.

In another form of assistance to contracting authorities, the service should post on its website models of tender documentation, decisions and contracts for their further use by contracting authorities.

The service should also create its database on public procurements covering at least the following essential information: what was procured (goods, services, or works), the procedure, contract prices and names of bidders.

The Service should have regular communication and good cooperation with the Public Procurement Office of the Republic of Serbia to which it, inter alia, submits quarterly reports on conducted public procurement procedures.

The Service should also be actively engaged in raising awareness of contracting authorities in the city/municipality on the importance of introducing quality management standard and organization.

3. Centralized public procurement

Table 1 shows the structure of share of contracting authorities in categories of public institutions in health care, education and culture and local self-governments in the total number of concluded contracts, and the share in the total value of public procurement in 2011 (3).

Table 1.

Category of contracting authorities	Share in number of concluded PP contracts (%)	Share in total value of public procurement (%)
Public institutions	54	14
Local self-government	19	11

Source: Public Procurement Office: „Report on public procurements in the Republic of Serbia in 2011“, 2012 Table 1 shows that 73% contracting authorities procured 25% of total value of public procurement, indicating that these two categories of contracting authorities have most pronounced fragmentation in public procurement. Since most health care, education and culture institutions are under the authority of local self-governments, the question is whether the consolidation of procurement for the needs of schools, kindergartens, etc. at the level of the city/municipality would result in savings on the grounds of lower purchasing prices and more favorable terms of purchase.

The answer to this question requires a prior considering of situations that justify consolidation of public procurement, i.e., the preconditions for centralizing public procurement.

4. Preconditions for centralization OF Public procurement

Centralized procurement implies that procurements for several contracting authorities are not conducted separately, i.e., individually, but rather that the needs of contracting authorities are consolidated in order to conduct a single public procurement procedure and purchase the specified subject of procurement which will meet the needs of each contracting authority by quality, attributes and quantity (4).

It follows that a prerequisite for successful consolidated public procurement is that the needs of several contracting authorities for given procurement subject are corresponding in terms of attributes, quality and other features, except for the quantity. Otherwise, one or more contracting authorities will end up getting what

they do not need, thus missing the key objective of public procurement. The second prerequisite to be fulfilled for a justified consolidation of procurement is that it can bring about more benefits than individually conducted procurements, primarily concerning the price. Namely, the purchase of larger quantities enables the companies (bidders) to achieve the effect of “economies of scale”. The greater the effect of economies of scale in given procurement matter, the bigger the potential for savings by centralization.

In order to determine cases that justify conducting of centralized public procurement, it is necessary to examine potential relations of demand and supply that may emerge on the market.

