This product is part of the RAND Corporation documented briefing series. RAND documented briefings are based on research briefed to a client, sponsor, or targeted audience and provide additional information on a specific topic. Although documented briefings have been peer reviewed, they are not expected to be comprehensive and may present preliminary findings.
Improving Contracting at the City of Los Angeles Airports, Port, and Department of Water and Power

Mark Wang, Nancy Y. Moore, Sarah Hunter, Nancy Nicosia

Prepared for the City of Los Angeles
The research described in this report was conducted within RAND Infrastructure, Safety, and Environment (ISE) for the City of Los Angeles.
PREFACE

This documented briefing presents research from a 90-day effort to find ways to improve purchasing, contracting, and leasing activities at the City of Los Angeles’s three self-supporting proprietary departments: the Los Angeles World Airports (LAWA), the Port of Los Angeles (Port), and the Department of Water and Power (DWP). This RAND Corporation effort was neither an investigation nor an audit of the proprietary departments. This study was intended instead to be forward looking on how to bring improved transparency, efficiency, and public trust to the proprietary departments’ purchasing, contracting, and leasing activities.

Beyond the Airport, Port, and DWP, this document is intended to support many other offices within the City of Los Angeles—including the Offices of the Mayor of Los Angeles, the City Administrative Officer, the City Attorney, and the Controller—that must work in partnership with the departments to improve contracting activities.

This report should be of interest to city, county, and state officials, staff, and contracting and purchasing professionals who are interested in learning from the experiences of the City of Los Angeles.

This research was conducted within RAND Infrastructure, Safety, and Environment (ISE), a unit of the RAND Corporation. The mission of ISE is to improve the development, operation, use, and protection of society’s essential built and natural assets, and to enhance the related social assets of safety and security of individuals in transit and in their workplaces and communities. The ISE research portfolio encompasses research and analysis on a broad range of policy areas including homeland security, criminal justice, public safety, occupational safety, the environment, energy, natural resources, climate, agriculture, economic development, transportation, information and telecommunications technologies, space exploration, and other aspects of science and technology policy.

Inquiries regarding RAND Infrastructure, Safety, and Environment may be directed to:

Debra Knopman, Director
1200 S. Hayes Street
Arlington, VA 22202-5050
Tel: 703.413.1100, extension 5667
Email: ise@rand.org
http://www.rand.org/ise
## CONTENTS

Preface .............................................................................................................................. iii
Summary .............................................................................................................................. vii
Acknowledgments ........................................................................................................... xiii
Background and Introduction ..........................................................................................1
The Current Contracting Environment at the Los Angeles
  Proprietary Departments ..............................................................................................11
Best Practices from Government and Industry ............................................................ 45
Recommendations for the City of Los Angeles Proprietary
  Departments .................................................................................................................. 76
APPENDIX A: Answers to Blue Ribbon Commission’s Ten
  Questions ...................................................................................................................... 94
APPENDIX B: Eight Steps in Strategic Sourcing ........................................................... 99
Bibliography ..................................................................................................................... 114
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.

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.

<table>
<thead>
<tr>
<th>Tactical ⇒ Strategic</th>
</tr>
</thead>
<tbody>
<tr>
<td>Reactive ⇒ Proactive</td>
</tr>
<tr>
<td>Lowest Price ⇒ Best Value</td>
</tr>
<tr>
<td>Regulatory Compliance ⇒ Most Efficient</td>
</tr>
<tr>
<td>Adversarial ⇒ Cooperative</td>
</tr>
</tbody>
</table>

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.

<table>
<thead>
<tr>
<th>Requirements</th>
<th>Implementation</th>
<th>Best Practices</th>
</tr>
</thead>
<tbody>
<tr>
<td>&quot;Low bid&quot; requirement</td>
<td>• Awarding lowest price doesn’t always mean lowest total cost</td>
<td>• Moving toward best value</td>
</tr>
<tr>
<td></td>
<td>• “Responsive” and “responsible” are interpreted as minimal supplier requirements</td>
<td></td>
</tr>
<tr>
<td>10% bid preference for small business</td>
<td>• Created cottage industry of one-person, “pass through” firms</td>
<td>• Moving away from financial preferences toward supplier mentor and developmental programs</td>
</tr>
<tr>
<td></td>
<td>• Discourages strategic sourcing, where economies of scale bring value</td>
<td>• Consolidating contracts to leverage buying power</td>
</tr>
<tr>
<td>Socioeconomic policy requirements on vendors</td>
<td>• Discourages some bidders, increases total costs</td>
<td>• Conducting periodic total cost/benefit reviews, sunset clauses</td>
</tr>
<tr>
<td></td>
<td>• Increases Departments’ administrative workload</td>
<td>• Automating process and pre-qualifying vendors</td>
</tr>
<tr>
<td>Dollar levels for Board and City Council reviews</td>
<td>• Kept pace with inflation?</td>
<td>• Streamlining routine and low risk reviews</td>
</tr>
<tr>
<td></td>
<td>• Encourages multiple, small contracts that are below review threshold</td>
<td>• Moving toward Board audit of the process rather than review of individual decisions</td>
</tr>
<tr>
<td>Economic, Feasibility, and Selection Analysis</td>
<td>• Conducted to satisfy requirement</td>
<td>• Benchmarking in-house performance with industry</td>
</tr>
<tr>
<td></td>
<td>• Done for protection from challenges</td>
<td>• Documenting for strategic knowledge management</td>
</tr>
</tbody>
</table>

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.
ACKNOWLEDGMENTS

The RAND project team would like to acknowledge many persons for their assistance with this research effort. Deputy Mayor Carmel Sella, from the Office of Mayor James Hahn, June Gibson from the Office of the City Administrative Officer, and Louisa Lund from the Office of the Chief Legislative Analyst met with RAND early on to define the study scope and assist in meeting the appropriate department and city staff. They and the Blue Ribbon Commission on Contracting, chaired by Professor Erwin Chemerinsky, and including Julie Butcher, Gene Hale, Jerry Selmer, Charlie Woo, Roberto Barragan, Kelly Martin, and Monsignor Terry Fleming, provided invaluable feedback during the course of this project.

We also would like to thank Controller Laura Chick and Deputy Controller Ruben Gonzalez for sharing their perspectives and providing background data.

We also thank the many officers and staff from LAWA, Port, and DWP for their complete cooperation, including providing volumes of relevant data and generously sharing their time.

A presentation of a draft version of this report was made in October 2004 to the Blue Ribbon Commission, representatives of each of the departments, and other City officials. Copies of the draft report were distributed, and the authors appreciate the careful review and helpful comments they received.
BACKGROUND AND INTRODUCTION

This documented briefing presents analysis from a 90-day research effort to find ways to improve 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). These proprietary departments are established in the City Charter, as self-supporting departments that transfer a percentage of their revenue to the city’s general fund. Our effort was neither an investigation nor an audit of the proprietary departments; rather, it was intended to be forward looking on how to bring improved transparency, efficiency, and public trust to its purchasing, contracting, and leasing activities.

We begin with an overview of contracting and leasing activities at the LAW, Port, and DWP. We present the operating environment and challenges to efficient contracting to put this research project’s scope and project tasks in context.
We then present findings from interviews with the proprietary departments and from a review of their documents. Next, we discuss examples of best purchasing practices from other cities and from states, commercial firms, and other appropriate enterprises as alternatives to current contracting practices employed by City of Los Angeles departments. We conclude with suggestions on how to transform the proprietary departments’ current contracting practices to move toward these best practices.
The three proprietary departments combined have over $1.3 billion in contracts spending a year, and several hundred million in lease revenue.

The LAWA and Port of Los Angeles have significant amounts of contract spending and leasing revenue. The fiscal year 2003 (FY03) LAWA contracts and lease data are from the City Controller’s recent audit reports. The contract value for the Port of Los Angeles is somewhat dated, however. It is from the FY01-02 Bureau of Contract Administration report on Reimbursement for Centralized Certification. The 2002 value of $194 million for Port lease revenue is from the Controller’s 2003 audit report “Leasing Practices of the Port of Los Angeles.”

The above figure shows that all three proprietary departments have a mix of contracting spending and lease revenue. The DWP, which has had contracts worth from $760 million to just over $1.0 billion from FY01 to FY04, has the largest contracting volume of the three proprietary departments.

---

1 This reimbursement for centralized certification value is an underestimate of total Port contracting, based on contracts and purchase orders valued at $50,000 or more. It may also reflect only those contracts that required certification of Disadvantaged/Minority and Women Business Enterprises and Small Local Businesses.
departments. DWP also has the smallest leasing activity resulting from just over $3 million in real estate activities.\footnote{The DWP leases land, such as under utility structures, to, for example, nurseries and parking vendors.}
In the past two years, the Los Angeles City Controller has issued audit reports critical of contracting and leasing practices of all three proprietary departments.\(^3\)\(^4\)\(^5\) Contracting issues have also been the focus of investigations and public scrutiny.

All three proprietary departments have been criticized for the lack of transparency and for vagueness in their purchasing, contracting, and leasing processes. Further, the deliberations and award justification seemed to be poorly documented, raising questions about the thoughtfulness and objectivity of contractor selection. The selection of lease tenants and suppliers could not be validated by the auditor, who cited a lack of evidence of analysis of best business value. The lack of adequate post-award contract monitoring, controls, and administration has also been cited as being too informal or deficient. It is unclear whether

the City is selecting the best suppliers or managing leases to get the best value.

While none of the audits alleged any specific wrongdoing, the Controller stated that there was “an environment ripe for potential abuse and conflict of interest.” In 2003 and 2004, press coverage of problems with specific contracts at the LAWA, Port, and DWP have further shaken public trust in the stewardship of those departments. This report includes short-term recommendations addresses these issues.

---

In February 2004, Los Angeles Mayor James Hahn announced the formation of a Blue Ribbon Commission to review contracting at the three proprietary departments. Over the course of several meetings and discussions, the Commissioners compiled a list of ten questions concerning the proprietary departments' contracting practices.

Based on our interviews with staff at the proprietary departments, we formulated answers to these ten questions, which appear in Appendix A.
The Mayor’s Office hired RAND to support the Blue Ribbon Commission. RAND was specifically tasked to recommend how purchasing, contracting, and leasing could be improved at the three proprietary departments. The first task of this study was to understand how the departments currently contract and lease. We then conducted a search of contracting “best” practices elsewhere in the city, state, and federal government. Finally, we analyzed both the current issues concerning the proprietary departments and best practices elsewhere to determine which recommendations make the most sense for the proprietary departments and the City of Los Angeles. We discuss each of the three main tasks in more detail. The ten questions from the Blue Ribbon Commissioners influenced and guided this RAND project.
The RAND study had three main tasks. The first task was for the RAND team to review the audit reports, review each department’s formal response to the reports, and meet with the Los Angeles Controller. We also reviewed relevant portions of the Los Angeles City Charter and Administrative Code, which govern City contracting at the proprietary departments.

For the second task, RAND conducted interviews with directors and staff at each proprietary department in August and September 2004. In these interviews, we asked staff to candidly describe their current purchasing or leasing practices. These interviews also allowed the research team to understand the changing environment in which each proprietary department operates. RAND researchers also collected and reviewed relevant documents and data relating to the departments’ contracting and leasing.

For the third task, RAND researchers searched for leading government best practices and other exemplars in purchasing. Given the limited time and resources for this study, this process drew on previous RAND research of commercial companies and federal, state, and city governments to identify practices that may help the proprietary departments improve their purchasing, contracting, and leasing activities.

How Did RAND Conduct This Study?

- Reviewed audits, audit responses, regulatory requirements, and background documents
  - Met with LA Controller, and staff from the City Attorney’s Office

- Interviewed LAWA, Port, DWP directors and staff to understand current contracting process and practices
  - Walked through the contracting process
  - Solicited feedback on challenges with the current process and execution, and suggestions for improvement

- Searched for government best practices and other exemplars
  - Drew on previous RAND best practices research
  - Literature search of selected practices
  - Conducted interviews with selected Los Angeles government officials and purchasing experts

RAND

© November 2004
A targeted literature search of leading practices and selected interviews with Los Angeles government officials and purchasing experts also led to insights on leading trends in purchasing. This task helped us to answer the question, what are leading enterprises doing with respect to contracting?
In this section, we discuss the current contracting environment of the proprietary departments. In addition to meeting and interviewing officials and staff at LAWA, Port, and DWP, each department responded to RAND’s requests for various background documents and data. Together, the interviews and information from the departments highlighted how the contracting environments within which the departments operate have changed significantly in recent years.

We also briefly discuss the regulatory environment within which each department must operate. The intent of the Los Angeles City Charter and the Administrative Code are clear, but the implementation of the Charter and Code poses challenges, and that implementation may benefit from review.
In general, the contracting and purchasing activities at each department follow traditional purchasing practices that are very familiar to many governmental organizations. (As discussed later in this report, these “traditional” purchasing organizations are typically reactive and tactical in nature.) The traditional techniques evolved when purchasing departments procured commodities that largely were traded in public exchanges. As such, market prices were known and economically efficient with little profit for the seller of the commodities. Fraud prevention was appropriately the major focus of procurement departments.

More and more, purchasing departments are procuring services, which are not commodities and for which no market price exists. In such cases, economic “should cost” models and market-testing processes (e.g., request for quotes, or RFQs) must be used together to ensure proper pricing and economic effectiveness.
During the previous decade, the proprietary departments faced significant external shifts in their operating environments:

• At the Los Angeles World Airports, revenue accounting was transformed from a residual to a compensatory methodology. Security requirements increased as a result of the events of September 11, 2001.

• At the Port of Los Angeles, terminal demand increased significantly due to international trade and consolidation of shipping companies.

• At the Department of Water and Power, markets for electricity changed due to deregulation of the electricity industry.

In addition, each of the departments experienced significant cutbacks in staff, including procurement personnel, due to the Staff Reduction Program (SRP) implemented during the Riordan administration.

All of these changes required adjustments to the departments’ long-standing business practices—including procurement and leasing practices. We describe the changes at each of the proprietary departments in further detail next.
The Los Angeles World Airports experienced two major environmental shifts during the past decade. First, LAWA changed its status from a residual to a compensatory airport in 1993. Then, nearly a decade later, security requirements increased due to 9/11, which placed additional financial burdens on the airports.

A significant component of airport revenues is derived from landing fees collected from airlines. Prior to 1993, Los Angeles International Airport (LAX) calculated landing fees using a residual methodology under a Use and Lease Agreement that had been in effect for more than 25 years (LAWA Board of Commissioners Report 8/2/2004).\(^7\)

In 1993, LAWA converted from a residual airport to a compensatory airport cost-recovery methodology. Under the original residual agreement, signatory airlines paid for any operating costs remaining after

---

\(^7\) *Residual airports* collect fees from all non-airline sources and then charge the remaining costs to the airlines. This approach assures that the airport breaks even because the airlines pay all the “residual” costs of operations (FAA/OST 1999).
payments from non-airline revenues. Under the new compensatory agreement, LAWA charges the airlines fees and rental charges designed to recover their share of LAWA’s operating costs. According to LAWA, the compensatory methodology has the potential to generate a higher level of cost recovery than the residual methodology. That is, the airport is allowed to generate a surplus rather than break even, depending on how the rates are set. What this conversion to compensatory status did was shift the risk of overall revenue shortfalls as well as the benefits of surpluses from the airlines to LAWA.

