

# CHAPTER 10

## The Purchase System



### Practice

Acceptable purchase systems that comply with purchasing regulations and still protect the interest of children create a lot of confusion in the market place. The confusion creates dialogues like this:

**"Line item award of bids is the only method that complies with Federal procurement guidelines."**

*"Then why are they using market-based prices in some school districts?"*

**"Those are probably rural locations. They are not as closely monitored as urban school districts."**

*"We use a small purchase procedure because we do not have staff with the expertise to develop product descriptions."*

**"Our purchase system is patterned after restaurants. We have a primary supplier contract, and prices are based on cost plus a percentage of the contractor's cost."**

*"Predicting our quantities is not possible; therefore, we can't go with bottom line as a basis for bid award."*

**"Do you have to predict quantities to award a bid on an all-or-nothing basis?"**

*"We award our bids on an all-or-nothing basis, and we do not use quantities. We simply add the case cost of all products and award the bid on the lowest bottom line."*

## CHOICE

"I read where some school districts are going direct to the manufacturer for prices."

*"We can't do that here. Our distributors will not agree to it."*

"There is some discussion about issuing bids for purchase of our food products. I am opposed to that. Tommy Smith from XYZ company has called on me for 10 years, and I enjoy our weekly visits. I am afraid he would not get any business if they develop food bids."

*"I read in a textbook that regardless of your purchase system you should keep up with the current market price for items. Those market bulletins are too difficult for me to follow."*

Many books are written on purchasing, almost all for the private sector. Purchasing in the public sector is the same in some respects, except for the requirement that schools maintain open and free competition. However, as many authors note, putting bids in the purchase equation adds complexity that is more difficult to manage.

Misinformation and lack of information are serious obstacles to improving purchase systems in school districts. The inconsistency and lack of guidance in this area creates total confusion for school purchasers and for companies trying to do business with school districts.

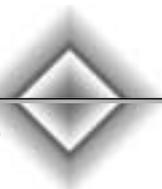
## INFORMATION

**Federal procurement regulations impose firm rules to keep in mind:**

1. Only responsible contractors who possess the ability to perform successfully can get contracts under the terms and conditions of

a proposed procurement. Contractor integrity, compliance with public policy, record of past performance, and financial and technical resources must be considered.

2. The purchase system must ensure open and free competition.
3. Schools must maintain written selection procedures. These selection procedures: (a) provide clear and accurate technical requirements for the material, product, or service and contain features that do not unduly restrict competition; and (b) identify all requirements the contractor must fulfill and other issues used to evaluate bids or proposals.
4. Cost plus a percentage of cost purchase is not an allowable system.
5. To purchase items costing more than \$100,000 in the aggregate requires a formal purchasing



method. Public organizations must follow the most restrictive of local, state, or Federal law/rules. Private nonprofit organizations can follow Federal rules, even when the Federal rules are less restrictive than the organization's own rules. Private nonprofit organizations are exempt from the state and local rules that apply to public organization purchases.

6. Geographic preference, commonly called "local preferences," is not allowed.
7. SFA's are required to the maximum extent possible to use domestic commodities. A "domestic commodity or product" is defined as one that is either produced in the United States or is processed in the United States substantially using agricultural commodities that were grown domestically.

**All purchases require three basic decisions:**

- ▲ the appropriate purchase method,
- ▲ the pricing mechanism, and
- ▲ the number of vendors required to perform the service or deliver the product.

<p style="font-size: 2em; margin: 0;">1. _____</p> <p style="font-size: 2em; margin: 0;">2. _____</p> <p style="font-size: 2em; margin: 0;">3. _____</p>
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Approximately every 10 years the USDA conducts a nationwide purchasing study. The 1996/97 school year study indicates that adopting certain purchasing practices would not necessarily lead to a reduction in food costs. The executive summary of the purchase study is on the World Wide Web at <http://www.fns.usda.gov/oane/>.

**Four basic purchase procedures are:**

- ▲ small purchase procedure or request for quotation (RFQ),
- ▲ competitive sealed bids (IFB),
- ▲ request for proposals (RFP) competitive proposals, and
- ▲ noncompetitive negotiation.

IFB and RFP are considered formal purchase methods. Noncompetitive negotiation can be used only when one of the following conditions exist:

- ▲ After conducting a request for prices, competition is deemed inadequate. For example, only one bidder responds to an IFB.
- ▲ An emergency exists where competitive procurement method would take too long.
- ▲ The Federal grantor agency (USDA) authorizes noncompetitive negotiation.

Most of the elements of the three remaining procedures are shown in the comparison on the next page:

# CHOICE

## Comparison of Purchase Procedures

Small purchase procedure	Sealed Bids (IFB)	Request for Proposals (RFP)/competitive proposals
Description of products required.	Description of products required.	Description of products required.
Instructions required.	Instructions required.	Instructions required.
Price quotes can be verbal or written.	Price quotes must be written; public opening required.	Price quotes must be written.
Price documentation required.	Price documentation required.	Price documentation required.
No advertisement required.	Formal advertisement required.	Formal advertisement required.
Suspension, debarment and noncollusion certification required.	Suspension, debarment and noncollusion certification required.	Suspension, debarment and noncollusion certification required.

### Small purchase procedure

The small purchase procedure is used for those simple and informal purchases that do not exceed the allowable dollar amount. Small schools also use this method but, though allowed, it does not yield the most cost effective pricing. Small purchase prices often are quoted over the phone or by a sales person. The purchaser must record the price quoted and maintain open and free competition when using the small purchase method.

### Invitation for Sealed Bid (IFB)

Sealed bids are the standard when the only variable is the price of a product being purchased. (Food and supplies are classified as “commodities” by other public purchasers in the school district but not by Child Nutrition staff to avoid confusing purchases with donated foods commonly called commodities.). Because the award goes to the lowest responsible bidder who

meets the terms and conditions, an IFB requires clear, concise specifications. Bids are accepted or rejected on a pass/fail basis. No negotiation of price or terms is permitted. An IFB is normally used to acquire products and nontechnical services.

Most school districts have standard contract language for sealed bids. This standard language is often called the boiler plate. Appendix 16 contains some examples of language which may be helpful in developing sealed bid documents. The usual sections of a sealed bid document are:

**Section I - Transmittal page and signature page** - Include the Certification Statement related to debarment or suspension in this section. (Ask the State Agency for a copy of the form.)

**Section II - Standard terms and conditions** - Some examples: correction of mistakes, collusion,

unit price prevailing, adherence to specifications.

