

Chapter 18

Procurement's Value: What Are We Really Measuring?

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INTRODUCTION

This chapter presents a commentary on procurement's role as a strategic management tool, how it can play a part in the measurement of public sector success, and how measurement of success might be achieved by applying the concept of public value. In commenting on how procurement's contribution to organisational success might be measured, the chapter also discusses the influences and situations that would facilitate that measurement by drawing on Australian public sector experiences. The commentary is supported by a discussion of Australian experiences including a case study that examines a program aimed at reforming procurement's focus, stakeholder influence on procurement's focus and contribution to organisational success in an Australian regional jurisdiction.

Public agencies are tasked with the delivery of services, establishment of frameworks and leadership of programs. These tasks generate expectations on the part of the public: parliamentarians, private corporations and individuals, and these expectations directly influence the perceptions of procurement's success as a strategic management tool. But do the traditional systems of measuring public sector success reveal to us how close public procurement teams come to achieving those expectations? Are the traditional systems capable of dealing with the emerging public sector environment? Are public procurement teams able to collect procurement data, determine success and influence future decisions accordingly?

There is a growing belief that the traditional systems are not adequate. "Some of these changes, such as those associated with

multi-party delivery, require new ways of thinking about how best to inform stakeholders about achievements” (Cameron, 2004, p. 67).

One of the lessons drawn from the case study that appears in this chapter is that procurement offers a basis for developing such a tool. The challenge is to identify a tool that can provide an acceptable measure of non-price outcomes and investments in systems; and that operates within management systems that continue to change as delivery systems change. Measuring achievements, or organisational successes, requires the establishment of reference systems that take account of diverse pressures from key stakeholders which act as drivers of public sector renewal.

OVERVIEW

Public value as a concept offers a unifying theme that facilitates the discussion of public sector success (Smith, Anderson & Teicher, 2004). Moore describes public value as a measure that recognises that public organisations consume public resources and these resources or “efforts” need to be accounted for in measuring success. “If the managers cannot account for the value of these efforts with both a story and demonstrated accomplishments, then the legitimacy of their enterprise is undermined” (Moore 1995, p. 57). This concept can be placed into an Australian context by assuming that public value is created when agencies deliver services, frameworks and programs that meet the expectations of the key funding stakeholders, including parliamentarians, treasury agencies and agency executives; and when agencies are held accountable for the efficient, fair and open delivery of these outcomes.

Public value is based on the perceptions and expectations of the stakeholder rather than a quantified set of measures. This presents a dilemma in that the expectations of various stakeholder groups may not be consistent. This can be satisfactorily resolved by measuring procurement’s success only in terms of the expectations of key funding stakeholders, including the executive arm of the elected government and the senior executive of each agency. As shown in the case study, the expectations and perceptions of other stakeholders influence and inform the expectations of the key funding stakeholders. Resolving the dilemma in this way is consistent with public choice theory. Public choice theory assumes, *inter alia*, that the actions of those acting in the public arena are

motivated by self-interest and that there is no direct reward for groups that infer benefits on a public that is aware of neither the benefits nor their source (Shaw, 2002).

Moore's suggestion that public value measures should also take account of effort as well as outputs also need to be placed into a resource management context. Generally such an assessment includes inputs only as direct resources and excludes the cost of managing the resources, costs such as those involved in identifying and sourcing those inputs. Even when attention is given to management of inputs in alternative models, such as Public Private Partnerships, the focus remains on outcomes or merely outputs. Inputs tend to be considered in either steady state models, assuming no other changes, or in terms of relative distributive efficiencies – the comparison of alternatives. Rarely is the effectiveness of a project's total resource management considered as a variable. This is underscored by the experience of jurisdictions undergoing procurement reform, such as South Australia (State Supply Board, 1996), that few agencies enjoy the capability necessary to accurately assess the return received on their investments in procurement capability and resources.

This narrow focus may result from a failure to understand the full scope of resource management. Resource management is the discipline by which the goods and services that agencies acquire (buy, lease, recruit or make) and apply to their operations are managed. External resources are significant, they can account for approximately two-thirds of public agency non-human resource spending (State Supply Board, 1996). Over time, significant attention has been given to internally sourced inputs, such as human resources, but far less attention has been given to external resources, those goods and services that are bought in or contracted out to other parties.

