Michael Rabins' Commentary on "Conflicts within a Manufacturing Firm"

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Conflicts within a Manufacturing Firm

Before getting too carried away about justice, fairness and "level playing fields" it is helpful to recognize some basic facts about the situation surrounding this Tool and Die case. First and foremost, Tool and Die is a for-profit company with several clear missions: it must deliver a profit to its owners or stockholders, it must justify the salaries it pays to its employees and mangers, it must deliver a competitive quality product and it must maintain professional standards in all of its operations. It is not in business just to support the outside vendors, although it clearly must maintain productive symbiotic relationships with those vendors.

If the internal tool and die department at T&D can produce the tooling designed by T&D at a price competitive with the cost of using outside vendors, then it would be foolish for T&D not to take advantage of that opportunity to save money. The question is how to do that while being fair enough to maintain continued open channels of communications with the outside vendors which will probably continue to be needed at some level.

Now, before we can consider the questions raised in version I of this case, it would seem appropriate to consider a different kind of competitive bidding than what has been used prior to T&D's internal tool and die department getting into the act. Previously, each outside vendor was undoubtedly asked for a single dollar price bid on each request for proposals. This dollar value is not really directly comparable to what the internal tool and die department will be bidding. The outside vendors' bids will include all direct costs, indirect costs (like heat, electricity, cleaning services, etc) and profit. The inside department bids will include just the first two items. That is what must be somehow compared. The equivalent of profit on the internal department bids is the moneys made available to the internal department (or others) for bonuses, other rewards for productivity and growth (i.e., profit reinvested in expansion or increased stock dividends).

To compare internal and external direct and indirect costs it would seem appropriate to prepare a new bidding format that indeed levels the playing field. Further it would not be appropriate to share the external bids with the internal department until all of the bids are in. Only then are all the T&D players acting as faithful agents and trustees of the T&D company. The appearance of fairness must be maintained in order to keep the vendors bidding. Any suspicion of bid rigging by the internal tool and die department must be avoided.

According to this analysis of the situation the response here to the 4 questions in part I of the case would be a combination of 3 and 4. In response to part II of the case, the analysis surely would support not using selection #1 in part I. If fair comparisons are not made between internal and external vendors in this case, there is also the danger of doing damage to the morale in other departments at T&D. Other department heads could argue that with rigged bidding, the internal tool and tie department has an unfair advantage over other T&D departments in showing increased productivity and looking good to upper management.

Regarding the internal tool and die department head's reasoning in part III of the case, it certainly sounds convincing and it is obviously true that all the departments must work together to maximize company profit. But that does not mean that purchasing should be a party to drying up the availability to T&D of outside vendors when they are needed. By sharing each set of bids with the internal tool and die department head after that bid is awarded, the opportunity is obviously provided for the internal department to be more competitive the next time around if it has not won the previous bidding competition.

The internal tool and die department head can certainly learn from comparing his previous losing bid to the winning external vendor's bid just exactly how his department can be more economical in determining future bids. This will eventually translate into increased profit for T&D in the long run and also maintain good relations with the outside vendors for as long as they are needed.

The key for this process to work is a carefully spelled out bidding procedure that allows apples to be compared with apples and clearly identifies the cost of labor, materials, direct overhead and indirect overhead. The last item is the most difficult to pin down equitably and accurately. Also, isn't the new procedure intended to gauge whether vendor's estimates are fair? If internal department doesn't blind bid, they will tend to try to always undercut bid and perhaps submit unrealistic estimate.

The federal government has a long standing discussion going on with industry and academia regarding this indirect overhead determination. In fact the subject has recently been front page news in regard to Stanford University and the resignation of the University President over audited misuse of the indirect overhead moneys paid Stanford by the federal government. This fact is mentioned only to indicate that T&D will have its work cut out to develop a fair and accurate comparison between internal and external vendors.