

# PUBLIC PROCUREMENT: ACHIEVING BEST VALUE THROUGH COMPETITION

## 1. BACKGROUND

Procurement is purchase of goods and services with designated parameters, for achieving certain identified objectives, by a public or a private enterprise, wherein the bidder with the best terms enters into an obligation to provide goods or services tendered. When goods or services are purchased by a public sector, it is called **public procurement**.

Most of the time, public procurement is carried out through competitive bidding or tendering process with the intention of achieving maximum economic efficiency through competitive process. Any anti-competitive practices in a procurement process, such as collusion, bid-rigging, fraud and corruption, could lead to artificially raised prices, or compromise on the parameters and consequently adversely impact public expenditure and the precious national resources. Ensuring effective functioning of public procurement markets is also a part of good governance, and necessitates addressing two distinct but inter-related challenges: (i) ensuring integrity in the procurement process (ie. preventing corruption on the part of public officials); and (ii) promoting effective competition among suppliers, including preventing collusion among potential bidders.

**In many countries, such practices of bid rigging and collusive bidding etc. are considered serious criminal offences, as they tantamount to a fraud on public exchequer, and have deterrent liabilities of imprisonment, and severe fines. In India, there are provisions under the Competition Act, 2002 for imposition of severe penalties for such offences.**

The central public sector enterprises in India contribute about 6%-7% to the GDP and more than 1.50 lakh crore to the exchequer in the form of dividends, interests, customs, excise duty, sales tax and other taxes and duties. **The size of the procurement of central PSEs during 2008-09 was more than Rs 8 lac crore.** An effective public procurement can help the PSEs in improving their margin and further improve their contribution to the public good.

## 2. COMPETITION COMMISSION OF INDIA AND ITS MANDATE

The Competition Commission of India has been entrusted with the mandate (Section 18 of the Act):

*“it shall be the duty of the Commission to eliminate practices having adverse effect on competition, promote and sustain competition in markets, protect the interests of consumers and ensure freedom of trade carried on by other participants, in markets in India”*

According to section 2(h) of the Act, the definition of “enterprise” includes Government Departments and PSUs, except matters relating to sovereign functions of the Government.

Globally, it is the interest of anti-trust bodies like Competition Commission of India to look into matters connected with bid rigging and collusive bidding in the Government procurement and thereby help the Government and Government agencies in achieving the best value for money. In various reports like of OECD, and International Conferences, like in Russia, it has been highlighted how such practices have helped in achieving upto 15-20% economy in public procurement.

Further, economically, Government has a pre-eminent role as a major buyer of goods and services in the Country, and their procurement operations have a direct and strong effect on the behavior of the market, and other activities down the line. There could be collusion and bid rigging (covered u/s 3 of the Act) by the supplier in certain situations involving rigid and inadequately designed procurement processes which may germinate such practices.<sup>1</sup> Similarly, designing standards and specifications without adequate care could facilitate abuse of dominance in procurement, which is covered by Section 4.<sup>2</sup> Thus, both the dimensions of Government procurement could be covered by two different Sections of Competition Act i.e. **Section 3** which deals with the anti-competitive behavior of bidders including bid rigging or collusive bidding, and **Section 4** which deals with abuse of dominant position and prohibits unfair or discriminatory conditions in purchase/sale or in purchase/sale price or practices further resulting in denial of market access.

To enforce these provisions, the Commission may pass appropriate orders<sup>3</sup> and impose penalties<sup>4</sup> after the enquiry under section 27 of the Act. This could be “*upto three times of its profit for each year of the continuance of such agreement or ten per cent of its turnover of each year of the continuance of such agreement, whichever is higher*”. The penalty can therefore be severe, and result in heavy financial and other cost on the erring party.

