

CHAPTER 5

Commercial Marketplace — The Preferred Approach

OVERVIEW

Earlier, you learned about the various mission areas in the federal government, such as supply and service contracting, research and development, contingency contracting, and major systems. Depending on the mission area, you could procure a variety of supplies and services. In shaping smart business arrangements, we strive to use the best available approach to meet customer needs. In this chapter, we will discuss our preferred approach to meeting customer needs and the value of using business practices from the existing marketplace.

Learning Objectives

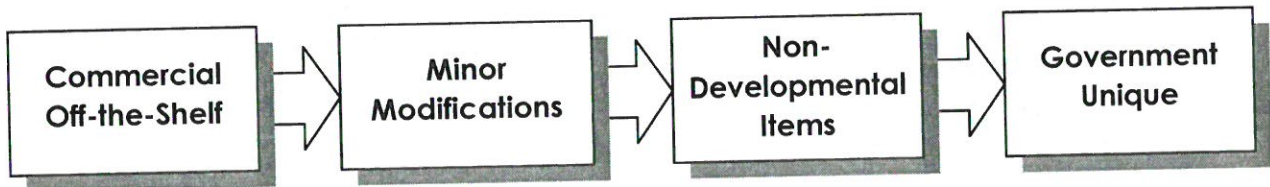
Given acquisition scenarios, describe the requirements of market research in identifying the best business arrangement to meet mission requirements. Specifically, upon completion of this chapter, you should be able to:

- 5.1 DESCRIBE the preferred approach to meeting customer needs using commercial off-the-shelf items.
- 5.2 RECOGNIZE the benefits and challenges of procuring commercial off-the-shelf items, modified commercial items, non-developmental items and government unique items.
- 5.3 IDENTIFY market research, benefits, and uses.

PREFERRED APPROACH

Since the passage of the Federal Acquisition Streamlining Act of 1994, the preference within the government has shifted from the acquisition of items developed exclusively for the government to the acquisition of commercial items. This change was necessary to take full advantage of available and evolving technological innovations in the commercial sector. The government's increased reliance on commercial items is essential to provide technology solutions that increase customer capabilities.

The preference for the government in procuring supplies can be shown on a continuum as reflected below.



COMMERCIAL OFF-THE-SHELF ITEMS

The government preference is to use items that are available as commercial off-the-shelf (COTS) items. What is a COTS item? COTS items are items that have been sold, leased, or licensed or merely offered for sale to the general public and that are offered to the government without modification. Buying a commercial off-the-shelf item for the government would be no different than walking into any department store and making a purchase.

How do you, the contract specialist, know if there is a commercial off-the-shelf item available to satisfy your requirement? Market research will tell you. When doing your market research, indicators of commercial sales are the existence of a commercial sales history, listings in catalogs, known established prices, existence of multiple distributors, and availability to the general public. Some examples of commercial off-the-shelf items in the various mission areas would be:

- Supplies and services: paper, pencils, computers, janitorial services, or data entry services
- Research and development: microscopes or glass tubes
- Contingency contracting: bottled water, wrenches, or toilet paper

COTS
include
services too.

- Major systems: software or new technology

Why COTS?

Why would the government look to buy COTS items? By expanding the use of commercial items, agencies can:

- increase competition;
- leverage technology investments of the private sector;
- reap benefits of reduced cycle times;
- insert new technologies faster;
- lower life cycle costs;
- achieve greater reliability and availability;
- take advantage of proven capability by the contractor who assumes responsibility when the product does not work;
- streamline the acquisition process; and
- increase the potential for identifying alternative products.

We will discuss some of these advantages in more detail below.

Competition

Competition in the commercial marketplace provides the government with various sources to consider. Let's say you are buying a microwave. Contractor A is selling a microwave for \$100, Contractor B is selling a microwave for \$105, and Contractor C is selling a microwave for \$120. Which would be the best buy or best value? If all microwaves meet the customer's requirement then Contractor A would be selected.

Technology Investment

By leveraging technology investments of the private sector, the government can take advantage of the technologies already used by contractors rather than using new, or sometimes obsolete, technologies to meet the government's needs. Thus, the government will realize a lower cost for its requirements and the contractor will have greater economies of scale, making it more competitive in the world or domestic markets for products using those

same technologies. The net result of being more competitive might well be more income to the contractor, which usually means more taxes being paid to the federal government, better growth opportunities for the contractor, lower unemployment rates, and a contribution to an overall stronger economy.

