

Happyland construction inc



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Happyland Construction is expanding and growing its operations. There is a need to make a huge capital investment in purchasing a crane necessary for its operations in the next ten years. GargantuLift 6000 crane model produced by Mega Corporation is recommended by engineering, maintenance, finance, purchasing, and management staff. Top management needs to decide which is more financially sound: to buy the crane or subcontract (lease) it from Digger Construction. According to the figures presented by the chief purchasing officer based on the research done by one of his assistants, it looks like that it is cheaper to buy the crane directly from Mega corporation. Total costs for buying the crane are \$15, 298, 500 over 10 years period.

The figure includes purchase price, travel related expenses, training, maintenance, operating expenses, major overhaul costs, salaries and benefits, residual value, and the 5% discount rate adopted by the finance section. This will come up to \$1, 529, 850 per year and \$127, 488 per month. On the other hand, costs associated with subcontracting will amount to \$17, 000, 000 over the 10 years period. Digger will cover all operating and maintenance costs with the exception of salaries and benefits. Annual costs will be \$1, 700, 000 and monthly costs will be \$134, 583. It is cheaper to buy the crane based on the above figures. Two important figures are still to be considered: the finance rate associated with buying the crane and if Happyland have a year by year commitment to the subcontract or it should be a 10 year commitment. I would recommend that Happyland buys the crane and make that vital investment for its growth.

Issue Identification: Happyland is planning to spend a lot of its resources in the next 10 years in paying for the crane. The company is evaluating the TCO of the crane involved in buying or leasing the huge machine. The purchasing section prepared a breakdown of all the costs involved in the two options available. The strategic decision will be made during a meeting between the CEO, the purchasing manager, and the finance director.

Systematic Issues: -A major decision will be made to invest in the crane for the next 10 years. Happyland management needs to be sure that the company will have enough projects and resources to pay for this capital investment. -The accounting system at Happyland depreciates assets over a 5 year period. There should be a special adjustment done to record the acquisition of the Gargantulift 6000 crane be it either bought or leased. This asset should be accounted for over a 10 years period and not five.

Qualitative Analysis:

Happyland has grown over the last few years and became a world leader in the design and construction of oil shale plants. The company is building a new plant and in need to acquire a huge lift crane to support its operations at the new facilities. There is consent among all the technical, engineering, and administrative sections about the crane brand name and model and the period of time the crane is needed. The huge price for the crane makes it crucial for senior management to make the right decision whether to buy the crane directly from the manufacturer or subcontract it from another company over a 10 year plan. The purchasing section prepared a detailed list of the total cost of ownership of the crane for 10 years. Also, the costs involved in leasing the crane were estimated and the company senior

management has to choose the cheaper and more appropriate option taking into consideration all factors related to assets, maintenance, finance rate, company liquidity, operating expenses, supplier relations, present and future probable conditions. Quantitative Analysis:

Betty, a purchasing section staff, prepared a list of all the costs involved in buying or leasing the crane lift. TCO associated with buying are: -The purchase price of \$11, 000, 000 -Travel related costs involved in assessing the different crane models and initial training for the crane operators: \$170, 000 -Annual maintenance costs of \$50, 000 for 10 year period -Annual operating costs not including the operators' salaries&benefits: \$100, 000 - Operators' salaries and benefits per year: \$200, 000 -Major over haul in 5 years: \$400, 000 -Residual crane value after 10 years: \$500, 000 Total costs over 10 years for the above items: \$14, 570, 000 After a 5% discount rate for the future value of money: \$15, 298, 500 Total costs of ownership in subcontracting the crane lift were itemized as follows: -\$1, 500, 000 annual lease charges for a 10 year period.

-\$200, 000 annual salaries and benefits for crane operators over a 10 year period Total costs for subcontracting the crane lift over 10 years: \$17, 000, 000

Alternatives: 1-Subcontract the crane. Happyland management could decide to lease the crane from Digger Construction over the 10 years period. Pros: Fixed installments known a head of time for the 10 years span regardless of the fluctuations in the financial institutions interest rates. Cons: More costly option compared to buying the crane.

2-Happyland can forget about acquiring the crane at the current stage and keep status quo. Pros: Resources planned to be spent in the purchase or lease process will be saved. Cons: The company will lose the competitive edge in its business operations that may lead to a loss in its market share.

Recommendation and Implementation: I recommend that Happyland buys the Gargantulift 6000 from Mega Corporation and finalize the finance deal with a local bank institution. The company is growing and needs to keep up with the changing markets in order to maintain an edge over competition. When clients and other potential customers see that Happyland is upgrading its facilities and equipment, they will be more encouraged to deal with this company. Also, this might turn Happyland into a major player in the design and construction industry not only in Canada but also on the international level. Two basic things needed to be addressed when finalizing the purchase deal: -Getting the lowest finance rate over the 10 years period.

-Depreciate the crane in the accounting books over 10 years not 5 years.

Monitor and Control: At happy land, management needs to make sure that the crane is utilized at full capacity by having periodic meetings between engineering, design and construction, and administrative sections. Also, finance department should make sure that crane loan payments are done on time to keep a good relation with the creditor bank and maintain good credit ratings. Records of crane scheduled maintenance and operational condition should be kept track of and implemented on a timely manner to keep it in a good working condition. Finally, Happyland should maintain a good

professional relation with Mega Corporation and ask for their advice on issues regarding the crane operation and any new technology in the field.