External resources are managed through procurement. Procurement is the business management process that “deals with the management of those external resources brought into an organisation to support its activities” (Kidd, 2005, p. 19). It ensures that the external resources that an organisation needs or may need to fulfill its strategic objectives are identified, sourced, accessed and managed. It exists to explore supply market opportunities and to

implement strategies to deliver the best possible supply management outcome to the organisation, its stakeholders and customers.

Russill describes the suppliers of external resources as being critical to an organisation's business success but difficult to manage because they sit outside of the business. The procuring organization is therefore reliant on a resource that might have a different culture and priorities and that may resent the customer's intrusion into its activities (Russill, 2003). It is procurement that provides the skills and systems that enable us to manage and motivate those external resources.

Procurement is a management discipline and profession that seeks, by drawing together the entire supply chain with agency strategic planning, to develop a broad alignment of supply management activities with organisational objectives that go beyond cost-based allocative and supply efficiencies. Procurement is also a discipline undergoing significant development with the result that it is expanding its body of knowledge and is awakening to the realisation that it can make a far greater contribution to organisational outcomes than previously recognised.

Procurement success, in particular, is an area of expanding thought and practice. Until the late 1980s buyers, particularly in public sectors within Australia, managed their supply function as a "lowest-price-driven" buying activity in which success takes little account of broad organisational objectives. If taken to its extreme, this model would totally discount future costs of ownership in relation to purchase price such that the other components of "total-cost-of-ownership," including operation, maintenance and disposal costs, carry no weighting in the evaluation process. The extreme form is generally not implemented, but it does serve to illustrate that any undue weighting towards price serves to focus procurement outcomes on project factors rather than organisational success. Recognition of this impact was one of the drivers behind the procurement reform process in Australia (State Supply Board, 1996). At that time, the experience in Australian jurisdictions suggested that the general public held the view that the public sector bought on price alone. Although inaccurate, this perception influenced the expectations and perceptions of stakeholders and worked to prevent the development of strategic relationships (State Supply Board, 1996).

The last decade has seen significant change. It has been well argued in Australia (House of Representatives Standing Committee on Industry, Science and Technology; 1994; State Supply Board, 1998; Wright, 2004) that “value-for-money,” rather than lowest-price, is a measure of success that more closely links procurement success to the achievement of individual project aims. Value-for-money is achieved when a good or service is supplied at a fair price effectively, e.g., in terms of delivery, fitness for purpose and supply market development.

Value-for-money, as a concept, held stakeholder attention even as the public procurement profession came to believe that it was too narrow a focus. McGuire (2004), amongst others, argues that value-for-money, when narrowly focussed, goes only part way to measuring procurement’s contribution to organisational success. While value-for-money remained a focus, broader concepts were “consistently overlooked in the rush by procurement managers and other supply chain managers to demonstrate the efficiency of their purchasing function” (Callender & Matthews, 2002, p. 4). This is still the case where procurement practitioners report to key stakeholders who are yet to be convinced that procurement has a strategic role and who seek price savings and process efficiencies above all other benefits. Such stakeholders, although a minority, still exist in some Australian jurisdictions.

Current thinking is leading public procurement professionals to look to structure their activities to seek out and realise a concept of success that goes beyond the total-cost-of-ownership model of value-for-money (Callender & McGuire, 2005; Foreman, 2003; McGuire, 2004; Weatherill, 2003). This concept of success suggests that procurement delivers value when it not only supplies a good or service at a fair price effectively but when it, at the same time, contributes to organisational goals.

A lesson from the Australian experience (see case study) is that funding stakeholders are increasingly asking for the public sector to manage its external resources as an investment that delivers an outcome over and above the traditional measures of value. While these stakeholders do not use the same language to describe the concept as do public procurement professionals, it is clear that they are independently arriving at the same conclusion.

The debate needs to grow to include what is being measured as well as how it is being measured. Focussing on a particular procurement project, even when taking account of its contribution to organisational success, does not address the whole picture. The focus should be on the entire procurement function in order to support arguments for further investment in procurement infrastructure. Agencies, when measuring and assessing the effectiveness of their investment in procurement, must take account of not only the external resources bought in, but also the investment in peoples' time and skills, in systems and in management. To position themselves to measure public value agencies should treat the resources expended in this activity as an investment and should ensure that this activity makes a return to their communities by acting not only as procurement experts but also as change agents in the services delivery areas supported by procurement.

