

Enhancing the Efficiency in Public Procurement: Supplier Rating Systems

Sofia Lundberg
Malin Arve
Mats Bergman
Lars Henriksson

Sofia Lundberg, Professor of Economics, Umeå School of Business, Economics and Statistics, Umeå University.

Malin Arve, Professor of Business and Management Science, NHH Norwegian School of Economics.

Mats Bergman, Professor of Economics, Umeå School of Business, Economics and Statistics, Umeå University.

Lars Henriksson, Professor of Law, Stockholm School of Economics.

“Inspired by rating systems found in private markets, this report takes a closer look at how a public rating system leveraging rather than discarding information may be designed and organized.”

In private markets, the reputation mechanism effectively disseminates information regarding the performance of suppliers, both positive and negative. This facilitates informed decision-making, thereby enhancing market efficiency. In the public sector, however, past performance typically does not influence the awarding of future contracts. To address this, a structured and transparent rating system is proposed to serve as the foundation for public procurement contracts.

Inspired by rating systems found in private markets, such as for hotels, taxi services, and second-hand housing rentals, this report takes a closer look at how a public rating system leveraging rather than discarding information may be designed and organized. The analysis shows that it is possible to increase efficiency in public procurements by using a national public rating system. Such a system could also make it less attractive for untrustworthy suppliers engaged in economic criminal activities to participate in public procurements. Our analysis does not uncover any significant legal barriers that would preclude the introduction of a rating system for contract awarding in public procurement.

More specifically, we propose a national rating system for contract awarding in public procurement, which could subsequently be expanded to cover the entire EU. Such a system would be able to counteract the classic incentive problem that a supplier having promised a high level of quality will deliver a low level as this costs less when services, works, or supplies are characterized by quality dimensions that are difficult to measure. We envision a system consisting of different product categories and well-defined areas of assessment, with rating scales ranging from poor to extraordinary performance. For such a system to be viewed as legitimate, it should be operated by a public authority. This ensures efficiency by collecting all ratings in the same system, which is then made accessible to all contracting authorities.

This rating system can be useful throughout the procurement process and used for, for example, market analysis, procedure selection, and qualification requirements, but it may also be used as a catalog of evaluation criteria and as a monitoring tool in public procurement. The latter may also serve as the basis for the potential activation of option periods. Such a system adds transparency and enables considering quality dimensions that are difficult to measure before, during, and after the procurement process, something that is relevant for contract awarding in future procurements. A systematized

reputation mechanism strengthens the incentives to deliver a high level of quality.

Implementing this system shifts transaction costs for reporting and providing information on hard-to-measure quality aspects from the supplier to the contracting authority. For example, when it comes to requirements concerning references in public tenders, unlike rating systems, the transaction cost falls on the supplier. This can make it more difficult for small and medium-sized enterprises to participate in public procurement tenders and thus distort competition. Introducing a rating system may thereby reduce the cost of participating in public procurements and contribute to an increased number of bids. The latter typically leads to lower prices and a maintained or higher level of quality. However, it is not just about more bidders – it is also about attracting the right (i.e., serious) bidders. With properly defined areas of assessment, the rating system may contribute to preventing crime and corruption in public procurement.

An important question when introducing such a rating system is how to manage new potential suppliers. In the report, we discuss whether these should be given an average rating or a minimum rating, depending on the maturity of the market. The suggested system allows for both alternatives.

Implementing and maintaining a rating system obviously entails costs, but these should be appropriately weighed against the costs of the inefficiency arising when relevant information on potential suppliers is not utilized when awarding public contracts.

SNS
Box 5629, 114 86 Stockholm
Phone: +46 8-507 025 00
info@sns.se www.sns.se

SNS, the Center for Business and Policy Studies, is an independent, non-profit organization founded in 1948 that aims to be Sweden's leading platform for objective debate and knowledge-sharing among decision-makers on key societal issues. SNS brings together representatives from the business community, public sector, academia, and politics. SNS takes no positions on policy issues, which supports its bridge-building role. Members include companies, public authorities, and organizations.