Payton Corporation

Payton Corporation had decided to respond to a government request for proposal for the R&D phase on a new project. The statement of work specified that the project must be completed within 90 days after go-ahead and that the contract would be at a fixed cost and fee.

The majority of the work would be accomplished by the development lab. According to government regulations, the estimated cost must be based on the *average* cost of the entire department, which was $19.00 per hour (unburdened).

Payton won the contract for a total package (cost plus fee) of $305,000. After the first weekly labor report was analyzed, it became evident that the development lab was spending $28.50 per hour. The project manager decided to discuss the problem with the manager of the development lab.

Project manager: "Obviously you know why I'm here. At the rate that you're spending money, we'll overrun our budget by 50 percent."

Lab manager: "That's your problem, not mine. When I estimate the cost to do a job, I submit only the hours necessary based on historical standards. The pricing department converts the hours to dollars based on department averages."

Project manager: "Well, why are we using the most expensive people? Obviously there must be lower-salaried people capable of performing the work."

Lab manager: "Yes, I do have lower-salaried people, but none who can complete the job within the two months required by the contract. I have to use people high on the learning curve, and they're not cheap. You should have told the pricing department to increase the average cost for the department."

Project manager: "I wish I could, but government regulations forbid this. If we were ever audited, or if this proposal were compared to other salary structures in other proposals, we would be in deep trouble. The only legal way to accomplish this would be to set up a new department for those higher-paid employees working on this project. Then the average department salary would be correct.

"Unfortunately the administrative costs of setting up a temporary unit for only two months is prohibitive. For long-duration projects, this technique is often employed.

"Why couldn't you have increased the hours to compensate for the increased dollars required?"

Lab manager: "I have to submit labor justifications for all hours I estimate. If I were to get audited, my job would be on the line. Remember, we had to submit labor justification for all work as part of the proposal.

"Perhaps next time management might think twice before bidding on a short-duration project. You might try talking to the customer to get his opinion."

Project manager: "His response would probably be the same regardless of whether I explained the situation to him before we submitted the proposal or now, after we have negotiated it. There's a good chance that I've just lost my Christmas bonus."

QUESTIONS

1. What is the basis for the problem?
2. Who is at fault?
3. How can the present situation be corrected?
4. Is there any way this situation can be prevented from recurring?
5. How would you handle this situation on a longer-duration project, say one year, assuming that multiple departments are involved and that no new departments were established other than possibly the project office?
6. Should a customer be willing to accept monetary responsibility for this type of situation, possibly by permitting established standards to be deviated from? If so, then how many months should be considered as a short-duration project?