Classic pen co. case

Classic Pen Co. Case

In the past Classic Pen Company had been the low-cost producer of black and blue pens and had profit margins over 20% of sales. Over the last five years Pen Co. decided to start producing red and purple pens. They require the same basic productiontechnologybut can be sold at 3% and 10% premium selling prices. Sales Manager Dennis Selmor is just seeing the financial results and is not happy with the numbers. The first issue that Pen Co. is facing is their decline in profitability. Even though the numbers show the red and purple pens are more profitable individually (red 14. %, purple 18. 2%), the overall return on sales is declining (13. 5%). A second issue that Pen Co. has is the issue of addition of resource costs. It requires a substantial amount of time for physical changeover of production from one colour pen to another. Particularly changing from another colour to red. The final issue Pen Co. faces is the increase of costs related to scheduling and purchasing activities. Most of the indirect labour costs and computer system costs are related to scheduling and purchasing.

Pen Company's declining profitability could be based on the amount of the company's overhead. They have determined overhead to be 300% of direct labour costs, when previously the overhead cost was only 200%. The make-up of this overhead is indirect labour, fringe benefits, computer systems, machinery, maintenance, and energy. The reason for such a large increase in overhead is because of the higher demand for indirect costs due to the addition of more complex and specialized products. While the cost for direct labour per one unit is the same for each colour of pen produced.

The cost for indirect labour is made up of three different activities: 50% for handling production runs ($10, 000), 40% for physical changeover or set up costs ($8, 000), and 10% for maintaining records or parts administration ($2, 000). The cost for computer systems is made up of two activities: 80% for production run activities ($8, 000), and 20% for record keeping or parts administration ($2, 000). Finally the remaining indirect costs are the machinery ($8, 000), maintenance ($4, 000), and energy ($2, 000).

These are all used to supply the machine with the capacity to produce the pens with a total of $14, 000. Overall Classic Pen Co. must improve upon several areas of demand in order to increase its profitability similar to what it had been in the past. They need to increase their planning and try to adjust their current planning system and organizing. They could invest in more computers to increase the amount of scheduling being done by computers and as a result lower their indirect labour costs.

Finally I recommend they should invest in some more machines to produce the different colour pens in. This would have a high cost of capital but would eventually save the companymoneyin the labour cost and time required for the physical changeover between colours Calculation Page Indirect LabourMachine Support Handling Production Runs = 10, 000Machinery = 8, 000 Set Up = 8, 000Maintenance = 4, 000 Parts Administration = 2, 000Energy = 2, 000 Fringe Indirect Labour = 8, 000Total = 14, 000 Computer SupportFringe for Direct Labour

Handling Production Runs = 8, 000Fringe = 8, 000 Parts Administration = 2, 000 Total Overhead = 60, 000

Calculating Activity Rate

Activities	Activity Cost	Cost Driver #	Calculation	Activity Rate		
1) Handling PR	22, 000	150	22, 000/150	146. 67 / Run		
2) Set Up	12, 000	526	12, 000/526	22. 81 / Hour		
3) Parts Admin.	4, 000	4	4, 000/4	1000 / Product		
4) Machine Support	14, 000	10, 000	14, 000/10, 000	1. 4 / Hour		
5) Fringe DL	8, 000	20, 000	8, 000/20, 000	0. 4 / DL Cost	Total	60, 000