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Full Length Research Paper

The Relationship between Contracting and Transactional Costs in State Owned Enterprises in Uganda

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Following Uganda's Economic Recovery Programme in 1987, the government enacted and published a statement on public enterprise reform and divestures in 1991. The overall goal was to reduce costs and deficits of the State owned Enterprises and also reduce the level of corruption within these entities. However, to-date, there are numerous complaints about poor performance of these entities due to poor contracting and inflated costs. The purpose of this study was to examine the impact of contracting on transaction costs in Uganda's State owned Enterprises. Primary data was obtained from respondents using self administered questionnaires to get data on the study variables. A total of 160 respondents were selected from 20 State owned Enterprises operating in Kampala and Entebbe districts, Uganda. The collected data were analyzed quantitatively. Findings show that there exists a significant and positive relationship between contracting and transactional costs ($r = .441^{}$, $p < .01$). In addition, contracting was found to predict transaction costs (Beta = .625, Sig. = .000). Hence, with proper contracting, it is envisaged that transaction costs can significantly reduce, which later, will lead to better performance in terms of efficiency and effectiveness of the processes of the State owned Enterprises. It also important that State owned Enterprises exploit other forms of searching for providers and avoid the traditional methods that are too costly. For example, they can use pre-qualified suppliers and also develop computerised systems for assessing and appraising the providers.**

Keywords: Procurement, Contracting, Transaction costs, Uganda

INTRODUCTION

Following the country's Economic Recovery Programme (ERP) in 1987, the government of Uganda enacted and published a statement on public enterprise reform and divestures in 1991 and this consequently came to be

known as the PERD Act 1993. The overall goal of divesting these public enterprises was to promote development through an efficient and effective private led sector (Ddumba and Mugume 2001). Another major

objective was to reduce on the budget deficits of the SOEs and also reduce the level of corruption in these entities. Although the government divested most these SOEs, the remaining ones in which it has over 51% of the shares continue face challenges low performance in terms of corruption, inflexible processes and government interference. Since 1993 105 SOEs have been divested including 31 liquidations and as per the PERD Statute, 34 SOEs remain to be privatised (Ddumba and Mugume, 2001).

Globally public institutions and in particular, State Owned Enterprises (SOEs), are operating in an increasingly competitive business environment that demands aspects like cost reduction strategies, flexibility in operations, efficient and effective procurement processes in order to ensure that their performance is good and can match that of competitors or customer requirements. This means that, to a certain extent, SOEs have to grapple with converting pure private sector best practices into public sector practice in order to improve performance (The Economist, 1995; Corcoran and McLean, 1998). A study by Omran (2004) reveals that there is inadequate performance due to increased transaction costs by SOEs caused by irregular contracting processes.

If the transaction costs are high and there is evidence of mal practices in the contracting process, then efficiency and effectiveness will not be achieved; this will consequently affect procurement performance of the SOEs. Currently SOEs face challenges in terms of high acquisition costs of items, non involvement of key stakeholders in decision making, absence of information systems, inconsistency of delivery schedules and mal practices among others.

Therefore if SOEs continue to follow the current procurement procedures, they will be faced with the challenge of balancing between their bureaucratic and irregular contracting processes and competing with the private firms for the same customers (Bwino, 2008). For example it is difficult for National Housing Construction Company to favourably compete with the privately owned construction companies whose procurement processes are not bureaucratic. The purpose of this study was to examine the impact of contracting on transaction costs in Uganda's SOEs.

Transaction costs

The concept of using transaction costs to explain the organization of firms and the way in which they interact along a supply chain gets its roots in the works of Coase (1937). While there is no standard definition of the term "transaction costs", they can be broadly interpreted to include costs associated with market exchange, including costs of searching for options, negotiating

contracts and enforcing agreements (Singh, 2008). They arise wherever there is any form of economic organization, i.e. within a vertically integrated firm or in a market (Hobbs, 1996).

In procurement, transaction costs fall into three main classifications: information costs (costs related to searching for providers), negotiation costs (contracting costs), and monitoring (or enforcement) costs. SOEs incur costs in the search for information about products, prices, inputs and buyers or sellers (Hobbs, 1996). Negotiation costs arise from the physical act of the transaction, such as negotiating and writing contracts (costs in terms of managerial expertise, the hiring of lawyers, etc.), or paying for the services of an intermediary to the transaction (such as an auctioneer or a broker). Monitoring or enforcement costs arise after an exchange has been negotiated. This may involve monitoring the quality of goods from a supplier or monitoring the behaviour of a supplier or buyer to ensure that all the pre-agreed terms of the transaction are met (Hobbs, 1996). Also included are the costs of legally enforcing a broken contract, should the need arise. This is consistent with Coase (1961) who asserted that in order to carry out "a transaction by means of an exchange on the open market", it was necessary for one to find out who was willing to participate in exchange process, to inform potential traders that someone was willing to trade on specific terms. He further pointed out that there was need to conduct negotiations which would lead to a contract and inspections that were necessary to make sure that contract terms were being observed.

