

# Endogenous Split Awards as a Protest Management Tool: A Modeling & Computational Approach

May 2012

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| Report Documentation Page                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                              |                                    |                                     |                                                           | Form Approved<br>OMB No. 0704-0188                  |                                 |
|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|------------------------------------|-------------------------------------|-----------------------------------------------------------|-----------------------------------------------------|---------------------------------|
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| 1. REPORT DATE<br><b>MAY 2012</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                      |                                    | 2. REPORT TYPE                      |                                                           | 3. DATES COVERED<br><b>00-00-2012 to 00-00-2012</b> |                                 |
| 4. TITLE AND SUBTITLE<br><b>Endogenous Split Awards as a Protest Management Tool: A Modeling &amp; Computational Approach</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                          |                                    |                                     |                                                           | 5a. CONTRACT NUMBER                                 |                                 |
|                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                        |                                    |                                     |                                                           | 5b. GRANT NUMBER                                    |                                 |
|                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                        |                                    |                                     |                                                           | 5c. PROGRAM ELEMENT NUMBER                          |                                 |
| 6. AUTHOR(S)                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                           |                                    |                                     |                                                           | 5d. PROJECT NUMBER                                  |                                 |
|                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                        |                                    |                                     |                                                           | 5e. TASK NUMBER                                     |                                 |
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| 7. PERFORMING ORGANIZATION NAME(S) AND ADDRESS(ES)<br><b>Naval Postgraduate School, Graduate School of Business &amp; Public Policy, Monterey, CA, 93943</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                           |                                    |                                     |                                                           | 8. PERFORMING ORGANIZATION REPORT NUMBER            |                                 |
| 9. SPONSORING/MONITORING AGENCY NAME(S) AND ADDRESS(ES)                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                |                                    |                                     |                                                           | 10. SPONSOR/MONITOR'S ACRONYM(S)                    |                                 |
|                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                        |                                    |                                     |                                                           | 11. SPONSOR/MONITOR'S REPORT NUMBER(S)              |                                 |
| 12. DISTRIBUTION/AVAILABILITY STATEMENT<br><b>Approved for public release; distribution unlimited</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                  |                                    |                                     |                                                           |                                                     |                                 |
| 13. SUPPLEMENTARY NOTES<br><b>Presented at the 9th Annual Acquisition Research Symposium, May 16 - 17, 2012, Monterey, CA.</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                         |                                    |                                     |                                                           |                                                     |                                 |
| 14. ABSTRACT                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                           |                                    |                                     |                                                           |                                                     |                                 |
| 15. SUBJECT TERMS                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                      |                                    |                                     |                                                           |                                                     |                                 |
| 16. SECURITY CLASSIFICATION OF:                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                        |                                    |                                     | 17. LIMITATION OF ABSTRACT<br><b>Same as Report (SAR)</b> | 18. NUMBER OF PAGES<br><b>56</b>                    | 19a. NAME OF RESPONSIBLE PERSON |
| a. REPORT<br><b>unclassified</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                       | b. ABSTRACT<br><b>unclassified</b> | c. THIS PAGE<br><b>unclassified</b> |                                                           |                                                     |                                 |

# Bid Protests & Split Awards: Agenda

- **Managing bid protests** in DoD procurement
- **Simple model** of bidding & protest process
- **Split awards** as a protest management tool
- Key question: What is the **right split**?
- Bids & prices with **fixed** split awards
- Bids & prices with **endogeneous** split awards
- **Conclusions**
- **Research agenda** moving forward

# “Managing” Bid Protests

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- **Objective is not to minimize** number of bid protests
- Protests intended to **correct procurement mistakes**
  - **Honest mistake:** Limited information & bounded rationality
  - **Dishonest mistake:** Bias or fraud by procurement officials
- Objective is to “**right size**” number of protests
  - Encourage protests that correct (significant) mistakes
  - Discourage protests that don’t make significant corrections
- **Modeling** the process could help identify, compare, & characterize **levers of control** for managing protests

# Bid Protests & Split Awards: Agenda

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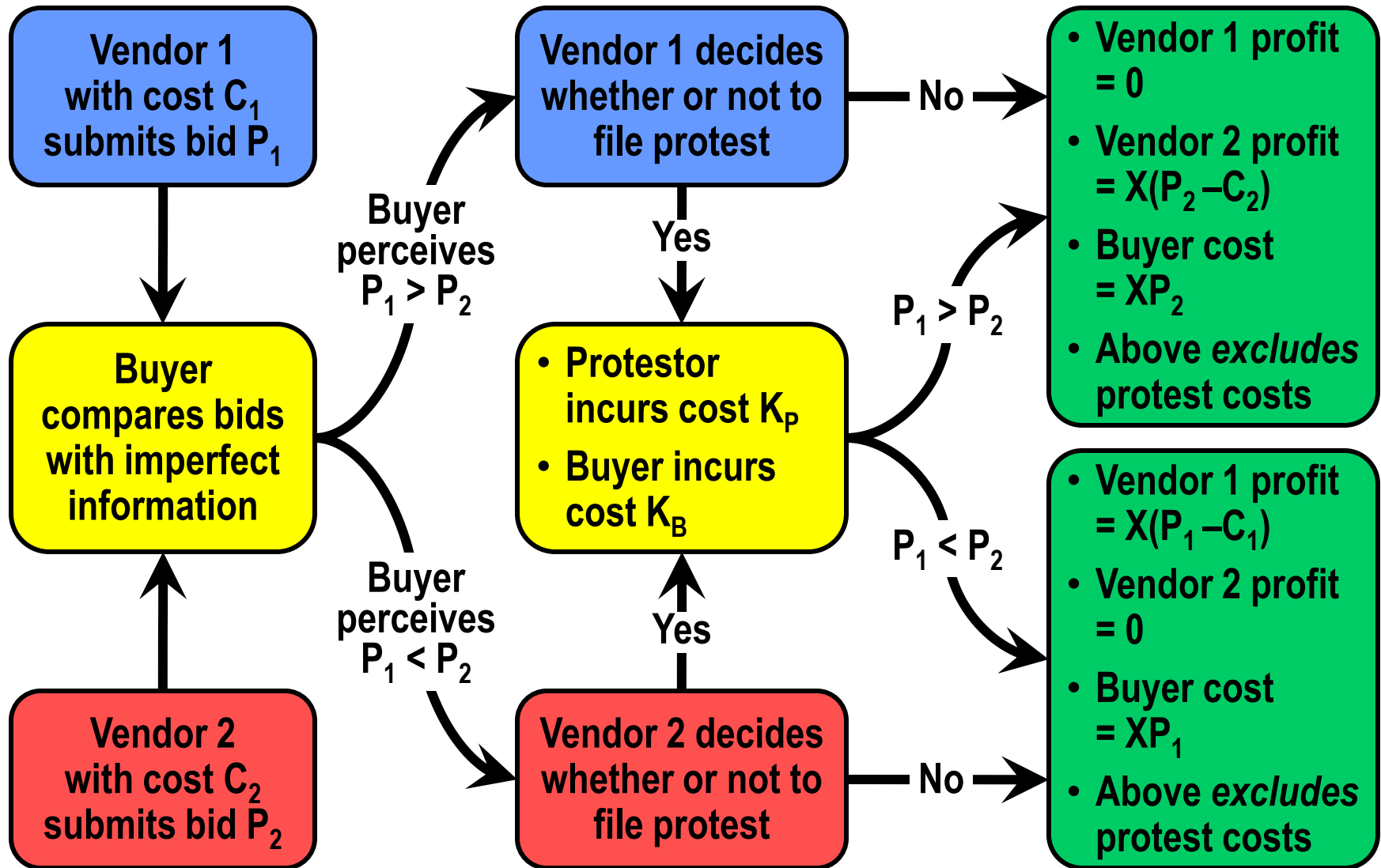
- **Managing bid protests** in DoD procurement
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# Modeling Bid Protests

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- As noted, the intended **role of bid protests** is, in the most general terms, to correct procurement mistakes
- Such mistakes – whether honest or dishonest – result from some form of **imperfect decision-making**
  - **How best to model** such imperfection?
- Consider a model driven by **imperfect information**
  - Imperfect info → **small mistake** more likely than **big mistake**
  - **Bias** → small injustice more likely than big injustice
- Imperfect information consistent with **empirical results**
  - “**Agency mis-evaluation**” is by far the most commonly cited reason for sustaining a DoD bid protest (Gansler, et al.)

