

BUNDLING DECISIONS

The potential *types and sources of benefits* of bundled service contracts, compared with a baseline of many small contracts, are widely understood by the commercial providers that we interviewed.¹ Each of these organizations was able to provide specific illustrations of the benefits. In addition, many of these benefits are validated in the academic and trade literature. In the next chapter, we discuss the potential types and sources of bundling benefits.

We were unable to find information about *methodologies* used to make bundling decisions for services in the academic or trade literature.² Further, the commercial buyers of bundled services that we spoke with did not have a standard methodology for making

¹Commercial providers were able to give us comprehensive information about bundling benefits during our interviews. In fact, several gave us information that they include in their Request for Information (RFI) responses to educate potential buyers about bundling. The commercial buyers and Air Force study teams (with one exception) that we spoke with did not appear to have performed a comprehensive analysis of bundling benefits prior to our visits. However, during our interviews, they described (without being prompted) many of the same benefits we had learned about from the commercial providers.

²Van Buer et al. (1997) proposes a linear-programming model to help buyers make bundling decisions for standard, commodity-like products. However, most of the literature on bundling decisions focuses on how *suppliers* decide to bundle products that they sell (e.g., copiers, supplies, and maintenance services) and optimal methods for pricing these bundles. See, for example, Hanson and Martin (1990), Lawless (1991), Sadrian and Yoon (1992), Yadav and Monroe (1993), Harlem et al. (1995), Yadav (1995), and Lyons (1998).

bundling decisions for services. These decisions appear to have been made in either an ad hoc or piecemeal manner.³ One buyer told us that its chief financial officer suggested examining the possibility of bundling its numerous facility management service contracts into larger contracts with fewer firms. The buyer then proceeded to investigate bundling options with limited market research (mostly phone calls). After deciding to bundle these services for one small part of its facilities with a particular provider, this buyer became convinced that it would benefit from expanding the scope of the bundle to include all of its facilities.⁴ Another buyer that primarily provided its facility management services using in-house personnel was directed to examine the possibility of outsourcing by its senior management when the firm faced a financial crisis. The decision to bundle services into a few large contracts arose out of the necessity of outsourcing on a tight time schedule. At the other extreme, a provider described one buyer's strategy as a "Pac-Man" approach to bundling.⁵ This buyer began by outsourcing a small group of services to the provider. As the provider demonstrated successful provision of services, the buyer incrementally added services to the provider's contract.

In fact, all of the service providers that we interviewed noted that most of their buyers originally approached the services bundling decision in a limited way. Until recently, outsourcing decisions were not recognized as being related to the strategic concerns of the buyer organization; thus, outsourcing and bundling decisions were largely made at the tactical level by individual functional or organizational groups, with bundles that were no larger (and often smaller) than the

³Unlike the Air Force, commercial firms typically infrequently make decisions about bundling services; therefore, they find it difficult to justify the resources to develop such a general approach. In fact, some buyers hire outside consultants knowledgeable in the best outsourcing practices (bundling and otherwise) for the specific services being considered.

⁴A buyer in a similar situation with many small contracts for its facility management services examined bundling as a solution to its financial difficulties. It expanded the scope of the bundle it initially considered based on information gathered during site visits to customers of potential providers.

⁵Pac-Man is a video game that was popular in the late 1970s through early 1980s; the players gobble-up one electronic dot after another.

services controlled by any individual group.⁶ The provider of logistics services that we interviewed told us that one of its buyers that previously segregated its third-party logistics service contracts by product line recently consolidated these services across product lines as a result of bringing in a new senior vice president of logistics who has responsibility for making strategic decisions that encompass all of its logistics functions. All of the service providers also told us that their more innovative existing buyers are expanding the workscope of their bundled contracts to cut across functional or organizational boundaries.⁷ One provider told us that 15 percent of its new business is attributed to existing buyers that are expanding their contracts, while another attributes 80 percent of its recent growth to expansion of its business with existing clients.⁸

When deciding about a potential shift to one or more large bundles or an expansion of an existing service contract, each buyer looks for evidence of the benefits of the new bundled strategy. Buyers tailor their choices of bundles to the types of services involved and the corporate goals that the services will support.⁹ For example, when a buyer's business strategy or culture leads to the need for local control or a great deal of customization of particular services by location or business units, those services are generally not well suited for bun-

⁶In addition, many providers were not large enough or sophisticated enough at that time to provide good service on a large scale across many diverse services nor was information technology good enough to allow the degree of monitoring and coordination needed to provide good performance across integrated services.

