

DEVELOPING PARTNERSHIPS IN PUBLIC PROCUREMENT OF SERVICES

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ABSTRACT

Legislation on public procurement does not address the concept of partnership. However, also public sector buyers wish to take advantage of the private sector's experiences of strategic purchasing and outsourcing practices. This working paper presents a pilot study of a larger research project where we will, by applying theories and practices from the private sector, investigate cooperation between buyers and supplier of public services. The purpose is to create tools for more effective and efficient purchasing practices in public procurement context by developing partnerships and networks between buyers and suppliers within the frames of legislation and EU regulations. The pilot study is a case study of how the provision of nursing services is developed in cooperation with municipality and private nursing homes. We take the public buyer's perspective to partnership and network creation, and focus on the pre-procurement phase. Our research contributes to the research of partnership and network building in developing public services.

Keywords: Public procurement, public services, partnerships, legislation

INTRODUCTION

Public procurement of goods and services has an impact on countries' competitiveness and inhabitants' well-being, and successful contracting is often an indicator of effective management within government. Most people buy goods and services in their private lives, and they can understand governments' purchasing successes or failures better than the other government policies (Bartle & Korosec 2003; Bof et al. 2010). In the private sector, the efficiency and effectiveness of an organization is determined by its operations on the supply side, and buyers aim toward a stronger and more centralized purchasing function, supplier base reduction and long-term relationships with preferred suppliers (Gadde et al. 2010; Håkansson & Snehota 1995). The tradition in public sector contracting has been, on the contrary, to implement arm's length relationships (Eriksson 2008; Erridge & Greer 2002). However, the characteristics of many public services, for example health services (Lian & Laing 2004) and construction projects (Eriksson 2008) would benefit from the relational stance of purchasing. Thus, also in the public sector, there is the pressure for change to employ private contractors' experiences of strategic purchasing and outsourcing practices (Karjalainen & Kemppainen 2008; Padovani & Young 2008; Knight et al. 2003). Many governments have turned to Public Private Partnership (PPP) arrangements, where public and private sector organizations work together to provide public services (Broadbent & Laughlin 2003; Zheng et al. 2008).

The dilemma for public procurement is the number of competing priorities, which cannot be resolved completely. The key driver for most purchases is productivity, because taxpayers want more for less. Furthermore, public buyers are responsible to their representatives in government for their expenditure of public money. There are greater demands to bring down the costs, and at the same time for quality improvement (Erridge & McIlroy 2002). However, public responsibility, competitive frameworks and the operating culture of the public sector have held up the development of supplier relationships and trust (Erridge and Greer 2002). Furthermore, the buyers in the public sector have to comply with a complex framework of legal regulations and laws (Essig & Batran 2005; Lian & Laing 2004).

Prior research on public procurement has paid some attention to service procurement (see for example, Lian & Laing 2004; Walker et al. 2008; Nisar 2007; Gelderman et al. 2006; Karjalainen & Kemppainen 2008; Caldwell et al. 2005; Zheng et al. 2008; Erridge & McIlroy 2002; Erridge & Greer 2002). However, more research is needed in on partnership building in the context of public procurement. Tang et al. (2010) call for more research of effective ways of how to manage the relationships between the public sector and the private sector. Erridge and Greer (2002) noted that both collaborative supply relations and competitive tendering have pros and cons, and conclude that more research needs to be conducted on the conditions under which each method can be developed. Caldwell et al., (2005) suggest research on key supplier relationship management and professional development. Furthermore, there is little in-depth empirical research on how, why and when contracts and relational mechanism complement, or substitute for each other (Woolthuis 2005). Bovaird (2006: 99) demand systematic studies on the integration mechanisms that rely on collaborative relationships between wide varieties of stakeholders in the public sector.

