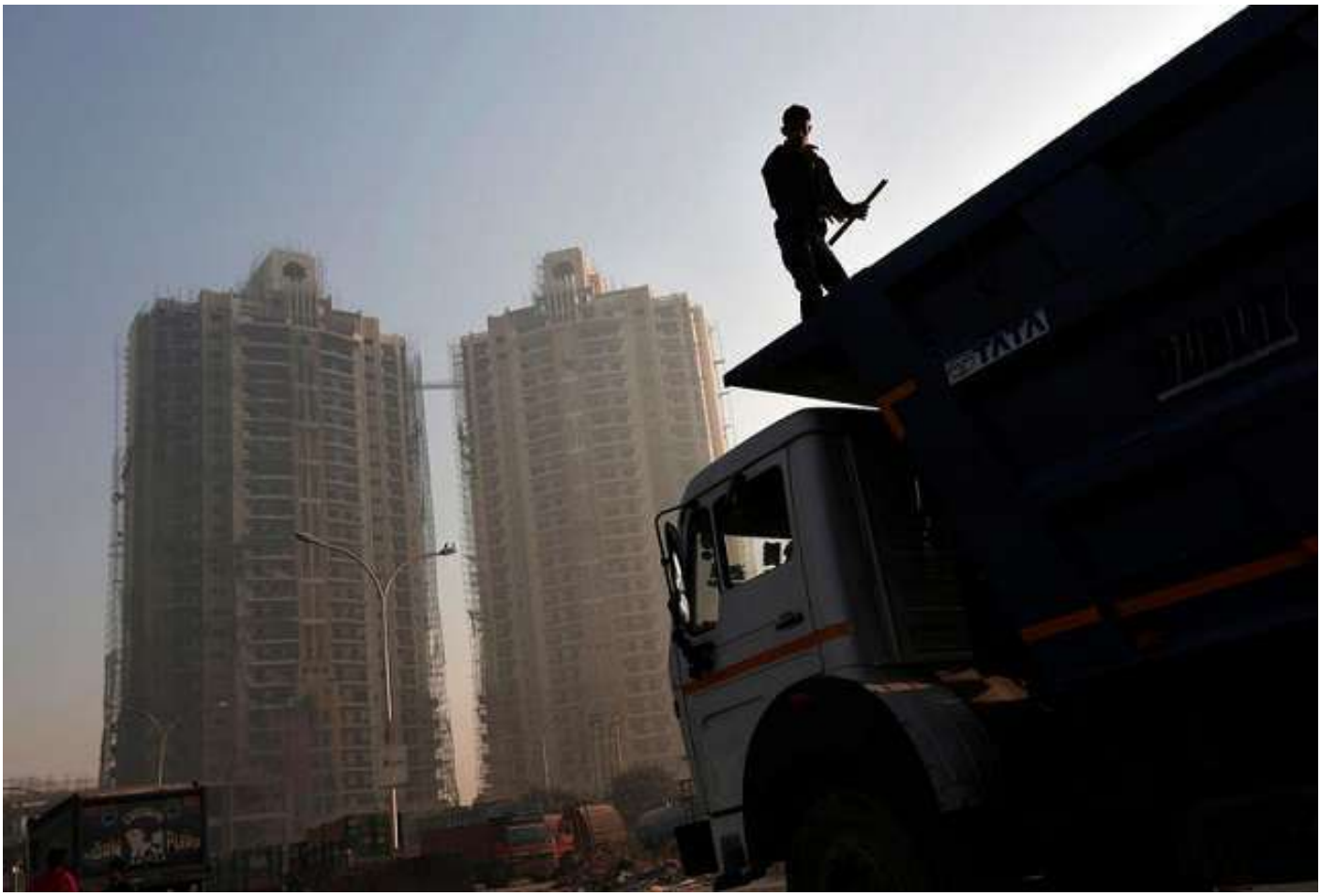
October 31, 2016 | Reji Kumar Pillai (http://infracircle.vccircle.com/author/reji-kumar-pillai/) | infra@vccircle.com (mailto:infra@vccircle.com)

The flip side of 'lowest bidder wins' tender process



To build a smarter India, we need smart and large companies. Photo by Reuters.

India will continue to be a developing country even in the 22nd century unless we find a framework to move beyond the process of buying from the lowest bidder to what is best in the national interest. If you look around, you will realise that we lack quality infrastructure and services because government agencies have to go through a process of tendering and the lowest bidder

wins the contract. The perils of this system are numerous and the damages it causes to the society are often beyond comprehension. But one thing is very clear to all—the lifecycle cost of anything bought under the lowest bid process is always higher than the best that could be bought at a reasonable price. Agencies both public and private struggle to transcend the barriers of the limitations imposed by the transparent bidding process and there are only limited success stories. Some of the precautions that purchasers take to prevent non-serious bidders or those who might offer inferior products and services and why these measures are not foolproof are summarised in the next paragraphs.

Qualifying criteria: Purchasers often put in stringent qualifying criteria for bidders. But bidders with connections in the right places will get that diluted, particularly in government tenders. Another way around is to produce fake certificates from unknown clients in faraway countries or from group companies. In certain cases they make consortiums with larger firms who will have no direct role in the project execution. In a classic case, one purchaser introduced the clause of 'CMMI Level 4 and ISO-9002' as qualifying requirements and at junior levels someone got the 'and' replaced with 'or' making it easy for non-serious entities to come in.

