

BEST VALUE APPROACHES TO INFRASTRUCTURE MANAGEMENT: FOR THE GOOD OF THE COMMUNITY OR SHAREHOLDERS?

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ABSTRACT

A Best Value approach to procurement decision-making was adopted in varying ways by businesses and governments in a number of countries during the 1990s. While its precise definition is elusive, the emergence of a Best Value culture in procurement has set the scene for significant debate about the merits of the concept and the complexity of achieving its goals. This paper examines the notion of Best Value or Value-for-Money from a number of perspectives. First, some of the challenges involved in defining Best Value are examined. Second, the nature of the Best Value concept in public procurement as compared with the private sector, will be considered. The paper concludes with a discussion of some of the complex contracting problems that arise from efforts to achieve Best Value outcomes.

INTRODUCTION

The nature of Best Value or Value for Money initiatives (the two terms are used synonymously throughout this paper) can be illustrated by a number of procurement problems that have forced those involved to re-examine their philosophies and practices. The introductory examples are designed to raise questions about both perceptions and realities of Best Value, and to demonstrate the difficulties of achieving contemporary Best Value goals from the outset.

The first example arises from problems associated with the provision of food for British Navy sailors in the 18th and 19th Centuries. Conventional wisdom suggests that the sailors of the period were poorly fed. Furthermore, this view claimed that Pursers, who were responsible for the procurement, loading and issue of food, obtained a substantial personal financial benefit by cheating the government and the ships' crews by providing food of poor quality and inadequate quantity. However, there is evidence that challenges this traditional view.

Jane (1915) suggests that the principal problem was not quantity of a ship's provisions, but rather its quality. The food was normally adequate in both quality and quantity when it arrived at the ship. However, a government decree of the period, in the interests of economy, demanded that any remaining food stocks be kept, regardless of its condition, and consumed before new stocks were distributed. As a consequence: "Every ship carried tons of good provisions going bad, while those already bad and decayed were being consumed. Consequently the men starved in the midst of relative plenty" (Jane (1915: 203-204). The Spithead Mutiny, which immobilized the British Navy during the Napoleonic Wars, was just one consequence, apart from significant incidence of avoidable

disease. This procurement policy delivered a Best Value outcome for the parliament and the civil service, but failed to provide Best Value for the recipients of the food, the ship's crew.

A more recent example provides a different perspective on the Best Value principle. At the end of April 2002, a strike over worker entitlements erupted in the factory that provides exhaust pipes to automobile manufacturers in Australia. This supplier had emerged as a strategic point of manufacture, most likely through a set of procurement decisions aimed at achieving the goals of Best Value through single sourcing to gain cost, quality and delivery advantages.

Once production of exhaust components ceased as a result of the industrial action, production at the plants of all the affected manufacturers also came to a halt. The combined effects of Just-in-Time Inventory Management, a sole supplier to the industry model, and worker unrest over a national, on-going problem of protecting worker entitlements in the event of a corporate collapse, exposed an inherent weakness in the Best Value strategy. Theoretically, the parties gained the efficiency and financial advantages of having a sole supplier, but once problems arose, this virtue became a liability. In this case, the Best Value policy was part of a set of initiatives that increased risk for the four automobile manufacturers using the services of this single supplier.

Serious industrial action in the automobile industry is now comparatively rare in Australia. Nevertheless, a similar problem over the provision of a small part from a single supplier arose some years ago (Lynch, 1995). It quickly became clear that no alternative sources of supply of the part existed and automobile manufacturers were forced to close their operations until supply of the parts was resumed. Some years later, it seems that cooperative arrangements between all the automobile manufacturers and a single supplier has increased, rather than reduced, manufacturers' risk from the consequences of production stoppages at the plant of its supplier. A Less Value option appears to have been created by this situation.

As these reflections suggest, a narrow definition of Best Value leads to contracting arrangements between buyers and suppliers that contain substantial elements of risk. Furthermore, the perception of Best Value may vary greatly between different parties within a total Supply Chain, even though decisions have been made that are intended to achieve the financial and operating goals of the parties. This paper will argue that successful achievement of Best Value has the potential to founder on definitions of the concept that are too narrow in scope and too vague to be implemented effectively.

