Ab thorsten case study analysis

Education

In my view, manufacture of XL-4 in Sweden is a well laid out plan and Mr. Ekstrom and his team has done good research and analysis of the project. However, I would not authorize the investment. To start with, the investment in Sweden will cost the company heavily as it will involve setting up a new factory at a whooping cost of Skr. 76. 385 million.

In making investments decisions, we must always consider all possible alternatives then come up with the most viable one. In this case for example, we have an option of expanding the Canadian plant which supplies the Swedish market to provide for the proposed increase in market share at a cost of only Skr. 7. 183.

The expansion would not only ensure minimal rise in the fixed costs but also save the company due to the economies of scale enjoyed by the Canadian plant. As compared to the five years that the company will take to recover its investments for the Swedish plant, upgrading the Canadian plant will only take 2. 5 years to give the company a return on its investments.

In addition, the company stands to benefit form the high internal rates of return in Canada which are set at 60% as opposed to the Canadian 15. 7% rate of return (Torre, 1999). Incorporating the production of more XL-4 to supply the 400 tons demand in the Swedish market would therefore prove more viable as it will save more resources.

The resources saved could actually be used for other purposes or be invested in projects that will bring forth higher returns within a shorter time such as investing in bonds and bank certificates. The investment in Sweden should therefore not be undertaken.

According to Ekstrom and his team, the proposed project was going to be a major breakthrough for the company with a potential market of 800 tons of XL-4 in Sweden. Customer trial conducted using three major companies have revealed that indeed thetechnologyof XL-4 can save the companies a great deal in terms of costs, material handling and fuel.

Ekstrom and his team are calling to the management to help in setting up a plant producing 400 tons of XL-4 each year at a cost of about Skr. 76. 385 million in plant and machinery.

Working capital of about Skr. 5. 6 million will be required as working capital. Ekstrom states that the plant can recover 60% of its inventory costs from the taxable income as the Swedish law permits it. The plant's life after which it will have to be renovated to suit advancement in technology is given as seven years.

By the end of the seven years, the Swedish plant should have reached a net present value of Skr. 15 million after taxes. The analysis is well performed using modern management tools and they are highly optimistic of all the figures presented.

The analysis however does not include the sales projects in case the company may decide to expand to Europe and the rest of Scandinavia. On the question as to where the funds would come from, Ekstrom explained that funding could be obtained from borrowing in Swedish banks if the demand surpassed 400 tons.

The Canadian divisional management is against the investments. They give several reasons to support their arguments. Gichoud, the director of sales argues that the sales of 400 tons per year were far too optimistic citing from his experience in marketing (Torre, 1999).

According to him, there is no way they can make 400 tons sales in Sweden alone while Roget's overall world market is only 600 tons. Director of manufacturing, Levanchy is also not very keen on the project saying that the manufacturing processes is very complicated for Sweden to undertake even with the presence of trained workers.

The Canadian management insists that this is an expensive undertaking for the company taking up a lot ofmoneywhich could have been saved if the production was done in Canada.

They compare the returns and number of years taken to get a return on the investments. As opposed to Sweden which will use initial costs of Skr. 76. 385, Canada would spend Skr. 7. 183; get returns in 2. 5 years as opposed to Sweden's five years; get a higher rate of return on capital of 60% as compared to Sweden's 15%.

The issues of uncertainty and market trends are ignored in estimating the demand of XL-4. Customer choice resulting from competition, increase in technology and changes in the markets is an important consideration before making an investment.

In the event that a new product comes to the market before the seven years proposed by Ekstrom and his team are over, the division is likely to suffer losses from the huge investments. Take for example that the target 400 tons per year falls due to the changes in market or emergence of a competitor.

The predicted plant's net value would be lower than Skr. 15 million. A 15% return cannot also be achieved. The management therefore ought to give an allowance for any changes in the market. This proposal takes the market as a constant playing ground which according to them will only change after seven years.