Techno-commercial evaluation: It is another popular practice to assign higher weightage for technical bid than financial bid. In this process, one technical bid and one price bid are submitted by each bidder in separate sealed covers. The purchaser evaluates all technical bids and assigns scores. Bids that do not meet minimum scores are rejected. Price bids of technically sound bidders are opened. The technical bids are often given 75% weightage and price bids 25% weightage. In some cases these ratios may be 60:40 or 70:30. Many times even large firms for the sake of making an entry in a new sector or new enterprise do drop their prices abnormally. Even when the technical bids have 75% or 80% weightage, if a bidder quotes half of the estimated cost, the process fails. There are numerous examples for this.

Stringent payment terms and penalty clauses: Purchasers put in very strict payment terms and penalty clauses in tenders to ensure only financially sound firms participate in the tender. But in reality, these measures often prevents large firms who have to report their quarterly results from staying away from projects where the cash flow will be negative for the first five-six quarters. Then again, the bidding will get reduced to only fraudsters' who knows how to 'manage' to get things done.

Limited tenders: In this system, the bidding process is limited to a set of reputed bidders. While it is easy for private firms to select those reputed bidders, it not so easy in the government sector. People with right contacts manage to get in the list.

Swiss Challenge: This is a lesser known process of procurement where technology interventions are high and the purchaser has no in-house capabilities to prepare the detailed bidding documents and cost estimates. In this case, the purchaser invites a leading entity in the domain and requests to prepare the detailed project report with bill of materials and cost estimates. The report thus prepared will be put up by

the purchaser on the reverse bidding process. Other parties who can supply the same quality and quantity of products and services at a cheaper cost than what the first party has estimated may submit their offers. The purchaser gives the right to the first party to match the lowest prices received. Though it looks flawless, in practice often the first party gets the order and hence competitors evince slim interest. In India, the Karnataka government has executed some projects through the Swiss Challenge method.

L2 bid: This is a system invented in Portugal. In this process, always the second lowest bidder wins the bidding process. This is rather more of a game theory than a competitive bidding—keep guessing who will play the spoilsport. Here again bidders can make cartels and can always find a L1 bidder to support another ones L2 bid.

While this dilemma of the Purchaser, particularly the Government Purchaser has no simple solutions in sight, the successful companies in the private sector often invite limited tenders from credible agencies and there after negotiate the price and terms with the ones who offered the superior quality and try to bring down the cost as much as possible to the lowest bid received. This procedure used to be followed by some successful PSUs in the past. In the two bid system, they used to evaluate the technical bids and assign T1, T2, T3 etc based on the technical scores. After price bid opening, they used to invite the T1 bidder to match the L1 price or resubmit the best offer. If T1 rejects the offer the chance goes to T2 and so on. The objective was to buy from the top quality bidders at the lowest possible price. Unfortunately vigilance departments interfered with the argument that this process allows subjectivity and opens the door for corruption. Today in none of the public sector procurement they are not allowed to negotiate with L2 or L3 bidders.

Way forward: In order to build smart cities, smart grids, smart transportation systems and other public infrastructure like the way it is built in developed countries, we should transcend the limitations of the L1 bidding system. In all new infrastructure, there is an increased share of technology play and in most cases purchasers have no in-house expertise to analyse what is best among all available in the market suited to their business requirements, nor they have the capabilities to efficiently maintain what they are buying. The best way forward is to enter into a long-term partnership with technology companies who will build and maintain the systems on mutually agreed terms, rather than buying from vendors or contractors whose interest will be just to supply or finish the work and walk away. When an agency knows they have to operate and maintain the equipment or systems for 10 years or more, the chances of receiving substandard products are rare.

If we have to build quality infrastructure, we need to use quality tools which require huge initial investments. Most firms struggling to get a piece of the cake from the smart city projects do not have deep pockets to invest in state of the art equipment. Neither these firms have resources to train their workforce. We should take a very conscious decision at this stage while promoting entrepreneurship—every third person in the country need not be a contractor making roads or buildings. A hundred large firms such as

Larsen and Tubro Ltd are good enough to make quality infrastructure in the country. Such large firms can afford to deploy best-in-class equipment and machinery, train millions of workers with appropriate skills needed for the job and can also pay them decent salaries on time. Employees and workers of small contractors are often exploited. To build a smarter India, we need smart and large companies and also need to invent innovative procurement process to buy the best at reasonable cost.

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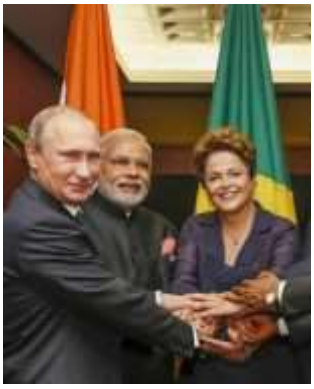

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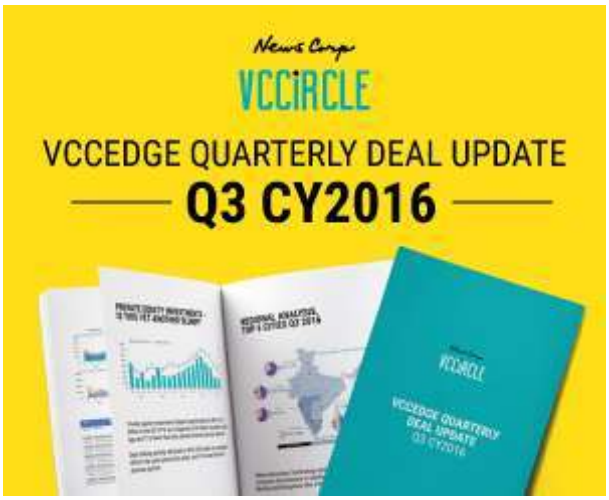

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