This working paper presents a pilot study of a larger research project where we will, by applying theories and practices from the private sector, investigate cooperation between buyers and supplier of public services. The purpose is to create tools for more effective and efficient purchasing practices in public procurement context by developing partnerships and networks between buyers and suppliers within the frames of legislation and EU regulations. The pilot study is a case study of how the provision of nursing services is developed in cooperation with municipality and private nursing homes. We take the public buyer's perspective to partnership and network creation, and focus on the pre-procurement phase. Our research contributes to the research of partnership and network building in developing public services (Bovaird 2006; Caldwell et al. 2005; Tang, Shen, and Cheng 2010). Our focus in the pilot study is on small- and medium- sized enterprises, which have got less attention in the public procurement research (Karjalainen & Kempainen 2008). Furthermore, we take into consideration the juridical frames of public procurement.

The paper is organized in the following way. First, we will discuss the Public Private Partnership concept and partnerships in the private sector. We will also address the concept of cooptation. The second section explains legal constraints that concern public procurement. In the third section, we will explain the research method. Thereafter follows discussion of the pilot study. The final section concludes the paper and presents the following steps of the research process.

PARTNERSHIPS AND NETWORKS IN PUBLIC AND IN PRIVATE SECTOR

Partnerships in the public sector

Traditionally, public sector relies on arms-length relationships with suppliers, because competitive tendering makes it difficult to establish strategic long-term relationships (Erridge & McIlroy 2002: 53). However, there are changes in the procurement environment that call for more collaborative relationships. For example, there is the change from adversarial to collaborative behavior, where each actor expects to gain benefits from helping to make the joint working more successful. Furthermore, the number of interfaces between service suppliers and service providers in the procurement processes has grown, because the public sector has fragmented into a large number of organizations. The growth is partly due to the unbundling of services, which requires more coordination in the procurement decision and more systematic procurement procedures (Bovaird 2006). Partnership can also be used for social purposes, such as supporting local and domestic firms (Karjalainen & Kempainen 2008; Walker et al. 2008). However, as (Karjalainen & Kempainen 2008) found out, the inadequate resources especially in legal expertise and administration are obstacles for SME involvement in public supply.

In prior research, public sector procurement practices have been compared to those in the private sector (Roodhooft & Abbeele 2006; Lian & Laing 2004; Walker et al. 2008; Eriksson 2008). The focus has also been in the management of contracts (Brown et al. 2006), value for money drivers (Nisar 2007), EU tendering directives and non-compliance (Gelderman et al. 2006), the involvement of small- and medium- sized enterprises (Karjalainen & Kempainen 2008), and the role of public procurement in promoting competitive markets (Caldwell et al. 2005). Some

research is conducted on relationships between public buyers and suppliers. Zhen et al. (2008) studied the dynamics of contractual and relational governance. Erridge and Greer (2002) focused on partnerships and building social capital through supply relationships, and Erridge and McIlroy (2002) on supply management strategies. Also Bovaird's research (2006) deals with developing new forms of partnership. Essig and Batran (2005) have conducted a national level study in Germany on economic and legal decision process of PPPs. Recently, a number of case studies in public procurement context have been conducted by IMP researchers. For example Cova and Salle (2011) studied unsolicited proposals, Mittilä (2008) interaction in public-private relations, and Ojala, Uusitalo and Mahlamäki (2008) special characteristics of public-private relationships in the Finnish Defense Forces.

In Public Private Partnership (PPP) arrangements, public and private sector organizations cooperate to provide public services (Broadbent & Laughlin 2003; Zheng et al. 2008). The definitions of PPP vary broadly in the literature. A general purpose of a PPP is defined by the US based National Council (The National Council for Public-PrivatePartnerships 2013):

“a contractual agreement between a public agency (federal, state or local) and a for-profit corporate. Through this agreement, the skills and assets of each sector (public and private) are shared in delivering a service or facility for the use of the general public. In addition to the sharing of resources, each party shares in the risks and rewards potential in the delivery of the service and/or facility”.

According to Commission of the European Communities the term PPP refers to

“forms of cooperation between public authorities and the world of business which aim to ensure the funding, construction, renovation, management or maintenance of an infrastructure or the provision of a service” (European commission 2011).

