Competition Issues in Public Procurement: Is Tender Design the Solution?

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Abstract: Public procurement is one of the most important economic activities for any economy. The forward linkages and its impact on social and industrial policy give it “an engine of growth” dimension. In this attempt, we try to study why competition is crucial for the success of any procurement policy. The fundamental need for public procurement is to be efficient, as an “efficient” public procurement not only reduces public expenditure but also has positive externalities. The basic framework within which we try and study the competition concerns in public procurement is based on two types of concerns, namely collusive and non-collusive. These two types of concerns emanate from a combination of numerous factors like number of sellers, demand conditions, and market dynamics. The factors, which result in inefficient procurement, are often not amenable to quick changes to ward off the threats completely. Therefore, a multi-prolonged approach is needed for efficient public procurement outcomes. Tender designs draw the boundaries of the competition field where sellers compete for the market. Therefore, they can incorporate elements to address specific threats that a particular procurement market face. Hence, the tender design is a potential tool which can be utilised to mitigate and address these concerns.

Keywords: Bid rigging, cartels, multiplier effect, market allocation, open tenders, corruption, participation costs.

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1. Introduction

Business dictionary defines procurement as “the action of obtaining or procuring something”. The process includes preparation and processing of demand as well as the end receipt and approval of payment. It often involves: (i) purchase planning, (ii) standards determination, (iii) specifications development, (iv) supplier research and selection, (v) value analysis, (vi) financing, (vii) price negotiation, (viii) making the purchase, (ix) supply contract administration, (x) inventory control and stores, and (xi) disposal and other related functions.

While procurement can be done by any entity, including individuals, businesses, non-profit making organisations and governments, the focus of the present article is on government purchases, i.e. public procurement. Governments need to buy goods and services for administrative purposes and for providing public services. At times, the government acts as an entrepreneur and requires supplies just like any other business concern – these supplies are also classified as public procurement. Thus, public procurement refers to the process by which public authorities, such as government departments or local authorities, purchase work, goods or services from companies, the underlining basis, for which, is to secure the best value for the public money.

The nature and scale of public procurement can lead to a multitude of benefits for the economy. However, anti-competitive threats lead to inefficient market outcomes in public procurement and in turn diminish the positive aspects of it. Therefore, efficient public procurement and mitigating anti-competitive concerns which mar it are of utmost importance in a developing country like India. Hence, this article attempts to highlight the crucial nature of an efficient public procurement. We will also explore a potential solution, i.e. tender designs, for addressing anti-competitive threats in public procurement.

The article discusses the scale of public procurement in the second section. In the third section, we look at the importance of an efficient public procurement system. The fourth section discusses in detail, the competition issues that can occur in public procurement. In the fifth section, we discuss how and to what extent tender design can resolve the competition issues.
in public procurement and in the final section, we draw conclusions from our discussion.

2. Public Procurement in India

The very nature of government requirements dictates that they usually need goods/services in large quantities; in turn, the size of public procurement is also huge in relation to the size of the economy. OECD (2007) estimates that public procurement globally amounts to approximately 15 per cent of gross domestic product, a figure that can even reach 25 per cent in the case of developing countries such as India.

While the exact figures of public procurement in India are not available, there are certain estimates available which give us some idea of the scale of public procurement. In the World Bank Report “Enhanced Transparency in procurement through voluntary disclosure under the RTI Act 2005” (World Bank, 2009), the scale of public procurement in India is stated to be around 30 per cent of the GDP. It is important to note that some of the government departments like Defense, and Railways are likely to devote more than 50 per cent of their budget to public procurement. The Draft Public Procurement Bill 2011 estimated the value of public procurement in India to be in the range of Rs. 12-15 lakh crores per annum, or about 15-20 per cent of the GDP. Though these figures are not exact yet they give a rough estimate that public procurement in India is in the range of 20-30 per cent of GDP.

The implications of such a big scale of public procurement for a developing economy like India can potentially be many. An efficient procurement in India can help generate aggregate demand necessary for making India a five trillion dollar economy. It can also have implications for the efficient use of scarce resources and employment generation. Thus, public procurement is a tool for achieving multi-dimensional goals and needs to be treated with care.