EMERGING BEST VALUE PRINCIPLES

A desire for less direct public investment in infrastructure capital expenditure has become a recurring feature of the neo-classical economic initiatives of the 1980s and 1990s. In the private sector, ways of achieving profitability goals through the management of cost efficiency, have also led to a different conceptualization of the nature and benefits of a Best Value approach, which requires a more sophisticated perspective as organizations step into the 21st Century. Value might be defined in terms of lower costs, improved quality, shorter delivery times, technically superior products and services, and a targeted return for shareholders. However as private and public sector managers face increasingly complex contracting requirements, the absence of a comprehensive understanding of Value-for-Money (Best Value) will inhibit its utility.

It has only been during the past fifteen years that procurement, as a function and as an emerging profession, has progressed from a mechanistic, clerically-focused, bureaucratic and undervalued process to one that has begun to enjoy increasingly higher status and a closer relationship with the strategic development of an organization (Burt & Doyle, 1993; Trent & Monczka, 1998). The importance of procurement has been of considerable interest to management in both public and private sectors (Gore, 1993; Cox, 1996; Callender, 1999) as organizations have sought to increase profitability through reducing the cost of the goods and services they purchase, and satisfy efficiency goals encompassing management of suppliers, quality, contract management, innovation and risk assessment.

For example, a review of government procurement in the USA led to a realization (Gore, 1993) that procurement guidelines were complex but also unsophisticated and that procurement activities were being devolved without adequate controls, training and direction. It was also found that public sector procurement practitioners were not taking account of the possibility of improving the quality of government purchasing, even though it was found that government procurement resulted in expenditure equal to around 20% of GDP in the USA (Thai and Grimm, 2000). In Australia, a national parliamentary enquiry to explore the scope and nature of purchasing within the Australian public sector (AGPP, 1994) revealed a function whose contribution to government activity was substantial in amount (up to 30% of national GDP) and in the number of public officials involved in procurement estimated at the time to be 40,000 officials).

As a result of these and other initiatives, more sophisticated procurement techniques have begun to emerge, through the development of principles of “value for money, open and effective competition, ethical standards and fair dealing” (Commonwealth of Australia, 1996). Governments have redefined the tendering process to encourage contracting out, and enhanced competitive tendering processes to increase market competitiveness, particularly in respect of markets dominated by government organizations (NCC, 1999). However, despite these improvements, it is apparent that in many jurisdictions, the adversarial, competitive tendering process remains the contracting technique of choice for major contracts and “least cost” is viewed as more easily achieved than Best Value.

DEFINING BEST VALUE

An early definition suggested that Best Value could be achieved “through the efficient and effective use of resources and ensuring that the users of such resources are accountable for them” (Keating, 1990:15). In this context, accountability was described as the capacity to provide “an answer for the way one has spent money, exercised power and control, mediated rights and used discretions (sic) vested by law in the public interest” (Waterford in Fuller and Roffey, 1993: 151). A subsequent attempt to define Value for Money in government, stated the concept was:

a procurement concept which requires objective consideration of all factors contributing to the utility, usability and usefulness of items offered for sale as inputs to the procurement decision, rather than automatic choice of the suitable item having the lowest purchase price.
(Commonwealth of Australia, 1991).

This definition provided a hint of the broader changes to procurement being sought by public procurement authorities, but it provided little help in definition. An area of particular difficulty was the concept of ‘objective consideration’. It could be argued that this concept encouraged even stronger use of the competitive tendering process as this ensured that the competing suppliers were treated in an ‘arms-length’ way and individual procurement officers could not be accused of favoritism. A measure of ‘objectivity’ was identified, but practitioners were given no guidance on how to assess “all the factors contributing to the utility, usability and usefulness of items offered for sale as inputs to the procurement decision.”

This segment of the definition was also difficult to implement in practice. Did this permit the development of preferred supplier lists, or the opportunity to receive advice from potential suppliers prior to a call for tenders? What were the elements that comprised ‘all of the factors’? The situation was not very clear and while some guidance was available from the national government’s Procurement Guidelines, it is likely that many procurement managers and their staff preferred to use the traditional tendering methods that were above reproach from their superiors, suppliers and the media.

