

June 1998

DEFENSE COMMISSARIES

Issues Related to the Sale of Electronic Scanner Data



National Security and
International Affairs Division

B-275202

June 26, 1998

The Honorable Constance Morella
The Honorable Roscoe Bartlett
House of Representatives

The Defense Commissary Agency (DeCA) operates approximately 300 Department of Defense commissary stores. In addition to the revenue received from store sales, DeCA also generates revenue by selling the data collected through its electronic scanners that register prices and goods sold. From January 1991 to March 1996, one firm had an exclusive rights¹ contract for this data.

In June 1995, DeCA solicited offers for a new 5-year, exclusive rights scanner data contract. The winning firm, in addition to paying for the data, was to provide DeCA expertise in implementing “category management,” a system by which retailers manage product categories (e.g., pet foods and beauty products) as strategic business units and track consumer preferences in these categories. However, shortly after DeCA selected a firm, the other competitors filed a protest with the General Services Administration Board of Contract Appeals (GSBCA). The GSBCA upheld the protest, which was appealed to a federal court. Subsequently, on May 19, 1998, the court vacated GSBCA’s earlier decision and granted motions to dismiss the appeal. During the relatively lengthy litigation period, DeCA entered into a nonexclusive² license agreement with three firms, pursuant to a “spot bid sale,” for the monthly use of the scanner data. Appendix I contains a chronology of events related to the sale of DeCA’s scanner data.

In response to your request that we review DeCA’s sale of scanner data and its implementation of category management, this report

- identifies DeCA’s total revenue from selling scanner data and compares license revenues (amounts received after March 1996) to amounts offered by firms responding to the June 1995 solicitation;
- examines DeCA’s implementation of category management as it relates to requirements contained in the 1995 solicitation; and

¹According to DeCA officials, exclusive rights means that the winning firm would be the only firm to receive and use the raw scanner data, and all other firms or individuals would be excluded from this data.

²Nonexclusive means that any firm obtaining a license would simply have the right to use the raw scanner data; DeCA would retain all ownership, right, and title to the data.

- discusses DeCA's future plans regarding category management, scanner data sales, and potential development of an in-house market analysis capability.

Results in Brief

DeCA collected almost \$6.1 million from the sale of its scanner data from January 1991 through March 1998. About \$3.9 million, or 65 percent of the total, was collected from the Air Force contract awarded in 1989. The remaining 35 percent, almost \$2.2 million, came from the license agreements. DeCA received slightly over \$1 million annually from these licenses—an amount significantly less than the minimum proceeds guaranteed by two offerors under the 1995 solicitation. The selected firm offered a 5-year annual average minimum payment of almost \$2.5 million. DeCA officials cited several reasons for the lower amount received from the license agreements, including the interim, nonexclusive nature of the sale and uncertainties regarding the litigation. According to a DeCA official, a new spot bid sale of DeCA's scanner data had been planned before the Court of Appeals' May 19, 1998, ruling, and increased revenue had been expected from this effort.

Since 1994, DeCA has been implementing the category management concept and techniques into its operations. According to DeCA officials, the type and level of category management assistance contained in the 1995 solicitation is no longer necessary. DeCA reorganized its buying function in mid-1994 to model the type of organization required to support the category management concept. Subsequently, it implemented a category management planning process; trained personnel; established product categories and completed many category plans; and began efforts to improve or replace data information and collection systems, including acquiring new store scanners. According to DeCA officials, existing category management capabilities need refinement, but the capabilities envisioned in the solicitation are no longer appropriate, resulting in the decision to cancel the requirement for category management services.

With resolution of the litigation associated with the 1995 solicitation, DeCA still plans to continue licensing its raw scanner data to multiple buyers. Further, DeCA hopes to continue selling scanner data to multiple buyers and further refine its category management system. Officials stated that DeCA has no plan or desire to develop an in-house market analysis capability for the purpose of selling refined DeCA scanner data products to vendors and suppliers.

Background

Commissaries are supermarket-type grocery stores operated primarily for military personnel. As part of the armed forces' overall compensation package, these stores sell food and household items tax free at cost, plus a 5-percent surcharge. Commissaries use point-of-sale electronic scanners to record sales and collect specific data on items sold (e.g., the brand name, quantity, and price). Raw scanner data has considerable commercial value when it is processed into product movement and other reports and sold to DeCA's suppliers and vendors.

The first contract for the sale of commissary scanner data was awarded in October 1989 by the Air Force under 10 U.S.C. 2487,³ 2 years before the October 1991 consolidation of all service commissaries under DeCA. The 5-year contract gave the contractor exclusive rights to the scanner data. The contract was implemented in early 1991 following a delay due to a protest and ended in March 1996.