PPPs are an extension of public management agenda for changes in the way public services are provided. It is argued that PPPs are a welcomed alternative to contracting out and privatizations, providing thus a qualitative move in the effort to combine the strengths of the public sector and the private sector (Hodge & Greve 2007). Cooperation may entail sharing resources and creating new products or services that no one would have thought if the public organizations and private organizations had kept back them to themselves. The PPP arrangements aim to deliver better services by combining the strengths of the public and private sectors working in partnership, where each partner is focusing on the areas it does best. PPPs are also claimed to bring in project management expertise to public sector (Tang et al. 2010; Nisar 2007). PPPs include risk sharing, and it is admitted that everything cannot be written into a detailed contract (Hodge & Greve 2007; Zheng et al. 2008). Relational and contractual mechanisms may function as complementary forms of exchange governance (Zheng et al. 2008). The EU Green Paper (2004) proposes a distinction between two forms of PPP.

1. PPPs of *purely contractual in nature*, where the partnership between the public and the private sector is based only on contractual links. One or more, smaller or bigger tasks are assigned to the private partner. Examples are design, funding, execution, renovation or

exploitation of a work or service. In these projects, the private partner provides a service to the public, though under the control of the public partner.

2. PPPs of an *institutional nature*, where the private partner is trusted to deliver long-term infrastructure projects, and operate and manage them following the output specification from the public sector (see also Broadbent & Laughlin 2003).

PPP projects are common in sectors such as transport, public health, education and national security. Public services such as waste management or energy distribution are more and more trusted to businesses, which can be public, private or a combination of them (EU Green Paper, 2004).

The following elements normally characterize PPPs:

- *The relatively long duration of the relationship*, and cooperation between the public partner and the private partner on different phases of a project.
- *The method of funding the project*. In part from the private sector, funding is sometimes organized by means of complex arrangements between the various players. However, public funds may be added to the private funds.
- *The important role of the economic operator*. The public partner concentrates primarily on defining the objectives to be achieved in terms of public interest, quality of services provided and pricing policy, and it takes responsibility for monitoring compliance with these objectives. In the private sector, buyers are more likely to engage service professionals, and administrative managerial staffs, meanwhile public sector buyers have mainly administrative managerial staff in the buying group (Lian & Laing 2004).
- *The distribution of risks* between the public partner and the private partner. The precise distribution of risk is determined case by case, according to the respective ability of the parties concerned to assess, control and cope with this risk (European commission 2011).

Although PPPs are perceived as an efficient way to create public infrastructure at little cost, there are several problematic cases with cost overruns, unrealistic price and income estimates, and legal disagreements between private suppliers and public purchasers. The costs of these problems have generally fallen to the governments (Tang et al. 2010). Buyers in the public sector need to develop buying skills, for example, in market management, specification, competitive process, negotiations regulation and monitoring (Roodhooft & Abbeele 2006).

Private sector partnerships

In the private sector, there are numerous empirical examples of co-operative relationships, and a great number of studies have focused on inter-organizational relationships and networks during the last two decades. One way to investigate relationship development from the buyer's

perspective is to focus on resource interfaces (Araujo, Dubois, and Gadde 1999). The productivity of a firm may be determined by the efficiency in the exploitation of a given resource combination at any one time. Innovativity, on its turn, is related to the development of new resource combinations over time. Araujo et al. distinguish four resource interface categories from customer's perspective: standardized, specified, translation and interactive.

In the current public procurement practices (purely contractual PPPs) interfaces are mainly standardized or specified. In standardized interfaces, there is no specific connection between buyer and supplier. Cost benefits arise from economies of scale and scope, and learning curve effects. However, indirect costs may arise, for example, if the buyer needs to adapt its resources to meet the standardized services. In specified interfaces, the buyer gives precise directions of the service and its provision, and gives suppliers limited possibilities to develop the services.

