

State deal benefits giant retailer

SMALL BUSINESSES RARELY PLAY ROLE IN SUPPLY CONTRACT

By Kimberly Kindy

Mercury News Sacramento Bureau

SACRAMENTO — State officials in 2006 hailed as “unprecedented” their success in getting small businesses involved in selling office supplies to California agencies.

Exceeding even Gov. Arnold Schwarzenegger’s ambitious target, small businesses were going to handle a “stunning” 98 percent of the sales of supplies to state agencies. Even better, the state’s contract with a partnership of nine small businesses — combined with the purchasing power of Office Depot — was going to cut costs in half.

Two years later, a Mercury News investigation has found that the contract failed on both counts.

The nine small businesses rarely play a role as state employees place orders each weekday for scissors, copy paper and batteries. In fact, not a single employee of any of these companies actually works at the Lafayette office where orders are processed. Instead, that office — which all nine listed as their address on state forms — is staffed by an Office Depot subcontractor.

The state spent more than \$32 million for office supplies in 2007.

As for the savings, a Mercury News analysis shows the annual cost for office supplies rose 20 percent under the con-

ELUSIVE SAVINGS

Savings from a state office-supply contract were often elusive, for a variety of reasons. One analyst who studied the state’s purchases called the contract “a scam.”



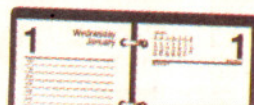
▲ GREAT DEALS VANISH

Acme scissors were among items offered at a great fixed price: 15 cents. But later, only the Office Depot generic brand (above) was available at that price; state agencies that bought Acme scissors paid more than \$3 a pair after the price change.



▲ LIST PRICE JUMPS

On other items, the state was promised a firm discount: 25 percent or more off the “base price.” But the base price of items often jumped, even if the manufacturer price held firm. One example: The base price of a Hewlett-Packard laser printer cartridge rose from \$42.99 to \$52.49.



▲ DEAL FOR USELESS ITEMS

The catalog provided in late 2006 offered a great deal on outdated daily desk refill calendars — just 22 cents. Orders for the requested 2007 model of the same calendar cost state agencies \$1.19.

How Office Depot enjoys benefits of contract to help small businesses

State offices buy paper clips, scissors, copy paper and all other office supplies through a special program that divides the state agencies between nine small businesses. But when it comes time to buy the office items, state employees may never have contact with any of the small companies.

1 An order is placed

State employees order supplies online through the small business that is assigned to their particular agency.

2 Order is redirected

The Web sites of the small businesses redirect the order to a Web site managed by Epylon, a subcontractor of Office Depot.

3 Source for customer service

The state employee who has questions or problems with an order is directed to pose questions through an Epylon e-mail address or by calling an 800 number that is answered by Epylon employees.

4 Office Depot fills order

Epylon's automated system sends the order to Office Depot for delivery. A copy of the invoice is sent to the state employee and to the small business.

5 Another company delivers the goods

Office Depot coordinates delivery of supplies. It uses another subcontractor, Dynamex, to transport the goods to state offices.

6 The state pays the bill

Epylon automatically bills the state agency that ordered the supplies. The state sends a payment to a bank lockbox in San Francisco. All nine small businesses share the same lockbox. The bank then divides the payment between Epylon, Office Depot and the assigned small business. The small business gets 5 percent of gross sales.



Source: Mercury News reporting

ROB HERNANDEZ — MERCURY NEWS

SUPPLIES | Office Depot contract

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tract and included tens of thousands of dollars in overcharges.

"I think it's a scam," said Rick Marlette, a professional marketing analyst whose audit of the office supply contract in Georgia spurred state officials to kill their deal with Office Depot last month. "They've played these tricks in the past, gotten by with it, and they've gotten bolder and bolder."

In Marlette's study of California's contract and billing records — more extensive than that conducted by the newspaper — he concluded the state has overpaid more than \$1 million in office-supply purchases. After being presented with

The contract proposal was presented as a hybrid business model that could give employees the best of both worlds: the personalized care of a small business, combined with the vast product offerings of a giant supplier.

The state was deeply involved in crafting this model from the beginning.

In spring 2006, after the state had already issued its invitation for companies to bid on the massive contract, the Department of General Services held two job fairs to match small businesses — even those without prior office-supply experience — with four Big Box office supply companies.

Office Depot beat its com-

The nine small businesses rarely play a role as state employees place orders each weekday. In fact, not a single employee of any of these companies works at the office where orders are processed.

brown cubicles and computer screens that blink with Office Depot's red and white home page.

It is staffed not by the nine businesses but by Office Depot subcontractor Epylon — which crafted the online ordering system for the contract. Epylon's dozen employees in the office manage the Web site, answer the customer-service calls, respond to e-mails from

sisted they are very involved in the deal, acting on the front and back end, as sales agents and bill collectors. "I'm helping customers with product selection. I answer questions about invoices," said Bonnie Cerkleski, owner of Rancho Cordova-based The Primary Source. "I collect. I'm always out there collecting."

Price questions

rather than the cheaper substitutes. In some cases, state agencies bought Acme scissors even at \$3.79 a pair. Similarly, California workers bought the Rubbermaid chair mat for as much as \$40, far beyond the original price of \$1.84.

State contract officials declined to comment on price discrepancies found by the Mercury News until their own audit is complete.

Other price changes — which the state approved — came in fall 2007. More than 2,900 of 8,000 prices increased on a second shopping list, called the "Market Basket." On these items, Office Depot promised to apply a fixed discount rate, but raised the price on which the dis-

to cancel its contract with Office Depot. Office Depot said it was "surprised" by that action, and said the company is "committed to the highest level of ethics, pricing, service and integrity in the fulfillment of these contracts."

Contracts elsewhere

Other states are examining their own contracts with Office Depot. North Carolina won reimbursements after identifying overcharges in an audit. Nebraska is expected to release its audit next week. And officials in New York and Wisconsin have called meetings with Office Depot, but it's unclear whether formal audits will be ordered.

Office Depot continues to