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DOCUMENTED
BRIEFING



Improving Contracting at the City of Los Angeles Airports, Port, and Department of Water and Power

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Prepared for the City of Los Angeles



RAND INFRASTRUCTURE, SAFETY, AND ENVIRONMENT

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SUMMARY

This research was done in an effort to find ways to improve the purchasing, contracting, and leasing activities at the City of Los Angeles’s three proprietary departments—the Los Angeles World Airports (LAWA), the Port of Los Angeles (Port), and the Department of Water and Power (DWP). The Los Angeles City Charter created these self-supporting departments. Combined, the three proprietary departments annually contract for more than a billion dollars, and receive several hundreds of millions of dollars in lease revenue. In 2003 the City of Los Angeles Controller issued audit reports critical of contracting and leasing practices of all three departments, citing a lack of transparency and documentation in their contracting processes.

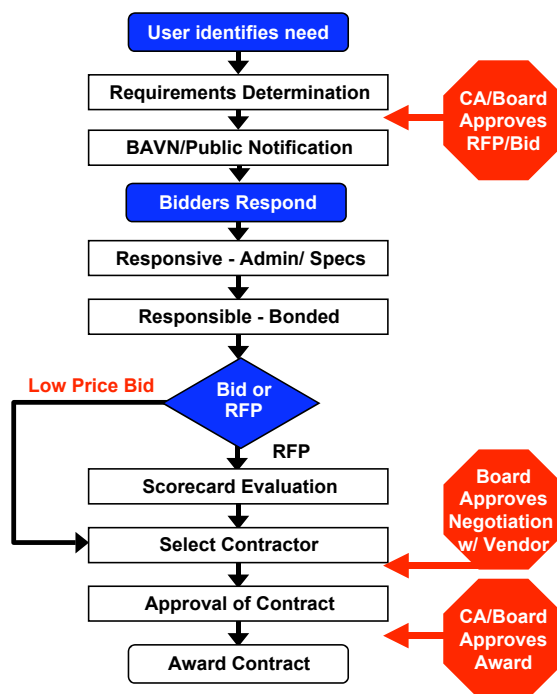


Figure S-1: Traditional contracting process followed by all three proprietary departments. (BAVN=Business Assistance Virtual Network, CA=City Attorney’s Office, RFP = request for proposal)

Our first task was to understand how the departments contract today. Next, we conducted a search of contracting “best” practices elsewhere in city, state, and the federal government. Finally, we analyzed both the current issues at the proprietary departments and best practices elsewhere

to determine which recommendations make the most sense for Los Angeles.

All three departments follow a traditional contracting process, shown in Figure S-1. The City Charter and Administrative Code place several key requirements on department contracting. These include requiring the departments' boards review of purchases exceeding \$150,000. Each year, this process results in hundreds of Board reviews at each department. The Los Angeles City Council may also subsequently provide review on contracts of 3 years or more, and the data show they approve most actions, rarely deny any actions, and request more information for a small fraction of actions. Dollar-value levels for Board reviews may not have kept pace with inflation, and may have encouraged multiple, small contracts that are below review thresholds. The reviews are also time consuming and labor intensive. This high percentage of approvals and infrequent denials suggests that there may be opportunities to streamline the process and minimize delays.

The implementation of several other City Charter and Administrative Code requirements can also affect the outcome of the contracting process. For example the Charter's "low bid" requirement is always interpreted to mean selection of the "low price" bid, which may not be the "lowest total cost." In addition, the implementation of a 10% price preference on contracts of \$100,000 or less for small, local businesses was reported to have created a cottage industry of one-person, "pass-through" businesses. Further, socioeconomic policy requirements for vendors may discourage some bidders from submitting proposals, while increasing the departments' administrative time and costs.



Figure S-2: Characteristics of Traditional Versus Best-Performing Organizations

In studying innovative purchasing and contracting practices of government and commercial enterprises, we noted some best practices within the proprietary departments, and elsewhere within the City of Los

Angeles. Studies of other cities reveal a variety of innovative purchasing practices, and several state governments, including California’s, use innovative practices such as strategic sourcing, best-value awards, and strategic partnerships. Characteristics of best performing enterprises are summarized in Figure S-2.

Requirements	Implementation	Best Practices
“Low bid” requirement	<ul style="list-style-type: none"> • Awarding <i>lowest price</i> doesn’t always mean <i>lowest total cost</i> • “Responsive” and “responsible” are interpreted as minimal supplier requirements 	<ul style="list-style-type: none"> • Moving toward best value
10% bid preference for small business	<ul style="list-style-type: none"> • Created cottage industry of one-person, “pass through” firms • Discourages strategic sourcing, where economies of scale bring value 	<ul style="list-style-type: none"> • Moving away from financial preferences toward supplier mentor and developmental programs • Consolidating contracts to leverage buying power
Socioeconomic policy requirements on vendors	<ul style="list-style-type: none"> • Discourages some bidders, increases total costs • Increases Departments’ administrative workload 	<ul style="list-style-type: none"> • Conducting periodic total cost/benefit reviews, sunset clauses • Automating process and pre-qualifying vendors
Dollar levels for Board and City Council reviews	<ul style="list-style-type: none"> • Kept pace with inflation? • Encourages multiple, small contracts that are below review threshold 	<ul style="list-style-type: none"> • Streamlining routine and low risk reviews • Moving toward Board audit of the process rather than review of individual decisions
Economic, Feasibility, and Selection Analysis	<ul style="list-style-type: none"> • Conducted to satisfy requirement • Done for protection from challenges 	<ul style="list-style-type: none"> • Benchmarking in-house performance with industry • Documenting for strategic knowledge management

Table 1: City of Los Angeles’s requirements, current implementation, and best practices

The City of Los Angeles’s requirements and their current implementation are contrasted with best practices in Table 1. Best performers are moving toward best value, instead of low-price awards; they are adopting broader interpretations of the City Charter’s requirements for “responsive” and “responsible” suppliers than are implemented in practice at the departments. Best performers are consolidating contracts to leverage buying power, and moving away from financial preferences toward mentoring and developmental programs for small business. These programs develop minority suppliers and small businesses rather than create minority and small-business subsidies, i.e., developing “value competitive” suppliers.

