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APPSHOP
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APPSHOP, INC.

Bonuses, gain-sharing, competitive pricing—these ideas were attractive and simple enough, but they made negotiating a contract much more challenging for Eric Clark, director of the Central Region for Appshop, Inc. Clark was in the throes of settling terms and deciding whether and how to do the OS-7 project, a major implementation of Oracle software in all seven international locations of a large multinational company (the "client"). Appshop had recently completed a successful implementation of Oracle financials in the client's Dallas headquarters. Appshop had met or exceeded all stated objectives, and would continue to support corporate Oracle applications for the client.

Appshop was the largest independent full-service Oracle consulting, applications-management, and outsourcing company. Privately held, Appshop had annual revenues of $25 million. Clark was responsible for growing the client base and selling additional professional services, as well as managing existing clients headquartered within his region. The client had told Clark that it would like Appshop to do all the consulting for the OS-7 project. Clark and a team of consultants spent two weeks working on the strategy, scope, and timeline for the roll-out. Based on that analysis, Appshop calculated that the project would require 1,000 hours of work per month for 24 months from a variety of contracted professionals and support personnel, which would result in a total cost to Appshop of $140 an hour. Because of their wide experience in doing these implementations, Clark and his team were confident that this level of effort would result in a completed and running implementation. How much the implementation would save the client and how pleased the client would be with its performance were yet to be determined.

Clark's team proposed that it bill the client and receive at the end of each month $175,000 in revenue over 24 months, which would provide a contribution of $35,000 a month. This amounted to a present-value contribution of $789,700 for the OS-7 project, using the Appshop discount rate of ½ percent per month (which compounded to 6.17 percent per year).

This case was prepared by Samuel E. Bodily, John Tyler Professor of Business Administration, and Eric Clark, based in part on a class assignment submitted by Eric Clark to Professor James Dyer, University of Texas. It was written as a basis for class discussion rather than to illustrate effective or ineffective handling of an administrative situation. Cost and revenue numbers are disguised.

After lengthy discussions, the client informed Appshop that it was prepared to award the contract to Appshop but not for the $175,000 monthly payment. The client wanted a lower price, and offered two alternatives: equal payments of $155,000 a month over 24 months or $125,000 a month plus a $1.5-million bonus paid at the end of month 24 if the work were completed with commendable performance, using standard measurements against stated benchmarks. Even though a system might work satisfactorily and be tuned to meet a specific benchmark, the multiple benchmarks were much harder to meet simultaneously. Based on previous experience with other implementations and the complexity and uniqueness of this international project, Clark's team arrived at a consensus probability of 0.7 of receiving the bonus.

If Appshop did not accept one of the two pricing alternatives, then the officers of the client company had said they would produce a Request for Proposal (RFP) and distribute it to Appshop's competitors, the so-called Big 4. Upon hearing this, Clark thought for a moment that maybe, just maybe, the multinational was bluffing and would acquiesce to Appshop's original request of $175,000 a month. "I guess that's just fantasy," he said to himself.

The terms of the client's RFP would include payment of the revenue-bid amount to the winning bidder at the end of each month, plus a gain-share reward at the end of the 24th month. The client would base the gain-share on the documented savings it would realize from the new Oracle applications, using precise cost-accounting procedures spelled out in the RFP. This approach was common in the software-consulting industry, and Appshop had successfully used it on some contracts in the past. The winning bidder for the RFP would receive a share of the savings according to the following schedule:

Savings	*Winning Bidder's Share of Savings*
< $4 million	0
$4 million up to $6 million	20 percent of excess above $4 million
$6 million up to $8 million	$400,000 plus 40 percent of excess above $6 million
> $8 million	$1.2 million plus 60 percent of excess above $8 million

Clark and his team had used their previous experience and judgmental assessment of the OS-7 implementation to forecast the client's savings. They concluded that savings would have a triangular distribution, with a low of $3.2 million, a high of $12.8 million, and a most likely value of $5.6 million.

Appshop would bid $150,000 a month for the RFP, if it were issued. This amount was lower than its original offer because of the gain-sharing reward built into the RFP. Appshop had a reasonable chance of winning inasmuch as it generally priced projects below the typical Big 4 price. The team's consensus estimate of Appshop's chances of winning the RFP at the $150,000 bid was 45 percent.

Clark and his team wanted the firm to do well with the OS-7 project. Clark's own compensation package depended primarily on total contribution in his region, with a secondary small incentive for keeping the region's blended hourly revenue rate high.