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THE WINNER'S CURSE IN THE SRI LANKAN CONSTRUCTION INDUSTRY

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Abstract
This paper presents a study on the size of winner's curses in the Sri Lankan construction industry. The study is interesting because the existence of large winner's curses is an indicator of information and other types of inefficiency. Large winner's curses are detrimental to the development of the industry and for individual clients as well. The winning margin and the distribution of bid prices are used in detection of possible winner's curses. Based on 389 bids in 64 private sector projects, the study finds evidence of the existence of large winner's curses in the Sri Lankan construction industry.

Keywords
Winner's Curse, Tendering, Bidding, Construction Industry, Sri Lanka

INTRODUCTION

This paper presents a study on the size of winner's curses in the Sri Lankan construction industry. The study is interesting because existence of large winner's curses is an indicator of information and other types of inefficiency (for example, inexperience or poor training on the part of the cost estimator) and is therefore detrimental to the development of the industry.

BACKGROUND

The winner's curse story begins with Capen, Clapp, and Campbell (1971). They claimed that oil companies suffered unexpected low rates of return in the 1960s and 1970s on outer continental shelf lease sales. They argued that these low rates of return resulted from the fact that winning bidders ignore information on the consequences of winning. That is, bidders naively base their bids on their own estimates of value which, although correct on average, ignores the fact that you only win when your estimate happens to be the highest (note that in construction tenders, the winning bid should be the "lowest") among bidders. But winning against a number of rivals following similar bidding strategies implies that your estimate is an overestimate of the value of the lease conditional on the event of winning. Unless this effect is accounted for in formulating a bidding strategy, it will result in winning a contract that produces below normal or even negative profits. The systematic failure to account for this adverse effect is commonly referred to as winner's curse: you win, you lose money, and you curse (Kagel and Levin, 2002).