

Commercial firms recognized for their purchasing excellence are progressively changing their purchasing and supply management practices. They are finding that they can increase performance and reduce costs by shifting toward larger, more integrated (i.e., bundled) service contracts.

The Air Force, as well as the Department of Defense (DoD) and other federal agencies, is considering ways to adapt and apply selected best purchasing and supply management practices that it observes in the commercial sector. But because all federal agencies have a legal obligation to support small businesses through their purchases, and because large, bundled contracts generally are beyond the capabilities of small businesses, application of contract bundling within the federal context presents particular concerns and challenges. Acquisition-related legislation such as the Small Business Act and the Small Business Reauthorization Act (SBRA) of 1997 has been put into place to provide guidelines that define when federal agencies can use bundled contracts.

Although there are many important policy questions associated with the effects of new purchasing practices such as contract bundling on small businesses, we assume in this report that the SBRA appropriately balances these issues. We take as given the Air Force's desire to apply the new purchasing practices, such as the use of bundled contracts, when there are clear performance and/or savings benefits to the buying organization. To support this, we propose a methodology that the Air Force could use to ensure that its choices of bundles properly balance (1) its desire for improved performance and re-

duced cost with (2) its legal obligations to small business, as reflected in recent legislation. The methodology is proposed in general terms so that it can be tailored to the individual circumstances of specific contracting activities.

This methodology was created in response to a request from the Deputy Assistant Secretary of the Air Force for Contracting (SAF/AQC) for a general methodology that can be tailored to individual service contracting circumstances to (1) decide when a bundled acquisition strategy supports broad Air Force goals for military capability, quality of life, and cost and, when bundling does support these goals, (2) facilitate gathering the information necessary to justify the decision in light of legislative guidelines. We discuss the details of this methodology below.

RAND'S ANALYTIC APPROACH

We used a two-part approach to create the bundling methodology.¹ First, we reviewed the relevant business, management, economics, and trade literatures to search for information on (1) bundling trends and methodologies, (2) the benefits, costs, and risks from the buyer's perspective associated with bundling, and (3) how these benefits, costs, and risks can be, or have been, quantified in general and/or in the context of specific cases.

Second, we conducted a series of structured interviews with organizations that care about bundling issues and/or have experience with bundled service contracts. In particular, we met with

- Three Air Force organizations conducting large bundled studies subject to the rules of the Office of Management and Budget (OMB) Circular A-76²

¹See Appendix A for a description of our general methodology for research on best commercial purchasing practices.

²OMB Circular A-76 provides the policy framework for the performance of commercial activities in the federal government. This policy includes a process through which the current in-house workforce competes with private sector firms for the right to provide a service. See Gates and Robbert (2000).

- One Air Force organization conducting a large bundled recontracting activity
- Five leading-edge commercial providers of integrated facility management services and integrated logistics services³
- Four buyers of bundled facility management services that are recognized by their peers and providers as having innovative bundling strategies for these services.

We chose to focus on facility management and logistics services in our commercial sector interviews primarily for three reasons. First, there is high-level Air Force interest in reevaluating provision of these types of support services. Second, we are observing increases in the sizes of commercial contracts as well as consolidation of the broader commercial supply base for these services, indicating that there may be significant opportunities for performance and/or cost benefits associated with bundling these services into larger contracts. Third, we perceive that these services have historically provided many opportunities for small businesses to participate as prime contractors to federal agencies, raising political sensitivity to bundles that include these services. However, the principles of our proposed methodology should apply to other types of services as well, such as more technical services associated with weapon system support.

In addition, we interviewed personnel from the Air Force Office of Small and Disadvantaged Business Utilization (SAF/SB) and the Small Business Administration (SBA) who are involved in implementation of the SBRA and Air Force bundling decisions. We also interviewed personnel from the Air Force Center for Quality and Management Innovation (AFCQMI), now the Air Force Manpower and Innovation Agency (AFMIA), who serve as advisors during A-76 studies, and personnel from SAF/AQC, the Air Force office in charge of contracting policy, who represent the Air Force in discussions about implementation of the SBRA. These discussions were particularly

³Four firms provide integrated facility management services; one firm provides integrated third-party logistics services. One of the facility management providers we interviewed is a management firm that has many alliance partners, and we also met with seven of them. We found that the principal sources of benefits and levels of benefits achieved by these firms' buyers were quite similar across the two types of service areas.

helpful because the recent SBA final rule (discussed in Chapter Three), which describes how the SBA intends for the SBRA to be implemented, was unavailable prior to the conclusion of our research.

In each of our interviews with Air Force study teams and commercial firms, we sought information on the types of benefits, costs, and risks associated with bundling from the buyer's perspective and the sources of each.

In addition, in each of our Air Force study team interviews, we explored the methodology used to construct the bundle, the justification of the bundle, any obstacles to the chosen bundling strategy, the small business participation strategy, and the study team's interactions with the small business community (firms and advocates) throughout the study process. In our interviews with commercial providers of bundled services, we sought information about how the benefits, costs, and risks can be quantified, whether commercial buyers require the participation of small businesses in their bundles, and if so, the methods used to provide these opportunities to small businesses. We were primarily interested in discerning whether any general information exists on these topics, but we also discussed these questions in the context of the experiences of individual buyer firms for which these provider firms provide large bundles of services. In each of our interviews with commercial buyer firms, we focused on the methodology they used to construct their bundling strategy, the levels of benefits they received from this strategy, and how, if at all, they provide opportunities for small businesses to participate in their bundles. In our interviews with personnel from the SBA, SAF/SB, AFMIA, and SAF/AQC, we sought information about how each organization is interpreting the implications of the SBRA and the Competition in Contracting Act (CICA) of 1984 for the Air Force's ability to bundle service contracts, Federal Acquisition Regulations (FAR) changes in response to the SBRA, and the costs to small businesses resulting from bundled contracts.

OUTLINE OF THE REPORT

The remainder of this report is divided into six chapters. In Chapter Two, we discuss the revolution in best commercial purchasing and supply management practices that is influencing the Air Force's desire to change the way it acquires services. Chapter Three explains

how legislation affects the ability of federal agencies to use bundled service contracts and discusses the new skills required to make and justify decisions to bundle services. In Chapter Four, we outline the findings from our interviews and reviews of the academic and trade literature relevant to making and justifying bundling decisions and options for participation of small businesses in bundled contracts. Chapter Five discusses the benefits and risks associated with bundled service contracts. In Chapter Six, we propose a tactical bundling methodology the Air Force could use to make and justify bundling decisions, as well as a strategic framework for implementing the methodology. We conclude in Chapter Seven by discussing implications of this research for Air Force recontracting activities.

In Appendix A, we describe the general approach we use in our research on best commercial purchasing practices. Appendix B contains examples of how many successful commercial firms are strategically reducing their supply bases. In Appendix C, we provide evidence of consolidation trends within three major industries of interest to the DoD. Appendix D contains a detailed guide to the SBA's final rule, implementing the Small Business Reauthorization Act of 1997. In Appendix E, we provide a guide to estimating the monetary value of potential improvements in performance associated with contract bundling.