

Gian auto corporation essay sample



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Gian Auto Corporation is a manufacture and supplier of components for manufacturers and suppliers of parts for automobiles, van and trucks. The company maintains an excellent track record with over 10 percent increase in sales in each year. One of the critical success factors of company's business strategy is the location of its plants in favorable business environments and areas with lower wage rates. One of GianAuto's earliest plant is the Denver Cover Plant, which basically prepares and sews coverings, mainly leather and upholstery fabrics. The person who was in charge of operating the Denver Cover Plant was Ted Vosilo.

ISSUES OF THE CASE

GianAuto Corporation found an external supplier, which can provide coverings at a lower price than the Denver Cover Plant. The budget for Denver Cover Plant's budget was set at \$82 million, whereas GianAuto can purchase those coverings from an external party at the price of \$60 million.

DENVER COVER PLANT

Budget and Operating Cost for Year ending December 31, 2004 (000s omitted)

Materials \$32, 000

Labor

Direct \$ 23, 000

Supervision \$ 3, 000

Indirect plant \$ 4, 000 \$30, 000

Overhead

Dep- Equipment \$ 5, 000

Dep.- Building \$ 3, 000

Pension Expense \$ 4, 000

Plant manager \$ staff \$ 2, 000

Corporate allocation \$ 6, 000 \$ 20, 000

Total Budgeted Cost \$ 82, 000

However, there are additional factors that should be considered before making the decision to shut down the Denver Plant:

1. Blanket order had been placed with major suppliers to ensure sufficient supply for the coming year.

Disadvantage: if order were cancelled due to the closing, termination charges of 15 % of direct material or \$4, 000, 000 would have to be paid off.

2. 400 plant employees would be laid off

Disadvantage: Employees may not be able to find a handsome rewarding job matching Denver, which is the highest in the area and Denver has the obligation to source for new employment for its employee that could cost additional \$ 1 million.

3. Denver's early retirement plan:

Disadvantage: The pension expense for the year 2004 would still be in force whether Denver Covers is open or not and this would cost the company \$ 3 million

4. Denver's Senior Management:

They would not be affected, as they would still be responsible to manage three other plants. This would cost the wages for Plant manager and the staff \$2 million per year.

Q1: Explain Gian Auto's competitive strategy and how this strategy should be considered with regard to Denver Plan Decision. Identify the key strategy factors that should be considered

Auto's(GA) competitive strategies are as follows:-

- * GA upholds excellent customer services and reliability. As such, this attribute to the increase in sales of more than 10% each year.

- * Always endeavors for lower production cost which reflect in its actions of continuing outsource more of its productions to the cost efficient manufacturer, take advantage of lower wage rates and favorable business environment around the world and others.

- * To apply the abovesaid strategy for Denver Plan is only applicable for strategy number 2 whereby the Denver Plan in general without consider any other cost i. e compensation for lay off, termination of contract and etc could generate cost saving of \$60 million per annum.

However, by purchasing the entire annual output of Denver Cover, there are possibilities that it would affect the quality of its products and reliability, which contradict, with its core strategy of excellent customer service and reliability. By depending to only one supplier would result to concentration risk whereby if the Denver Cover plant fails to produce as per expected, the whole GA operations flow would be effected as well.

The key strategy factors that should be considered are as follows:-

- * High quality and reliable products
- * Efficient production / low cost production
- * Good customer service.

Q2: GianAuto Corporation plans to prepare an analysis to use in deciding whether to close the Denver Cover Plant. Using the preceding information, identify the relevant and non-relevant costs in this decision.

Analysis:

Gross Saving = \$22 m

Related costs

a. Direct material compensation = \$4. 8 m

b. 1 year employment assistance = \$1 m

Net Benefit = \$16. 2

Relevant information:

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a. Termination charges of direct material = \$4. 8m

b. 1 year employment assistance = \$1 m

c. Equipment depreciation

- as it uses the units-of production method. If the plant closed, it will not be depreciated

Non - Relevant Information:

a. \$ 3 million of the 2004 pension expense would continue whether Denver Cover open or not

b. Ted and his direct staff - they will be re-employed to managed the other 3 plants

c. Building depreciation charges - depreciation charges will be applied either the plant running or not

CONCLUSION

In this particular case of Denver Cover plant, we can see that cost structure of the plant is not in line with the cost minimization business strategy practiced by GianAuto. If the company thinks short-term, then it may purchase the coverings from an external party. However, if the company is concerned about long-term implications, there should be an intervention from the top-management of the company to investigate the causes of the higher operating cost of Denver's plant. Maintaining the internal supplier, the company will be able to control the cost, quality and reliability of the used

materials (coverings). Therefore, it is very critical for the company to conduct to identify inefficiencies which led to higher operating expenditures in Denver plant. With that, the company will be able to correct the transfer pricing mechanism which is dysfunctional at the moment due to higher internal price offered by Denver Cover plant compared to an external party.