# Simple Model of Bid & Protest Process



# Managing Vendor Protest Incentives

- **Losing vendor 1 protests iff**  $\text{Prob}(P_1 < P_2) \times X - K_p > 0$
- Recall the **two goals** of protest management:
  1. Encourage/allow “good” or **efficient protests**
  2. Discourage “bad” or **inefficient protests**
- **Levers of control?**
  - **$\text{Prob}(P_1 < P_2)$**  → Influence initial assessment accuracy
    - Change or shift burden of proof
  - **$K_p$**  → Influence expected costs
    - Different costs for successful vs. failed protests
  - **$X$**  → Influence gain from successful protest
    - **Split awards**

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# Bidding with *Fixed* Award Splits

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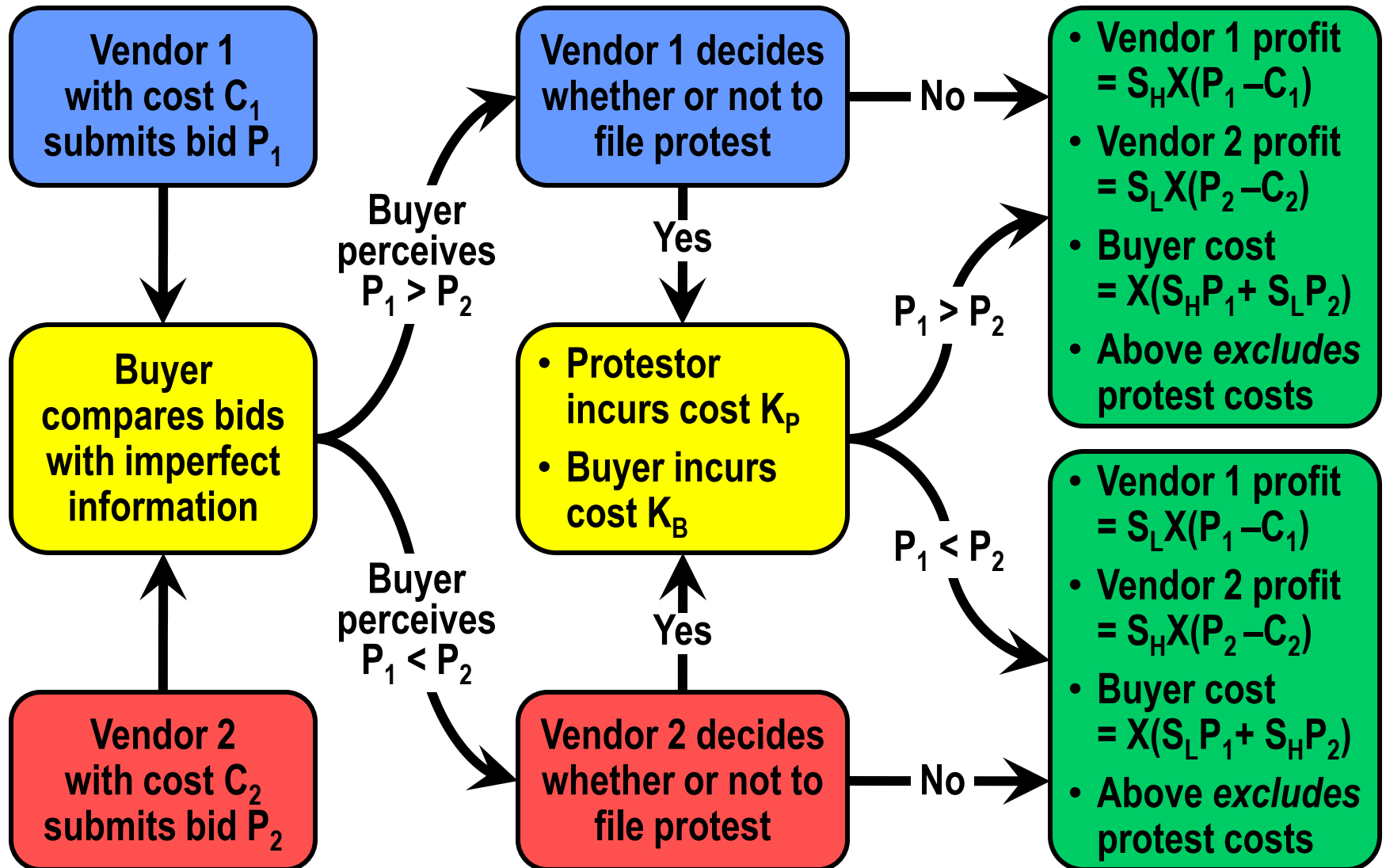
## Contract splits:

- $S_L$  = Share or split awarded **low-price** bidder
- $S_H$  = Share or split awarded **high-price** bidder
- $S_L + S_H = 1$
- $0 \leq S_H \leq \frac{1}{2}$  &  $\frac{1}{2} \leq S_L \leq 1$

## Award Determination:

- If final decision is that  $P_1 < P_2$ :
  - Vendor 1 awarded contract to produce  $S_L X$  units
  - Vendor 2 awarded contract to produce  $S_H X$  units
- If final decision is that  $P_1 > P_2$ :
  - Vendor 1 awarded contract to produce  $S_H X$  units
  - Vendor 2 awarded contract to produce  $S_L X$  units

# Bid & Protest Process with Split Awards



# Revised Vendor Protest Incentives

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- **Winner-take-all awards:** Losing vendor 1 protests  
**iff**  $\text{Prob}(P_1 < P_2) \times X - K_P > 0$
- **Split awards:** Losing vendor 1 protests  
**iff**  $\text{Prob}(P_1 < P_2) \times (S_L - S_H)X - K_P > 0$
- Split awards **raise the hurdle** for profitable protest
  - Is the hurdle high enough to limit “bad” protests?
  - Is the hurdle low enough to allow “good” protests?
- **Defacto split awards** already a *response* to protests
  - Alternative contracts, subcontracts, agency settlements, “Fed mail” buy-offs
  - Why not formalize this “under the table” process?

# Bid Protests & Split Awards: Agenda

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# Key Question: What is the Right Split?

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- Higher  $S_H$  → **lower protest incentive**
  - $E\Pi_1(\text{protest}) = \text{Prob}(P_1 < P_2) \times (1 - 2S_H)X - K$
  - $\delta E\Pi_1(\text{protest}) / \delta S_H = -2X \times \text{Prob}(P_1 < P_2)$
- Higher  $S_H$  → **higher total contract expense**
  - Winner-take-all cost =  $XP_L$
  - Split-award cost =  $X(S_H P_H + (1 - S_H)P_L)$
  - Difference =  $XS_H(P_H - P_L)$
- Higher  $S_H$  → **incentive to submit higher bid**

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# Equilibrium Bidding with Fixed Splits

## Focus on bid-stage only (for now):

- Ignore “continuation value” of protest stage
  - Effect of protest on bidding strategy ambiguous
- Also ignore buyer’s imperfect information
  - Assume buyer perfectly informed regarding  $P_1$  &  $P_2$
  - Symmetric imperfect info → neutral impact

## Expected profit function:

- $$\begin{aligned} E\Pi_1(P_1) &= X(P_1 - C_1)[\text{Prob}(P_1 > P_2)S_H + \text{Prob}(P_1 < P_2)S_L] \\ &= X(P_1 - C_1)[S_L - \text{Prob}(P_1 > P_2)(S_L - S_H)] \end{aligned}$$

# Equilibrium Bidding with Fixed Splits

## Expected profit function:

- Assume  $C_1, C_2$  identically & independently distributed over interval  $[0, M]$
- Symmetric bidding strategy  $\lambda(C)$ 
  - $\lambda: [0, M] \sim [0, M]$
  - $\lambda(M) = M$

## Equilibrium bidding strategy:

- $$I(C_1) = \frac{S_H M + (S_L - S_H)(1 - F(C_1))E(C_2 | C_2 > C_1)}{S_L - (S_L - S_H)F(C_1)}$$
- Complete derivation included in appendix

# Equilibrium Bidding with Fixed Splits

- Let  $C_1, C_2 \sim U[0,100]$  →

$$I(C_1) = \frac{S_H M + (S_L - S_H)(1 - F(C_1))E(C_2 | C_2 > C_1)}{S_L - (S_L - S_H)F(C_1)}$$

$$I(C_1) = \frac{100S_H + (S_L - S_H)\left(1 - \frac{1}{100}C_1\right)\frac{1}{2}(C_1 + 100)}{S_L - \frac{1}{100}(S_L - S_H)C_1}$$

$$I(C_1) = \frac{20,000S_H + (S_L - S_H)(100 - C_1)(C_1 + 100)}{200S_L - 2(S_L - S_H)C_1}$$

$$I(C_1) = \frac{20,000S_H + (1 - 2S_H)(10,000 - C_1^2)}{200S_L - 2C_1(S_L - S_H)}$$

$$I(C_1) = \frac{20,000S_H + 10,000 - C_1^2 - 20,000S_H + 2S_H C_1^2}{200S_L - 2C_1(S_L - S_H)}$$

$$I(C_1) = \frac{10,000 + (2S_H - 1)C_1^2}{200S_L - 2C_1(S_L - S_H)} = \frac{10,000 - (S_L - S_H)C_1^2}{200S_L - 2C_1(S_L - S_H)}$$

# Equilibrium Bidding with Fixed Splits

$$S_H = 0 \text{ } \vdash \text{ } I(C_1) = \frac{10,000 - C_1^2}{200 - 2C_1} = \frac{(100 - C_1)(100 + C_1)}{2(100 - C_1)} = 50 + \frac{1}{2}C_1$$

$$S_H = 0.1 \text{ } \vdash \text{ } S_L = 0.9 \text{ } \vdash \text{ } I(C_1) = \frac{10,000 - 0.8C_1^2}{180 - 1.6C_1}$$

