



North American Development Bank

Prequalification of Contractors

PREQUALIFICATION NOTE

This note is prepared for the exclusive use of the borrower (the purchaser in this document) and should not be included in the prequalification documents made available to applicants.

To simplify presentation the note focuses mainly on construction contracts (the most common application of prequalification procedures). Care should be taken when preparing prequalification documents for other types of contracts to ensure that the prequalification criteria refer to the needs and characteristics of the specific procurement, while being consistent with the general principles outlined in the note.

Competitive Bidding for Construction Works

1. The successful execution of contracts for large buildings, civil engineering, supply and installation projects, and major, custom-made equipment requires that contracts are awarded to competent contractors, usually on the basis of competitive Bidding procedures. Large contracts financed under loans from the North American Development Bank (the Bank) are awarded, as a rule, through open bidding.

The Requirement for Prequalification of Bidders

2. This document relates specifically to the selection of competent contractors, prior to the issue of the invitations to bid, a procedure known as prequalification. Prequalification of contractors is recommended for large or complex works and, exceptionally, for custom designed equipment and specialized services. Prequalification is also desirable in other circumstances, for example, in sector projects with a programmatic approach, and when a large number of contracts are let on a "slice and package" basis.
3. The qualification of a contractor is a separate process from the bid evaluation procedure, which concentrates on the price and merits of the bid itself. Details of the bid evaluation procedure are addressed in the Bank's Model Bidding Documents and Procurement Note: Bid Evaluation Procedures.

Benefits of Prequalification

4. The prequalification process is of advantage to contractors and purchaser alike.

5. The prequalification process enables contractors, who may be insufficiently qualified on their own, to avoid the expense of Bidding or to form a joint venture, which may give a better chance of success. The assurance that competitors which lack the necessary qualifications will be excluded from bidding thus encourages leading contractors or suppliers to bid. The well-qualified firms may also price their bids more competitively with the knowledge that they will only be competing with other qualified bidders meeting realistic minimum competence criteria.
6. Prequalification enables purchasers:
 - (a) to assess the interest generated by the project among qualified firms, and to make any necessary adjustments in the procurement process (including, in particular, the conditions of contract—sharing of risk, payment terms, liquidated damages, or completion times—which may be perceived as onerous by potential bidders) in the event that only a limited number of applications are received;
 - (b) to reduce the amount of work and time involved in evaluating bids from unqualified contractors;
 - (c) to encourage local firms to form joint ventures with other local or international firms, thereby benefiting from their resources and experience; and
 - (d) to reduce significantly, if not eliminate, problems associated with low prices submitted by bidders of doubtful capability.

Basis for Prequalification

7. Under Bank-financed projects, the purchaser is responsible for preparing the prequalification documents and evaluating the applicants. The prequalification documents should provide a clear basis upon which prospective bidders can be evaluated, following an objective process based on fair and transparent criteria. The documentation sought should always be relevant, clearly stated and, so that prospective bidders are not deterred, should not impose an excessive burden of preparation or paperwork.
8. Prequalification should be denied only to those prospective bidders who do not meet the specified criteria. Thus, those who prepare prequalification documentation for a project are responsible for ensuring that the criteria are drawn in accordance with the realistic needs of the project and that the criteria are sufficiently stringent to assure that only properly qualified firms are included in the final list. Excessively “soft” criteria may result in an excess of unsuitably qualified applicants and may lead to (a) deterring the better qualified firms from bidding and (b) obtaining a low bid from a marginally qualified contractor or supplier.

9. Since prequalification is a preliminary stage in the process of awarding a contract to a competent bidder, the purchaser must be able to verify the statements made by the applicants and to retain the right to solicit information from past purchasers and financial institutions. Because there may be many applicants at the prequalification stage, the extent of verification should be limited to significant issues, with applicants being afforded the benefit of reasonable doubt. In subsequent stages of the procurement process, such doubts may be investigated if they remain relevant.

Eligibility to Prequalify

10. The prequalification process should not be used to limit the number of bidders, and all prequalified applicants must be permitted to bid. Some agencies maintain registers of firms that meet pre-set qualification requirements. Such registers are not a substitute for the prequalification process under open bidding.
11. Prequalification in Bank-funded projects is open to contractors, suppliers, and joint ventures from any country or countries.

