

A BUSINESS-FOCUSED SOLUTION TO COLLUSION IN PROCUREMENT

Collusion between suppliers and procurement teams is a known problem at many organizations. Despite the costs, however, many companies turn a blind eye to signs of collusive behavior because of concerns over disrupting operations or supplier relationships, which enables these activities to go unchecked and value to be systematically drained. Some organizations see this as simply a cost of doing business, particularly in the developing world.

If they want to get to the bottom of the potential problem, clients are frequently faced with an unpleasant and difficult decision. Formal investigations into collusion can be inefficient and disruptive. The scope of the problem is rarely clear. And these investigations have a definite cost without any guaranteed return.

An alternative, business-first approach, though, focused on increasing competition in the procurement process, can address these concerns without upsetting ongoing operations. It can facilitate the recovery of lost value and may actually strengthen relationships with suppliers, who may themselves be victims of these activities. Even if suspicions are not justified in the end, this approach could still leave the buying organization with savings in hand.

A MATERIAL COST

The Association of Certified Fraud Examiners estimates that organizations typically lose 5% of annual revenues to fraud.¹

Not all of that is related to procurement activities, of course. But we have worked in situations where existing procurement processes were subverted, and buyers were paying prices that were 6 to 10% higher than they should have been.

Moreover, the costs of collusion aren't limited to the direct expense of overpaying for these goods. Suppliers paying kickbacks are frequently less capable, which in turn means the best suppliers may be excluded and working with competitors instead.

Because of the lack of competition, collusion also inevitably leads to less control over the supply chain. Inferior-quality, finished goods can negatively impact brand value as well as sales. If defects are left unchecked, it could even lead to product recalls.

The lack of control also increases the risks of suppliers becoming lax in their attitude to other key considerations such as social compliance. Damage to the brand can be costly and difficult to repair.

1. ACFE 2016 Global Fraud Study

TRADITIONAL APPROACH

A formal investigation may be appropriate or even necessary in certain circumstances. However, all too often, the investigator receives only vague clues and is unable to uncover enough hard evidence for decisive actions like employment dismissal.

Collusion schemes are, by definition, off the book. Electronic discovery focused on company emails and phone records would typically identify traces of evidence or weaknesses in internal controls but is often too inconclusive to pin down the perpetrators unless they are particularly careless in leaving fingerprints.

Furthermore, an investigation is, necessarily, backward looking. There is a certainty that operations will be distracted, and expenses will be incurred. However, there is no certainty of rooting out the problem.

A NEW APPROACH: KILLING TWO BIRDS WITH ONE STONE

Rather than conducting a formal investigation, we recommend launching a procurement savings initiative to achieve savings from sourcing whilst having preparations in place to detect non-compliant behavior. The key in designing such a project is to put pressure on the suppliers that will force symptoms of collusion to the surface after having first put into place monitoring precautions and measures. And any monitoring can be more discreet and less disruptive than a full investigation.

Depending on the level of suspicions, different monitoring mechanisms can be established. At a minimum, email activity of the procurement team should be monitored. Usually, this can be accessed remotely through email backup servers without disruption or suspicions being aroused.

Once this is in place, initiating a procurement savings initiative sends a strong signal to colluding suppliers that a new way of working is starting. They should either get on board and cooperate, or they might be phased out. Introducing competitive pressures is key to this approach. A supplier conference with strong 'new entrant' participation sends a strong message that the company is serious by showing all incumbents the competition they will face. As part of the supplier conference all principal suppliers will be interviewed.

Any signal that indicates suppliers are unhappy with the process should be explored discreetly. Reviewed alongside email traffic, this creates a second line of enquiry and additional evidence.

The evidence from the supplier conference can be corroborated with email traffic and any other warning signs. Any investigation can be targeted and discreet. In our experience, if fraud is occurring, information will leak out during the process. If this is captured and identified, then the collusion can be confronted.

Criminal-level evidence may not be necessary or even desirable. This can result in a long, drawn-out process and requires the involvement of many external parties as due process must be followed in the capture of evidence. Many companies prefer an outcome in which the colluding employees are confronted with the available evidence and dismissed based on breaches of the code of conduct.

This can be implemented quickly with minimal distraction to the business. The colluding supplier can also be blacklisted if warranted and if there are competent alternatives in the market.

In the best of cases, suspicions of collusion may not prove founded, but the procurement initiative would still deliver savings and incremental EBITDA to the corporation, which is in any case the goal of eliminating such behavior.

SUNLIGHT IS THE BEST ANTISEPTIC

The response to procurement collusion does not have to be turning a blind eye or launching a formal investigation. This alternative approach, with competition and transparency at its heart, has been proven to successfully help corporates root out collusion and recover value for their organizations.

With the introduction of a truly competitive process with potentially new faces across the table, suppliers will see that the buyer sincerely 'means business.' Competition is thus restored to the process. Procurement savings will be achieved, and control over the supply chain can be restored.

Even in the event where suspicions prove unfounded and no collusion is detected, such an approach would still generate procurement savings and improved EBITDA by extracting lower prices from the supplier base subject to increased competition. The background investigation steps will not be known to the buyer's staff, and there will be no disruption to an organization that earns a clean bill of health.

What are the warning signs?

SYMPTOMS IN THE ORGANIZATION		WHY THESE COULD BE COLLUSION
Staff	Purchasing staff have long tenures in the same position	Staff in HK/China, where many sourcing offices are located, change jobs frequently for promotions
	Purchasing staff often don't take holidays	Need to manage suppliers 'personally' to reduce the risk of being uncovered
	Purchasing team knows all the alternative suppliers in the market, but have never engaged with them seriously	Need to show knowledge of supply market, yet cannot switch suppliers due to 'special relationship'
	Purchasing/related staff are strongly protective of 'their' suppliers, deeply resistant to any change	Purchasing/related staff have a financial interest in 'their' suppliers continuing to supply
	Deep silo culture – small disconnected 'pods' of people, systems don't talk to each other, no transparency between HQ and offshore	Easiest way to keep buyer/supplier collusion secret is to stay within an isolated 'pod' of people
Suppliers	Suppliers also have long tenures but capabilities are undifferentiated in the market	Supply markets change very fast in the Far East, so supplier change is common
	Price movement not correlated with raw materials, or no movement in spite of massive new entrant pressure	Supplier is confident they cannot be displaced
	Unusual/outlier patterns of transactions between specific suppliers and specific staff over time	Specific staff have an unusually close and exclusive relationship with supplier(s)
Others	Supplier audits are 'restaurant meetings' not objective actual on-site inspections	Local 'pod' manages to deflect detailed scrutiny by emphasizing the importance of relationship

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ABOUT US

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These are the moments when everything is on the line – a sudden shift in the market, an unexpected performance decline, a time-sensitive deal, a fork-in-the-road decision. But it's not what we do that makes a difference, it's how we do it.

Tackling situations when time is of the essence is part of our DNA – so we adopt an action-oriented approach at all times. We work in small, highly qualified teams with specific industry and functional expertise, and we operate at pace, moving quickly from analysis to implementation. We stand shoulder to shoulder with our clients until the job is done, and only measure our success in terms of the results we deliver.

Our approach enables us to help our clients confront and overcome truly future-defining challenges. We partner with you to make the right decisions and take the right actions. And we are right by your side. When it really matters.

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