⁷Some Air Force bundles, such as the multiple support function bundles associated with the Air Education and Training Command's Pick-a-Base activities and Vance Air Force Base, are much larger than the typical bundled service contracts found in the commercial sector. The umbrella base operations and maintenance contract at Vance Air Force Base includes such diverse services as aircraft maintenance, childcare, and installation support.

⁸Surprisingly, this expansion of bundles is happening at a fairly slow rate in the commercial sector overall. The same provider that attributes 80 percent of its growth to expansion of business with existing clients also told us that 85 percent of its current clients still purchase services in "mini-bundles" of fairly closely related services, i.e., transaction management, project management, or facility management services. So the expansion of business is often due to growth in the scope of services within these mini-bundles. For example, one buyer expanded the scope of its facilities call center to include additional corporate facilities.

⁹Moore et al. describe the tailoring process and the tradeoffs associated with different bundling strategies in an internal 1997 RAND memorandum. Please contact Nancy Moore at (310) 393-0411 or Nancy_Moore@rand.org for more information.

dles across sites or units. In contrast, the need for standardization of certain services across locations favors bundling across sites. Similarly, individual services that are related to a single end-to-end process are well suited for bundling across services because of the potential for aligning management and incentives and for reducing transaction costs at each boundary.¹⁰

Some firms are satisfied making these decisions based on logical arguments of benefits; others require quantification of the levels of potential savings or performance improvements. One buyer told us that its standard of evidence required to make scope expansion decisions varies with the magnitude of the expansion and the number of other internal organizations or employees affected by the decision. For small-scale expansions that involve services that fall within a single internal function (e.g., property management), this buyer may be satisfied with logical arguments about sources of benefits from consolidating the additional services into an existing contract. However, for large expansions that cross organizational boundaries, this buyer wants credible evidence of the levels of expected benefits, in addition to the intuition behind them. This evidence is necessary to convince the stakeholders in the other organizations that the consolidation is in the best interest of the firm and that the transition costs associated with the change are worthwhile.

Although, as mentioned above, there is a gathering consensus about the potential types and sources of benefits available through a few large, rather than numerous small, service contracts, there does not appear to be any consensus about the *general* levels of those benefits. Commercial providers and buyers were able to provide information about levels of savings that individual buyer firms have experienced; however, the ranges of these savings were quite large. No examples of the levels of performance improvements associated with bundling were offered.¹¹

Based on the anecdotal evidence offered by the buyers and providers that we interviewed, buyers of facility management (FM) and logis-

¹⁰See Boyson et al. (1999) and Ernst & Young and the University of Tennessee (1999).

¹¹Ernst & Young and the University of Tennessee (1999) provide examples of how logistics performance can vary depending on the number of nodes in the distribution pipeline.

tics services appear to save between 10 and 30 percent in direct contract costs (not including any associated administrative savings that the buyer experiences) when they transition from small, unbundled service contracts to large bundles that are tailored to the buyers' needs.¹² (See Table 4.1 for a summary of these reported savings.) Much of the available evidence is from examples in which multiple contracts for the same services provided by one or more firms are consolidated into a single or a few contracts with one or a few providers. For example, one buyer recently reduced the number of janitorial firms that it deals with from 50 to 3 (one large and two small firms) and saved between 10 and 15 percent in direct contract costs. Another buyer that used 67 janitorial firms in five states added this service to its facility management bundle; as a result, the provider reduced the number of janitorial firms to 6, which led to more than 30 percent savings in direct contract costs to the buyer.

