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**CLIENT ABUSES OF THE COMPETITIVE TENDERING
SYSTEM: SOME GENERAL PRINCIPLES AND A CASE
STUDY**

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CLIENT ABUSES OF THE COMPETITIVE TENDERING SYSTEM: SOME GENERAL PRINCIPLES AND A CASE STUDY

ABSTRACT

What constitutes unacceptable client behaviour in competitive tendering is considered based on theoretical, legislative and moral considerations. A range of malpractices is then identified through the examination of reported abuses. Finally, a case study is presented which illustrates some of these practices and the difficulties faced by those affected in offering resistance. It is suggested that a practical solution may be found by requiring clients to make a more direct contribution to tenderers costs.

Keywords: Competition, Tendering, Bidding, Code of Tendering, Tendering Abuses, Tendering Dysfunctions, Tendering Regulation.

INTRODUCTION

In the construction industry, tendering today provides the predominant means by which clients¹ obtain services to execute a specified scope of work. The construction industry consists of a set of markets that form a very competitive system, so competitive that it has been said to be one of the closest systems to perfect

¹ The term 'client' is synonymous with 'owner', 'principal' and 'proprietor'.

competition (Runeson, 1996) – in many markets so close as to be almost identical. The end product, and therefore the services required, is identical for all suppliers (tenderers); there are many suppliers each of whom is responsible for only a very small part of the total market output; there is little or no collusion between suppliers; and buyers and sellers have a good knowledge of the construction prices prevailing generally in the market. No supplier has enough market power to set the price above the market price, as they communicate their offers to the buyers through competitive tenders. However, the system with competitive tendering does leave some room for opportunism. Unfair opportunism² is discouraged by practice codes and legislation with the intention of ensuring both probity and equity among all parties involved as well as enabling the client to obtain a competitive price. There have, however, been reports that the tendering and selection processes used by government agencies, for example, are inconsistent, lacking accountability, unfair, inequitable and lacking transparency (ISC, 1997:50)

This paper examines opportunistic aspects of the tendering process in practice. In contrast with previous work (Daniels, 1978; Gyles, 1993; IQS Sussex Branch Committee, 1979; Lee, 1990; McCaffer, 1976; Moyles, 1973; Ray *et al*, 1999; Sheldon, 1982; Whittaker, 1970; Zarkada-Fraser and Skitmore, 2000), which concentrated on the contractor, the behaviour of the client is scrutinised in relation to what is acceptable practice and general impact on the procurement process as a whole.

² 'Opportunism' is used here in the sense of Williamson (1985) to denote "self-interest with guile" where, more often than not, opportunism involves subtle forms of deceit - both active and passive. But

THE THEORY OF COMPETITION

Competition is a match or trial of ability - "the rivalry in strife for the same object" (Macdonald, 1978). In the business environment, competition is defined as the commercial rivalry between business concerns (Adam, 1985). Competition is also generally regarded as being the key to the success of capitalist and mixed economies (Gilpin, 1986).

In an ideal competitive situation, each trader may freely accept or reject the terms offered, (ie offer or accept tenders). All participants are free to pursue gain and avoid loss, *motivation based on self-interest being socially and politically acceptable* (Gilpin, 1986). It is obvious, however, that the opportunistic pursuit of self-interest is incompatible with conventional social values. As Muller (1993:101) observes, citing Adam Smith, "If the pursuit of self-interest prompted us to violate the person and property of others, this natural egoism would bring about the dissolution of society ... a descent into the Hobbesian state of nature in which each man is the enemy of every other". Smith, in fact, was well aware that the potential moral benefits of commercial society were threatened by opportunism within commercial society itself. "Indeed, the pursuit of individual wealth might lead to consequences which threatened the very virtues upon which society depends" (Muller, 1993:137), exposing "... the commonwealth to many gross disorders and shocking enormities" (p148). Muller further comments on the lack of leisure time and ability to conceive of "any generous, noble or tender sentiment..." (p149) - cited by critics of capitalism (including Karl Marx) as testimony to the alienating effects of capitalism.

it also includes more blatant activities such as lying, stealing and cheating.