3. Why does Public Procurement need to be efficient?

It is clear that the scale of public procurement makes it an important activity of the economy. However, there are other aspects related to public procurement which make it even more important. Firstly, the government spending on procurement creates a cycle of income and investment
which contributes to the economic growth of the country. Government expenditure increases the national income of the country by multiples. This phenomenon is called the “multiplier effect”. Government expenditure through public procurement also provides business opportunities to the private sector. Public procurement impacts the level of participation in the economy by creating “effective demand”, thus creating new opportunities. The general increase in the income in the economy in turn improves the business and investment environment. The increase in the level of participation also enhances competition in the market in the long run. Thus, public procurement has a growth aspect attached to it. Secondly, effective procurement has a direct impact on the quality of public services in the country. The effectiveness of government and its performance, hence, depend heavily on effective public procurement.

The above discussion reveals that there is an absolute need for public procurement to be efficient, as an efficient public procurement not only reduces public expenditure but also has positive externalities which affect many aspects of the economy. Here, efficiency essentially entails the selection of suppliers with the lowest price (with a given level of quality) which means achievement of the best “value for money”. If expenditure is made in an efficient way then, as stated above, all the secondary effects or externalities associated with public procurement can be realised. The relation may be depicted as in Figure 2.
The relation signifies that value for money or the least possible cost is essential for an effective and efficient public procurement. Another observation which can be made from Figure 2 is that competition is essential for efficient procurement. Competition among suppliers/manufacturers by providing them with a fair chance to participate in public procurement, as in any other market, ensures that the most efficient supplier is incentivised. Other economic efficiency features like investment and innovation are also spurred through competition. Thus, competition can be thought of as a core element for any efficient and effective public procurement.

The anti-competitive acts and conduct of sellers introduce many inefficiencies in the procurement market. Firstly, cartels don’t breed cost-cutting and the focus of the cartels is on rent sharing. Secondly, protected markets don’t generate innovations and are not known to be quality conscious. Therefore, any anti-competitive conduct or feature in public procurement puts the efficacy of procurement in jeopardy.

4. Competition Concerns in Public Procurement

Public procurement differs from any other purchase in a fundamental way. Generally, a private purchaser has a wider set of strategic options for
purchase whereas the public sector is subject to government guidelines/rules/regulations which may be constraining. For example, public procurement in India is subject to General Financial Rules-2017 of MoF, GoI, CVC guidelines, manuals on procurement issued by PSEs, etc.

While transparency and non-discrimination obligations together with formal requirements with which procurement processes have to comply are set up as an attempt to avoid any abuse of discretion by the public sector, the resulting lack of flexibility limits the public purchaser’s options in which procurement can be done (OECD, 2007). Therefore, the prominent way through which public procurement takes place is “bidding” especially if the procurement involves relatively larger amounts. Bidding essentially ensures that suppliers of the required goods come to the public procurer. Competitive bidding then ensures two things: firstly, it identifies the most efficient supplier of a certain good or service and secondly, it determines the efficient price. Thus, the “bidding” mode of procurement suits the transparency and non-discrimination commitments of the government and therefore, it is the most prominent way through which public procurement is conducted.²

The discussion above gives us a basic framework within which we would try and study the competition concerns in public procurement. This framework revolves around public procurement through the process of “bidding” or “tendering”. Though competition concerns which may arise in public procurement are not drastically different from other markets, we can classify them as non-collusive and collusive (see Figure 3).

**Figure 3: Competition Concerns in Public Procurement**

<table>
<thead>
<tr>
<th>Competition Concerns in Public Procurement</th>
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<tr>
<td><strong>Non-Collusive</strong></td>
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<tr>
<td>- Limited number of suppliers</td>
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<td>- Barriers to Entry</td>
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<td>- Limited/Single Tender</td>
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<td>- List of registered vendors</td>
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<tr>
<td>- Bureaucratic hassels and complex procedures</td>
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<tr>
<td>- Information asymmetry</td>
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<td><strong>Collusive</strong></td>
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<td>- Bid Rigging</td>
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<td>- Corruption</td>
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Concerns from Collusive Behaviour

Collusive behaviour here implies understanding or agreement between two or more than two entities/people who are involved in the procurement process. Thus, understanding may be among suppliers of a particular product or between supplier(s) and procurement official(s).