Contractor Capability

Proven capability by a contractor is very important in the commercial market. How long would a contractor stay in business if their products were less than average and they did not stand behind their products? The commercial market keeps the sellers competing with each other in price, technology, quality, etc. The government, as well as the taxpayer, benefits. The government realizes greater reliability and availability of many commercial products and enhances its ability to acquire new technologies as available.

Reduced Cycle Times

The government also reaps the benefit of reduced cycle times by using commercial items that have already been developed to meet agency needs. The government is being challenged to acquire and maintain better capabilities faster and cheaper. Access to the commercial marketplace will also provide access to the latest advances in technology.

Alternative Products

When the customer has established a requirement, including specifications, then market research is conducted. During market research alternative products with additional features that were not considered in the original requirement may be found. The government will then revise the requirement if it is determined that the additional features are actually needed and not just nice to have.

Maximize Support

Buyers and sellers enter the marketplace with different amounts of leverage. Leverage is determined by a number of factors, in addition to the traditional forces of supply and demand that make buyers and sellers attractive business partners to one another. Buyers increase their leverage when larger quantities are purchased, full lines of products offered are taken advantage of, flexible terms and conditions are used, unique requirements or specifications are minimized, and existing commercial distribution systems are used. This will maximize the support from the private sector. The more attractive the government can make itself as a buyer, the more likely it is that world-class sellers will enter into contracts with the government, negotiate favorable terms and conditions, and offer lower prices.

MODIFIED COMMERCIAL ITEMS

If after completion of extensive market research, you determine no commercial off-the-shelf items will meet your needs, your next preference is procuring a modified commercial item. You must determine whether the market items can be or have been modified to meet unique government requirements while retaining their classification as a commercial item. By determining that the product is considered a modified commercial item, the government recognizes similar benefits as if purchasing a commercial off-the-shelf item, thus saving taxpayer dollars and providing better growth opportunities for the contractor leading to an overall stronger economy.

Example

For example, many of the large corporations own Gulfstream jets that are used by their executives. DoD also owns some of these aircraft. While the aircraft is a commercial product, the DoD version has been modified to include secure voice and data communication equipment, as well as DoD-unique avionics and instrumentation systems. Even though DoD has made some modifications to the aircraft, it still retains its predominate commercial functionality.

NONDEVELOPMENTAL ITEMS

The next preference for buying in the commercial market is purchasing a non-developmental item, better known as an NDI. NDIs are considered commercial items if the procuring agency determines that they were developed expressly for government use exclusively at private expense and sold in substantial quantities on a competitive basis to multiple state and local governments.

Example

An example of a NDI is the third-generation mid-wavelength infrared (MWIR) imaging system that is in production for the U.S. Marine Corps V-22 Osprey. It allows the Osprey pilots to see through darkness, smoke, haze, and adverse weather. This system has demonstrated superb image quality and range performance using nondevelopmental, in-production components to provide higher resolution imagery than current long-wavelength infrared

systems. This version enables pilots to fly and navigate on low-level missions or detect and identify long-range targets from higher altitudes.

GOVERNMENT UNIQUE ITEMS

There are times when, after your market research, you discover there are no commercial off-the-shelf items, modified commercial items, or nondevelopmental items that meet the needs for your requirement. At this point in time, you are facing a government unique product, which is at the opposite point on the preference continuum from commerciality. Some examples of government unique items are armaments (excluding small arms), nuclear submarines, tanks, radars, and lasers. Do you think an aircraft carrier would be considered a commercial off-the-shelf item or a government unique item?

Let's review: buyers increase their leverage in the commercial market by:

- purchasing larger quantities;
- taking advantage of full lines of products offered;
- using flexible terms and conditions;
- minimizing unique requirements or specifications;
- committing to long-term partnerships; and
- using existing commercial distribution systems.

Now consider procuring a government unique product such as an aircraft carrier? How many aircraft carriers do you think the government purchases as opposed to buying light bulbs? Do you think aircraft carriers are built like the Love Boat? Think about specifications...would an aircraft carrier need unique specifications?

