Contrasting Bid Shopping and Project Buyout

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Estimators have the responsibility of obtaining bids and performing project buyout while maintaining high ethical standards. As construction professionals more fully understand the ethical issues separating the unacceptable practice of bid shopping and the acceptable practice of project buyout, they will improve the efficiency and quality of the estimating and subsequent project management processes.

Key Words: Bid Shopping, Project Buyout, Ethics, Estimating

Introduction

Project buyout and bid shopping are two concepts familiar to construction professionals. Project buyout is a necessary and ethical practice conducted during the preconstruction process which enables a general contractor to clarify scopes of work and streamline specific activities for the project. Project buyout occurs between the award of the bid to the general contractor and the issuing of subcontracts and purchase orders. Bid shopping is a legal, yet unethical practice where details of a bid are revealed to a competitor in an effort to affect an overall lower bid. A better understanding of ethical vs. acceptable construction practices will help construction professionals identify the difference between bid shopping and project buyout while steering clear of unethical quagmires and still remain competitive.

Bid Shopping

Under typical practices for a competitive bid process, the owner sends out a set of plans for general contractors to bid. However, "most building projects cover a … broad scope of work, making it impractical for the contractor to perform most of the work (themselves). To complete the project on time and be the lowest responsible bidder on the bid, the contractor needs to solicit subcontract(or) bids... Subcontractors submit their bids to the contractor to be incorporated into the contractor's bid" (Degn, 2003, p.48). The general contractor then selects the lowest qualified bids from among those subcontractors and offers an overall bid to the owner. If at any point during the bid process a general contractor discloses a subcontractor's bid with another subcontractor the contractor is guilty of bid shopping, an unethical practice.

The justification, for some contractors, when arguing in favor of bid shopping is, that if a bid is revealed to another subcontractor, then a lower bid may be forth coming, which may translate into a lower overall bid on the project, benefit the owner, and thus increase the likelihood of being awarding the project. It can be argued that this is no different than shopping for a car or bartering for goods in a foreign country. However, in the auto industry there is an expectation that pricing will be disclosed to other dealers in the buying process. That expectation does not exist in the construction industry. A construction project is something yet to be built. It is not an existing product and any changes in the cost typically will affect the quality or schedule of the project. Therefore, the owner is not receiving the same product if bid shopping occurs.

Bid shopping can be looked at from almost any standpoint as unethical. Bid shopping is often characterized as a bad practice, conducted only by general contractors. This is not the case. Project owners may bid shop general contractors. Consider the owner who calls a general contractor after bids have been submitted and asks the general contractor to lower their price to meet or beat a competitor's price; a perfect example of bid shopping. An owner who rebids a project without a substantial change in project scope, it is also bid shopping because, in essence, the general contractors now know each other's bids. General contractors may reveal one subcontractor's bid to another subcontractor with the expectation of receiving a lower bid. Subcontractors may shop bids from their suppliers with the same expectation of receiving a lower bid. Ironically, a perception in the industry is that it is unethical for the general contractor to shop bids, while it is acceptable for a subcontractor to shop pricing from their suppliers. Each is a form of bid shopping and is unethical.

An equally unethical behavior closely related to bid shopping is "bid peddling". Bid peddling occurs when a subcontractor, supplier, or general contractor coaxes the company receiving the bid to reveal the lowest price they have received, with the intent of modifying their own price to then be the lowest bid. The only difference between bid peddling and bid shopping is whether the disclosed bid price flows upstream or downstream.

Consequences of Bid Shopping

Attempts to prevent bid shopping have made the industry less efficient. The most common technique to prevent bid shopping is to submit a bid at the last minute, thus preventing the contractor receiving the bid from shopping the bid. This practice is referred to as "just in time" bidding. While a "just in time" bid reduces the contractor's ability to shop the bid, it also prevents the contractor from being able to review the bid's completeness by verifying price, scope, and schedule (Atkins, 2007). When just in time bidding occurs, the buyout process becomes much more demanding. Without a careful review prior to bid acceptance, errors increase and additional adjustments are necessary during the buyout process.

A strategy that bid shopped companies employ in order to remain competitive is to reduce their bid so they are awarded the project, and then aggressively seek change orders to restore the profit lost during the bidding process. Such companies may also look for short cuts and other methods or materials that will reduce their costs, restoring the lost profit. This often results in additional rework and project delays resulting in an overall higher project cost and a reduction in project quality. Additionally, long term affects of bid shopping can translate into increased life cycle costs on the project. For example, a tile contractor whose bid was shopped may use less expensive cement and sealant to place the tile. After a few years the grout for the tile begins to crack and the tiles break loose from the floors. By the time the defects are noticed the warranty period is over and the owner's only solution is to replace the tiles prematurely (McNeil, 2008 personal communication).