Other examples illustrate savings from consolidation of contracts for different kinds of related services. One buyer that was purchasing

Table 4.1
Ranges of Savings Reported by Commercial Firms Implementing Bundled Contracts

Buyer	Bundling Action	Estimated Savings (%) (Direct Contract Costs)
A	Reduced janitorial providers from 50 to 3	10–15
B	Added janitorial to FM bundle; reduced janitorial providers from 67 to 6	30
C	Consolidated 5 different functional service areas	15
D	Bundled 85 separate contracts for FM services	15–20
E	Consolidated 15–20 separate service contracts	30
F	Expanded existing bundle	20–30 of provider's fee

¹²It is reasonable to assume that the examples offered during our interviews with the selected innovative firms might represent some of the best, or most optimistic, examples of bundling benefits received by buyers. (See Appendix A for a description of our firm selection methodology.) In addition, it was difficult for us to rule out for certain the possibility that other changes in acquisition strategy occurred simultaneously, contributing to the reported savings.

services that fell within five different functional areas asked potential providers for bids for a bundle that included all five service areas as well as bids for each of the single-service areas. One of the providers we interviewed submitted bids for this work; its bid for the bundle was about 15 percent lower than the sum of its bids for the five individual service areas. One buyer saved 15 to 20 percent in direct contract costs by consolidating 85 separate contracts for a variety of facility management services such as elevator maintenance and custodial services into a single bundle with one prime provider and nine subcontractors. Another buyer consolidated 15 to 20 service contracts into a bundle with a single provider and saved 30 percent annually in direct contract costs. One provider reduced its fee for the current workload by 20 to 30 percent for a buyer that expanded the bundle it had purchased.

We also found one example of savings from contract bundling within the DoD. The Air Force's Air Combat Command substantially reduced its total annual costs associated with operations, maintenance, and support of the Tethered Aerostat Radar System (TARS) for drug interdiction by bundling separate contracts for these services across sites.¹³

Providers assert that part of the difficulty in generalizing levels of bundling benefits can be attributed to the fact that the magnitude of benefits depends upon a number of factors that can vary widely across buyer firms. Perhaps the most obvious factor is the differences in the composition of bundles across buyers. Some buyers have been more aggressive than others about expanding the scope of contracts across sites and services. The more aggressive strategies are believed to generally result in greater savings and performance benefits; although, as we discuss below, some bundles can be too large. Similarly, benefits may depend on the other dimensions of the acquisition strategy chosen.¹⁴ For example, a process-based ("how-

¹³See Moore et al. (1999). The initial bundling resulted in 50 percent savings in total annual costs for this system. In addition, by reinvesting in equipment, partnering with its provider to standardize operations, and sharing savings with its provider, Air Combat Command was able to reduce TARS costs by an additional 25 percent.

¹⁴Dimensions of an acquisition strategy include the market research plan, bundle, proposed statement of work, source selection criteria, transition plan, contract type, incentives structure, performance metrics, and performance management plan.

to”) statement of work for a bundled contract can limit the provider’s ability to put in place innovations that create some types of bundling benefits. Other factors concern differences in the methods of acquiring services prior to bundling. One provider told us that bundling benefits should be greater the larger the number of small contracts previously used to purchase the services and the longer those particular contracts have been in place.¹⁵

In addition, innovative buyers often have dynamic bundles that grow and change over time as buyers’ organizations grow or needs change. Two buyers that we spoke with had experienced large changes in their bundles through mergers during the past few years. In one case, additional sites and services were added while at least one service was removed from the bundle (the acquiring firm had not previously outsourced this service and chose not to adopt the acquired firm’s bundling strategy). These buyers indicated that the dynamic nature of their bundles makes it difficult to track and quantify benefits over time.¹⁶

Finally, generalizing levels of bundling benefits is made difficult by the lack of comprehensive information about some buyers’ costs and performance prior to implementing bundled service contract strategies, i.e., the unbundled baselines. This applies to buyers that bundled as part of an original outsourcing activity as well as those that had already outsourced these services through many small contracts.¹⁷

When meeting with a prospective buyer about purchasing a bundle of services or an existing buyer about expanding the scope of its contract, providers use proprietary “models” based on benchmarking studies of their existing sites to estimate the resources they would need to provide the desired levels of performance for that buyer’s

Moore et al. describe these dimensions of the acquisition strategy in the context of facility management contracts in a 1997 RAND internal memorandum.

