



Office of the Inspector General

Commonwealth of Massachusetts

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High-Priced Contracts Waste Taxpayer Money

August 2004



The Commonwealth of Massachusetts
Office of the Inspector General

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August 30, 2004

Philmore Anderson III
State Purchasing Agent
Operational Services Division
One Ashburton Place, Room 1017
Boston, MA 02108

Dear Mr. Anderson:

I am writing to share my concerns about the high cost of the Operational Services Division's current statewide contracts.

After a review of your agency's contracts, I am convinced that OSD could save millions in taxpayer money by harnessing technology that encourages more competitive bidding.

I recommend that your agency immediately implement two Internet-based purchasing systems designed to increase competition for the commonwealth's business and lower the prices state agencies pay for goods and services.

First, OSD should create a price-shopping guide that will require vendors to post their prices on the World Wide Web in a format that will allow buyers to easily compare costs.

Second, OSD should immediately seek a new contract for reverse auctions, an "eBay in reverse" system that harnesses the power of competition by allowing vendors to bid against each other, over the Internet, in real time.

As the state's procurement agency, OSD is responsible for establishing and/or monitoring more than 250 statewide contracts. Those so-called blanket contracts offer procurement officers a pre-approved list of vendors that sell everything from fish food and moving boxes to computers and electrical services. Executive agencies are required to buy off the statewide contracts while independent authorities and cities and towns are encouraged to use the service.

All told government entities spend some \$2 billion a year through these pre-approved blanket contracts, according to your staff.

Although OSD promises its customers "best value" on all its contracts, my office conducted a random review of items available on a variety of blanket contracts and found better prices in retail stores and on the Internet.

On photocopy machines alone, state agencies could save tens of thousands of dollars by shopping on the Internet rather than buying from OSD-established blanket contracts.

State agencies spent more than \$1 million on photocopy machines in fiscal 2004, records provided by OSD show. Of that, the state spent more than \$130,000 buying Xerox-brand copiers from OSD’s blanket contract with the Xerox Corporation.

My staff’s research found that Xerox is offering substantially better prices on its website than through OSD. For instance, the OSD contract lists the Xerox DC 480 (a no-longer manufactured machine) for \$49,000, but www.xerox.com sells the DC 480’s faster, better-equipped replacement, the Xerox C75, for \$23,000, a \$26,000, 53-percent, savings.

The Xerox DC 420S sells for \$11,800 through the OSD contract but \$3,400 through www.xerox.com, an \$8,400, 71-percent, savings. The table shows the savings my office found on other Xerox copiers.

Model	OSD price	Replacement Model	Xerox.com Price	Savings
DC 470	\$35,300	C 65	\$17,400	\$17,900
DC 460ST	\$31,000	C 65	\$17,400	\$13,600
DC 432	\$12,800	C 35	\$ 6,000	\$ 6,800
DC 440	\$12,800	C 45	\$ 8,000	\$ 4,800

The www.xerox.com prices do not include the cost of delivery, installation or training, which are included in the OSD price.

My office also found substantial savings on facsimile machines. State agencies spent more than \$400,000 on fax equipment and supplies in fiscal 2004, OSD records show.

The Xerox/Ominfax WCP 685, a high volume fax machine, listed at \$3,148 on the OSD contract, is no longer sold in the United States, but its replacement the F12 is available on businessneedz.com for \$1,039, a 66-percent savings. Although each vendor is required to tell OSD when it discontinues a machine, OSD’s procurement website Comm-Pass still lists the WCP 685 as an available fax machine.

The Ricoh 5000L, another high volume fax machine, sells for \$2,630 on the statewide contract but is available on businessneedz.com for \$1,965, a 25-percent savings.

And while Massachusetts’ government agencies can buy a Muratec F-110 fax machine for \$472, the state of Utah’s contract price for the same machine is \$400, a 15-percent savings.

It’s not surprising that Massachusetts’ prices are high since OSD’s bid documents don’t mention cost as part of the evaluation process. OSD officials promote “best value” contracting, saying that focusing on price leads to purchasing sub-standard goods and services.

However, I believe that in this belt-tightening era, the state should do everything it can to drive down costs – without sacrificing quality. Paying a premium for name brand equipment when the same model is available for less elsewhere, certainly isn’t getting the “best value.”