The Federal Aviation Administration/Office of the Secretary of Transportation (FAA/OST) (1999) notes that residual and compensatory statuses are associated with particular business practices. For example, residual airports often give signatory airlines the right to review and approve airport capital development. Residual airports also tend to offer airline tenants longer-term contracts.

With the shift from a residual to a compensatory cost structure came increased awareness of opportunities for revenue generation. For instance, concession and retail operations within airport terminals now contribute directly to the bottom line of LAWA’s balance sheet. Retailers are recognizing that air travelers are getting to the airport earlier due to security requirements, and those travelers waiting for their flights represent a target market. The new challenge for airport authorities is how to maximize the income opportunities across retailers and concessionaires, given the limitations of existing airport facilities, municipal regulations, and security requirements.

In effect, the shift from a residual to a compensatory cost structure transferred market and environmental risk from the airlines to the City of Los Angeles. As a result of the increased risk that is born by the city, the LAWA procurement organization must significantly increase its skills, tools, efforts, and policies to cope with this situation. Best-practice procurement departments have rigorous procurement risk-management.

---

8 Signatory airlines sign leases that reduce their airport user fees, but lock them into repaying airport debt over a certain period. Other carriers, called ordinance airlines, operate on a month-to-month basis and pay higher fees.


10 Garden, McKay, “Are We Free to Buy Where We Fly,” Shopping Center Business, December 2001, p. 78.
processes that use real-life options and portfolio concepts to correctly evaluate these types of risks.¹¹

The switch from residual to compensatory status has also complicated discussions regarding the allocation of increased security costs resulting from September 11. There has been an ongoing dispute between LAWA and the airlines over the level and apportionment of security costs. Security levels at LAX have long surpassed the level of security common at most airports. Initially, the security levels were an internal decision made by LAWA. Airlines disputed the security measures and their responsibility to absorb the associated costs, arguing that security measures imposed by LAWA were due to City of Los Angeles requirements rather than federal mandates and airline requests. LAWA agreed with this argument and did not initially pass along the additional security costs to the airlines in the form of increased maintenance and operation (M&O) rates.

After September 11, federal intervention in airport security matters transferred regulation of airport security from LAWA to federal authorities. The newly established Transportation Security Administration (TSA) set security standards for airports, including LAWA, that superseded city requirements. LAWA now feels that these federally mandated security measures are recoverable through M&O rates. The remaining question for LAWA is how such costs should be allocated to users. However, the airlines have not acquiesced to absorbing the security costs and insist that the lease agreements allow them the right to approve the inclusion of these costs in M&O rates.

The shift to compensatory status and the increased security measures due to September 11 have increased LAWA’s risk of shortfalls in operating revenue and increased the need for LAWA to focus on its business practices.

According to the Department of Transportation’s Maritime Administration, the Port of Los Angeles is now among the top 10 ports in the world in total container volume and the largest port in the United States for container cargo. The growth at the Port is the product of two primary factors: the changing world economy and consolidation in the shipping industry. Of particular importance to this study is how the dramatic increase in world trade combined with consolidation within the shipping industry transformed an environment of excess port capacity to an environment of excess demand.

The primary cause of the Port of Los Angeles’s growth has been the increase in world trade. World trade on an annual basis is now an $11 trillion industry.\(^\text{12}\) Thirty years ago, U.S. trade was only 8% of U.S. gross domestic product (GDP). By 1999, that figure had increased to 27%, with economists predicting additional increases through 2010. More recently, imports to the United States have increased 50% from 1993 to 1999. For Los Angeles, an important factor is the increase in imports from the Far East due to changes in trade patterns. West Coast ports handled nearly

three-fourths of Asian trade in 2003. Approximately 75% of the Asian trade at West Coast ports passed through the San Pedro Bay via the Ports of Los Angeles and Long Beach. Overall, the Ports of Los Angeles and Long Beach accounted for 65% of all West Coast trade in 2002—a total of $205 billion worth of imports and exports (Los Angeles Business Journal, February 10, 2003). More than half ($110 billion) passed through the Port of Los Angeles alone. This amount represents an 18% increase over 2001 volume.

While trade accounted for part of the growth at the Port of Los Angeles, it was not the only cause of the growth. A second factor in the shift toward excess demand was consolidation among shipping lines. In particular, Maersk’s purchase of Sea-Land from CSX in 1999 created one of the largest shipping companies in the world. Maersk-Sealand moves approximately one million containers annually on 300 vessels. The importance of the merger to the Port of Los Angeles manifested itself in the recently merged Maersk-Sealand’s announcement that it would leave the Port of Long Beach for the newly constructed Pier 400 at the Port of Los Angeles. Maersk-Sealand became the primary tenant of the largest exclusive/proprietary container terminal in the world. At completion, Pier 400 comprises approximately 500 acres.

The shift from excess port capacity to excess demand changed the focus of the Port’s leasing practices. In an environment of excess capacity, Port staff had dedicated their business search efforts to identifying and attracting potential lessees. Staff often had to initiate contact with shipping companies to “market” the leases. However, in the new environment of excess demand, the Port now has multiple bidders for its available space. This shift in the focus of leasing practices is not trivial. Staff must now evaluate multiple business plans offered by potential lessees in an effort to determine the proposal that most benefits the Port and its constituents. To do so, the Port must have a current strategic plan that outlines the mission and goals of the Port to guide staff in those evaluations. Staff must also have a transparent and clear process that documents selection decisions and protects the Port from any appearance of impropriety.

---


14 Phase 1 of the terminal project was christened in 2002 and was expected to handle one million 20-foot equivalent units (TEUs) in the first 12 months (see http://www.apmterminals.com/Global+Terminals/North+America/Los+Angeles+Pier+400/Terminal/).
The Los Angeles Department of Water and Power is a municipally owned public utility. It has had a monopoly on the supply electricity to Los Angeles since the early 1900s. In Los Angeles, as had been common throughout the state, the electricity industry was vertically integrated. One firm controlled generation, transmission, and local distribution. Often, these firms were local monopolies.\textsuperscript{15}

The state-wide and even nation-wide trend toward deregulation, however, has changed the environment in which the DWP and other municipal utilities operate. During the 1990s, a substantial share of the electricity industry was deregulated in an effort to introduce competitive forces. Assembly Bill 1890 (AB 1890) was enacted in September 1996 to restructure the electricity industry and establish consumer protections. The law required that the three elements of the industry (e.g., generation, transmission, and distribution) be separated. With respect to the structure of the industry, AB 1890 required:\textsuperscript{16}

1) An Independent System Operator (ISO) to manage transmission

2) A power exchange to operate wholesale power markets, and

3) Divestiture of power plants (except hydro and nuclear) by investor-owned utilities.

California led the states in these deregulation efforts with offerings beginning in April 1998. In the new structure, only the distribution to the local customer remained a local monopoly. The “direct access” competition established by AB 1890 allowed the customer to purchase the electricity from firms other than the local utility. The newly divested utilities must now buy and sell power through the power exchange. Transmission from the generators to the local areas is managed by the ISO. The state Public Utilities Commission oversees the local monopolies distributing power to customers.

During the deregulation of the electricity industry, the Department of Water and Power remained a vertically integrated entity. Nevertheless, in November 1997, DWP prepared an action plan to deal with the new competitive forces in the industry. The move was intended to anticipate DWP’s exit from the power generation business (Barrington-Wesley Group 2002). DWP proposed, and later implemented, plans to reduce its workforce, freeze residential rates, and reduce its debts and operating costs. Staffing levels were reduced despite a postponement of DWP’s own deregulation—the spinning off of its generation activities.

Although staffing levels have increased somewhat since 1998, they remain below their peak levels: current staff numbers approximately 8,000, compared with 11,600 in 1994 (Barrington-Wesley Group 2002). The staffing reductions, particularly among mid-senior management, resulted in the loss of institutional knowledge (PriceWaterhouseCoopers 2002). Current staff indicated to RAND that the staff reductions of the 1990s continue to complicate current operations, including contracting.
The City of Los Angeles is a “chartered” city in which the City Charter governs. It is within the Charter that the general provisions for the proprietary departments are formally documented, including their creation, Board composition, the responsibilities of their general managers, and various limitations.

The Charter contains several key city requirements governing contracting: an overarching requirement that all contracts should be openly and competitively bid “as reasonably practicable and compatible with the City’s interest.” Awards should go to the “lowest responsive and responsible bidder.”

According to the City Administrative Office, the term “responsive” relates to the bidder’s ability to meet the technical bid specifications for completion of a construction project; and for commodities (goods, supplies, equipment), and includes elements to ensure product quality, performance, longevity, specific equipment specifications to meet the City’s needs, and other elements. As will be discussed later, the term “responsive” in practice is interpreted largely in relation to the submission of documentation to determine compliance with the contracting requirements.
Similarly, the City Administrative Office interprets the term “responsible” more broadly than what is observed in practice at the departments. Through “responsibility hearings,” City Council-controlled departments have found competitive bidders to be non-responsible due to poor performance and barred those bidders from a particular bid and from future contracting opportunities for a period of time. In contrast, department staff reported that the term “responsible” in practice generally refers to whether a contractor was bonded or insured.

Beyond awarding the lowest-bidding responsive and responsible bidder, the Charter states that the bidder must provide “satisfactory security for performance” and this determination may be made on the basis of “lowest ultimate cost” of the items. There is also a provision that the city may reject any bidder or proposer that has not performed satisfactorily in the past. Free and open competition is the clear intent within the Charter. As we will discuss in greater detail, while “lowest responsive and responsible” bids are considered, the weighing of contractor performance and analysis of total costs are not common practices at the three proprietary departments.

The City’s Administrative Code (AC) further specifies more detailed actions, such as a 10% financial preference toward small, local businesses on bids or proposals of $100,000 or less. There is also a requirement to perform an economic and feasibility analysis when hiring independent contractors whenever city employees are available to perform the contracted work. Provisions governing contract value and term limits for those purchases that general managers may authorize, and regulations on when the department’s Board of Commissioners or the City Council must approve those purchases, also reside in the Administrative Code.

The question of whether these provisions are generally followed by the proprietary departments was raised by the Blue Ribbon Commission (see Appendix A).

---

17 Under Administrative Code Section 10.25, a small, local business is defined as one for which the principal office is located in Los Angeles County and that has annual receipts of less than $3 million in the previous fiscal year.
Purchasing by the city proprietary agencies follows a traditional contracting process (see Figure 1). Users, not a centralized purchasing office, initiate purchasing requests. The user is responsible for specifying the need for the purchase.

Bids are first reviewed for their responsiveness and responsibility. From interviews with staff at the proprietary departments, “responsiveness” is interpreted largely as the bidder’s ability to meet the technical specifications and administrative requirements of the statement of work (SOW) or request for proposals (RFP). These technical specifications may include prerequisites such as an engineering license, construction license, or other business licensing and certification. Responsive bids also include administrative requirements such as meeting the proposal deadlines and submitting required paperwork, which may include documentation of the bidder’s “good faith effort” for subcontracting to minority- or women-owned business enterprises, a childcare program, a child support program, and living-wage requirements. If these technical and
administrative requirements are not properly satisfied the bid is deemed “nonresponsive” and is not considered for an award.

“Responsible” refers to the bidder’s ability to meet the needs set forth in the RFP or SOW. In the case of goods or construction SOWs, staff told us that “responsible” is largely satisfied by showing evidence that the bidder is bonded or insured. LAWA is the only proprietary department that has adopted a Contractor Responsibility Policy that is similar to the Contractor Responsibility Ordinance applicable to Council-controlled departments. Despite these ambiguities, none of the proprietary departments associated the term “responsible” with a broader set of quality metrics such as reliability, timeliness, efficient, or effective performance. Departments are focusing more on legal risks such as uninsured suppliers and quoted price rather than broader total cost measures.

Bids and RFPs are evaluated differently, after they are deemed responsive and responsible by the proprietary departments. For bids, we were told that lowest price is the single criterion used for selection after a bidder has been determined as being responsive and responsible. Lowest price refers only to the goods, supplies, equipment that are bid and is not a total cost accounting, which might include factors such as transaction, administrative, or other costs. Staff reported that they do not consider past performance in awarding these kinds of contracts.

For RFPs, a number of factors, besides proposed price, are weighed in the selection process. These factors may include the contractor’s expertise, experience, reputation, past performance, and others, which are weighed in a scorecard evaluation. While the criteria are usually listed in the RFP, the weights are not always shared with bidders. For RFPs, the highest scoring bidder is selected, which may not have the lowest-priced proposal. For service contracts, we were told that expertise and past performance are considered, with bidders evaluated using a scorecard approach.

18 The Ordinance requires that bidders and proposers complete a responsibility questionnaire that covers a range of areas with respect to performance and compliance with local, state, and federal wage, hour, and employment law. LAWA attaches to each bid and RFP a package of administrative requirements, which may include requests for (depending on the nature of the contract) an affidavit of non-collusion, an affirmative action form, child-care program form, child support obligation form, a listing of other City of Los Angeles contracts, and a business tax registration certificate.
For purchases greater than $150,000 at the Port and DWP, or $100,000 at LAWA, and for contracts longer than three years, the respective proprietary department’s Board of Commissioners must approve the SOW/RFP before it is released to the public.

For contracts that require Board oversight, the departments must ask the Board for approval to negotiate with the selected vendor. The Board again reviews the contract before it is awarded to the vendor.

The current Board review process is time consuming and labor intensive. The Board members at each of the proprietary departments are Commissioners that are appointed by the mayor and typically step down at the end of a mayoral term. As a result of their term length, they do not always have sufficient experience in the contracting practices of the departments. Thus, the department boards are ill equipped to efficiently perform a fraud-prevention or collusion-prevention function for the procurement organizations and lack the tenure required to evaluate suppliers’ overall cost effectiveness versus their prices. Given the composition of department boards, performing an audit function (fraud detection) of the procurement processes would allow the procurement departments to expand their contribution to the City of Los Angeles.
Transforming the Board into process overseers versus process controllers would be a significant step toward developing best practices and would be a source of resources. We raise three issues with respect to the Board reviews. While the Board can add value, there are opportunities for reducing the burden to staff and the delays in the procurement process. First, the requirement for three Board reviews is a recent change that has increased the burden to staff. In the first Board review, staff members request permission to issue an RFP. Because these are rarely denied, the Board seems to be simply asking for information about upcoming procurements. Board members may be made aware of upcoming purchases in a more efficient manner. Second, it may be unnecessary to approach the Board for low-risk commodities. For example, large purchases of items, such as cables, are routine, and there is little room for added value from the Board. Third, a rigorous audited sourcing process that documents the selection process and outcomes can ensure transparency while reducing the need for Board review. There is, however, an important role for the Board in periodically auditing the processes rather than reviewing selection decisions for individual contracts. There is also some scope for the Board to review (but not participate in) the process for high-risk high-value goods and services.

The City Council also provides additional oversight for City contracts via Charter Section 245, which allows the Council to review any Board decision and require that it be reconsidered. Department staff reported to us that the reviews by the Board and Council have led to increased paperwork and substantial delays in decision-making (i.e., a previous RAND report states that DWP staff estimated that it takes 90 to 120 days to award contracts for more than $150,000—about twice the time it takes for smaller contracts).

The proprietary departments’ legal personnel are also involved in the purchasing process. The departments’ legal staff are representatives from the City Attorney’s Office and resident at the proprietary departments.