### **Section III - Special**

**instructions** - Examples: extensions, drained weights, brands approved, how to offer alternate brands or substitutions. Often included in this section are responsibility criteria set at minimums for elements critical to successful bidder performance. These criteria include such factors as experience and delivery capability. The instructions should identify how the bidder demonstrates compliance with criteria.

### **Section IV - Product list and descriptions**

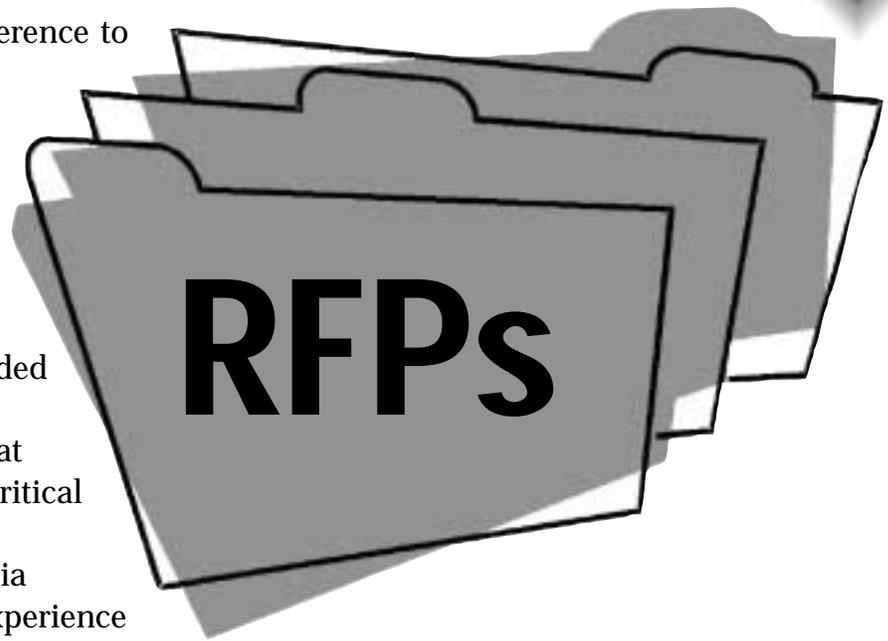
#### **Section V - Billing address and**

**delivery locations** - Exceptions to delivery frequency are often noted on this list. For example, a notation of schools that require delivery during the summer months.

### **Section VI - Potential bidders**

## **Request for Proposal (RFP)**

A request for proposal is the standard method when purchasing the product or service requires evaluating several subjective criteria along with the price. Some of the services requiring RFPs are pest control, telecommunications, courier, marketing, equipment maintenance, computer software maintenance, staff training, insurance, legal service, auditing, consulting, and



garbage removal. If food is purchased using anything other than a firm, fixed-price contract, an RFP should be used.

An RFP allows evaluation of other variables besides cost. To develop a request for proposal, identify the variables and assign a point value to each variable. Budget/cost is a critical variable that should get more than 50 percent of the total points.

A two-step process is recommended to evaluate responses to an RFP. The first step is negotiating variables in the technical proposals. The second or final step is negotiating the price. The RFP instructions should indicate how proposals are selected for negotiation. Because the budget/cost portion of the RFP evaluation is objective, it is an appropriate way to select vendors for negotiation. The instructions might read, "The two vendors offering the lowest budget/cost proposals will be selected for negotiations." On the following page is an example of RFP criteria for equipment:

**CHOICE****Selection criteria for equipment maintenance RFP**

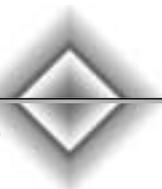
Selection criteria	Maximum points	Points for this response
Years company has been in food service maintenance business	10	
Years experience of technical staff	5	
Brands of equipment owned by school district compared to bidder's factory authorized service	10	
Time required to get parts for equipment not covered by factory authorized service	5	
Response time on emergency calls	10	
Membership in Commercial Food Equipment Service Association, Inc. (CFESA)	5	
Budget - routine maintenance bottom line	20	
Budget - hourly rate for emergency service	15	
Budget - percentage discount off manufacturers list price for replacement parts	20	
<b>Total Points</b>	<b>100</b>	

Use an RFP selection committee to evaluate proposals. Each individual on the selection committee scores the responses to the RFP separately, and the scores are averaged. Another approach is to rank RFP panel scores or discard the low and high score to negate the effect of a panel member who gives very high or very low scores.

The SFA might undertake negotiation when, for example, the proposed response time for emergency calls was unacceptable to the school district. Negotiation begins with the two vendors who offered the most favorable budget/cost proposal, based on the instruction presented above. Step 1 negotiates an acceptable response time with the two vendors. The two vendors

are then allowed to offer revised budget/cost proposals, and evaluation of the proposals is complete. It is possible that the technical score and the budget/cost score of both vendors could change. That is why the school district retains documentation showing the initial scoring and the final scoring.

When scoring the responses, award the lowest price quote the maximum number of points. Adjust all other responses to a percentage of the maximum score. Thus, if the lowest budget for routine maintenance was \$4,000, then 20 points would be assigned to that response. The next response offered a price of \$5,000, so the calculation of points would be as follows: \$4,000 divided by \$5,000



equals 80 percent. Eighty percent of 20 points equals 16 points. In the example, calculate the hourly rate for emergency service and the percentage discount off the manufacturer's list price for replacement parts the same way. If the service is bid as a bottom-line request for prices, there would be only one budget calculation.

A different approach to an RFP is to add or subtract from the price quoted on the basis of variables. Be sure to specify the variables in the request-for-proposal instructions. Here is an example from the Oregon Child Nutrition Coalition RFP documents for 1997/98. The potential vendors were asked to respond with a yes or no answer to the following question:

**Will the vendor provide discounts for quick payment of net 10 days? Yes No**

**Will the vendor provide discounts for quick payment of net 15 days? Yes No**

**Will the vendor provide discounts for quick payment of net 20 days? Yes No**

.....

**Yes answer (net 10 days), \$30,000 will be subtracted from the bottom-line.**

**Yes answer (net 15 days), \$20,000 will be subtracted from the bottom-line.**

**Yes answer (net 20 days), \$10,000 will be subtracted from the bottom-line.**

**A no answer has no impact on the bottom-line.**

The amount subtracted would be adjusted based on the estimated total dollars involved in this anticipated purchase. **Placing a value on variables is less subjective than the point system. Only if the district routinely pays promptly can the district consider including the quick payment discount in the RFP. The discount must be consistent with a payment schedule that the district can meet. For example, the district cannot award an RFP based on pricing with a net 10 days payment if the district never pays in less than 12 days.**

An RFP is appropriate when purchasing food and supplies not using a firm fixed price. The instructions provide the following information to potential suppliers, as in this example:

- ▲ Suppliers may petition for cost price escalation every six months. Any increases granted are based on market price increases between the RFP bid and petition for increases. Third Party Market Reports are the only acceptable source of documentation for market increases.
- ▲ The School District can petition for cost price decreases on the same basis as suppliers petition for increases.
- ▲ The fixed fee per item remains firm for the duration of the contract and any extensions.
- ▲ The school district reserves the right to conduct competitive negotiations with the two suppliers who offer the best bottom-line fee.

