



## Full Length Research Paper

# Contracting and Procurement Performance of State Owned Enterprises in Uganda

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Contracting is one of the most important aspects in public procurement because it provides the framework for the economic exchange, outlining the nature and terms of the relationship, objectives of the contract, legality of parties, what is to be provided and the rights of contract parties. However, contracting has increasingly become problematic for Ugandan State owned Enterprises because of the nature of the public procurement procedures that are prone to heavy transaction costs and mal practices. Teams entrusted with negotiating do not abide with the contract objectives and sometimes do not have the ability to contract. This coupled with the bureaucratic nature leads to exploitation of the procurement process. This study therefore aimed at examining how contracting affects procurement performance of State owned Enterprises in Uganda. The study adopted a cross sectional research design. A correlation survey research design was applied to establish the relationship between contracting and procurement performance of State Owned Enterprises. Findings reveal that there existed a strong positive relationship between contracting and procurement performance ( $r = .653^{**}$ ,  $p < .01$ ). The results also indicate that contracting predicts procurement performance of State owned Enterprises ( $\text{Beta} = 0.595$ ;  $p < 0.01$ ). For better procurement performance, there should be clear contracting procedures or governance structures that must be followed throughout the contracting process and above all, those involved in the contracting process should have the ability to contract so as to avoid future contracting costs and non execution of the procurement contracts. Further, State owned Enterprises should set clear procedures for those who are involved in the contracting process since it was found that the absence of clear procedures tempts the contracting team to set their own procedures.

**Keywords:** Public procurement, Contracting, Procurement performance, Uganda

## INTRODUCTION

According to the Public Procurement and Disposal of Assets (PPDA) Act 2003, a "contract" means an agreement between a Procuring and Disposing Entity (PDE) and a provider, resulting from the application of the appropriate and approved procurement or disposal

procedures and proceedings as the case may be, concluded in pursuance of a bid award decision of a contracts committee or any other appropriate authority.

Contracting is one of the most important aspects in public procurement because it provides the "framework" for the economic exchange, outlining the nature and terms of the relationship, objectives of the contract, and legality of parties, what is to be provided and the rights and obligations of parties to the contract (Cuganesan,

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2007). Contracts fulfil an important role in minimising potential opportunistic behaviour and reducing unanticipated transaction costs. This can occur through ex ante mechanisms that bind the parties together, such as requiring parties to undertake transaction-specific investments or credible commitments to the relationship to minimise transaction costs (Williamson, 1983).

On the other hand, procurement performance refers to how procurement as a function contributes to the set strategic objectives and the two fundamental dimensions that must be measured relate to efficiency and effectiveness of procurement because they show how successful procurement is (Neely, 1999; Chan, 2004; Chai, 2005; Khudsen, 2008).

Contracting has increasingly become problematic for Ugandan State owned Enterprises (SOEs) because of the nature of the public procurement procedures that are prone to heavy transaction costs and mal practices. For example the teams entrusted with negotiating do not abide with the contract objectives and sometimes do not have the ability to contract. This coupled with the bureaucratic nature of the public procurement procedures and opportunism, leads to exploitation of the entire contracting process. This in the future leads to uncertainties and incomplete contracting (Williamson, 1985) which negatively impacts procurement in terms of efficiency and effectiveness. For example National Social Security Fund's Nsimbe Estate Housing Project was cancelled by the IGG citing contracting difficulties like inflated costs and corruption throughout the procurement process. This study therefore aimed at examining how contracting affects procurement performance of SOEs.

### **Procurement performance measurement**

A procurement performance measurement system is supposed to provide the purchasing department with unbiased and objective information regarding procurement performance (Knudsen, 1999). According to literature, the generic performance measures include, time, service quality, resource utilisation and cost among others. This study adopted the two dimensions of efficiency and effectiveness as far measuring procurement performance was concerned.

Whereas the aims of the public procurement are worthy, the procurement processes may not achieve the end objectives of the SOEs since they must compete with other private firms (Bwino, 2008). Given the nature of the procurement procedures and specifically the contracting process, SOEs may not register the same level of procurement performance as private firms in terms commercial considerations like discounts, payment terms, etc . An effective procurement performance management approach must be put in place for the SOEs to understand what is involved in the process, while usefully embedding change (Moran and Avergun, 1997; Johnson and Scholes, 1993). To be effective though,

performance management systems must focus on "measuring the correct things" (Speckman et al., 1994; Leenders, 1998; White and Hammer-Lloyd, 1999). SOEs must therefore measure their performance in relation to the procurement processes.