If a contractor has a reputation of bid shopping, subcontractors and suppliers will often inflate their prices to that contractor because they know their bid will be shopped. This extra mark-up allows them to drop prices later and still preserve profit. "If we know a GC that's looking for 5 percent every time, we're going to raise our price 5 percent going in," says a member of the American Subcontractors Association. "I'm going to give my best price to the (contractor) who doesn't shop or try to beat me down" (Russo, 2007).

Sharing the price of early bidders robs them of their expertise and competitive advantage. The time and effort put into the bid is now shared with other bidders who obtain the same competitive advantage without the requisite effort. This creates a problem in that other bidders don't know exactly what thought processes were involved in creating the bid. Prices are now equal but the methods of construction and materials used may be vastly different. By diviluging a competitor's price, an argument could be made that intellectual property rights have been violated.

A few contractors justify bid shopping as a way to keep their favorite subcontractors honest. This however makes no sense, how can you keep your subcontractors honest when your own practices are not.

The gray area

A glulam supplier related the following situation: One of their largest customers who had ordered exclusively from the company approached them with a concern. The customer said they were approached by a different supplier who offered a lower price. The original supplier decided to lower their price and keep the business of the long time customer. Was this unethical? Some readers may feel that this client should not approach the original supplier and inform them they have a lower offer. In this scenerio, there are additional factors to be considered. The customer wanted to continue using the original supplier because of the long relationship and the known level of service and quality of the product. The customer also needed to do their own due diligence on behalf of their customers by providing the best possible price. The original supplier appreciated the customer offering them the chance to renogotiate the price and did not consider this situation unethical for the following reasons:

1. The customer didn't go back and forth from supplier to supplier trying to get each company to repetitively lower their price.
2. The customer didn't reveal the other company's name or price; they just asked if they could reexamine their price to be more competitive.

The original supplier dropped their price a little but retained the customer and a long-term relationship. The customer also retained a supplier who they knew had the ability to supply a quality product in a timely mannner. They both retained a long-term relationship that had historically been mutually beneficial. Situations like this make it hard to determine whether one is renegotiating a price or whether bid shopping is ocurring. In this situation, the authors feel that bid shopping did not occur.

Why bid shopping occurs. A subcontractor being shopped assumes that if they do not reduce their price they won't get the job. Sometimes business is slow and the subcontractor is willing to accept a lower profit in order to keep their crews busy even if it means they will only break-even on the project. The most common bid shopping pit fall for a subcontractor is the promise of more work if the current job goes well (Marrot, 2008 personal communication). Too often this ends with a subcontractor finding more work, but the additional work does not led to higher overall profits. Often, over time, the subcontractor finds themselves being squeezed job after job until they end up in bankruptcy.

General contractors who do not bid shop can still be impacted by these unethical practices. During the course of a bid, a general might receive a "revised" bid from a sub who finds themselves the new low bidder. This could be the effect of another general contractor shopping bids and having that number trickle through to all those bidding the project.

Who benefits from bid shopping? If bid shopping occurs during the bidding process, the owner benefits by receiving a lower price for the project. However, the owner receives a lower quality project and runs a higher risk for warranty problems down the road. If bid shopping occurs after the bid is awarded, the general contractor who is bid shopping stands to benefit from the lower bids and the owner receives a lesser quality project. Ultimately the owner has been robbed of the quality project they paid for.

When bid shopping or bid peddling is encountered, trust, communication, and cooperation are usually lost. The atmosphere on the project becomes tense and everyone is looking out solely for their own self interest and the spirit of cooperation does not exist (Smith, A., 2008 personal communication).

Bid Shopping Summary. In an ideal situation the contractor has time before the bid closing to review all the bids, solicit additional bids, and negotiate bid scopes and prices. There is nothing wrong with crunching numbers, checking historical data, comparing bids, and asking subcontractors if their bids are their best bids. This helps keep the contractor's price competitive and provides the best price to the owner of the project.

The problem arises when "letting one bidder know where their price stands in relation to the competition and letting that bidder adjust their pricing accordingly" (Plue, 2008 personal communication). Bid shopping focuses the project only on ones self interest and ignores project quality, schedule, safety, and integrity. The ultimate consequence of bid shopping is losing the trust of others.

Project Buyout

To compensate for insufficient time during the bidding process for a contractor to analyze the bids, generally a period of time is allotted after the award of the bid to the general contractor and prior to the award of subcontracts and purchase orders, during which the general contractor completes the review of all bids. This period of time is often referred to as “project buyout”. Project buyout is the process of converting all subcontractor bids to subcontracts and all material quotes to purchase orders (Johnston, 2004).