Advertisement

12. The prequalification of bidders should be advertised following the procedures for notification and advertising specified in the Bank's Procurement Policies and Rules. Adequate time for response should be allowed. (See also the Bank's Note on the Preparation and Publication of Procurement Notices).

Prequalification Criteria to Be Pre-set

13. A clear statement of the requirements for qualification should be sent to all applicants who wish to be considered for prequalification.
14. The specific criteria, and the prequalification document as a whole, must be considered with care as early as possible in the procurement process. However, the prequalification documents should be issued only when the preparation of engineering designs and bidding documents is well-advanced, and the works are reasonably well-defined.

Two-Envelope System

15. The evaluation of prequalification applications precedes the issue of invitations to bid. Procedures such as the "two-envelope system"—which entails submitting prequalification and bid documents at the same time, in separate envelopes—do not meet the requirements of the Procurement Policies and Rules and defeat one of the key objectives of prequalification—that of saving unqualified prospective bidders the expense of bidding. The two-envelope system should not be used in open bidding.

Cofinanced Projects

16. Individual contracts may only be financed jointly by the Bank and other lenders, if the co-lenders agree to the application of the Bank's Procurement Policies and Rules. The procurement process is then the same as in any project funded by the Bank.
17. However, there is not always a full agreement among cofinanciers on the procurement procedures to be followed. In such cases, specific discrete contracts are procured, following the respective cofinanciers' rules, under "parallel cofinancing" arrangements. The prequalification documents must then address the requirements of the respective cofinanciers for the contracts they finance.
18. In some cases, the cofinancing arrangements (including the extent of the participation of the various co-lenders, the allocation of their funds to the various discrete elements of the project, and the extent to which joint cofinancing will apply) may not have been determined at the time of inviting firms for prequalification, and therefore the prequalification requirements for the various elements of the project would not be known. The prequalification documents should make the position clear to the applicants and allow for possible subdivision of the project into discrete elements for a potential parallel cofinancing arrangement.

Multiple Contracts

19. Where a project may be divided into separate contracts (slices) that may be combined into groups of contracts (packages), applicants may be invited to prequalify for each specific contract separately, or for a package of contracts which are essentially of a similar type and size but sometimes with longer durations. Applicants should be asked to state for which "slices" or "packages" they wish to prequalify. Applicants may prequalify for a specific contract, any single contract, any combination of contracts, or the entire package.
20. An applicant may be allowed to bid for any contract for which it is prequalified, and it may be awarded more than one, depending on its capacity to carry out a combination of contracts. In such cases, awards are made by the purchaser on the basis of the least cost for the entire package of contracts, taking into account any discounts offered by bidders for multiple contract award.

Subcontractors

21. The experience and financial resources of subcontractors may not be added to those of the Applicant for purposes of prequalification. The cumulative experience and capacity of an applicant as a former subcontractor may qualify them as applicants for certain works. In cases where a highly specialized process must be used, applicants should be required to specify the names and qualifications of such specialist subcontractors, if the particular process is not available in-house. Lack of such specialized support,

essential in certain construction operations that require, for example, chemical grouting or underwater repair work, could result in disqualification of the Applicant.

Joint Ventures and Other Forms of Association

22. The Bank encourages the formation of joint ventures of contractors or suppliers from the purchaser's country with foreign contractors or suppliers, but does not accept conditions for prequalification or bidding which make such joint ventures mandatory.
23. When two or more firms apply jointly for prequalification, special considerations must be met. The prequalification document must set out clearly the conditions applying to such joint ventures, whether existing or proposed; to any change in the membership of the joint ventures; or to the association of prequalified firms after prequalification. Each party of the joint venture must submit the complete documentation required of an individual firm applying for prequalification.
24. The requirements described for joint ventures apply to associations, partnerships, consortia, and other ventures in which firms associate with each other formally for the purpose of carrying out a contract jointly. Partners of a joint venture must confirm that, if prequalified, the joint venture bid will be submitted with a formal joint venture agreement and that all parties to that agreement will be legally bound jointly and severally for the bid and any consequent contract. The lead partner in the joint venture should also be designated, as well as the individual with overall responsibility for the joint application, who will be the principal contact for communications. The requirements do not apply to subcontract arrangements.
25. A firm may apply for prequalification both individually and as part of a joint venture. It will not, however, be permitted to bid for the same contract as an individual firm and as part of a joint venture. In the event that it bids for the same contract as an individual firm and as part of a joint venture, this will result in the rejection of all bids for that contract in which the party is involved.
26. Formation or regrouping of joint ventures after prequalification will only be considered if the additional firms or joint ventures have already been prequalified. However, such new joint ventures will not be approved if, in the borrower's opinion, this would substantially reduce competition.