Often times, you will see government uniqueness in the research and development arena as it relates to product development. Government unique requirements present several challenges for you in procurement. These challenges are limited competition; higher risk in cost, technology, and schedule; and higher administrative burden. When you have limited competition, considerable pricing power goes to the seller. As a buyer, you have lost your lev-

erage. When the procurement risk is high in cost, technology, or schedule, you will have to use a contract type that alleviates some risk in order to attract contractors to compete. These contract types, such as the cost-reimbursement type contracts, require a significant amount of oversight, which equates to higher administrative burden for you and the contractor. More administrative burden = higher cost.

Unlike commercial acquisitions, which are limited to fixed-price type contracts, government unique acquisitions may be either fixed-price or cost reimbursement contracts. Frequently in research and development acquisitions, the technical and cost uncertainties (i.e., higher or unpredictable risk) involved in contract performance do not permit costs to be estimated with sufficient accuracy to use any type of fixed-price contract, thus a cost-reimbursable type contract may be more appropriate.

MARKET RESEARCH

How does the government make itself more attractive as a buyer? By understanding the requirements as well as the marketplace, the acquisition team is better able to match marketplace capability with customer need. Using a team-based approach is the best way to affect market research. Members of this acquisition team could be the user, program manager, engineer, contract specialist, budget and cost analyst, logistic specialist, and possibly others.

Figure 5-1 Acquisition Team Member Contributions to Market Research	
Team Member	Contribution
Users	Drive the requirement forecast and formulate the long-term sustainment and provisioning over the entire life cycle. The government can use this forecast information to develop favorable pricing throughout the program's life span, plan for modernization through spares, and negotiate terms for optimal management of inventory and distribution. Market research can provide insight into the total life-cycle requirements for similar systems, products or processes using similar (or the same) commercial items. The information gathered from this research will permit users to conduct a comparative and parametric analy-

Figure 5-1 Acquisition Team Member Contributions to Market Research	
Team Member	Contribution
	sis to more accurately forecast total commercial item requirements.
Program Managers	Responsible for creating the program management plan, the acquisition strategy plan (the overarching plan that covers every contract and procurement for the program), the source selection plan, and the market research plan. They work hand in hand with contracting officers and specialists in organizing and planning the market research, addressing decisions such as who should conduct the actual research and who should comprise the market research team. Program managers identify how commercial items will fit into government systems.

Figure 5-1
Acquisition Team Member Contributions to Market Research

Team Member	Contribution
Engineers	Make decisions that principally drive the total cost of ownership. They also select the commercial items that will become part of (or will be needed to support) a system, product, or process. The engineering team usually designs, selects, or approves the use of a commercial item. Before systems engineers make this decision, they should conduct extensive market research to identify the full array of commercial items that may meet the requirement and try to select an item that will be commercially available from a multitude of sources. In addition, the engineers should consider the short and long term requirements of this item (e.g., product or process improvement, projected life cycle of the commercial item, and the source's commitment to its support and inventory). Engineers also assess items to determine whether they are "of a type" sold in the commercial market and whether essential physical characteristics would be changed by a modification. Furthermore, they help extrapolate engineering differences to support price analysis. Engineers evaluate features, options, and tradeoffs. They also review and modify the government requirement as necessary to allow commercial items to meet their needs, which alleviates the use of unique requirements.
Contract Specialists	Work hand in hand with program managers on the organization and planning of the market research. The contract specialist usually works closely with the rest of the market research team in an effort to determine whether the commercial marketplace offers products that satisfy the agency's essential requirements or that could satisfy them with some tradeoffs or modifications. Contract specialists seek information on customary contract terms and conditions, incentive provisions, customary practices of the particular industry regarding product modifications and tailoring and expected pricing practices for the requirement.