---

19 The history of this Charter section evolves from Proposition 5, a measure incorporated into the Charter during the Bradley administration. This provision was modified in the City Charter that was approved by voters in 1999. Although the phrase “Prop. 5” continues to be used colloquially, today Charter Section 245 allows the Council to assert jurisdiction over actions taken by the City Board and Commissions. Upon asserting jurisdiction, the Council may only reject the item and return it to the Commission for further consideration.

Expertise in product knowledge and/or purchasing is not assumed, because their responsibility is to review contracts for legality, not assess best value or make other business decisions. All key stakeholders, including the City Attorney and Board, however, would benefit from knowledge of best purchasing and best industry practices to be better participants in the process.

In summary, for higher-cost/longer-length contracts, a single bid may require up to three Board reviews and one City Council review. First, purchasing staff must request that the Board authorize the RFP or SOW to be released. Second, the staff must seek Board approval to negotiate with the top-ranked bidder. Finally, the Board approves the award. LAWA staff noted that the three-step process for the Board is relatively new. Historically, staff would have to approach the Board only once during the process. However, recent LAWA Commissioners had asked for increased Board involvement, which was the impetus for the three-stage process for Board review.
The departments’ contracting personnel reported that the Board review process creates a substantial task for them (i.e., preparing materials) as well as for Board members. Boards review hundreds of actions each year. Staff at two of the three proprietary departments reported that they were perpetually in Board preparation mode. Because the Boards of the proprietary departments meet every two weeks, staff must develop, review, and send out packages prior to every meeting. Staff at LAWA noted that no requests to put contracts out for bid have been denied. It appears that the Commissioners simply want to know what is going on in advance of a request/bid being issued.

We requested the number of purchasing actions that were reviewed by the proprietary departments’ respective Board over the past three fiscal years. For LAWA, information on the number of contracts approved, denied, or deferred for more information was not easily available. However, actions by the Board of Airport Commissioners (BOAC) are numbered sequentially by LAWA, and a quick count of Board resolutions and orders (dealing with leases) could be made over the past ten years. The numbers of BOAC resolutions were more than the numbers of BOAC orders. Combined resolutions and orders averaged between 350 and 450 actions per year over the past decade.
LAWA and DWP also provided some data on the numbers of Board actions that subsequently were reviewed by the Los Angeles City Council. This review happens for contracts of 3 years or more. Council reviews of department actions are an exercise of their political power to review and make final decisions on all actions taken by the Boards. The possibility of Council repudiation contributes to staff efforts to thoroughly prepare and document all Board actions.

Because total numbers of BOAC resolutions and orders averaged 350 to 450 per year, the data suggest that roughly ten percent are subsequently reviewed by the City Council. The data show that a vast majority of actions that went to the City Council were approved, and more information was requested for several of them. For the approvals, one may infer that the department actions were justified and documented to the satisfaction of the Council.

The high percentage of approvals and rare City Council denials may also lead to questions of whether actions by the Council could be streamlined to minimize delays in the contracting process, while still exercising their discretionary authority. Certainly, some Board actions require discussion and deliberation before Council approval, and the data show more information was requested for a fraction of actions.
For DWP Board actions, the number of Council reviews is roughly twice that of Council reviews of LAWA actions. This may be due to the much higher total numbers of contracts at the DWP compared with LAWA. Like LAWA, the majority of DWP actions receive Council approval, and very few are denied. The percentage of Council actions that are returned to DWP for more information is higher than that for LAWA, which may suggest that the DWP actions require more complete documentation or discussion.

Our observations of Council reviews mirror the observations of Board reviews. Similarly, there may be opportunities for the Council to add value, while reducing the burden to staff and the delays in the procurement process.
While the intent of the Los Angeles Charter and Administrative Code are clear, their implementation at all three departments may need review.

As mentioned earlier, the Charter’s “low bid” requirement is almost always interpreted at the proprietary departments to mean selection of the “low price” bid.\(^1\) Other Charter requirements to award contracts based on satisfactory performance or lowest ultimate costs are not widely cited or followed. The interpretations of “responsive” and “responsible” bids and proposals are minimal: whether a vendor has met technical specifications and administrative requirements, or is bonded or insured. Other common associations with “responsible,” such as having a contractor perform work on time or efficiently, or promptly returning phone calls, are not within the current interpretation of the Charter call for “responsible” contractors at the proprietary departments.

---

\(^1\) In Charter Sec. 371a, the word “price” does not appear. The verbatim Charter provision states, “Contracts shall be let to the lowest responsive and responsible bidder furnishing satisfactory security for performance. This determination may be made on the basis of the lowest ultimate cost of the items in place and use.”
These factors combine to result in diminished incentive for current contactors to focus on good performance, given that bids for renewals or follow-on contracts are issued based on low price. Poor performers are not excluded from winning bids, except for documented extreme cases, if they submit the lowest bid. As a result, the City may award the lowest-price bid, but not necessarily the bid with the best value or lowest total cost.

Staff indicated that a cottage industry has developed for meeting some of the goals of the City Charter and other requirements, which may not match the original intent.\textsuperscript{22} For example, the 10\% bid preference on contracts of $100,000 or less for small, local businesses has resulted in one-person “pass--through” businesses that do not employ others. Staff told us about a one-person, local “post office box” business that has no staff or any inventory. Basically, when a purchase order is received, the business owner calls a major supplier to order the product, a supplier the department would have purchased from directly were it not for the 10\% preference given the small firm and department practice of always awarding the lowest-price bid. In other scenarios, staff indicated that the one-person business will hire freelance support. Staff further reported that in these situations, it is not uncommon for the small, local business to perform poorly, sometimes resulting in department personnel spending up to 25\% of their day following up with the firm.

A 1989 mayor’s directive led to the city’s “good-faith-effort” program to increase participation by minority- and women-owned business enterprises (MBE/WBEs).\textsuperscript{23} The implementation is sometimes done as a “set-aside” program, requiring prime contractors to try to subcontract 15-20\% to a MBE/WBE, even when the prime contractor itself is a MBE/WBE. Bids from prime suppliers are required to provide documentation of outreach activities as part of the bidding package. LAWA uses a scorecard to assess whether MBE/WBEs were included in the bidding package, i.e., “good faith effort.” The process to meet the good faith effort for personal-services contracts includes several performance indicators, such as advertising, and documenting communications with the firm. The documentation requirements are rather lengthy and require advance notice and planning by prospective

\textsuperscript{22} This behavior was reported by staff based on their past experiences with selected small businesses. It represents an unintended consequence of the 10\% small-business preference on contracts of $100,000 or less. While it would be useful to generate some measure of frequency, it would be difficult to further document this behavior without direct contract monitoring.

\textsuperscript{23} Mayor’s Executive Directive No. 1-C (dated March 6, 1989) requires outreach to all subcontractors: MBE/WBE and Other Business Enterprises (OBEs).
prime suppliers. Given the pace of current procurement practices, city requirements may be diverging from current business practices (e.g., documentation of written solicitation to MBE/WBEs is required; however, email or phone correspondence is not allowed).

Staff reported that many potential suppliers see the extra paperwork associated with the bidding process as the cost of doing business with the City. However, some also noted that they were aware of qualified bidders who had opted not to bid because of the excessive City paperwork. In addition, the time involved in receiving an award from the city department (and for some departments, the time to receive payment) can also be prohibitive. The Board approval process is lengthy and slow. Staff noted that they sometimes receive only one – or no – response to RFPs or requests for bids (RFBs).

Other city ordinances may also inflate costs. For example, staff from the Port perceive the living-wage ordinance as inhibitory in a number of industries, such as city-contracted service work at the cruise ship terminals. Later in this document, we recommend reviewing the implementation of socioeconomic programs to investigate the effectiveness of each program and weigh the costs versus the benefits. Facilitating compliance by contractors to reduce the administrative burden would benefit both the City and contractors. But the City may consider exploring alternative implementation to improve effectiveness and reduce costs in achieving goals.

The dollar levels of Board-review limits and delays associated with reviews were the subject of much of our discussions with department purchasing staff. Staff suggested that the $150,000 ($100,000 at LAWA) limit was too low, especially for non-service-related contracts. Some staff reported that the $150,000 limit led to repackaging of requirements because the review process was so slow and cumbersome — i.e., many contracts are written just under the dollar limit. The DWP staff indicated that the limit would be more appropriate if it were set at $500,000–$1,000,000. Similar amounts were discussed by staff at LAWA. Staff felt that the current $150,000 limit has not been properly adjusted for inflation over the years since the limit was first set. An alternative

24 The Living Wage Ordinance (Administrative Code, Division 10, Chapter 1, Article 11, Section 10.37) has been applicable to the proprietary departments since 1999. It is applicable to employees of service contractors working at the terminals (e.g., landscaping, custodial, security). It does not apply to all employees of a contractor but only those working on a city contract. From the LAWA website, it certifies among other requirements that prime and sub contractors agree to pay employees a living wage — currently $10.03 per hour or $8.78 if the contractor pays for health benefits.
suggestion at LAWA was to make the $150,000 limit an annual limit rather than a contract limit. LAWA staff also reported that the length of some types of contracts at LAWA was shorter (5 years) than the industry average (7 years).
Our interviews with department staff indicated that the City might not always get the best value. Best value is an accepted best practice whose benefits are well documented in the literature. An Aberdeen Group survey of supply management in the public sector indicated, “…selecting suppliers based on price alone can actually increase the total cost of ownership of a product or service. The total cost of supply includes both price and life cycle costs, including delivery, handling, infrastructure, training, and maintenance. These costs often exceed the price of the goods or services acquired.”

It involves an evaluation of the transaction costs (pre- and post-purchase), supplier performance, and supplier characteristics. The burden of the evaluation falls mostly on staff, although contractors may be required to supply additional information. This is not contradictory to our recommendation to review and reduce regulatory requirements. The goal is to focus staff efforts (or staff expense) toward maximizing the benefit for the City.

---


26 It is important to note that best value should be interpreted with care. In the case of standard commodities, like Number 2 pencils, it may be sufficient to consider low bid and satisfactory previous performance. A more complicated or higher-value purchase would require more in-depth evaluation. Best-in-class firms tailor the criteria to a
Awards based on low price do not always mean lowest total cost (or “total ultimate costs” as stated in the Charter). Staff at the three proprietary departments stated that the City Charter mandates that they accept the lowest-price bid when purchasing goods and construction services. In these situations, staff indicated that they sometimes believe that the lowest bid is not the best value (i.e., best price and quality). As price and not performance governs which contractors will be awarded renewal or follow-on business, current contractors have a decreased incentive to perform well, if good performance will not be rewarded. Staff reported that the reliance on the low-bid criteria has sometimes led to increased follow-up costs after the contract award process. That is, the low-bid criterion motivates some bidders to “low-ball” their bid and then resort to follow-up change orders to complete a project. Staff reported that the Board reviews change orders carefully and that the approval process can take months. As a result, the departments end up spending more money and time to complete projects that would be better completed by best-value bidders. Staff seemed aware of the problems associated with selecting a vendor solely on price, but reported that they are mandated to follow this selection process by the City Charter.

While moving from low bid to best value may seem to make the procurement process less transparent if evaluated subjectively, the process can be implemented in a very rigorous manner, using weighted, merit-based criteria supported by controller-audited, activity-based costing models. First, the full specification of evaluation criteria and weights clarifies the goals of the City to potential suppliers. The Aberdeen Group notes that the City must “explicitly detail all the cost and service parameters of the contract and how they will be evaluated.” A documented procedure using evaluation scorecards to generate a selection ensures the integrity of the process.27

Professional services, such as advertising, legal counsel, and consulting services, pose a challenge because the deliverables may be intangible or difficult to evaluate head-to-head with alternatives. An article in Purchasing Today magazine noted that to measure effectiveness and efficiency, the buyer “…needs to decompose the purchased services into components that can be analyzed and benchmarked to the market. The strategies that follow are described in terms of advertising services, but

---

they are applicable to the procurement of all professional services.”

A cost-benefit trade-off may also be weighed, such weighing the additional costs of hiring outside law firms with specialized expertise against the savings from reduced liability costs.

Another problem with selection based solely on price that staff reported is that many times the lowest bid offered might be from a supplier who has performed poorly in previous contracts. Staff said that the low-bid mandate does not allow them the flexibility to exclude the poor performers from future contracts, nor does it allow them to consider their previous performance in the award process. Staff conveyed the sense that “poor performers must be considered.” The departments claimed that only in the most extreme cases, such as when contractors have been debarred (barred from bidding), found non-responsible, or fired, can contractors be disqualified. However, staff reported that the debarment and non-responsibility processes are lengthy and thus rarely undertaken. Instead, staff will generally work with poor performers to satisfy the terms of the contract at the cost of considerable personnel time.

The staff at the proprietary departments cited their City Attorneys in guiding these contracting practices. Staff stated that the attorneys discouraged selecting bids that were not the lowest price, which may lead to court challenges. On the other hand, the City Attorney’s Office stated that this sort of guidance might indicate that the departments had not rigorously documented their contractor selection criteria and justifications in a defensible manner.

Transition costs and value-added metrics are not rigorously calculated or weighed during selection. Staff reported that many times projects last longer than the initial contract length, in which case they are required to re-bid the work. Staff at the DWP reported an example in which they wanted to keep their original vendor whose performance was viewed as being good, but the low-price bid requirement led to an award to another bidder. They reported that the transition adversely affected production and increased costs while the new supplier was brought on board. In addition, the re-bid effort is expensive because department functional experts, purchasing and legal staff are obligated to engage in the

---


29 These processes involve documenting and substantiating the poor performance of a contractor, and affording the contractor an administrative hearing and the opportunity to bring an attorney to the hearing.

30 The City Attorney’s Office has attorneys resident at LAWA, Port, and DWP to review contracts and represent the interests of the City of Los Angeles.
development of a new SOW/RFP and in the evaluation of bidders, as well as in the selection of and negotiations with potential awardees.

Vendor performance is not measured rigorously, largely because it is not used in bid-selection criteria. Because the proprietary departments do not use past performance to select vendors for goods and construction, it is not considered to be information that is pertinent to future purchasing decisions. Staff reported limited use of performance indicators to manage vendor performance.

Staff reported that departments have difficulty maintaining long-term relationships with their best performers. Staff also reported that the lack of performance data inhibited the development of long-term relationships with good suppliers. Staff suggested that supplier performance should be used not only to identify superior performers but also to identify inferior ones.

31 While all the proprietary departments have a contractor evaluation form, none have adopted the City’s Contractor Evaluation Ordinance, which requires departments to complete an evaluation of contractor performance at the end of the contract, and to maintain that information on a database.
RAND requested and received actual contract-level data from the Port of Los Angeles. The above figure shows all Port Executive Director personal services agreements (PSAs). These contracts may be approved without review by the Board of Commissioners. In total, there were 1,234 such agreements from May 20, 1992, through September 21, 2004.

Plotting the agreements data sequentially illustrates the effects of review thresholds set forth in the Administrative Code. Prior to 2001, the limit above which the Board must approve contracts was $100,000. The figure shows that many agreements were at or near that contract value. In 2001, the limit was increased to $150,000, and subsequently many of these executive director–approved agreements were at or near the higher limit. The frequent incidence of contracts valued at $100,000 prior to 2001 and at $150,000 after the review threshold was raised created a clear “jump” in contract values.