The Commission has also been entrusted with the task of undertaking competition advocacy, creating awareness, and imparting training about competition issues, under **Section 49**<sup>5</sup> which

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<sup>1</sup> Section 3(3) - Any agreement entered into between enterprises or associations of enterprises or persons or associations of persons or between any person and enterprise or practice carried on, or decision taken by, any association of enterprises or association of persons, including cartels, engaged in identical or similar trade of goods or provision of services, which (a) directly or indirectly determines purchase or sale prices; (b) limits or controls production, supply, markets, technical development, investment or provision of services (c) shares the market or source of production or provision of services by way of allocation of geographical area of market, or type of goods or services, or number of customers in the market or any other similar way; (d) directly or indirectly results in bid rigging or collusive bidding, shall be presumed to have an appreciable adverse effect on competition:

<sup>2</sup> Section 4(2) -There shall be an abuse of dominant position if an enterprise or a group directly or indirectly, imposes unfair or discriminatory condition in purchase or sale of goods or service; or price in purchase or sale (including predatory price) of goods or service.

<sup>3</sup> Section 27(a) - .....direct the parties to discontinue and not to re-enter such agreement; direct the enterprise concerned to modify the agreement; direct the enterprises concerned to abide by such other orders as the Commission may pass and comply with the directions, including payment of costs, if any; and pass such other orders or issue such directions as it may deem fit.

<sup>4</sup> Section 27(b) - .....up to 10% of average turnover for last three preceding financial years upon each of such persons or enterprises -parties to bid-rigging or collusive bidding In case, bid-rigging or collusive bidding agreement has been entered into by a cartel, Commission may impose upon each member of cartel a penalty of up to 3 times of its profit for each year of continuance of such agreement or 10% of its total turnover for each year of the continuance of such agreement, whichever is higher.

<sup>5</sup> Section 49(3) – The Commission shall take suitable measures for the promotion of competition advocacy, creating awareness and imparting training about competition issues.

provides for competition advocacy and inculcating competition culture in the country. Sensitization of public agencies is equally important from the point of view of avoiding litigation by private sector agencies against them in procurement.

### 3. GAINS FROM COMPETITION IN PUBLIC PROCUREMENT: INTERNATIONAL EXPERIENCE

There are substantial gains from the promotion of competition in government procurement. As per the findings of an OECD survey, savings to public treasuries between 17% and 43% have been achieved in some developing countries through the implementation of more transparent and competitive government procurement regimes. Given below are some of the instances wherein the impact of introduction of competition in various procurement processes has been assessed.<sup>6</sup>

- An independent external study for the European Commission found that increased competition and transparency resulting from implementation of the “Public Procurement Directives” of the European Communities in the period between 1993 and 2002 generated cost savings of between € 5 billion to € 25 billion. On the other hand collusion in public procurement markets has been conservatively estimated to raise prices on the order of 20% or more above competitive levels.
- In Russia, as a result of the reform in the field of public procurements, in 2008 an amount of \$7 billion of the Russian budget was saved
- In Pakistan, a saving of more than Rs.187 million (US \$3.1m) for the Karachi Water and Sewerage Board through the introduction of an open transparent bidding process
- A substantial reduction in the budget for expenditures on pharmaceuticals in Nicaragua, due to the establishment of a transparent procurement agency accompanied by the effective implementation of an essential drug list

### 4. COMPETITION CONCERNS

Bid rigging/Collusive bidding is a particular but highly pernicious form of collusive price-fixing behavior by which firms coordinate their bids on procurement or project contracts. Bid-rigging schemes often include mechanisms to apportion and distribute the additional profits obtained as a result of the higher final contracted price among the conspirators. Anti-competitive behavior in procurement process can take many forms, some of which are as follows:

- **Collusive bidding:** Collusive bidding can take form of an agreement among firms to divide the market, set prices, or limit production. It can involve "wage fixing, kickbacks, or misrepresenting the independence of the relationship between the colluding parties." In legal terms, all acts affected by collusion are considered void.

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<sup>6</sup> Source: OECD, Transparency in Government Procurement: The Benefits of Efficient Governance (TD/TC/WP/(2002) 31/Rev 2/14 April 2003)