Benefits of Project Buyout

Project buyout allows a period of time for the contractor to ensure that each scope of work is covered by only one subcontractor. Occasionally a contractor finds that two subcontractors submitted bids for an overlapping scope of work. Since both subcontractors do not need to perform the work, the general contractor will determine which subcontractor will perform the work for the overlapping scopes. The subcontractor that doesn’t perform the overlapping work will generally provide a credit to the general contractor for the reduction in their scope of work. If the opposite is found and there has been work that was assumed to be included in a subcontractor’s scope of work, but was not included in the bid, the general contractor generally negotiates with a subcontractor to have the work included in their subcontract and that negotiation may increase the contract amount for the subcontractor.

Another instance where changes could be made during the project buyout process results when a subcontractor anticipated a different project schedule than the general contractor. As a result, the subcontractor may not have sufficient crews to complete the job in the timeframe or manner desired by the general contractor. In this case, the general contractor may elect to use a different subcontractor in order to maintain the project schedule.

After the bid process has been completed, the project manager for the general contractor may review the bids and desire to bundle a set of the scopes of work together. An example of this may be to subcontract the road base and asphalt together. By doing this, the project manager has one point of contact, rather than two. By bundling the scopes into one contract, greater efficiency may be obtained.

Project buyout should occur as soon as possible. This helps to lock-in material prices and prevent price escalation on the project. Most subcontractors and suppliers state that their bid is good for a specified number of days, (e.g. 30 days). It is then incumbent upon the general contractor to issue purchase orders and subcontracts in a timely manner in order to prevent price increases.

The process of project buyout can have a profound effect on the relationships of the parties involved. Therefore, the project buyout process should be done in an ethical and timely manner. This increases the spirit of cooperation and teamwork on the project.

Industry Advice

Unethical practices have proven to hurt the industry. Curt Smith, owner of a small remodeling company, stated a good portion of his success comes from providing honest, hard work. Regarding bid shopping he said, “We all want to make money and get jobs, but the way to do that is by providing a quality product or service at a fair price. Bid shopping transfers the focus away from quality to money” (Smith, 2008 personal communication).

While bid shopping is unethical it does not mean a contractor must accept the submitted bids. A general contractor can perform their own takeoff, price it out and if the general contractor thinks they can secure a better price on the work, the general contractor can refuse all bids and continue to seek a better price. If this practice is followed, a general contractor should never reveal prices of bids they have previously received. As long as the contractor doesn’t disclose other contractors’ prices, this is not bid shopping. However, a contractor who elects not to accept initial bids assumes additional risk. The contractor may determine a price they feel the work is worth, however, they may be unable to find a subcontractor to perform the work at their estimated price and subsequently spend more than the original bids. Either way, this is within the contractor’s perogative as a strategy for obtaining work.

It has been suggested that legislative action should be taken to require contractors to choose among the original bidders. While on the surface this appears to be a good solution to bid shopping, the problem with such legislation is that the contractor may have valid reasons or project strategies to change a subcontractor or supplier, some of which have been discussed earlier. As long as bid prices are not revealed, bid shopping is not occurring.

To help prevent bid shopping and provide clear scopes to all the subcontractors, an online bid depository may be available. Bid depositories assist the contractor to manage the scopes of work prior to bid day. The bid depository reviews the construction documents and creates bid forms that are customized to each project allowing the bids to compare "apples to apple" for the various scopes of work. While bid depositories may not cover all the scopes of work on a project, they assist the general contractor in ensuring that the scopes of the various trades are uniform. Bid depositories also reduce if not eliminate the opportunity for bid shopping to occur. An example of one such online bid depository is the Builders Bid Service of Utah (http://www.buildersbidservice.com).

Conclusion

In conclusion, it is each party's responsibility to maintain ethics in all business endeavors. Each company can improve the industry's image. Chris Plue, VP of Webcore Concrete, said bid shopping wasn't a problem at his company because they refused to do it. However, he mentioned, "We are at times on the receiving end of bid shopping…. It is then our choice as to whether we want to do future business with firms like that" (Plue, 2008 personal communication).

The following quote by Mr. Jim Jordan, director of construction services for Dallas/Fort Worth-based Weaver and Tidwell LLP, sums it up best. He says, "In the many years I have spent in the construction industry, I've found that most contractors are highly ethical and committed to doing the right thing. They stand by what they say and are fair in their dealings. However, all industries have their bad apples" (Jordan, 2005).

Having reviewed the differences between and ethical issues surrounding bid shopping and project buyout the authors believe, contractors can make better decisions during the bidding and preconstruction processes, and thereby elevate the integrity of the bidding process. Additionally, contractors who are more aware of what is happening during the bidding process and who choose to act with high ethical standards, can have a positive effect on the industry and how others view it. Ethics can and should be practiced by construction professionals who act with integrity and still provide customers with competitive prices, high quality, and outstanding service.

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