Contracting and Transaction costs

According to transaction cost economics literature (Nj, 2007), the criterion for efficient contract management is to minimize contract costs (Bello and Lohtia, 1995). Such costs arise from impediments in reaching and enforcing agreements within a procurement contract and are associated with activities such as bargaining (Nj, 2007). In contracting, objectives of the contract must be determined so as to guide the entire process. Usually what needs to be achieved at the contract must be communicated early enough. There must also be governance structures in terms of clauses and conditions if the contract is to be successful.

As technocrats meet to agree on the specific clauses to be enforced by either party in the contract, a number of costs are incurred; these may include contract amendment costs, allowances for contract negotiators and time. These have been classified by the scholars as transaction costs which are as a result of an economic exchange and cannot be avoided but can be mitigated by ensuring that each party in the transaction attains value for money. In public procurement, costs are

manifested at this phase for example it may take up to six months when SOEs are still negotiating. The contracting process can last this long because of contracting difficulties like unrealistic objectives set by the SOEs or instances of corruption geared towards inflating the contract values.

The PPDA audit report (2008) pointed out that some government agencies did not even have evidence of contract award decisions. Contracts had been awarded to providers without award letters. This meant that some contractors could have exploited such loopholes to rescind the contracts at any time in case of disagreement. The report further pointed that user departments were not involved in the contracting processes leaving such contracts at the mercy of those involved in drafting them. According to this very report, contracting was the most abused stage by PDEs and consequently the represented the number one cause of unwanted costs.

In certain cases, contracts are signed with the providers but the public entities take long to enforce and this forces providers to abscond the contracts which takes back the public entities to the first stage since market conditions would have changed drastically this simply increases the costs of transacting (Summit Business Review, 2009). Therefore if the contracting stage is mismanaged, unnecessary costs will be incurred for example costs of re-advertising the procurement opportunities, allowances for the contracting teams, correcting defects among others. Such costs will later translate into high transaction costs for example enforcement costs which will later negatively impact procurement performance of the SOEs.

Data sources and instruments

Primary data was obtained from respondents using self administered questionnaires to get data on the study variables. On the other hand, secondary from reports, journals, text books among others were used. Information got from the secondary sources was in form of literature.

Sampling

Using random sampling method, a total of 20 SOEs registered in Uganda, particularly those operating in Kampala and Entebbe districts were selected. Stratified sampling technique was then used to select 2 employees from 4 stratum of each of the participating SOE. The study therefore had a sample of 160 respondents.

Response Rate

One hundred and sixty (160) questionnaires were administered and 120 usable ones were returned, giving a response rate of seventy five (75%). According to Rubin and Earl (2009), a response rate of 70% is very good for analysis and reporting.

Measurement of variables

The responses to the statements in self administered were anchored on five likert point scale ranging from 1- strongly disagree to 5- strongly agree. The variables were measured using scales obtained from the works of previous scholars and adopted the Ugandan setting.

- i. Contracting was measured in relation to the terms of contract objectives, contract Governance and ability to contract (Nj, 2004; Loader, 1997)
- ii. Transaction costs was measured using the search and information costs; information gain, information relevancy, information reliability, time (Arun, 2009) while contracting costs were measured in relation to time spent while drafting contracts, negotiating, agency costs and contract governance costs (Williamson, 1985; Steane and Walker, 2000; Bello and Lohtia, 1995). Enforcement costs were measured in relation to monitoring costs, legal costs, communication costs among others (Grimwood, 1996)

Validity and reliability testing

A questionnaire was developed in harmony with the guidelines specified by Sekarani (2003). Item analysis was done to check whether the items in the instrument were correct and a pre-test was carried out using focus group and experts, to check for validity and reliability. Reliability (internal consistence and stability) of the instruments was tested basing on Cronbach (1951). Coefficient Alpha values of 0.5 and above were accepted. Table 1 presents the reliability results.

Results in table 1 show that the questionnaire was reliable since both variables scored a Cronbach Alpha > 0.6.

Data analysis

The collected data were analyzed quantitatively using frequencies and percentages (for background characteristics) and correlation and regression for examining relationships between the variables.

