

# Guillermo furniture store scenario



Running Head: GUILLERMO FURNITURE GUILLERMO FURNITURE: A CASE STUDY Guillermo Navallez had a good business manufacturing and selling furniture in his shop in Sonora. His business advantage lay in quality work, for which he could charge a premium on the price, and cheap labor cost. However, high-tech competitors entered the market, and labor costs rose, eroding Guillermo's profit margin. Guillermo was unwilling to consider merging with, acquiring, or being acquired by, other furniture manufacturers and dealers. He has, however, the option to consider several other alternatives. The case explains what accounting information may be needed by which to make a choice among the alternatives, and what ethical issues may arise as a result.

#### GUILLERMO FURNITURE: A CASE STUDY

This case study concerns the strategic challenges faced by a relatively small but successful local furniture maker in the face of a large foreign competitor with superior technology and lower prices. The salient facts are as follows.

##### Facts of the Case

1. Guillermo Navallez is a furniture manufacturer in Sonora, prospering with low labor cost and charges premium price for quality.
2. In 1990 two relevant events occurred:
  - a. A new competitor entered from overseas, with high tech methods and low prices. The plant in Norway was highly automated, used very little labour (used robotics). Production could move between products quickly, and runs on a 24- hour basis (shift-differentials could be more than offset by reduction in labor).
  - b. The cost of labor increased substantially due to the entry of a large

retailer.

3. Other furniture manufacturers consolidated by means of merger or acquisition.

4. Guillermo favored neither acquiring nor being acquired, nor merging.

Guillermo had several options of addressing the problem other than consolidation.

1. Guillermo may tie up with a Norwegian competitor which did not want to operate retail outlets locally but preferred to rely on chain distributors.

Guillermo, while retaining the high-end custom work, intends to represent the Norwegian company, converting his company's primary focus from manufacturing to distribution.

2. Guillermo had a patented process for creating a coating for his furniture which was flame-retardant and, with further processing, stain resistant.

There was market for the flame-retardant but not the finished coating.

3. There was another product that Guillermo could buy to apply to his furniture that would add the same amount of value for the furniture.

Questions:

1. How could Guillermo use budgets and performance reports in his decision making process?

2. How might ethics influence his accounting decisions?

3. What accounting information is most relevant for Guillermo to consider when making decisions?

Analysis:

1. Guillermo could use budgets and performance reports in his decision making process in the following manner:

Budgets represent short-term financial forecast, particularly of expected

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cash flows, based on the business plans drawn by the company, to see if forecasted cash outflows and their timing could be sufficiently covered by cash inflows (revenues and liabilities), and if not, to allocate for future financing at the time they would be needed.

Past performance reports to see the history of costs and sales, and to draw insights as to the behavior of costs and revenues given the environmental indicators. Ratios, trends and sensitivity analyses of costs and revenues compared to each other and to economic indicators is important in determining how the company will be affected by a prospective decision. Ratio analysis of historical and cross-sectional accounts are helpful to test for activity, profitability, liquidity, and solvency given the various scenarios.

## 2. Ethics may influence Guillermo's accounting decisions

Many accounting procedures allow the accountant to exercise his discretion in choosing which among several accounting procedures or methods he would prefer to use, given the particular business and problem for which he is conducting the evaluation. For instance, the matching of costs and revenues has proven to be a source of ethical decision making. Some companies would record the accounting returns as they accrue, while delaying the recording of their corresponding expenses.

Another way that ethics may influence Guillermo's otherwise quantitative determination is consideration of the non-quantitative aspect. Guillermo should determine if it is ethical to manufacture and sell, for instance, his own line of furniture while acting as marketing representative of his Norwegian partner. Doing so may mean that Guillermo may harbor conflicting interests against the Norwegian firm, by acting as its competitor and distributor at the same time. Also, Guillermo may decide that shifting to distribution rather

than manufacturing will save him in labor costs, which is a positive accounting consideration, but this means laying off several workers who have been with the company for a long time. Guillermo is faced with the ethical dilemma of how to ease his employees' transition to other kinds of jobs.

3. What accounting information is most relevant for Guillermo to consider when making decisions?

In the course of carrying out his business, Guillermo needs to make different kinds of decisions. Some involve operations, which is essentially internal to the company. He may need to address issues involving the market such as what features of products to offer, what price to offer them at, and how many of them to supply. And certainly, Guillermo will need to make decisions concerning his co-shareholders and partners, such as the Norwegian firm, because they would want to ensure the optimal level of profitability.

Accounting systems can be divided into four main sections, based on who they provide information to.

Financial accounting (Drury, 2007) provides information to people outside the organisation, investors, and governments in particular. This provides investors with a means to check how their money is used, and relative information on where to invest.

Cost accounting (Drury, 2007) provides the appropriate valuations of stocks and produced goods and {for} financial accounting. This is in some ways a sub-system of financial accounting.

Management accounting (Arnold & Hope, 1990) provides information for managers for decision-making and control. It allows internal decisions within a company to be appraised.

National Accounts provide information for governments, international organisations and investors as to the state of the national economy (Anon, 1998).

When deciding about the alternatives in this particular case, Guillermo should undertake an incremental cost-return analysis. This involves forecasting the set of expected additional costs and additional returns that his furniture company is expected to incur, if the company were to adopt each one of the alternatives he was considering. The advantage of the incremental method over a full-cost-return analysis is that all common expense and return items are considered sunk and do not need to be determined for the purpose of making the alternative choice. The alternative that produces a net positive incremental profit is that alternative that should be chosen.

Since the problem indicates the possibility of making long-run decisions, Guillermo should also consider doing a capital investment decision, through any one of the following methods: Accounting Rate of Return, Payback Period, Internal Rate of Return, Net Present Value, or Profitability Index. Guillermo should also verify the capital acquisitions and installation costs, the tax rates involved, the amount of financing required and the cost of said additional financing, and other stakeholders' expected return.

#### Conclusion

The case does not give sufficient data to determine the optimal choice based on accounting considerations. Suffice it to say that accounting information and analysis will be helpful in determining the best alternative based on forecasted costs and returns. However, the accounting analysis must be supported by other non-accounting considerations, such as strategic

planning and business ethics.

#### REFERENCES

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