The biggest threat to competition in public procurement is that of bid rigging. It defeats the basic purpose of the bidding process, i.e. determination of the most efficient price offered by the market. Bid rigging occurs when bidders act in concert and intentionally predetermine the outcome of the bidding process. Bid rigging may take many forms which are as follows:

i. **Collusive bidding**: Agreement between firms to divide the market, set prices or limit production – involves kickbacks and misrepresentation of independence.

ii. **Bid rotation**: Conspiring firms continue to bid but they agree to take turns being the winning bidder.

iii. **Cover bidding**: It is also called complementary or symbolic bidding – here the bidder agrees to submit a bid which is higher than the designated winner bid or puts certain conditions which are known to be unacceptable to the procurer. It is designed to give the appearance of genuine competition.

iv. **Bid suppression**: Bidders agree to refrain from bidding or withdraw bids in favour of the winning bidder.

v. **Market allocation**: Competitors divide the market and agree not to compete for certain customers or in certain geographic areas so as to select the winner.

The next threat to competitive outcome in public procurement is that of collusion between bidders and the officials of the procuring agency. The primary aim of bidders is to win the bid and to capture the market. If there is competition in the market then the most efficient supplier is expected to win as it would be able to supply the tendered goods at the most economical cost. However, any participant can increase the odds of winning the tender if that participant can turn the tender process in its favour.
One of the ways to do this may be to get the officials responsible for the tendering on board and change the rules of the game. This is done to alter the tender process in such a way so as to ensure that a particular bidder wins the tender. The emphasis here is to fix the end result of the tendering process. Thus, instead of the most efficient bidder, the corrupt bidder, who managed to get procurement officials in his favour happen to win the tender. This way competition is adversely affected by corruption in the public procurement. It is important to note that this form of collusive behaviour is not technically bid rigging as the agreement is not between bidders. The officials acting in concert with bidders are doing unethical and illegal acts and therefore, the action comes under the ambit of corruption.

**Bid Rigging as defined in the Competition Act, 2002**

The Competition Act, 2002 defines bid rigging as “any agreement, between enterprises or persons referred to in sub-section (3) engaged in identical or similar production or trading of goods or provision of services, which has the effect of eliminating or reducing competition for bids or adversely affecting or manipulating the process for bidding.”

Clearly for bid rigging to exist, an agreement has to be between bidders who are horizontally placed in the competition parlance and are engaged in identical or similar trading or production of products. Therefore, if one of the parties undermines the competition in the bidding process by indicting the officials involved in public procurement, it cannot be held accountable under the Competition Act.

**Competition Concerns from Non-Collusive Aspects**

Non-collusive concerns in public procurement arise when the bidding structure distorts competition, and as a result gains from competition do not occur in public procurement. Thus, the competition process is undermined not by any understanding or agreement between the parties but by the bidding structure itself.

The first thing which may undermine the efficient outcome is that the bidding structure limits the number of bidders. When procurement rules lay down very specific technical/financial specifications, then the process
of bidding renders a number of suppliers ineligible for bidding. This, in effect, means a limited number of suppliers can participate in the bidding.

Another way the number of bidders gets limited is by shortlisting suppliers beforehand in the garb of an approved suppliers list. Such shortlisting is done generally on technical and financial grounds. These short-listed suppliers become the only suppliers eligible for participation in the bidding process. This type of pre-selection is generally done by procurers where there are safety and security concerns or when procurer needs the goods delivered quickly. However, this becomes a barrier to entry in itself and undermines competition. For example, the Railways in India procure products only from suppliers who are on the approved list maintained by Research Designs & Standards Organisation (RDSO). It is not uncommon to observe that for many simple products there are just three or four approved suppliers.