Translational and interactive interfaces are more costly, but they have benefits for productivity and innovations. In translation interfaces the buyer specifies the required functionality of the service rather than the actual service. There is room for economies of scale and scope, which adds productivity. Interactive interfaces provide opportunities for learning and the creation of social capital (Nahapiet and Ghoshal 1998). Open dialogue between the buyer and supplier allows considering the direct and indirect cost for both parties. The supplier also learns about the buyer, and will be able to provide new service solutions. Furthermore, the buyer takes more responsibility, and can exploit experiences from other interfaces, and thus be more innovative (Araujo et al. 1999).

Coopetitive relationships

Cooperation and competition can be parts of the same relationship, and they are both vital to innovation (Teece 1992). The concept of coopetition is used to describe such a relationship (Brandenburger & Nalebuff 1996). Coopetition can be defined as the balance between cooperation and competition in a specific transaction relationship, resulting from the actors' simultaneous cooperative and competitive behaviors (Eriksson 2008). Specifically small and midsized enterprises can benefit from building networks where they cooperate and compete simultaneously. The aim with coopetition is generally to develop better services to clients, and to gain better market position (Kock et al. 2010).

Bengtsson and Kock (2000) categorize relationships between competitors into three different groups; cooperation-dominated relationships, equal relationships and competition-dominated relationships. Functions that occur nearest the client include generally more competition than cooperation, meanwhile functions that are conducted far away from the client include more cooperation than competition (Bengtsson & Kock 2000). Functions with focus on cooperation are, for example, research and development, purchasing, production and marketing (Walley 2007). In public sector, the buyer's procurement procedures facilitate a focus on competition (Eriksson 2008).

LEGAL CONSTRAINS IN PUBLIC PROCUREMENT

In the public sector, outsourcing decisions are often cost driven as well as ideological choices. Similarly to private sector, economic analysis is the first step. However, in the public sector, a complex framework of legal regulations and laws has to be considered (Brown et al. 2006; Broadbent & Laughlin 2003; Essig & Batran 2005). When a public sector buyer decides to involve third parties in economic activities, and if this involvement qualifies as a public contract or a concession, the community provisions for public procurement and concessions must be complied with (Official Journal of the European Union 2008).

In Finland, the Ministry of Employment and the Economy is responsible for the preparation of legislation concerning public procurement. Procurement regulation concerns, for example, different phases of the tendering procedures, drafting of the contract documents, advertising and closing of public contracts. Public procurement procedures must follow the national procurement legislation and the directives of the European Union. The main purpose of the procurement regulation is to increase the efficiency of the use of public funds, and to increase the competitiveness of European and Finnish businesses. With the help of the regulation, the fundamental freedoms that were laid down in the Treaty establishing the European Union will be secured: free movement of goods, services, capital and labor (Ministry of Employment and the Economy n.d.).

The ultimate principles of the public procurement regulation include transparent and efficient tendering and equality and non-discriminatory treatment of tenderers. Transparency principle requires that the public contracts are appropriately publicized. Transparent and equal tendering procedures enable efficient competition. According to the Ministry of Employment and the Economy, "*Competition in tendering procedures opens up opportunities for contracting authorities to conclude as economically efficient purchases as possible*" (Ministry of Employment and the Economy n.d.). Furthermore, public contracts shall be awarded based on either the most economically advantageous tender or the lowest price. In addition to the national legislation and the EU directives, Finnish contracting authorities follow the World Trade Organization Agreement on Government Procurement (GPA).

The rules and principles deriving from Community law on public contracts and concessions apply in the selection of the private partner and the implementation of the partnership. Competitive tendering procedures create formal and rigid relationship with suppliers (Erridge & Greer 2002). Too many and too strict rules are considered as an obstacle to the development of PPPs within the EU, and problems arise when these rules and principles are applied in practice. As a tool to "new public management", EU has created an instrument called "competitive dialogue", which allows the integration of suppliers at a very early stage of purchasing process, and moves public procurement towards public supply chain management (Essig & Batran 2005). The aim of competitive dialogue is to make it easier to create public-private partnerships.