A more comprehensive definition emerged over the ensuing years and by 1996, a national authority stated that Value for Money considerations required that:

procurement decisions must not be based on price alone but must take into account all relevant considerations including, for example, fair price, quality, delivery arrangements, inventory and warehousing, contractor capabilities and whole -of-life costs where appropriate. (Industry Commission, 1996: 342)

The new definition was still vague, exchanging "objective considerations" for "relevant considerations". However, the definition began to identify specific activities for practitioners to consider. Surprisingly, issues of risk management were still omitted for the revised definition, even though managing political, financial and economic risk are a major problem at national level, especially in relation to defense contracting (Arbon, 2002). A complementary definition was issued by a sub-national government, which considered the assessment of value for money to be:

A trade-off between risks and benefits ... some of the price and non-price factors to be considered include ... competency and experience of contractors, fitness for purpose, costs over the contract period, likely state of the market at the end of the contract period, financial stability, quality of service. (Industry Commission, 1996:342).

In the United Kingdom (UK), Best Value principles are defined in the Local Government Act 1999 as:

'The duty upon best value authorities to make arrangements to secure continuous improvement in the way in which they exercise their functions, having regard to a combination of economy, efficiency and effectiveness'.

This comparatively vague notion of Best Value has since been linked to the performance requirements of local government authorities in relation to the achievement of strategic objectives, cost efficiency, service delivery, quality and community access (Bovaird and Halachmi, 2001). This can be compared to definitions of Best Value in the United States of America (USA) where Bovaird and Halachmi (2001) record that the U.S. Army defines the concept in terms of:

the outcome of any acquisition that ensures we meet the customer's needs in the most effective, economical, and timely manner.... Under this concept, best value is the goal of sealed bidding, simplified acquisition, commercial item acquisition, negotiated acquisition, and any other specialized acquisition methods ".

It is clear that there are a variety of official definitions of Best Value, none of which really set out all the potential parameters of the concept. Of course, it is not just the public sector that is involved in Value for Money considerations. The proportion of national GDP spent on private sector procurement activities is not easy to estimate, although its greater share of national GDP suggests that private sector procurement will be much more substantial than that administered by the public and not-for-profit sectors. Value for Money concepts should be a major consideration for this sector as it seeks to achieve profitability goals anticipated by investors and other stakeholders.

To what extent Value for Money, as distinct from cost minimization, remains established procurement practice is not clear. This concern is supported by reports suggesting that multinational organizations have been early to take advantage of supply chain models through their membership of institutions such as the Supply Chain Council in the USA and Europe. However, research by a Deloitte and Touch Consulting Group in North America found that "80% of the [200] companies surveyed still have not developed any concrete initiatives for the optimization of their supply chains" (Heinzel, 1999: 126). Does this mean that value for money and other more sophisticated procurement principles are being overlooked by the majority of private firms?

Honda of America is one of the corporations that adopts a Value for Money approach through its capacity to apply cost modeling within its procurement processes. Having set cost goals, Honda then works with suppliers to enable these goals to be achieved without impairment in delivery reliability, or quality (Laseter, 2001). Honda also applies its value for money goals to its relationship with its local suppliers, who provide 80% of the automobile parts

required by Honda operations in the USA. In this case, value for money is defined in terms of cost, quality, design, delivery timing, supplier competency, and supplier location, and an inherent "trade off between risks and benefits".

The Enron failure in the USA and the related complications involving accounting services to that organization, also typifies the different operating agendas of public and private organizations. In Australia, the private sector has also been the location of recurring financial debacles over the past twenty years that, in some cases, have been sufficient to force nearly half the sub-national governments of Australia out of office (those of Western Australia, South Australia, and Victoria). Prosecution of some of the principal players has occurred though outcomes remain minimal. Recently, major financial losses have occurred among some 'New Economy' Internet 'Start-Ups' in Australia which are reputed to have cost shareholders over \$USD1 billion (Verrender, 2001).

It seems both public and private sectors need much stronger and explicit Best Value models.

BEST VALUE: A CASE STUDY

The terrorist attacks in the USA of 11 September 2001 have wreaked economic and social havoc across the USA and also across global industries, especially those dependent upon international travel and trade (Lunsford, *et al.* 2001). However, the wider impact of this day and its aftermath may prove to be more fundamental. Baker and Crooks (2001: 12) suggest that at the end of September 2001, the US President "quietly brought to a close more than a decade of US economic policy orthodoxy", at that time through his agreement to help the US airline industry survive post-September 11 but more recently through overt support for the US steel industry. In Australia, the media is increasingly questioning government's selective non-interventionist model in the economy, citing a number of situations where insurers, airlines and manufacturers have failed for lack of potential government support (Hewitt and Millett, 2002). Comparisons have been made with Bush administration's comparative willingness to provide public money to support instances of special financial need.

