

Options for Negotiations Settlement

1. Contractor accept Government Offer at Government max 10% Fee
 - Requires new approval for a lower floor
2. Government obtain new Business Clearance to Higher ROC
3. Contractor achieve an Effective ROS at combination of higher cost / lower fee or lower cost / higher fee

Unless you are willing to compromise, society cannot live together.
— Alan Greenspan

When the final result is expected to be a compromise, it is often prudent to start from an extreme position.
— John Maynard Keynes

Effective ROS Calculation for CPFF

- Target Cost Differential is added to Sales, yielding an Effective ROS

	Deal Agreement	Cost Achievement	Formula
Cost	\$11,000,000	\$10,100,000	
TCD	\$0	(\$900,000)	\$10.1M - \$11.0M
COM	\$110,000	\$101,000	Cost * 1%
Fixed Fee	\$1,210,000	\$1,122,000	Cost * 11.0%
Price	\$12,320,000	\$11,424,000	Cost + Com + Fee
ROC	11.0%	11.0%	
Negotiated ROS	10.7%	10.7%	(COM+Fee)/(Price)
Effective ROS		11.6%	(COM+Fee)/(Price+TCD)

Effective ROS Calculation is Based on an Assumed Cost Achievement

Example – Deals 1 & 2: Extreme Options

- Extreme Options: Maximum Cost with minimum fee; Minimum cost with Maximum fee

Deal 2: Min Cost; Max Fee

	Deal 1	Cost Achievement
Cost	\$12,000,000	\$10,000,000
TCD	\$0	(\$2,000,000)
COM	\$120,000	\$100,000
Fixed Fee	\$1,200,000	\$1,200,000
Price	\$13,320,000	\$11,300,000
ROC	10.0%	10.0%
Negotiated ROS	9.9%	
Effective ROS		11.5%

	Deal 2	Cost Achievement
Cost	\$10,000,000	\$10,800,000
TCD	\$0	\$800,000
COM	\$100,000	\$108,000
Fixed Fee	\$1,300,000	\$1,300,000
Price	\$11,400,000	\$12,208,000
ROC	13.0%	13.0%
Negotiated ROS	12.3%	
Effective ROS		11.5%

Example – Deals 3 & 4: Middle Options

- Middle Options: Probable Settlement Range

Deal 4: 10.5% Fee

	Deal 3	Cost Achievement
Cost	\$11,300,000	\$10,400,000
TCD	\$0	(\$900,000)
COM	\$113,000	\$104,000
Fixed Fee	\$1,243,000	\$1,243,000
Price	\$12,656,000	\$11,747,000
ROC	11.0%	11.0%
Negotiated ROS	10.7%	
Effective ROS		11.5%

	Deal 4	Cost Achievement
Cost	\$11,700,000	\$10,250,000
TCD	\$0	(\$1,450,000)
COM	\$117,000	\$102,500
Fixed Fee	\$1,228,500	\$1,228,500
Price	\$13,045,500	\$11,581,000
ROC	10.5%	10.5%
Negotiated ROS	10.3%	
Effective ROS		11.5%

Probable Settlement Range

Cost & Price Trade Space

Scenario	Negotiated Cost	Price	ROC
Impasse	\$12,000,000	\$13,620,000	12.5%
Move 1	\$11,000,000	\$12,485,000	12.5%
Move 2a	\$11,000,000	\$12,430,000	12.0%
Deal 1	\$12,000,000	\$13,320,000	10.0%
Deal 2	\$10,000,000	\$11,400,000	13.0%
Deal 3	\$11,300,000	\$12,656,000	11.0%
Deal 4	\$11,700,000	\$13,045,500	10.5%

Highest Price;
Lowest Fee

Lowest Price;
Highest Fee

Higher Fee Can Lead to Lower Negotiated Price

Negotiation Results

	ROC	Negotiated Price
Deal 1	10.0%	\$13,320,000
Deal 4	10.5%	\$13,045,500
Deal 3	11.0%	\$12,656,000
Deal 2	13.0%	\$11,400,000

	ROC Rank	Rank of Negotiated Price
Deal 1	4	1
Deal 4	3	2
Deal 3	2	3
Deal 2	1	4

- Example shows an inverse relationship between Fee and Price for a negotiated price

A Negotiated Settlement is the Beginning of the Story



Range of Execution Results

	ROC	Negotiated Price	Final Price with 25% Cost Achievement	Final Price with 50% Cost Achievement	Final Price with 75% Cost Achievement	Final Price with 100% Cost Achievement
Deal 1	10.0%	\$13,320,000	\$12,815,000	\$12,310,000	\$11,805,000	\$11,300,000
Deal 4	10.5%	\$13,045,500	\$12,679,375	\$12,313,250	\$11,947,125	\$11,581,000
Deal 3	11.0%	\$12,656,000	\$12,428,750	\$12,201,500	\$11,974,250	\$11,747,000
Deal 2	13.0%	\$11,400,000	\$12,410,000	\$12,612,000	\$12,814,000	\$12,208,000

	ROC Rank	Rank of Negotiated Price	Rank of 25% Cost Achievement	Rank of 50% Cost Achievement	Rank of 75% Cost Achievement	Rank of 100% Cost Achievement
Deal 1	_____	_____	_____	_____	_____	_____
Deal 4	_____	_____	_____	_____	_____	_____
Deal 3	_____	_____	_____	_____	_____	_____
Deal 2	_____	_____	_____	_____	_____	_____

Execution Cost Drives Fee/Final Price Relationship

Takeaways

- Contractors negotiate to obtain a “business deal” that aligns with company goals
- Government negotiates to obtain a “fair and reasonable” price
- Closing the deal requires flexibility with the two key drivers: Cost and Fee
- The concepts behind this mathematically simple CPFF example can be extended to other cost contract types
- It is all about execution!



THE VALUE OF PERFORMANCE.

NORTHROP GRUMMAN