According to the EU White paper (European Communities 2005) the majority of the problems in public contracts concern the competitive dialogue procedure, the selection of private partners, the contractual framework, and subcontracting.

- *The suitability of competitive dialogue procedure.* In the context of a purely contractual PPP, the competitive dialogue is applied. The competitive dialogue is supposed to provide interested parties with a procedure which is particularly well adapted to the public contracts, which at the same time ensures the fundamental rights of economic operators. However, competitive dialogue is claimed of not offering the flexibility required for large, complex projects, and it is perceived as a costly procedure for bidders. Specifically SMEs see the cost so high that it hinders fair competition. Furthermore, it is difficult for contracting authorities to specify all their needs and requirements in the initial contract notice, and other needs may appear in the course of the dialogue (Lian & Laing 2004).
- *The selection of private partners for contractual partnerships.* Distinguishing between various types of public contracts and concessions under EC public procurement law and uncertainty of the appropriate public procurement procedure is problematic. Furthermore, there is a problem with the accuracy of the bids. Inaccurate bids may favor certain bidders. The participants in PPP procurement procedures may calculate their bids improperly, and win the contract. Afterwards, this requires a renegotiation of the terms. Green Paper on the modernization of EU public procurement policy (European commission 2011) concludes current requirements from stakeholders, which are related to supplier relationships. In certain service contracts, for example related to social services, where the professional experience and qualification of the service providers are important, it would be necessary to take into account criteria relating to the tenderer himself in the award phase. Furthermore, the directive should explicitly allow contracting authorities to take into account their previous experience with one or several bidders.
- *The contractual framework for PPPs.* When deciding on a reasonable term for a PPP, technical continuity, security of supply, optimization of maintenance and renovation of infrastructure should be considered. Furthermore, PPP contracts should have some scope for adjustment, because of the changing needs of consumers and authorities. Reopening negotiations to make some modifications usually leads for a better contract for the original private partner. In addition, frequent competition procedures resulting from short-term PPP contracts or concessions are thought to increase the overall costs of a PPP. The service improves over a longer period, and provides innovations in public services, while shorter-term contracts might encourage the supplier to focus on maximizing revenue generation before the next competition (Gelderman et al. 2006; Lian & Laing 2004). The structure of public tendering processes can have an unintentional consequence of locking suppliers out of a market. One solution to create an innovative procurement practice is to use coordinated purchasing and framework agreements. Framework agreements allow the control negotiation of a contract, but permits entrusted users to manage their spending. Framework agreements involve commitment and creative management to make them work (Caldwell et al. 2005).
- *Subcontracting.* Some problems arise related to the control over the performance of public services, and to the position of subcontractors. It is proposed that a right to exclude individual subcontractors or the possibility to limit subcontracting to a certain share of

the contract or to require that the contractor accomplishes essential parts of the contract himself (European commission 2011).

RESEARCH METHOD

In order to understand public procurement and the relationships and networks it involves, we are conducting a longitudinal qualitative case study. Case studies in a network context give a rich description of the relationships and help to understand the process by which specific relationships develop over time (Dubois & Gadde 2002). Case research can lead to new and creative perceptions and development of new theory. Case research can also have high validity also for practitioners (Coughlan & Coughlan 2002). We apply action research, where members of an organization are involved in a problem that is of current importance for them, and where expert research knowledge and local knowledge are shared (Brydon-Miller et al. 2003). The action researcher aims to bring about improvements through making changes in a problematic situation, and to generate new knowledge and new insights (Gummesson 2000; McKay & Marshall 2001).

The researchers have been involved in a public service procurement process in the City of Vaasa in its early phases, i.e. in the pre-procurement phase. Researchers have attended in several meetings with the head of procurement and the nursery school administrative personnel during the spring 2013. Furthermore, a researcher had the opportunity to attend the technical dialogue, arranged by the head of procurement for the nursery schools in May 2013.

