

# Snow white paper company case study

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“ If I were to price these boxes any lower than \$480 a gross,” said James Brunner, manager of Snow White Paper Company’s Thompson Division, “ I’d be countermanding my order of last month for our sales force to stop shaving their bids and to bid full cost quotations. I’ve been trying for weeks to improve the quality of our business. If I turn around now and accept this job at \$430 or anything less than \$480, I’ll be tearing down this program I’ve been working so hard to build up. The division can’t show a profit by putting in bids that don’t even cover a fair share of overhead costs, let alone give us a profit. ” Snow White Paper Company was a medium-sized, vertically integrated paper company, producing white and kraft papers and paperboard.

A portion of its paperboard output was converted into corrugated boxes by the Thompson Division, which also printed and colored the outside surface of the boxes. Including Thompson, the company had four producing divisions and a timberland division, which supplied part of the company’s pulp requirements. For several years each division had been judged on the basis of its profit and return on investment. Top management had been working to gain effective results from a policy of decentralizing responsibility for all decisions except those relating to overall company policy. Top management felt that the concept of decentralization had been successfully applied and that the company’s profits and competitive position had definitely improved.

Early in the year, the Northern Division designed a special retail display box for one of its finished papers in conjunction with the Thompson Division, which was equipped to make the box. Thompson’s package design and development staff spent several months perfecting the design, production

methods, and materials that were to be used; because of the unusual color and shape, these were far from standard. According to an informal agreement between the two divisions, Thompson was reimbursed by Northern only for the out-of-pocket cost of its design and development work. When the specifications were all prepared, the Northern Division asked for bids on the box from the Thompson Division and from two outside companies, West Paper Company and Erie Papers, Inc. Snow White's division managers normally were free to buy from whichever supplier they wished, and even on sales within the company, divisions were expected to meet the going market price if they wanted the business. At this time the profit margins of converters such as the Thompson Division were being squeezed.

Thompson, like many other similar converters, bought its board, liner, or paper and printed, cut, and shaped it into boxes. Though it bought most of its materials from other Snow White divisions, most of Thompson's sales were to outside customers. If Thompson got the order from Northern, it probably would buy its linerboard and corrugating medium from the Southern Division of Snow White. The walls of a corrugated box consist of outside and inside sheets of linerboard sandwiching the corrugating medium. About 70 percent of Thompson's out-of-pocket cost of \$400 a gross for the order represented the cost of linerboard and corrugating medium. Though Southern had been running below capacity and had excess inventory, it quoted the market price, which had not weakened as a result of the oversupply.

Its out-of-pocket costs on liner and corrugating medium were about 60 percent of selling price. The Northern Division received bids on the boxes of <https://assignbuster.com/snow-white-paper-company-case-study/>

\$480 a gross from the Thompson Division, \$430 a gross from West Paper, and \$432 a gross from Erie Papers. Erie offered to buy from Snow White the outside linerboard with the special printing already on it, but would supply its own inside liner and corrugating medium. The outside liner would be supplied by the Southern Division at a price equivalent to \$90 per gross of boxes, and would be printed for \$30 a gross by the Thompson Division. Of the \$30, about \$25 would be out-of-pocket costs.

Since this situation appeared to be a little unusual, William Kenton, manager of the Northern Division, discussed the wide discrepancy of bids with Snow White's marketing vice president. He told the marketing vice president, " We sell in a very competitive market, where higher costs cannot be passed on. How can we be expected to show a decent profit and return on investment if we have to buy our supplies at more than 10 percent over the going market? " Knowing that Brunner had on occasion in the past few months been unable to operate the Thompson Division at capacity, the marketing vice president thought it odd that Brunner would add the full 20 percent overhead and profit charge to his out-of-pocket costs. When asked about this over the telephone, Brunner's answer was the statement that appears at the beginning of this case. Brunner went on to say that having done the design and developmental work on the box at only out-of-pocket cost, he felt entitled to a normal markup on the production of the box itself.

The vice president thought about the cost structures of the various divisions. He remembered a comment the controller had made to the effect that costs that were variable for one division could be largely fixed for the company as a whole. He knew that in the absence of specific orders from top

management, Kenton would accept the lowest bid, namely, that of West Paper for \$430. However, it would be possible for top management to order the acceptance of another bid if the situation warranted such action. And though the volume represented by the transactions in question was less than 5 percent of the volume of any of the divisions involved, other transactions could conceivably raise similar problems later. Questions: 1.

What are the additional costs to Snow White Paper Company if Northern buys the boxes from West or Erie, rather than from Thompson? 2. Does the present system motivate Mr. Brunner in such a way that actions he takes in the best interests of the Thompson Division are also in the best interests of the Snow White Paper Company? Explain. 3. What should the marketing vice president do?