There is likely to be some clustering at any threshold. However, the current low limit generates a high volume of contracts above the threshold that requires review. The process burdens staff and the Board. Increasing the limit to a higher total would also reduce the total number of contracts, because staff would not split contracts to expedite the procurement process and meet internal customer needs.
The above figure presents data on the numbers of Port Executive Director personal-services agreements, which were not subject to Board review. The data are grouped by the value below the Port Board of Commissioners review-threshold limit. The data are shown in decreasing groups of $10,000, below the $100,000 limit before 2001, and $150,000 limit thereafter. The largest column, at the top of the graph, represents agreements that were at or just under the limit for Board approval. Note that there are several times as many personal-services agreements at or just under the limit than there are in any of the lower-valued groupings of agreements.

These data do not necessarily indicate that staff are trying to circumvent authority as much as they are trying to be more efficient in terms of speeding the process and reducing administrative burden. With several hundred million dollars in total annual contracting, combined with a review threshold set at $150,000, it follows that many routine individual contracts must be prepared for (possibly three rounds of) Board review.
Our interviews and review of information provided by the departments suggest that purchasing staff play a traditional role within each proprietary department. That is, the purchasing function is viewed as a support function within the department with the primary responsibility to ensure that contracts are compliant with the City Charter and Administrative code, as well as other rules and regulations such as federal or state environmental, legal, and ethical requirements.

To illustrate their primary role, purchasing staff at LAWA produced a large stack of regulatory paperwork and said that one of their responsibilities was to ensure, on a contract-by-contract basis, that all administrative requirements were properly included with each bid package. Staff members also produced five sample bid packages for us to examine, all of which were for routine purchases, such as 1,200 leather gloves for airport ground staff or a few-day rental of golf carts for a Van Nuys airport open house. Each bid package had a two- or three-page specification of purchaser requirements, followed by dozens of pages of vendor requirements. That is, any firm that wanted to sell gloves to LAWA would have to certify compliance with nondiscrimination, equal
employment practices, affirmative action, child support obligations, and a good-faith effort toward minority/women/disadvantaged business-enterprise participation.\textsuperscript{32}

Given this traditional administrative role—ensuring that compliance and other clerical functions are properly handled—the purchasing function at the departments is largely tactical and reactive. The purchasing group may also be viewed as a cost center within each department. DWP staff reported that they were under-resourced, and constantly in a reactive mode, while focusing on regulatory administration. This left them very little time to perform activities such as pre-bid market analysis or open bidders conferences, which reduces the amount of information collected on suppliers, industries, and markets. With such little time and information, and a low-bid emphasis, purchasing department personnel primarily establish arms-length vendor relationships, which tend to be more adversarial.

A strategic, proactive, and cooperative approach would improve procurement. For example, an urgent need may arise for a complex high-value purchase. In a traditional tactical environment, the procurement personnel would react only to a customer request. Given the time and resource constraints, the procurement personnel have little time for in-depth analysis and documentation and are under pressure to speed the process in order to meet customer needs. In a strategic, proactive environment, procurement personnel constantly monitor key internal requirements and industries in order to prepare for quick response. This requires an understanding of the department’s strategic goals, the department’s current and likely future requirements for each major group of goods and services, and a detailed knowledge of supply markets for each good/service including major cost drivers, industry trends (e.g., technology, capacity, and capabilities), and leading suppliers.

\textsuperscript{32} The current child care policy is currently a form that a contractor must complete to identify whether or not child care benefits are offered to employees. It is informational to the Commission for Children, Youth, and Their Families (CCYF). As part of the effort to streamline the contracting process, as a follow-up to the Mayor, City Attorney, and Controller joint proposal, the CAO will be recommending that the Child Care Policy form be eliminated.
Most of this report has focused on contracting or purchasing activities. However, we also noticed reactive activities within the departments’ leasing operations.

LAWA’s terminal concessionaires are a source of leasing revenue. These businesses, which provide news, dining, shopping, and parking at the airports, were dramatically affected when new security procedures limited airport gate area access to passengers only. LAWA issued relief assistance and lease extensions to its concessionaires, because they faced uncertain economic realities. During our interviews, LAWA discussed the possibility of using a lead concessionaire to help manage other vendors.

At the other end of the spectrum, LAWA and the Port of Los Angeles generate hundreds of millions of dollars in leasing revenue through multi-decade leases with airlines and shipping companies. Selection of LAWA and Port lease tenants and lease terms is much more an evaluation of complex business proposals. These complex deliberations benefit from having a strategic business plan to help guide decision-making, especially during periods of intense demand, such now with the current competition for space at the Port. LAWA’s strategic plan has not been updated since 2000, despite the altered airline industry economics and security.
environment of post-9/11. The stakes are higher with airport terminal and port leasing; however, reactive tendencies remain.

DWP’s modest-value real estate leases, which consist primarily of leases with nurseries and parking vendors for land in the vicinity of utility structures, generate only $3 million a year. Lease rates which should have been regularly readjusted had lapsed, as had renewal management. Given how small this activity is within DWP, the department’s solution to hold public auctions for vacant property and to issue one-time renewals was both an efficient and effective one.
BEST PRACTICES FROM GOVERNMENT AND INDUSTRY

Mayor’s Office Hired RAND to Support the Blue Ribbon Commission

• How do LAWA, port, and DWP contract today?
• What are the best government and commercial practices for contracting?
• What contracting recommendations make the most sense for LA departments?

In the next section, we discuss what we have learned in our search for best government and commercial practices. What are those who are employing best practices doing differently with respect to contracting?
Before we present specific examples of government and industry contracting and purchasing practices, we would like present the context of some of the characteristics we observed in best performers. Leading enterprises have dramatically improved the quality of their purchasing and supply management (PSM) activities by transforming their traditional tactical, reactive, lowest-price, regulatory-compliant, and adversarial practices. Leading enterprises change their practices to take a more strategic, proactive, effective, efficient, and cooperative approach. This approach is discussed in greater detail below, and is summarized here to help readers to identify institutional differences in purchasing practices at other organizations.
We observed that LAWA, Port, and DWP already have adopted several notable practices. Each has developed a purchasing manual to assist department users and staff in the purchasing process. Several of the practices listed in the chart above are in use at two or three of the departments.

LAWA in particular has placed its comprehensive purchasing guide online, with active links to direct staff to relevant pages. We also observed an open-bidders conference, in which questions and answers were discussed in front of all interested bidders. Attendee lists were also copied and distributed as an aide for both prime contractors and subcontractors who must partner to fulfill a “good faith” subcontracting requirement for utilization of women- or minority-owned businesses. LAWA also seemed to be increasing its use of prime contractors to manage concessionaires, such as newsstand and advertising vendors, which can be very difficult to manage when there are many of them.

The Port of Los Angeles generates revenue based on the throughput of containers per square acre. Port leadership gave examples of proactively analyzing their container throughput data and then working with shipping companies to identify win-win improvements. The purchasing staff also has generated a list of pre-qualified environmental consulting contractors to streamline access to their services when needed. In 2004, the

| Proprietary Departments Already Have Adopted Several Notable Practices |
|---|---|---|
| LAWA |
| • Developed purchasing guide and on-line procurement wizard |
| • Use of open-bidders conferences and attendee lists |
| • Using prime contractors and concessionaires to subcontract to small businesses |
| • Board orientation manuals |
| PORT |
| • Proactively reviewing container traffic and working with shippers to identify win-win process improvements |
| • Pre-qualified contractors for responsively assigning task awards |
| • 2003 AAPA Award: Pier 400 Phase I Terminal and Transportation Corridor Program (Only 1.8% change orders during construction) |
| DWP |
| • E-procurement initiatives to reach a broad supplier base |
| • Public bid openings and auctions |
| • Constructive feedback to non-awarded bidders and proposals |
| • Piggybacking on existing government contracts |
| • Electronic delivery confirmation, invoicing, and payment |

AAPA = American Association of Port Authorities
Port received two American Association of Port Authorities (AAPA) awards, including citations for their Pier 400 terminal project and transportation corridor project. The projects had a low number of change orders, a figure sometimes used as a measure of the accuracy of the requirements definitions and the contracts.

The DWP has developed and made extensive use of electronic procurement initiatives to announce contracting and bid opportunities to a broad supplier base. Because deliveries of equipment and parts may occur over a large geographic region, DWP uses an electronic delivery confirmation and invoicing system, which also aids in making timely payment to the vendor. DWP personnel indicated that they also leverage the overall purchasing power of existing government contracts. DWP also holds open public bids on and auctions of its real estate holdings. When requested, purchasing staff give constructive feedback to unsuccessful bidders and proposers.

We highlight DWP’s efforts and initiative in pursuing a system to save time and money while trying to give small businesses more opportunity to compete and to make the process more open. We have not seen their E-Procurement system nor evaluated its effectiveness, specifically in comparison with the City’s Business Assistance Virtual Network (BAVN).
We searched for examples of innovative contracting practices at other cities and municipal departments. The former mayor of Indianapolis, Stephen Goldsmith, described some of the initiatives that helped that city run more efficiently, such as benchmarking performance not just against government, but also with private-sector firms.\(^{34}\)

The City of Lynn, Massachusetts, is profiled by the U.S. Conference of Mayors for saving millions of dollars through a standard’s-based “Design/Build/Operate” bid for a wastewater construction contract.\(^{35}\) Of note is the city’s discussion of options with operators, contractors, consultants, engineers, organized labor, environmental groups, and the Urban Water Council. This search for options resulted in a modification of an early plan to build a five-million-gallon storage tank, to change to a wastewater treatment facility. The discussions also led to the issuing of


two separate RFPs, one for the combined sewer overflow project and the other for its operation and maintenance.

A survey of selected major ports and harbors found that the Port of New Orleans publicly posts a comprehensive list of contracts and bid information, including an archive of construction contracts.\(^{36}\)

Increasingly, industry is partnering with third-party operators for specialized services when comparable expertise does not exist in house. As mentioned earlier, the changing environment of airports includes increasingly important retail operations. Perhaps not surprisingly, companies that manage traditional shopping malls are increasingly being selected to manage airport retail leases and concessionaires—i.e., companies whose core competencies are management of retail tenants and maximizing concessionaire-generated revenue.\(^{37}\)

---


Within the City of Los Angeles, there are many examples of and recommendations for efficient purchasing activities. The General Services Department just received the 2004 Leaders In Supply Management award from PeopleSoft, largely for its consolidation of warehousing, inventory reductions, and business efficiencies. Among its excellent practices are the use of supplier performance and evaluation forms and the use of past performance in contractor selection. The City through PRIMA (Purchasing, Receiving, Inventory Management, Accounts Payable) and LAOPS (now the Mayor's Office of Small Business Services) has also developed citywide contracts for major supplies purchases.

Mayor Hahn, the Los Angeles City Attorney, and the Controller have together issued a joint call to improve city contracting and procurement processes. They are asking for recommendations on streamlining, training, and technological efficiencies, such as prompt payment to make the city

---

easier to do business with. The recommendation to promote prompt payment may be one of the best things the city can do to support small businesses, because it would help their cash management and ability to meet payrolls and expenses.

The three recent audits of LAWA, Port, and DWP also contain recommendations and suggestions for improvements. While they include a fair number of monitoring and oversight control recommendations, the audits also call for supplier performance measurement and documentation of supplier selection analysis, which echo the practices of progressive commercial firms.

---


The California state government also provides some examples of contracting innovations and initiatives. The National Association of State Chief Administrators (NASCA) and the National Association of State Purchasing Officials (NASPO) both identify California exemplars in procurement practices.

For some major California procurements, the state used problem-oriented bidding to encourage supplier innovation. This type of bidding focuses on outcomes. It employs an iterative process to develop and refine bid requirements through increasingly detailed proposals. It allows the state to weigh the costs and benefits of various innovative ideas in the early stages of discussions with vendors, and it also allows vendors to delay pricing until the final submission, enabling more accurate costing when requirements are more fully described.

<table>
<thead>
<tr>
<th>The State of California Provides Several Examples of Innovative Contracting Initiatives</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Some Major CA Procurements</strong></td>
</tr>
<tr>
<td>Problem: Vendors are reluctant to incorporate innovative, but unsolicited, features in a bid, if those features will increase price and make the bid non-competitive</td>
</tr>
<tr>
<td>• Uses an iterative multi-staged process: high-level concept papers, more detailed proposals</td>
</tr>
<tr>
<td>• Allow vendors to delay actual pricing until the final submission and to disengage</td>
</tr>
<tr>
<td>• Weigh the costs and benefit of innovative ideas presented in early stages, refine their requirements and provide that information so all vendors can respond.</td>
</tr>
<tr>
<td><strong>California Franchise Tax Board Tax Collection System Upgrade</strong></td>
</tr>
<tr>
<td>• Pre-screens vendors with a statement of their problem and asked for workable solutions (Rather than draw up detailed bid specifications)</td>
</tr>
<tr>
<td>• Finances the project from the savings and new revenue generated by the benefits of automation</td>
</tr>
<tr>
<td>• Realized payback was five times higher than what was originally estimated (vendor paid back in five months rather than two years)</td>
</tr>
<tr>
<td>• Completed in only four months compared to the average 18 to 24 months</td>
</tr>
<tr>
<td><strong>CA Performance Review Recommendations</strong></td>
</tr>
<tr>
<td>• Vest full procurement authority in State Agencies (eliminate delay and expense of duplicative layers of bureaucracy and channel decision-making authority closest to the need)</td>
</tr>
<tr>
<td>• Establish a three-tier statewide procurement structure: “Strategic,” “Tactical,” and “Operational”</td>
</tr>
<tr>
<td>• Routinely audit procurements to insure compliance and validation of performance targets</td>
</tr>
</tbody>
</table>
The California Franchise Tax Board formed strategic partnerships with vendors to upgrade and replace their tax collection system. By stating the problem but not detailing any required solution, it allowed the vendors to propose innovative solutions.

In August 2004, Governor Schwarzenegger’s “California Performance Review” report proposed sweeping changes to state procurement practices. These include organizational changes, professionalization of the state’s procurement workforce, consolidation and simplification of statutes and policies, reformation of the vendor protest process, removal of bidding preferences, and elimination of duplicative reporting requirements.

The State of California has recently selected A.T. Kearney’s Government practice, along with CGI-AMS, part of CGI Group Inc., to execute the largest state-wide strategic sourcing analysis and implementation in the country and to streamline the state’s procurement processes. Through this agreement, CGI-AMS and A.T. Kearney will help the state to better leverage the estimated $4.9 billion it spends for goods and services into buying power, based on economies of scale and proven and reliable procurement best practices. The contract model recovers the full cost of the initiative directly from the resulting savings that will accrue to the state.

41 For the announcement of the California Performance Review Bulletin recommendations and proposed changes, see “Governor Schwarzenegger’s ‘California Performance Review’ Report Proposes Sweeping Changes to State Procurement Practices” (available at http://sdm3.rm04.net/servlet/MailView?ms=MjcxMjQ1S0&r=NjQ0OTQwMjY5S0&j=NDQwMjA0NQ82).

Other States Have Leveraged Strategic Partnerships and Best Value Contracting

**Massachusetts**
- Reformed procurement policies and procedures to empower departments to procure goods and services at best value
- Handbook states: "...higher quality may be more cost effective over time when compared to a lower quality, less costly procurement. Long-term investments, as appropriate and necessary, and long-term value are also important considerations beyond cost...."  