All OSD's contracts do include a "most favored customer clause," which requires that "no other U.S. Customer of similar size and similar terms and conditions shall receive a lower price." However, OSD has found that this clause is extremely difficult to enforce.

OSD needs to amend its standard Request for Response to encourage competitive pricing.

The bid documents also offer no hint of the volume of business vendors can expect.

Clearly, OSD can't promise vendors that dozens of agencies will buy a particular item from a particular vendor. But companies need volume guidelines in order to make informed business decisions and offer the best-possible prices.

OSD could cure this deficiency by annually surveying agencies about their upcoming needs and past year's buying practices and including a snapshot of those survey results – without any promises – in bid documents. If, for instance, the state's copier machine Request for Response noted that the survey found 25 government agencies expected to buy new high-volume copiers in the coming year, Xerox and other vendors could tailor prices to the expected volume.

Shopping outside blanket contracts, we also found significantly better prices on copy paper. The state contract lists standard 20-pound weight copy paper at \$31 a case. We found MaxBrite, the Office Max brand for \$25 a case, a 19-percent savings. While the OSD contract offers significant discounts on bulk paper purchases, we believe a more price-conscious system would yield cost-savings across the board.

The commonwealth spent \$2.4 million on copy, computer and bond paper last year.

In addition, our research found lower-than-OSD prices on a variety of smaller-ticket items, including some food and clothing. State agencies spent some \$15 million buying food and more than \$500,000 on sweatshirts and other casual clothing last year, according to figures provided by your staff. Our researchers were unable to match OSD's prices on other items including vehicles, grass seed and printer cartridges.

While our research found a mixed bag, in this era of budget cutting, I believe OSD should be offering state agencies the best price on every contract.

Despite the potential for savings, it would be unwise to scrap the state's procurement and competitive bidding laws and simply send agencies' buyers shopping on the Internet.

Instead, my office proposes two innovative Internet-based approaches that, if aggressively implemented, will increase competition for the commonwealth's business and lower the prices state agencies pay for goods and services:

- OSD should create a price-shopping guide for its buyers;
- OSD should immediately seek a new contract for reverse auctions.

A price-shopping guide could be modeled after the web pages sponsored by Yahoo, Google and other search engines that many state employees use at home to find the best prices for their personal purchases.

The guide would cover both goods and services and, in most cases, offer multiple vendors for each item. Vendors would have to win a statewide contract using OSD's current Request for Response process. They would also have to agree to update their prices at least quarterly.

Most vendors would be required to agree to a price ceiling for the life of the contract, meaning prices would mostly go down during the life of the contract. Contracts for volatile commodities like fuel and paper could include price-adjustment indexes.

The site could also offer vendor-specific "shopping carts" that would allow buyers shopping for many smaller items – like office or school supplies – to see quickly which vendor offer the best deal for their total purchase.

Since the website would include side-by-side comparisons, vendors would have to offer low prices to win business on a daily basis.

Buyers seeking an even-lower price could call or e-mail any of the vendors in the guide to get an up-to-the-minute price quote.

The technology now exists to create a shopping guide that is much more sophisticated than the multi-state, online mall, or e-mall, that OSD pioneered in the late 1990s. The e-mall, according to OSD, cut administrative costs by as much as 72 percent through its paperless ordering system. However, the e-mall started out extremely small, with only 20 vendors participating, offering little incentive for price competition.

The shopping guide my office proposes would focus on both price-cutting and convenience.

As far as my staff can determine, no other state currently uses a price guide for its procurements. But the technology exists. One industry-expert whose company builds Internet stores for Yahoo and other private companies estimated that the state could build an Internet mall for between \$75,000 and \$300,000, an expenditure that could be recouped through a nominal vendors' fee.

Reverse auctions offer a proven way to harness the power of competition by allowing vendors to bid against each other, over the Internet, in real time. Some people call reverse auctions "eBay in reverse" with the posted bids pushing the price of goods and services down rather than up.

In general, vendors submit their qualifications and proposals before the auction, allowing the purchasing agency to pre-qualify companies for the online event. A separate money bid is sealed – and often encrypted – in an electronic lockbox. It is opened at the beginning of the auction and can be updated electronically throughout the event, which can last as little as 10 minutes or as long as an hour.

Each auction is set up differently, but generally vendors can see how their price relates to the other bidders' prices. In all of the systems my staff explored, vendors cannot see the identity of the other bidders.