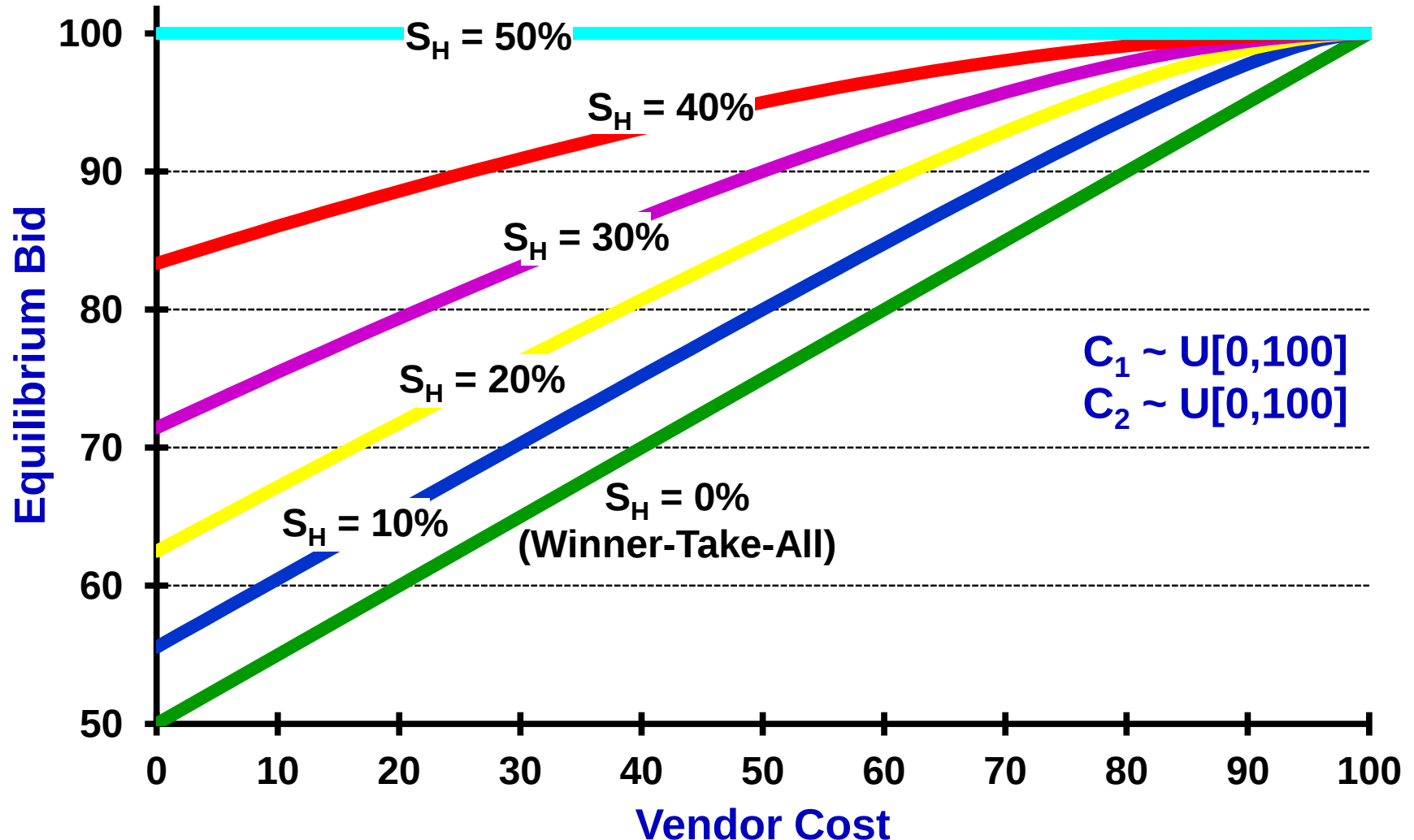
$$S_H = 0.2 \text{ } \vdash \text{ } S_L = 0.8 \text{ } \vdash \text{ } I(C_1) = \frac{10,000 - 0.6C_1^2}{160 - 1.2C_1}$$

$$S_H = 0.3 \text{ } \vdash \text{ } S_L = 0.7 \text{ } \vdash \text{ } I(C_1) = \frac{10,000 - 0.4C_1^2}{140 - 0.8C_1}$$

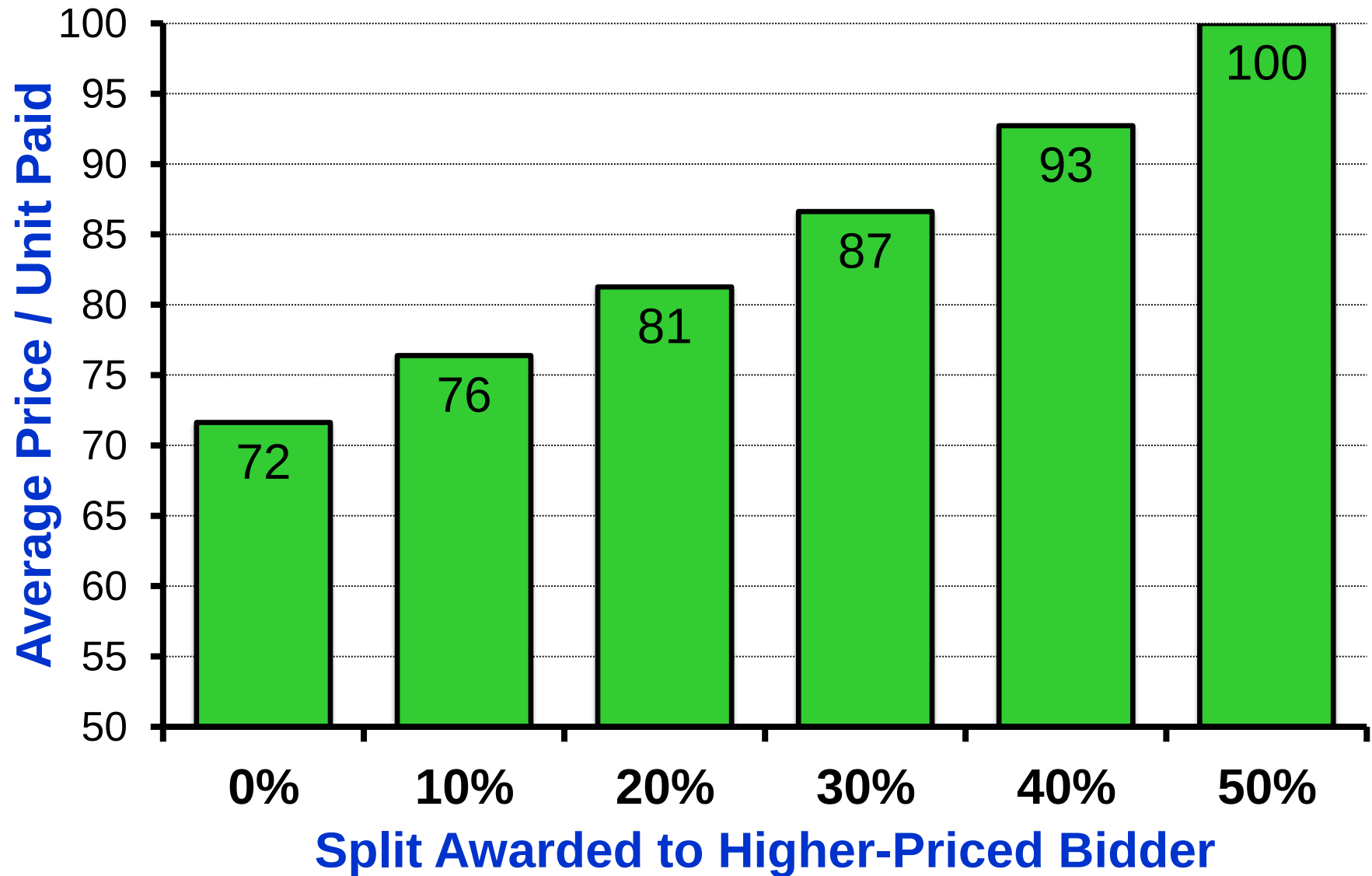
$$S_H = 0.4 \text{ } \vdash \text{ } S_L = 0.6 \text{ } \vdash \text{ } I(C_1) = \frac{10,000 - 0.2C_1^2}{120 - 0.4C_1}$$

$$S_H = 0.5 \text{ } \vdash \text{ } S_L = 0.5 \text{ } \vdash \text{ } I(C_1) = \frac{10,000 - 0}{100 - 0} = 100$$

# Equilibrium Bidding with Fixed Splits



# Average Price / Unit with Fixed Splits



# Bid Protests & Split Awards: Agenda

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# Extension: Endogenous Split Awards

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- Split awards **reduce frequency** of bid protest 😊
- BUT **2 cost inflation effects** from split awards 😞
  - Direct additional cost =  $X S_H (P_H - P_L)$
  - Indirect additional cost = bid inflation
- **Note:** Both inflation effects mitigated if size of  $S_H$  is **inversely related to  $(P_H - P_L)$**
- Potential solution: **Endogenous split awards**
  - Let  $R_L = P_L / P_H$  (such that  $0 \leq R_L \leq 1$ )
  - Let  $S_H = F(R_L)$
  - $0 \leq F(R_L) \leq 1/2$
  - $F(R_L)$  increasing in  $R_L$

# Example Split Award Function

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- Let  $S_H = \alpha R_L^\beta$ 
  - $\alpha$  = **maximum share** to high-price bidder ( $0 \leq \alpha \leq \frac{1}{2}$ )
  - $\beta \geq 0$
  - $S_H$  is **increasing in  $\alpha$  &  $R_L$**
  - $S_H$  is **decreasing in  $\beta$**
- Buyer decision: What are the **best  $\alpha$  &  $\beta$** ?