### **Public procurement process**

These are the successive stages through which public organizations/entities acquire goods and services. The public sector procurement process begins with procurement planning, an advertisement to tender for services, projects and works based upon documents and specifications usually developed within the responsible ambit of some level of government regulation (PPDA Act, 2003; Balunywa, Mwebaza, Sserwanga and Matama et al, 2009).

The tender documents are in turn considered by contractors or providers who later submit their tenders for evaluation (Steane and Walker, 2000; Balunywa et al, 2009). After evaluation, Services or projects are awarded by the state entity (principals) to the successful contractor who acts as an "agent". This entire process presents costs and as a result the public entities incur a number of procurement transaction costs (Steane and Walker, 2000).

It is said that the costs of both public and private institutions have increased highly and unpredictably because of the procurement processes that are complex, unrealistic and expensive (Summit Business Review, 2009).

### **Contracting and Procurement Performance of SOEs**

The procurement decisions taken at the contracting stage of the procurement process can not establish governance forms that facilitate better procurement performance of public entities through price, output control, and behaviour management throughout the contracting process (Erickson and Laan, 2007). For example Ethical codes of conduct in contracting are seldom used (Erickson and Laan, 2007). In contracting, trust is the most important variable in relational exchange (Lambe et al., 2001) and is considered to be the foundation of future successful strategic partnerships. The importance of trust in contracting is that all opportunistic behaviour will be avoided and the contract will achieve all the stated objectives without any party loosing.

The behaviour of procurement practitioners especially trust and cooperation is affected by the procurement procedures (Latham, 1994; Egan, 1998) yet good behaviour is a key factor that contributes to project success (Cheung et al., 2001). Reports commissioned by the World Bank and USAID indicate that fraud, mistrust and opportunistic behavior are common during the contracting stages of the public procurement process; It is common for companies to pay bribes for public

contracts and it is alleged that procurement officials and administrators inflate the cost of procurement contracts in collusion with private suppliers and share the non-reported difference, which can be as much as five times the true cost. This greatly affects the performance of state owned enterprises because there will be no value for money.

Furthermore, the constant replacement of employees due to fraud tendencies creates inefficiencies, since a new learning curve must be climbed by all the parties each time (Cox and Thompson, 1997). This non value adding activities erode sustainable contracting leading to poor procurement performance (Ingirige and Sexton, 2006). As a result scholars suggest that it is hard for SOEs to register good procurement performance due to high transaction costs and poor procurement practices (Williamson, 1996; Das and Teng, 2001)

Better procurement performance results from clear contracting objectives and efficient governance of contracts which requires tailoring of procurement procedures to contracting characteristics (Williamson, 1985; Aulakh et al, 1996; Eriksson, 2006). Hence, it would be interesting to investigate the current contracting procedures from a transaction cost analysis, and behavioural perspective in order to examine their relationship with the procurement performance of SOEs.

From the above review, contracting costs arise from impediments in reaching and enforcing agreements within activities such as bargaining, contracting, monitoring performance, and activities that are not directly productive but which are engaged in only as a consequence of a need to coordinate procurement activities. Poor behavioural practices also affect the contracting process and contribute towards transactional costs and consequently affect procurement performance.

From the above it can be concluded that for the current public procurement processes (specifically the contracting stage) cannot help the SOEs to register better performance given that transaction costs and the unethical practices that are evident in the contracting process.

## **METHODOLOGY**

This section presents the research methods used during the study.

### **Research design**

The study adopted a cross sectional study. A correlation survey research design was applied to establish the relationship between contracting and performance of State Owned Enterprises.

### **Study population**

The current population of State Owned Enterprises (SOEs) is thirty six (34) where the Ugandan Government is the majority shareholder and they are required to use the PPDA laws (Public Enterprise Reform and Divestiture Act, 1993; Public Finance and Accountability Act of 2003; Public Utility Sector Reform Project, 2001; Parliament of Uganda, 2009; Monitor Business Directory, 2009).

### **Sample design**

A sample of 20 SOEs was selected randomly. In each of the 20 selected SOEs, 2 employees dealing with procurement issues were selected from 4 categories namely; User department, Procurement and disposal unit, Contracts committee, Contract management committee, hence, sample of 160 participants.

### **Data analysis**

Primary data collected from the field was coded and entered into SPSS for analysis using quantitative analysis methods such as descriptive frequencies, percentages and correlation and regression methods.

## **FINDINGS**

### **Sales revenue per year**

Data were gathered in order to examine the sales revenue of participating SOEs. Table 1 presents the results.

