

Dealing with incumbent providers in procurement

Public sector agencies often re-engage an existing supplier (an “incumbent provider”) to provide goods or services. This can happen in a number of ways and can involve either a continuation of existing supply, or new goods or services.

However, when an incumbent provider competes for new work, it may have (or be perceived to have) certain advantages, such as an understanding of an agency’s needs, established relationships with agency staff, and knowledge that is not available to other potential suppliers. These advantages may affect the likelihood of competitors being given an equal, unbiased opportunity.

This guide by the NSW Independent Commission Against Corruption (“the Commission”) explains the inherent probity and corruption risks when dealing with incumbency in procurement, and how these risks may be mitigated.

Why is incumbency sometimes an issue?

Incumbency can provide, or be perceived as providing, a significant advantage that can undermine the integrity of a procurement process. There may be conscious or subconscious reasons for public officials to improperly favour an incumbent. One reason might be that reappointing the incumbent is convenient and avoids the extra time, effort and resources needed to:

- undertake a new procurement exercise
- train the new provider
- work with the provider to overcome challenges and get things bedded down
- establish new working relationships
- possibly revisit and refine processes and systems.

Such perceived advantages may significantly reduce the level of competition for a contract in the market, ultimately impacting on the ability to achieve value for money.

Perceptions of an “uneven playing field” for tenderers increase:

- the more times that an incumbent has won a contract and/or the longer the period of the incumbency
- if there is a close relationship between the incumbent, or its staff and the agency
- where there are conflicts of interest, the acceptance of inappropriate gifts and benefits by public officials and other questionable ethical practices
- if there is a view that the incumbent won the contract the first time under questionable circumstances
- if there has been a history or suspicion of improper practices in other procurements.

Probity considerations

Key probity considerations in relation to incumbents include (1) fairness, (2) value for money, (3) transparency and (4) accountability, each of which is explained below.

Fairness

All parties involved in a procurement process should be treated fairly – incumbents, other providers and potential providers should not be unfairly advantaged or disadvantaged because of whether they have previously been engaged by an agency.

Incumbent providers have an obvious advantage in that they have had the opportunity to deliver high-quality goods or services at a price that represents good value for money.¹ This opportunity to establish a good track record is not an *unfair* advantage. But, a fair process involves allowing all competitors to demonstrate their ability to meet the requirements of the agency.

¹ Conversely, the provider might have performed poorly or charged excessive prices.

Value for money

It is sometimes argued that awarding a contract to an incumbent provider promotes value for money, as they have the existing knowledge to do what is required and this avoids the costs of transitioning to a new provider.

It may also be claimed that appointing an incumbent reduces risk because it is a known quantity, the quality of its work has been shown, it has already been measured against key performance indicators (KPIs), and a reasonable working relationship has been established between staff of a public sector agency and the incumbent.

Yet, it does not follow that reappointing an incumbent provider results in a material advantage to an agency over the long term. Moreover, in some situations, appointing an incumbent may represent poor value for money, as:

- other potential providers may be discouraged from participating in a market-testing exercise, or they may spend a minimal amount of effort in submitting their bid because they see the incumbent as having an advantage
- incumbent providers may take an agency for granted, shifting their efforts and resources to new contracts with other clients
- incumbent providers may, rightly or wrongly, assume they have an advantage over their competitors, which can translate into higher pricing or reduced quality
- personal relationships may be more likely to develop and grow with incumbents, leading to over-identification with the incumbent's interests and reductions in value for money (in more extreme cases, personal relationships can lead to collusion or corrupt conduct)
- new technologies or product developments may be available from other providers.

Transparency

The procurement process should not only treat all suppliers and potential suppliers fairly, according to the prescribed evaluation process and taking account of value for money, it should be transparent that this has happened. This is particularly important where there is an incumbent provider. Where transparency is poor or absent, even if the incumbent provider wins on the merits of its proposal, the market may feel that the decision was unfair or improper. Conversely, if the incumbent provider fails to win the contract, it may feel that it was improperly disadvantaged.

Transparency should be addressed in the following stages of a procurement process:

- before going to market in planning a procurement
- during a procurement

Incumbency and corrupt conduct

It may be corrupt conduct to:

- supply the incumbent provider with information that is not available to other potential providers with the intention of inappropriately advantaging the incumbent
- set the specifications, evaluation criteria, evaluation weightings or information requested to improperly favour/disadvantage the incumbent provider
- make the tender period too short, with the intention of improperly favouring the incumbent provider
- conduct the evaluations and write the evaluation report in a partial manner
- award the contract to inappropriately favour/disadvantage the incumbent provider.

