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Fighting Invisible Procurement Collusion: Avoiding the Big Squeeze

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Why and how your organization's purchasing, legal, and finance professionals can form a formidable defense against profit-killing price-fixing, bid-rigging, monopoly and other anticompetitive schemes that could be costing your company millions.

The chief executive started her day like any other. Hot coffee and a scan through the day's business news. Then came a sinking feeling. A question popped into her head that she could not answer. More questions followed. She had just read an article about how several suppliers in the food industry had been engaged in an elaborate, decades-long conspiracy that drove prices of their products sky high, costing wholesalers millions of dollars a year and consumers millions more.

That wasn't her industry but, still, was her company falling for such a scheme? It was eating at her and, she feared, her bottom line. Did her company unknowingly rely on conspirators, monopolists or cartels in critical segments of their supply chain? Are any of their vendors colluding to make her team believe they are paying fair prices or that they are really the best and only game in town?

In other words: Was her company being squeezed? Did she really know what was going on back at the office? She was coming up empty.

Before her feet hit the floor, she contacted her head of supply chain procurement, a long-time and loyal member of the company. He greeted her with calm and confidence. "No, it's all fine," he said. "We have a great relationship with our suppliers. It's highly competitive. We've got best practices systems run by a highly professional team. No collusion or anything untoward to see there. We're solid."

What a reassuring response! Everyone can breathe easy, right? While everything might very well be fine, there are several problems with his answer.

1. Participants in anticompetitive schemes are good at it. They are sophisticated; they know how to disguise their conduct. Ask other people in the industry and they, too, will say all is well. As long as everyone in the market is growing, why would anyone complain? Making everyone, especially buyers, believe all is well is something conspirators do well. As Warren Buffett says, "You only find out who is swimming naked when the tide goes out."

2. Unscrupulous suppliers know how to gain your trust. This happens to even the most savvy individuals who are soliciting bids, running auctions. placing orders and making purchasing decisions.

3. What may seem like good procurement practices may actually be harmful. Intuitively, working with the same suppliers for years sounds smart, but it may be occluding vendor collusion and/or costly over-charging.

4. Procurement pros may be unwitting participants in anticompetitive schemes. Even individuals with experience and the highest integrity, which describes the vast majority of buying professionals, have been fooled. This is not meant in any way to disparage these professionals. The most intelligent, forthright and well-meaning among us can fall victim to highly skilled and motivated conspirators. It happens all the time. That’s why it keeps happening at the highest levels of corporate America and government, too.

In fact, procurement professionals are a company’s best resource in rooting out and mitigating the risks of price fixing, bid-rigging and monopolization schemes. Enlisting them in a critical look at vendor conduct is imperative, as is discussing indicators or red flags of a potentially corrupt market. They are in the best position to push back against suppliers, but they cannot do it alone.

While they may not be aggressive or skeptical by nature — perhaps not the most common characteristics of procurement professionals — that is where Chief Legal Officers or COOs can partner with them for the good of the business and its bottom line.

This internal collaboration is especially necessary when, for example, seeking alternative suppliers. A dominant vendor might see this as a threat, and be tempted to abuse its power by retaliating against the buyer. This has occurred to the great detriment of even the most sophisticated, name-brand companies.

Lessons from the public sector.

Recently, the Antitrust Division of the Department of Justice — recognizing the need to step up efforts to root out this costly and illegal behavior in government procurement — established the Procurement Collusion Strike Force (PCSF), a network of U.S. attorneys who train data analysts, criminal investigators and others, and assist with investigations into procurement collusion.

The Antitrust Division and the Strike Force are in lockstep with the Organization for Economic Cooperation and Development (OECD) Competition Committee, comprising representatives of nearly 30 nations. According to the OECD, the elimination of bid rigging in the public sector could help reduce procurement prices by 20 percent or more. The deterrent effect of greater enforcement against illegal collusion in public procurement should save taxpayers billions of dollars per year, the OECD estimates.

And there is no question: the private sector is not immune. Just ask companies like Dell, HP, Western Digital, PIMCO and many, many others

When it comes to identifying and proving collusion, companies can learn valuable lessons from these global public sector initiatives. More importantly, companies can fight competition-crushing conduct and collusion in their markets through private litigation.

Fertile Ground

The temptation to collude becomes more powerful during a troubled economy, or when other forces challenge a corporation's ability to meet revenue projections and shareholder expectations. The economic situation in 2020, made dire for many sectors by the novel coronavirus pandemic, is just the kind of atmosphere that exerts pressure on industry players, causing supply-chain disruptions, cratering sales, failing mergers and acquisitions, and the insolvency of heretofore industry fixtures. To make a bad situation worse, collusion drives up prices for corporate purchasers and consumers who are experiencing financial pressures of their own. New market entrants are deterred. Innovation languishes.