Variable	Maximum points allowed	Score for this response
Ability to provide all products listed in contract section IV	5	
Previous history of fill rate on first order (98% or better acceptable)	5	
Ability to identify cost of product minus revenue to the vendor for purchase of product	10	
Noted exceptions/alternate brands from those listed in contract section IV (No exceptions is equal to maximum points. Comparison of exceptions/alternates determine any reduction in points. Failure to provide copies of labels for alternate products can also result in a reduction of points.)	20	
Fees quoted	30	
Cost and freight of product	30	
<b>Total Points</b>	<b>100</b>	

**Following are sample responses to this RFP:**

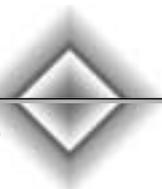
Vendor	Technical Score	Fees - bottom line	Cost - bottom line
A	30	\$190,029.75	\$1,000,156.58
B	35	\$200,119.05	\$1,000,595.26
C	25	\$209,570.81	\$997,956.23
D	28	\$226,502.93	\$1,258,349.59

The instructions read, "Negotiations will be conducted with the two suppliers who offer the best bottom line price for the fees." Based on the announced instruction the school district can negotiate the technical proposal changes needed with Vendor A and B.

Identify possible issues related to the technical proposal:

1. The alternate brand offered on two products is not acceptable.
- 2.
- 3.
- 4.
- 5.

After negotiations, vendors A and B would be allowed to offer new fee and cost proposals. When all issues related



to the technical proposal have been resolved, the prices offered determine which vendor wins the contract.

### Number of vendors

With all purchases, the school must decide if products can be bundled together to form a group. Whether the products are bundled will determine how many vendors get contracts. When purchasing only one product the decision is easy, but many different products are required to operate a Child Nutrition Program.

### There are two basic methods for selecting the number of vendors:

- 1) Line item awards – the price offered on each product is considered independently.
- 2) Bottom-line awards, sometimes called all-or-nothing awards – the prices offered on products are considered as a group.

### Line item

In the line item example below, products are the same. Prices vary, as they would in actual practice.

### Vendor award method: Line item

Product name	Potential vendor A	Potential vendor B	Potential vendor C
Peaches	\$20.36 <small>low</small>	\$22.94	\$23.41
Pears	\$22.49	\$23.95	\$22.46 <small>low</small>
Sugar	\$19.06	\$18.75 <small>low</small>	\$21.45

In this example Vendor A will deliver the peaches, Vendor B will deliver the sugar, and Vendor C will deliver the pears.

The delivery cost is almost the same whether the distributor delivers one case or 100 cases. Distributors have matured in their management systems. Today a distributor knows the cost of every stop a delivery truck makes. Line item bids offer the distributor no guarantee about the number of cases that will be delivered – that is, the delivery drop size.

Although distributors don't publish costs associated with delivery, there seems to be common agreement that each stop a delivery truck makes costs

in the range of \$50 to \$100. Some experts in the industry maintain that for each delivery vehicle operated the distributor must have \$1 million in sales to stay in business.

School districts frequently receive notices that distributors are placing a minimum invoice amount on all deliveries. This practice shouldn't anger school district staff. Customers need distributors to make a reasonable profit so they will stay in business. Line item award methods offer the distributor no drop size guarantees.

Line item has the least potential for conflict with business partners (distributors and manufacturers). The volume is splintered, and therefore the

# CHOICE

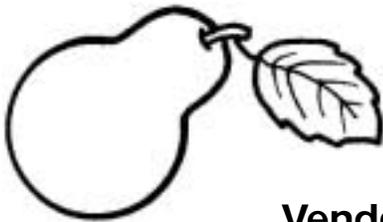
business is not that important or visible.

- ▲ This method can be used without projecting quantities. Projected quantities should be used with all purchase systems, but they are not a required element for line item.
- ▲ The purchasing task is most likely to fail at the point product is received.
- ▲ The administrative cost of managing this system is higher than with other systems.
- ▲ Developing long term relationships with business partners is not possible.
- ▲ If quality is consistent with that required in other purchase systems, the price paid for product will almost always be higher.

## Bottom line

Bottom-line award makes business more attractive to distributors because the system guarantees increased drop size. Hidden costs associated with school purchasing also go down with bottom- line, notably the cost of processing purchase orders, receiving, and invoice processing. The May 1988 *Cornell H. R. A. Quarterly*, in an article entitled "Developing Your Procurement Strategy," gave the following typical delivery costs by delivery size.

Number of cases	Cost per case
10	\$5.00
30	\$2.33
50	\$1.80
100	\$1.40
200	\$1.20
300	\$1.13



Here is an example of a bottom-line award.

### Vendor award method: Bottom line

Product name	Quantity	Potential unit price	Vendor A extended	Potential unit price	Vendor B extended	Potential unit price	Vendor C extended
Peaches	25 cs	\$20.19	\$504.75	\$22.02	\$550.50	\$21.50	\$537.50
Pears	10 cs	\$20.94	\$209.40	\$20.48	\$204.80	\$21.50	\$215.00
Sugar	15 bags	\$15.98	\$239.70	\$16.63	\$249.45	\$14.10	\$211.50
Bottom line total			\$953.85 Low		\$1,004.75		\$964.00

Bottom line adds a new element to the award: **the extended price (unit price multiplied by quantity)**. To compare prices among potential vendors, consider both the unit price and the vendor's extended price.

As visibility increases, so does the potential for conflict with business partners. With line item the potential vendor can pick and choose items on which to offer a price. Bottom line requires a price quote on all items.

- ▲ Schools must project reasonably accurate product quantities for three or four months with bottom line. The school must monitor amount purchased against projected quantity. Donated food delivery schedules aren't predictable, which makes accurate short term projection of quantities difficult.
- ▲ Purchasing is still likely to fail when the product is received. The frequency with which brands and vendors change causes this failure.
- ▲ The administrative cost of managing the system is about the same as line item with quantities.
- ▲ Developing long-term relationships with business partners is not possible.
- ▲ A bottom-line approach increases the size of each order and therefore decreases the distributor's operating cost, which should be passed on to the school district. The decreased cost may not be evident in the first or

second year. The school district must prove credibility before realizing the decreased cost.