- after the procurement, especially in providing feedback to unsuccessful tenderers (including the incumbent provider if they did not win).

Accountability

The procurement process should meet the procurement objectives, follow the rules and address material risks. Accountability entails demonstrating that this has occurred; something that is particularly important when dealing with incumbent providers given the increased probity challenges that can arise.

Some additional measures associated with these principles are described below.

Mitigating the risks and helping to ensure integrity

Incumbent involvement in the approach to market

It is often convenient to ask an incumbent provider for technical, operational or other information to be used in a procurement process. As an incumbent provider deals with matters on a day-to-day basis, it may be easy for them to collect such information. It is also tempting to ask an incumbent to assist with the other aspects of the tender pack or procurement plan.

The risks in doing this are significant, as an incumbent:

- may, or may be perceived to, gain insight from the information collected, giving it an unfair advantage

- could provide inaccurate, incomplete or subjective information that gives it an improper advantage, or may be perceived as doing so.

In general, the greater the role of the incumbent in developing a procurement process, the greater the risk. For example, allowing an incumbent to have a significant role in setting specifications, establishing assessment criteria and weightings, developing testing methodologies, setting timelines, and conducting market research would cause material probity concerns. In most cases, incumbent providers should be precluded from undertaking or assisting in any of these activities.

If, in exceptional circumstances, incumbents participate in developing a procurement process, then significant additional probity measures should be taken to mitigate the increased risk. The additional measures could include the establishment of an ethics wall between the incumbent staff participating in the activities and their colleagues. Such an ethics wall would require, among other things, the participating incumbent staff to sign non-disclosure agreements and refrain from participating in their company's tender submission.

Access to information

An incumbent should not have access to information that the other tenderers and potential tenderers do not. Incumbents should also not be given information before other tenderers; for example, to comment on the tender pack or aspects of it.

In particular, the incumbent provider may have knowledge of the agency's budget or pre-tender estimate. This knowledge could be direct (for example, the incumbent might have inadvertently been provided with access to a relevant document) or indirect (for example, the incumbent has gleaned information from routine discussions with agency staff). If it is possible that the incumbent is aware of this information, the agency should consider providing its budget or pre-tender estimate (or at least a range) to all tenderers.

Providing potential tenderers with a detailed site visit and pre-tender briefing can also assist the agency to reduce the incumbent provider's advantage.

Security of information

Information about the procurement process should be kept secure to prevent an incumbent provider from gaining access. Incumbents often have access to offices and IT systems where they are in a position to obtain information about a procurement and overhear conversations. They may also be copied into emails, be recipients of group texts and receive other communications that could include information about the procurement to which other tenderers do not have access.

Measures to secure information include:

- providing staff participating in a procurement process with instructions about information security requirements

- saving information in locations that are only accessible by the individuals who need access for the procurement, and implementing other IT access controls
- logging access to the information and reviewing access reports
- general cyber security controls.

Is there an information imbalance?

If the incumbent has information that would provide an unfair advantage in the procurement process, then consideration should be given to including this information in the tender pack or briefing to redress the imbalance. An example is where the tender pack calls for an activity to be priced and the incumbent is the only tenderer who knows how long it takes.

A data room may be used to help ensure a level playing field during a tender process. A data room is a location, usually a virtual space, where confidential information about the operations of the contract are disclosed to tenderers in a controlled manner. For example, in a complex facilities maintenance contract the agency could provide tenderers with detailed information from the contractor about asset performance and asset conditions, and so on.

Is there a time imbalance?

Due to their knowledge and experience of an agency, an incumbent provider is likely to be able to prepare a tender proposal quicker than other tenderers. Consequently, care needs to be taken to ensure that the incumbent is not given an unfair advantage with a short submission deadline. This also applies where the agency requires further information or clarification from tenderers after submissions have been received.

The role of the contract manager

There is a risk that an agency's contract management staff and employees of the incumbent provider will develop relationships that are so close that it may reasonably be perceived as a conflict of interest. This is especially so if they socialise outside of the work setting, if their families socialise, if incumbent staff have given large or frequent gifts or benefits to contract staff, and so on.