Other examples of governments moving to provide financial support for key industries include the interim protection of the Swiss flag carrier, Swissair, saved by an injection of funds from the Swiss government (Grant and Hall, 2001). Air New Zealand has also been saved by its re-privatization by the New Zealand government (Evans, 2002). Although this action prejudiced the investment of major shareholders, the lack of public complaint by this group seems to suggest that the preservation of the airline and a diminution of their investment was a "better" value outcome than losing their entire investment. However, this expansion of government support for particular industries could be seen as another form of government-private sector procurement.

The non-market-intervention model of achieving Best Value has also been pursued by governments seeking to improve competition in markets. Rail and airlines are two examples. In Australia, the national government tackled this objective by developing a National Competition Policy (NCP). This resulted in the formation of the National Competition Council (NCC) which targeted the creation of a national electricity market, "fair and free trade in gas ... reform of water supplies, highway transport and third party access to significant infrastructure facilities" (NCC, 1999: 38). Reform and privatization of public monopolies and development of competitive markets, where government monopolies had previously existed, were also agenda items.

The NCP Inquiry (1993) created a focus upon macro-procurement activities, especially larger-scale contracts and market restructuring imposed by the NCP Agreements. Macro-procurement activities, for the purpose of this paper, describe major contracts between governments and the private sector that are related to large scale undertakings that were traditionally undertaken by governments. Despite their macro-nature, the need for value for money remains highly relevant for the large-scale, long-term contracting associated with major infrastructure activities. This approach increases the mix of internal and external providers identified by Halachmi and Montgomery (2000), but the issues of risk management and accountability of the private to the public sector (and civil society) remain unclear.

For example, the Australian Snowy Mountains Hydro Electric Authority was a GBE founded to build a group of dams and electricity generating plants in southern Australia commencing in 1949. The scope of this project rivals the scale of the Tennessee Valley scheme of the same era (Clark, 1980). Qantas, the major national airline, although now a private sector company, was 'nationalized' by the Australian government in 1947 to ensure it had the funds to grow into an international airline (Gunn, 1986). At the same time, the government formed its own national airline, to ensure there was competition at some level with the sole major private sector airline then in existence (Sabey, 1979).

The case of the railroad link between the city of Sydney and its nearby international airport provides a good example of the risks associated with seeking Best Value through an arranged enhancement of market competition. Furthermore, it illustrates that over a 150-year period, the outsourcing and contracting process has been struggling to achieve Best Value for government, passengers and private contractors.

In 1849 the Sydney Railway Company was formed by a group of local citizens who believed that a profitable railway could be operated between the city of Sydney and Parramatta, a major town fourteen miles away. However, private investors were found to be reluctant to become involved and the railroad was only finished when the state government assumed the financial risk for the project, eventually becoming the owner of the entire railroad, which commenced operations in 1856.

During the initial year of operation, this small railroad operated at a significant profit under an outsourcing agreement between the principal builder of the railroad and the state Government. Despite the success of this outsourcing, the government seemed determined, for reasons of prestige and power (Clark, 1980), to assume control of all railway operations in the state of NSW and operate them all as an integrated Government Business Enterprise (GBE). The virtue of single entity ownership of the rail system was reaffirmed in 1926 during construction of the electric rail system and Harbor Bridge in Sydney. Chief Engineer Bradfield (1927: 299) noted that:

As the State owns the railways and tramways it has been possible to devise a scheme enabling trains to be run between suburbs and outlying districts and the business area of the City without changing passengers from one railway system to another as is usually necessary in large cities.