Using total cost management, they are analyzing all costs, including those from administrative and regulatory requirements. A best practice is correctly (cost effectively) balancing fraud detection with fraud prevention. These programs spend less on board review (prevention) and spend more on auditing (detection).

Best performers have streamlined routines and low-risk reviews, to focus on higher-value and higher-reward contracts. These best performers

perform analysis that contributes to strategic knowledge management, e.g., to leverage prior analysis to be the most informed buyer possible and to improve future procurement.

Like at many government entities, contracting processes and practices at LAWA, Port, and DWP resemble those of a traditional purchasing organization. For instance, many challenges that traditional tactical and reactive organizations face were cited in critical audits from the Controller. We suggest that the City consider five steps toward a more strategic, proactive, effective, efficient, and cooperative approach to its departments' contracting:

1. Clarify and streamline the processes to focus on higher-value and/or higher-risk contracts
2. Select suppliers and lessees offering "best value" rather than "best price"
3. Document industry analysis, selection deliberations, and supplier performance
4. Periodically review implementation of all goals for effectiveness and efficiency
5. Clarify governance roles of the Board of Commissioners.

Clarifying the purchasing process to all stakeholders is a necessary step toward increased transparency and efficiency. This includes streamlining and automating as many routine purchasing activities as possible and reducing bureaucracy and other inefficiencies associated with Board and Council reviews. This should not be interpreted as recommending less documentation or analysis. To the contrary, we believe there should be better documentation and analysis, while balancing oversight responsibilities and efficiency. Efforts to clarify and streamline the purchasing process should have the added benefit of making the City easier to do business with from a vendor's perspective, which is essential to attracting the best providers.

We recommend that the proprietary departments shift toward selecting suppliers based on "best value" rather than "low price." The Charter and Administrative Code do not appear to need modification for this change, as provisions for awards based on "ultimate cost" already allow for selection based on best value. Selection based on value must be done rigorously, however, and not subjectively. This requires *more* analysis and

documentation to be defensible, rather than selection simply based on low price. To do this, the departments must develop and use analytic tools to create data-driven and rigorous measurements of the *total costs* of their procurement activities.

These analyses and documentation provide valuable institutional knowledge that should be captured and preserved so that it can improve future procurement. An area in which to concentrate efforts is rigorous measurement of contractor performance, and using this information in determining best-value awards. Measuring performance for all contractors formalizes monitoring, controls, and administration of contracts, but it has many other benefits as well. Current contractors will properly have an incentive to perform well, if there is an expectation that good performance will be an advantage in contract renewal or follow-on bids. Rigorously measuring past performance will also help Los Angeles's departments to justify and maintain longer-term relationships with their *best* providers, to the benefit of City residents.

The intent of the Los Angeles Charter and Administrative Code seems clearly to promote the goals of free and open competition, to support small and disadvantaged businesses, and to ensure varying levels of review. However, there are costs with these requirements and sometimes unintended consequences. Thus, periodic review of all requirements should be done to realign intent and implementation for maximum effectiveness in achieving the City's goals. This research highlights a need to review dollar or term limits, which trigger Board and City Council review. Adjusting these limits would require Council approval, and more analysis than is presented here. The departments and its Boards would benefit from conducting an analysis of their contracts spend as inputs into any discussion of adjusting dollar or term limits for review.

Commissioners cannot be expected to be experts on all the commodities purchased, the markets and industries involved, or the nuances of various contracts, leases, and agreements. However, they should understand the processes used to procure the City's supplies, equipment, and services and to set leases. Orientation and training sessions for Board members would help clarify roles and responsibilities and provide a valuable opportunity to clarify contracting goals and processes, including input from the City Attorney's Office and other stakeholders.

Moving towards a best performing organization must fundamentally change the characteristics of purchasing and contracting, beyond tactical steps or process changes. Implementing these recommendations cannot be accomplished solely by the purchasing groups within each proprietary department. Creating a strategic and proactive organization will take

sustained leadership focus within the proprietary departments and partnerships with leaders across the City. Fundamentally changing “low price” purchasing to “best value” purchasing requires developing the analytic skills to rigorously evaluate value and working with the City Attorney’s Office to properly justify contractor selection. Establishing controller-approved economic and activity-based costing models, prior to contracting, would improve both process transparency and selection justifications.

The mayor appoints Commissioners to the Boards of the LAWA, Port, and DWP, so the Mayor’s Office should be involved in conducting early orientation and training, conveying goals, and clarifying governance roles based on economic and social objectives of the City. The Board and Council may also participate in rebalancing fraud prevention (reviews) and detection (audit selection of suppliers that maximizes economic value).

Though it may be challenging for the proprietary departments to implement these recommendations quickly or smoothly, putting them into practice will allow the City to specifically address shortcomings in contracting transparency and documentation that the Los Angeles City Controller’s office raised in its recent critical audit reports.