AMERICAN LOGISTICS ASSOCIATION
1101 Vermont Avenue N.W. Suite 1002 Washington D.C. 20005
Phone: (202) 466-2520 Fax: (202) 296-4419
www.ala-national.org

Legal and regulatory issues on introducing private label DeCA products

The Boston Consulting Group Report (BGCR) concludes that if the current requirement to sell commissary merchandise at cost plus 5 percent were removed, the introduction of private label products into the commissary inventory to compete with brand name commercial items has the potential of generating significant sums of money by managing the margins to be used to pay DeCA operating costs and drive down product costs for brand name items offered for sale in the commissary while keeping the shelf price the same—margin dollars. Private label or distributor's label refers to products that are sold by a single retailer, food chain, wholesaler, or buying group under a name that is owned or controlled by the retailer. The BGCR recommends that DeCA use a partnership or broker managed model while developing a broader private label strategy it can build over time. Under the partnership model DeCA would sell existing private label merchandise obtained from the partner just as brand name products are procured today. Under the broker managed model, a broker would coordinate the development, manufacturing and supply chain for a DeCA unique line of private label products.

In the mid-1990s a private label line of products was proposed for introduction into DeCA and the military exchanges known as Always Home. One brokerage firm was proposed to do what is contained in the BGCR report; the difference being that the revenues raised did not involve DeCA margins, the price was to be as every other price in the commissary, at cost. The plan was after the goods were paid for, the broker would take the difference between what it paid for the merchandise and the amount remitted by the Government to the broker and donate it to the USO after their management fee was deducted. This was to be a non-competed effort. Numerous brokerage firms demanded the right to compete for this line of business and the brand name manufacturers objected to the introduction of a private label line of goods into the various categories in a commissary.

During the research on the private label issue, it was learned that the development of a private label line of goods involved many different disciplines ranging from sources of raw goods, through the manufacturing process, to the distribution of the product. Such things as developing levels of quality for the products to be offered to patrons; food safety and security throughout the entire manufacturing and distribution process; pricing issues to ensure that the commissary benefit was still provided; and numerous start up and cost issues. The study results indicated that DeCA did not have the internal capability of either overseeing the development of a commercial program, or developing its own program. The Always Home concept was dropped and a provision introduced into Federal law that defined brand name commercial items that were subject to the exemption in the Competition in Contracting Act that applies to commissary resale items.

The Draft DoD Report to Congress (Report) dealing with Budget Neutrality for DeCA takes the BGCR report recommendations and incorporates them into the concept of how to raise dollars from sales to patrons to be used to offset operating costs of the commissary benefit. The Report clearly recognizes that the benefits of a private label program cannot be obtained without the approval of DeCA implementing the variable pricing strategy. (See paper on the legal and regulatory issues that must be resolved prior to the approval of Variable pricing in commissaries.)

Adoption of the option to sell an existing private label brand in the commissary creates the appearance of the endorsement of those products; they were purchased with appropriated funds for resale by a government activity so therefore DeCA is recommending the brand. For example, putting a line of Kirkland products (an existing private label in the commercial sector today) is an endorsement of Costco products by the government. The Federal government, as a consumer, is prohibited for endorsing commercial products. This will also create a conflict between the DeCA shelf price and the Costco shelf price. The second example of a private label product suggested in the BCGR is Exchange Select. Legal authority already exists that would allow the exchange to sell its private label products to DeCA to be offered for resale. The Exchange Select brand is not broad enough to cross into all categories in a commissary recommended in the BGCR to gain the maximum margin dollars the report believes are potentially available. In addition, the commissary will be in direct competition with the exchange and the full potential of margin proceeds will not be realized.

The BGCR recommends the use of a Request for Quotations to obtain business proposals from private label brokers to coordinate the development of a line of DeCA private label products. In order to do this DeCA has to define its requirements and follow the provisions contained in the FAR, i.e. develop an acquisition plan, do a draft solicitation, a solicitation, receive proposals and evaluate the proposals received. There will be adequate competition since there are numerous firms that have the ability to meet the demands of this process. (There is a Private Label Manufacturers Association supporting worldwide private label efforts.) The hardest issue for this approach is the development of the actual DeCA requirements document for inclusion in the solicitation. Neither the BCGR nor the Report addresses the practical implications of this recommendation. Simply put, solicitations simply do not “fall out of the air” in the government contracting world as opposed to an individual at a commercial business having the recognized expertise to maximize available margin dollars. DeCA must carefully develop a requirements document stating the actual needs of DeCA for private label products. Simply buying already existing products using the DeCA ROA does not account the myriad of issues ranging from including quality, pricing, warranties, ordering and delivery schedules. While an existing line of private label products may exist, who makes the judgement call that that line meets the government’s needs?

The BGCR states that the introduction of private label products will enable category managers to leverage those products to obtain better pricing from name brand manufacturers for their products. Both the BGCR and the Report convey the conclusion that this can be accomplished without raising the shelf price of the brand name products, i.e. protect the benefit. This conclusion is not factually supported by the language in either report. The literature recognizes that it is impossible to obtain the true cost of private-label and name brand products. Advertising and promotional allowances do not appear on the invoices as a deduction. Neither do the promotional costs and other costs of services demanded by DeCA, such as merchandising support. Neither report discusses the cost of display space, and the impact on brand name products. Leveraging the acquisition cost down for name brand products may have far reaching impacts on manufacturer willingness to support servicemembers and other beneficiaries.

Private label products in the commercial grocery sector are an important part of retailers merchandising strategies. They have the well-developed expertise to take proper advantage of the ability to increase profitability through managing the margins on their brand name and private label products. Those firms today have a well-developed base of customer loyalty. The commissary system has no such base, i.e. it must start from scratch to build loyalty and expectations. Margin management will not gain sufficient revenues to offset APF costs for years to come.

All of the issues raised in the discussion of variable pricing impact on this line of proposed business. Without legislative authority given the GSA to authorize variable pricing, and the implementing regulations and policies to accompany that authorization, the introduction of private label into the commissary using variable pricing to manage margins to gain dollars out of the beneficiaries budget to offset APF costs has no legal foundation to support it.

DeCA has an advertisement on the street for a GS 1101-14, Private label developer. Without the predicate authority discussed in these two papers, DeCA is premature with this vacancy announcement. Further, the announcement does not state that an Annual Financial Disclosure Statement must be filed by the individual. Because of the nature of the program suggested in the BGCR and the Report, particularly leveraging margins, there is a high potential for a conflict of interest.

The BGCR assumes that DeCA is the same as any commercial grocery business in the United States and does not recognize the constraints put on DeCA by Federal law, and policies. DeCA is a benefit provider, not a “for profit business.” It has been the philosophy of the Congress for years that beneficiaries of the commissary should share in the cost of the benefit. They do so pursuant to the surcharge requirement, and the funds generated thereby are used to construct and equip facilities which are used to provide the benefit. Contrary to the commercial sector, once completed, a commissary structure is turned over to the taxpayers of the United States. Even though the United States now owns the facility, maintenance and improvements to the government building are paid by the beneficiaries. Nothing in the language of the two reports reflects the value of these contributions. Instead, beneficiaries are being asked a second time to contribute more funds to the delivery of this non-pay benefit.