The Massachusetts state treasurer recently began using reverse auctions to sell bonds and buy certificates of deposit. In addition, legal offices under the governor's authority are experimenting with reverse auctions for legal services. While those programs are just getting started, the federal

government as well as numerous cities, towns and states around the nation are seeing real savings by using reverse auctions to buy goods and services.

Since 2002, when the Kentucky League of Cities teamed with the company Ecuity to offer no-cost reverse auctions, Kentucky's municipalities have used reverse auctions to buy \$15 million worth of goods and services and saved more than \$1.5 million, a 10-percent savings.

The Louisville-area sheriff's department cut its ammunition-purchase costs by 22 percent using a reverse auction, according to the league of cities.

The Kentucky auctions don't cost cities and towns anything, since the winning vendor pays Ecuity a percentage of the contract price. If the city or town rejects all the bids – either for price or qualifications – the auction is free.

State of Minnesota officials estimate that they've saved \$1 million since they started running reverse auctions a year ago. Those savings jump to \$22 million over the five-year life of the contracts awarded through the Internet bidding system, said Brenda Willard of the Minnesota Materials Management Division.

Minnesota trimmed its \$10 million copy paper contract by \$1.2 million, a 13-percent savings; chopped its \$200,000 paint contract by \$36,000, an 18-percent savings, and slashed \$67,000 from its \$432,000 body armor contract, a 16-percent savings.

Minnesota paid \$70,000 for a year's subscription to Archimedian Software's reverse auction program. The self-service subscription allows Minnesota to run as many auctions as it wants.

Treating the first year as an experiment, Minnesota ran simultaneous reverse auctions and traditional paper bid competitions for every purchase. The idea was to determine what commodities and services were best suited for the new technology.

Minnesota state officials are only beginning to quantify the lessons of those 60 auctions, Willard said.

In general, Minnesota found reverse auctions didn't save money on small – under \$5,000 – purchases. Minnesota state officials also discovered that vendors of some commodities refused to participate in the electronic auctions. However, Willard speculated that some reverse auctions would have drawn more interest if vendors didn't have the traditional paper-bidding option.

In addition, the General Services Administration, which buys for the federal government, the U.S. Postal Service and the state of Texas have all saved money by harnessing reverse auction technology.

As I'm sure you know, even OSD has had success with reverse auctions. For instance, using services provided by Procuri, Inc., the Massachusetts Highway Department saved more than \$100,000 – cutting 20 percent off its previous \$500,000 bill for the aluminum it uses for road signs.

Although OSD has had Procuri under contract since October 2002, the agency has only

conducted four reverse auctions during that time: the aluminum auction, which MassHighway paid for, and three no-cost auctions that were a condition of the contract.

OSD's reverse auction for recycled paper saved 5 percent off the blanket contract prices, said the deputy purchasing agent for OSD. However, the reverse auction contract only covered a large, one-time, end-of-year purchase, leaving other agencies to buy at the higher, blanket-contract price.

The deputy purchasing agent said the \$3,000 per-auction price tag made it impractical for your cash-strapped agency to conduct more reverse auctions. She described the agency as unwilling to pay to save someone else money.

The deputy purchasing agent also said OSD is unlikely to seek new reverse auction services when Procuri's contract expires in October since Phase II of the enhanced Comm-Pass website, expected to be up and running in five years, will include software that will allow OSD to conduct no-cost reverse auctions in-house.

Given reverse auctions' proven track record and the state's continuing \$1 billion structural deficit, I believe it is unacceptable for OSD to wait five years to take advantage of this technology.

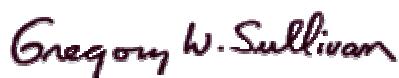
OSD should strongly consider implementing a new reverse auction program with payments modeled after the Kentucky League of Cities contract, which does not require an intimidating upfront expenditure by OSD or any other state agency.

Although Massachusetts General Law Chapter 30B currently prohibits cities and towns from running their own reverse auctions, if OSD had an effective reverse auction program, my office would sponsor legislation updating Ch. 30B to allow municipalities more latitude in conducting electronic transactions, including reverse auctions.

I understand that OSD is currently undergoing a thorough review of its purchasing systems by an outside consultant and applaud the administration for looking for cost-savings and other efficiencies.

I believe our recommendations for harnessing technology can be implemented along side any internal streamlining your outside consultant suggests.

Sincerely,



Gregory W. Sullivan
Inspector General