This conclusion is well documented. An example is the United Kingdom where an independent review of British public sector efficiency resulted in a series of recommendations aimed at delivering improved efficiencies across the public sector (Gershon, 2004). This review concluded that improved efficiencies are dependent on change agents operating in the areas of requirement management, resource management and program management to drive these efficiencies to align "front-office" and "back-office" functions. As part of this drive, public procurement would aim to improve:

- strategic management of major supply markets to consider supply-side issues;
- strategic visibility and influence exercised over total agency spend;
- professional support of procurement activities; and
- services procurement to ensure a focus on value-for-money.

Alignment of "front-office" and "back-office" functions is necessary, "while much is made about the extent of public procurement's broad range of power in expending the public's money, certain boundaries exist that often go unnoticed. Each public agency has stringent policies and guidelines on how procurement will be handled" (Matthews, 2003, p. 4). These boundaries stem from the failure to allow purchasing experts to have control, or even influence,

over the entire process; “purchasing officers essentially serve as the final processor of the acquisition at hand” and from that position cannot influence resource management. “Innovation, and possibly creativity, tends to be limited when government agencies follow uniform and routine standards. Though consistent methodologies do have their benefits, they can also aid in masking the accountability for those employing them” (Matthews, 2003, pp. 9-10).

These boundaries have the effect of making it difficult to align procurement activity to agency objectives in a way that focuses procurement on achieving agency success. The consequences of continuing to operate systems that do not align resource management with organisational objectives can be severe. Procurement is one of the major economic activities performed by governments. Allowing that major economic activity to continue as a clerical transaction-focussed function without alignment to the agency’s priorities and strategic objectives severely limits its potential to contribute to public value (Government-Wide Review of Procurement Task Force, 2005).

The failure to recognise the need to align procurement with agency objectives is linked to a general failure to recognise resource management’s role in determining if agencies are achieving public value. The solution to the problems caused by these failures requires public sector executives, including funding stakeholders, as a first step, to acknowledge procurement as a management profession. This is a key action in giving procurement professionals the freedom and the discretion to assess opportunities, to link procurement to the goals of their organisation and through them to the policy objectives of the government.

There have been some significant programs in South Australia [see case study (State Supply Board, 1998)] and the United Kingdom (Gershon, 1999) designed to lead public sector executive recognition of procurement as a profession. The case study that follows outlines the progress made toward a professional public procurement community through reforms initiated by South Australia’s then State Supply Board. The reforms sought to implement a value-for-money culture in which procurement’s alignment with strategic outcomes was promoted. The thinking behind these reforms has continued to develop toward greater alignment to agency objectives.

South Australia, as a discrete public sector jurisdiction, provides a useful reference for this discussion. A key lesson from South Australia is that intelligent and strategic resource management is particularly important in public sector reform. It is not enough to give public procurement professionals greater discretion, nor is it enough to describe the linkages between agency procurement activity and agency strategic outcomes. Effective resource management, and therefore procurement, requires information.

It has been said that you can only get what you can measure (Kaplan & Norton, 1992) and a critical issue facing procurement professionals is determining what to measure and how to measure it. The lack of such a measure not only prevents public value being determined, but the lack of a single high profile and easily understood measure has served to prevent procurement's gaining the attention of senior managers and executives (Steele & Court, 1996).

Studies (Howarth & Wynen, 2003; Lee, 2004) have demonstrated the value that the collection and analysis of resource management information can bring to an organisation. Lee, for example, studied over sixty companies that had focused on resource management as a broad concept and found that the collection and analysis of supply function and supplier market data is as important to organisational success as sales and sales forecast data. Firms that concentrated only on the effectiveness of their operations, without building an understanding of their external resources, did not achieve the same level of value as firms that measured both sides of the equation.

Howarth and Wynen (2003, p. 1) found that "one of the greatest differentiators of best-of-breed purchasing operations is the ability to consolidate and monitor - easily, effectively and continuously - what a company spends on what goods and services, and with which suppliers". These organisations collect data and assess it in a strategic context. In the public sector, effective data collection and analysis linked with a strategic mindset enables procurement, as a management discipline, to contribute to service improvements through more effective and efficient networks (Harland, 2003). Examples of these networks in action include multi-jurisdictional community-led community renewal projects underway in the United Kingdom and projects to engage the community in the redevelopment of social infrastructure such as the Lyell McEwin Hospital Redevelopment in South Australia. The South Australian project

involved a broad cross-section of the community in the redevelopment project through training, volunteer and other programs.