In the following, the current state of the City of Vaasa's nursery school service provision and its major problems are explained. Furthermore, some major challenges related to partnership and network building, and possible solutions are discussed. The research will continue in the autumn 2013 with additional interviews and discussions with the buyer, and also the suppliers will be activated to take part in the research.

NURSERY SCHOOL SERVICES – THE PILOT CASE

In our pilot case study, the development of nursery school services is of present interest for the City of Vaasa. Currently, there are 10 private nursery schools for c. 400 children, which cover 10 % of the needed day care. Practically all the local providers are utilized to provide nursery services for the city.

Most private nursery homes are owned by nursery school teachers, who are not specialized in running a business. The entrepreneurs find the public procurement laws and regulations complicated, and they have difficulties in the formulating their tenders. Some of the nursery schools are foundations and third sector actors with their own business culture. Except for the tendering formalities, the nursery schools have some major problems in providing flexible services. For example, it is difficult for the city to estimate the need for day care for different age groups, because the city is growing due to some internationally operating enterprises. The need for day care for children under three years has grown during the current contract period. Moreover, the enterprises are hiring foreign employees, whose children need to be integrated to

the Finnish culture, and language skills are important, both for the children, and for the nursery school personnel. Another severe problem is finding substitutes during holidays and sick leaves.

In the discussions with the head of procurement and the purchasing team in the city of Vaasa, enhancing cooperation as well between the buyer and the service supplier as between the suppliers themselves is essential. The buyer aims is to help these small local providers to develop their functions, and at the same increase the quality and flexibility of the services. To enhance cooperation, the head of procurement in the City of Vaasa involves the nursing schools into the planning of the tendering process. The previous tendering process was the first one in which the nursery schools were involved and they all experienced the process to be very stressful. The aim of the head of procurement is to make the forthcoming process smooth and less demanding for the nursery schools. During the previous tendering process, there was very little cooperation between the buyer and the service providers. As generally in functions that are near the client (cf. (Bengtsson & Kock 2000), there is no cooperation between the service providers, i.e. the nursery schools.

The first step towards cooperation was the technical dialogue, where the head of procurement opened up a discussion of how the cooperation could be developed. Technical dialogue is the procedure in which the buyer seeks and accepts advice on the tender documents for the tender procedure which it aims to declare. Generally, the technical dialogue is used by the buyer in the case of public supply contracts, public service contracts or public works contracts, which involve innovative specifications or terms of execution. The technical dialogue was conducted after the announcement of the tender procedure. The advice should, however, have no effect in impeding the competition.

The buyer aims to create translation relationships (Araujo et al. 1999) with the nursery homes in order to give the them some flexibility to propose innovative solutions to the day care problems. However, a prerequisite would be that the nursery schools would cooperate to some extent, and build a network in order to share their resources and learn from each other. The challenge is how to find the right balance between competition and cooperation. Another challenge is how to arrange the cooperation in practice. The buyer gives the possibility for the suppliers to get to know each other in shared meetings. However, there is still a great amount of change resistance towards cooperative relationships, and no consensus of how to arrange the cooperation.

The action research process with city of Vaasa will continue in the autumn 2013 with discussion of how to implement cooperation between the buyer and the suppliers, and how to help in implementing cooperation and network practices between the suppliers.

CONCLUSIONS AND THE NEXT STEPS IN THE RESERCH PROCESS

This working progress paper provided a theoretical overview of public-private relationships in service procurement and its major challenges. We have also explained the current state of the City of Vaasa's nursery school service provision and its major problems. Furthermore, some major challenges related to partnership and network building, and possible solutions are

discussed. The research will continue in the autumn 2013 with additional interviews and discussions with the buyer, and also the suppliers will be activated to take part in the research. The pilot case research will continue in the autumn 2013 with discussion of how to implement the partnership and network practices in nursery home services in the frames of legislation and EU regulations.

By the end of the year 2013, three more cities will be joining the research. Different kind of services, which are of current interest to the city's purchasing functions, will be sought as research objects. The intended managerial contributions will help both buyers and providers of public services to use their resources more efficiently, and to provide better quality services to the end customers.

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