# Split Award Scenarios with $S_H = \alpha R_L^\beta$

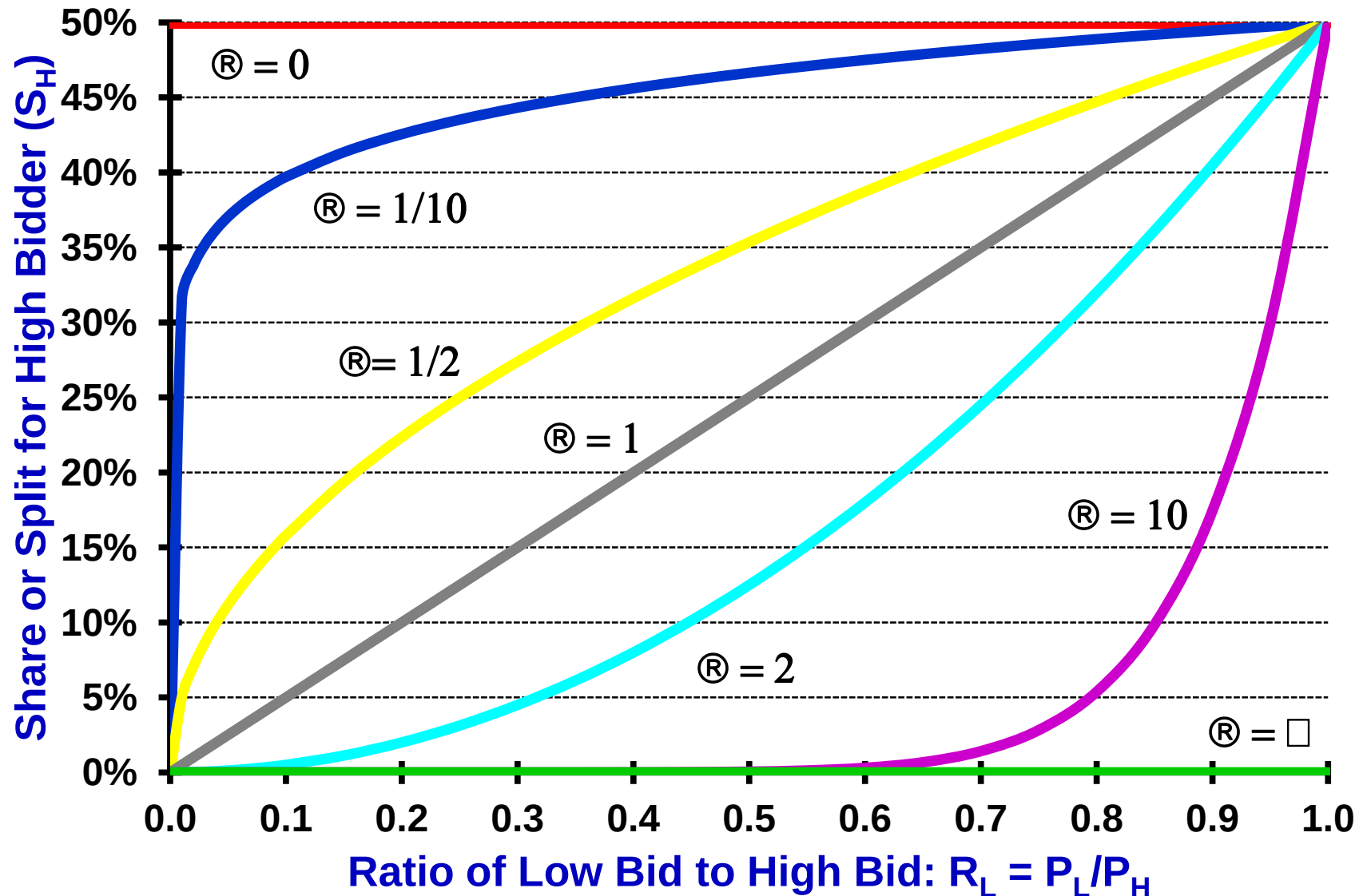
|                            | $\beta = 0$                              | $0 < \beta < 1$                                          | $\beta = 1$                                              | $1 < \beta < \infty$                                     | $\beta = \infty$                    |
|----------------------------|------------------------------------------|----------------------------------------------------------|----------------------------------------------------------|----------------------------------------------------------|-------------------------------------|
| $\alpha = 0$               | $S_H = 0$<br><b>Winner-Take-All</b>      | $S_H = 0$<br><b>Winner-Take-All</b>                      | $S_H = 0$<br><b>Winner-Take-All</b>                      | $S_H = 0$<br><b>Winner-Take-All</b>                      | $S_H = 0$<br><b>Winner-Take-All</b> |
| $0 < \alpha < \frac{1}{2}$ | $S_H = \alpha$<br><b>Fixed Split</b>     | $0 \leq S_H \leq \alpha$<br>$S_H > \alpha R_L$           | $0 \leq S_H \leq \alpha$<br>$S_H = \alpha R_L$           | $0 \leq S_H \leq \alpha$<br>$S_H < \alpha R_L$           | $S_H = 0$<br><b>Winner-Take-All</b> |
| $\alpha = \frac{1}{2}$     | $S_H = \frac{1}{2}$<br><b>Even Split</b> | $0 \leq S_H \leq \frac{1}{2}$<br>$S_H > \frac{1}{2} R_L$ | $0 \leq S_H \leq \frac{1}{2}$<br>$S_H = \frac{1}{2} R_L$ | $0 \leq S_H \leq \frac{1}{2}$<br>$S_H < \frac{1}{2} R_L$ | $S_H = 0$<br><b>Winner-Take-All</b> |



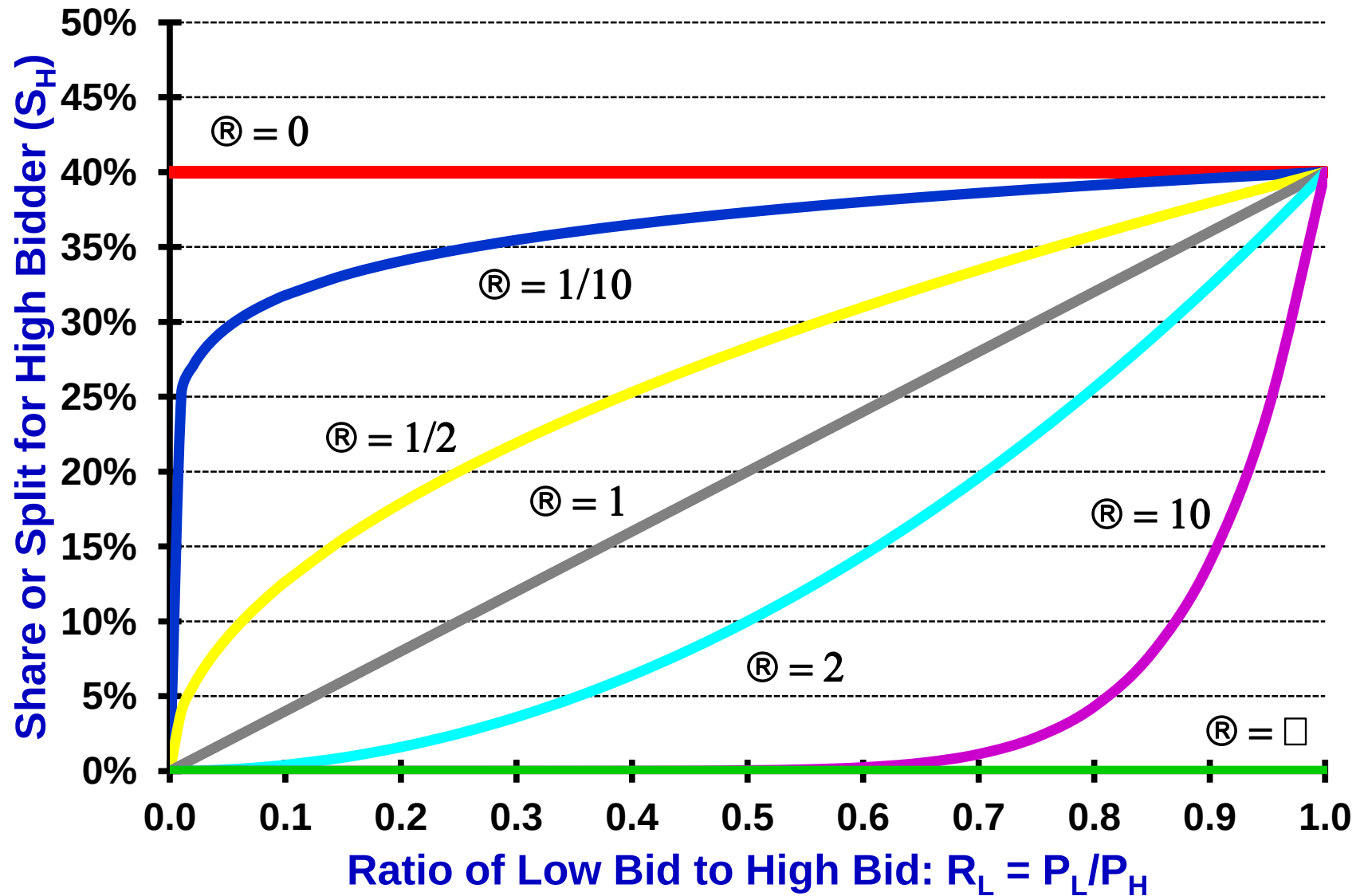
**Better** for **High** Bidder  
**Worse** for **Low** Bidder