The development of a tool for measuring procurement's contribution to public value, taking it well beyond the simple concepts of price, total-cost-of-ownership and savings, is the next major step that public procurement needs to take. When this has occurred, and a single, high profile, easily understood and recognised measure of procurement effectiveness is in place, public sector stakeholders will be positioned to recognise the effectiveness of agencies in contributing to organisational success.

Australian jurisdictions are addressing this need for a new tool. South Australia is one (see case study); Queensland is another and Western Australia a third. Queensland has the requirement that agencies undertake procurement-profiling in order to support agency strategic procurement activity (Queensland Purchasing, 2000). This policy, including the profiling requirement, is supported through training and development activities and by expert teams based in a central agency to work with client agencies in the specialist-profiling task.

Western Australia systems and policy framework are implemented through its *Procurement Reform Toolkit*. This toolkit aims to deliver significant and better quality procurement outcomes by enhancing the professionalism of procurement activities, the skills of procurement officers, the processes and systems used by procurement specialists and by streamlining procurement policy.

The *Procurement Reform Toolkit* and the program it supports are having a significant impact upon the management of agencies and the recognition of the value of procurement as a strategic management tool. The system mines spend data from agencies across the public sector and produces detailed reports that compare agency spending patterns against benchmarks and against other agencies. Measurement against benchmarks allows the potential savings lost by agencies to be estimated and advised to agency executives.

The Western Australian system does not yet fully measure procurement's contribution to public value. A future step could be to factor the investment in procurement into the benchmarks, as this

will enable the total cost of the external resources used in public sector initiatives to be determined.

The data produced by procurement-profiling activity is required to enable the collection and assessment of the strategic intelligence necessary for the implementation of strategic procurement (Callender & McGuire, 2005). Strategic procurement is the process by which procurement focuses on organisational objectives by challenging the assumptions that describe procurement as a clerical function (Kidd 2005). The data that procurement-profiling produces can also be used to measure resource management effectiveness and to enable agencies to measure their effectiveness in achieving public value.

Despite the progress of recent years, gathering procurement data is not easy going. Howarth and Wynen (2003) tell us that the solution is not to be found solely in software solutions. Successful Western Australian and South Australian initiatives in procurement profiling support this. Information produced by software solutions needs to be placed into an organisational context, a context that not only allows analysis of trend data over time and benchmarking against others, but one that also links to the organisation's goals and the strategies it has in place for achieving those goals.

Similar messages come from other studies. For example, a review (Tonkin, 2003) of the roll out of electronic purchasing systems in public sectors looked at a number of countries, with Australian jurisdictions used as case studies for assessment. A key finding is that electronic purchasing, seen by some to be a panacea for a range of public sector administrative ills, has, often, been rolled out without due planning and research. A "fundamental confusion about the rationale for the adoption of e-procurement by government entities has given rise to a failure to perform adequate analysis in support of business case development. There is little evidence that adequate baseline information to assess the impact of E-procurement initiatives is collected" (Tonkin 2003, p. 2). Without the baseline information, there is not only little potential for success but there is little prospect of measuring any success. This suggests that the development of the data collection framework is an intermediate step, following a comprehensive baseline project, in implementing electronic purchasing systems.

The gathering of data is critical to planning and decision-making intended to align outcomes with agency objectives. However, the collection of data is not of itself sufficient. The skills and contribution of experienced professionals are required to place that data into an agency context and to develop strategies for aligning that business activity to agency goals in order to deliver public value. Conversely, the public procurement profession cannot truly define and measure public value if it is unable to take account of the investment in resources and management effort that its activities consume.

**CASE STUDY:
SOUTH AUSTRALIAN PUBLIC PROCUREMENT REFORM**

The public sector in Australia operates at three levels: the Australian government at the national level; state and territory governments at a regional level; and city, district and shire councils at the local level. South Australia is state jurisdiction of approximately 1.5 million people and an \$A15 billion in annual state government budget.