In June 1995, DeCA solicited offers for a new contract. The solicitation called for a basic performance period of 3 years—1996 through 1998—with two 1-year options. The winning firm would receive exclusive rights to the scanner data and pay DeCA the higher of (1) a guaranteed minimum annual sum or (2) a percentage of the contractor's gross receipts from selling information derived from the scanner data. Unlike the terms of the previous contract, the 1995 solicitation also required the awardee to (1) help DeCA develop a category management system, (2) train DeCA personnel in category management concepts and techniques, and (3) provide category management consultation and analysis services to DeCA.

DeCA received proposals from four firms and subsequently made its selection in October 1995. In November 1995, the firms that were not selected filed a protest with the GSBGA, arguing that the procurement was for automated data processing services and that DeCA did not have the required delegation of procurement authority from the General Services Administration. One firm subsequently withdrew from the protest. In February 1996, the GSBGA ruled in favor of the protesters, declaring that the award was void. The contract awardee subsequently appealed this decision to the Court of Appeals (Federal Circuit). On May 19, 1998, the court vacated GSBGA's earlier decision and granted motions to dismiss the appeal.

³Congress enacted this law in 1986 to authorize the sale of commissary scanner data using competitive procedures.

In early May 1996, DeCA announced its decision, pending the outcome of the litigation, to license the rights to the use of the scanner data on a monthly, nonexclusive basis. The highest bid received established the monthly price for all purchasers. Each firm wanting to purchase the scanner data was issued a license valid until 30 days following the resolution of the litigation.

Revenue Summary and Comparison

From 1991 through March 1996, DeCA received about \$3.9 million, or an annual average of almost \$750,000, from the sale of scanner data under the contract awarded in 1989. In 1995, the last full year of the contract, DeCA collected over \$1.1 million. DeCA's revenue from this contract increased each year as the contractor's total product sales increased.

In May 1996, DeCA decided to license the use of its scanner data on a monthly basis because of the ongoing litigation at the time. Since then, each of three firms has paid DeCA \$30,000 per month (the highest bid) for the scanner data—a total of almost \$2.2 million for the 2 years ending March 1998. At the time of the bid, DeCA anticipated resolution of the litigation within 8 to 18 months, at which time the licenses would terminate. Table 1 lists the revenue collected annually by DeCA from each scanner sale source.

Table 1: Scanner Revenue Collected Annually by Source

Year	1989 contract	License agreements	Total
1991	\$315,417	0	\$315,417
1992	501,278	0	501,278
1993	772,556	0	772,556
1994	1,009,076	0	1,009,076
1995	1,118,235	0	1,118,235
1996	214,020 ^a	\$810,000 ^b	1,024,020
1997	0	1,080,000	1,080,000
1998	0	270,000 ^c	270,000
Total	\$3,930,582	\$2,160,000	\$6,090,582

^aJanuary through March 1996.

^bApril through December 1996.

^cJanuary through March 1998.

Annual revenue from the license agreements is less than two offers received in response to the 1995 solicitation and about \$1.4 million less than the offer made by the selected firm. Specifically, the selected firm offered an annual average payment of almost \$2.5 million over the 5-year period—1996 through 2000—covered by DeCA’s solicitation.

According to DeCA officials, following DeCA’s technical evaluation of the offers received, two firms were tied and one was rejected because its technical score was not high enough to be considered. The tie breaker—guaranteed revenue—was invoked for the two remaining firms. The revenue guaranteed to DeCA by one firm was less than the amount currently being received under the license agreements, whereas the firm that was eventually selected offered more revenue. The highest offer, in terms of guaranteed revenue, was made by the rejected offeror.

According to officials from DeCA, the revenue from the license agreements was lower than amounts guaranteed under the 1995 solicitation primarily because of the expected short-term and nonexclusive nature of the licenses and uncertainties regarding the litigation. In addition, the value of the monthly data was reduced for two firms because DeCA could not provide the historical sales data from the 1989 contract, which had granted the contractor exclusive rights to that information. Thus, the value of the monthly data for these firms was reduced because certain trend analyses and other reports, which require about 1 year of data to produce, could not be generated from the licensed data.

Category Management Implementation

Category management is a relatively new marketing concept that has been evolving in the U.S. retail industry since the late 1980s and early 1990s. It is a mechanism and process to manage product categories as strategic business units or entities and attempts to shift the traditional management approach from “sell what you purchase” to “buy what sells.” Customized merchandising and marketing plans, called category plans, are developed through a cooperative retailer/supplier process for specific product categories, such as soft drinks, pet foods, and beauty products. Information developed from raw scanner data and other sources is assessed to determine category strategies and consider how prices, advertising, and promotional efforts compare with the competition.