**Worse** for **High** Bidder  
**Better** for **Low** Bidder

# Split Award Scenarios with $S_H = \frac{1}{2}R_L^\beta$



# Split Award Scenarios with $S_H = \frac{2}{5}R_L^\beta$



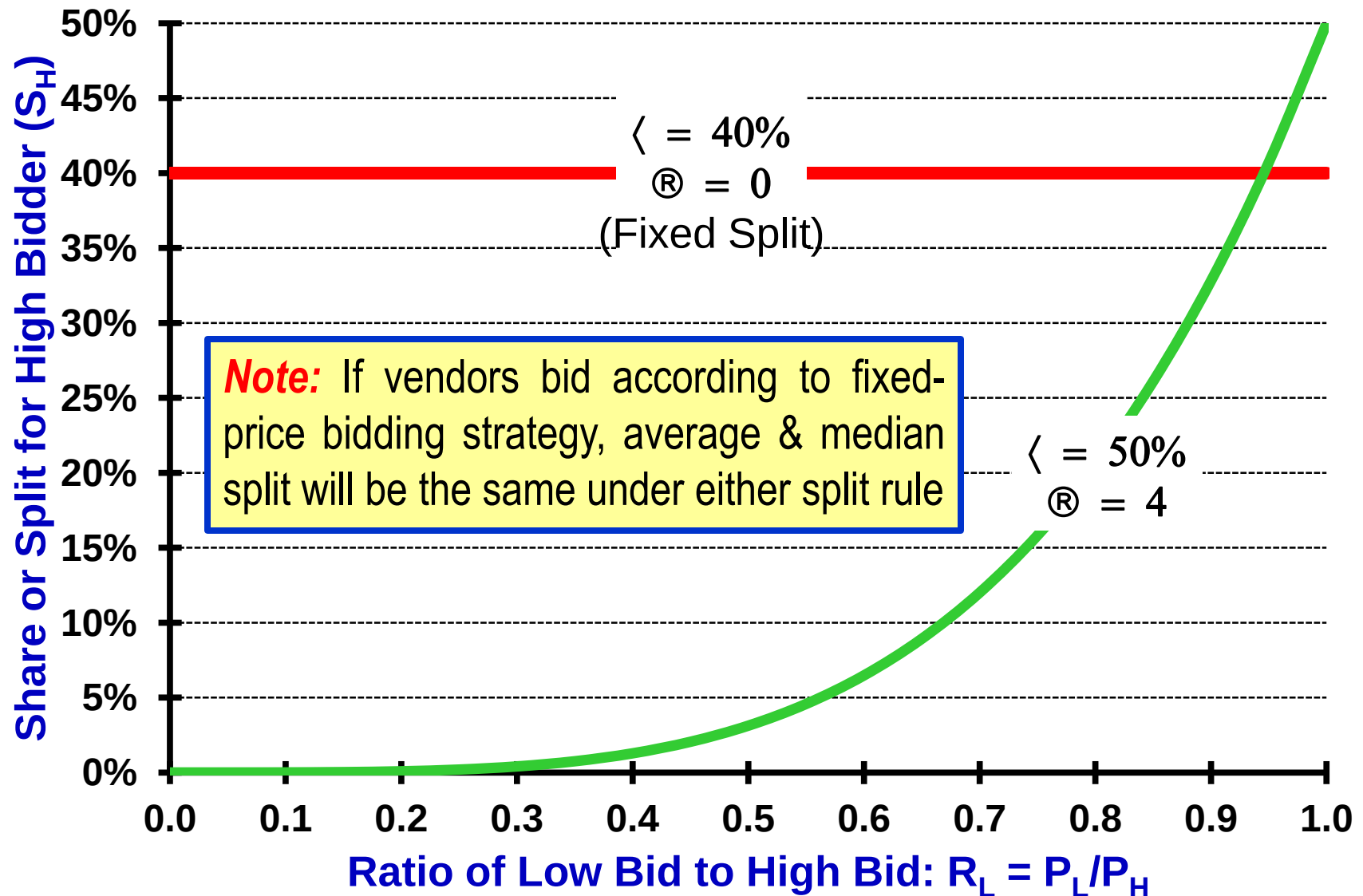
# From Fixed Splits to Endogenous Splits

- Recall that the **equilibrium bidding strategy** under **fixed splits** of  $S_H = 0.4$  &  $S_L = 0.6$  with  $C_1, C_2 \sim U[0,100]$  was given by:

$$P_j = I(C_j) = \frac{10,000 - 0.2C_j^2}{120 - 0.4C_j}$$

- In equilibrium, this yielded an expected **price per unit** of **93**
- Now, consider the following **endogenous split award function**:
  - $S_H = \alpha R_L^\beta$  with  $\alpha = 1/2$  &  $\beta = 4$
  - $S_H = 1/2 R_L^4$
- If both vendors continue to bid according to the above fixed-split equilibrium bidding strategy, we have:
  - Average split (average value of  $S_H = 1/2 R_L^4$ ) = 0.4
  - Median split (median value of  $S_H = 1/2 R_L^4$ ) = 0.4
  - Thus, **“apples-to-apples” comparison** to compare bidding under these two award rules (one fixed, one endogenous)

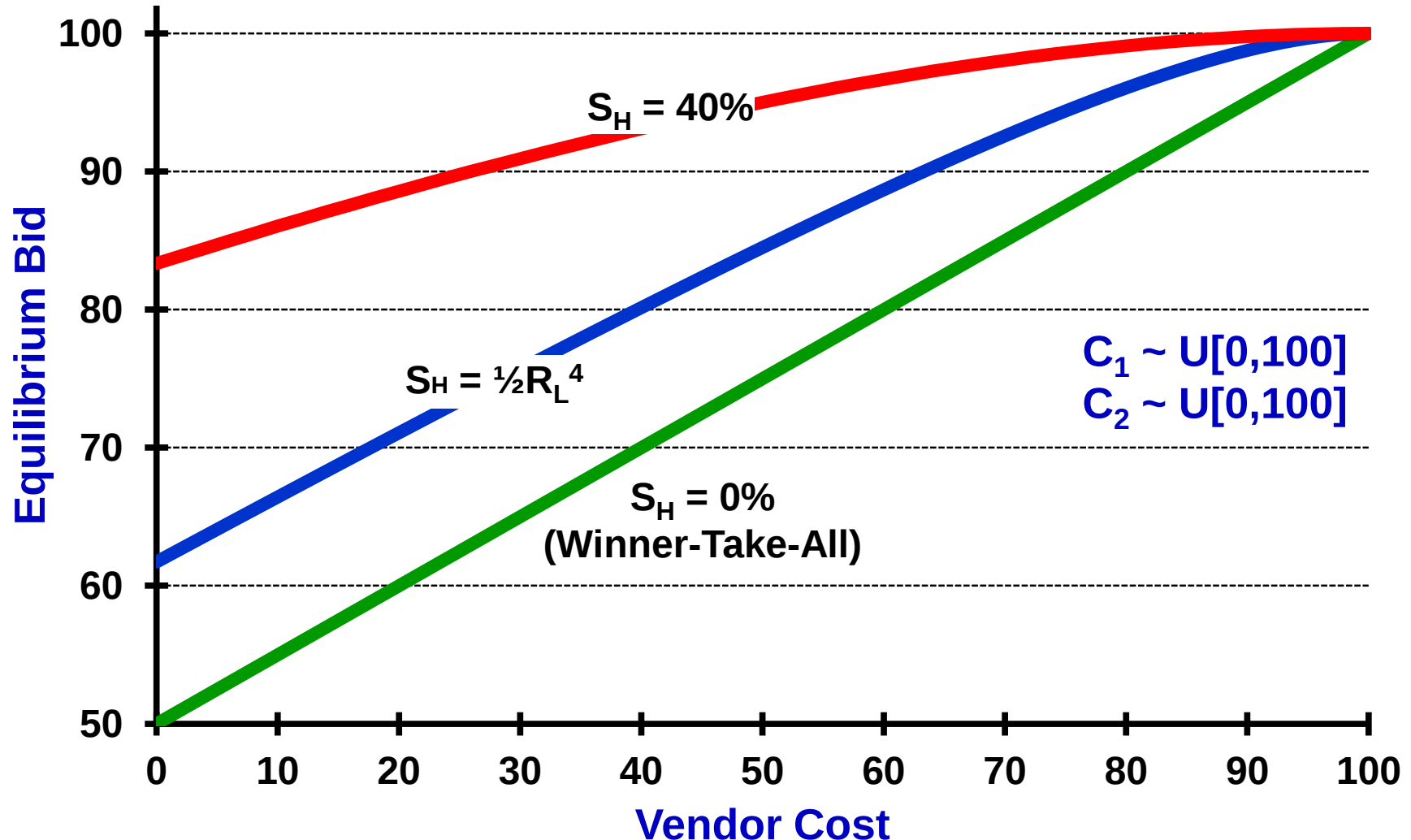
# Split Award Scenarios with $S_H = \alpha R_L^\beta$