Reminder

When assessing whether a relationship could create a conflict of interest, anyone "who is more than an acquaintance" is a good rule of thumb to use. See the Commission's publication *Managing conflicts of interest in the NSW public sector*, (April 2019).

Even where the relationship does not create a conflict of interest, it may be close enough for it to affect the impartial judgment of internal contract management staff or to be perceived as doing so. Factors that increase this risk include:

- contract managers and staff of the incumbent provider having frequent meetings in casual offsite locations such as restaurants
- contract managers letting infractions by the incumbent provider slip
- contract managers not scrupulously monitoring performance, including KPIs
- contract managers not implementing all the appropriate internal controls associated with the contract.

There are many factors that could affect the working relationship of contract management staff and the incumbent provider, including the length of time of the incumbency, the degree to which contract management staff rely on the incumbent in excess of a typical contractual relationship, and whether the contract manager just oversees that one contract.

When there is a conflict of interest because of the relationship between the agency's contract management staff and staff of the incumbent provider, this should be handled in accordance with the agency's rules and procedures for conflicts of interest in procurement processes. If there is a close relationship, this should be disclosed to those managing the procurement process.

Contract managers may also be prone to unconscious biases highlighted in behavioural economics, such as:

- **self-serving bias**, in which an official might attribute causes to whatever is in their own best interest (for example, a contract manager may have an interest in justifying their initial selection and subsequent management of the incumbent)
- **overconfidence bias**, in which an agency may overestimate the positive aspects of an incumbent provider's performance because it indicates that the contract manager has done a good job
- **loss aversion bias**, because not to reappoint the incumbent provider might cause the agency a perceived loss
- **confirmation bias**, in which greater emphasis is placed in information that aligns with existing views. This could work for or against an incumbent depending on the position taken about the performance of the incumbent.

It is good practice for contract management staff not to take a dominant role in a procurement process. This can be a challenge in instances where the contract is highly technical and there are not many agency staff with the necessary expertise. If it is considered appropriate to keep the

contract manager involved, risks can be mitigated through methods that include:

- where the contract manager has a role in setting the tender evaluation criteria, specifications or methodology, then:
 - ensuring there is full documentation, including the reasons for choices
 - applying additional scrutiny to these documents, typically via peers and independent experts
- limiting the role of the contract manager in the evaluation or not having them participate in the formal scoring of tender responses
- having a subject-matter expert appointed to the panel from another agency
- each panel member preparing their evaluation scores on their own and before any discussions with the contract manager
- the contract manager giving their ratings and comments after everyone else in tender evaluation meetings
- clarifying that the contract manager cannot be an intermediary for lobbying by the incumbent provider or arrange contact between the incumbent and other members of the evaluation panel
- clarifying that the contract manager cannot receive or pass on to other panel members information that might be received from the incumbent provider after the receipt of tenders, unless it is through the same process that applies to all other tenderers
- where possible, periodically rotating contract managers onto new contracts
- appointing a probity auditor/adviser and providing probity training prior to the tendering process.

Some of these mitigation measures should also apply to other tender panel members who have interacted significantly with the incumbent provider as a client.

In addition, if a contract manager (or any agency staff member) has been nominated by the incumbent provider (or any other tenderer) as a referee, there is a significant chance of perceived favouritism. Ideally, an agency representative should not be both a referee and a scoring member of the evaluation panel. One possible solution would be to require tenderers to only nominate external referees.

Setting specifications

Specifications should be set to reflect the genuine needs of an agency for the supply of the contract and generally should be outcomes-oriented as opposed to inputs-based. It is better practice for the manager or committee approving the specifications to be given documented reasons for

those specifications where there is an incumbent provider and especially where the incumbent is perceived as being entrenched in an agency.

Setting specifications so that they are substantially a description of the incumbent provider's experience, capabilities, business operating model and other details may be perceived as corrupt and a breach of probity.

Costs of transition

When a provider changes, an agency may need to incur certain costs – such as costs related to supplying equipment or resources, training contractor personnel or simply enduring a learning curve – until the provider becomes proficient in the agency's processes and systems.