When the Airport Rail Link was announced, the state government pledged that it would not cost taxpayers 'one cent'. However by the time the line was ready to go ahead, the government (and taxpayers) had agreed to contribute \$USD235 million towards the project after "being threatened with legal action by the private joint venturer" (Morris and Coultan, 1994). Seemingly to allay taxpayer concerns, State Rail, the government railroad authority claimed in an Annual Report that during construction and for the first thirty years of operation, the "majority of risks and benefits ... rest with the (contracting) company" (SRA, 1996: 55). A subsequent review by the NSW Audit Office found to the contrary. The audit showed that "private sector equity of \$USD15million ... is rarely at risk during the entire agreement term", and the State Rail group, and therefore taxpayers may be liable to "maintain cashflows to ALC (Airport Link Company) so that ALC receives revenue ... expected" (NSW Auditor General, 1996: 56).

However, the Airport Link Company recently went into liquidation. The major cause of financial collapse was claimed to be that State Rail staff overestimated the likely passenger numbers and therefore income projections were over-optimistic. The shareholder risk looks to be minimal compared to NSW taxpayers, who are waiting to hear the final cost of the railway that was not to cost 'one cent'. Bradfield's remarks in 1926 regarding the value of continuity of rail network ownership have come back to haunt this project. Because of separate ownership, tickets for the airport railroad could only be purchased at Rail ticket counters (open only for certain hours) and not from automatic ticket machines (open 24 hours each day) and the arrangements for using the rail link were obscure. The rolling stock was often quite old, there was no space for passenger luggage and the ticket price was high. Now that the airport railroad has been taken back into the public rail network, ticket prices have fallen, ticket availability has improved and the complex consequences of this failed outsourcing may yet be settled in the legal system.

In the UK, single ownership of the rail system was dispensed with through the creation of a rail market and private ownership of Train Operating Companies. While this satisfied government's ideological need to foster market competition, there have been many problems. For customers, operators and the government, safety and reliability have been consistently recurring issues (Haigh, 2000). The complex ownership and operating structures have also resulted in the creation of a complex National Rail Timetable reputed to consist of two-volumes and 2800 pages (Doe, 2000). On a number of measures, it seems that the railroad model in the UK has failed to deliver many Best Value outcomes to its stakeholders.

These examples briefly outline a recurring theme concerning the risks inherent in major contracting initiatives despite positive expectations of the public and contractors in terms of Best Value concepts. It is clear in each case that there is a belief that because government is one of the contracting parties, taxpayers might be expected to meet any income shortfall or rescue the venture should it fail. Most of the situations provide a clear example of the failure of Best Value so far as taxpayers are concerned. It is also apparent that while the risk to shareholders is being minimized through income guarantees, taxpayer risk is being maximized. Considering these cases in the light of the Australian Government's 1991 definition of Value for Money, it is difficult to see that prior to the signing of each contract, the parties made an 'objective consideration of all factors contributing to the utility, usability and usefulness' (Commonwealth of Australia, 1991), nor has there been any apparent "trade-off between risks and benefits".

CONCLUSION

The way in which Best Value is enacted at a practical level can have significant consequences for an administration at national, state and local level. Issues of accountability, economic efficiency, and access to markets by local suppliers are just some of the aspects of procurement influenced by Value for Money principles. It is clear that some solutions to the dilemmas posed in this paper are available. However, these solutions required a significant increase in the sophistication of all the approaches to contracting. Furthermore, there will be no certainty that the proposed solutions will work in all circumstances.

First, the concept of Best Value could be assessed on a financial basis through the adoption of a 'whole of life' costing approach to enable procurement practitioners to work with suppliers to identify and manage the full spectrum of costs. Second, such a move will require an increased propensity to manage strategic alliances and other collaborative relationships with suppliers that permit the sharing of cost, production, quality, delivery and other relevant matters at the heart of a particular contract. Third, procurement decisions demand assessment and management of risk, perhaps commencing with a "due diligence" financial assessment but also considering issues such as political and operational risks.

Fourth, the consequences of devolution means that procurement decisions may be made by those who lack expertise in contracting and this shortfall in professional skill will either need to be redressed or included in the assessment of risk. Finally, it would be helpful to start of move away from general and uncertain definitions of Best Value, to include much more specific descriptions of the concept and the material ways in which it can be assessed.

Best Value represents a conceptual approach to the assessment of procurement contracts and the potential parties to these contracts. The definitions and case studies are designed to highlight the current shortfall in the rigor that could be brought to this topic, both in calculable assessment as well as broader evaluation of emergent risks in an environment. It is clear that Best Value principles require significant enhancement if they are to provide a more valuable operational guide for procurement managers.

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