DeCA, aware of the increasing use of category management in the retail marketplace, decided to adopt the concept in order to remain competitive and meet the needs of its customers. Thus, in June 1994, DeCA reorganized

its buying organization to model the type of operation needed to support category management. DeCA also evaluated in-house category management capabilities and found it had little experience in the area.

During this period, DeCA started the planning process to develop a new solicitation for the sale of scanner data. DeCA decided to use an exchange/sale-type contract. In exchange for DeCA's product movement or scanner data, the contractor would provide monetary payments and services to assist DeCA in (1) developing a category management capability, (2) training personnel in category management concepts and techniques, and (3) providing category management consultation and analysis services.

After the selection of the winning offeror was protested in November 1995, DeCA continued to implement category management. As a result, DeCA believes it has developed most of the capability sought under the 1995 solicitation through the use of in-house and outside resources. Specifically, DeCA has

- completed the reorganization of its buying function, called the Marketing Business Unit, and increased its staffing from 83 to 122 by transferring positions obtained from regional consolidation;
- implemented a category management planning process, using a food industry association study;
- developed a category management template, a key document in the category management process, to collect movement and other data on products from vendors and suppliers;
- identified 118 product categories to manage as business units and completed 72 associated category plans; and
- initiated actions to improve or replace data information and collection systems,⁴ including new front-end scanners.

Although progress has been made, DeCA does not have some capabilities that would likely exist if the 1995 award had not been protested. For example, DeCA does not currently have (1) direct access to private sector comparative market information or causal information⁵ or (2) a routine

⁴DeCA is modernizing a number of systems, including new scanners for all commissaries. Other programs include the Defense Commissary Information System and Telecommunications Modernization. These core business improvements complement, but are not driven, by the implementation of category management.

⁵Comparative market data analyzes DeCA sales of same or similar product categories to private sector stores in competitive geographic areas; causal data provides consumer demographics and information on the effectiveness of product promotions and sales displays in commissary stores.

support arrangement with a private sector category management consultant. In September 1996, citing the progress made in implementing category management, DeCA officials canceled the requirement for category management services contained in the 1995 solicitation. During the period in which litigation was ongoing, DeCA relied on information provided by vendors and suppliers for comparative and causal information as category plans were prepared and revised.

Future Plans

DeCA plans to continue its existing programs to upgrade and replace information systems and equipment. Further, DeCA hopes to continue the licensing of scanner data to multiple buyers and further refine its category management system by adopting the best practices and characteristics of the private sector's category management procedures and processes. Before the recent Court of Appeals' ruling, DeCA had also planned to conduct another spot bid sale in the near future in response to direction from the Office of the Secretary of Defense.

Ultimately, DeCA would like to establish a relationship with a scanner data processor modeled after the practices followed in the private retail sector to provide periodic category management consultation and analysis work. Officials stated that DeCA has no plan or desire to develop an in-house market analysis capability for the purpose of selling refined DeCA scanner data products to vendors and suppliers.

Conclusions

Due to several factors, such as uncertainties regarding the litigation associated with the 1995 solicitation, the annual revenue of \$1 million that DeCA has received from its scanner data license agreements is considerably less than the potential minimum proceeds guaranteed by offers to the 1995 solicitation.

DeCA began implementing category management in 1994 and continued the process utilizing both in-house and outside resources. Although DeCA presently lacks some of the capabilities included in the 1995 solicitation, DeCA officials believe that sufficient progress had been achieved to warrant the cancellation of the requirement for the level of category management services thought appropriate at that time. DeCA hopes to continue selling scanner data to multiple buyers and refining its category management system.

Agency Comments

In written agency comments, the Department of Defense stated that our report accurately presents the facts associated with these issues. (See app. II.)

Scope and Methodology

To accomplish our objectives regarding DeCA's sale of electronic scanner data and the status, implementation, and future plans associated with category management, we conducted work primarily at offices in the Office of the Secretary of Defense in Washington, D.C.; DeCA headquarters at Fort Lee, Virginia; and the offices of the three remaining firms that submitted offers for the 1995 category management solicitation. These firms are located in Bethesda, Maryland; McLean, Virginia; and Chicago, Illinois.

To compare the revenue that DeCA received under the previous Air Force contract and the revenue received under the license agreements, we obtained the amount of payments received by DeCA from firms for scanner data between January 1991 through March 1998.