The South Australian government began the process of procurement reform in 1996 through a major review of its procurement processes (State Supply Board, 1996). In summary, this review found that the procurement activities of the government were focussed only on goods, was clerical and process-focussed, and did not address agency line managements' needs resulting in a relatively level of compliance. The procurement processes were not strategic and did not address objectives broader than the project or program level.

These findings were of significant concern as the management of external resources through the procurement process was (and still is) a high priority for the South Australian government. A major and comprehensive review of expenditure found that in the 1994-95 fiscal year, South Australian agencies spent more than 40% of their total budgets on operating expenditure (including goods and services, building works and community services) as much as on human resources (State Supply Board, 1996). More recent assessments indicate that this proportion is growing as service delivery arrangements change and as greater community involvement in community development programs is sought (Department of Treasury and Finance, 2006).

As a result of the reform process initiated in 1998 and renewed in 2004, the South Australian government is well advanced in restructuring and reforming its procurement activities with strategic procurement as the driver of resource management. When fully implemented, South Australia will be positioned to establish the systems and disciplines required to measure its contribution to organisational success taking into account the resource management applied to its programs.

The requirement that strategic procurement be linked to government objectives was initially enunciated as an outcome of the work of the then State Supply Board (1996; 1998). Its status as a key priority has been confirmed both by the *State Procurement Act 2004* (Parliament of South Australia, 2004) and in a series of cabinet decisions supporting the rolling out of the associated implementation program. The Act requires public agencies to advance the priorities of government through a system of procurement that delivers a number of key outcomes including value for money, transparency and ethical behaviour

The original reform program, initiated in 1997 by the then State Supply Board sought:

- enhanced and more strategic procurement practices;
- introduction of efficiency and effectiveness objectives for government agencies;
- recognition of the capacity for government purchasing power to improve supplier performance and competitiveness as a driver of economic development;
- the opportunities afforded by a new business environment enabled by technological innovations such as electronic commerce;
- introduction of innovations such as electronic commerce; and
- support for public sector managers to manage effectively and in a way that ensures accountability requirements are met.

Procurement practitioners' increased discretion and greater focus on the linkages between procurement and agency outcomes both require information to be successful. Key objectives of the reform program are to implement systems to measure procurement activity,

including supply decisions, and to ensure agency investment in and the development of procurement systems and capability. Some agencies, as will be discussed shortly, have implemented procurement-profiling programs and are collecting procurement data for use in strategic procurement. The availability of this information provides opportunities to ensure procurement activities support overall government policy and contributes to organisational success.

The Department for Administrative and Information Services (1998, p. 20) noted, “better and smarter buying enabled by the powerful use of information technology is the catalyst to achieve significant, ongoing savings in procurement. The availability at both whole-of-government and agency levels of timely, accurate and extensive information on government contracts, purchasing patterns, supplier capability and performance will be critical in supporting agency decision making, buying effectiveness and productivity improvements.”

Procurement based resource management in South Australia is an emerging element of leading edge public sector management praxis. Foreman (2003, pp. 3-4) described the general acceptance of this position by noting that procurement “activity should deliver the greatest value to the community for the expenditure made on its behalf” for there is more to “supply than merely ensuring goods turn up when needed and that we paid the lowest possible price for them. Procurement should be a key enabler in the achievement of organisational goals.”

State public procurement practitioners are called on to take into account the South Australian government’s identified key policy objectives, goals such as environmental sustainability, economic development and social inclusion. There is an expectation at Cabinet level, and drafted into the *State Procurement Act 2004*, that achievement of these goals will be supported by procurement based resource management (Weatherill, 2003).

The South Australian government’s across-government electricity contract is an example of this. This contract achieved excellent price outcomes in a time of significant price instability; it achieved positive developments in the supply market that led to benefits for all consumers, and it gave a base-load to “green energy” that supported the generation of energy from renewable sources that in turn

supported the Government's environmental sustainability objective. These included the installation of photovoltaic cells on a range of public buildings including schools. Involvement of schools allowed not only savings in power costs but also the inclusion of practical environmental science applications in the schoolroom. High profile installations also contributed to broader community understanding and take up of alternative energy systems.

