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DEPARTMENT OF THE AIR FORCE
HEADQUARTERS UNITED STATES AIR FORCE
WASHINGTON DC

Office Of The Assistant Secretary

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MEMORANDUM FOR ALMAJCOM-FOA-DRU (CONTRACTING)

FROM: SAF/AQC
1060 Air Force Pentagon
Washington DC 20330-1060

SUBJECT: Reverse Auction (RA) Guidance

In recent months, the concept of RA has emerged as a potentially viable contract pricing tool. This memorandum will help to ensure that you have the necessary information to decide whether incorporating RA into your acquisition strategy is appropriate.

My staff recently completed analyses using data provided by corporate users and providers of RA services. They also reviewed regulatory and statutory guidance to determine if RA conflicts with any existing FAR guidance. These analyses helped to gain insight into commercial application and best practices. The results also indicate that the overarching policy remains unchanged--contracting officers must still adhere to the FAR 15.402 requirement to purchase supplies and services from responsible sources at fair and reasonable prices.

Summarized results of the analyses are attached. You can also review the full text of the analyses on the AF Contracting web site: http://www.safaq.hq.af.mil/contracting/reverseauction/. Here you will find additional information to assist you in the process of conducting your RA, such as information on available service providers.

Should you have questions regarding the use of RA, please contact
Lt Col Alan J. Boykin, SAF/AQCP, DSN 425-7056; email alan.boykin@pentagon.af.mil
or Maj Greg Snyder, SAF/AQCK, DSN 425-7048; email gregory.snyder@pentagon.af.mil.

DARRYL A. SCOTT, Brig Gen, USAF
Deputy Assistant Secretary (Contracting)
Assistant Secretary (Acquisition)

Attachment:
Air Force Reverse Auction Analyses

2001-7-C

AIR FORCE ANALYSES ON REVERSE AUCTIONING

February 2001

In September 2000, SAF/AQC conducted a series of analyses to consider the practical use of reverse auctioning (RA) in an AF acquisition environment. The basic intent of the analyses was to determine RA's utility and placement in the AF's arsenal of procurement tools. The full-text, unedited version of these analyses can be viewed on the AF Contracting web page: http://www.safaq.hq.af.mil/contracting/reverseauction/. A summary discussion of the content is as follows:

- **Corporate User Analysis**: Analysis of market research data on major corporations in order to learn more on industry "best practices." Intent was to determine if similarities exist between industry and the AF that would enable the AF to apply RA in a logical manner.
- **Provider Analysis**: Analysis of market research data on RA providers (hence forth called "enablers") to learn more on alternative solutions. Intent was to determine what qualities contracting offices could select from various providers when contemplating the use of RA.
- **Policy Analysis**: Analysis of pricing and policy impacts within AF to learn more on corporate e-business strategies, "best-business" solutions, and regulatory compliance.

Corporate User Analysis

The overall intent of this analysis was to gather specific information on industry's use of RA, "best-fit", decision strategy, concerns, and long-term strategy.

It is evident that some large corporations have not yet developed a cohesive strategy with respect to incorporating RA into their routine buying practices. Of all the respondents, only one corporation appeared to pursue a cogent strategy. They first explored the use of RA with indirect materials such as adhesives and fasteners, and are now beginning to explore its use with more complex procurements involving direct materials. Their key advice on when RA is an appropriate sourcing strategy can be summarized by saying that *advance preparation is critical and must focus more upon the market rather than the product or service*. Many respondents suggested that the characteristics of a market that could be exploited by the use of RA include the presence of a number of competent, competitive suppliers; the presence of a clearly defined requirement that competitors find attractive; and management support for changing suppliers if required. Some other interesting findings include:

- Companies focused on health of the supplier base of products;
- RA is used to stimulate competition (intent sometimes to reduce supplier base);
- Many users pre-qualified sources; and
- Most RAs were not awarded to lowest bid -- used "best-value" considerations.

Attachment

Below are sample questions / answers captured from the corporate surveys:

- ***Q: Why should a company use RA? Response: Cost savings; competitive way to reduce supplier base; stimulates competition; move to e-business operation.***

- ***Q: When is RA appropriate? Response: Competitive bidding makes sense; many qualified buyers; competition determines price; accurate specifications.***

- ***Q: How do you prepare and execute RA? Response: Market research is key; know your business; ensure thorough exchange of information for all RA participants; performance factors evaluated before auction; pre-define success; incorporate "lessons-learned".***

- ***Q: What risks do you face? Response: Focus not on what we buy, but the actual market that exists; failed market (no bidders); technology failure; collusion; damage to supplier relationships.***

- ***Q: How do you determine who participates? Response: Pre-qualify suppliers; use past performance; down-select suppliers – RA on 2nd round; responsibility determination – essentially, no different than what we do now.***

Bottom Line: If you are contemplating using RA as a pricing tool in one of your upcoming acquisition, carefully review the thought process used by industry, and only proceed when you've carefully researched all of the key points mentioned.