Clarification Meeting

27. Where circumstances warrant (usually for very large or very complex projects), a clarification meeting should be held to clear any doubts the potential applicants may have about the documents or the project. If such a meeting takes place, all firms that have been issued with prequalification documents, should be sent, at least three weeks before the submission date, a copy of the minutes of the meeting, listing any changes made to the prequalification requirements or procedure as a result of the meeting.

Pass/Fail Criteria

28. The Bank very strongly advocates that applicants should be prequalified by meeting predefined, precise minimum requirements. The method entails setting pass/fail criteria which, if not met substantially by the applicant, results in disqualification. Other methods that involve the use of subjective criteria to evaluate firms, have been found to be flawed and have resulted in complaints from potential bidders that were unjustly disqualified, and in serious delays in project implementation. One such method is the points system that relies on the apportionment of "merit points". This system is better suited to the evaluation of consultants, or for contracts which entail highly specialized services.
29. The criteria adopted must relate to characteristics that are essential to ensure satisfactory execution of the contract, and must be precisely stated. In essence, the criteria must be chosen so that only contractors who are well qualified to carry out the work are permitted to bid. The criteria must also be set so that they neither inhibit competition nor set a predetermined number of firms to be prequalified: all firms that meet the criteria should be invited to bid. The prequalification criteria for joint ventures should be the same as those for single applicants.

Information to Be Sought

30. To enable potential bidders to be prequalified, it is necessary to seek only such information as is essential for the purchaser to determine the applicant's capabilities to perform the contracts satisfactorily. These capabilities are normally categorized under the headings of experience, personnel capabilities, equipment capabilities, financial position, and litigation history.

Experience

General Experience

31. The applicant's general capabilities should be related to the availability of current, relevant experience and the value of work undertaken. Minimum experience requirements should be stipulated as an annual value of the general construction work carried out over a stated period, e.g., five years.
32. The value of relevant work carried out should be presented as the annual turnover, in terms of invoices to clients for work carried out during the year, expressed in its equivalent in a convertible currency, i.e. US\$. The value of each contract should be calculated at the exchange rate at the end of each year reported. The criterion for qualification should be set at a level that ensures that the potential contractor will not be overwhelmed by the size of the new contract. For instance, the applicant's annual turnover should normally be not less than 2.5 times the expected annual cash flow of the proposed contract. The multiplies may be reduced for very large contracts (say US\$

500m) or very small (say US\$ 1m or less), or in special circumstances, but should not be less than 1.5.

33. Testimonials and certificates are of doubtful value in assessing applicants' capabilities, and are not always available. Thus, applicants should not be required to submit such documents as a condition of prequalification.

Particular Experience

34. Applicants should demonstrate that they have carried out work of a nature, size, value, and complexity similar to that of the project in question. There are two principal criteria for prequalification.

- ◆ First, the applicant should have carried out similar work of at least a magnitude approximating that of the package of work for which prequalification is sought. Depending on the nature of the works to be bided, the criterion should be related to the applicant having carried out one or more projects of a certain value referred to that of the proposed project over a specified period, usually the last five years (or less, in special circumstances). The individual value of such previous contracts should be about 80 percent of the estimated cost, including contingencies, of the contract to be undertaken.
- ◆ Second, the applicant should have performed operations of a volume and quality similar to those required for the project. For example, where large-volume earth moving, tunneling, or concrete placing is involved, the applicant should demonstrate experience in those operations, having performed them at the rates necessary to meet a percentage (e.g., 80 percent) of the peak annual rate required for the project.

35. Applicants should not be disqualified because they have not had direct experience in the purchaser's country or region.