The Smithian solution to this was to show how self-interest can provide an acceptable psychological basis for social institutions, *if properly structured* within a suitable legislative framework, the intention being to "maximise economic benefits by preventing the circumvention of the market" as well as "maximising the moral benefits of commercial society by fostering institutions to counteract the characteristic moral hazards of that society" (Muller, 1993: 139). The legislation needed was seen to be a matter requiring great care and discretion, with risks of either over or under regulation.

Of course, much has happened since Smith and the current preoccupation is with non-legislative solutions to the problem of opportunism through the development of more trusting relations between participants. That this follows a lengthy period in which *planning* was pursued as an equally promising solution is one of the central insights of Williamson's (1985) *transaction cost economics* (TCE) which seeks to account for all three approaches. TCE, however, is essentially concerned with the economics of *being in* contracts rather than the economics of *getting into* contracts and so has only limited application to the process of tendering. What is of interest here though is TCE's treatment of the different types of legislative requirements of each system. Thus TCE holds that planning assumes there is a potential for significant opportunism but minimal uncertainty and therefore that a completely predefined legal framework is possible as well as desirable; while cooperation (eg., through alliancing) assumes a significant level of uncertainty but minimal opportunism and therefore that a simple pledge to act currently in a 'joint profit-maximising manner' and seek only fair returns will suffice. Where both uncertainty and opportunism are accepted as significant issues, TCE has little to say other than in situations where the parties have continuing mutual interests. Where there are no continuing mutual

interests (such as is usually the case on construction contracting), it is noted that "fraud and contract deceits are deterred by court ordering" (Moore, 1992:175).

For fair and healthy competition to exist, therefore, requires the compliance of the participants to prevent practices, which restrict, distort or prevent competition. From Smith to Porter it has been understood that each competitor's self-interest is best served by somehow avoiding having to compete at all, and that the main (only?) legislative need is to restrict anti-competitive behaviour. This is currently controlled through legislation (eg., Anti-trust laws in the US; the Competition Act in the UK).

However, the degree, character, and intensity of competition in markets is strongly influenced by the nature of the participants and their bargaining power, in fact, microeconomic theory may be said to be a theory of the implications of market power (eg Lipsey, 1963)

CONSTRUCTION TENDERING

The origin of construction tendering in UK dates back to the early eighteenth century, where it was used for the procurement for barracks during the Napoleonic wars (Thompson, 1967). It remains more or less unchanged today. Even in its infancy, the construction tendering process was believed to impose both probity and competition on tenderness. Later, the tendering process was further developed and adapted by the British Civil/Construction industry as the process to ensure that keen competition among tenderers was reflected in the outcome of the process.

Today, the government continues to be the single largest consumer of building services in Australia (Budd, 1999:3), and the expectations are that the government will approach the process of reviewing and awarding tenders in a manner that is both professional and transparent to the industry. On one hand, the government seeks to adhere to its own stipulated terms and procedures to ensure the probity of the process. On the other hand, it seeks to inject flexibility into the tender process, not only to obtain the most competitive price but also to implement desired competition and development policies. Price competition is *de rigour* as it ensures accountability for public money (eg., Hilmer, 1993). Governments therefore focus heavily upon price for awarding contracts (ISC, 1997:50) with their agencies predominantly accepting the lowest tender price for building projects (Merna and Smith, 1990).

The construction industry is noted for the competitive attitude of its firms. Relationships within the industry tend to be competitive rather than cooperative – even between buyers and sellers. This culture, it is argued, arises from the nature of its Smithian system of contractor selection and price formation. Contracting parties live and die (in a commercial sense) according to terms of bargains that are struck; therefore the commercial fate of a project is dictated by positions and statements adopted during the tendering stage (Dorter and Sharkey 1998:1011). In addition, the project-to-project focus of the construction process results in the predominance of short-term relationships between clients and contractors that tends to exacerbate opportunistic behaviour³.

THE CODE

NPWC/NBCC (1990) and CIDA (1993) have recommended strategies for the manner in which tendering is conducted within the building and construction industry to ensure fairness. NPWC/NBCC recommended the establishment of a Standard Code of Tendering imposing ethical and commercial obligations upon clients, contractors and consultants in turn ensuring the tendering process remained fair, equitable and free from manipulation. The recommendation from both NPWC/NBCC (1990) and CIDA (1993) was further developed into the Australian Standard Code of Tendering AS4120 (Standards Association of Australia, 1994).