**Missouri**
- Statutory authority to award to the "lowest and best" bid/proposal
- Contracted a vendor to serve as the "single point of contact"
- Prices and product offerings automatically change with the market
- Contract performance monitored and measured against mutually agreed-upon goals
- Saved the state approximately $10,000,000 over five years

**New York**
- New York's procurement statute was amended in 1995 to "best value" or "low price."
- "Low price" in the new statute, includes far more than just the cost of an item or service
  - Administrative, training, storage, maintenance, delivery, life span and life-cycle cost factors

**Texas**
- Best-value IT procurements since 1993, including evaluation criteria
  - Life-cycle costs, employee productivity improvements and vendor performance

The National Association of State Chief Administrators (NASCA) and the National Association of State Purchasing Officials (NASPO) have also cited many other states for their innovative purchasing practices, including innovative service contracts for information technology and computer support, an area in which volatility in pricing and rapid changes in the industry make managing contracts very expensive and time-consuming.

Many examples of strategic partnerships between state governments and vendors, problem-oriented bidding, and best–value purchasing are described by a NASPO report on innovative procurement strategies. Focusing on best value also includes measurements of life-cycle costs. Government examples of best-value purchasing include the following excerpts from a NASPO whitepaper “Who's Doing Best Value”:  

“The Commonwealth of Massachusetts recently reformed its procurement policies and procedures. The changes empower departments to procure goods and services at best value. Their handbook states: ‘...higher quality may be more cost effective over time when compared to a lower quality, less costly procurement. Long-term investments, as appropriate and necessary, and long-term value are also important considerations beyond cost.’”

“Missouri has applied best value consideration for years in its procurements in accordance with the statutory authority to award to the ‘lowest and best’ bid/proposal. In applying best value consideration, the state considers various criteria such as technical capabilities and contractor support, method of performance, experience and reliability of a company, qualifications of individuals proposed for a project, life-cycle costs, and other information learned while evaluating proposals.”

“The state of New York's procurement statute was amended in 1995 providing agencies the statutory authority to contract for services and technology on the basis of "best value" or "low price." Even "low price" in the new statute, includes far more than just the cost of an item or service, for example: the administrative, training, storage, maintenance, delivery, life span and life-cycle cost factors.”

“The state of Texas has been applying best value to its information technology procurements since 1993. The evaluation criteria include life-cycle costs, employee productivity improvements and vendor performance.”

In addition,

“Value-based procurement was implemented in New Mexico as a standard for Information System Technologies in the mid 1980's. An electronic library has been established with both procurement documents and contracts. Quality assurance improvements have been added with document preparation assistance and document review prior to issuance, enhancing the quality assurance review process. Real time procurement consultation is provided throughout the procurement process. These improvements are accompanied by procurement manager and evaluation committee member training for every procurement as an integrated step in the procurement process.”

and the National Association of State Directors of Administration and General Services (NASDAGS).
The federal government’s efforts to reform acquisition practices have led to a large number of improvements at the federal level. The above chart summarizes some recommendations for best business practices at airports from the Federal Aviation Administration (FAA) and the Office of the Secretary, Department of Transportation. These items include a number of recommendations on terminal leasing between airport authorities and airlines.44

General Accounting Office (GAO) reports on best practices include a report on the acquisition of services, which recommends securing up-front commitment from top leaders; obtaining improved knowledge on service spending; creating supporting structures, processes, and roles; and sustaining leadership, communication, and metrics.45 Another GAO report describes how to use a spend analysis to implement strategic procurement; it recommends compiling and culling data across the entire organization, organizing it into commodity and supplier categories, and

---

analyzing cost cutting, streamlining, and supplier-reduction opportunities.46

The United States Postal Service (USPS) provides an interesting model for the proprietary departments. The USPS, as described by Leenders et al. (2002), is “a quasi-governmental organization, operating under an 11-member Board of Governors. It is self-supporting through the sale of its services.”47

"Under the Postal Reorganization Act of 1970, USPS is permitted to establish its own procurement rules and regulations, operating like a private business. It is exempt from many of the laws, regulations, and executive orders pertaining to federal procurement, such as the Competition in Contracting Act and its policy of 'Full and open competition.'"

The USPS’s purchasing philosophy is built on four guiding principles, stated as follows:

1. We make our requirements known to the marketplace.
2. We tell suppliers how we will evaluate proposals.
3. We award contracts on the basis of best value for our purchasing dollars.
4. We promote economic development in the community we serve by providing access to small, minority, and women-owned businesses.

"As a quasi-governmental organization, the USPS purchasing and materials section tries to combine private-sector innovations and efficiencies with public-sector focus on fairness and accountability of a public agency."

Department of Defense (DoD) acquisition reform is another example of a federal initiative, which addresses the DoD’s concerns over job losses and public-private competition. According to Lucyshyn and Gansler (2004), “In examining DoD data, it is clear that much of the claims of the negative impact of competitive sourcing on federal employees are unfounded.48 A

comprehensive study by Hill (2004) is summarized, “The study examined data from all Defense Department competitive sourcing competitions conducted between 1994 and 2003 – about 1,200 total. . . . Cost savings were significant: $11.2 billion, or 44 percent of baseline costs. Relatively few people were laid off: only 5 percent of employees subjected to a competition. And although contractors won 56 percent of all competitions held over the 10 years studied, the tide turned sharply in recent years. By 2003, feds won twice as many as contractors did.”

During our search of public- and private-sector best practices in purchasing, we found three surveys of government purchasing that may provide some benchmark examples. We did not have time or resources to conduct a benchmarking survey or analysis, and the surveys cited do not necessarily reflect best practices. However, the proprietary departments should view all opportunities to benchmark as being potentially important tools.

The Center for Advanced Purchasing Studies (CAPS) has two benchmarking surveys of interest. Their survey of municipal government purchasing includes input from the Council-controlled Los Angeles departments (the non-proprietary departments). It shows that the purchasing function at over a third of respondents is centralized and the remainder is a mix of some centralized purchasing and some decentralized purchasing at major operating divisions or locations. The

50 See http://www.capsresearch.org/.

51 Centralization of purchasing is typically best for maximizing leverage and minimizing total costs. However, individual business unit may have unique needs that are not amenable to centralization. It is important to note that even in a centralized purchasing model, key stakeholders are included on the procurement team for complex purchases.
move toward centralization is cited as one of three trends in Leenders et al. (2002): “Procurement reform in public purchasing is occurring at all levels – federal, state/provincial, and local (counties and municipalities). . . . Three evident trends are centralization, privatization, and the adaptation of commercial business practices to public purchasing.”

Of municipal governments with programs to increase participation of minority and women--owned businesses, the CAPS survey shows that twice as many municipal governments have set-aside programs as have price-preference programs. The City’s program is an outreach program; however, LAWA has for at least some of its RFPs and bids implemented a subcontracting requirement—i.e., a set-aside program. The City’s support for small, local businesses is implemented as a financial preference program.

CAPs has also conducted a benchmarking survey of purchasing by utility companies (not including the DWP). The survey data show that more than half the utilities’ purchasing groups report to individuals below the top-executive level. This is in contrast to the best performers who have elevated the purchasing function, or even designated strategic positions, such as a Chief Procurement Officer. And more than half the utilities have a formal supplier-evaluation and supplier-rating system.

The Aberdeen Group recently conducted a survey of supply management in the public sector. They surveyed 250 federal, state, county, local, and defense agencies. One of the key findings was that “complying with procurement regulations” is a primary driver of public sector supply management strategies. The report concludes, “Optimizing value from the procurement function will require government agencies to emulate total cost management (TCM) strategies employed by private sector firms.”

---

For low-risk, low-value commodity purchases that are common across the enterprise (e.g., office supplies), centralization is usually optimal.


53 Aberdeen Group (May 2004).
The Aberdeen Group survey (Aberdeen Group, 2004) reported that government agencies have significantly longer purchasing cycles than the cycles common among private-sector firms. Today, commercial firms excel at strategic purchasing because corporate survival depends on successful strategic partnerships. Many companies have outsourced entire functions, as evidenced by the growth of contract manufacturing to parts of the world with lower labor costs. Third–party providers also typically handle service support, warehousing, distribution, and other logistics functions.

Supplier management is increasingly important for firms that depend on strategic partners. Toyota’s legendary cooperative supplier relationships are said to give the automaker a $2,000 per automobile advantage in production costs over U.S. auto companies. With 80% of those costs in purchasing, Toyota enjoys roughly a $1,600 per auto advantage due to supplier management.

---

Governments are not the only enterprises that strive for socioeconomic benefits in their purchasing, although one important difference between government and industry should be noted. The costs and benefits of social programs may accrue to different stakeholders for government initiatives. That is, City departments follow regulations and requirements, to benefit taxpayers, small local businesses, or other organizations. Still, there are similarities, as Leenders et al. (2002) state, "... government buying basically does not differ from industrial purchasing. The same concepts of good supply management ... are applicable and should be followed to obtain maximum value for public dollars spent." Corporations must also be accountable and transparent to their Boards and shareholders. According to the American Express Senior Vice President for Global Procurement Rion Needs, "In order for global procurement to meet objectives of the company’s businesses, it’s important for purchasing professionals to run an integrity-based operation that maintains objectivity, and communicates well the rationale and purpose for its activities." These similarities make it worthwhile to examine private sector initiatives to learn how other organizations implement similar goals.

The efforts of Gillette and other leading corporations to develop and mentor minority-owned business enterprises are described in several Institute for Supply Management (ISM) reports. Leading companies such as Hewlett-Packard (HP) have conducted spend analyses to rigorously analyze their organizational spending and to help identify opportunities for improvements. Good management of institutional knowledge can also provide a strategic advantage for a company. For example, HP documents its market analysis from one purchase so that it can use it again for a future purchase.

---

55 Leenders, Michael R., et al. (2002), chapter on “Public Purchasing.”
56 Avery, Susan (2004).
57 The Institute for Supply Management has numerous reports on diversity issues. See http://www.ism.ws/SiteSearch/search.cfm?Keyword=Diversity.
These practices are amenable to public entities. Benchmarking supplier diversity programs can yield best practices for accomplishing the programs’ socioeconomic goals. During the market research process, firms search broadly for high-quality minority suppliers (e.g., through the National Minority Supplier Database and internal databases). Supplier development improves the competitiveness and growth potential of these small businesses and is used in lieu of price preferences. Commercial firms work with Tier 1 suppliers to develop Tier 2 opportunities for small businesses. In addition, another practice links minority sourcing to past performance—a process that mirrors selection for all contracts. The Small Business Administration (SBA) has a number of programs to assist small businesses without preferences, such as mentor-protégé programs that link small business to larger businesses that help them improve.
From our survey of best practices in contracting and purchasing in government and industry, we have identified steps toward a rigorous strategic sourcing process. The above chart contains an eight-step strategic sourcing process, which is a synthesis of different strategic sourcing processes in the literature. Each of these steps is discussed in detail in Appendix B.

A rigorous strategic sourcing process can provide the transparency and accountability that the departments were criticized as lacking in the controller’s audits. Conducting a rigorous analysis of past and current spending, and current and future needs, is part of a thoughtful and deliberative contracting process. It includes steps to analyze the supply market and industry suppliers, and steps to develop a sourcing strategy that makes purchasers knowledgeable and informed buyers. Utilizing a highly skilled, cross-functional sourcing team brings objectivity and internal reviews to the evaluation and supplier selection. Beyond implementing and executing agreements, measurement of contractor

60 The number of steps in the specific strategic sourcing process that enterprises use can vary from as few as five to seven, eight, or more. Some of the steps can be done in parallel—work can start in a subsequent step before the previous step is completed.
performance and use of past performance in future contracts helps to monitor and to provide oversight controls for contractors.

**Tactical ⇒ Strategic**

**Reactive ⇒ Proactive**

**Lowest Price ⇒ Best Value**

**Regulatory Compliance ⇒ Most Efficient**

**Adversarial ⇒ Cooperative**

---

This process differs from that used by the proprietary departments, as outlined earlier in this report, in its focus on analysis and rigorous understanding of past and current spending prior to development of a formal RFP or bid requirements. This is more than a difference between the individual steps or tactics of a traditional purchasing organization and those of best performers. As shown in Figure 2, the characteristics of a rigorous strategic sourcing process differ along a number of dimensions from our review of contracting best practices. As stated earlier, the best performers are strategic, proactive, focused on best value and efficiency, and develop a cooperative relationship with suppliers. Each of these dimensions is discussed in detail in the following pages.
Over the past two decades, continued outsourcing has increased the importance of purchased goods and services and of suppliers. Through benchmarking other enterprises, they learned that some enterprises had significantly reduced the cost and improved the quality and delivery of their purchased goods and services.

Consequently, many enterprises elevated the importance and capabilities (e.g., skills) of their purchasing function, linked its objectives to their strategic goals, and charged the organizations with changing how purchased goods and services were acquired to better support the entire enterprise (Moore et al., 2002). To elevate purchasing functions, some organizations have established Chief Procurement Officers (CPOs) or linked the responsibilities of their purchasing organizations directly to the senior leadership. One of the first things enterprises often do when they take a more strategic approach to their purchasing is to assess enterprise-wide opportunities to improve. They begin by assigning an enterprise-wide cross-functional team to analyze, group, segment, and prioritize total spending. The team documents and analyzes total enterprise spending by

\[ \text{Shift Tactical Contracting to More Strategic Purchasing} \]

- Elevate importance of purchasing activities
  - Improve personnel skills/education/positions

- Establish cross-functional teams
  - Analyze, group, segment, and prioritize total spending
  - Document the current supply base
    - Capabilities, capacities, performance
    - Identify prospective supply risks

- Automate administrative tasks

- Increase analytic rigor of strategies and decisions
  - Require that they be data driven

---

61 For many enterprises, purchased goods and services went from less than a third of their budget to more than two-thirds and sometimes much more than two-thirds of their budget.
category groups and sub-groups (i.e., spend analysis). They also
document the current supply base’s capabilities, capacities, and
performance, and identify prospective supply risks.

Risk management—the art of reducing uncertainty where possible and
increasing the number of options for dealing with surprises—can only be
conducted from a high-level, strategic review of an organization’s
purchasing activities. The environments in which LAWA, Port, and DWP
operate have shifted in recent years due to 9/11, the global economy, and
deregulation. Some commercial firms have taken a “portfolio approach”
in cutting risk, allowing leaders to diversity and spread the risk over a
number of options.62 (A risk assessment of the City of Los Angeles’s
purchasing was beyond the scope of this research.) However, it is clear
that elevating purchasing functions for an overall and strategic view is
required.

These enterprises also realized that the traditional purchasing/
procurement process reacted to a user need and that purchasing personnel
did not have the time or take the time to rigorously and analytically do
supply planning, refine requirements, develop a contract strategy, select
suppliers, and finalize the contract.63 Instead, purchasing personnel spent
the bulk of their time (a ratio of about three to one) on administrative
tasks that can now be automated, such as inspecting, monitoring,
matching invoices, cleaning data, expediting, and firefighting (Steele and
Court, 1996). Thus, they needed a more proactive strategic approach to
purchasing, but where should they start?

