



# EFFECTS OF PROCUREMENT GOVERNANCE, TRANSACTION COSTS TO CONTRACTING BUSINESS AND TENDING PROCESS IN NIGERIA.

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## Abstract

Public sector organisations undergo a procurement process to select a competent consultant and character to carry out the construction work using pre-determined selection criteria or guideline as stated by the public procurement Act 2007. The Act objectives are to provide the best value for money, economy, transparency, accountability and competition among bidder (PPA 2007). However, it must be noted that the Act has not taken into account the transaction costs incurred with participation in the tender processes due to the varied activities undertaken by clients, consultant and contractors. The aim of the study is to assess the effects of procurement governance transaction costs with respect to contracting business and tendering process. A multi-stage stratified random sampling procedure was used in selecting the respondents from construction firms within some selected states of the North-west zone of Nigeria (sokoto, kaduna and kebbi) that are registered in the bureau of public procurement database of contractors that have participated in any federal government tendering process as respondents of the study. One hundred and thirty five (135) responses were retrieved from various respondents. Using structural equation model (SEM), an analytical tool, using procurement governance and transaction cost as independent variable, with tendering process as intervening variable and contracting business as dependent variable, the result of research shows that transaction cost variable and procurement governance has significant influence toward contracting business, procurement governance variable has indirect influence toward contracting business through tendering process with significance influence. The research recommended that both client and contractors can reduce procurement governance effect by promoting: fairness in the award of contract to the lowest bidder; harmonious relationship between project client and contractor; sound knowledge on construction project procurement by

both parties and more attention on how they can improve their bidding strategies based on the procurement governance guidelines.

**KEYWORDS:** contracting business, construction projects, procurement Act 2007, transaction costs, tendering and transaction costs theory.

## INTRODUCTION.

In construction projects in Nigeria, clients undergo a procurement process to select a competent consultant and contractor to carry out the construction work using pre-determined selection criteria (Ogunsanmi, 2013; Peter, love,devis and Edwards, 2008; Mc whirt, Adh, Jennifer & Kelly, 2011) or guideline as stated by the public procurement Act 2007. The Act objectives are to provide the best value for money, economy, transparency, accountability and competition among bidders (PPA 20P7).

To ensure aggregate procurement, there is need to obtain economies of scale and reduce procurement costs (PPA 2007). However, it must be noted that the Act has not taken into account the transaction costs incurred with participation in the tender processes due to the varied activities undertaken by clients, consultant and contractors. It's a common fact that contractors devote considerable time and resources in determining the owner (Like, Arditi & Wang 2013). The client is interested mostly in the price quoted by contractors.

This price is the rate at which exchange will take place. Price to the contractor becomes a cost to the owner (Hillebrandt & Hughes, 2000). However, the actual cost of a construction project is not the only production cost. The cost of preparing a bidding document, estimating, drawing up a contract condition, advertisements, administrative aspects and dealing with any deviations from construction (Arbitration or Dispute resolution) are also important. In construction these cost are incurred by clients, consultant or contractors as the case may be.

The costs are known as transaction costs in the study of economics a transaction occurs when a goods, workers or services is transferred across a technologically separable interface (Williamson, 1987). Similarly, in construction using the PPA ( 2007), a services or goods are supplied to the client in return to a stated amount agreed by client.

However, it is not clear whether transaction costs characteristics were reduced by the use of the PPA since they are not defined systematically(Li at.al 2013). Also, it is not clear or understood weather transaction cost have positive or negative impact on the tendering process phases of a construction project. Various researchers have proven the existence of such cost in the construction industry and other areas of studies. These to include construction related topics, projects organisation and governance, ( Piertoforte, 1997; Turner & Keegan, 2001; winch, 2001; Muller & Turner, 2005; job in,2008), Agriculture ( Hip, 2015; Ferris 2005 ) and marketing and sub-contracting (Eccles,1981; Gunarson & Levittown 1982; reve & Levittown, 1984; winch, 1989; constantion, 2001).

Most of the aforementioned researchers on transaction costs indicated how stakeholders are face with challenges due to the costs incurred during transaction by both parties. These leads to higher costs of construction, less economic efficiency in the procurement chain system. For instance in the United kingdom UK about 0.57% of the total project value was identified to be spending as the bid costs by the contractors weather they win or lose in a bidding processes ( Hughes,2016). This is against the fact that, such costs make a significant impact on the retained operating turnover for the construction firm or company.