Essentially, the code is intended to encourage honesty and fairness; the duty of all parties is to act honestly and in good faith. The general underlying principles of the code insofar as clients are concerned are that:

- *Clients shall have regard to the cost of tendering*
- *Clients shall arrange for all necessary project funding*
- *Parties shall not engage in improper arrangements.*
- *Tender documents shall clearly specify the client's requirements*

Particular client's obligations during the *pre-tender stage* are to:

- ensure the project brief is clear and specific, adequately defining the project
- select a procurement strategy best suited to the project
- arrange for adequate finance to complete the project

³ As Smith says "Where people seldom deal with one another, we find that they are somewhat disposed to cheat, because they can gain more by a smart trick than they can lose by the injury which it does to their character (reputation)" (LJ(B) p538-9).

- prepare complete tender documentation reflecting the style of procurement strategy
- where appropriate, to apply pre-qualification criteria for the selection of suitable firms invited to tender

and at *tender stage* to:

- select a tendering method, having regard to the costs associated with tendering
- answer all questions during the tender period, all answers to queries must be circulated to all tenderers
- avoid amendments to the tender documents

becoming, at *post-tender* stage to:

- arrange for the safeguard and security of all tender submissions upon receipt
- discard a tender which does not comply with the tender documents
- consider the tender most advantageous to the client for acceptance

PROBITY

The issue of probity is a major concern in all tender processes, particularly in the government/public sector (Budd, 1999:1). In general, probity involves the client ensuring that the processes of calling tenders and evaluating responses is fair, and complies with the conditions of the Code. From a government perspective, there are important public policy reasons why tenders must be evaluated fairly and strictly in accordance with the requirements of its Code (Budd, 1999:1): governments in general need to be seen by the industry and the public alike to be acting in a business like fashion; and to preserve confidence and ensure continued support for government

projects. The laws relating to competition combined with purchasing policy also operate to impose stringent requirements on government bodies following the tender process (Budd, 1999:5). In particular, there is a risk of incurring civil liability towards disappointed tenderers, in the event that tender evaluation procedures are not followed (Dean, 1996:33). Clients are required to demonstrate due care with representations made in tender documents and tender meetings. If the representations prove to be false, the contractor may incur substantial loss in law.

REPORTED CLIENT ABUSES

The tender process is vulnerable to manipulation by all parties. It is protected to some extent by the general legislation against gross misdemeanours such as fraud, and by more special legislation against anti-competitive behaviour such as collusion. The Code currently falls outside the legislative framework, rather offering suggestions of appropriate individual behaviour - leaving the "invisible hand" of market competition to provide the long-term economic solution.

In concentrating on pre-contract client behaviours that contrast with the Code, industry reports and research suggest the existence of three major and distinct areas of activity comprising *Standard Industry Contracts*, *Tender Review and Award*, and *Non-Conforming Tenders* as described below.

Standard Industry Contracts

A number of standard forms of contract have been developed to aid in the contract drafting and overall formation process. These are intended to provide a maximum degree of commonality between individual contracts to reduce the amount of time needed for their understanding, enable a body of experience in their use to be developed, and provide an opportunity for their gradual improvement in equitable provision over time. Familiarity with the standard forms therefore is expected to reduce the amount of time and risk involved for tenderers. Clearly, for the intention to be realised, it is necessary for amendments to the standard form to be kept to a minimum. Where, such amendments are unavoidable (eg., due to the special characteristics of the project, project team, etc), the Code recommends they be clearly noted and the tenderers' attention drawn to the amendments (NPWC/NBCC, 1990:10). Gross amendments alter the base risk allocation of the contract (Budd, 1990:7)⁴. In some circumstances clients develop their own suite of general conditions of contract which are drafted and prepared by the client's lawyer. For instance, Telstra corporate property services have their own general conditions of contract. The contract generally, is not modelled on any standard industry form of contract and reputedly increases the contractor's exposure to additional costs. It is necessary, therefore, for the tendering contractors to review the contract in detail to ensure risk is adequately priced, this adds to the costs of tendering also uncertainty

Tender Review and Award

⁴ An example is where an architect redrafted clauses of a standard form of contract by pasting the revised clauses over the top of the original clauses. A dispute later arose over the interpretation of the amended clauses. In the ensuing legal proceedings (Taylor Woodrow v The Minister for Health (1978) AFCC 104), the presiding judge commented, famously, that "...the departure from traditional

The tendering and selection processes used by government agencies are reported to be inconsistent, lacking accountability, unfair, inequitable and lacking transparency (ISC, 1997:50). For example, although legally bound to do so under the tendering contract, clients often fail to communicate to the industry the manner in which the tenders are to be reviewed.