62 Billington, Corey, “HP Cuts Risk with Portfolio Approach,” Purchasing, February 21,
2002, p. 43.

63 See for example, Raedels, Alan R., The Supply Management Process, Institute for Supply
John, The Management of Business Logistics, A Supply Chain Perspective, 7th Ed., Mason,
Because some purchases are more valuable to an enterprise than others, and because some items are much easier to purchase than others, enterprises often segment the various groups and subgroups of purchases by some measure of vulnerability and value to the enterprise (i.e., a 2 x 2 matrix) to better match limited resources to prospective opportunities and risks. Typically, groups of goods and services that are of high value and high vulnerability, often called “strategic” goods and services, receive the most attention, resources, and highest-skilled personnel, and those goods and services with the lowest value and vulnerability, often called “generics,” receive the least attention and less-skilled and less-experienced personnel to purchase and manage them. Those goods and services with mixed levels of vulnerability and value (i.e., those with high vulnerability and low value, often called “bottleneck” goods and services, and those with low vulnerability and high value, often called “leverage” goods and services) typically receive some level of attention and resources falling between the two extremes (Steele and Court, 1996). Further, very different types of supply strategies and e-commerce approaches are often applied to the four different segments of goods and services. For example, for strategic goods and services, the key criterion is long-term availability, the goal is to carefully manage the supplier, and the time horizon is up to ten years, whereas for generics, the key criterion is for functional efficiency,
the goal is to minimize attention to routine activities, and the time horizon varies but is typically 12 months (Carter et al., 1999, and Steele and Court, 1996).

The following recommendations are synthesized from our search of best purchasing practices:64

- Link purchasing activities to strategic goals
- Develop knowledge of current and future requirements for all key goods and services groups
- Develop knowledge of current contract details (e.g., expiration, terms)
- Analyze spending for key goods and services groups and for key suppliers
- Develop in-depth knowledge of industries and supply markets for all key goods and services groups
- Develop a supply strategy for key goods and services groups
- Estimate the total costs of ownership
- Develop and maintain a supplier--performance database

Document the source selection for knowledge management (e.g., using prior analysis to make better future purchases).65

64 The search included a review of Leenders (2002), Carter et al. (1999), and Steele and Court (1996).

65 There are many definitions of “knowledge management,” and many of those involve use of IT systems and data mining. We use the term here more broadly, referring to the strategies and processes of identifying, capturing, and leveraging knowledge to enhance competitiveness (adapted from the American Productivity & Quality Center.)
Leading enterprises have learned that price is only one component of the total cost of a purchase. Thus, they rigorously determine the total-cost components of purchases and use that information to drive supply strategies and supplier selection and evaluation. For example, purchases of relatively low-cost and low-risk commodities, such as office supplies or facilities maintenance, repair, and operations supplies, are often consolidated into one or a few preferred-supplier contracts, which enable Web-based purchases using government purchase credit cards off pre-negotiated agreements. Innovative enterprises also know that suppliers that perform poorly add significant costs to a purchase. Hence, these enterprises also include rigorous supplier-selection criteria in their work and supplier evaluations to weed out very costly and/or poor-performing suppliers.

Supplier value must be validated through the combined use of market analysis and economic “should cost” models. For low-risk commodities, such as office supplies or air travel, market-testing tools, such as “web scrapers,” might be an effective solution to test price effectiveness over time. For example, the Talaris Corporation makes software tools for low-risk “employee business services” (package shipping, travel, and such). For high-risk commodities, valid activity-based costing models are a requirement. These models are especially important for labor-based services and outsourced functions.
Leading enterprises also understand that the administrative burdens that they place on their suppliers drive up supplier costs and, hence, the prices buyers pay and affect their attractiveness and value to prospective suppliers. Buyers, as well as suppliers, need to be easy to do business with. Hence, leading buyers continually evaluate the total cost burden (both internal and to suppliers) of each and every administrative and regulatory requirement, such as bidding and reporting requirements and socioeconomic goals for small, minority-owned, and women-owned businesses. One way some government organizations help to ensure that administrative/regulatory requirements do not become too onerous is to add “sunset clauses” to some regulations, so that they expire if not automatically renewed.

Leading buyers also evaluate the effectiveness of their policies at attaining their desired goals and adjust them if they observe unintended outcomes. For example, government bid price preferences for small, local business suppliers have led to the creation of a “cottage industry” of pass-through suppliers that exist only by marking up and selling to government the products of other, often non-disadvantaged, and much larger suppliers. Such supplier relationships typically benefit only the business owner and do not provide the employment benefits that are often the intention of small business support programs. Leading commercial companies have
programs to develop and mentor their small, minority-owned, and women-owned business suppliers. They help their disadvantaged suppliers to improve and grow by implementing developmental and mentoring programs, enabling those suppliers to successfully compete without price preferences.

Many enterprises have learned that you cannot inspect quality into a process (Zangwill, 1994, Trent, 2001). Thus, they carefully design their sourcing processes to produce high-quality outcomes. They understand the cost in time and resources of frequent administrative reviews and have set review thresholds high enough to avoid most of those costs. However, they do not do so without carefully auditing the purchasing process to ensure that it is designed to produce quality outcomes, continually measuring its performance, and periodically re-auditing to insure that it is still in producing high-quality results. They also make personnel involved in the purchasing process accountable for poor outcomes. In addition, they select suppliers for the quality and reliability of their processes as well as for the quality of their products because the production of high-quality goods and services depends on high-quality processes. However, these enterprises continually measure supplier performance and test the market to insure that suppliers are continuing to provide the cost effective quality, delivery services, and value that they need.
Leading buyers have learned that by working with their best suppliers they can reduce costs and improve the performance of their supply chains. One of the most famous examples of such an arrangement is Wal-Mart working with suppliers such as Proctor and Gamble to directly and electronically link point-of-sale customer-purchase information back to those suppliers, which in turn is used for production, replenishment, and supplier payment. Leading automotive manufacturers such as Toyota also share production data with key suppliers. Establishing such close working relationships with key suppliers requires mutual trust, which develops only over time as buyers and suppliers get to know and trust one another. Further, through increased dialogue with suppliers, many buyers have learned about costs that they inadvertently place on their suppliers, and vice versa. Further, trust promotes relationships in which the buyer can work with the supplier to take costs out of the end-to-end supply chain and share best practices for improving internal production and support processes. In some instances, such relationships have developed to the point that buyers and suppliers share technology roadmaps for products and their strategic plans. Such high levels of mutual trust can be fostered only if both the buyer and seller protect each other’s proprietary information.
Cooperative purchasing is particularly well suited to tailored goods and services, as well as to contracts requiring specific product knowledge. As a result, it should be expected that most spending categories and suppliers will not be part of these collaborative programs. A rigorous, fact-based sourcing process would ensure that the City of Los Angeles’s proprietary departments are not bound to a suboptimal supplier. Elements of this process would include careful supplier selection, extensive market research, and performance incentives. Performance metrics must be specified and monitored. Continuous market research verifies that the supplier remains the best choice for the department.

Protecting suppliers’ proprietary information can be particularly challenging for government organizations seeking transparent processes. However, the federal government and other governmental organizations have found ways to protect this information while providing as much transparency as possible and not violating the trust of suppliers. Such information can be marked confidential, stored in a way that access to it is strictly controlled, and provided only to individuals who have a need to know, similar to the way that government handles sensitive security information.
Earlier, we discussed how LAWA, Port, and DWP contract today. And we just outlined best contracting practices from innovative government and commercial enterprises. This final section discusses which practices would make the most sense for the proprietary departments of Los Angeles, and how the departments may improve their contracting practices.
The left and center columns of the above table list key Los Angeles City Charter and Administrative Code requirements and their current implementation, which presents challenges to the proprietary departments. The right-hand column lists the sort of best practices that innovative business enterprises are using to address such challenges.

Instead of always selecting the low-price bid, innovative enterprises are moving towards best-value selection criteria. These criteria are rigorously calculated through analysis and understanding of the total life-cycle costs of contracts, particularly those that involve maintenance or ongoing costs, and the transition costs from moving from one supplier to another.

They are also moving away from price subsidies for small businesses to mentoring and supplier-development programs. When they contract with small and disadvantaged businesses when it makes good business sense, leading enterprises also can leverage buying power through consolidation and strategic sourcing initiatives. According to Leenders et al. (2002), “This practice [local-biller preferences] is opposed by most purchasing professionals as being non-competitive, which means that higher prices are paid for purchases than are necessary. It negates the advantages of economic specialization, and the local supplier, knowing that such a preference is to be applied, will have a tendency to submit a bid that is...”

### Efficient Enterprises Have Addressed Each LA-Specific Issue That We Noted Earlier

<table>
<thead>
<tr>
<th>Requirements</th>
<th>Implementation</th>
<th>Best Practices</th>
</tr>
</thead>
<tbody>
<tr>
<td>“Low bid” requirement</td>
<td>• Awarding lowest price doesn't always mean lowest total cost</td>
<td>• Moving toward best value</td>
</tr>
<tr>
<td></td>
<td>• “Responsive” and “responsible” are interpreted as minimal supplier requirements</td>
<td></td>
</tr>
<tr>
<td>10% bid preference for small business</td>
<td>• Created cottage industry of one-person, “pass through” firms</td>
<td>• Moving away from financial preferences toward supplier mentor and developmental programs</td>
</tr>
<tr>
<td></td>
<td>• Discourages strategic sourcing, where economies of scale bring value</td>
<td>• Consolidating contracts to leverage buying power</td>
</tr>
<tr>
<td>Socioeconomic policy requirements on vendors</td>
<td>• Discourages some bidders, increases total costs</td>
<td>• Conducting periodic total cost/benefit reviews, sunset clauses</td>
</tr>
<tr>
<td></td>
<td>• Increases Departments’ administrative workload</td>
<td>• Automating process and pre-qualifying vendors</td>
</tr>
<tr>
<td>Dollar levels for Board and City Council reviews</td>
<td>• Kept pace with inflation?</td>
<td>• Streamlining routine and low-risk reviews</td>
</tr>
<tr>
<td></td>
<td>• Encourages multiple, small contracts that are below review threshold</td>
<td>• Moving toward Board audit of the process rather than review of individual decisions</td>
</tr>
<tr>
<td>Economic, Feasibility, and Selection Analysis</td>
<td>• Conducted to satisfy requirement</td>
<td>• Benchmarking in-house performance with industry</td>
</tr>
<tr>
<td></td>
<td>• Done for protection from challenges</td>
<td>• Documenting for strategic knowledge management</td>
</tr>
</tbody>
</table>

* RAND 40 November 2004*
higher than it otherwise would offer. If one believes in totally fair, open competition, then all suppliers, regardless of location, should be permitted to compete solely on the basis of their ability to provide maximum value for the public funds expended. The National Association of State Purchasing Officials has gone on record as strongly opposing local preference laws.\textsuperscript{66}

Implementing socioeconomic policy through procurement is common with all government contracting. The message from leading companies is that there can be better, more effective ways to support socioeconomic goals than price preferences. The City may re-evaluate all policies based on their total costs and benefits.

Streamlining routine functions is a major efficiency initiative everywhere. Time is money, and reducing process delays can quickly reap benefits. This includes leveraging IT systems to automate administrative tasks wherever possible, and to pre-qualify vendors to shorten processing steps when complex requirements arise.\textsuperscript{67}

High-value and high-risk contracts will always require high-level review; however, leading firms take steps to make these reviews as streamlined as possible. By streamlining reviews of routine and low-risk actions, analysis and reviews can focus on higher-dollar-value and higher-risk contracts. The review roles may also need clarification, to emphasize auditing the contracting process, rather than reviewing individual decisions.

Finally, leading firms constantly measure performance in a rigorous and data-driven fashion. They benchmark themselves against leading enterprises, from the public or private sector. And they use that data and information to guide future activities. Institutionalizing knowledge management, such as leveraging prior analyses to better inform future purchases, is a goal for leading firms.

\textsuperscript{66} Leenders et al. (2002), p. 612.

\textsuperscript{67} Programs for prequalification should be designed carefully so as not to overburden staff at either the Bureau of Contract Administration or the proprietary departments. We heard an experiment of prequalifying vendors, for which the annual certification had City staff and vendors in constant renewal cycles. Another more successful implementation enabled pre-qualified scientific firms to responsively perform time-sensitive environmental impact studies.
This RAND analysis and report reviewed purchasing, contracting, and leasing activities at the Los Angeles proprietary departments of LAWA, Port, and DWP. Like many government entities, their processes and practices resemble those of a traditional purchasing organization. And many symptoms of traditional, tactical, and reactive organizations that are present in the proprietary departments were cited in audits from the Controller.

We observed a number of excellent practices at each department, but they are largely the result of excellence from individual initiative rather than departmental policy. Transforming an entire department toward a more strategic, proactive, effective, efficient, and cooperative approach will provide greater benefits to the City and its residents.

We discuss each of the five recommendations listed above in more detail. They provide first steps toward better procurement, while addressing current concerns.

Procurement is process-driven, and problems with procurement should be addressed through process improvements focused on maximizing value. At the same time, intelligent investments should be made in appropriate controls (detection, prevention, and correction of process errors). Changing the procurement process may call for continuous-improvement
programs, rather than one-time directives. Adopting a formal procurement risk-management approach must include reevaluating and readjusting the contracts portfolio over time.

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 require focused leadership at the proprietary departments and partnerships with City leaders across Los Angeles. Fundamentally changing “low-price” purchasing to “best-value” purchasing requires developing the analytic skills necessary to rigorously evaluate value and working with the City Attorney’s Office to properly justify contractor selection. The mayor appoints Commissioners to the Boards of the LAWA, Port, and DWP, so the Mayor’s Office should be involved in conveying goals and clarifying governance roles to facilitate the changes that are underway.

Changing the roles of proprietary department staff, officials, and Commissioners will not be fully successful without the supplier base completely understanding these changes. As such, all City officials must participate in communicating the message of how to best do business with the City. This communication includes explaining both the intent and implementation of City requirements, so that regulations can be met in the most streamlined and efficient manner possible. Outreach to all suppliers, including small, local, minority-owned, and women-owned businesses, on how good performance and best value will be measured and evaluated will bring benefits from aligning the expectations of the City and its suppliers.
Where should the proprietary departments start in transforming their traditional contracting roles and purchasing functions? A sizeable increase in staff headcount or resources is unlikely. Thus, the first step is to free up personnel time, so that staff can focus on higher-value and higher-risk contracts. This step includes streamlining and automating as many routine purchasing activities as possible.

Clarifying the purchasing process to all stakeholders is a necessary step toward increased transparency and efficiency. This step includes a better understanding of the purchasing process by the proprietary departments themselves. While segmenting contracts by dollar value is done regularly, lower-risk and higher-risk contracts need to be segmented and better understood. Enhanced internal understanding of all contracts will lead to a better definition of goals and more clearly defined processes and selection criteria.

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. This will help attract the best providers who may have avoided City contracts due to bureaucratic rules and regulations. This last point on reducing bureaucracy does not necessarily mean opening up opportunities for fraud. We are not saying there should be
less documentation or analysis. To the contrary, we believe there should be better documentation and analysis to support the departments’ own knowledge management and benefits. This point speaks to balancing fraud-prevention measures and red tape—a dilemma requiring many efforts at all levels of government to solve. Skilled purchasing staffs, such as those who can identify bid proposals that are either too vague or too restrictive, are needed. Consequently, this skill set calls for a very experienced and highly professional purchasing organization.

A balance between oversight responsibilities and efficiency should also be a goal of Board and Council reviews. As the data show, many purchases are made for amounts that at or just below review limits, and staff reported that this is a product of their trying to achieve timeliness and efficiency, rather than circumventing authority (as we noted earlier, nearly all Board and Council reviews are eventually approved). Delays resulting from lengthy reviews may hinder the department’s ability to get a job done. Any opportunities to improve the efficiency of review processing may also reduce the need to adjust dollar limits.

Clarifying and streamlining the process is most easily begun from within the departments in a two-pronged effort: (1) purchasing staff identifies those purchases that are low-risk or routine and that could be streamlined and automated, and (2) department managers categorize those high-value and high-risk contracts that are the most critical and important to the organization. As these efforts to categorize the department’s contracts spending proceeds, staff and management will be in a better position to understand the requirements of each.