Similarly, many a times there remains information asymmetry in the market for public procurement. Experienced and resourceful players often have access to information which other potential bidders in the market lack. This places better-informed players in an advantageous position and overtime it discourages small players from participating in the bidding process. Lack of proper publicity, advertising, and calling for limited tenders enquiries (LTE) are issues that come under this category. Another problem that information asymmetry introduces in the procurement is the problem of adverse selection. The buyers may fear a rigged trade (cartel) and it may result in delays and cancellation of the procurement process. A “safe and strong” tender design will help ward off these fears and can prevent the market from failure.

Bureaucratic hassles and complex procedures may take many forms, for instance, insufficient time for filling bidding documents or lengthy procedural requirements. The excessively tedious process for participation sometimes discourages participation in the bidding, thus limiting the number of bidders and undermining the competition. For example, paperwork involved, requirements of numerous NOCs (No Objection Certificates), etc., are expensive in terms of time and money. Therefore, over-reliance on them can discourage participation.
5. Tender Design: Possible Solution of Anti-competitive Concerns in Public Procurement

The above discussion has enumerated many competition concerns which have to be dealt in public procurement. We have also seen that corruption is not covered in the Competition Act, 2002. However, corruption has ramifications for the competitive landscape and, therefore, needs to be curbed in public procurement in order to realise the benefits of competition.

Hence, there are basically two main things we need to take care of, first limit the possibility of bid rigging and second increase competition primarily by ensuring that a sufficient number of bidders are there in the market. In this section, we would look into the question, how tender design can inculcate these qualities in public procurement.

Tender process or “Tendering” refers to extending an invitation to suppliers to send in proposals to supply specific goods or services. Tenders can basically be of the following three types:

a. Competitive Tenders: All the bidders eligible to apply can participate in the process.

b. Limited Tenders: Invitation is extended only to select few eligible suppliers.

c. Single Tender: Invitation is extended to only one supplier at the discretion of the procuring agency.

All the aspects related to the proposals to be sent by the suppliers come under tender design. These aspects may include contract terms of supply, time by which proposals are to be sent, who can participate in the tender (eligibility criteria), how to send in proposals, etc. Let’s see how tender design can be utilised for addressing competition concerns in procurement.

Firstly, as far as possible procurement must use an open tender system instead of limited/single tender system. Competitive tenders attract wider participation than other forms of tenders. Single/Limited tenders limit the number of participants and thus undermine the full potential of competition. Sealed bid tenders, wherein bidders are required to submit their final best price offers, make selection somewhat uncertain. Thus, the
incumbency effect and advantage of big players are neutralised. Therefore, sealed bid tenders encourage small players to participate in the bidding process. It is important to note that open tender and sealed bid tenders also comply with the non-discriminatory principle which is one of the principles enumerated in GFR-2017. Therefore, advertised tender enquiry best suits to optimise competition in public procurements.

Secondly, technical and financial criteria to be fulfilled by potential bidders must not be exceedingly/prohibitively complex and stringent. Financial and technical standards in tenders must be in proportion to the criticality of the products to be procured. For example, for procuring simple products like computer hardware and electrical supplies, technical and financial standards for suppliers can be kept low to encourage wider participation. The high standards are usually kept to reduce the cost of evaluating bids and to ensure the stability and quality of supply. However, it may lead to high entry barriers for new entrants leading to inefficient outcomes. As far as possible rather than specifying minutely details of products, performance expected from products should be specified. One should not specify the minimum requirements pertaining to controls on the size, composition, or nature of firms as far as possible so that they do not create obstacles to participation.

It is important to note that the minimum requirements/standards of the firms must depend on the product being procured. Thus, it essential that procurement officials are all well versed with the market conditions of the product being procured. Prior information about demand and supply conditions and nature of firms in the market must be collected to set eligibility criteria for bidding firms.

Thirdly, in a number of tenders, eligible bidders comprise only a previously approved list of suppliers (for example, RDSO approved lists of various products and their suppliers who can participate in railways procurement). Thus, the set of potential participants in the bidding process consists of selected few. This in effect works as an entry barrier. For example, if the approved list for a product includes just four suppliers, then open tender in effect becomes a limited tender (because bidding is restricted to the four approved firms). A limited set of potential competitors also helps in cartel formation and sustaining them. Thus, bid rigging is encouraged by pre-
selecting potential bidders, especially if the approved lists are available in the public domain.

