Chapter 4  
Tendering Methodology

Introduction

One of the most important aspects of contract management is the initial selection of an appropriate contractor to perform the contract. There are two frequently used methods for achieving this which we will examine in this chapter. These are:

- Open and Closed Tendering - a formal process whereby contractors are invited from the market place (open) or from a list of re qualified and approved providers (closed) to submit firm and unequivocal offers.

Many contracts officers use ‘open tendering’ as a means of selecting the ‘right’ contractor for any type of contract but when the ‘contract’ is a major, possibly lengthy, contract, there are some powerful arguments against that process. We will examine some of the considerations around this argument.

Closed Tendering

In order to ensure that only those contractors are invited to bid whose technical capability and management competence are judged adequate for a defined type of work, a specific list of proposed contractors for each tender should be selected from the organisation’s approved list if it has one. Much would depend here on the organisation’s history of awarding contracts of a similar nature to the one that is in the process of being developed and awarded.

However, an estimated €433 billion (£379 billion) is spent outside procurement departments’ approved routes at European companies, according to recent research. Although 95% of organisations have set up preferred contractor lists, just half of the 162 firms surveyed said they had adequate controls to ensure staff who buy use them. On average, there was only 66 per cent compliance to preferred contractor lists and 64 per cent compliance with contracted rates.

It is inadvisable to invite too many contractors to bid for a given contract in view of the considerable costs incurred by contractors in preparing tenders, which will ultimately be reflected in their prices, not to mention the time and effort spent by the buying organisation itself in evaluating the bids. There is no ‘ideal’ number of potential contractors (tenderers) but many contracts officers would say that three to six is sufficient.
In tendering for major works and services where the local contractor capacity may be limited, it may be advisable to consider inviting bids from international contractors who are not already established in the country. In such cases a specific prequalification exercise should be carried out in order to select a suitable short list of contractors who are technically competent and interested in bidding for the work.

When a project/contract involves complex or new technology it is sometimes advisable to ask a limited number of pre-selected contractors to prepare a feasibility study at a lump sum price, agreed up front, usually based on effort required. On the basis of these feasibility/optimisation studies, the buying organisation can formulate much more cost effectively the scope of works to be tendered subsequently, and contractors run a much lower risk when submitting bids.

The cost of such pre-tendering feasibility studies should be only a fraction of the overall project costs but, because of the better understanding of the project requirements, could result in significant savings on contracting costs.

Open Tendering

Arguments in favour of open tendering focus on the idea that requesting bids from only a small number of pre-qualified bidders will not stimulate the competitive pressures that should exist in a supply market and that, only by stimulating these pressures will the contracts officer obtain the ‘best’ deal. The counter-argument is that there is no point in allowing potential contractors who are not capable of completing the contract satisfactorily to submit proposals because, if they are not experienced in the type of work required, they may indulge in ‘kite flying’. This would only serve as a waste of the contracts officer’s time.

When considering open tendering it should be remembered that public sector organisations and private companies providing public services or utilities (e.g. water companies or railway companies) will be constrained by EU Procurement Directives to use open tendering for contracts that are likely to be above a certain price threshold although there are exceptions. There is the restricted procedure which comprises a two-stage process whereby contractors need to pre-qualify before being allowed to put their bid forward. This procedure is most often employed when there is a need to establish whether or not firms bidding possess the relevant skills or qualifications and would appear to support the perceived advantages of the RFP process detailed above.

It is difficult, if not impossible, to resolve the argument between open tendering and the closed approach but for major, expensive contracts, it would appear that the closed approach has the major advantage of going some way towards ensuring that only contractors that are experienced in and knowledgeable of, the work will be asked to bid. This would go some way towards ensuring that the bid evaluation process should be more straightforward and that time will not be wasted in evaluating bids that
originate from potential contractors that would be incapable of performing the contract satisfactorily. Certainly, appraisal of contractors/contractors will be necessary at some stage and carrying it out before the tendering process begins, so that only qualified contractors are requested to provide bids, should provide the advantages mentioned above.

