

Guarding against hidden conflicts of interest



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MOST PUBLIC AGENCIES have adopted conflict of interest rules to prevent self-dealing by elected officials, public officers and employees. Generally, such rules require disclosure of any conflicting relationship with a supplier that may influence discretionary decision making. The rules will also impose prohibitions or regulations upon involvement in transactions relating to a supplier in which the person concerned has a direct or indirect material interest.

As important as these measures are, unfortunately they very often do not go far enough. Since most of the conflict rules across the public sector are fairly common, it is possible for an unscrupulous supplier to structure arrangements that skirt beneath applicable conflict of interest requirements. Government buyers need to be aware of some of the tricks of the trade, so that they can guard against them.

The most subtle forms of hidden conflict of interest involve turning different constituencies within the customer against each other. The purchase of new printers can be used to illustrate the problem. The finance department may be primarily interested in minimizing initial outlay. The operating departments may be more concerned with full-life cost. Printers need toner, which is usually supplied in pre-packaged cartridges. If a supplier has a unique cartridge design, it can lower the price for its printers, because the customer will eventually pay more when ordering toner cartridges. The use of refilled cartridges may jeopardize warranty coverage. The result is that the customer pays for a warranty that does not protect them.

The use of consultants raises a host of potential conflict problems. For instance, some consulting firms have hidden links to suppliers, and will attempt to use their influence over sourcing, to direct contracts to them. Subtle steering may involve raising the spectres of “incompatibility” with existing equipment or software, the possibility of increasing “training costs” if new technologies are adopted, and sundry other “risks” associated with a competitors products. “Linked” or “tied” consultants have also convinced public employees to sole source a contract to their affiliated supplier, so as to bypass any formal tender or RFP, by exaggerating the unique attributes of a particular supplier’s products or services.

Hidden conflicts of interest can arise where a consultant is acting for a customer in relation to one contract, while competing against other suppliers to win a different but similar contract. For instance, a customer may retain a design consultant to advise it regarding a construction project. The same advisor may compete as part of a design-build team for a second contract. In such a case, the consultant may be able to exploit information learned about the customer’s priorities, constraints and latitude for negotiation in relation to the first contract, in order to compete more effectively for the second.

Moreover, the consultant may learn how to structure a bid, so as to gain additional profit from a tender. For example, the consultant may have learned from the advice that it gave on another contract, that the customer will pay a premium of some kind for some added product or service feature, where it issues a tender for a basic

description of a product or service. The consultant thus knows to include that feature in its bid for the second contract. From a value for money perspective, the exploitation of such knowledge may not present a problem – but only if the supplier’s cost savings are passed onto the customer. However, whether or not this saving is passed along, the practice raises serious questions about the fairness and transparency of the tender.

A more innocuous, but nevertheless equally prejudicial, form of conflict of interest can grow out of narrow focused training and experience. Where employees or consultants are used to a particular technology, they may become blinded to the possible advantages of some competing technology. Specifications are drafted by them in reference to the product features of familiar equipment, rather than the performance needs of the ordering department.

Resistance to new technology can also cause a hidden conflict of interest. Managers do not like to lose staff time to training. However, by avoiding training, the staff falls behind the times. The result can be disastrous. From the 1950s to 80s, the US electronic and car industries lost its technological lead over Japan, partly as a result of a “not invented here” mentality. American workers failed to appreciate the advances that were being made elsewhere. The same can be true in procurement. Buyers keep buying yesterday’s technology, because client departments are only familiar with such technology. Suppliers often exploit backward looking customers by offering “ridiculously low” prices. The customer thinks it is getting a great deal. In reality, it is buying its way into a technological dead end, picking up obsolete equipment that otherwise has no market. Managers should not forget that back in the 1980s, when most people were buying PCs, some people still kept buying typewriters.

The complicating factor in attempting to address the problem of hidden conflicts of interest is that the many different roots of the problem make it difficult to deal with it by way of regulation or prohibition. Sensitizing buyers to the risks of hidden conflict is an effective partial solution. However, since it is not possible to put old heads on young shoulders, a necessary supplement is to target review of procurement decisions on the identification of situations that are likely to give rise to a hidden conflict. While these steps may fall short of a perfect solution, they improve on doing nothing at all. ~~~

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