# Case 1

# Advanced Computer Logic, Inc.[i]

## Summary

Eleanor Jamison, the director of purchasing for Advanced Computer Logic (ACL), Inc., was becoming increasingly concerned about the large number of orders placed for some of the company's least-expensive component parts.

## Suggested Assignment Questions

1   How should Tom Camp respond to Eleanor?
2   Is this an appropriate application for systems contracting? If so, what are the possible savings?
3   Is this an appropriate application for a reverse auction? If so, what are the possible savings?

## Analysis

**1. How should Tom Camp respond to Eleanor?**

Tom should write a memo to Eleanor using the analysis outlined in 2 & 3 below.

**2. Is this an appropriate application for systems contracting? If so, what are the possible savings?**

Systems contracting is an effective cost effective solution given the cost savings estimates outlined in the case.

|   |                        | Current System | Systems Contracting [1] |
|---|------------------------|----------------|-------------------------|
| 1 | Purchase Price         | $ 967,000      | $ 647,890 [a]           |
| 2 | Inv. Holding costs     | 75,600         | 51,255 [b]              |
| 3 | Purchase cost          | 185,000        | 55,500 [c]              |
| 4 | Obsolescence cost      | 91,900         | 91,900 [d]              |
|   | Total related costs    | $ 1.319,500    | $ 846,545               |

[1] The assumptions for the analysis are:

   a) Given the apparent competitive bidding pressures the successful supplier will achieve significant economies of scale. In this analysis it is estimated that ACL will receive at least a 33 percent discount. The estimated purchase price is expected to decrease by $319,110

[967,000-(.33*967,000)]
b) The inventory holding rate is assumed to be 25 percent.
c) Based on the case data the purchase cost will decrease by 70 percent.
d) The obsolescence rate is expected to be (30 percent) the same in each case.
   The buyer cannot mitigate the risk of obsolescence by implementing a
   systems contract.

The results above clearly shows that ACL must give systems contracting serious consideration. The Ms Jamison should schedule a meeting with the ten department managers. The expected one half million dollar savings can easily serve as leverage in the decision making process. Each department manager should be given an opportunity to present their objections to the systems contracting proposal. In some cases the current suppliers may be offering the departments valuable consulting services and market information. If the relationships are vital the components can remain under the current procurement system. From an organizational incentive point of view the department managers who accept reasonable cost saving proposals should be offered budgetary incentives.

## Option 1
One key to any systems contracting arrangement is the quality of the successful bidder. It is recommended that a comprehensive prequalification process be conducted prior to releasing the request for proposal (RFP). The prequalification process includes financial analysis, management capabilities, technical qualifications and plant visits. The total purchases on the systems contract should be divided between at least two qualified suppliers. As an example the primary supplier should be allocated an 80 percent share and the remaining 20 percent share allocated to the secondary supplier. This allocation schema will ensure both economies of scale and competition.

## Option 2
Historically systems contracting have been used for relatively stable MRO items. If the components are relatively expensive, unstable or have a high level of obsolescence systems contracting should not be used. The average component values range from $.75$133.00 and the items have an obsolescence rate of 30 percent. Perhaps systems contracting should be used for component values that range from $.75-$50. Components between $50 - $133 should remain with current suppliers. Of course the final clustering decision should be based on the various distributions.

**3. Is this an appropriate application for a reverse auction? If so, what are the possible savings?**

A Reverse auctions for ACL is out of the question unless ACL has already invested in the hardware, software and training.