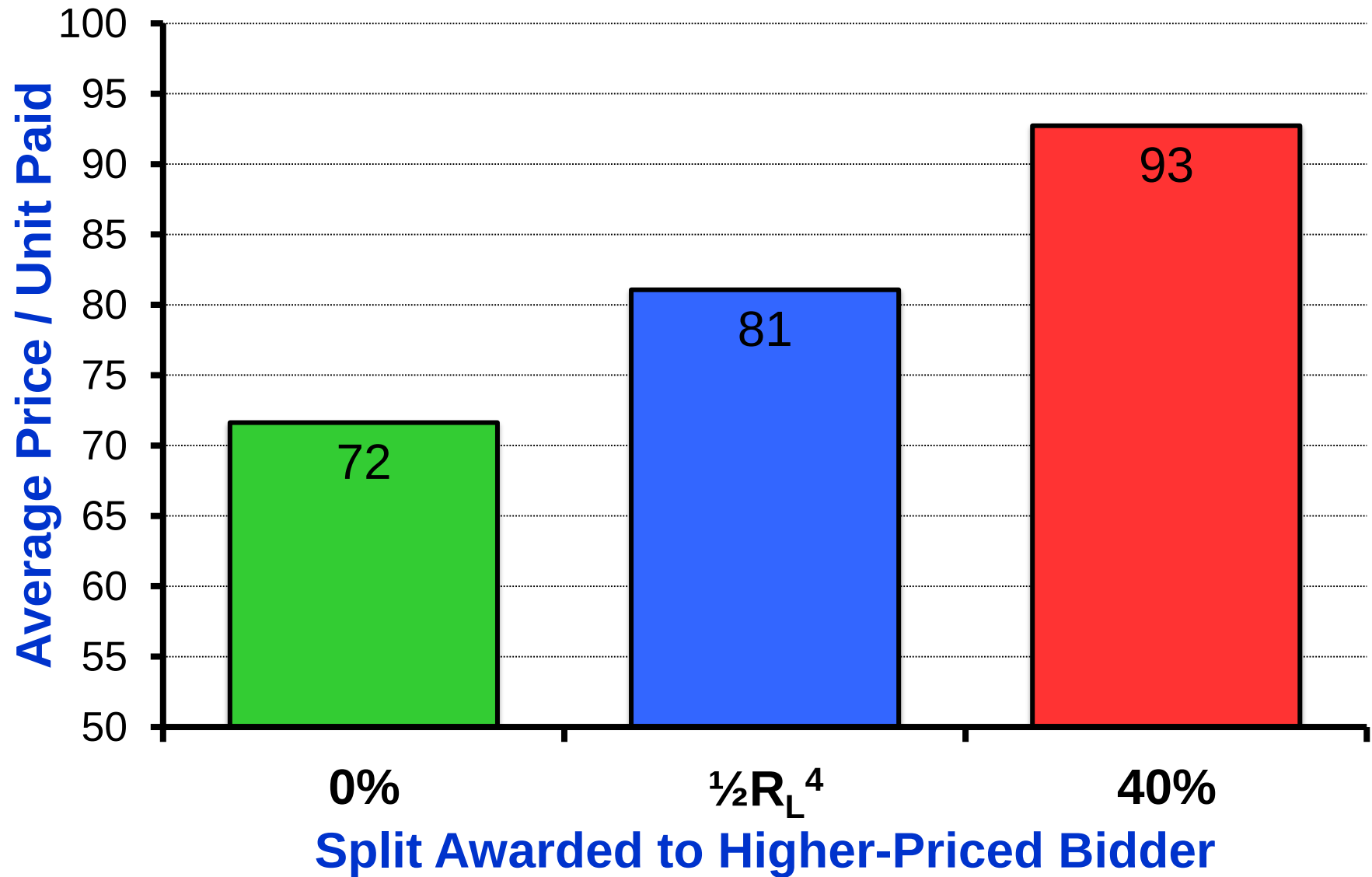
# From Fixed Splits to Endogenous Splits

- If vendors follow fixed-split bidding strategy for  $S_H = 0.4$ , expected & median values of the endogenous split should **still** be  **$S_H = 0.4$** 
  - But is this strategy still optimal when splits are endogenous?
- So, when contract **splits are endogenous** & given by  $S_H = \frac{1}{2}R_L^4$ :
  - What is the **equilibrium bidding strategy**?
  - What is the **average price per unit** paid by the buyer?
- We answered these questions **computationally**
  - **Closed-form solution** to equilibrium calculation is problematic
  - Thus, solve via “**iterative best-response**”
    1. Start: Assume vendor 1 follows given fixed-price bid strategy
    2. Compute: What is vendor 2’s best-response bidding strategy?
    3. Iterate: What is vendor 1’s best-response to 2’s best-response?
    4. Repeat: Until you reach a “fixed-point” solution

# Equilibrium Bidding with Endogenous Splits



# Average Price / Unit with Different Splits



# Bid Protests & Split Awards: Agenda

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# Bid Protests & Split Awards: Conclusions

---

- Objective is to **manage**, not minimize protests
  - Encourage protests that correct (significant) mistakes
  - Discourage protests that do not
- **Split awards** are lever for protest management
  - Raise the hurdle for profitable protest
  - Filters out unmerited protests more than merited
- Challenge is determining the **right split**
  - Higher split to 2<sup>nd</sup>-vendor reduces protest incentive
  - BUT higher 2<sup>nd</sup>-vendor split also increases costs
  - Higher fixed 2<sup>nd</sup>-vendor split induces bid inflation
- **Endogenous** split awards offer potential solution
  - Retains protest “filtering” benefits
  - Reduces inflation of bids & average price paid

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# Research Agenda Moving Forward

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## ■ Research questions:

- What is the **optimal split award function**?
  - » Minimize expected and/or long-term buyer cost
  - » Including cost of protests & corrective benefit of protests
  - » Include impact of other benefits of split awards
- What is the impact of **changes in key variables**?
  - » Vendor & buyer information, costs of protest, etc.
- What is the impact of **repeated procurements**?
  - » Inter-temporal effects: Experience & innovation

## ■ Research methodology:

- Closed-form **game-theoretic solutions** & dynamics
- Numerical **computation** & **simulation**



# Endogenous Split Awards as a Protest Management Tool: A Modeling & Computational Approach

*Appendix: Equilibrium Bid Strategy with Fixed-Splits*

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# Temporary Simplifying Assumptions

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- For now, ignore “continuation value” of protest stage
  - Effect of protest on bidding strategy ambiguous
- For now, also ignore buyer’s imperfect information
  - Assume buyer perfectly informed regarding  $P_1$  &  $P_2$
  - Symmetric imperfect info → neutral impact

# Expected Profit Function (Bid Stage)

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- $E\Pi_1(P_1) = X(P_1 - C_1)[\text{Prob}(P_1 > P_2)S_H + \text{Prob}(P_1 < P_2)S_L]$   
 $= X(P_1 - C_1)[\text{Prob}(P_1 > P_2)S_H + [1 - \text{Pr}(P_1 > P_2)]S_L]$   
 $= X(P_1 - C_1)[S_L + \text{Prob}(P_1 > P_2)(S_H - S_L)]$   
 $= X(P_1 - C_1)[S_L - \text{Prob}(P_1 > P_2)(S_L - S_H)]$

# Cost Distribution & Bidding Strategy

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- Assume  $C_1, C_2$  identically & independently distributed over interval  $[0, M]$ 
  - Distribution function  $F$
  - Density function  $f = F'$
- Symmetric bidding strategy  $\lambda(C)$ 
  - $\lambda: [0, M] \sim [0, M]$
  - $\lambda(M) = M$

# Equilibrium Bidding with Fixed Splits

- Calculate optimal bid  $P_1$  for vendor 1 assuming:
  - Vendor 1 has cost  $C_1$
  - Vendor 2 is bidding according to strategy  $\lambda(C_2)$
- $\text{Prob}(P_2 < P_1) = \text{Prob}[\lambda(C_2) < P_1] = \text{Prob}[C_2 < \lambda^{-1}(P_1)]$   
 $= F(\lambda^{-1}(P_1))$
- $E\Pi_1(P_1) = X(P_1 - C_1)[S_L - \text{Prob}(P_1 > P_2)(S_L - S_H)]$   
 $= X(P_1 - C_1)[S_L - F(\lambda^{-1}(P_1))(S_L - S_H)]$
- Chain rule + inverse derivative theorem  $\rightarrow$   
 $\delta E\Pi_1 / \delta P_1 = X[S_L - F(\lambda^{-1}(P_1))(S_L - S_H)]$   
 $\quad - X(P_1 - C_1)(S_L - S_H)f(\lambda^{-1}(P_1))/\lambda'(\lambda^{-1}(P_1))$

# Equilibrium Bidding with Fixed Splits

- First-order condition →

$$S_L - F(\lambda^{-1}(P_1))(S_L - S_H) = (P_1 - C_1)(S_L - S_H)f(\lambda^{-1}(P_1))/\lambda'(\lambda^{-1}(P_1))$$

$$\lambda'(\lambda^{-1}(P_1))[S_L - F(\lambda^{-1}(P_1))(S_L - S_H)] = (P_1 - C_1)(S_L - S_H)f(\lambda^{-1}(P_1))$$