Non-Conforming Tenders

A regular criticism of competitive tendering is the lack of flexibility provided for tenderers to display their efficiency and innovate (Budd, 1999:4). For many government clients any tender that does not comply exactly with the tender documents is regarded as a non-conforming tender and is therefore discarded, with the Code requiring these to be identified in a tender report, together with the reasons for their non-conformity. Anecdotal evidence suggests that both public and private sector clients utilise non-conforming tenders for the means of further negotiation, that is, the tenderer is contacted after the official opening of bids and requested to either amend or withdraw the offer. In some instances, the tenderer merely removes the qualifications on the tender thereby making it a fully compliant tender. This practice is, of course, a breach of implied contract between the client and tenderers. A better practice is for tenderers to submit a conforming tender *and* an alterative offer, although this has the disadvantage of increasing tendering costs.

terminology in amending the well known variation clause... is anomalous and deplorable. It is like tipping an entirely gratuitous truck load of manure into this already sufficiently muddied stream”

CASE STUDY

The case study project was selected as it provides a practical demonstration of many of the client influenced aspects of the tendering process. It is, however, typical of many projects where clients are actively involved in the process. For reasons of confidentiality, the project studied is referred to as project X and the client and contractor given aliases to obscure their respective identities. All dates and figures, however, are factual.

Project X involved the refurbishment of a foodcourt located within a prominent retail centre. It was envisaged that the work would be executed in a staged program to ensure that the foodcourt remained operational at all times while the retail centre was open to the public. This requirement would therefore necessitate the contractor to work after normal working hours.

Initially, the client (referred to here as *Daylight Developments*) requested an Architect and Quantity Surveyor to prepare a sketch design and relevant costing of a scheme for the foodcourt development. The Architect and Quantity Surveyor had already been involved in other stages of the retail development and therefore had sufficient understanding and historical data concerning the project. Daylight Developments informed the foodcourt tenants of the development options under consideration. The tenants were dissatisfied with the proposed developments and a solicitor representing several of the tenants forwarded a letter to the developer voicing their objections. Daylight Developments ignored the letter of objection and proceeded with the plans to develop the project.

The Quantity Surveyor prepared a preliminary estimate based on a single sketch, floor plan, and a detailed briefing session with the Architect. An indicative estimated construction cost of \$1,200,000 was reported to Daylight Developments on 13 February 1996. The estimate included for escalation up to December 1997.

Daylight Developments were dissatisfied with the design and the overall response of the foodcourt tenants and postponed the project until further notice. Daylight Developments did not comment at this stage on the acceptability or otherwise of the Quantity Surveyor's estimate.

The tenants then threatened legal action on the basis that Daylight Developments had misinformed them of their intentions and that this amounted to deceptive conduct as defined in the Trade Practices Act (Pengilley *et al*, 1990). As a means of settling this, Daylight Developments offered a tenancy leasing incentive to all tenants of \$1000/m² of net rentable area (NRA) to refit their tenancy. All the tenants accepted this. However, Daylight Developments did not negotiate a formal contractual agreement with the tenants stating the incentive was instead of the proposed foodcourt development. The total cost of the leasing incentives to Daylight Developments was \$275,000.

Daylight Developments continued to absorb pressure from the foodcourt tenants after the leasing incentives were provided. Later, in February 1999 Daylight Developments decided to continue with the foodcourt development. The Quantity Surveyor and Architect were contacted and requested to commence a redesign of the foodcourt in a manner similar to the design presented to Daylight Developments in February 1996 at

a total estimated construction cost of \$1,200,000. The Quantity Surveyor responded to the request and noted that the estimate included for project escalation only up to December 1997 and therefore the budget would need to be recalculated in line with current market rates.

The Quantity Surveyor recalculated the estimated construction cost of the February 1996 and reported a figure of \$1,325,000, whereupon Daylight Developments requested the Quantity Surveyor and Architect produce a revised design that would reflect the original estimated cost of \$1,200,000. The design was subsequently revised and the Quantity Surveyor reported the revised estimated construction cost of \$1,080,000 on 7 February 1999.