To document DeCA's progress in implementing category management, we reviewed the June 1995 solicitation and data documenting DeCA's present category management capability. We also reviewed DeCA's newly developed category management policies, procedures, category plans, personnel training, and plans to improve or replace data information and collection systems. We obtained data on DeCA's progress in acquiring capabilities that were sought under the category management solicitation from DeCA officials in the agency's newly formed Marketing Business Unit.

To assess how DeCA plans to structure future awards for the sale of raw scanner data and perform market analysis, we held discussions with DeCA's top management, contract managers, and attorneys concerning plans to (1) continue licensing the data, (2) establish a relationship with a scanner data processor modeled after practices followed in the private sector, (3) comply with the court decision, (4) continue selling to multiple sources, and (5) develop an in-house market analysis capability.

We performed our work in accordance with generally accepted government auditing standards.

We are sending copies of this report to interested congressional committees, Members of Congress, the Secretary of Defense, and the Directors of DeCA and the Office of Management and Budget.

If you have any questions regarding this report, please contact me at (202) 512-8412. Major contributors to this report are listed in appendix III.

A handwritten signature in black ink that reads "David R. Warren". The signature is fluid and cursive, with a long horizontal stroke at the end.

David R. Warren, Director
Defense Management Issues

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Abbreviations	
DeCA	Defense Commissary Agency
GSBCA	General Services Administration Board of Contract Appeals

Chronology of Events

1986: Congress enacted 10 U.S.C. 2487, which authorizes the sale of commissary raw scanner data using competitive procedures.

1989: The Air Force, on behalf of the various commissary agencies of the military services, awarded a 5-year contract for the sale of raw scanner data to a single contractor. The contract gave the contractor exclusive rights to the data but did not include providing category management services. This contract was protested to the General Services Administration Board of Contract Appeals (GSBCA), causing a start-up delay.

January 1991: After a delay of 16 months, the Air Force contract started.

October 1991: The military services' commissaries were consolidated under the Defense Commissary Agency (DeCA). An agreement between the contractor and DeCA recognized that the new agency was organized differently from the previous military services' commissary systems. Accordingly, the contract was again delayed to permit the contractor to purchase and deploy the computers necessitated by the new organizational structure and DeCA's different information requirements.

June 1995: DeCA issued a solicitation for a new contract to sell scanner data and obtain category management services. The contractor would make an annual payment and receive exclusive rights to DeCA's scanner data.

October 1995: DeCA made its selection from the four proposals that were received.

November 1995: All three unsuccessful offerors filed a protest with the GSBCA, arguing that the contract was for automated data processing services and that DeCA did not have the required delegation of procurement authority. (One firm subsequently dropped out of the appeal.)

February 1996: The GSBCA agreed that DeCA did not have a required delegation of procurement authority and upheld the protest, declaring that the contract was void ab initio.

March 1996: The former 1989 Air Force contract expired. Also, the successful offeror under the 1995 solicitation appealed GSBCA's decision to the Court of Appeals (Federal Circuit), arguing that DeCA did have proper authority to award the contract.

May 1996: To continue scanner-generated revenue, DeCA announced its spot bid sale as an interim measure. DeCA entered into a license arrangement with one firm.

September 1996: DeCA entered into license agreements with the remaining two firms. Also, the firm that DeCA had selected under the 1995 solicitation filed a lawsuit in Federal District Court to stop the licensing of DeCA's scanner data to other firms. The firm argued that it had an exclusive license to scanner data. At this time, DeCA canceled the 1995 requirement for category management services.

October 1996: Reflecting DeCA's cancellation of the category management requirement, the Department of Justice filed a motion to dismiss the March 1996 appeal as moot. Also, the District Court ruled that DeCA may license data to other firms. This decision was appealed to the Court of Appeals (4th Circuit).

July 1997: The Court of Appeals (4th Circuit) affirmed the District Court's ruling that DeCA may license scanner data to others as an interim measure.

May 1998: The Court of Appeals (Federal Circuit) vacated GSBICA's February 1996 decision and granted motions to dismiss.

Comments From the Department of Defense



FORCE MANAGEMENT
POLICY

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MAY 11 1998

Mr. David Warren, Director
Defense Management Issues
National Security and International
Affairs Division
U. S. General Accounting Office
Washington, D.C. 20548

Dear Mr. Warren:

This is the Department of Defense (DoD) response to the General Accounting Office (GAO) draft report, "DEFENSE COMMISSARIES: Issues Related to the Sale of Electronic Scanner Data," dated April 27, 1998 (GAO Code 709250/OSD Case 1598).

Technical corrections to the report were separately provided. The Report now accurately presents the facts.

The Department appreciates the opportunity to comment on the draft report.

Sincerely,

Francis M. Rush, Jr.
Acting Assistant Secretary



Major Contributors to This Report

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