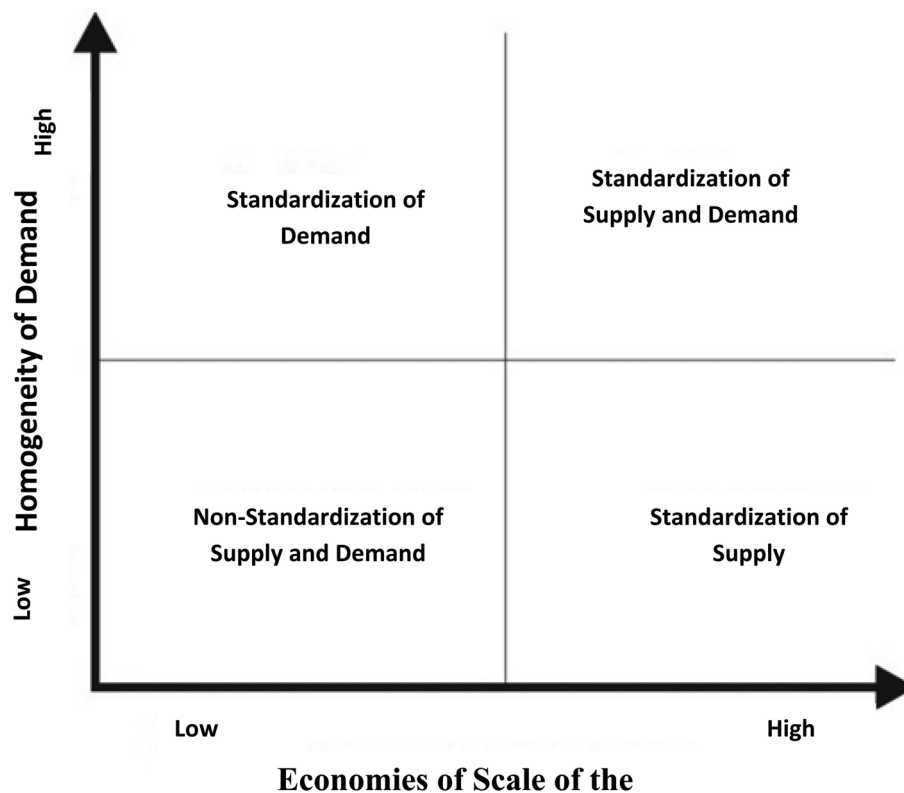


Figure 1. Interrelation between homogeneity of demand and economies of scale in supply

Source: OECD (2010), “Public Procurement Training for IPA Countries”, Sigma Training Manual, OECD

Where high homogeneity on the part of demand - which implies that contracting authorities have the same or very similar needs concerning attributes and quality of the goods, times and places of delivery, and other requirements - coincides with pronounced (high) economies of scale on the part of supply (Quadrant 4 in Figure 1), it is justified to consolidate public procurements for several contracting authorities.

Where contracting authorities have heterogeneous requirements concerning attributes or quality or terms (timelines and places of delivery, etc.), consolidating such procurements will not result in suiting their needs best. Thus, in cases of non-standardized requests (Quadrant 2, Figure 1), consolidating public procurements is not justified even if there are significant potentials to achieve economies of scale. Small series products (Quadrant 3, Figure 1) entail no economies of scale and therefore there is no reason to consolidate procurement, even where several contracting authorities intend to buy the same goods.

Finally, where there is neither economies of scale nor homogeneity on the part of demand nor possibilities to achieve “economies of scale”, there is certainly no reason to conduct consolidated public procurement (Quadrant 1, Figure 1); instead, contracting authorities should conduct individual public procurement procedures.

It can be derived that centralization of public procurement is justified in a relatively small number of cases where a high level of homogeneity of demand coincide with a pronounced effect of economies of scale.

5. Positive effects of public procurement centralization

Benefits that can be achieved by centralizing public procurement, provided it is justified, are manifold (5). Most important positive effects of centralization are as follows:

- 1) Higher purchasing power of contracting authority, placing it into a more favorable position vis-à-vis bidders;
- 2) Large potential to reduce purchase prices on the basis of achieving “economies of scale”;
- 3) Cutting transaction costs, since several procedures are being replaced by one;
- 4) Concentrating and upgrading knowledge (expertise) to the benefit of most contracting authorities;
- 5) Reducing the risk of unsuccessful procedure;
- 6) Better coordination and higher standardization level, and
- 7) Lower risk of favoring any particular bidder.

Aggregating demands, as the hallmark of centralization, ensures better bargaining position of buyer in relation to bidders. This creates an environment of tougher competition for the job on the part of supply and results in more favorable conditions of purchasing for the contracting authority.

Purchasing larger volumes enables the bidders to create effect of “economies of scale” for standardized products. With the higher share of fixed costs in overall production costs, producers will be able to go further with reducing the offered price.

The effects of centralization of public procurement on this basis can be seen in the case of public procurements conducted individually by elementary schools in the City of Niš in 2008, as opposed to procuring the same items in 2009 in a consolidated procedure by Public Procurement Division of the City of Niš City Administration, on behalf of the same category of contracting authorities, i.e., elementary schools (Table 2) (6).