Worthy of note in the construction transaction in Nigeria is that they offer various transaction costs characteristics (Lingered, Hughes & Chinook,1998: costantino, Pellegrino & piertoforte, 2011; Enshassi,Mohamed & El-Karriri, 2010; thomassen,vassbo, solheim-kiel & Lohne, 2016; Li , Aridit, & Wang, 2012; Li et.al, 2013 ) in respects of their Assets specificity, transaction environment uncertainties, contractors behaviour, owners behaviour and project management efficiency that can have positive or negative impact on tendering process in Nigeria. Objective of this study is to assess the effect of procurement governance ( PPA), transaction costs to contracting business and tendering process in Nigeria. Tendering process considered in this study are preliminary bids examination ( technical bid phase I.e eligibility requirements), detailed evaluation ( Financial bid phase), bids comparison, post qualification verification and bids evaluation report phases.

Thus, the primary research hypothesis of this study are:

1. Procurement governance has a significant effect on transaction costs
2. Transaction costs has a significant effect on contracting business
3. Procurement governance has a significant effect on contracting business
4. Tendering process mediates the effect of procurement governance on contracting business.
5. Procurement governance has a significant effect on tendering process

### **Translation costs theory (theoretical Review).**

Transaction costs economics theory has become a predominant theoretical framework (model) for explaining organisational boundary decision. Like most influential theories, transaction costs theory was not fully developed at the outset. It has been and continues to be retained and reformulated, corrected and expands in response to new theoretical and empirical development ( Geyskens, steenkamp & Kumar, 2006).

Transaction costs theory has its origin from coase (1937), in his article "The nature of the firm" in which he explained market and hierarchies as

Alternative governance structures. The market is viewed as the dominant model of the logic of economic organisation both in manufacturing, construction and overall (hakansson,Ford, gadde, snehato & waluszewski, 2009). Classic economic theory views the market as an economic system that "work itself " with supply adjusted to demand and production adjusted to consumption (coase, 1937). According to coase (1937), firms exist because the cost associated with organizing a transaction within the firm are lower than those associated with organizing it by exchange on the open market. In other word, there are certain costs

associated with operating the market and it is necessary to firm an organisation to reduce these costs (Coase, 1937).

Pass et.al (2000) explains that transaction cost is occurred due to input, goods, service or asset exchange between two individuals or more and even between companies. Transaction could happen through market involve purchasing and selling using price system. Transaction could be internalized through various department and frequently use transfer pricing which is categorized as internal. Coase (1998) states that the lower transactional cost the higher specialization, the biggest economic productivity, and the higher living standard of the people within that economy. The level of transaction cost depends on certain institution within a country, political and law system, culture, etc.

Zhang (2000) has identified factors influencing transaction cost, as follows:

- Goods characteristics and the rights to those goods ( according to information about goods and personal status on those things.
- Actor's identity is involved in transaction, related to search, accept , store, process information; lack of available information.
- Technical situation and social regulation, trading things related to the trading.
- Based on explanation about definition and factors influencing the amount of transaction cost Li et.al ( 2012 & 2013) formulated four determinant or transaction costs, which are:
  1. Predictability of the owners behaviour which is relationship with others parties, experience in similar projects, payment on time, organisational efficiency and change orders.
  2. Predictability of the contractors behaviour which are bidding attitude, qualification, relationship with others parties, experience, material substitution and frequency of claims.
  3. Project management which includes leadership, quality of decision making, communication type, conflict management and technical competency.
  4. Uncertainty in the transaction environment which are project complexity, project uncertainty, completeness of design, early contractor involvement, competition among bidders, design integration, bonding requirements, incentives and fair risk allocation.

### **PUBLIC PROCUREMENT Act 2007( procurement governance).**

It is about decades (4<sup>th</sup> June, 2007) ago that Nigeria joined the league of Nations that enacted legislation on public procurement of goods, works and services. The Act contributed and as well improved the country's standard of living through public expenditure on capital goods and services. On the other hand, it is faced with many challenges and constraints during its implementation by the various organs of government's ministries, departments and agencies ( MDAs). Many stakeholders have opined that having such an Act in place despite all challenges associated with its better far than what the country was before the enactment ( onyema, 2011; EU,2011).