- ▲ The number of "shorts" and "outs" should decrease. It may take a year or two to realize this benefit. As confidence in projected quantities improves service level should improve.



A common and legal method of awarding business is to state in the pricing request that the award will go to two primary vendors. The two vendors with the most low prices get the business. These two vendors supply the rest of the items based on who offered the lowest price for each item. Prices will be higher than with strict bottom line because the vendor has only a partial guarantee of quantity.

**CHOICE****Vendor award method: Two primary vendors**

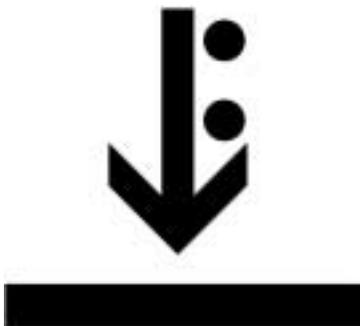
Product name	Quantity	Potential unit price	Vendor A extended	Potential unit price	Vendor B extended	Potential unit price	Vendor C extended
Peaches	25 cs	\$20.19 <i>low</i>	\$504.75	\$22.02	\$550.50	\$21.50	\$537.50
Pears	10 cs	\$20.94	\$209.40	\$20.48 <i>low</i>	\$204.80	\$21.50	\$215.00
Sugar	15 bags	\$15.98	\$239.70	\$14.10 <i>low</i>	\$211.50	\$16.63	\$249.45
Crackers	20 boxes	\$13.98	\$279.60	\$15.65	\$313.00	\$13.15 <i>low</i>	\$263.00
Spaghetti	30 boxes	\$6.95 <i>low</i>	\$208.50	\$7.05	\$211.50	\$7.35	\$220.50
Macaroni	20 boxes	\$6.95	\$139.00	\$6.90 <i>low</i>	\$138.00	\$7.25	\$145.00
Number of items with low bid		2		3		1	
Lowest price on crackers						X	
Crackers awarded		X					
Number of items in final award		3		3		0	

In this example Vendor A and Vendor B were selected.

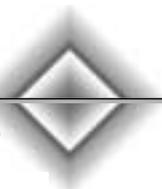
Some schools want to use bottom line as the award method but do not want to project quantities. One of the major reasons to use quantities is to avoid potential low ball on a vendor's

price quote. The school district is inviting unfair price quote practices unless it supplies accurate quantities. Unfortunately vendors often know more about quantities purchased than the school district does. Consider the bottom-line example again without any

mention of quantities to be purchased. The school district buys few pears, and Vendor B knows it, so he decides to lose money on pears to gain the peach and sugar business.



## THE BOTTOM LINE



### Bottom line, no quantities specified

Product	Potential Vendor A unit price	Potential Vendor B unit price	Potential Vendor C unit price
Peaches	\$20.19	\$23.02	\$21.50
Pears	\$20.94	\$15.06	\$21.50
Sugar	\$15.98	\$17.63	\$14.10
Bottom-line total for bid award	\$57.11	\$55.71 <b>low</b>	\$57.10
Actual cost paid by school district	\$953.85	\$990.50 <b>high</b>	\$964.00

Because the district failed to provide quantities, the award went to Vendor B. Therefore the final actual cost paid by the school district was almost \$50 higher. The vendor knew the quantities the school district usually ordered, which allowed him to low ball the price for pears and increase the cost for two items that the school purchased more often.

## GROUPING PRODUCTS FOR BOTTOM-LINE BIDS

A term frequently heard in conversation is, “We have a prime vendor contract.” What does a prime vendor contract mean? The common reference and purchasing textbooks do not define the term. Does it mean 100 percent of the items are purchased from a single vendor? Does it mean 100 percent of the meat, grocery, and staple items are purchased from a single vendor? What pricing mechanism is used? Are bottom line and prime vendor the same concept?

A bottom line can be for as few as

two products or as many as “everything purchased.” School purchasers are trained to think of generic product groupings — milk, bread, frozen vegetables, frozen fruits, canned vegetables, canned fruits, meats, fresh produce, dry groceries. This concept must be put aside when products are grouped for bottom-line awards. The distributors available in the specific market influence how products are grouped.

Milk and bread present few grouping problems since distributors specialize in these markets. Paper supplies, fresh produce, and small equipment are easy to analyze because the following distributors usually serve these markets:

- ▲ Paper supply specialty distributors
- ▲ Fresh produce specialty distributors
- ▲ Equipment specialty dealers
- ▲ Broadline distributors who sell paper, fresh produce, and small equipment

## CHOICE

Meat, dry groceries, canned and frozen fruit and vegetable categories require a different approach. The following distributors serve these markets:

- ▲ Meat specialty distributors
- ▲ Dry groceries specialty distributors
- ▲ Broadline distributors who sell all products

When grouping these categories for bottom-line awards, think not in terms of groups but in terms of individual products. Appendix 3 provides a form for analyzing the market.

Pay attention to the specialty distributor as products are placed in groups. The broadline distributor can offer a price regardless of how products are grouped. The product line of the specialty distributor will determine the groups. The groups might look like this:

**Group 1 or bid 1:** Chicken products, pizza, ground beef, turkey products, and beef patties

**Group 2 or bid 2:** Canned fruits and vegetables (except mandarin oranges), and selected dry groceries

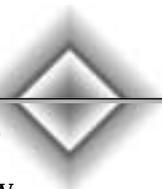
**Group 3 or bid 3:** All other meats, all other dry groceries, and mandarin oranges

The meat distributor would offer a price on group 1, the dry grocery distributor a price on group 2, and the broadline distributor a price on group 1, 2, and 3. The market analysis provided a mechanism to balance the dollars in

all three groups. If the broadline distributor offers a successful bid only on group 3, it is important that it have cost-effective drop sizes.

### Pricing mechanisms

The pricing system chosen by the school district establishes the degree of risk the vendor must take when quoting a price. The discussion on this issue has escalated to the point where both industry and school districts are taking extreme positions. Isolated incidents where a vendor quoted a firm price and was forced to deliver at a loss when the market suddenly rose has created these extremes. These extremes also create situations where the vendor reports “shorts or outs” at a level unacceptable to the school district. If vendors have too many price increases, they stop reordering those items. Of course good purchasing practice suggests that the school district can force the vendor to deliver a contract item. In actual practice the legal cost and work involved in forcing compliance exceeds the resources of most school districts, and the “shorts and outs” continue. Establishing long-term relationships among business partners (manufacturers, distributors, and schools) is imperative. To achieve effective partnerships will require discussions about how prices of food products and pricing systems can be modified. Schools need the manufacturers and distributors who sell and deliver product to stay in business, and companies are in business to make a profit.