Daylight Developments reviewed the revised design and estimated cost commenting favourably about the overall design concept; however, Daylight Developments queried the accuracy of the Quantity Surveyor's estimate. The Quantity Surveyor reviewed the estimate and confirmed that the estimated construction cost was correct.

Daylight Developments were adamant the estimate was incorrect and requested the Quantity Surveyor to submit a detailed elemental breakdown of the estimate. The Quantity Surveyor refused to supply Daylight Developments with this. Instead, the following breakdown of costs was provided:

Cost Centre	\$
Net Construction Cost	860,360
Preliminaries/Margins/Overheads	94,640
Gross Construction Cost	\$ 955,000
F.F&E (Directly Sourced and Fixed by Daylight)	85,000
Project Contingency	40,000

**Estimated Construction Cost (7/2/99)
(Excl. Escalation and GST)**

\$ 1,080,000

Daylight Developments requested another professional Quantity Surveying firm compile an estimate of construction cost for the project. A cost of \$1,100,000 was reported to Daylight Developments on 15 February 1999. Daylight Developments still considered the estimated construction cost excessive and contacted an experienced contracting firm who had completed a number of projects for Daylight Developments in the past. The contractor, referred to herein as *On Time Constructions* (OTC) were given two days to compile an estimate for the project.

OTC reported an estimated construction cost of \$1,250,000 to Daylight Developments on 28 February 1999. Daylight Developments were unhappy with this and demanded that OTC revise the estimate. Two weeks later OTC reported a revised estimated cost of \$1,030,145 (which compared favourably to the Quantity Surveyor's Estimate of \$1,040,000 plus \$40,000 contingency).

Daylight Developments called a meeting with the Architect, Quantity Surveyor and OTC in which all parties were advised that the project budget to redevelop the foodcourt was to be \$750,000 and the design must be modified to reflect this. In addition, OTC and the Quantity Surveyor were requested to work as a "Team" to bring the project back to this budget.

After numerous meetings and discussion between the Architect, OTC and Quantity Surveyor, the design was subsequently revised. However, its integrity could not be maintained at the anticipated budget cost of \$750,000. The Quantity Surveyor

reported that major design omissions and revised quality expectations would need to be made to reduce the budget by the requested 44%. Daylight Developments rejected the report and invited OTC to submit a tender for negotiation with the Quantity Surveyor.

OTC submitted a tender dated 7 April 1999 totalling \$946,148 excluding F.F&E, which compared with the Quantity Surveyor's estimate of \$955,000. Daylight developments requested OTC to omit a number of items detailed on the contract documentation and advised OTC, in writing that these items were to be supplied and fixed directly by Daylight Developments. OTC resubmitted their tender 23 April 1999 of \$917,207 with a qualification deeming the offer was valid for the next thirty days only (Valid to 23 May 1999).

Daylight Developments did not accept the figure submitted by OTC and believed a more competitive figure could be procured through tendering the work to similar sized contractors. Four contractors were invited to submit a tender for the same scope of work as OTC's original tender dated 7 April 1999. The tender results received on 26 May 1999 were as follows: -

Contractor	\$
OTC Constructions – No Qualifications	942,302
Contractor A – Qualifications	958,343
Contractor B – No Qualifications	1,029,000
Contractor C – No Qualifications	1,042,135

Daylight Developments rejected all of the tenders and contacted OTC to accept their tender of \$917,207 (23 April 1999) on the basis that the thirty day period had only just expired and it would be unreasonable for OTC to enforce this time bar. OTC did not enforce the time bar and commenced construction within two weeks of acceptance.

The project was completed 11 August 1999 at a final construction cost of \$1,081,494 an approximate budget over-run of \$1,500.

DISCUSSION

The main client breaches of the Codes and law in general include:

- resorting to market testing without a bona fide intention to proceed with the project
- failure to acknowledge the costs associated with tendering
- repudiation of an implied contract with invited tenders that the most advantageous price would be accepted.