The above discussion makes it clear that the system of accepting bids from only a set of suppliers which gets approved, restricts competition by limiting the number of bidders. However, we need to appreciate the fact that for maintaining the quality of service, safety and continuity of supply must be ensured by procuring agencies. This aspect assumes more importance in certain cases like defence-related products, certain railway supplies like brake axels, etc., and health-related supplies like vaccines.

Therefore, the rationale of procuring critical and complex safety items through limited tenders is based on sound principles since ultimate objective is to procure quality material on time (Malhotra, 2012). These practices subsist in other countries as well, for instance the Association of American Railroads in the US follows similar practice (CUTS, 2012).

Hence, the solution lies in streamlining and expediting the procedures for approval of firms for supplying products and enabling them to be able to participate in the bidding processes. The approving mechanism must be objective, clear and time-bound. This will help interested and eligible firms enter the bidding market. Thus, the approval system must be so designed that it does not become an entry barrier in the bidding market rather it should help in expediting the approval of firms for participation in the bidding process.

Therefore, as far as possible, a system of maintaining approved/registered lists of suppliers must be avoided. In cases where, for safety and other considerations it is necessary to pre-select suppliers, the approved lists must be updated periodically.

Tenders must be designed with a view to keep the participation costs of the bid to a minimum. The costs of participation may be monetary in nature or otherwise (labour and time). This can be accomplished in a number of ways:

- By streamlining tendering procedures across time and products (e.g. use the same application forms, ask for the same type of information, etc.).
- By packaging tenders (i.e. different procurement projects) together to spread the fixed costs of preparing a bid.
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- By allowing adequate time for firms to prepare and submit a bid. For example, consider publishing details of pipeline projects well in advance using trade and professional journals, websites or magazines.

- Tenders must state the requirements as clearly as possible in the tender offer documents. Specifications should be independently checked before final issue to ensure they can be clearly understood by all the potential participants.3

In this context, it must be said that the time span between issues of the request for proposal to submit bids must be sufficient for potential bidders to prepare and submit the bids. It should be taken into consideration that time span is not short so that incumbents or big players who have prior experience and resources to quickly prepare bids, have an advantage. Large monetary guarantees which limit participation by small firms should be avoided by those issuing tenders. As a general principle upfront payment of depositing amount must be avoided and monetary guarantees should be used. Monetary guarantees must also be just high enough to ensure guarantee and not block entry.

Repetitive and predictable cycle of tenders encourages collusion and bid rigging. A predictable and regular bidding frequency helps members of a bid rigging agreement to allocate contracts among themselves. In addition, the members of a cartel can punish a cheater by targeting the bids originally allocated to him4 in the next round of bidding. Thus, as far as possible, predictability in tenders is best avoided. Innovative ideas can be adopted for this, for example, clubbing together two or more tenders.

Another important factor in tender design is to limit the possibility of cartelisation among the bidders. If bidders have information regarding all the bidders who participated in the tender, their quoted offers, the winning bid amount, etc., of past tender offers, they can easily indulge in collusion, especially if the number of firms in the market are few. As said by Marshall and Marx (2012), ‘[a]s a general rule, the more information the [contracting authority] conveys about bidder identities, the bids submitted, and auction outcomes, the easier it is for a ring to be effective in its work of suppressing rivalry among members’. The availability of information about the winning bid and
the winner helps in detecting cheaters in case of collusive bidding. Thus, one of the crucial conditions for sustaining cartels, i.e. punishing cheaters, is made enforceable by easy access to such information. Therefore, full transparency related to all aspects of the tender process encourages bid rigging and should be avoided by tender designers.

Collusion may also be reduced by introduction of some degree of uncertainty, and secrecy, in disclosing information of the outcome of the procurement process.

