Chapter 2

An Overview of Federal Food Procurement Programs

Introduction

Several government agencies administer large-scale food procurement programs. At the U.S. Department of Agriculture (USDA), two agencies—the Farm Service Agency (FSA) and the Agricultural Marketing Service (AMS)—purchase food products for domestic distribution on behalf of a third—the Food and Nutrition Service (FNS). Those products are distributed through domestic food assistance programs, such as the National School Lunch Program (NSLP) or The Emergency Food Assistance Program, which are financed by FNS. About three-quarters of the food purchased under domestic food assistance programs is distributed to school districts under the NSLP, while the rest is distributed through a variety of smaller programs, described more fully in chapter 3. The two USDA agencies spent $849 million on food purchases for domestic programs in 1996.

Food procurement forms a small part (less than 2 percent) of total FNS expenditures on domestic food assistance. Most of the total FNS food assistance budget of $38 billion goes to support direct cash transfers, such as payments to foodstores for redemption of coupons and vouchers under the Food Stamp and Women, Infants, and Children Programs, or cash payments to schools for subsidized meals under the NSLP. Schools receive about 20 percent of their USDA support in the form of commodities, with the rest in cash support.

FSA also purchases and ships food and agricultural commodities to foreign countries under the Food for Peace program (PL480) and other international assistance programs. The programs are administered and financed by the State Department's Agency for International Development (AID) or another USDA agency, the Foreign Agricultural Service (FAS), for which FSA acts as the buying agent. FAS expenditures for PL480 programs were $1.21 billion in 1996. In addition, FAS spent another $84 million on food expenditures for the Food for Progress program. Under this program, U.S. agricultural commodities are provided to developing countries and emerging democracies that have commitments to introduce and expand free enterprise in their agricultural economies.

At the U.S. Department of Defense (DoD), the Defense Personnel Support Center (DPSC) purchases food for military bases, ships, and other military facilities. DPSC purchases for all four branches of the military, acting as the buying agent for the Defense Logistics Agency (DLA). In addition, DPSC has contracts to act as purchasing agent for the U.S. Coast Guard, some prisons, and some school systems. DPSC food purchases amounted to approximately $525 million in 1996, and the agency also provided $115 million in other contract services.

At the Department of Veterans Affairs (VA), the Office of Acquisition and Materials Management (OAMM) purchases food for 173 VA facilities, primarily medical centers. OAMM food expenditures amounted to $60 million in 1996, along with another $12 million in food equipment and supplies. The agency also aims to obtain contracts to act as purchasing agent for other entities; for example, OAMM handles food purchases for medical facilities in the U.S. Army Medical Command.

Program Goals

Each agency tries to reach several primary and secondary goals through their procurement strategies. For example, the USDA agencies traditionally have had dual goals—surplus removal and food assistance. USDA has historically purchased substantial volumes of agricultural commodities in order to support prices for "program crops," such as wheat, corn, and dairy products. The Department has then had to find ways to dispose of the accumulated surpluses, and one way has been to distribute them outside of normal commercial channels through food assistance programs to low-income households and countries. Surplus removal, used for Section 32 purchases by AMS, often emphasizes the rapid distribution of large volumes of particular commodities, those that have had large harvests and falling prices, in order to support producer prices. As a result, AMS procurement has generally emphasized agricultural commodities and less processed food products because of their closer link to the farm sector.

Food assistance programs include the distribution of emergency supplies of staple food items to areas hit by such natural disasters as floods, hurricanes, and earthquakes, and the regular distribution of food products to members of low-income households. Assistance goals include the assurance of nutritionally adequate diets among client groups, as well as income support for food assistance recipients. Because most expenditures have been aimed at staple food products that are often storable for extended periods, procurement procedures have emphasized the acquisition of simple, nutritionally sound foods at competitive prices.

DoD and VA purchasing agencies do not operate under surplus removal expectations. Because they provide a substantial share (up to 100 percent, for some) of the food consumed by their clients, they are under greater pressure to provide for product variety, and not simply nutritional adequacy. Moreover, because DoD client food demands may fluctuate sharply (for example, when a ship arrives at a base or when a reserve unit is activated), DPSC—DoD's procurement agency—must respond rapidly to unexpected service demands. As a result, the agencies' procurement strategies emphasize quick delivery of a wide variety of food products.

Food procurement agencies also aim to realize some secondary goals that often are imposed by statute. Each is required to support small businesses by setting aside a certain percentage of purchases for firms that are designated as small businesses. USDA is required to buy foods that use products from American farms, and the Merchant Marine Act requires FSA to arrange for ocean shipment in American ships. VA medical centers are expected to purchase a percentage of food in local areas in order to support local economic development. USDA agencies often attempt to encourage good dietary and purchase habits through example, by offering low-fat versions of food products and by forgoing more expensive commercially branded products.