36. In some projects, specific environmental conditions may require applicants to have particular relevant experience.

37. Applicants should not be disqualified solely because they have not carried out the exact type of project proposed if their experience is comparable. For example, a contractor who has not done so before may be capable of constructing sewer and water mains if the contractor has adequate comparable civil works and building experience.

Personnel Capabilities

38. The managerial and technical competence of a contractor is largely related to its key personnel on site. The extent to which the applicant should demonstrate having staff with extensive experience should be limited to those requiring critical operational or

technical skills. The prequalification criteria should therefore refer to a limited number of such key personnel, for instance, the project manager and those superintendents working under the project manager who will be responsible for major components (e.g., superintendents specialized in dredging, piling, tunnelling, or earthworks, as required for each particular project).

39. Applicants should normally be required to name a principal candidate and an alternate for each key position. Criteria of acceptability should be based on:
 - ◆ a minimum number of years of experience in a similar position; and
 - ◆ a minimum number of years of experience and/or number of comparable projects carried out in a specified number of preceding years.
40. The requirement of specified education and academic qualifications is normally unnecessary for such positions, as contractors often employ competent staff who have learned their profession “on the job” and who lack formal qualifications.
41. It may be appropriate to specify that certain positions are filled by individuals who have held posts of comparable authority for, say, three years with the applicant. This is so that key staff, in executive site positions, have sufficient knowledge of the applicant's management, policy, procedures, and practices to act with confidence and authority within that framework.

Equipment Capabilities

42. An inventory of construction equipment represents a high capital cost overhead to a contractor. In consequence, not all competent potential bidders will maintain an inventory of high-value items that are in suitable condition for major contracts. In most cases applicants can readily purchase, lease, or hire equipment. It is thus usually unnecessary for prequalification to depend on the contractor's owning generally available items of equipment. The pass/fail criteria adopted should therefore be limited only to those bulky or specialized items that are critical for the type of project to be implemented and which may be difficult for the contractor to obtain quickly.
43. Even in such cases, main contractors may not own the equipment; rather they may rely on specialist subcontractors or equipment hire firms. The availability of the subcontractor and the specified equipment should be subject to verification (at the time of prequalification, or at the time of bidding) in such cases.
44. Particular care is needed in setting pass/fail criteria for equipment because of the different skill levels and techniques that contractors bring to construction projects. For example, heavy lift capability may best be related to the need for placing specified items or for constructing components in position, not simply for specifying a crane rated at so many tons at its minimum working radius. Thus, performance-based criteria may be more relevant.

Financial Position

General Information

45. Because of differing international accounting practices and tax laws, published information on the financial position of companies, and financial ratios derived therefrom do not provide an equitable international basis for evaluating the financial standing of companies for prequalification purposes. Nevertheless, audited financial statements or balance sheets should be sought as a general guide to the financial health of the applicant. For example, the financial results over the last five years and the projection for the following two years should be positive. Consistent losses or a risk of insolvency shown in the accounts may be cause for rejecting the applicant.
46. Some firms, particularly those whose shares are traded on stock markets, may justifiably object to providing confidential financial projections. In such cases, the omission of the information should not be grounds for rejecting an applicant, provided that other financial indicators are satisfactory.
47. The purchaser should normally require applicants to provide the following background information to support the presentation in the application forms:
 - ◆ audited annual financial statements for the last five years supported by audit statements or tax returns. Firms owned by individuals and partnerships may not be required to maintain audited accounts by the laws of their countries of origin. In such cases, their balance sheets should be certified by a registered accountant, and supported by tax returns.
 - ◆ names and addresses of the applicant's banker(s), as well as the names and addresses of individuals familiar with their financial standing.

Cash Flow Capability Requirement

48. The purchaser must be satisfied that the bidders will, at the time of award, have the financial resources to implement the project satisfactorily. Prequalification followed by updating information with the bid, and verification prior to award of contract are both necessary to determine the financial capabilities of the potential contractor, prequalification being a preliminary stage in the process.
49. The cash flow qualifying criterion should be based on the means to finance fully the purchaser's estimate of cash flow for both local and foreign currency requirements for a specified "critical" period. Assuming monthly periodic payments, a suggested method of determining these requirements is based on a straight line monthly cash flow for the contract, neglecting any effects of the advance payments and retention monies. Calculating from the beginning of the month invoiced, the "critical" period is determined

by adding a contingency period of one to two months to the cumulative time period needed by the engineer to issue the interim/monthly certificate and the time needed for the purchaser to pay the amount due. One month contingency should suffice for cumulative time periods of three months or less and two months contingency for longer periods.

