

## NAVAL OPERATING BASE, ARKLADDELPHIA

Lieutenant June Early, a Navy contracting officer, was perplexingly involved in a difficult sole-source negotiation. The Trustworthy Equipment Company, with whom she was negotiating, was really giving her problems.

The Trustworthy Equipment Company was the only supplier of a special machine costing tens of thousands of dollars. This machine was useful in the maintenance and repair of nuclear submarines. Using the machine, it was possible for three or four mechanics to complete in an afternoon a job that would otherwise require a week or more. Thus, the purchase of Trustworthy machines would not only save the Navy money but would also reduce substantially the “down time” on submarines. The Navy Supply Management Office, where Lieutenant Early worked, had been requested to obtain 100 Trustworthy machines.

In conducting the negotiations, Lieutenant Early encountered the following overhead rates, which the company willingly provided as part of a cost breakdown to explain its fixed price quotation. The Navy considered this quotation to be too high.

- Manufacturing overhead: 170 percent of direct labor
- Engineering overhead: 93 percent of direct engineering labor
- General and administrative expenses: 25 percent of operating cost (i.e., materials, direct labor, and manufacturing overhead)

Additionally, the company had included a contingency allowance of approximately 3.3 percent of all other costs.

Compared with other firms in the same general line of business, the overhead rates seemed unusually high. Therefore, Lieutenant Early requested detailed statements of the cost included in each of these overhead pools. After receipt and review of this information, Lieutenant Early concluded that many of the costs were highly questionable. An inspection of the company's facilities further confirmed this conclusion. It was the inspector's impression that inattention to duties, loafing around the soft drink machines, and similar practices were standard operating procedures. For these reasons, Lieutenant Early asked a representative of the Trustworthy Company to come to Arkladelphia to discuss the breakdown of costs with her.

When the representative arrived, Lieutenant Early pointed out to him the items that she regarded as questionable. She questioned the necessity for the company to employ one stenographer for every five production workers. She questioned the need in a small company for Trustworthy's elaborate management structure with its three separate echelons of management. Moreover, Lieutenant Early pointed out that members of the Hawthorn family, who owned the enterprise, seemed to occupy positions in management that duplicated those of other people in the management hierarchy. Lieutenant Early was particularly interested in one item of salary that she learned was being paid to the estate of an individual who had died over two years ago. When Lieutenant Early suggested that the Trustworthy Company must be a most pleasant place to work, the representative smiled and agreed with her. “People have a good time at the company,” he said, “and there are lots of opportunities for relaxation and sociability.”

Throughout the negotiation, the Trustworthy representative was pleasant and amiable, but he insisted that the costs the company had submitted were necessary and justified. Although Lieutenant Early succeeded in eliminating a few dollars in the cost of producing the item, she was unable to achieve any substantial reduction. She realized that the Navy needed the equipment and that use of the machines would save the Navy many times their cost. Yet she also recognized that the Navy's supply management policy was based on the assumption that prices should reflect reasonable costs. With these thoughts in

mind, Lieutenant Early, as the negotiator, wondered what her next step should be.

1. Should Lieutenant Early question costs that appear to be caused by “inefficient management”?
2. What action should Lieutenant Early take with respect to the contingency allowance of 3.3 percent?
3. What can Lieutenant Early do if the Trustworthy representative is unwilling to eliminate some of the unusual cost items?