Additional management and governance focusing on higher-value and higher-risk contracts and purchases is an important goal of this effort. Risk management should explore options, such as whether contracts should be structured as being long-term or short-term, and possible risk sharing between the City and cooperating suppliers. Department leadership and the department Board should examine formalizing risk management and evaluating procurement options.

Clarifying the bidding requirements for the marketplace and telling suppliers exactly how proposals are evaluated benefit both routine and critical purchases. Low-risk commodities and supplies may be sourced

---


efficiently to providers who best understand and respond to the requirements. On the other end of the spectrum, high-value and high-risk contracts benefit from the additional analysis, the categorization process, and identification of exactly what factors make a purchase critically important. The contractor selection also benefits from increased transparency, because award justifications may be documented more rigorously.
We recommend that the proprietary departments shift toward selecting suppliers based on best value rather than low price. Selection based on value must be done rigorously, however, and not subjectively. This requires more analysis and documentation than a low-price selection would require to be defensible. 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. This includes measuring the administrative “costs” for transitioning from one supplier to another to help determine the proper lengths of contracts. It also includes assigning values to prompt and accurate service and provider responsiveness. Many current contracts for installation, delivery, construction, and engineering services are selected through low-bid procurement that neglects value-added qualities that could be justified based on an analysis of total costs.

While other cities have modified their statutory code to allow for best-value procurement, the Los Angeles Charter seems already to contain provisions that enable awards to be made based on performance and total cost. Beyond the “responsive and responsible” language, the Charter already contains requirements to award the bidder “furnishing satisfactory security for performance” with the determination made “on the basis of the lowest ultimate cost.”
Current contractors will have a proper incentive to perform well, if there is the 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.

Using performance data in contractor selection naturally leads to greater measurement of all contractor performance. This expanded measurement especially helps monitoring and oversight of problem contracts and contractors. If the contract language or terms are problematic, they can be revised to the benefit of the City. Poor performers are also likely to bid less frequently, after it is made clear that a rigorous selection includes weighing of supplier performance.

Because the departments have so much history in selecting contracts based on “low price” as the sole criterion, this shift toward “best value” will require additional effort and collaboration among several City organizations. If criteria beyond price are important (such as the contractor’s on-time performance, experience, timeliness), the departments may opt to switch some contracts that were issued previously as bids to a request for proposal (RFP) process, for which the departments already have experience with scorecard evaluations. Moving bids to RFPs may not be the best option, however, for purchases for which potential suppliers traditionally use a bid process. For these bids, the departments internally must develop clear criteria beyond low price and rigorous analysis for measuring value.

Externally, both the supplier base and the City Attorney must be brought into the process in order to develop clear criteria and defensible justifications for contractor selections—i.e., contracting transparency. An economic and activity-based costing model may also benefit from Controller review prior to contracting as part of a rigorous analysis of value and risk, and formalized process-focused controls.

The American Bar Association’s (ABA’s) 2000 update on the Model Procurement Code for State and Local Governments may assist in this effort. According to the ABA, this update “brings the previous (1979) edition of the Code to the forefront of leadership in good procurement practices. The Year 2000 Revisions update the provisions to provide for electronic communications, extend the opportunities for cooperative

---

purchasing among state and local governments, add flexibility to procurement methods, and add design-build, design-build-operate, and design-build-finance-operate to the menu for delivery options.” The underlying policies and purposes of The Model Procurement Code for State and Local Governments are stated as follows:

a. to simplify, clarify, and modernize the law governing procurement by this [State]

b. to permit the continued development of procurement policies and practices

c. to make as consistent as possible the procurement laws among the various jurisdictions

d. to provide for increased public confidence in the procedures followed in public procurement

e. to ensure the fair and equitable treatment of all persons who deal with the procurement system of this [State]

f. to provide increased economy in [State] procurement activities and to maximize to the fullest extent practicable the purchasing value of public funds of the [State]

g. to foster effective broad-based competition within the free enterprise system

h. to provide safeguards for the maintenance of a procurement system of quality and integrity, and

i. to obtain in a cost-effective and responsive manner the materials, services, and construction required by [State] agencies in order for those agencies to better serve this [State’s] businesses and residents.
Documentation should do more than satisfy requirements or protect contractor selections from being challenged. Market and industry supplier analysis should be conducted through a thoughtful and deliberative strategic-sourcing process, which provides valuable institutional knowledge that can be captured and preserved for improving future procurement, rather than conducting a market analysis from the beginning for each new contract.

The term “knowledge management” is frequently used to describe processes that capture, store, transform, and disseminate information within an organization, with the minimum goal of promoting efficiency and at most achieving innovation and competitive advantage. If data are captured in a manner that facilitates aggregation and more-strategic spend analysis, this can lead to a department-wide understanding of past and current spending. Trends in the data can also be used to identify current and future needs or requirements. This is a critical and necessary step toward many of the award-winning initiatives in the Los Angeles General Services department, and other city, state, federal, and commercial enterprises.

A centralized and searchable database of contracts, current and past suppliers, and supplier performance would benefit all City departments.
Therefore, collaboration among LAWA, Port, DWP, and the Council-controlled departments would be advantageous. Performing supplier and market analysis is clearly a staff function. But monitoring market prices could be done using sampling or Web-based tools as part of an effort to streamline and automate routine purchases. Ensuring that the analysis is used strategically to improve future procurement is ultimately the responsibility of department management and the Board.
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 associated with these requirements and sometimes-unintended consequences. Thus, periodic review of all requirements may better align intent and implementation.

For instance, a review of the 10% financial preference on contracts of $100,000 or less for bids from small, local businesses may raise the question of whether these businesses are meeting the intent of the Charter and Administrative Code. Are these firms growing, employing more people, or adding other value, as may be the original intent of the Charter? What tax revenue and community payrolls do the firms that benefit from these policies create?

What are the costs and benefits of other requirements, such as child care, good faith requirements for MBE/WBEs, and paying a living wage, for contractors wanting to do business with the City? Combined, are these requirements so onerous that some of the best providers are not responding to bids and requests for proposals? These questions are not to suggest that child care and a living wage are not important. But perhaps there are better ways to meet the intent of the original requirements.
The review requirements for contracts of specific value and length can be affected by inflation and changing industry practices and, hence, should be regularly reviewed. The large number of Board and City Council reviews suggests that the review requirements may be set too low. At a minimum, streamlining routine reviews should be a priority so that governance activities can focus on higher-value and higher-risk contracts.

This research highlights the need to review dollar and term limits, which trigger Board and City Council review. Adjusting these limits would require Council approval and more detailed analysis than is presented here. For instance, if commodities that have an open market are not likely to incur a loss of greater than 5%, the review of a $150,000 contract at most will place $7,500 at risk. Are costs of Board inspections and city controls likely to exceed this amount? Different contracts, leases, and purchases will have different levels of risk and dollar values. The proprietary departments and their Boards would benefit from conducting an analysis of their contract spending and periodically reevaluating risk-mitigation options. Such an analysis would also provide input into a discussion of adjusting dollar or term limits.

Some data that would be quite informative are not readily available. The departments should construct a database of Board-review and Council-review actions so that the various types of purchases can be examined in depth. Assessing the benefits and effectiveness of the City Charter and Administrative Code requirements seems to be a joint responsibility of the mayor and the City Council. This assessment should be conducted in collaboration with the departments, within which implementation issues can also be reviewed.
At a meeting of the Blue Ribbon Commission in September 2004, a Commissioner of the DWP spoke of the lack of training and orientation for the Board member role. To ensure the proper oversight role for purchasing, a training and orientation session to introduce Board members to their department’s duties and processes should be required.

Commissioners cannot be expected to be experts on all the commodities the departments purchase, the markets and industries involved in the purchases, 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 should know how to process leases. As such, the Board of Commissioners should concentrate on auditing processes rather than reviewing a large number of individual decisions. Orientation and training sessions for the Board, for both newly appointed and current members, would help to clarify roles and responsibilities. Because the end-to-end contracting process involves the City Attorney, Controller, and other city departments, these sessions would also provide a valuable opportunity to clarify contracting goals and processes.

In the past, Commissioners were allowed to serve on both supplier selection committees (or subcommittees) and to participate in awarding major contracts, either with or without proprietary department staff. The
mayor recently issued two executive directives prohibiting the participation of Commissioners on selection committees, which is consistent with federal practices (e.g., the military commander is typically separate from the acquisition-selection committee or team; by law, the senior contract administrator must be a civilian). A third executive directive allows for a subcommittee of a Commission to negotiate contract terms subsequent to a Commission’s approval of a contract so long as that participation is part of a public meeting. Consistent with these Executive Directives, subcommittees of the full commission may meet to review staff bid selection recommendations prior to their review and award by the full Commission, again as long as such subcommittees are convened at a publicly-noticed meeting.

The mayor appoints Commissioners to the Boards of LAWA, Port, and DWP; thus, the mayor could help early in defining Board responsibilities, i.e., to audit the process, not review decisions. The Board and Council may also participate in rebalancing fraud prevention (reviews) and fraud detection (audit selection of supplier that maximizes economic value). The City Attorney could also be involved in explaining the Charter and other regulations, as well as the implications of and expectations for City contracting. Following this orientation and training, the department management should present their strategic sourcing process, including spending segmented into routine and critical purchases. Clarifying an approach to streamlining some Board reviews so that governance attention may focus on higher-value contracts will build towards a more transparent contracting process.

71 The Goldwater-Nichols legislation directs that the acquisition function be placed under the control of the civilian leadership within the military departments.
The recommendations listed above for moving the Los Angeles proprietary departments toward best practices also address the issues raised in the Controller’s audit reports. Clarifying and streamlining processes to achieve best-value and performance-based supplier selection also serve to increase the transparency between the City and its suppliers. These improvements also free time for proactive industry analysis, making City purchasing officers smarter and more informed and contractor selection and award justifications more rigorous. Understanding the goals, requirements, and roles of all stakeholders in contracting for and purchasing and leasing of goods and services improves the contracting process at all levels of administration and review. Periodically reviewing implementation of the City’s goals in this area and measuring actual effectiveness and process efficiencies also aid in managing contracts post-award and improving administration of the entire contracting process. Finally, capturing rigorous industry analysis and deliberation on vendor selection will improve future contracting and secure the best value for contracting dollars for the departments, the City, and its residents.
APPENDIX A: ANSWERS TO BLUE RIBBON COMMISSION’S TEN QUESTIONS

The Blue Ribbon Commission formed by Los Angeles Mayor James Hahn focused on ten questions regarding contracting at the City’s proprietary departments. Of the ten questions, the Commission decided to address two of them (questions 4 and 7), which deal primarily deal with organizational roles and responsibilities. RAND focused its efforts on the remaining eight questions, which guided our interviews with department officials and staff.

1. Are there adequate written procedures governing the issuance of contracts?

At all the proprietary departments, RAND found that there were purchasing and contracting manuals that staff could refer to and use. These manuals contain detailed information about the City Charter and Administrative Code, and information on contracting requirements such as the dollar-value/contract-length limits that trigger Board or other contract review. At LAWA, an online “procurement wizard” helps to step users through the process. These manuals contain or can lead users to the various departmental forms that need to be filled out.

2. Are decisions for the issuance of contracts sufficiently “transparent” and visible?

The perception regarding a lack of contracting transparency at the proprietary departments stems from the varying levels of contract-award justification and documentation in selecting one RFP proposal over another. We reviewed a sample of contract-review packages that Board members would examine. For some contracts or agreements, such as the setting of airport landing fee rates or contracts for engineering/technical services, the packages were very thorough and included background, methodology, and a summary presentation of the analysis.

Other documented award justifications were less convincing, primarily those used in contracting for less “concrete” services (e.g., business consulting). Where multiple firms submitted proposals, the justifications in general recommended one firm and cited that one firm’s capabilities. The rationale for selecting one firm over another
was not provided in the examples we reviewed. While staff we interviewed stated that contractor-award deliberations always weighed the relative strengths and weaknesses of firms, “negative” comments on non-awarded firms are not documented. Purchasing staff stated that because City department documents are public record, negative statements may open the City to challenges or lawsuits.

The recommendations in this report address clarification of the contracting process, awards based on rigorous performance-based criteria and analysis of total cost, and better institutional knowledge management, such as use of analysis of past contracting to improve future decisions. These processes improve transparency by providing a better understanding of merit-based selection criteria.

3. Where written rules for contracting exist, are they followed?

Along the lines of the answers to the previous questions, the proprietary departments do have contracting manuals, and do follow the steps prescribed in them. The issue is the degree to which award justifications and deliberations are documented.

4. Is decision-making properly divided between the general managers and the Commissions?

This question was one of two the Blue Ribbon Commission elected to address. Nevertheless, in this report, we show that the department’s Board of Commissioners must review hundreds of actions per year. It is not likely or reasonable to expect that any individual Board member would be an expert on the range of commodities, equipment, leases, and services that may be the subject of review. An appropriate governance role for the Board would be auditing the contracting process and ensuring that steps, such as contract-award deliberation, result in rigorously justified award recommendations rather than reviewing individual decisions.

5. Are dollar sums and lengths of contracts set in the Charter, such as those specifying when Council approval is needed, appropriate, or in need of revision?

The dollar and time length limits set in the Charter result in hundreds of Board review actions annually. The City Council further reviews some of those decisions, approving most and rarely denying any. Given that limit before Board review is required is set at $150,000, and the departments contract for more than $1.3 billion of goods and services annually, implies that many reviews are of routine purchases. Another issue is whether the overall numbers of Board and Council
reviews are too numerous to allow proper governance reviews, in which case adjusting dollar sums and lengths of contracts may reduce the numbers of reviews. Streamlining the reviews for routine contracts may free up time for deliberation on higher-value or higher-risk contracts, whether or not the Charter requirements are revised.

6. Are provisions in the Charter requiring Council approval circumvented by contracts just under the dollar or duration limits or by requesting Council approval after the fact?

The data presented in this report show that many contracts and agreements are at or just below the limits. This appears to be more the result of a desire for greater efficiency than a deliberate circumventing of review for fear of denial (as Board and Council reviews rarely result in denials). If a contract is above $150,000, the department may be required to request Board approval three times. These reviews require considerable effort and constitute a substantial delay. The large number of contracts at or just below the limits seems more likely to be a response to a purchasing group’s need to get the job done and provide service to its customers.

7. What role does the City Attorney play in the contracting process? Is this the appropriate role and should it be changed?

This is the second question the Blue Ribbon Commission chose to address. In our interviews with department officials and staff, we learned that concerns stemming from contractor challenges and lawsuits affected the amount of contractor award documentation and justifications provided. As a result, documentation and justifications may seem to be limited even if the staff deliberations were significantly more involved. Department staff reported that the guidance of the City Attorney regarding what actions may or may not be defensible may have encouraged current practices, such as always selecting the low-price bid and omission of negative comments in documentation. The City Attorney’s review of contracts was also claimed to increase delays in issuing contracts.

On the other hand, staff from the City Attorney’s Office stated that their role was to review contracts for legality and not for whether they provided the best value or the best business rationale for a department. The City Attorney’s guidance is based on existing departmental documentation, which if not rigorously prepared or complete, may lead to delays in the City Attorney’s review and limit guidance toward more defensible contract awards.
8. Is there adequate compilation of information, or a system for identifying “problem contractors”?

