Birch paper company essay sample

Mr. Kenton should accept Bid #2 – West Paper Company at $430 as it was the lowest bid and thus will give Northern Division the highest return. Under the current company policy each division is judged independently based on profit and return, thus Mr. Kenton would only be interested in his own division's success and not the overall success of the company.

In order to decide which bid is in the best interest of Birch Paper Company we need to examine each bid separately:

Bid #1: Thompson Division – $480

* Thompson Division's cost = $400

* Purchasing liner and corrugating medium from Southern Division: $400*70% = $280

* Therefore, other costs would be: $400-$280 = $120

* Southern Division's cost = $280*60% = $168

* Total cost to the Birch Paper Company: $168+$120 = $288 Bid #2: West Paper Company – $430

* Total cost to the Birch Paper Company: $430

Bid #3: Eire Company – $432

* Selling price of Thompson = $30

* Thompson Division's cost = $25

* Thompson Division's profit = $30-$25 = $5

* Selling price of Southern Division = $90

* Southern Division's cost = $90*60% = $54

* Southern Division's profit = $90-$54 = $36

* Total cost to the Birch Paper Company = $432-$36-$5 = $391

Answer: Bid #1 – Thompson Division is in the best interest to the Birch Paper Company as it has the lowest total costs thus producing the highest overall revenues for the company. However, this answer does not reflect what would be in the best interest of the Northern Division as they would receive much lower profit margins from accepting the higher bid. Birch Paper Company is earning most of their profits in the Southern Division which has a 66. 7% markup ($280-$168=$122 or 66. 7% markup) and the Thompson Division which has a 20% mark up ($480-$400=$80 or 20%) and not necessarily the Northern Division which would not be able to sell the product at any significant mark up due to the transference of costs from the other companies. The case states “ on inter-company sales, divisions selling to other divisions were expected to meet the going market price.” Obviously, Southern division didn’t use market-based transfer prices which gave rise to its inefficiency and then resulted in an unevenly spread profit over the three divisions.

We believe that the Vice-President should intervene as Birch Paper Company has a number of issues in its current pricing model that are evident in the case: * Thompson Division is justifying its 20% mark up for compensating work which went into the design elements of the boxes. However, Thompson Division was previously compensated for this work from Northern, thus this is a sunk cost and should not be factored into their offer. * There is also an issue that Southern Division is over pricing their materials to Thompson Division. Although Southern Division is currently running below capacity and has excess inventory they still quoted Thompson using a 66. 7% mark up. Looking at this from the Company level, in order for Southern Division to become more efficient they should decrease this mark up to help increase sales which would raise capacity and decrease the excess inventory. This in turn would help share the profit margin with Thompson Division and Northern Division. * By assessing the overall costs to the company, Bid #1 from Thompson has a total cost to the company of $288 while their bid is at $480, which is a total of 66% markup. Birch Paper Company should have the ability to match this lower offer of $430 (which would still be a 50% markup) and disperse the cost margins more equally throughout the Southern Division, Thompson Division and Northern Division. Action: The VP should intervene in the current transaction by lowering the bid offer to $430 to reflect the going market value of the cardboard. He then needs to decrease the margins that Southern and Thompson are using for the current transaction so that all three divisions involved are making a reasonable return. Each division might use cost-based transfer prices (provide material or service to other divisions at its actual cost). The profit earned by the end division (Northern division in this case) will then be equally distributed to each throughout the value chain. As a result, each division would have incentives to control its own cost and therefore serve the best interest of the company as a whole. In this way, the interest conflicts among divisions would be diminished as well. However this would only address the current case. As future transactions could conceivably raise the similar problems, and these problems root in that the four divisions are too independent, the regulation about internal transactions should be formulated. The VP should meet with upper management and discuss the issues evident with the current pricing model. There should be more consistency between divisions as to what are fixed and variable costs. This would address future issues similar to Thompson Division compensating for design elements in their margins. Additionally, the Birch Paper Company should re-visit the company's evaluation model so that the divisions are motivated to not only increase individual profits and returns but are also motivated to increase contributions that would increase the overall profits of the Birch Paper Company. In conclusion, by making the above suggested changes, Birch Paper Company would be able to take advantage of its lower cost, distribute profits more evenly throughout the divisions of its company and be more competitive in the market place. Although the current transaction only represent less than 5% of the volume of any division, by intervening the VP will insure that Birch Paper Company are not loosing future bids due to problems associated with their current pricing model.