- At symmetric equilibrium,  $P_1 = \lambda(C_1) \rightarrow \lambda^{-1}(P_1) = C_1 \rightarrow$

$$\lambda'(C_1)[S_L - F(C_1)(S_L - S_H)] = (\lambda(C_1) - C_1)(S_L - S_H)f(C_1)$$

$$S_L \lambda'(C_1) = (S_L - S_H)[F(C_1)\lambda'(C_1) + \lambda(C_1)f(C_1) - C_1 f(C_1)]$$

$$(S_L - S_H)[F(C_1)\lambda'(C_1) + f(C_1)\lambda(C_1)] = S_L \lambda'(C_1) + C_1(S_L - S_H)f(C_1)$$

$$(S_L - S_H) \frac{F(C_1)\lambda'(C_1) + f(C_1)\lambda(C_1)}{C_1} = S_L \lambda'(C_1) + C_1(S_L - S_H)f(C_1)$$

# Equilibrium Bidding with Fixed Splits

$$(S_L - S_H) \frac{1}{C_1} \frac{d}{dC_1} [F(C_1)I(C_1)] = S_L \frac{d}{dC_1} [F(C_1)I(C_1)] + C_1(S_L - S_H) f(C_1)$$

$$(S_L - S_H) \int_{C_1}^M \frac{1}{C_1} \frac{d}{dC_1} [F(C_1)I(C_1)] dC_1$$

$$= S_L \int_{C_1}^M \frac{d}{dC_1} [F(C_1)I(C_1)] dC_1 + (S_L - S_H) \int_{C_1}^M C_1 f(C_1) dC_1$$

$$(S_L - S_H) [F(M)I(M) - F(C_1)I(C_1)]$$

$$= S_L [F(M)I(M) - F(C_1)I(C_1)] + (S_L - S_H) \int_{C_1}^M C_1 f(C_1) dC_1$$

$$(S_L - S_H) [F(M)I(M) - F(C_1)I(C_1)] = S_L [F(M)I(M) - F(C_1)I(C_1)] + (S_L - S_H) \int_{C_1}^M C_1 f(C_1) dC_1$$

$$- S_H [F(M)I(M) - F(C_1)I(C_1)] = (S_L - S_H) \int_{C_1}^M C_1 f(C_1) dC_1$$

$$= (S_L - S_H) [F(C_1)I(C_1) - S_L I(C_1)]$$

$$S_H [F(M)I(M) - F(C_1)I(C_1)] + (S_L - S_H) \int_{C_1}^M C_1 f(C_1) dC_1 = [F(C_1)I(C_1) - S_L I(C_1)]$$

# Equilibrium Bidding with Fixed Splits

$$S_H M + (S_L - S_H) \int_{C_1}^M C_1 f(C_1) dC_1 = I(C_1) S_L (1 - F(C_1)) + I(C_1) S_H F(C_1)$$

$$S_H M + (S_L - S_H) (1 - F(C_1)) \frac{\int_{C_1}^M C_1 f(C_1) dC_1}{1 - F(C_1)}$$

$$= I(C_1) S_L (1 - F(C_1)) + S_H F(C_1) I(C_1)$$

$$S_H M + (S_L - S_H) (1 - F(C_1)) E(C_2 | C_2 > C_1)$$

$$= I(C_1) S_L - S_L F(C_1) + S_H F(C_1) I(C_1) = I(C_1) S_L - (S_L - S_H) F(C_1) I(C_1)$$

$$I(C_1) = \frac{S_H M + (S_L - S_H) (1 - F(C_1)) E(C_2 | C_2 > C_1)}{S_L - (S_L - S_H) F(C_1)}$$

# Equilibrium Bidding with Fixed Splits

- Let  $C_1, C_2 \sim U[0,100]$  →

$$I(C_1) = \frac{S_H M + (S_L - S_H)(1 - F(C_1))E(C_2 | C_2 > C_1)}{S_L - (S_L - S_H)F(C_1)}$$

$$I(C_1) = \frac{100S_H + (S_L - S_H)\left(1 - \frac{1}{100}C_1\right)\frac{1}{2}(C_1 + 100)}{S_L - \frac{1}{100}(S_L - S_H)C_1}$$

$$I(C_1) = \frac{20,000S_H + (S_L - S_H)(100 - C_1)(C_1 + 100)}{200S_L - 2(S_L - S_H)C_1}$$

$$I(C_1) = \frac{20,000S_H + (1 - 2S_H)(10,000 - C_1^2)}{200S_L - 2C_1(S_L - S_H)}$$

$$I(C_1) = \frac{20,000S_H + 10,000 - C_1^2 - 20,000S_H + 2S_H C_1^2}{200S_L - 2C_1(S_L - S_H)}$$

$$I(C_1) = \frac{10,000 + (2S_H - 1)C_1^2}{200S_L - 2C_1(S_L - S_H)} = \frac{10,000 - (S_L - S_H)C_1^2}{200S_L - 2C_1(S_L - S_H)}$$

# Equilibrium Bidding with Fixed Splits

$$S_H = 0 \text{ } \vdash \text{ } I(C_1) = \frac{10,000 - C_1^2}{200 - 2C_1} = \frac{(100 - C_1)(100 + C_1)}{2(100 - C_1)} = 50 + \frac{1}{2}C_1$$

$$S_H = 0.1 \text{ } \vdash \text{ } S_L = 0.9 \text{ } \vdash \text{ } I(C_1) = \frac{10,000 - 0.8C_1^2}{180 - 1.6C_1}$$

$$S_H = 0.2 \text{ } \vdash \text{ } S_L = 0.8 \text{ } \vdash \text{ } I(C_1) = \frac{10,000 - 0.6C_1^2}{160 - 1.2C_1}$$

$$S_H = 0.3 \text{ } \vdash \text{ } S_L = 0.7 \text{ } \vdash \text{ } I(C_1) = \frac{10,000 - 0.4C_1^2}{140 - 0.8C_1}$$

$$S_H = 0.4 \text{ } \vdash \text{ } S_L = 0.6 \text{ } \vdash \text{ } I(C_1) = \frac{10,000 - 0.2C_1^2}{120 - 0.4C_1}$$

$$S_H = 0.5 \text{ } \vdash \text{ } S_L = 0.5 \text{ } \vdash \text{ } I(C_1) = \frac{10,000 - 0}{100 - 0} = 100$$

# **Endogenous Split Awards as a Protest Management Tool: A Modeling & Computational Approach**

**Unused Back-Up Slides**

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# Bid Protests of Growing Concern

**A NEW  
CYBER-  
SECURITY  
PLAN TAKES  
SHAPE 4**



## FEDERAL TIMES

THE NEWS SOURCE FOR THE BUSINESS OF GOVERNMENT

April 6, 2009

[www.federaltimes.com](http://www.federaltimes.com)

### PAY AND BENEFITS

#### DoD performance pay

The Government Accountability Office warns against pulling the plug on Defense's performance pay system. **Page 4**

#### On furlough

Seven states are putting Social Security Administration employees on furlough, worsening the claims backlog. **Page 6**

### FACILITIES MANAGEMENT

#### Move to Guam

The Defense Department plans to build a \$10 billion Marine Corps base on Guam, the first step in a broadening military presence there. **Page 8**

### PROCUREMENT

## The rising problem of bid protests

### Why large contracts are being sidelined

By ELISE CASTELLI

[ecastelli@federaltimes.com](mailto:ecastelli@federaltimes.com)

**W**hen the General Services Administration announced 29 winners of the \$50 billion Alliant contract in 2007, agency leaders heralded it as the government's premier contract for information technology purchases.

"With its expansive scope, access to the best in class in the private sector and ability to provide customized solutions tailored to agencies' unique IT needs, we can again prove that GSA is at the forefront of serving the acquisition needs of the federal government," GSA's Federal Acquisition Service Commissioner James Williams declared at the time.

But 18 months later, a lot has

changed. The contract was held up because of bid protests from several firms that didn't make the cut. A federal court ordered GSA to re-evaluate all bidders. And it wasn't until two weeks ago that GSA got the giant Alliant contract back on track by awarding it to 59 companies.

Alliant is one of a few high-profile, high-value procurements — another is the Air Force's tanker contract — that have been waylaid by protests in recent years. While these large procurements get all the attention, most bid protests concern smaller contracts.