Because the proprietary departments currently award the low-price bidder, contractor performance information is not rigorously documented for excellent, satisfactory, or problem contractors. Department staff stated that detailed performance documentation is limited to more extreme cases that may lead to disbarment, findings of non-responsibility, or firing of the contractor. This report recommends two changes to the current process—(1) that performance be measured and documented for all City contracts and (2) that the contractor performance data are used when awarding bids. This new process will encourage current contractors to perform well, discourage poor performers from bidding on City contracts, and help departments justify long-term relationships with their best providers.

9. Are Charter provisions followed concerning when outside contracting can be done?

The Charter requires that both economic and feasibility justifications be provided when hiring an independent contractor if City staff are available to perform the work. We observed that the department contracting manuals include the Charter requirement and forms that must be completed. We understand that the departments do conduct an economic and feasibility analysis, although we did not have time to review individual award documentation or assess the level of analysis conducted.

The context in which departments associated this requirement, however, seems narrower than might be expected. Departments immediately realized that this economic and feasibility analysis must be performed when their departments already had relevant in-house staff. For instance, each department has in-house engineering/technical staff that, on occasion, may need to be augmented to handle a surge in staffing requirements. Departments may not associate the requirement for analysis when other City departments outside the proprietary departments housed those capabilities. For instance, City janitorial and custodial services reside in the General Services Department. Staff at the proprietary departments were less clear whether the proprietary departments were even allowed to procure custodial services from General Services or were expected to conduct an economic and feasibility analysis regarding use of those services.
10. Are there sufficiently efficient procedures in place for the contracting process?

There are certainly some excellent examples of efficient contracting practices at the proprietary departments. However, they are typically tied to individuals and small initiatives. Board, Council, and City Attorney reviews need to be streamlined, along with the processes for routine, low-value, and low-risk purchases, contracts, and leases. A goal should be to free up purchasing departments’ time and resources to focus on higher-value and higher-risk contracts.
APPENDIX B: EIGHT STEPS IN STRATEGIC SOURCING

Key Factors that Distinguish Strategic Sourcing from Traditional Sourcing

- Direct link to enterprise’s strategic goals
- Multi-functional sourcing teams
  - Responsible, accountable, and measured by the quality of the outcomes
- Analytic rigor
  - Fact based, value focused, with all costs and risks explicitly considered
- Transparency
  - Well documented
- Knowledge management
  - Market/industry research, supplier performance

We reviewed a large number of examples of best contracting and purchasing practices and synthesized those examples into an eight-step process for a rigorous and strategic sourcing. The recommendations in this report are the first steps in its implementation. This appendix describes the key factors distinguishing strategic sourcing from traditional sourcing, and discusses each step in detail.

A number of key factors distinguish a strategic sourcing process from the traditional sourcing process. First and foremost is that the strategic sourcing process is guided by and tightly linked to an enterprise’s strategic goals. These goals shape the outcome of the process, i.e., the specific supply strategy as well as every step in the process including source selection and evaluation criteria.

A second key factor in strategic sourcing is that it is executed by a cross-functional sourcing team that includes highly-skilled purchasing, technical, and other key stakeholder personnel, including full or part-time
customer representatives, legal staff, and socioeconomic advocates, all of whom are responsible and accountable for and measured by the effectiveness and efficiency of the outcome.

Analytic rigor is the third key factor that distinguishes strategic sourcing from more traditional purchasing. Decisions about the sourcing strategy as well as supplier selection and evaluation are based on extensive analysis of the facts to the maximum extent possible.

A fourth key feature of strategic sourcing is the transparency of the process. The process and the analysis done at each step are well documented and serve to justify the sourcing decisions. At the same time, any proprietary data on suppliers are carefully protected, yet available to those with a need to know.

A fifth key factor of strategic sourcing is effective knowledge management. Current and past spending is well-documented and available for input to future sourcing decisions, as is extensive industry, market, and supplier research that supports past sourcing decisions. In addition, strategic sourcing continually monitors current supplier performance and scans and tests the market for any trends or significant changes that need to be incorporated into current supplier management and future supplier selection.
1. Spend Analysis: Understanding Past and Current Spending

- What has been purchased?
- How many purchases have been made?
- What is the total spend for each good and service?
- From whom has it been purchased?
  – Socioeconomic status of suppliers?
  – Percent of sales?
- How often is it purchased?
- What is the length of supplier relationships?
- What is the nature of the supplier relationship?

One of the first steps many enterprises take when shifting to strategic sourcing is to do a spend analysis to better understand past and current spending. A spend analysis often involves culling information from a number of different data systems to paint an enterprise-wide picture of what has been purchased and how many different transactions or contracts were used to make those purchases. The total spend analysis for each major category of goods and services, includes information on from whom the goods and services have been purchased, the socioeconomic status of each supplier, the enterprise’s percent of the supplier’s sales, how often purchases are made, the length of contracts/supplier relationships, and the nature of the contract/supplier relationship (e.g., fixed price, time and materials, award fee, arms length, partnership).72

A spend analysis examines purchases by product, commodity group, or service, dollar value, number of contracts, supplier, and purchasing organization. Other factors to examine include the frequency of purchases (i.e., how often the same good or service is bought), length of contracts, type of contract instrument (i.e., purchase order, blanket purchase

---

72 Awards fees are generally associated with saving the government total costs, and may be structured to share savings between the government and contractor.
agreement, purchase card, etc.), and type of contract terms (i.e., firm fixed price, award fee, etc.). A spend analysis also evaluates the supplier base by industry, firm, geography, risk, dependency, and socioeconomic variables.

It helps buyers identify key indicators of prospective opportunities to become more effective and efficient in purchasing goods and services and to minimize current risks. The opportunities a spend analysis identifies may include opportunities to leverage buying power by identifying corporate family relationships, interrelated suppliers, and duplicate suppliers (or two different suppliers providing the same good or service). A spend analysis can also be used to measure compliance with preferred vendor programs across a decentralized procurement structure.
2. **Identify Current and Future Needs/Requirements**

- Define in terms of outcomes/output, not activities
- Determine current level of customer satisfaction
  - Are minimum requirements being met?
  - Are some requirements over-met?
- Identify trends and factors that may
  - Increase future demand
  - Decrease future requirements
  - Change the nature of future needs

The next step in the strategic sourcing process is to fully understand current and future needs and requirements. The significant difference between strategic sourcing and more traditional sourcing is that in the former needs and requirements are specified in terms of outcomes while in the latter they are typically specified in terms of activities (i.e., how the good is to be made or the service performed). The sourcing team needs to determine the current level of customer satisfaction for the good or service and whether minimum needs and requirements are being met, or if some requirements are currently being over-met. Because an enterprise’s needs and requirements for specific goods and services can change over time, the sourcing team must identify any trends in technology, practice, or society that are likely to effect the future needs and requirements for the group of goods or services under consideration. This step allows the sourcing team to structure the sourcing strategy and supplier relationship to best meet not only current needs but future needs, whether they increase, decrease, and change in nature.
A key step in the strategic sourcing process is a thorough analysis of the supply market and suppliers. *Market research* is a process for examining the industry, market, and suppliers and understanding how the needs of the customer are affected. Familiarity with industries is generated through market research.

An enterprise needs to know who its current suppliers are and the capacities of each supplier—that is, how much could the supplier increase production, if necessary? Enterprises also need to know the breadth of capabilities of a supplier and whether the goods and/or services it is currently buying are part of the supplier’s core competencies. If a supplier is particularly good at meeting the enterprise’s needs, it may want to consider expanding the breadth of what it buys to increase its leverage and justify more cooperative relationships. However, enterprises typically do not want to be too much of a supplier’s business as that can create supplier dependency and adversely affect the supplier if the buyer’s demand decreases substantially. An enterprise also needs to know the performance and reputations of its current suppliers and how the performance it receives compares with the performance suppliers give other customers. If the performance it receives is less than what other customers receive, it must be careful not to jump to the conclusion that suppliers are shirking on the responsibilities of their relationship. This
analysis may reveal very good reasons, such as business volume or opportunities for supplier development for why other customers may get better performance.

An enterprise also needs to know who other possible vendors/suppliers are and their core competencies, capacities, capabilities, and reputations and past performance. This helps the enterprise to determine if its current supplier’s performance is high by comparison, whether it may want to encourage current suppliers to improve their performance, or whether it is time to re-compete the scope of the work.

While analyzing the supply market, an enterprise needs to understand what the standard industry terms and conditions are and the packages of goods and services offered so that it can attract the best suppliers.
4. Develop Sourcing Strategy

- Focus on outcomes when drafting SOW/RFP
- Understand total costs
  - Cost to change suppliers, i.e., transition costs
  - Cost to offer or re-offer draft SOW/RFP
- Allow for supplier input
- Criteria for bid and supplier evaluation
  - Cost
  - Quality
  - Delivery
- Alternative requirement consolidation, e.g., design (bid) build

When developing a sourcing strategy for a specific purchase it is important for the sourcing team to focus on the desired outcomes, and not on the specific way the supplier might create the good or service, and to specify the SOW or RFP to prospective bidders in terms of desired outputs.

Prior to developing their sourcing strategy, the sourcing team should have a good estimate of the total cost of procuring the specific good or service, including the cost to change suppliers, such as transition costs and the cost to offer or re-offer the specific procurement.

For complex purchases, it is often advisable to include some supplier input as to the appropriate scope and structuring of the offer.

The strategy should also include not only how bids will be evaluated (i.e., what criteria will be used and how different criteria are weighted) but also how suppliers will be evaluated in terms of key metrics, such as cost, quality, and delivery.

Lastly, the sourcing team needs to explore alternative aggregation or consolidation of requirements. For example, for construction projects, the design and build tasks can be done as separate bids or included in the same offer. The specific aggregation or separation of requirements can significantly change the alignment of supplier incentives and
accountability and, hence, dramatically affect supplier performance and final project outcomes.

This process involves crafting a statement of work and/or a request for proposal in terms of the desired outcomes rather than as the process used to achieve the outcome. This requires that the department involve relevant stakeholders and understand the goals of the procurement. For example, a traditional statement of work for janitorial services might specify the number of times that trash must be emptied daily. However, an outcome-based statement of work would instead specify the goal—a clean work environment. A benefit of this process is that it allows contractors to provide innovative approaches to accomplishing goals. Successful outcome-based contracting requires that performance metrics be created and evaluated on a periodic basis. Key stakeholders involved in the process (e.g., engineers, procurement personnel, legal, etc.) must be trained in how to specify and measure requirements in terms of outcomes.
5. Solicit Bids

• Insure that request for bid matches best industry practices
  – Revise solicitation if best suppliers do not respond

• Include quantitative criteria for evaluation
  – Bids
  – Supplier performance

The sourcing team needs to make sure that the SOW/RFP matches best industry practices. If the enterprise does not use standard terms and conditions in its offer, or if it does not package its requirements to match standard industry offerings, it should not be surprised if some of the better suppliers decide not to bid. And, if none of the top suppliers bid, the enterprise should seriously consider revising the bid to better match standard industry packaging and practices and try the offer again.

The team needs to include in its solicitation the criteria from the supply strategy on how bids will be evaluated as well as how suppliers will be evaluated in terms of their performance. This information does two things—it helps suppliers to decide whether to expend internal resources to bid and it also sets expectations for how they will need to perform.
6. Evaluate, Select, and Negotiate Supplier Relationship

- Key criteria
  - Cost
  - Quality
  - Delivery
  - Past performance/reputation
- Fact-based
- Best-value
- Feedback to all bidders
- Negotiation of final relationship
- Jointly tailor final performance-management plan

Bids should be evaluated and suppliers selected based on the selection criteria and the relative weights of those criteria as outlined in the sourcing strategy as well as the SOW/RFP. Typical criteria include cost, quality, delivery, and past performance or reputation and any special criteria related to the solicitation, such as use of small and disadvantaged businesses or employee-turnover rate. The selection process should be as fact-based as possible. Detailed industry, market, and supplier research done prior to the solicitation provides the selection team with a basis from which to evaluate bids according to the pre-specified criteria. Selection should be based on best value to the enterprise, which means that the total cost of managing suppliers, including the cost of managing bad suppliers, also needs to be understood prior to the supplier evaluation.

Anecdotal information from the federal government suggests that when suppliers understand that past performance will be a significant factor in supplier selection, the poorest suppliers will refrain from bidding.

The selection process should be transparent and all bidders should get feedback as to their relative position in the selection process and why they did or did not win.

Once a winner has been selected, the final buyer-supplier relationship needs to be negotiated to include the frequency of performance
measurement and payment and the final metrics with which the supplier will be evaluated. Often, for complex services such as facility management services, the contract will specify the process through which specific performance metrics are jointly determined. Some buyers leave the actual determination of metrics outside of the contract, so that they can be changed upon mutual agreement as the buyer’s needs change and as both parties learn what best works to support the buyer’s objectives.
After the final relationship has been negotiated, the buyer and supplier need to work together to implement and execute their agreement. If the supplier is a new supplier due to outsourcing or a change in suppliers, careful attention must be paid to transitioning key personnel, information, and workloads to minimize any prospective adverse impacts on the buyer. However, even when the supplier stays the same, there may still be personnel, information, and workload transition issues due to any new terms and conditions and/or work scope of the new agreement.

Regular communication and feedback are critical to the success of any buyer-supplier relationship. Suppliers need to know if they are or are not meeting the buyer’s expectations and, if not, what needs to improve. And buyers need to know if they are doing things that adversely impact the suppliers’ ability to meet the terms of the agreement. And, suppliers need to inform buyers of any prospective problems as they are identified so that no one is caught by surprise and so that actions can be taken as quickly as possible to mitigate the impact of the problems.

7. Implement/Execute Agreements

• Manage transition
  – Personnel
  – Information
  – Workload

• Regular communication and feedback
  – No surprises
After the contract has been awarded, the buyer needs to carefully measure supplier performance against agreed-upon criteria and provide regular feedback to the supplier on whether the supplier is exceeding, meeting, or failing to meet expectations. Supplier performance should also be documented for use in future supply-strategy development and for future solicitations.

Buyers need to reward good performance from their suppliers. Rewards can be in many different forms within performance-based contracting, from increases in business, to renewal or extension of contracts, to awards fees based on achieving savings or other efficiencies.\(^7\)

If the supplier is failing to meet expectations, the buyer and supplier need to jointly agree on a “get well” plan with a schedule listing specific milestones for when specific actions will be taken and performance will improve.

\(^7\) Award fees are frequently set up to share savings when a contractor is able to achieve savings for the government sponsor. However, awards may also be set up to award completing projects ahead of schedule, or for exceptional performance, or because of other factors the sponsor considers to be important.
Ideally, both parties need to work together to continually reduce costs and improve performance throughout the value chain of the agreement and jointly share any rewards as a result.

Lastly, buyers should continuously monitor the market for any changes or innovations that may raise the bar in terms of what is considered superior cost and performance by suppliers. While buyers need to carefully select and then trust their suppliers, they need to continually verify that their suppliers are still the best at meeting their needs.
BIBLIOGRAPHY


Garden, McKay, “Are We Free to Buy Where We Fly,” *Shopping Center Business*, December 2001.


Innovative Commercial Firms, Santa Monica, Calif.: RAND Corporation, DB-334-AF, 2002.


State of California, California Performance Review Report (available at http://sdm3.rm04.net/servlet/MailView?ms=MjcxMjQ1S0&r=NjQ0OTQwMjY5S0&j=NDQwMjA0NQS2).