50. The amount estimated from the above calculations should be stated in the prequalification documents as the pass/fail criterion. Applicants should demonstrate their access to liquid assets, lines of credit, unencumbered assets, and other financial means sufficient to meet the specified cash requirement, net of other known commitments at the time of award, and subject to verification.

Litigation History

51. Purchasers should be on their guard against contractors who resort to excessive claims and litigation as a means to increase income after an award of contract. However, in some countries, resorting to claims is an established business practice.
52. Applicants with a consistent and significant history of excessive contract arbitration and litigation resulting in awards or decisions **against** them should not be qualified to bid. So that the litigation history may be evaluated, applicants should be required to list all contracts over a stated number of years (normally the last five years) that resulted in litigation or arbitration proceedings, with an indication of the matters in dispute, the parties involved, the amounts in dispute and the outcome of the litigation.
53. The criterion for rejection should be one of numerous arbitral awards or court decisions against the applicant; for instance, the occurrence of one or two cases over five years, for a contractor handling, on average, ten construction jobs simultaneously should not be a cause for rejection. Under the best of circumstances, some projects “go sour” for causes such as clash of personalities or incompetent management by the purchaser. On the other hand, if litigation is found relatively frequently in the business of the applicant, it may indicate an attitude of the management of the firm which could be unacceptably risky for the purchaser if the applicant were awarded the contract.

Conditional Prequalification

54. When an applicant fails to meet some of the qualifying criteria by a small margin, the applicant may be “conditionally prequalified”, that is, prequalified subject to certain specific requirements being met substantially prior to a prescribed deadline, such as: the notification of the results of the evaluation, the issuance of an invitation to bid or the submission of a bid by the applicant.

55. The following typical requirements (*inter alia*) might justify “conditional prequalification”:
- the provision of additional, acceptable, critical information;
 - revisions to a preliminary joint venture agreement;
 - improving senior managements;
 - access to a special item of equipment;
 - the hiring of experts in specialized fields;
 - the applicant’s questionable ability to undertake the proposed works due to the pending award of other significant contracts; and
 - the substitution of a critical specialist supplier or collaborator.

Updating Prequalification Information

56. Because circumstances may change in the period between prequalification and the submission of bids, contracts must be awarded only to bidders who continue to meet the requirements for prequalification. The bidding documents should specify which essential items of the information submitted with the prequalification document should be updated with the bid. In particular, the purchaser should be satisfied that bidders continue to have the required financial capability.
57. The purchaser may harbor reasonable doubts about the veracity of statements made by a bidder. If a perceived weakness could materially affect the bidder's capability to perform the contract satisfactorily, then the prequalification information should be verified.

Prequalification Report

58. The purchaser should evaluate the applications received and prepare a report for the Bank’s review. The report should address for every applicant each of the pass/fail criteria set in the documents. Disqualification of applicants who marginally fail to meet the criteria should be highlighted, and in marginal cases, details should be submitted. The Bank may ask the purchaser to justify the evaluation and/or request further information or clarification.

Notification of Prequalification

59. After the purchaser has processed and evaluated the prequalification submissions, and received the Bank's “no objection” to the results of the evaluation, the purchaser should notify the applicants of the decision.
60. In all cases, the notification should indicate that prequalification will be followed by verification at the time of bidding, and that bids shall be rejected by the purchaser, at its

discretion, if the verification is unsatisfactory or if the bidder is unable to confirm the specified requirements.

61. Applicants should be advised that only firms and joint ventures that have been prequalified under this full process will be eligible to bid.
62. The purchaser should make available the list of prequalified bidders prior to the issuance of the invitation to bid, in order to allow subcontractors and suppliers (particularly local firms), to contact the prequalified bidders.

Invitation to Tender

63. Invitations to bid should follow as soon as possible after prequalified bidders have been notified. The bid documents should be issued only to prequalified firms and should refer to the need to provide specified updated information and any pre-award verification requirements.