**There are three basic pricing types:**

1. firm price for a specified period of time,
2. reimbursable cost plus a fixed fee with a petition for escalation/de-escalation based on third-party market reports, and
3. a fixed fee for storage, delivery, cost of money, and profit, with the cost of product established by third-party market reports.

The school must identify the pricing method in the IFB/RFP documents. If the pricing mechanism changes a new IFB/RFP must be issued.

**1) Firm price for a specified period of time**

Firm-price contracts should be limited to one-time delivery or short-term contracts because vendors are reluctant to commit to a fixed price for long periods of time. If firm price is the only system the school or school district can consider, then the question is how long the bid period should be. Consider these concepts when making the decision:

- ▲ The longer the price is held firm, the higher the cost.
- ▲ Short term protects the vendor from unexpected cost increases.
- ▲ Short term protects the school district from unexpected market decreases.

If the school district chooses firm price, consider putting a clause in the instructions that protects the vendor

from unexpected cost increases. Allow the vendor to provide proof from a third-party market report of a price increase. If the item is absolutely essential for service to children, the school could agree to release the vendor from the contract and obtain new price quotes for the item. Chapter 11 contains a discussion of third-party market reports. See standard contract language in Appendix 16 for suggested wording related to release from contract due to market-driven cost increases.

**2) Reimbursable cost plus fixed fee with escalation/de-escalation clause**

Some schools have successfully established long-term contracts that allow price escalation/de-escalation petitions, based on third-party market reports. With long-term contracts schools can establish stronger partnerships with their business partners and invest in effective training for site receivers. Market-based bids offer the advantage of long-term contracts or partnerships with vendors, but the length of the contract must be carefully considered. Factors to consider:

- ▲ State laws sometimes limit the length of contracts or the number of times they can be renewed.
- ▲ Potential vendors need some protection from increases in their operating cost; therefore consider one-year contracts with an option for mutually agreeable renewals for a specified number of years.

## CHOICE

- ▲ Funding for school nutrition program operations is dependent on annual budgets; therefore, bid instructions should include a fiscal funding clause. See Appendix 16 for recommended language.

### Such contracts include two prices:

- ▲ The potential vendor's cost of product and freight. The contract can be direct with manufacturer or with a distributor.
- ▲ The distributor's cost of doing business – cost of financing inventory, delivery cost, marketing cost, and profit. This is often called the fee-per-bid unit.

The contract vendor may petition for a product price increase, based on market, but the fee must remain firm for the duration of the contract. The request for pricing instructions should read as follows:

- ▲ Vendors may petition for increases in the invoice price once every six months.
- ▲ Vendors may petition for an increase based on an emergency created by unusual market conditions.
- ▲ Petition decisions are based on the upper number when the market price is quoted as a range.
- ▲ Petitions for increases shall be received by the school a minimum of 15 days prior to the effective date.

- ▲ Petitions for increases shall be based on the cost of product and freight only.
- ▲ Approval or rejection of requested increases will be based on third-party market report.
- ▲ Market research from the following reports is given blanket approval: The Food Institute Report, Urner Barry's Price Current, Urner Barry's National Provisioner Yellow Sheet, Urner Barry's HRI-Buyers Guide, USDA/AMS On-Line market reports.
- ▲ Vendors may propose an alternate market research source. The school district will decide on the alternate source based on the experience of the firm, the market research methodology, and references provided by the market research firm.
- ▲ If a petition for an increase is not covered by a third-party market report, the school district may request that the vendor obtain new price quotes from several sources.
- ▲ The vendor is expected to pass on market decreases to the school district. The school district may petition for an invoice decrease based on third-party market reports. (The author's experience was that vendors did not pass on decreases to the school district. However, if the vendor is given this mandate the sentence would read: "The vendor is required to pass on market decreases . . .")

*Chapter 11 contains a list of recommended sources for third-party market reports. This chapter also covers how to determine whether petitions for escalation/de-escalation should be granted.*

### 3) Fee plus cost

The request for pricing is in two parts: The distributor quotes a fixed fee to cover the cost of storage, delivery, money, profit, freight from manufacturer to their dock, and sales. A third-party market report determines the cost of the product. For example, the AMS/USDA Southeastern Farm Market Summary for Wednesday, January 31, 2001, for the Florida market listed the price for Grade A large fresh eggs as \$0.67 to \$0.68 per dozen. The quote from the vendor might be AMS/USDA Florida market plus \$0.02 fee per dozen. Therefore the school district invoice cost for the week of February 5 - 9, 2001 would be \$0.70 per dozen and \$21.00 for a 30-dozen case. In this example the school district had a policy of using the upper range of the market. The request for price instructions contained this information.

The wording for the request might read as follows: "Eggs will be purchased based on the five-day average market cost as reported by AMS/USDA, using the (insert region) market. We will purchase medium eggs in cases of 30 dozen per case.

"Each Monday afternoon the school district will advise you of the invoice cost for deliveries on Wednesday and Thursday of that week. Please quote a

fee per dozen. Establish your fee based on how much under the market you are able to purchase eggs, your operating and delivery cost, and required profit margins."

The price of fresh produce is another item that could come from third-party market bulletins. With the AMS/USDA online reports, a school district could establish the cost of product and obtain a bid for delivery based on fee over cost. Look at this example of the steps in this process.

- Step 1** Choose the terminal market that serves your area for the base.
- Step 2** Begin reviewing the reports daily.
- Step 3** Decide on a day of the week to establish prices.
- Step 4** Meet with produce vendors and discuss the proposed change. Share copies of the last few weeks terminal market reports.
- Step 5** Allow the vendors a week or two to study the change and materials.
- Step 6** Contact each vendor and discuss the change.
- Step 7** Issue the bid for fees.
- Step 8** Award the delivery contract.
- Step 9** Decide how to transmit weekly cost to the successful vendor and the site receivers.
- Step 10** Settle any quality issues related to product.
- Step 11** Begin delivery.

## CHOICE

**A major change in a purchase system will raise questions. Be prepared to answer some of these:**

**Q** We purchase the product for less than the terminal market quote. Are we to invoice what you say regardless of what we pay?

**A** Yes. The process is fair because we have chosen to use the third-party terminal market as our cost. There will be no audit of your cost. The effectiveness of your purchasing system could be reflected in your fixed fee when you offer a bid.