Table 2. Comparative overview of purchase prices for decentralized and centralized public procurement –City of Niš

Subject of public procurement	Individual procurement*	Consolidated procurement*	Savings (%)
School chair	15.0	12.0	20
Computer desk	65.5	32.0	51
Computer configuration	197.5	182.0	8
Monitor	115.0	93.5	19
Computer configuration with monitor	314.0	253.0	20

* prices are in EUR, pursuant to average exchange rate of the National Bank of Serbia on the day of concluding contract

Savings by centralization of public procurement is also achieved on the grounds of reducing transaction costs, since several procedures for the same procurement subject are replaced by a single procedure. Consolidating several procedures into one results in significant savings in man/hours and allows employees to carry out other tasks important for the functioning of their organization. This increases the total amount of savings from centralization, as well as cost-effectiveness of public procurement procedure and efficiency in using resources of contracting authority, primarily human ones.

Concentrating knowledge by means of centralizing public procurement facilitates the use of the highest level expertise for broader range of contracting authorities covering not only those for whom the public procurement is conducted, but also the others who can approach the body in charge of centralized public procurement seeking advice, model of tender documentation or contract, etc.

Centralized conducting of public procurement has another key advantage in significantly reducing the risk of cancelling public procurement procedure due to non-compliance. Given that centralized procurement, as a rule, is conducted by most competent experts commissioned for the needs of several contracting authorities, it is more likely that tender documentation will be better prepared in terms of quantifying the quality criteria and other elements and that the procedure will be duly conducted, than if each contracting authority conducts its own procedure. Reducing the risk of repeating the procedure contributes to increased cost-effectiveness of public procurement measured by spent man/hours, and also to costs stemming from disruptions in supply and a regular operation of contracting authority (public company, school, kindergarten, hospital), and this all reflects on the end-users – citizens.

Centralization achieves better coordination and higher level of standardization among contracting authorities. Individual contracting authorities, either autonomous or belonging to a larger system, typically possess specialized knowledge. However, without an efficient exchange of information and without mutual sharing of experience and information, the efficiency of the system as a whole will be limited.

Centralization enables updating information and quicker finding solutions to be used by all parties within the system. Since certain products and services are interlinked, such as PCs and printers, banking and insuring services, there is the need for exchanging information about associated and related markets, intensity of competition on those markets, and potential bidders. It is also recommended to use the central level to seek and identify solutions for the best scoring system and defining contractual requirements, which will altogether contribute to a greater efficiency of public procurement from the aspect of the system as a whole. Standardization is a major factor in reducing purchase prices by means of enabling consolidation of procurement of goods and services on the part of the demand (the so-called buying “in bulk”) allowing at the same time the producers to produce large quantities of products with the same attributes, thus attaining lower unit costs based on the effect of “economies of scale”.

In addition, centralization of public procurement contributes to reducing the risk of favouring certain hand-picked bidders. Tailoring specifications and criteria for the purpose of favoring specific bidder is most often based on local specificities in terms of delivery, product attributes, etc. “Tailoring” specifications, criteria and terms to a hand-picked bidder is revealed more easily at the centralized level than when conducting a number of smaller procurements.

Centralized conducting of public procurement is justified in specific instances that are not characterized by homogeneity of demand or by economies of scale on the part of supply.

One such example is strategic procurement. Strategic procurements are those that have far-reaching implications on the economy, or ones having a broader social impact. It is reasonable to apply centralization in the above areas, exactly because of the effect of such procurements. This applies to areas such as: health care, which requires central coordination in order to ensure consistent standards, then education, security and defense sector, and environment which requires ensuring a comprehensive and coordinated approach. Finally, centralization of public procurement is also justified in emergency situations such as natural disasters, earthquakes, epidemics, etc.