Enabler Analysis

The basic premise of this analysis was to gather specific information on enabler capabilities and value-added customer opportunities.

The services offered by enablers range from the simplest (and least expensive) RA service (e.g., access to a simple "do-it-yourself" RA website tool) all the way to extremely complex offerings which can only be fully exploited by advanced users. These more mature offerings include participation in fully integrated e-business exchanges in which RA is but one tool. Thus, a buying office's corporate strategy should dictate what type of service provider is needed. Buying offices should clearly understand that RA does not constitute the universe of electronic commerce, and should be approached as a small element, which must eventually be incorporated into a grander strategy.

Some of the key findings were:

- The market is evolving into a homogenous marketplace (i.e, numerous enablers are beginning to offer the same types of services; distinction is becoming more difficult);
- A key discriminator is the level of additional service provided within the e-business domain;
- Pricing is market-share driven -- very competitive; and
- Enablers provide enhancement to CICA requirement (i.e. enablers can foster inclusion of competition for your requirement, not exclusion).

Below are sample questions / answers captured from the enabler surveys:

- ***Q: What differentiates you from your competitors? Response: Level of service offered.***

- ***Q: Who owns business data? Response: Customers own data; providers use data.***

- ***Q: How is security ensured? Response: Software, network, and physical security measures; registration through SSL page; procurement integrity guaranteed via non-disclosure policy.***

- ***Q: How do you provide value-added service? Response: Help buyers reduce costs & effort; streamline process; assist buyers with sourcing; train buyers & vendors on processes -- bring them together in the marketplace; logistics support; finance; security.***

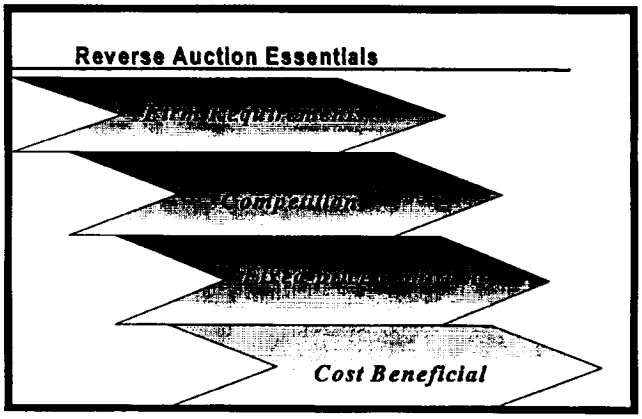
Note: For FY 01, the AF has partnered with the Army Communications-Electronics Command (CECOM), Ft Monmouth NJ, to provide RA software and training which provides the AF the opportunity to conduct RAs free of charge. This, however, is not designated as mandatory for use, as there are many other providers which are also available to provide this service (e.g. GSA, NAVSUP). The AF Contracting web page provides the appropriate information to access these vehicles. The one that fits your specific acquisition situation should be used.

Policy Analysis

The purpose of this analysis was basically to ascertain whether the use of RA is within the boundaries of the FAR. Bottom-line: the overarching policy established at FAR 15.402 must be maintained. It states: "Contracting officers shall . . . purchase supplies and services from responsible sources at fair and reasonable (F&R) prices . . ." As such, regardless of the method of acquisition or pricing strategy, the fundamental philosophy and policy guidance does not change. RA is merely a pricing tool to be used to facilitate your acquisition and assist the contracting officer (CO) in carrying out their specific responsibility.

The following highlights our analysis and recommendations of pricing and policy impacts within the AF as we learn more about employing RA in corporate e-business strategies, "best-business" solutions, and regulatory compliance:

How do you determine a F&R price when using the RA tool?
<u>Analysis</u>: Per FAR 15.403-3, considering the CO responsibility to make a fair and reasonable determination, we recommend characteristics which resemble the following model:



Is price analysis sufficient to determine a F&R price in the RA environment?
<u>Analysis</u>: Per FAR 15.404-1

- *F&R price determination is a must – RA or not!*
- *F&R does not necessarily mean "lowest price"*
- *Must consider the fact that a "low" bid must receive same due consideration as any other bid*
- *Must consider implication of "buy-in" strategy which should accompany contractor responsibility determination*

How do "competition" and "price integrity" affect RA opportunities?
<u>Analysis</u>: Per FAR 15.403-1

- *RA is competition-driven; market research is key!*
- *RA must go beyond FAR definition of "adequate price competition -- requires more than "perception"*
- *RA prices must be "real-time" competitive -- "real-time" price-leveraging*

How do we ensure Competition in Contracting Act (CICA) compliance?
<u>Analysis</u>: Per FAR 6 / FAR 9.2

- *RA does not conflict with CICA requirements; RA is open to all responsible vendors who wish to participate*
- *Competition is key element in RA strategy*
- *Must provide appropriate synopsis of RA option*
- *Offeror responsible for web access capability; adequate vendor training on RA software is key!*
- *RA open to small-business set-asides*