**Q** Sometimes a truck comes by and offers a very good price on product. At what price do we sell that product to you?

**A** We have a contract that specifies the price and quality of the products we purchase. We must honor the contract. We do not want to purchase distressed or second quality product no matter how good a buy it seems.

**Q** When the season is changing on the growing region for a product such as oranges, how will we know you want to change the variety and region?

**A** We will monitor the market and advise you when we are ready to change. In the example of oranges we will tell you whether we want Florida, Texas, or California oranges, based on the market cost.

.....

### Milk

#### Purchase method:

Sealed bids are the usual purchase method for milk.

#### Number of vendors:

Most schools must receive deliveries of milk every day. Daily deliveries add to the cost, but schools aren't built with adequate chilled storage space for more than a few days' milk supply. Imagine having one vendor deliver the low-fat unflavored milk, another low-fat chocolate, and yet a third vendor the other milk types. Almost all school districts award milk on a bottom-line, all-or-nothing basis.

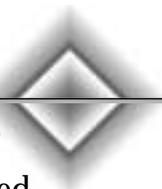


**Pricing mechanism:** Milk contracts frequently are based on an escalation/de/escalation clause tied to a third-party market bulletin. Here is an example:

"All prices shall be firm for 30 days, after which prices for milk can increase or decrease in accord with changes in Class 1 raw milk prices based on monthly Federal Milk Order Announcements for the applicable geographical zone. Prices for milk delivered can be increased or decreased at the rate of \$0.001 per half pint for each full \$0.15 increase/decrease in raw milk per hundred weight."

Bidder should specify the geographical zone on which the price is based. The bidder may use either the processing plant location or the school district location.

At the time the bid is issued, specify the date of the milk market order that is the base for the price offered. If one vendor bases the price quoted on the



June order and another the July order, prices can't be compared. Check with the regional milk market administrator to find out when the order is updated. (Get the name of the milk market order administrator on the internet at <http://www.ams.usda.gov/dairy/orders.htm>.) Choose the market order closest to the bid opening date, allowing the vendor time to get the price and complete the bid.

**Bread**

**Purchase method:** Sealed bids are often used. Many school districts have difficulty maintaining competition for this business. When food restaurants receive weekly deliveries of bread, all bread is received frozen – an option to increase competition.



**Number of vendors:** To serve a fresh product most schools receive deliveries of bread frequently. Frequent delivery increases cost; therefore, schools select their bread vendors on the basis of bottom line, all-or-nothing bids.

**Pricing mechanism:** Firm price for one year.



**Fresh produce**

**Purchase method:** Sealed bids for a fee per case or an RFP for a service provider contract.

**Number of vendors:** Bottom line

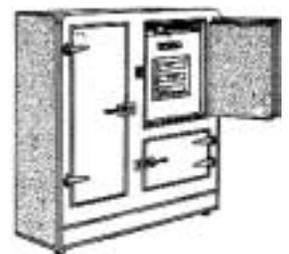
**Pricing mechanism:** Whole produce such as apples, oranges, potatoes,

onions, and tomatoes is best purchased on a firm price contract with an escalation/de-escalation clause. The escalation/de-escalation clause allows both the school district and the vendor to petition for weekly changes in the cost. The petition is based on a third-party market report.

Precut produce has a more stable price than is commonly believed. Consumers want lettuce and cabbage to be perfect round heads. Agricultural products are not always perfect. The precutter contracts to purchase all of the rejected product from a grower on a long-term basis and can therefore offer long-term pricing to their customers. Firm price with a petition for escalation/de- escalation every six months is the best pricing mechanism for the purchase of precut produce. The petition is based on a third-party market report.

**Frozen, dry, and refrigerated products**

**Purchase method:** Sealed bids for a fee per case or an RFP for a service provider contract. High volume product is best bid



direct to manufacturer if the cooperative or school district is large enough to purchase in truck load or mixed truck loads. A second bid is issued to distributors for purchase, warehouse and storage of the product.

**Number of vendors:** Increasing the volume per stop (drop size) allows distributors to deliver products to

## CHOICE

schools cost effectively. As the number of distributors serving a market continues to decrease, schools must make their business attractive to potential bidders. Bottom-line bid award is one way to do that.

**Pricing mechanism:** Firm price with a petition for escalation/de-escalation based on third-party market reports. The petition period could be every three or six months. No research studies document whether the increased paper work associated with every three months is justified by reduced cost



### Direct to manufacturer

Bench marking is one of those modern terms that describes how a company with an excellent performance reputation manages a given process. In food service management, restaurant chains enjoy a good reputation for the way they manage purchasing. Most major restaurant chains – whether fast food, white table cloth, or family dining – have entire corporate departments devoted to purchasing products for the facilities they own or franchise. The owners of these companies recognize that purchasing is the key to success and allocate reasonable resources to this task.

Schools should consider bench marking the purchasing practices of restaurant chains in their area through partnerships or "Adopt a school" programs between local businesses and schools. Choose a restaurant chain that has an excellent national reputation and invite them to teach purchasing. When

choosing a benchmark partner, review its menu before making a contact. A partner that has a menu with a wide variety of products can give the most assistance. A limited- menu restaurant has a much simpler purchasing task than most schools.

Some school purchasing innovators have successfully used benchmark partners to assist them in improving their purchasing practices. These school learned:

- ▲ For many items two-part contracts are useful – one with a manufacturer for the product and freight and a second contract with a distributor for delivery.
- ▲ Combining the volume of many restaurants gives them the edge to establish cost-effective contracts with manufacturers. The use of cooperatives provides schools the same benefits.
- ▲ Restaurants purchase low-volume items through the distributor in the same manner as most schools.
- ▲ Cost for product is stabilized when the contract is direct with the manufacturer.
- ▲ Small distributors can compete more successfully with large distributors under a direct-to-manufacturer system.

Applying open and free competition rules to manufacturer contracts is not easy. The collective advice from school districts using this approach is to select a few items and experiment. Early opposition from the distribution

community will be intense. However, if the restaurants can do it, why shouldn't the schools use this approach to serve the children better?

**Purchase method:** Sealed bids

**Number of vendors:** Line item for the majority of products. Some small groups on a limited basis. An example: combination of straight-cut and crinkle-cut French fries. However, other speciality potato products cannot be added to this group because of the lack of similarity among manufacturers.

**Pricing mechanism:** Firm price with petition for escalation/de-escalation based on third-party market reports.

### Low volume products

School districts often place very low volume items, such as food coloring and spices, on the bid and obtain prices each time a bid or price quote is issued. This practice wastes vendors' time and needlessly lengthens the product list that schools must manage. Schools could easily make a list of all the items that they buy only one or two times per year.