Tendering is potentially a very expensive process. This expense may be justified by the savings and other benefits it may bring to the organisation but there are some potentially major problems with tendering:

**Open Tendering and Total Quality Conflicts**

The total quality concept suggests that the policies of single sourcing and ‘partnership’ be adopted so that the contracts officer may work with a chosen contractor over time to improve quality and develop a ‘total quality’ approach throughout the supply chain. Tendering may be perceived as being in conflict with this aim for the following reasons:

- Emphasis on price as a key variable – the total quality ideal suggests that total cost of ownership is more important than consideration of price alone.

- Need for very tight specification – this goes against the total quality focus on performance specifications

- Emphasis on lowest price, not lowest cost of supply.

- The lowest bidder is accepted so contractor base widens

- The total quality approach tends to lead to a reduction of the supply base.

It is a widely held opinion that the use of Approved Lists can reduce or eliminate these areas of conflict. This is because the evaluation process leading to contractors generally being included in the approved list should focus on quality.

**Disadvantages of Open Tendering**

- Contractors may quote a price that is too low leading to subsequent disputes if goods or services are unsatisfactory.

- Tendering is unsuitable for certain contracts where consultation with one or more of the more favourable tenderers is often essential in order to clear up some technical points.

- The tendering process is too slow for emergencies.

- Where tenderers are accepted on the principle of the lowest price, credit may not be given to contractors for past performance.
Tendering can be an expensive procedure for the contracts officer.

Tendering is expensive for the contractor due to the, sometimes complex, process of submitting bids.

**Technical and Commercial Evaluations (Split Bids)**

Normally bids will be jointly evaluated for technical and commercial considerations but in some it may be advisable to separate the technical evaluation from the commercial one. The idea behind split bids is that the user will evaluate the technical offer and will rank them in order of their technical scores. Then the commercial offer is opened by the Contracts Officer. The contractor who is technically acceptable and offers the lowest price is awarded the contract. This approach, which is popular in some industries (oil and gas) is designed to avoid “gold plating” whereby the user opts for a technical solution that goes beyond what is really fit for purpose and thus increase costs. The main draw back of this approach is that contractors tend to focus on the bear minimum in terms of quality, safety etc so that they are just compliant and they may work on very small profit margins ands then seek income via the use of minor work orders and variations.

The two aspects of bid evaluation are as follows:

**Commercial Issues**

- **Cost and Price** (including discounts, price breaks, etc.)
- **Quantity** – care is required over quantities required on a regular basis such as every week or month.
- **Delivery time(s)** – again, this is particularly important when repeat deliveries of an item are required by the contracts officer
- **Whether the vendor is offering direct ordering or call-off facility**
- **Method and terms of payment** – this is always important for any contract although higher value items such as buildings or items of plant and machinery may well have either (or both!) of the following clauses attached to their contract:
  - Retention clause
  - Stage payments
- **Duration and terms of any guarantee or warranty** – the terms and time period of any guarantees offered by vendors as part of the bidding process may be evaluated and compared as part of that process.
- **Maintenance and after-sales costs** – these will only apply to contracts of equipment

- **Assembly/installation costs** – again, these will only apply to contracts of equipment or buildings

- **Is any price escalation formula envisaged** – these have the advantages of being fair to both parties. Accurately monitoring inflation in a manner that is relevant to the specific contract. Their only real disadvantage is that they can be unwieldy and time-consuming to monitor.

- **Results of life-cycle costing or investment appraisal** – this mainly applies to capital items which, by their very nature, are kept by buying organisations for many years and, during this time, the item’s ‘life-cycle’, costs will attach to them. Examples of the kind of costs under consideration are:
  - Cost of spares
  - Cost of maintenance (allied to projected service intervals)

**Technical Issues**

There is a great amount of variety here in terms of different types of items having different bid evaluation requirements. Bids for branded items will usually be evaluated simply against the variables of price and availability. However, items made especially for the buying organisation (e.g. components used in manufacturing companies) will require full evaluation of these technical aspects.