Overall, the protests rose 44 percent since 2001 — in part because companies were recently allowed to protest not only ad-

See **PROTESTS**, **Page 19**

### ON THE RISE

The number of bid protests lodged each year has increased considerably since 2001:



SOURCE: Government Accountability Office

GRAPHIC BY CHRIS BRIZ

### GSA STIMULUS PLAN

## Hundreds of buildings to be upgraded

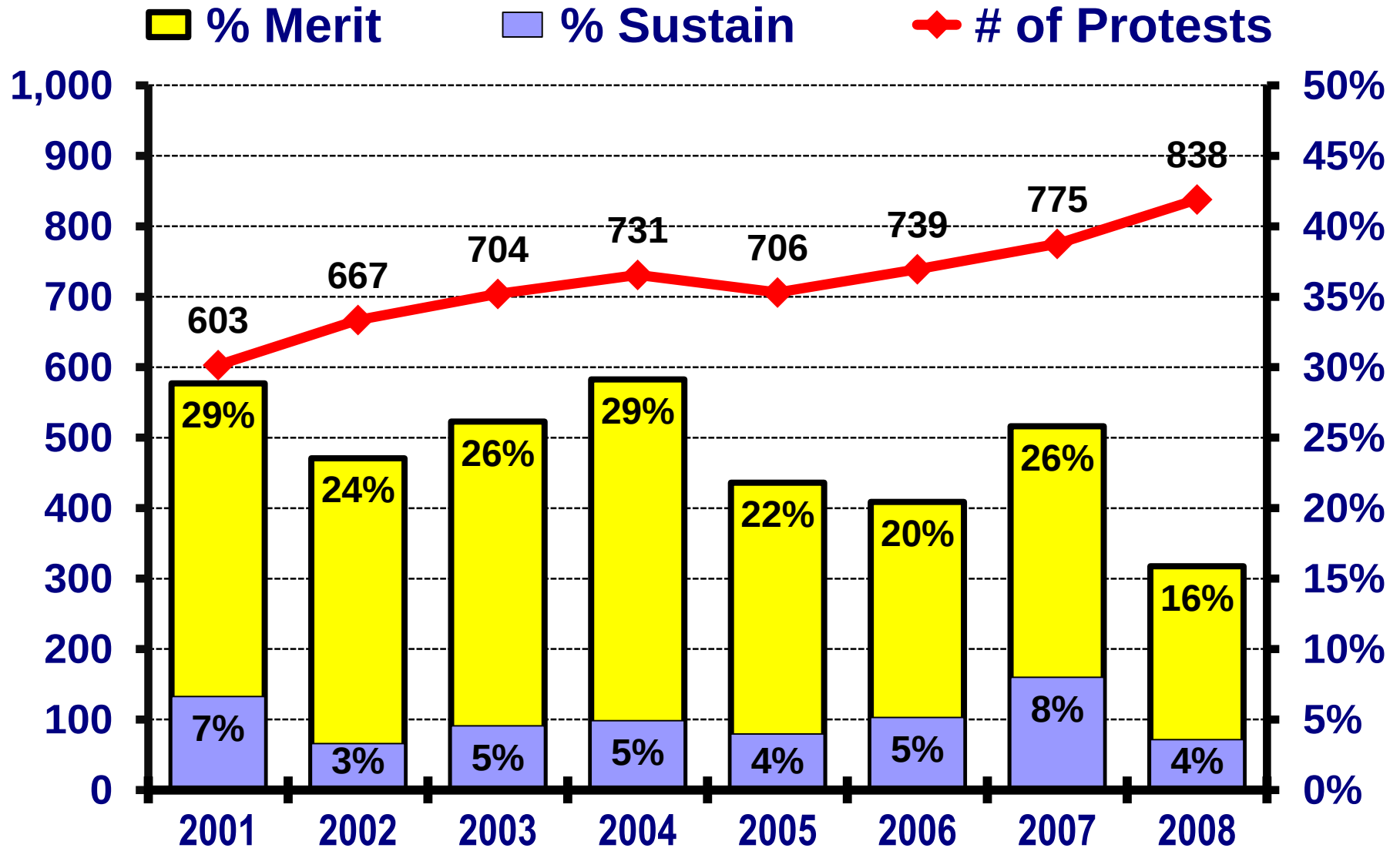
By TIM KAUFFMAN

[tkauffman@federaltimes.com](mailto:tkauffman@federaltimes.com)

**H**undreds of federal buildings across the country will be going green in the next year or two under the General Services Administration's plans for spending more than \$5.5 billion in stimulus funds.

Many will benefit from features such as advanced meters to improve monitoring of electricity and water use, lighting controls and sensors that turn off lights when not needed, new or improved heating and air-conditioning systems, and renewable

# DoD Bid Protest Trends



# Vendor Protest Incentives

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- Expected **Profit** from Protest  
= Expected Benefits – Expected Costs
- Expected **Costs** =  $K$   
= Research + Legal + Reputation + Opportunity Costs
- Expected **Benefits**  
= Probability of Success  $\times$  Gain if Successful
- **Gain** if Successful = Contract Revenue =  $X$
- **Probability** of Success  
=  $\text{Prob}(P_1 < P_2)$  *given* that buyer perceived  $P_1 > P_2$
- Expected Profit from Protest =  **$\text{Prob}(P_1 < P_2) \times X - K$**

# Modeling Buyer Imperfect Information

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- Let  $\mathbf{R}_1 = P_1 / (P_1 + P_2)$  &  $\mathbf{R}_2 = P_2 / (P_1 + P_2)$ 
  - $0 \leq R_1 \leq 1$  &  $0 \leq R_2 \leq 1$
  - $R_1 + R_2 = 1$
- Let  $\mathbf{r}_1$  = buyer's **estimate of  $R_1$** 
  - $r_1 = r / N$  where  $r \sim \text{Bin}(N, R_1)$
  - **Binomial** with  $N$  draws & success probability =  $R_1$
  - Higher  $N \rightarrow$  more accurate estimate of  $R_1$
- Let  $\mathbf{r}_2$  = buyer's **estimate of  $R_2$** 
  - $r_2 = 1 - r_1$

# Perceived Probability of Protest Success

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- Assume **buyer discloses estimate  $r_1$** 
  - $r_1 < 1/2 \Rightarrow$  vendor 1 wins
  - $r_1 > 1/2 \Rightarrow$  vendor 2 wins
- If vendor 1 loses, his estimate of the **probability of a successful protest** is:
  - $\text{Prob}(P_1 < P_2)$  *given* that buyer perceives  $P_1 > P_2$
  - $\text{Prob}(R_1 < 1/2)$  *given* that buyer estimates  $R_1$  at  $r_1$
  - $\text{Prob}(R_1 < 1/2)$  *given*  $Nr_1$  successes from  $\text{Bin}(N, R_1)$
  - $\text{Prob}(R_1 < 1/2 \mid Nr_1 \text{ out of } N)$

# Perceived Probability of Protest Success

$$\begin{aligned} & \text{Pr ob}\left(R_1 < \frac{1}{2} \mid N r_1 \text{ out of } N\right) \\ &= \frac{\text{Pr ob}\left(R_1 < \frac{1}{2}\right) \text{Pr ob}\left(N r_1 \text{ out of } N \mid R_1 < \frac{1}{2}\right)}{\text{Pr ob}\left(N r_1 \text{ out of } N\right)} \\ &= \frac{\int_0^{\frac{1}{2}} \text{Pr ob}(z) \text{Pr ob}\left(N r_1 \text{ out of } N \mid R_1 = z\right) dz}{\int_0^1 \text{Pr ob}(z) \text{Pr ob}\left(N r_1 \text{ out of } N \mid R_1 = z\right) dz} \\ &= \frac{\int_0^{\frac{1}{2}} \text{Pr ob}(z) \binom{N}{N r_1} z^{N r_1} (1-z)^{N(1-r_1)} dz}{\int_0^1 \text{Pr ob}(z) \binom{N}{N r_1} z^{N r_1} (1-z)^{N(1-r_1)} dz} \end{aligned}$$

where  $\text{Prob}(z)$  reflects vendor 1's *prior* probability distribution of  $R_1$

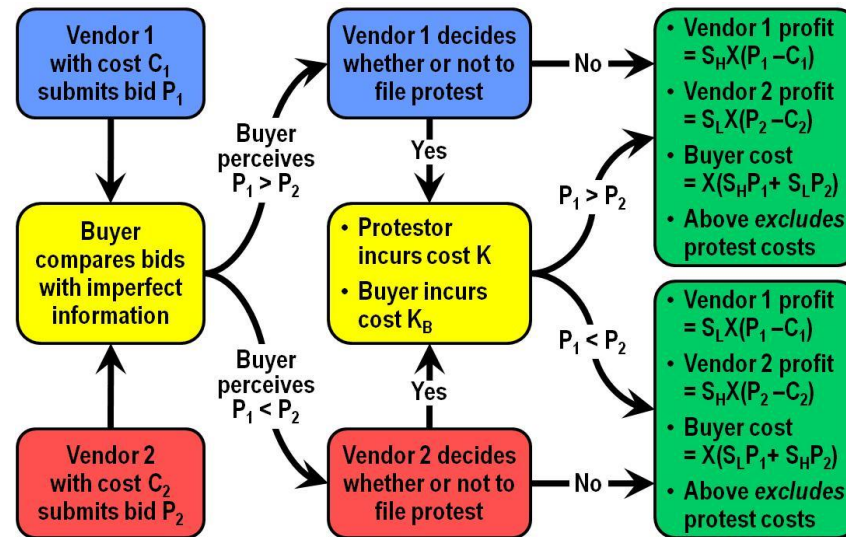
# Extension: Repeated Procurements

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- What are the **other benefits** of split awards?
  - Why are split awards **used currently?**
- Split awards **preserve competition** for repeated or follow-on procurements
- ***Direct modeling implications:***
  - Appropriate to model as **repeated** bidding game
  - Implies presence of **learning/experience** effects
- ***Indirect modeling implications:***
  - Incorporate **innovation** to avoid trivial outcomes
  - Innovation driven by “**shocks**” or **investment**

# Extension: Repeated Procurements

## Individual Procurement Period



- Learning/Experience Effects
- Investment & Innovation
- Discounting Future Periods