**Purchase method:** Sealed bid

**Number of vendors:** A bottom-line award with one vendor is the most cost effective.

**Pricing mechanism:** Firm price with an effective period of a week or 10 days. The product would be ordered for delivery all at the same time or, if several sites are involved, over several days. If volume warrants a second order, the school could get prices for different periods each year. To assure

fresh product, the school might issue bids for the starting week of school and again in January.

Everyone is a winner in this scenario. The school or school district has substantially decreased its paper work, and the vendor's risk of cost increases is minimized.

### Warehouse deliveries

**Purchase method:**

Sealed bid

**Number of vendors:** Since the quantity of a single item must be adequate for a distributor to make a cost-effective delivery, the award method of choice would be line item. It might be necessary to bottom-line some low volume items.

**Pricing mechanism:** If the school district operates a warehouse, short-term firm prices lower the risk to the vendor, who should give the district a better price quote. School districts increase the cost of operating a warehouse when they require that the price quote remain firm long term on small volume orders.

### Small Equipment

**Purchase method:** Sealed bids

**Number of vendors:** All school districts use bottom-line award when they equip a new school. Architects employ one or two subcontractors for all kitchen equipment. When districts purchase small equipment on a bottom-line bid award, they can receive one



## CHOICE

delivery and complete this task for the year, the most cost effective way for a school or school district to purchase small equipment. Placing orders for small equipment throughout the school year lowers the volume of any one order, thereby increasing the cost.

**Pricing mechanism:** Requesting firm prices for a one- or two-week period decreases school paper work and the vendor's risk of cost increases. Everyone is a winner.



### Service contracts

School districts contract for many services. Examples of service contracts are pest control, garbage removal, courier service, equipment maintenance, staff training, auditing, software support, computer hardware service, and marketing programs.

**Purchase method:** Request for proposal

**Number of vendors:** A bottom-line contract for all of the components of a service.

**Pricing Mechanism:** A firm price for a specified period of time.

### Technology and e-commerce

Purchasing software has been developed as an additional module with point of sale. The quality of the purchasing software reflects the afterthought nature of the development. Perpetual inventory most often provides the base of data. Bid award is often one of the features. An informal survey of school districts in one state revealed

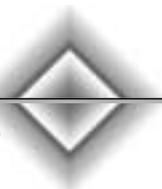
that only one school district was a satisfied customer. It had taken that school district five years to get all the necessary data keypunched. The survey covered all major software with a purchasing module.

**Some substantial limitations when using these software programs include:**

- ▲ The software limits the size of the descriptions used on the request-for-price documents.
- ▲ The number of approved brands is often limited by the space provided.
- ▲ The format of the request-for-price documents pays no attention to good reading format.
- ▲ The software often forces the school district to ask what brand is being bid on every item, even if the school district does not care.
- ▲ The software often forces the vendor to complete a how-packed section even if the school district specified a single pack “only” and variations are not acceptable.
- ▲ The software will not allow bid award on the appropriate bid unit (i.e., portion cost) thereby causing increases in food cost.

A good spreadsheet or data base software application often offers more flexibility and can accomplish the purchasing task more efficiently than most purchasing software currently marketed to schools.

A software package that focuses on



the order process at the site would improve the entire purchasing system. Systems must be developed to reflect actual work done at each level. Purchasing begins at the kitchen site. As discussed in Chapter 4, all products are not ordered the same way. Software that recognizes the diversity of the products necessary to produce today's meals would help the inventory control process. Perpetual inventory in a situation where the site gets weekly delivery produces extra work and reduces the time that can be allotted to control of inventory. A perpetual inventory system for the major components of the meal that produces the production record but does not require the site manager to record the use of staple food items could be justified. The diversity of products must be recognized. If development was approached as a tool for the site instead of the central administrative office, the functionality of the software would change. This change would solve many of the problems of the central administrative unit and the site. Software would become management focused rather than control focused.

**What would effective purchasing software look like? It would:**

- ▲ Allow for management of the product list in several ways:
  - ▲ classified and managed by order type - stock level, menu driven, annual, stocked by delivery man (such as milk or snack items)
  - ▲ classified and managed by purchase method
  - ▲ classified and managed by brand approval type
  - ▲ classified and managed by production record type (category in menu pattern or on production record and whether purchased or USDA donated)
- ▲ Allow the length of the food description to be flexible on the request for pricing.
- ▲ Format the request for pricing in left-to-right columns.
- ▲ Allow the vendor to submit the request for pricing either online or by disk.
- ▲ Produce an order catalogue for the site manager that provides the pack of all items – or, even better, allows for the development of a weekly order by week of the cycle menu and allows the site to input the quantity of each choice to produce. The software would then complete the math to produce the weekly order.
- ▲ Allow the site manager to view current contracts online at the site and place the site order online.
- ▲ Automatically order the stock items unless the quantity is changed by the site.
- ▲ Allow central office approval of the order and transmit the order electronically to vendor.
- ▲ Interface the order with the vendor's inventory and report shorts and outs back to school district.

## CHOICE

- ▲ Prepare a receiving report for the site manager that indicates quantity ordered and brands to be verified at time of delivery.
- ▲ Allow the site to indicate the order is received in total (by count and dollars) rather than by item.
- ▲ Allow the site to record the total amount of all invoices for receipts and post against the site budget, always showing the site manager how much budget authority is left for the month.
- ▲ Capture the purchase history by site and as a district aggregate and allow the central office to retrieve by site or aggregate for specified time periods.
- ▲ Track usage history for rebates and prepare reports for submission to manufacturers.
- ▲ Interface with nutrient analysis software, and other software (menu costing, inventory management) used by the school district.

What does the purchasing future look like? Child Nutrition spends more dollars on commodities (the term used by the purchasing community for food, as well as pens and pencils) than in any other area of the school district. Only a small percentage of the instructional and office supply budgets are spent on commodities. E-Commerce, purchasing cooperative administrators, and distributors are beginning to recognize this fact. “Penetration of the account” is a term used by sales staff when

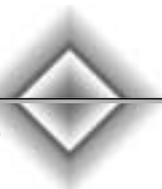
discussing what percentage of the school’s business it has obtained. The sales objective is to obtain as close to 100 percent of the business as possible.