However, this aspect of tender design comes in conflict with the transparency and disclosure commitments of the government. Transparency and disclosure in the tendering process are crucial elements to fight corruption in procurement. Thus, there is a need to balance out these different aims in the tendering process. It is important to note that there is no standard tender design which is “fit for all”. There is a need to design tenders according to the market structure and the existing competition in the market. Therefore, the procurement process must decide on some crucial questions in this regard like what is to be disclosed at the time of bidding, what information is to be disclosed at the time of publishing the results. As a general principle, sensitive information must not be disclosed to players in the market.

For instance, if potential bidders are large in number then free flow of information may not encourage collusion, but the situation would be different if there are only 3 or 4 potential participants. In such a scenario, it would be necessary that if interested suppliers are invited for a pre-tender primer by the procuring agency for the technical and administrative specifications of the procurement opportunity, they must not be primed together. Tender document can also make it mandatory for bidders to disclose all communication with competitors relating to the bidding project.

Tenders should avoid sub-contracting by the winner of the tender and this should be stated clearly in the tender offer. Sub-contracting is often a tool to share excess profits generated through bid rigging. Similarly, the practice of splitting the quantity into bidders decreases the incentive to compete in the bidding. In such circumstances, when supply order is split, there is little incentive for competition among tenderers, as L1, in any case, may not get supply order for the 100 per cent quantity. Similarly, the L2 firm
anyway gets a substantial portion of the order. In such a situation, there is an incentive to keep the bids at a higher level for collusion, therefore, the benefits of competition are not realised fully in such a scenario. Thus, as far as possible every contest must be a “winner takes all” contest (System of placing developmental orders, e.g. 5 per cent of supply orders to non-RDSO approved firms in Railway can be an exception).

The Practice of conducting negotiations with bidders after receiving the bids also affects the competition in the market. Though, the Central Vigilance Commission (CVC) guidelines allow negotiations in rare and exceptional situations and that too only from the lowest technically suitable tenderer, in Railways tenders negotiations are held in almost all high-value items. Negotiations discourage quoting of competitive rates. In fact, firms tend to quote inflated rates which result in negotiation to reduce rates and the same process continues in subsequent tenders. In such cases, the market rate is never received and the last accepted rate is taken as the basis for the settlement of future tenders, which may not be correct rate in the first instance.

The tender offer must include a strict warning regarding the sanctions for bid rigging. This is even more important in the case of countries where competition law is rather in a nascent stage like in India. The tender offer must also make it mandatory for bidders to sign a declaration that they are aware of the bid rigging provisions and have not indulged in bid rigging as defined in the Competition Act, 2002. The help of Certificates of Independent Bid Determination (CIBD) can also be taken in this regard. CIBD requires bidders to certify that they have arrived at their tender price absolutely independent of other bidders.

6. Conclusion

We have seen above the tricky nature of the tender designs. It is seen that certain aspects of the tender design may increase intensity of competition in the market but at the same time may increase chances of corruption in the market. We have also seen that complete transparency may make it easier for bidders to form a cartel and indulge in bid rigging, but if we move away from it then chances of corruption may increase. Thus, there is only one thing that can be stated with conviction in regard to tender design is that “there is no one size fits all approach”. The structure of the market,
the product being tendered, interaction between the bidders in the market, frequency of tenders, etc., dictate the way a tender should be designed. Therefore, competition authorities are unable to provide model tenders for procurement agencies. However, for ensuring vibrant competition the public procurements officials must be made aware of the benefits of competition and the non-competitive issues which generally arise in public procurements.

It is also equally important to raise awareness on how corruption affects competition in public procurement. Without an honest public procurement system, no competition authority can ever dream of helping the system realise the benefits of competition. However, we have noticed above that corruption in public procurement is out of the purview of the Competition Act, 2002. Thus, strong and effective advocacy with the lawmakers and procurement agencies can have an impact in eliminating competition concerns which stem out of corruption. This way an honest and competitive procurement system will help in fully realising benefits of competition and would help in nation-building.

**Endnotes**

1  https://www.lexico.com/definition/procurement


3  For more details see OECD Guidelines for Fighting Bid Rigging in Public Procurement and FTC’s Detecting, Mitigating and Fighting Bid Rigging in Public Procurement: Guidelines and Checklist.

4  OECD Guidelines for Fighting Bid Rigging in Public Procurement.

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