- **Quality standards** – the importance of evaluating the relative quality of product offered by different contractors cannot be overstated.

- **The extent to which the product matches the specification** – for items that are likely to have a fundamental effect on the operation of the contracts officer’s company’s finished product or have a critical supporting role of some sort it is vital that specifications are carefully considered, as follows:
  - Specifications lower than requested; these might, upon consideration, be accepted and might give the contracts officer a lower price and/or better availability. This kind of evaluation must be made by technical personnel.
  - Specifications higher than requested; these might be accepted because they might be able to improve the contracts officer’s company’s product or service such as to provide competitive advantage although this may mean higher prices.
The quality and appropriateness of the specification will go a long way towards determining how successful the item is and will have a major effect on input costs.

- **Test results** – it may well be worth having samples of items tested before a decision to contract is made.

- **Variation from specification** – this refers to situations where contractors, in effect, say “we cannot supply exactly what we want but we can supply this item that we believe will satisfy your requirements”. The usual contracts officer’s reaction would be to ignore such a bid but it could be worth investigating.

- **Availability period for spares** – for many capital items, this can be critical.

- **Terms and conditions of contract.**

A good system for analysing/evaluating quotations is to use a scorecard or bid tabulation, in the form of a grid or matrix shown below:

<table>
<thead>
<tr>
<th>Selection criteria</th>
<th>Contractor A</th>
<th>Contractor B</th>
<th>Contractor C</th>
</tr>
</thead>
<tbody>
<tr>
<td>price</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>delivery period</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>quality</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>etc.</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

This bid tabulation allows we to see at a glance how potential sources compare.

**Appraisal of Contractors**

Appraisal of contractors should follow a well-defined process such as is described below and selection of the ‘right’ contractor will include consideration of the well-known Ray Carters 9 C’s model for contractor selection. Having an effective selection process, weighting systems, validity and evidence is critical to the process. The validity of the evidence submitted by the contractor needs to be verified. This is measured in the model by reviewing and assessing the information provided against the following key statements:
The validity or quality of the evidence is scored and is then reflected in the overall score awarded to the contractor.

**Critical Selection Criteria for Contractors**

The extent and rigour with which the well-known 9Cs process is applied is dependent upon a number of factors, including:

- Contract risk.
- Contract spend.
- Criticality of contract outcome.
- Complexity of work required to complete the contract successfully.

The higher the total values of these variables, the greater should be the extent and rigour of the appraisal process. The 9Cs process is as follows:

- **Competence**
  - This is the ability of the contractor to perform the contract.

- **Capacity**
‘To meet present and future demands’: if the contractor does not have sufficient capacity, the timely completion of the contract is unlikely. Evidence of such capacity might be as follows:

- **Order book** – what is the state of the contractor’s order book?
- **Forecasts** – what future business does the contractor forecast that it is likely to obtain?
- **Administrative resources** – Does the contractor have the necessary systems and procedures to support good quality and service?

**Consistency**

This is the contractor’s ability to provide consistent levels of quality and services. Evidence of this would arise from:

- **Contractor’s reputation**
- **Outputs** – the buying organisation’s Quality Manager should inspect a sample of the contractor’s work output to ascertain product quality at first hand.
- **History** – it is useful for the contracts officer to request references relating to other customers from the contractor.

**Control of Key Processes**

It is important to try to gain a ‘feel’ for how the contractor manages and controls these ‘key’ processes. Each is important, in its own way, in terms of ensuring that they are able to supply the goods in line with the 5 ‘rights’ of procurement. Examples of how each of these might contribute to the achievement of the ‘5 rights’ might include:

- **Inventory** – if the contractor carries enough stock they are likely to be able to supply the right quantity at the right time although carrying too much stock will adversely affect their ability to supply at the right price because of excessive input costs.
- **Quality** – control of the contractor’s quality processes enables them to supply at the right quality.
- **Operations** – good control of operations will enable the contractor to supply at the right time and in the right quantity and will have an effect on the right quality.
- **Procurement** – companies are heavily dependent on key contractors to provide good quality, service, innovation, etc., while keeping costs down.
- **Marketing** and to a greater extent, **distribution** – good, efficient processes here will allow the contractor to supply at the right time and in the right quantity.
- **HSE** – good systems and procedures here, such as a good safety record will contribute to the morale and motivation of the contractor’s workforce.
Cost

A full analysis should be carried out to examine the following:

- **Profit** – is the contractor profitable?
- **Variable costs** – costs directly associated with production and which increase with production volume.
- **Fixed costs** – The contracts officer should assess and analyse the specific level of such contribution.
- **Margins** – what is the contractor’s profit margin
- **Break-even point** – this is the quantity of production where total costs equal revenue. Above this point the contractor makes a profit and below this, a loss.

Commitment to Quality

Does the contractor have a quality policy and a commitment to its success? This may be assessed by examination of whether the contractor used any or all of the following.

- **SPC** – Statistical Process Control
- **TQM** – Total Quality Management.
- **QC** – Quality Control – what specific measures does the contractor employ to measure the quality of output?
- **CIP** – Constant Improvement Processes.
- **Culture and values** – does the contractor have an organisational culture and a set of corporate values, communicated to everyone who works there, which focus on quality and its achievement/improvement at all times?
- **ISO 9001/14001** – is the contractor accredited to either of these standards?

Clean

Contractors and their products/services should satisfy legislative and other environmental requirements such as ISO 14001

Culture and Relationships

Contractors and client should share similar values.

Cash/Finance

It is important that any contractor has ‘financial stability’ and evidence of this might be taken from:

- Balance sheet
- Profit and loss account
- Credit rating
- Reputation – what kind of reputation for, e.g. financial propriety or profitability, does the contractor have?

**Contract Execution/Completion**

Once the highest scoring contractor has been selected and the contract awarded, its progress must be monitored and managed up to its conclusion. The selection of an effective contractor is by no means the end of the process and is, in fact, only a small part. This will be dealt with in some depth in other parts of this book, notably in chapters 6, 9 and 14

**Chapter summary**

In this chapter we have considered the means of tendering, both ‘closed’ and ‘open’ that are widely used in procurement. Both methods have advantages and disadvantages but the closed method can be seen to have some advantages over the open method when we are dealing with complex, potentially long-lasting, contracts.

We have also considered the appraisal of potential contractors that often takes place prior to the approved/closed process in order to ensure that only suitable contractors submit bids.

**Case Study**

The Pharmaceutical Agency is a wholly owned government organisation, set up to manage and administer the collection of royalty payments from drug companies operating within the UK. The Agency is about to embark upon a complete upgrade of its payments system. This will involve integrating from a well established (but traditional) clerical based system to a fully integrated IT based system.

The key customers of this new system include the CEO, plus Finance and Operations, both headed by strong personalities who have already started to have "initial" discussions with several of the approved major IT providers in the market place. The Agency is under pressure to demonstrate its added value and the need to make things happen quickly and effectively. The Head of Finance states "we need to get this project off the ground as soon as possible; we should use the scope of work provided by our approved providers in the market place. They have experience of implementing similar systems and we could start the process of closed tendering immediately".

The Head of the Agencies legal section has highlighted the fact that given the value of this project, the contract must go through the full rigour of the EU “Open” contracting process. She states "this will no doubt frustrate the customer, alienate the contractors, but it has to be done and we have no choice in the matter".
The Head of Operations is keen to get the project up and running, but he favours extending the scope of the existing IT support contract, currently with Delta Consultants. This is a medium sized organisation, specialising in providing IT consultants support to the public sector. The company has a standard consultancy contract with Delta. The Head of Operations states “why go through the whole “open” or indeed the “closed” tender process when we think we already have an adequate contractor in place?”

**Task**

As a consultant what advise would you give to the Agencies CEO?