The Department of Transport, Energy and Infrastructure (DTEI) provides an example of the requirement for procurement-profiling in action at the state government level. DTEI undertook a comprehensive procurement-profiling project that provided it with a baseline of agency procurement activity. This baseline provided a detailed analysis of what the agency purchased, how it undertook purchases and how those purchases were spread across business units and regions. Using this information, DTEI developed and rolled out an electronic purchasing system during 2004. This agency is confident, and early results indicate, that the system gives the agency greater control of its procurement spend, through improved reporting, benchmarking and reporting against benchmarks. The system also provides the springboard for ongoing improvements in procurement strategy aligned to agency and government objectives. This linkage will enable DTEI to use its supply activity and investment to support its pursuit of public value. Other South Australian government agencies following the same strategies include the Department for Administrative and Information Services (DAIS). DAIS is also finding that the action of gathering data is providing significant benefits in establishing the patterns of spend enabling co-coordinating activities to be implemented, as well as positioning it to establish and report against benchmarks in procurement.

The progress made in leading public procurement practice toward professional status is timely. Initially the calls for agencies to contribute greater public value through improved resource management were driven by practitioners themselves and by agency executives. Now, other general community leaders are recognising the potential benefits and are also calling for the public sector to become more strategic and effective in program delivery. For example, the South Australian government established a Social Inclusion Board, whose chairperson has publicly advocated for greater attention to be placed on the procurement of services to

reduce lead times and to improve outcomes. This call is based on the recognition that traditional price-focussed supply mentalities linked with poor program management is one cause of poor social service outcomes.

The state's Economic Development Board (EDB) is another body to have identified specific actions to be taken to ensure that procurement delivers outcomes that support its expectations of public value. In 2003 the EDB (Economic Development Board, 2003) called on the state government to introduce program management and resource management systems that are simpler; to ensure that accountabilities are clearer; and to require that reporting and management oversight should be strengthened. "The community wants the government to be long-term in its outlook ... be transparent and open about its plans, and follow best practice in providing an appropriate level of services" (Economic Development Board, 2003, p. 22). Its report called on the public sector to become a "demanding consumer," essentially describing what others, such as the State Supply Board see as procurement professionals.

A link between procurement and organisational success is critical. To achieve this EDB (2003, p. vi) recommended that the government:

- "Introduce a whole-of-government State Strategic Plan that will outline the process to improve coordination and resource allocation;"
- "Improve measurement, monitoring and reporting of government performance;"
- "Encourage greater accountability, clarity and delegation;"
- "Rejuvenate the public service to make it more responsive and professional;" and
- "Ensure that the South Australian Government has the best productivity possible from available resources."

In South Australia, the measurement of public value will, eventually, not only identify and weigh the investment in procurement against the benefits delivered by strategic procurement; it will include measures of public procurement's contribution to the deliverables

identified in the State Strategic Plan. Procurement performance measurement will support this.

The changes that will be required to achieve the calls being made by community leaders will have a significant impact on the way that South Australian government agencies are managed and measured. Fortunately, other institutions with oversight responsibilities, such as the State Supply Board (2000), had already identified these imperatives and implemented reforms aimed at delivering the same or similar outcomes through the introduction of procurement as a management profession.

The development of the capability to measure procurement's success, the return from investment in procurement infrastructure and to accurately determine the investment in resources will enable the South Australian government to ascertain the effectiveness of its delivery of public value taking full account of the resources applied to the activities.

CONCLUSION

Broadening the focus of the on-going discussion of the achievement of public value, so that it considers procurement, offers the potential to more clearly and accurately assess the return that agencies receive for their investment in delivering outcomes. And, importantly, the potential to provide this information in a form that key stakeholders can absorb and within a context that is relevant to them. As the concept of public value is based on perceptions and expectations it should not be seen as a measure that replaces quantitative assessment. Rather it should be seen as another tool in a toolkit that public procurement professionals could use to engage stakeholders in the development of procurement as a strategic management function.

Achieving this broader focus, however, requires the public sector to establish systems to collect information in order to allow measures of performance against targets aligned to organisational objectives. The experience in both public and private sectors is that such measurement systems are not easy to implement but emerging evidence indicates that it can be done and it does add value. Procurement professionals need to focus on this issue and to be supported by agency executives in the pursuit of systems that are

based on the agency's procurement profile and that align and measure their contribution to their agency's strategic objectives.

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