Procurement Methods

USDA, DoD, and VA use different procurement methods. Most USDA procurement is done through sealed-bid auctions for the delivery of a limited variety of food commodities to central warehouses or further processors. Client agencies then generally take responsibility for distribution from warehouses, reprocessing some commodities (such as cheese and flour) into more highly processed foods (such as pizza), delivery to points of consumption, and local preparation. By contrast, DoD and VA have recently introduced "prime vendor programs," in which a private firm (the prime vendor) is responsible for ordering products from processors, providing storage for an inventory of products, and delivering a wide variety of food products to all facilities within a region, with clients then responsible only for their own ordering and for local preparation.

A Brief Description of USDA Procurement Methods

FNS receives the appropriation for USDA programs; it also allocates funds to the client State and tribal distributing agencies, collects food commodity and product orders from these agencies, and ensures their compliance with program requirements. State and tribal agencies use FNS program guidelines to determine if individuals are eligible to receive food products and to deliver products from warehouses to the targeted population.

Client agencies place orders for food products, working from product lists (with likely price ranges) provided by FNS. USDA's procurement agencies, FSA and AMS, then aggregate the orders to truckload quantities, and produce invitations for vendors to enter bids to produce the orders. An invitation usually includes multiple auctions, where each auction is for the award of an order for delivery of truckload quantities of a precisely defined food product to a distribution point within a defined time period. The time period is usually a 2-week span, the distribution point is usually a warehouse in reasonable proximity to the client, and food products are defined as to type (say, all-purpose flour or bread flour), package size, and ingredient requirements.

USDA distributes invitations and runs auctions once a month for some products, while auctions for others are held weekly (ground beef), seasonally (some fruit products), or annually (infant formula). Vendors (food processing firms) respond by submitting sealed bids; sealed bids are not known or observed by rivals, as would occur in the sort of open verbal auctions used at art auction houses. Vendors typically do not offer bids on all auctions in an invitation, but frequently enter bids on more than one. A bidder may place a maximum on the total quantity that they would be willing to produce from all the bids entered in an auction, and bidders in some auctions may also place minimum quantities, below which they will accept no awards.

USDA aims to award the order to the best bid in an auction, subject to several constraints. For international shipments, USDA considers ocean transport charges as well as the vendor's quoted prices for delivery of a product to a domestic port—that is, the winner is determined by the lowest total cost to USDA. When low bidders are above their maximum or below their minimum total quantities, agencies will attempt to make awards in ways that will minimize invitation-wide total costs to USDA. Finally, some orders are set aside for small businesses, as long as a qualified small business enters a bid that is within 5 percent of the lowest bid.

Vendors are expected to arrange for transportation to warehouse points or, in the case of international shipments, to ports. Commercial freight forwarders arrange for ocean shipping to international clients, while domestic clients arrange for transportation from warehouses. USDA requires onsite inspection of all products; inspectors for some products are employed by AMS, while another USDA agency, GIPSA (the Grain Inspection, Packers and Stockyards Administration), provides inspectors for other commodities. Laboratory testing services supplement the onsite inspectors and are supplied by AMS and GIPSA.

Prime Vendor Programs

USDA's procurement auctions rely on competition among processors to obtain precisely defined food products at favorable prices. Prime vendor programs also rely on competition, but for a different sort of award.

Under the DoD program, the country is divided into regions, and in each region, a single prime vendor supplies military facilities with food products. DoD now has 50 Prime Vendor contracts in the continental United States. Contracts are for a single base year, with provisions for three or four 1-year extensions. The prime vendor is generally not itself a manufacturer; most are foodservice wholesalers. Prime vendors offer distribution facilities and choices from a wide range of food items. They obtain products from processors, assemble loads for clients, and deliver from the prime vendor's warehouses directly to ships, base dining halls, and other locations. Prime vendors also provide a central point of contact for problems with deliveries, product quality, or errors in orders.

Prime vendors in the VA program perform a similar function, but the VA divides the country into 16 regions. The geographically larger VA regions are able to combine hospital purchases into a large enough aggregate to correspond to the business opportunities offered to prime vendors in DoD regions.

Prime vendor contracts are awarded after competitive bidding among potential vendors. The contracts are for indefinite quantities because base food demands are not perfectly predictable far in advance. The DoD procurement agency, DPSC, provides bidders with a list of items wanted, along with estimated quantities and likely minima and maxima; the agency also estimates the likely dollar volume of sales for each region. In response to the invitation, and after pre-proposal conferences, bidders submit very large and extensive proposals. DPSC then evaluates the proposals. It considers a business segment of the proposal, in which it asks for price quotes on a sample of items, as well as the bidder's fee per item. The agency also assembles a technical panel to make site visits and to review the bidder's ordering systems, inventory controls, and delivery technologies.

VA technical panels review the size of bidder warehouses, the variety of products and the capability to add new items, transport options, and purchase and accounting systems. Price quotes are also included for evaluation in the business segment of bidder proposals.