- **Bid rotation:** In bid-rotation schemes, conspiring firms continue to bid, but they agree to take turns being the winning (i.e., lowest qualifying) bidder. The way in which bid-rotation agreements are implemented can vary.
- **Cover bidding:** Cover (also called complementary, courtesy, token, or symbolic) bidding occurs when individuals or firms agree to submit bids that involve at least one of the following: (1) a competitor agrees to submit a bid that is higher than the bid of the designated winner, (2) a competitor submits a bid that is known to be too high to be accepted, or (3) a competitor submits a bid that contains special terms that are known to be unacceptable to the purchaser.
- **Bid suppression:** Bid-suppression schemes involve agreements among competitors in which one or more companies agree to refrain from bidding or to withdraw a previously submitted bid so that the designated winner's bid will be accepted.
- **Market allocation:** Competitors carve up the market and agree not to compete for certain customers or in certain geographic areas. Competing firms may, for example, allocate specific customers or types of customers to different firms, so that competitors will not bid (or will submit only a cover bid) on contracts offered by a certain class of potential customers which are allocated to a specific firm etc.

Besides, Public Sector Enterprises have been the victim of International Cartels which often reflects monopolistic behavior of the suppliers in the market who often co-ordinates the production to maintain high level of prices. In the past, such behaviour has been noticed in sectors like Fertilisers, Sugar, Wheat, Pulses, and Construction Material etc. In many countries, as in Canada, price fixing and supply restrictions are criminal offences but export cartels are exempted from competition law and they can impose huge costs on developing countries.

## 5. DETECTION OF ANTI-COMPETITIVE PRACTICES

### 5.1 Market structure prone to anti- competitive practices

Various characteristics signifying more prone to anti-competitive practices:

- **Small number of companies:**
- **Little or no entry.**
- **Market conditions**
- **Industry associations**
- **Repetitive bidding**
- **Identical or simple products or services**
- **Little or no technological change**

## 5.2 Monitoring the Behaviour

Bid-rigging, price fixing, and other collusion can be very difficult to detect; since these activities are unlawful, those involved in such agreements will do their utmost to keep them secret. ***Suspicious may be aroused by unusual bidding or pricing patterns or something a vendor says or does.*** In most cases, it is necessary to look for clues such as unusual bidding or pricing patterns, or something that the vendor says or does.

As per observation of CVC and CAG, numerous cases of collusive bidding, price collusion, setting up of standards to create entry barriers have been noticed. Sample investigation of few public procurements has revealed signs like dispatch of tender applications from the same post office at the same time in seriatim and the receipt issued is also in seriatim, **bids sent by the same fax, same address, several bids identical in value upto even decimal points**, communications sent to the same address in respect of two or more bidders, joint representation by two or more bidders have also been seen. Undue favour to one or the other participant could be suspected in setting specific standards i.e. not capability based but parameter based. Similarly at the evaluation stage due to subjectivity involved in technical evaluation, there have been instances of aberrated evaluations to the advantage of few. The various provisions of the Competition Act, 2002 empower CCI to penalize the colluders as the third 'C' of watch dogs i.e. CAG, CVC, if such instances are reported to CCI.

There are several IT tools used globally to detect anti- competitive behavior of firms participating in the procurement process. These tools facilitate monitoring the behaviour of conspiring bidders. These tools will also be deliberated in the Conference.

## 6. PREVENTION OF BID-RIGGING: SOME SUGGESTIONS

Some of the steps that procurement agencies can take to promote more effective competition and reduce the risk of bid rigging in public procurement:

- Gathering information about the market
- Maximize the potential of participation of genuinely competing bidders
- Unambiguous drafting of the specifications
- Design of the tender process
- New and innovative bidding processes
- Appropriate evaluation criteria

It is in this background a conference is proposed to be held with PSEs . The objective of the conference is to sensitize the central public sector enterprises about the potential cost savings that can be generated by introducing increased competition and transparency in the procurement practices. Focus will also be made on the identification, detection and prevention of anti-competitive practices. International experiences will also be shared by renowned U.S. experts on the subject. One session is proposed to be devoted on the Indian procurement framework and

deliberations will be made on how some of the anti-competitive practices could be avoided through effective tender designing.

Besides, possibility of non-compliance of the provisions of the Competition Act by PSEs operating in a similar sector by entering into prohibited agreements under the Competition Act can also not be ruled out. It may either be due to ignorance or as a matter of practice or under the instructions from the concerned administrative Ministry. Therefore, to ensure compliance of competition provisions by the central PSEs and enhance standards of corporate governance and corporate social responsibility to the best prevalent practices in the world, one session would be devoted on competition compliance.