¹⁵Benefits may also be greater for outsourcing versus recontracting if the buyer has relatively less ability to control an internal workforce.

¹⁶In another 1997 RAND internal memorandum, Moore et al. provide more details about the dynamic nature of bundles.

¹⁷One firm told us that one of its primary reasons for bundling was to get access to large firms that have good information systems that can accurately track costs and performance.

facilities. They then compare that estimate to the best information available about the buyer's current cost and performance.¹⁸ Thus, providers *can* estimate achievable bundling benefits, but only on a case-by-case basis, after expending considerable resources.

SMALL BUSINESS PARTICIPATION IN BUNDLES

Although we focused on bundling issues from the buyer's perspective, small business concerns are at the heart of the important policy questions on contract bundling. Therefore, when opportunities arose during our interviews with commercial buyers and providers of bundled services, we asked how, if at all, small businesses participate in bundled contracts. In addition, during our interviews with small business advocacy organizations, we sought information about how small businesses may be affected by bundled contracts. The discussion in this section is not meant to be conclusive but rather to suggest opportunities for further investigation.

Through our interviews with commercial buyers and providers as well as our review of the purchasing literature, we learned that many commercial buyers value small business participation in their purchases. For example, some buyers have corporate goals that encourage shaping their supply bases to mirror their customer bases in demographics or geography. Other buyers in highly regulated industries or that supply goods or services to the federal government have small business purchasing goals that they must meet. During the sourcing process, these buyers convey their desires for their providers to create opportunities for small businesses to participate in their bundled service contracts. However, providers indicated that most buyers do not include formal goals for small business participation in their contracts. In these cases, providers generally do not track their subcontracts with small businesses for formal reporting purposes.

¹⁸As mentioned above, commercial buyers often do not have dependable information about current costs and performance. This is especially problematic for the Air Force and DoD more broadly. Financial management data systems focus on budget execution rather than actual costs, with an emphasis on functional organizations rather than service outputs. See Booth (2000). In addition, this focus on processes rather than service outputs means that few of the needed performance data currently are collected.

Other buyers (often those that have formal small business purchasing goals themselves) do give their providers of bundled services explicit goals for small business participation.¹⁹ In these cases, providers carefully track small business participation in those bundles and convey this information through formal reports to the buyers. Although we were not able to learn the details, these buyers seem to be able to count subcontracts held by their providers toward their own corporate small business goals.²⁰

Generally, buyers allow their providers of bundled services to choose which services to subcontract to small businesses and pick the small businesses and contract structures that will best meet the buyers' needs. The providers that we interviewed have diversification and mentoring programs that they can draw on to select the services and corresponding small business providers that will lead to the best performance and cost outcomes for their buyers.

Several of the large providers that we spoke with seek ways to expand their business with their best small business subcontractors, including them in new business opportunities when possible. In addition, the one small business that we spoke with (it is participating in an alliance with large firms) told us that it is anticipating further business opportunities through its partnership relationship with the other firms.

During our interviews with the SBA and SAF/SB, we heard of several concerns small businesses have about working with large providers as subcontractors as part of bundled contracts rather than directly with the federal buying organizations as prime contractors. These include the perception that subcontractors have restricted or more expensive access to capital, lower profits, or access to only the "menial" aspects of workscopes. However, we aren't aware of any research confirming or refuting these concerns. In addition, we were told that small businesses worry about large providers luring away

¹⁹Some firms have goals that target particular types of small businesses, e.g., minority-owned firms.

²⁰We did hear about a few buyers that chose to retain their prime contracts with small businesses even though they were moving toward bundled services. These firms asked their providers of the bundled services to manage the small business contracts. We do not know why these firms chose this strategy rather than "taking credit" for their providers' subcontracts with small businesses.

their key employees with specialized knowledge that is difficult to replicate. However, several large providers that we interviewed told us (without us bringing it up in the conversation) that they have formal agreements with many of the small businesses that they work with that preclude them from hiring key personnel from the small businesses without permission.