This is because the reforms has helped to confront the problems caused by corruption, fiscal irresponsibility, non-value for money, absence of public financial control, paucity, and non-use of certified procurement staff. This problem has resulted in time and cost overrun in much government expenditure ( ogbanna & kalau, 2012). In addition, the huge cost incurred by the government in the procurement of goods and services could not be reasonably

justified. The citizens were either disappointed or were doubtful of the sincerity of the government. Jacob (2010) stated some positive impacts of the Acts. This to include harmonizing the current policies and practices of government public procurement processes, accountability and transparency, establishing pricing standards and benchmarking in the procurement system. However, these impacts and others are the core objectives of the Act as stated in part ii section (4)(a)-(d).

Furthermore, the Act provides the use of open competitive bidding (NCB) for all procurement of goods, works and services by all procuring entities except where such approval for other method where given by the Bureau due to special condition as stated in the Act.

### **Contracting Business in Nigeria.**

In Nigeria, organized construction began in the early 1940's with a few foreign companies. The oil BOOM that followed about 10 years after independence led to an upsurge in construction and demand for construction services, as the country at that period opened up to foreign and local investments and the obvious needs for infrastructure to drive economic growth. Foreign companies have dominated the industry since the 60's and 70's generating revenue for government and jobs for the citizenry (NBS 2015).

However, there have been down sides to this as these companies have been known to import resources and even skilled labour as opposed to using locally manufactured resources and promoting local content. The construction sector has grown over the years, as a result of demand for real estate and housing and the provision of infrastructure to support an increasing population size, the need to open up communities to foster inter-state and inter-regional trade and movement.

This loosened up the market for construction and services within the industry, to include even local companies, albeit a few, especially in the construction of commercial and non-commercial real estate. Also, investors within the sector have increased, the biggest being the federal government of Nigeria as a huge chunk of capital formation goes into investments in real estate and infrastructures development. The level of government interaction within the industry is majorly as regulators purchasers and financiers. Public private partnership in this area is robust and fuelled by the inability of government to provide the necessary expertise and skills to execute projects. As a consequence, the industry has recorded an average growth rate of 18.08% between 2010 and 2012. Also, because of the Labour intensiveness of construction and construction services, jobs have been created and there is still potential to expand, in order to accommodate the rising need for services in that sector.

Zielczynski (2008), defined a requirement to be "a condition or capability to which a project, product, service or system must conform". So, that cost, time and energy will be saving throughout the construction period. The issue of construction project requirements includes; lack of review and feedback to the client brief; client change requirements and design frequently; needs of end users not clearly stated etc (Ann, Yu & Shen, 2013). Ann et.al (2013) recommends that in order to reduce or mitigate the problem of requirement in

construction project, an experienced project participant as the client requirement manager should be appointed. In addition to this, a formal procedure to record, manage and track changes in client requirement must be maintained.

Mandatory requirements includes not only tax, pencom, ITF, NISTF and IRR, but also the additional evidence to proof to the clients' the capacity to carry out the construction project technically and financially (PPA,2007) to build confidence both to the clients and other business.

Zielczynski (2008); Li et.al (2012 and 2013) summarised many studies and research on bidding success, and identified some components including clients needs, contractors behaviour, transaction environment, information access, project management efficiency and magnitude of the transaction. The public procurement Act 2007 identified about ten (10) key components in construction project bidding: tax clearance pension certificate, industrial training certificate, national social insurance, financial capability, equipment ownership, court affidavit, bank guarantee performance bond, advance payment guarantee and interim registration report by BPP.

### **Conclusion.**

The purpose of this study is to the effect of procurement governance, transaction costs to contracting business and tendering process in Nigeria. Procurement governance (PPA 2007), is to ensure transparency, competitiveness, value for money and professionalism in the public sector procurement system. In addition, the law is to ensure openness of the procurement procedure, free competition of suppliers as well as equal and to reduce the risk of the commissioning party to the minimum.

Public procurement is important because of its role in the development process, the amount of resources it consumes, and it's susceptibility to undue influences. A 2006 study by transparency international found that public procurement amounts to about 15-30% of GDP or more in many countries ( EKWEKWUO, 2016). It estimated procurement related corruption at normally 10% to 25% and in some cases as high as 40 to 50% of the contract value. It also found that few activities create greater temptations or offer more avenues for corruption than public procurement. In this paper, procurement governance in relation to construction projects was established by reconciling the views of different researchers, PPA 2007 and an empirical study was conducted to find the effects of procurement governance, transaction costs to contracting business and tendering process.

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