Figure 5-1 Acquisition Team Member Contributions to Market Research	
Team Member	Contribution
Budget/Cost Analysts	Assist in forecasting the total cost of ownership. The program budget and cost analysts contribute to the DoD market research effort to determine whether other government agencies are already ordering or using a commercial item. If so, those agencies can provide input on the item's quality, the market environment, pricing strategies used, and any unique aspects of their particular acquisition. This is particularly significant for sole-source commercial items. These analysts conduct cost tradeoff analysis (comparing commercial items to government-unique items) and cost/benefit analysis (commercial versus government approaches).
Logistics Specialists	Involvement of logistics specialists during the concept and design phase of a program ensures that lengthy and costly support requirements — after the system product, or process is deployed — are considered in every design and development decision. Their contribution to the marketing research effort normally focuses on how effectively the proposed commercial spare parts can meet the long-term logistics requirements. To address this question, they research the length of time the commercial spare part will be manufactured, how the source plans to support the item (e.g., in terms of replacement parts, service, upgrades, product improvement), warranties, inventory management, packaging and distribution, and any specialized disposal requirements. These specialists conduct reliability/price tradeoff analysis.

Collect Data

Generally, the requiring activity, which sometimes is the program management office, uses market research to collect information in three areas — technical, pricing, and terms and conditions — before submitting a requisition for purchase. In the past, the requiring activity would seek assistance and input mainly from the technical community as a part of market research.

FAR
2.101

NO guidance on who does market research.
However CO will see that's done.

Commercial Marketplace — The Preferred Approach

In today's business environment, the acquisition team refines the requirement based upon market research in order to maximize the benefit of competitive market forces. In the absence of an acquisition team, the contracting officer should take responsibility for the market research effort.

- Can we take advantage of seller's quantity price breaks?
- Can we write the requirement in a way that enables us to receive the benefit of buying the same products offered to the general public? What would happen if the public and private sector required two separate products, thus causing the seller to need two product lines? Do you think this might cause a difference in price?
- Can we shape smart business arrangements using flexible terms and conditions to attract a larger industrial base?

Benefits of Market Research

Agencies conduct market research to arrive at the most suitable approach for acquiring supplies and services and to determine potential sources. Thorough market research will help to identify market conditions or other factors that may affect the price of the item or service. Some specific benefits from performing thorough market research include:

- minimizing the risk of doing business for both the government and the contractor;
- uncovering and identifying potential problems, thereby enabling strategy to reduce risks associated with contingencies;
- obtaining information to support price reasonableness determination;
- creating a benchmark to track progress during contract performance;
- evaluating the contract's success;
- identifying additional sources; and
- gaining a better understanding of:
 - the options available to satisfy the government's requirement;
 - prices for commercial items sold, or offered for sale, to the public;

prices were fair due to competition achieved.

- the potential value of modifications to commercial items;
- acquisition histories, including prices paid for purchases of similar items; and
- prices for similar items on mandatory and optional schedules and product catalogs and price lists.

The grouping and timing of requirements, the specifications and packaging, testing requirements, payment terms, and the like can all influence the ability to get the best deal for the government.

Every member of the acquisition team plays a role in ensuring that the government has maximum leverage in the marketplace. By working as a team, the various functional experts can achieve optimum results instead of simply maximizing the outcome according to the narrow perspective of the experts particular functional area. Often, tradeoffs among the various functional experts on the team are necessary.

Continual Market Research

It is important that market research continue throughout an acquisition to gather the kind of data needed for making smart acquisition decisions. Information is a changing commodity and sound business judgments depend on up-to-date details.

The team should actively conduct market research to develop a sound acquisition strategy, a good understanding of customary commercial terms and conditions, and sufficient information to achieve fair and reasonable pricing. The level of detail gathered will vary by stage in the acquisition process. When the initial requirements statement is being developed, a general understanding of terms and conditions and pricing may suffice for making higher-level requirements analysis judgments.

As the acquisition matures, the market research information will need to be increasingly precise. To be sure that the market will be able to respond to the government's needs and to ensure that the final acquisition strategy and solicitation will fit the particular market's customary business practices, the team will need a more in-depth understanding of the terms and conditions offered commercially. Furthermore, the team will also need a firm knowledge of market pricing information in order to plan for contract obligations and determine price reasonableness.

Life Cycle of Market Research

Market research must be used when developing government requirements (and determining how to satisfy them) because the decisions made in the presolicitation phase will be key factors in defining what the government receives and the price the government will pay. A better understanding of the marketplace increases the likelihood that the government's needs will be met at a reasonable price.

