**Procurement Mechanisms for Differentiated Products**

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**Abstract:**

We consider the problem faced by a procurement agency that runs an auction-type mechanism to construct an assortment of differentiated products with posted prices, from which heterogeneous consumers buy their most preferred alternative.

Framework agreements (FAs), widely used in the public sector, take this form.

When evaluating the bids, the procurement agency must optimize the trade-off between offering a richer menu of products for consumers versus offering less variety, hoping to engage the suppliers in more aggressive price competition.

First, imposing different practical constraints, we characterize the optimal buying mechanisms, which typically restrict the entry of close-substitute products to the assortment to increase price competition among suppliers, without much damage to variety.

Second, we use these optimal mechanisms as benchmarks to recommend improvements to the Chilean government procurement agency’s current implementation of FAs, used to acquire US$2 billion worth of goods per year.

Finally, we discuss how these recommendations are being implemented in practice.