In emergency situations, centralizing public procurement brings several advantages (4):

- 1) Ensures better coordination of procurement;
- 2) Reduces risk of purchasing goods, services or works of inadequate attributes and/or quality, and
- 3) Reduces the risk of corruption in the management of the approved emergency funds and increases possibilities to reveal possible misuse, as shown by the case of procuring the vaccine against the swine flu in 2009 (5).

6. Disadvantages of centralized public procurement

Centralization of public procurement has certain flaws when compared to the decentralized procurement system. Key disadvantages of centralized procurements are (7):

- 1) Aggregation of demand may lead to aggregation of supply, so that eventually only a small group of bidders or even a single bidder is able to meet a specific need. This case entails a risk that few existing bidders can easily enter into collusion on price or other terms that, in the end, are less favorable than in case of in-

dividual procurements. Likewise, the bargaining position of bidders improves in proportion to the decline in their number, and it is least favorable where only a single bidder is capable of meeting the aggregated public procurement;

2) Large procurements, as a rule, are an obstacle for small and medium enterprises, although these are often quite capable of offering superior and more innovative solutions in certain market segments (niches);

3) A smaller number of large procurements entails a risk for those who lose contract to end up being excluded from a significant portion of the market for a longer period of time. Namely, when contracting authorities purchase individually, each for themselves, if a bidder loses one tender it still has a fair chance, provided that it adjusts its bid, to win a tender issued by another contracting authority. In consolidated procurements, bidders who lose contract end up with a smaller part of the available demand than under the scenario without centralization. The bigger share of demand covered by centralization, the greater the risk of elimination from the market for a period of time (for the duration of contract);

4) Where contracting authority relies on a single large supplier who also deals with other major clients of its own, this may give the bidder a better bargaining position relative to contracting authority and may turn the tables in the bargaining to the detriment of contracting authority.

7. Recommendations for centralization

Centralization of public procurement can increase cost-effectiveness of public procurement. A positive impact of centralization to cost-effectiveness of public procurement is reflected primarily in reducing the purchase prices and the transaction costs. In addition, centralization has a positive impact in strategic procurement and in certain emergency situations.

However, circumstances under which consolidation of public procurement has positive impact are not widespread, so that the share of public procurement conducted by centralized bodies in the total value of procurements in the EU countries is approximately 5% (8).

If centralization of public procurement is conducted under inadequate terms, the negative impact may be manifold: inappropriate "value for money" for contracting authority and creation of small number of big bidders who may easily collude and create non-competitive conditions at the expense of the contracting authority. It is therefore important to clearly determine, on the basis of market analysis, the items whose centralized procurement is justified and to define measures to prevent the decrease in the participation of small and medium enterprises and subsequent waning of competition.

Therefore, it is very important that local self-government properly determine which goods and services should be purchased by public procurement service on behalf of other contracting authorities, and also in which cases the Service should provide them another kind of assistance, most notably the advisory one.

Conclusion

Local self-governments in Serbia in the coming period should prepare their respective medium-term strategies for the next 5 years, in terms of the way in which public procurement offices will be set up. This is turning into necessity having in mind that, so far, a substantial number of public procurement officers have been certified and they should now be appropriately organized into adequate public procurement offices at the level of local self-governments. Well designed public procurement strategies and policies will facilitate reaching a quality management standard in public procurements coupled with appropriate organizational structure of public procurement offices in cities and municipalities, and this will in turn result in savings and increase in the efficiency of operation of local self-governments.

When designing the organization and operation of public procurement offices, special attention should be given to exploiting potentials for centralization of public procurements in order to achieve a positive impact while minimizing the risks inherent to centralization. This can be accomplished if each procurement subject is carefully considered in terms of fulfilling the prerequisites for centralization, instead of opting for an indiscriminate application of this method. The limitation of conditions conducive to application of centralization is also indicated by the fact that mere 5% of total value of public procurements in EU Member States is realized by central bodies for public procurement. Lastly, it is important to warn that centralization may have a substantial negative impact and cause long-term disruptions in the market, if applied where the adequate preconditions were not fulfilled.

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