The advantage of avoiding these costs may be overestimated in setting the evaluation criteria and weightings. From a probity perspective, overestimating transition costs is likely to provide a benefit to the incumbent provider and amount to a breach of fairness requirements. If done intentionally, it may be corrupt conduct. It may also discourage other suppliers from seriously tendering, consequently reducing value for money. The weighting to apply to transition costs will vary from contract to contract.

The Commission's advice is that, in order to encourage competition, the weighting should be as low as possible and the agency should consider ways it can bear these costs itself.

It is advisable for an agency to be transparent about how costs of transition will be handled in the evaluation so that incorrect assumptions are not made by potential tenderers and allegations of impropriety are avoided.

Request for information from tenderers

The tender request for information should be checked to ensure that it does not favour the incumbent by failing to request all relevant information, especially about capability and performance. This includes requiring tenderers to provide referees that can provide information about past performance.

If the agency fails to ask for relevant information, it is likely to draw on its practical experience dealing with the incumbent. This may provide the incumbent with a considerable unfair advantage or disadvantage.

Evaluation of information not in the tender submission

As noted in a Commission publication:

Generally speaking, there will be relevant information about all tenderers that is not contained in their request for tender (RFT) responses. If the TEC [tender evaluation committee] decides to obtain and rely on this information for one tenderer but not others, it would risk creating an "uneven playing field".

An "even playing field" is maintained where the tenderers are only assessed on the basis of what is submitted or all tenderers' other, additional, experience is considered.²

An agency typically has ample information about the performance of its incumbent provider, including the quality of its staff, its adherence to contract KPIs,³ its safety and environmental practices, and so on. While the agency is not expected to exclude this information from its evaluation, the "uneven playing field" will arise if it does not make genuine attempts to obtain equivalent information about other tenderers.

The main way to address this is to ensure the tender request asks for all the information the agency requires to assess each tenderer's capability. However, the evaluation process can make use of other sources of information. For instance, the tender panel can balance its knowledge about the incumbent with information about other tenderers by:

- conducting due diligence procedures⁴
- speaking with the tenderer's key customers, including other public sector agencies that have worked with the tenderer
- asking for work samples, product demonstrations or visiting the tenderer's premises
- interviewing key personnel from each tenderer.

Similarly, there may be information in the incumbent provider's tender submission that the agency knows to be untrue. For instance, the incumbent's tender submission might state that it provides "peerless customer service" and "always meets its contract KPIs", which might not accord with its real performance. If the agency knows these claims to be an exaggeration, it would make no sense to consider the tender submission as written. However, an uneven playing field will arise if the agency fails to acknowledge that other tender submissions could make similar, tendentious claims.

If the agency decides to base its evaluations on sources of information other than the submitted tender responses, it should ensure all tenderers are apprised. In particular, tenderers should be advised if the agency proposes contacting their customers (or any other referee not nominated by the tenderer).

The tender report

Tender evaluation reports should be objective, impartial and written to give the decision-maker all the information they need. Reports should contain all of the relevant information,

² *Probity in procurement: tips from a professional*, interview with Scott Alden, HWL Ebsworth partner, September 2021.

³ To minimise the chance of dispute, agencies should formally document the performance of their providers over the life of a contract, including achievement against KPIs and any contract breaches.

⁴ See the Commission's publication, *Supplier due diligence: a guide for NSW public sector agencies*, June 2020.

especially both good and bad about the preferred tenderer; not just the information that supports the preferred tenderer.

Competing tenderers with equivalent experience and capability should be equally assessed. That is, a tenderer should not be given a higher score just because its relevant experience happens to be with the agency.

If the incumbent provider is not selected, the reasons should not relate to personality differences, unreasonable expectations, irrelevant matters or problems that have been the fault of the contract manager.

The readers of the report should be satisfied that no bias has been shown to the incumbent.

Avoiding incumbency capture

Care should be taken to ensure that, at the end of a contract, an agency does not find itself in a situation where it is excessively difficult or costly to separate itself from the incumbent provider and engage in effective market testing.

When engaging a new provider, for some complex arrangements, agencies should develop a transitioning-out plan. Key measures may include obligations concerning transfer of data, disclosure of information collected during the contract by the incumbent provider, and ensuring ownership of intellectual property by the agency.

A transitioning-out plan may also require the incumbent provider to sell, at an agreed value, key assets that have been acquired for the project to a tenderer that might win the next contract, or where the method of depreciation or valuation has been agreed.



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