In addition to the relative financial health of an industry, the Strike Force and the OECD agree on what characteristics make one market more conducive to collusion than another.

- Is the same supplier often the lowest bidder?
- Do some companies always bid but never win?
- Do certain companies take turns winning?
- Does the winning bidder repeatedly subcontract work to unsuccessful bidders?

To identify red flags, the Antitrust Division recommends a "MAPS" analysis, an acronym for Market, Applications, Patterns, Suspicious Behavior.

Market: Profile and Characteristics

First, you need to survey the competitive landscape. How many suppliers are in the market? The fewer the sellers, the easier it is for collusion and monopolistic conduct to occur. A market can be far narrower than most people might think, though. It can be a sub-segment of a sub-segment. One category of product can have many sub-categories of goods made for very specific and different purposes. Think of a lightbulb made for a table lamp versus one used in aerospace or in high-temperature environments. The dominant players in one may not dominate the other. Think of computer chips. Some are made for personal computers, others for giant mainframes, still others for smart phones. While these all may be made by the same company, they also may be made by many different companies which either have special expertise, unique designs, or have managed over the years to become the go-to provider in a given market, based on exceptional service, for example. If a small group of vendors controls a large share of a market, and especially if the product is standardized and other products cannot be easily substituted — in which case price is the differentiating factor — this is fertile ground for supply chain abuse.

Vendor Conduct: Applications, Patterns and Suspicious Behavior

Next, consider the activities taking place in the market, and by and among competitors. Questions a company should ask in examining conduct include:

- Do proposals from different vendors appear similar? As examples, do they contain similar errors, addresses, or evidence of similar last-minute price changes.

- Are the same vendors winning contracts consistently?
- Are there fewer vendors vying for your business?
- Have you noticed that vendors seem to take turns winning contracts?
- Are you making repetitive purchases, to the point where they vendors all get to know one another?
- Are offered discounts tied exclusive requirements or unattainable targets?
- Are discounts offered when there is a threat of competition?
- Are there veiled threats of supply disruptions if competitors are thought to be gaining a foothold?

Is there anything suspicious in how a vendor is submitting proposals?

- Are they vying for work you know they aren't qualified to perform?
- Are they suggesting they have knowledge of a competitor's bid?
- Are their prices nearly identical to others and stay that way for a long time?
- Do prices increase without justification or unsupported pretexts, such as increased production costs or some other factor?
- Similarly, are discounts discontinued without reason?

Action Plan

With these insights in mind, we suggest the following game plan to make sure you are not falling victim to pricing schemes and that you are adequately protecting your bottom line.

- Form an internal Procurement Task Force comprising key stakeholders from your organization, a cross-functional team representing purchasing, legal, finance, operations, technology, compliance, human resources, etc.
- Enlist the assistance of a third-party professional or firm with experience analyzing markets and investigating anticompetitive schemes such as price fixing, bid rigging and monopolies. Look for a third-party that can bring economic, business, legal, and compliance expertise to the process.
- Provide regular mandatory training to ensure employees know red flags when they see them and what the procurement process involves.
- Enable employees to report any suspicious behavior among vendors and suppliers.

- Conduct periodic supply-chain purchasing audits that:
- Analyze your suppliers' markets to see if they are fertile for collusion. See Fertile Ground above.
- Review your organization's purchases by category, vendor, price, and volume, then examine trends.
- Assess any red flags that may suggest suppliers are overcharging you or colluding.
- Review your existing vendors and suppliers, and how long you have worked with them. Have they experienced pressure that would drive them to overcharge? Have they been investigated or charged with anticompetitive or other unethical conduct in the U.S. or abroad?
- Examine the history of bids received by your company and the reasons proposals have been accepted or rejected. Are there changes in patterns there? See Vendor Conduct: Applications, Patterns and Suspicious Behavior above.
- Report out findings and recommendations, then make it someone's job to follow through, perhaps an unbiased third party.

Conclusion

In a perfect world, you have great and honest relationships with your suppliers. They win because you keep coming back. You win because you get great service at competitive prices. This is not a condition you want to leave to chance, however. As with any part of your business, you want to have a program in place to ensure your bottom line is as healthy as it can be. Forming a team, training your employees, and reviewing your vendors and procurement program are sound steps for keeping it that way.

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