Synopsis: The balance of unbalanced bidding

JOHAN NYSTRÖM

Abstract
Unbalanced bidding is portrayed as a serious problem in the construction industry. The concept refers to a situation with asymmetric information when using unit price contracts (UPC). UPCs are used in different sectors but are the most common contract when tendering construction work. Bids for these contracts are price vectors, where the contractors submit unit prices for estimated quantities. The estimated quantities are provided by the client. In building a road, the list of quantities consists of e.g., cubic meters of gravel, yards of concrete, square feet of asphalt, etc. UPCs open up for an informed contractor to skew unit prices in order to enhance profit. There is an incentive to cut unit prices on overestimated quantities and raise unit prices on underestimated quantities. This creates an inefficient information rent.

There is however a lack of empirical support for the existence of this bidding behavior. The common view in the industry of this being a serious problem is based on anecdotal evidence. Results from the few existing studies on this topic, using US data on road construction, indicate that unbalanced bidding is not a major determinant in preparing bids. This paper, using more project-specific control variables, tests the magnitude of skew bidding on road construction in Scandinavia. It is concluded that the effect is even smaller than in earlier studies.

Hence, there is a mismatch between, on the one side, the industry opinion and theory and on the other side statistical studies. Apart from providing new empirical insights on unbalanced bidding from Scandinavia, this paper sets out to explain the mismatch. There are a few potential explanations for this contradiction, such as risk-aversion, the legal system, contract details and client strategies. By going outside conventional methods in economics and interviewing contractors, these and other explanations are to be “tested.” The contribution of the paper lies in providing new insights regarding bidding behavior with UPCs.

Structure of the paper

1. Introduction
2. The concept of unbalance bidding
3. Research on unbalanced bidding
4. Data and estimation model
5. Analysis*
6. Institutional explanations**
7. Conclusion

*Data mining has been done and initial results show smaller/non-existent results compared to earlier studies that are based on US data (Bajari et al. 2014 and Miller 2014)

**The lack of statistical support for unbalanced bidding in road construction is intriguing. In order to understand this I intend to go outside conventional methods in economics and interview contractors. Why don’t contractors skew bids since there are obvious openings to do so? There are a few institutional candidates to explain this, such as risk-aversion, the legal system, contract details and client strategies. These are to be “tested” in the interviews. Apart from providing new empirical insights on unbalanced bidding from Scandinavia, the explanations of contradictions between theory and data is the real contribution of the paper.

References