Table 1. Reliability testing

	Cronbach's Alpha
Contracting	0.900
Transaction	0.866

Table 2. Academic qualification of the respondents

Qualification		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	High school	7	5.8	5.9	5.9
	Diploma	11	9.2	9.3	15.3
	Degree	52	43.3	44.1	59.3
	Masters	34	28.3	28.8	88.1
	Professional	12	10.0	10.2	98.3
	Others	2	1.7	1.7	100.0
	Total	118	98.3	100.0	
Missing	System	2	1.7		
Total		120	100.0		

Table 2. Correlation results

Variables	Contracting	Transaction Costs
Contracting	1	.441**
Transaction Costs	.441**	1

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

Table 3. Regression results

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
(Constant)	.420	.281		.112	.231
Contracting	.423	.067	.625	1.725	.000

Dependent Variable: Transaction costs

FINDINGS

Academic qualifications of the respondents

The table below presents the academic qualifications of the respondents. Majority of the respondents had undergraduate degrees (43%), 28% masters degrees 10% professional qualifications, 9% diploma qualifications and 6% had attained high school education as shown in the table below;

Correlation results

As earlier stated, correlation was used to analyze the relationship between study variables. The results are presented in table 2.

The results in table 2 above showed that there exists a significant and positive relationship between contracting and transactional costs. These results indicated that as SOEs contract, transaction costs increase ($r = .441^{**}$, $p < .01$). Such transaction costs arise because of the unclear contracting processes for some contracts are cancelled and the SOEs have to re-advertise procurement opportunities to the potential contractors. It must be noted that advertising itself is a search and information costs under transaction costs.

Regression results

Regression was used to test if contracting determined or predicted transaction costs. The results are presented in table 3.

Results in table 3 reveal that contracting predicts transaction costs (Beta=.625, Sig. = .000)

DISCUSSION OF FINDINGS

As earlier mentioned in the literature the principle for efficient contract management is to minimize contract costs (Bello and Lohtia, 1995) and that such costs arise from impediments in reaching and enforcing agreements within a procurement contract (Nj, 2007). Therefore if the contracting stage is not well managed, there is likelihood that SOEs will incur high transaction costs. Literature further points out that, contract objectives must be determined so as to guide the entire contracting process and that what needs to be achieved at the end contract must be communicated early enough. The implication here is that failure to communicate what must be achieved by the contract may increase the contracting costs which would later increase the transaction costs and consequently affect the performance of SOEs.

Findings from this study indicate that there exists a significant and positive relationship between contracting and transactional costs. For example before SOEs contract, they must look for the person/firm they are going to contract with; perhaps that is why the study found out that as SOEs contracted; a number of transaction costs were incurred and to be specific contracting was found to be positively related to search and information costs and enforcement costs. This means that SOEs incur costs during the contracting stage and therefore there is need for all officers involved in such activities to effectively and efficiently manage the contracting process. The above findings are consistent with the findings of NJ, 2007 and Summit Business Review, 2009) who found that as public entities contracted a number transaction costs were incurred since this was a pure market exchange.

Contract objectives, a well defined process and People with ability to contract must be clearly assessed and if such issues are not given attention, transaction costs are likely to increase.

CONCLUSION AND RECOMMENDATIONS

There is positive and significant relationship between contracting, transaction costs, behavioural practices and procurement performance. If the contracting process is not well planned and executed, and if there is evidence of mal behavioural practices like bribery and deceit, then the transaction costs will increase which later impacts on the procurement performance of the SOEs. Contracting is a key predicator of procurement performance this is because every activity to be performed in the agreement must have been determined

at this stage. So failure to have clear contracting objectives is likely to affect procurement performance. It can further be said that transaction costs and bad behavioural practices will also affect procurement performance.

Transaction costs impact procurement performance, the higher the transaction costs the lower the procurement performance of the SOE. It is widely accepted that transaction costs are in three forms, i.e. search and information costs, contracting costs and enforcement costs. SOEs incur all these costs, for example they look for providers and when looking for these providers, costs are incurred such as communication costs, advertising, physical visits among others. When an agreement has been reached between the SOE and providers, enforcement costs that get the contract performed are incurred by the SOE. These costs are in form sending reminders to suppliers, litigation or arbitration costs etc. SOEs should therefore devise means of managing such costs in an effective manner.

If the above are observed, transaction costs will significantly reduce which later will lead to better performance in terms of efficiency and effectiveness of the processes of the SOES. It also important that SOES exploit other forms of searching for providers for example they can use pre-qualified suppliers and developing a computerised system of assessing and appraising the providers. The costs of enforcing contracts will consequently be reduced if the above recommendations are put in practice.

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