Clearly in this case, the client was exposed to legal action from unsuccessful tenderers. However, at no time did anyone object to the manner in which the tender and review processes were conducted - even after the original negotiated tender was rejected and re-accepted after the lapse of the validation period - despite the Code urging all parties to refuse to condone behaviour that is unacceptable. Thus, all the participants in the case study, by tacit acceptance of the client's actions, effectively condoned the behaviour of the client.

The reason is that all are fiercely competing for projects and any objections to client behaviour is seen as being likely to place them in disfavour and jeopardise the chances of further work. The bargaining power of the client may appear overwhelming. Faced with this prospect, there is no means of resistance by the tenderers as "it is better to be exploited in business than not to be in business at all". Or, as Saul (1981:271) somewhat cynically puts it "... the only truly ethical companies are going out of existence".

One of the most significant aspects of the study is the apparent failure of the client to recognise the costs associated with tendering. Of course, in pure financial terms, clients have no need to be concerned with this as such costs are not passed on directly. From an industry-wide perspective, however, the costs are necessarily passed on indirectly by the contractors' recovery of overheads through higher prices generally. To attempt to reduce overheads by inducing better-behaved clients is, it is submitted, something that can only be achieved by penalising the individual for the benefit of all. Although clearly a counter philosophy to that of free competition, it is worthy of examination as a means of maintaining fairness. In other words, the question is 'How can we change the rules of the game' to solve the problem? The obvious starting point is for the client to bear, at least partially, the cost of tendering, as this should certainly encourage a more efficient process.

CONCLUSION

Competitive tendering provides the vehicle by which a client may obtain offers from the "market" to execute a specified scope of work. It is widely believed that the

tendering process will ensure both probity and equity among all parties involved in the process ultimately leading to the client obtaining the most competitive price. The pursuit of the most competitive price is responsible for the continued competitive culture existing in the construction industry. The competitive culture has always existed due to the differing business interests of all parties involved within the construction process. The process breeds a project-project focus, that is, short term relationships between clients and contractors. This, together with the competitive tendering system itself, encourages self-interest to dominate which, in turn, exacerbates the difficulty in maintaining the fairness of the tender process whenever there are differences in bargaining powers.

From the research conducted, it is evident that clients are not always adhering to the guidelines and underlying principles enforced in the Code. This leads to the question whether the Code in itself is, or ever can be, sufficient to prevent malpractices. But if the Code cannot bring about acceptable behaviour, what is then required?

The case study illustrated the realities of tendering and the difficulties faced by those in the market place. The case study demonstrated a failure of the client to behave, or encourage others to behave, in a socially acceptable manner. Moreover, it showed that, in the face of the client's bargaining power, resistance is impracticable if not impossible. The root of the problem is self-interest. It is self-interest that justifies each client's exploitative behaviour and each contractor's self-interest (ie., staying in business) that justifies it being suffered. Yet self-interest is the very basis of the ideal of free competition. This has, of course, not gone unnoticed, and even the ideal of perfect competition has its opponents (eg., Stigler, 1966; Richardson, 1964). These maintain that perfect competition, even if realisable, would be unworkable, and point to

the fact that those markets which approximate most closely the supposed market structure (eg., some international commodity markets) "exhibit chronic and wasteful instability" (Bullock and Stallybrass, 1980). Competition, it would seem, in both theory and practice within the industry, fails to reward effort, loyalty and continuity (Hinds 1998:5).

An alternative, more optimistic, approach was suggested by Smith himself. "In the areas in which government activity was necessary to maintain the prerequisites of market activity or to counteract the negative consequences of the market, Smith tried to design institutional means to channel private interests to favourable public outcomes" (p153). "When the market is judged to be an inadequate mechanism, the Smithian predisposition is to design structures of incentives which create some of the disciplining effects of consumer choice upon the providers of public services" (p199). It would be most in keeping with the spirit of Smith's work to recognise the reality of disharmonies of private and social costs [as noticed by Pigou], so that the real costs are borne by those who make and consume the commodities which create the negative by-products" (p200). To do this, Smith tried to devise market-like mechanisms that subjected providers to the discipline of competition and tied payments to the actual performance of services (p152) - eg., a flat rate for judges. One contemporary application of this method is the imposition of a tax on polluters equal to the cost imposed by polluter on others" (p200). In the case of construction tendering, it is suggested the costs of abortive tendering be borne more directly by the client, being the major recipient of the benefits accruing.

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