AAA, INC.
(A SERVICES CONTRACT MANAGEMENT CASE)

Purpose

The purpose of this case is to discuss the supply manager's role in managing a services contract. Specifically, the case addresses the appropriate level of supply manager involvement in a supplier's problems, and effective methods of avoiding problems. The case examines source selection and the disadvantages of cost plus percent of cost contracts.

Discussion

The case asks the following questions:

1. How could the supplier problems be avoided in this particular case?

   This question points out the importance of sufficient bid time, being sensitive to the supplier's limitations, and contract terms and conditions which give the appropriate level of control to the buying firm.

2. What are the potential implications of a cost plus percent contract?

   This question addresses the issue of providing proper incentives to the supplier and the disadvantages of cost plus percent contracts. It examines cost plus incentive fee contracts when the buying firm has an objective other than price (in this case, schedule).

3. What type of sourcing procedure should have been used?

   This question examines sourcing methods and the use of source evaluation criteria.

4. In this particular case, what should the supply manager do?

   This question examines the advantages and disadvantages of canceling the services contract and selecting a new source.

Question 1:

How could AAA have avoided the problems it experienced with Comstock?

Comment:

At the outset, AAA placed itself in a disadvantageous position by not ensuring hat there was sufficient time for the source selection process. In addition, AAA placed an unnecessary restriction in its specifications by stipulating that the contractor would have to perform all work in-house. If Comstock had been permitted to subcontract for the talent it could not provide from within, it could have avoided many of the problems encountered. AAA could have retained control over the subcontracting process by requiring that it have final approval of subcontractors.

Finally, there was no clause in the contract to prevent Comstock from delaying or asking for relief from the contract provisions. AAA's only legal recourse was to sue Comstock for breach of contract. AAA's objective, however, was the timely completion of the modernization project, not a court victory. AAA would have been more in control had the contract specified a plan of action and key milestones for the project. The significant milestones, in turn, should have been tied to progress payments, with penalties for noncompliance. Ideally, such provisions would inspire the desired performance.

Question 2:

What are the potential implications of the type of contract AAA used? Discuss.

Comment:

The terms of AAA's contract with Comstock are cost plus a percent of cost with a cap of $3.3 million. This means that Comstock receives, as profit, a percent of what it spends. Obviously, with this type of contract there is no incentive for Comstock to control costs. In fact, there is an incentive to increase costs since profit increases as costs increase. However, in this case, low cost was not the primary objective. With time being the main focus of attention, it would be safe to assume that AAA would allow Comstock the entire $3.3 million as long as the project is completed on time. AAA may even tolerate cost overruns to obtain time savings.

AAA should have considered the use of another type of contract that would have rewarded Comstock not for cost efficiency, but for time efficiency—e.g., a cost plus incentive contract. Tying Comstock's profit to milestones would have greatly increased the likelihood of completing the project on schedule.

Clearly, with a cost plus percentage contract, there is no incentive for the supplier to perform efficiently. AAA, in turn, was slow to react to Comstock's sluggishness.

Question 3:

How could AAA have improved its approach to sourcing?

Comment:

As suggested earlier, AAA could have prevented many of the problems encountered later by allowing more time during the source selection process. Influenced by a tight timetable and a strong desire to maximize coordination with the project team, AAA appears to have chosen the first acceptable solution to its sourcing needs. In so doing, AAA severely limited its options and ignored sources of information that could have been very valuable in the source selection process. Even a cursory analysis of key financial data and ratios could have provided important information on the relative financial condition and the managerial ability of the potential suppliers.

In addition, AAA should have asked all potential suppliers for data regarding projected utilization and backlog for the next 12 months. This information would have placed AAA in a better position to evaluate the relative capabilities of the prospective suppliers.

Use of a multiple sourcing strategy probably would have improved AAA's source selection. This sourcing alternative could have been accomplished by contracting with firms specializing in either electrical, mechanical, or civil engineering, with AAA acting as the project coordinator. Another option would have been to award the contract to one engineering company that would subcontract with specialized engineering companies required for the project.

Question 4:

What should AAA do now? Discuss.

Comment:

AAA has two basic choices: remain with Comstock or develop a new source. What are the format advantages and disadvantages of remaining with Comstock; of changing to a new firm?

Remain With Comstock:

- \+ AAA will not incur changeover costs associated with obtaining a new supplier.
- — AAA probably will experience more and continued problems with Comstock, which leads to $1.2 million/month lost opportunity costs.
- — AAA will be without electrical engineers until Comstock's efforts to transfer and recruit come through.
- — Comstock may lack adequate incentive to complete the AAA project on schedule.

Change To Another Firm:

- \+ AAA may obtain a properly staffed firm.
- \+ AAA may obtain a contract that is less costly.
- — The time necessary to find a new firm may set AAA's project schedule back.
- — The new firm may be more costly and just as bad as Comstock.
- — It will take extra time for the new firm to sift out what Comstock has completed and where it left off.
- — When Comstock learns of AAA's search for a new firm, the quality of Comstock's work will suffer.

AGE BUILDERS, INC.

Purpose

The purpose of this case is to provide an introduction to the understanding of value analysis and the decision making process involved.

Discussion

Part of the decision making process for AGE will involve careful analysis of quality, economic, and reputation factors that will have a tremendous impact on their company if the proper decision is not made. In discussing this case the following should be kept in mind:

When considering the use of a product or service stemming from value analysis work, it should be considered an upgrade. It is not and should not be something that will reduce quality. It should improve it and make it a more economic process.

Question 1:

What are the advantages and disadvantages of using waferboard?

Comment:

Waferboard is less expensive. It is a much more consistent material than plywood, as far as having no core voids and knotholes, which makes it easy to work with. Because of its makeup, the waferboard also tends to be much more weather resistant than the plywood. All this seems to confirm is that it is a quality product, but there is still the big drawback that it is a new product in the industry. Another disadvantage of the waferboard is its appearance. It doesn't have a finished appearance, as does plywood. It also resembles a type of board used by the industry for nonstructural items, known as particleboard. This in itself creates an image problem with the individual home buyers because most home buyers are not familiar with waferboard. They are accustomed to seeing nice, clean looking plywood. This could create a negative attitude toward the builder as having poor quality that leads to a bad reputation.

Question 2:

If AGE Builders does not use waferboard, does it risk falling behind competition?

Comment:

This depends on whether the industry has accepted the use of waferboard as a standard. AGE will have to do research to see if the product conforms to Building Code. If competitors are using it and passing inspections, and sales are consistent, it clearly will reduce costs. Then AGE may seriously want to consider the use of waferboard. But like most new products there is always hesitation. Sometimes an innovative start is what makes the difference between competitors.