Results in table 1 on the analysis of sales revenues for SOEs per year reveal that most state owned enterprises were in the category of more than 360,000,000/= sales revenue per year (46%), 33% of the SOEs experienced sales revenue below 12,000,000/=, while 16% had sales revenue between 13,000,000 – 360,000,000/=. These results are presented in the table 1 below.

### **Number of employees employed by the SOEs**

In addition, data were collected about number of employees in SOEs and analyzed as seen in table 2.

The results in table 2 show that most State Owned Enterprises employed more than 50 employees (41%) while those that employed below four employees and between 5-50 employees constituted about 31% and 28% of the sample respectively.

**Table 1.** Sales revenue per year

			Frequency	Percent	Valid Percent	Cumulative Percent
Valid	below	12,000,000	39	32.5	37.5	37.5
		13,000,000- 360,000,000	17	14.2	16.3	53.8
		more than 360,000,000	48	40.0	46.2	100.0
		Total	104	86.7	100.0	
Missing		System	16	13.3		
Total			120	100.0		

**Table 2.** Number of employees

			Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Below 4 employees		35	29.2	31.0	31.0
	5-50 Employees		32	26.7	28.3	59.3
	More than 50 Employees		46	38.3	40.7	100.0
		Total	113	94.2	100.0	
Missing		System	7	5.8		
Total			120	100.0		

**Table 3.** The relationship between variables

Variable	Contracting	Procurement Performance of SOEs
Contracting	1	.653**
Procurement Performance of SOEs	.653**	1

\*\* Correlation is very significant at the 0.01 level (2-tailed).

**Table 4.** Regression results

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
(Constant)	.187	.376		.423	.261
Contracting	.596	.071	.595	8.346	.000

Dependent Variable: Procurement Performance State Owned Enterprises (PPSOEs)

### The Relationships among the Variables

Pearson (r) correlation analysis was used to examine the relationship between contracting and procurement performance. Table 3 presents the findings.

Results in table 3 reveal that there existed a strong positive relationship between contracting and procurement performance ( $r = .653^{**}$ ,  $p < .01$ ). In addition, Procurement performance was also positively related to contract objectives, ability to contract, and procedures. This implies that SOEs with a good procurement performance are associated with good contracting systems. It is therefore evident from the findings that if SOEs are to improve on their procurement performance attention should be devoted towards strengthening the contracting process and avoiding activities that would undermine the successful working of the contracting process.

### Regression results

Regression modelling was used to determine the predicting power that contracting has on procurement performance. Table 4 presents the findings.

Findings revealed that contracting predicted procurement performance of SOEs up-to nearly 60% variance for every unit percentage positive change (Beta=0.595;  $p < .01$ ). These results suggest that SOEs that exercise good contracting processes have higher procurement performance levels and vices versa.

### DISCUSSION OF FINDINGS

Findings indicated that contracting had a strong positive relationship with procurement performance. The results also revealed that contracting significantly predicted

procurement performance of SOEs. The findings are in line and consistent with literature (see for example Erickson and Laan, 2007; Lambe et al., 2001; Latham, 1994; Egan, 1998; Cheung et al., 2001; Cox and Thompson, 1997; Ingirige and Sexton, 2006; Williamson, 1996; Das and Teng, 2001; Williamson, 1985; Aulakh et al, 1996; Eriksson, 2006).

## CONCLUSION AND RECOMMENDATIONS

Contracting is fundamental in determining procurement performance. If the contracting process is mismanaged by the SOEs, transaction costs will increase. Increased costs mean that procurement will be affected in terms of efficiency and effectiveness.

Therefore for an SOE to achieve better procurement performance it is important for it to set clear contracting objectives that will determine what to be achieved at the end of the contract.

There should be clear contracting procedures or governance structures that must be followed throughout the contracting process and above all, those involved in the contracting process should have the ability to contract so as to avoid future contracting costs and non execution of the procurement contracts. If a contract is not performed then the costs of enforcing such a contract will rise tremendously. Increased costs mean poor performance.

SOEs should set clear procedures for those who are involved in the contracting process. If there is no set criteria/procedure, then the contracting team may set its own procedures that it will follow. An established criterion guides the contacting team on what to do. This criterion should not be complex because it would cause confusion in the contracting team.

Since SOEs are the private arm of government, the government should allow the SOEs to develop their own procurement procedures that will enable them to effectively compete with other private businesses. SOEs are in business not only to provide services to the public but also to make profit. Therefore there is need for the SOEs to align their procurement activities to those of the private sector. If this is done then SOEs will register better performance in terms of efficiency and effectiveness. This is being done in other countries and can be done here in Uganda.

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