Contract awards are made on the basis of the lowest priced, technically feasible, proposal. DPSC managers expect, however, that the basis for awards will shift somewhat toward best value, which would add considerations of past performance and service quality to the awards decision.

DPSC purchases some military-unique food items, including those with special packaging to withstand shipboard or airborne conditions as well as foods that are prepared for field consumption. DPSC runs competitions to select a single manufacturer for each military-unique item, and handles orders and payment to the manufacturer. Prime vendors then assemble and deliver military-unique items to bases.

DoD and VA procurement agencies do not rely on extensive onsite inspection to provide quality controls as USDA does. Instead, pressures to maintain quality and to meet contractual obligations arise from several sources. First, contracts are renewable, and past performance becomes a factor in competitions for renewed awards. Second, military facilities are not obliged to spend all of their food dollars at prime vendors; they may also purchase from local vendors. Third, mess halls and other dining facilities are not obliged to accept deliveries from prime vendors; they may reject and return unacceptable products. Fourth, the agencies retain the right to audit the relevant records of prime vendors during the course of the contract. Finally, most prime vendor food products are identical to those the vendor supplies to its other commercial clients. Vendors have incentives to maintain and assure the quality of their private-label brands and services; if quality deteriorates, they risk losing not only DoD and VA business, but commercial sales as well.

Causes of the Shift to Prime Vendor Programs

DoD prime vendors supplanted a system of military depots. Prior to the shift to prime vendors in 1995, DPSC ordered food products on behalf of military facilities, much as USDA's agencies now order on behalf of school districts and other clients. Food products were then delivered to depots operated by the Defense Logistics Agency (DLA), and from there were distributed to base warehouses. Finally, products were delivered to mess halls, ships, and other dining facilities from the base warehouses.

Two problems drove the shift to a prime vendor system. First, aging military depots and warehouses were in need of substantial investments in construction and maintenance. Second, food deliveries required long lead times, 45 days between order and delivery. Prime vendors provide substantially improved service to dining facilities; over 99 percent of orders are delivered within 2 days, if substitution among brands and package sizes is allowed. Vendors operate 7 days a week, and offer a wide variety of products. The military has been able to consolidate depots and warehouses, and to realize substantial savings in the costs of carrying food inventories, which fell from $230 million prior to initiation of the program to $69 million in late 1996, with a goal of $15 million after full implementation.

Of course, the need for warehouse space does not disappear with the introduction of the program—prime vendors now provide services of storage, repackaging, delivery, and administration that the military used to do by itself. DPSC managers estimate that vendor fees for these services amount to 11-12 percent of commodity sales. DPSC receives additional payments equal to 6 percent of total expenditures for prime vendor commodities and services. DPSC provides translation software to enable the different services to order through a consistent computer system, advises facility managers on sound purchasing strategies, handles the flow of payments from bases and DLA through DPSC to the vendors, and administers the system of prime vendor contracts.

Procurement agencies and clients must make some adjustments under prime vendor programs. With a wider range of available products, clients must learn more about the products that are commercially available, and they need to invest in learning about electronic ordering and tracking systems. Agencies assume greater responsibility for advising clients and for reviewing and supervising vendors.

The VA's 1995 shift to a prime vendor program came slightly before DoD's did. Before then, VA purchased about 300 different food items distributed through a depot system. In the view of VA managers, vendor prices were relatively high, and delivery times through the depot system were poor. Food item distribution costs appear to have been subsidized by pharmaceutical items in the VA depot system. When pharmaceutical procurement was pulled out of the depot system, the food procurement program came under substantial financial pressure, leading to a search for alternatives. In the VA case, managers cite lower product prices, wider variety, more timely delivery, and the elimination of depot facilities, along with their associated expenses, as advantages of the new system. Prime vendor fees average 9-12 percent of food product costs, and the VA's procurement office, the Office of Acquisition and Material Management (OAMM), charges a one-half-percent fee for its services.

The VA provides some volume guarantees to prime vendors by committing at least half of a region's purchases to the prime vendor. Clients may also reduce costs on some items by providing volume commitments on specific products to the manufacturer/vendor from which the prime vendor purchases.

Conclusions

USDA's procurement programs are designed to obtain a limited variety of precisely defined food products at the lowest possible cost to USDA for delivery to warehouses. As we shall see in later sections, USDA relies on tight specifications and direct inspection to ensure product quality. The system is decentralized in that final delivery, reprocessing, and distribution to dining facilities are the responsibility of the client. The prime vendor programs used by DoD and the VA are designed to obtain important services, such as variety (and associated inventory) and rapid delivery, in addition to food commodities. Vendors are expected to compete to offer packages of service and price. DoD and VA aim to ensure product quality through reliance on commercial labels and continued competition among vendors for contract renewals.