Think back a few years to a time when the services of many vendors were required to acquire the products used in a school kitchen. Today a large percentage of the products are purchased from a broadline distributor. Step outside the black box and envision a truck backing up to the loading dock and unloading food, office supplies, instructional materials, basketballs, bats, band instruments, computers, and phones. For help with the vision of the future, make a visit to the World Wide Web at

<http://www.patriotfoodservice.com>.

This broadline distributor is already preparing for the future.

The 2000 revision of The American Bar Association (ABA) model procurement code modified and added new definitions that allow procurement processes to adapt to the electronic age. The ABA model defines electronic as “electrical, digital, magnetic, optical, electromagnetic, or any other similar technology.” The authors of the model code comment “(1) The purpose of this definition is to facilitate the use of electronic documents of all types. The code does not attempt to anticipate the specific technologies that may allow the procurement process to be performed electronically, but provides the (policy office) with the necessary flexibility to adopt regulations that do so. (2) The implementation of electronic procurement processes should include sound system checks and balances that



demonstrate a high level of accountability and integrity.”

A lot of articles are being written and a lot of attention is paid to e-commerce, but will it benefit school food service? A search of the World Wide Web on May 31, 2001 using the search words “e-commerce & food” listed seven sites that serve restaurants. Readers are encouraged to visit some of these sites. As the systems now exist, it does not appear that there are many benefits for child nutrition. The literature does not provide any practical examples of money saved or quality improved. E-commerce could be a real benefit to school purchasers. An e-commerce company could register school districts for an array of products, determine the quantity that will be used in a year, and produce for those member school districts a manufacturer’s contract price. Then the school district would contract with a distributor for delivery. The e-commerce company would serve as the cooperative headquarters for many school districts’ direct contracts with manufacturers. The current problem is that contracts are negotiated without full and open competition, and pricing does not consider quantity purchased. Most e-commerce companies are either focusing on drop shipments or allowing the school districts to choose from an array of distributors. Although no numbers are available, experience indicates that when distributors do not know how much they will deliver, the price will be high. The future is bright and offers many opportunities for long-range improvement in child nutrition

purchasing through the use of technology and e-commerce.

### **Evaluating purchasing systems**

Evaluate current practice as a basis for selecting the purchase system that is best for the school/district. The suggestions below are a guide for conducting a self evaluation of the purchase systems presently in place.

- ▲ Are the product movement policies of the SFA clearly defined?
- ▲ Are the receiving practices adequate to assure delivery of the product as purchased? A random, on-site review of deliveries is the best way to check this. Have an individual in central administration involved with awarding bids follow the distributor trucks for a week as deliveries are made. Are receiving practices adequate? If the answer to the question is no, determine where the system is failing.
- ▲ Are product descriptions adequate to assure comparability? A third-party product specialist is the best person to answer this question, to evaluate the quality and fairness of descriptions as written. If budget constraints do not permit the employment of a third-party, ask the state agency and the National Food Service Management Institute (NFSMI) for a list of school districts with good descriptions. Obtain a copy of the descriptions these districts use for comparison.

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- ▲ Do the purchase systems in the district reflect innovations in systems developed in the last 10 years? When was the last time the purchase systems were changed? Review articles in the School Food service and Nutrition Journal and other trade publications. Food purchasing cooperatives are a good source for information on the latest innovations in purchasing.
- ▲ Is the purchasing environment conducive to change? Whether child nutrition is autonomous from a central purchasing department provides part of the answer.
- ▲ Is staff time available for purchasing adequate to manage changes?
- ▲ Is staff expertise strong enough to manage change? If the answer is no, are resources available to train appropriate staff for purchasing?
- ▲ Is computer technology used to support purchasing?

### Changing the purchasing system

If evaluation of the purchase system shows that a change is needed, take it easy. Change will generate a lot of conflict with business partners. Make a change from line item to bottom-line award in phases. Market based bids probably should be phased in over five to 10 years. Drastic change could create a situation where no one will deliver the products. Below is an example of a long-range plan for changing the purchase system. Each school district

must evaluate where they are and what they want to accomplish and then develop a customized plan.

- ▲ Year one — project quantities and begin improving descriptions.
- ▲ Year two — refine system to project quantities, complete description improvement project, and classify products by anticipated brand approval type.
- ▲ Year three — begin screening products for brand approval, convert milk and milk products bid to firm price with an escalation clause based on third-party market bulletins.
- ▲ Year four — complete brand approval, begin studying third-party market bulletins for fresh produce, and complete a market area analysis in preparation for conversion to bottom-line firm price (Appendix 3).
- ▲ Year five — Convert to approved brands only on a line item bid, convert fresh produce to a third-party market based bid system, and continue to work on market area analysis in preparation for conversion to bottom-line firm price.
- ▲ Year six — Convert to a bottom-line firm price bid for meat and groceries, begin studying third-party market bulletins, and compare prices paid for products to the market bulletins.
- ▲ Year seven — Convert two or three high volume items to reimbursable

cost plus a fixed fee with a petition for increases based on a third-party market bulletin.

- ▲ Year eight — Convert some additional items to third-party market bulletin prices. Experiment with contracting directly with a manufacturer for a few high volume items.
- ▲ Year nine — Convert entire bid for meat and groceries to reimbursable cost plus a fixed fee with a petition to increase cost based on a third-party market bulletin.

- ▲ Year 10 — Remove spices from the meat and grocery bid and establish two contracts, one with the manufacturer for the cost of the product and a second with the distributor for delivery.

The only certain thing about purchasing food is that it changes constantly and the purchaser must be willing to change with market conditions.

# CHOICE

## Summary

Three basic decisions must be made for all purchases. The decisions are:

- ▲ The appropriate purchase method
- ▲ The pricing mechanism
- ▲ the number of vendors required to perform the service or deliver the product

Three basic purchase procedures are small purchase procedure, sealed bids, or request for proposals.

Two basic methods for selecting the number of vendors are:

- ▲ Line item awards - the price offered on each product is considered independently.
- ▲ Bottom-line awards, sometimes called all-or-nothing awards - the prices offered on products are considered as a group.

Three basic pricing types are:

- ▲ firm price for a specified period of time,
- ▲ reimbursable cost plus a fixed fee for service with petition for escalation/de-escalation based on third-party market reports, and
- ▲ a fee for storage, delivery, and cost of money with the cost of product established by third-party market reports

To improve purchasing systems, communication between the manufacturer, distributor, and the school district will need a lot of improvement. Purchasing is the same for the private sector as the public, except public sector customers have to use bids that guarantee open and free competition and comparability.



Creative approaches to purchasing in the public sector must be developed if schools are to apply quality measures to the purchasing process. Change will take the best efforts of manufacturers, distributors, and schools. School children deserve nothing less than the best from these partners.