This same understanding of the marketplace will provide the basis for developing more accurate contract price estimates than have historically been available. Preliminary price estimates resulting from thorough market research, as well as increased insight into the factors that affect contract price, are key inputs to acquisition planning and possibly even to the final determination of price reasonableness.

Market Research Techniques

Since market research is a business operation, it should be conducted in a cost-effective manner. You will have to conduct market research appropriate to the circumstances before developing new requirements documents. The extent of the market research will vary depending on such factors as urgency, estimated dollar value, complexity, and past experience.

Some general market research techniques include:

- contacting knowledgeable individuals in government and industry regarding market capabilities;
- reviewing results of recent market research reports covering similar items;
- publishing formal requests for information;
- querying government databases that provide information relevant to agency acquisitions;
- querying Internet information sources;
- obtaining source lists from other agencies or from associations;
- reviewing catalogs and product literature; and

- conducting interchange meetings or holding presolicitation conferences and other government/industry interchanges.

Best Business Arrangements

Due to the nature of the federal procurement business, you may find yourself purchasing anything from commercial off-the-shelf items to NDIs to modified commercial items to government unique items. No matter what you are procuring, remember in all cases to incorporate the best business practice available to you. This business practice may be a commercial business practice or an innovative business practice created by the government. You, as a business advisor, are expected to generate the best business arrangement for each procurement.

Some business practices typically used in the government and commercial marketplace to procure goods and services are in Figure 5-2.

Figure 5-2 Government and Commercial Business Practices	
Business Practice	Definition
Just-in-time distribution	Reliance on supply chain management to reduce costly inventories.
Electronic transaction processing	Faster, more convenient, and less costly. It continues to grow in both the commercial sector and the government.

Figure 5-2
Government and Commercial Business Practices

Business Practice	Definition
More streamlined payments	Payment on delivery is the norm in the commercial sector. However, in some commercial markets, the buyer is required to make a payment upfront when the contract is signed or makes payments upon completion of certain milestones. For instance, when you are having a house built, you generally have to make a down payment before any work starts and then at prescribed times (e.g., 30 days, 60 days, 120 days after the start date) or completion of specific tasks (e.g., the foundation is poured, the exterior framing is complete), you have to make additional payments. You make the final when the house is complete and you take title to the property. The government frequently makes payments to contractors before delivery of the end item or service to help with the contractor's cash flow and these are called finance payments.

Business Advisor

As a business advisor, you are expected to be innovative in making sound business arrangements. To make a sound business arrangement, you must know what you are purchasing, your market, and the norm in business practices for that market.

Example

Let's consider this example: a government contract specialist received a request to purchase personal computers. After extensive market research, the contract specialist realized personal computer sales peaked in the months preceding winter and slumped in the summer time. This contract specialist generated a smart business decision by purchasing personal computers in the "off season," or the summer time. This was a win-win situation for everyone. This arrangement allowed the contractor to have continual production all year with no seasonal employee lay-offs, and the government, and taxpayer, received their computers at a lower price.

Make Smart Business Arrangements

As you grow in the contracting career field and purchase a wide diversity of items, whether commercial off-the-shelf or government unique, remember to make smart business arrangements. Look to invoke the best business practice available to you through your market research. If you find no best business practice is available, be smart and innovative and create your own. Always remember that FAR 1.102(d) encourages you to exercise initiative:

The role of each member of the Acquisition Team is to exercise personal initiative and sound business judgment in providing the best value product or service to meet the customer's needs. In exercising initiative, government members of the Acquisition Team may assume if a specific strategy, practice, policy or procedure is in the best interests of the government and is not addressed in the FAR, nor prohibited by law (statute or case law), Executive order or other regulation, that the strategy, practice, policy or procedure is a permissible exercise of authority.

Be a leader...make your own smart business arrangement!!!

SUMMARY

This chapter looked at the preferences for purchasing from COTS to government-unique items, the benefits for purchasing in the commercial market, and how best to perform market research. When it is all said and done, remember you are looking for existing smart business practices or be creative and develop your own!!

CHAPTER REFERENCES

Commercial Advocates Forum's Terms & Conditions Database:
<http://www.cadv.org/>

DAU Market Research Continuous Learning Module:
<http://www.ar.navy.mil/aosfiles/tools/marketresearch>