Problems facing campagnie du froid economics essay

The aim of this report is to analyse the problems faces by Jacques Trumen, the CEO of Campagnie du Froid S. A., by reviewing the performance of the 3 regional managers. The report is based on the financial analysis and the evaluation of the facts and figures provided in the case study. This report ends with recommendations for a fair compensation system.

In this case, Jacques has to evaluate the performance of the 3 regional businesses in France, Italy and Spain and decide regarding the compensation of the managers according to that. Until recently, he was giving the bonus of 2% of the corporate profit to each one of the managers. However, in 2009 the performance of Spain region was very poor and had affected the overall profit of the company. This has forced Jacques to rethink about the fairness of the evaluation system.

The report answers Jacques problem in deciding the strategic changes in the compensation system by evaluating the performance of each region.

The Italian Region

Taking into consideration all the facts and figures in the case study given, it can be said that Peirre Giraux, the regional manager of Italy, performed good in 2009. He could get 12. 6% more profit than was estimated the profit plan. The negative variance of his cost of goods sold (COGS) is expected as he has increased the sales volume. The COGS increased at a lower rate in comparison to the sales which resulted in a positive variance in his contribution margin which increased by 1. 65% higher than the budgeted figure.

His performance is admirable because although the production is ice cream increased, he could reduce other costs like supervision, electricity, and maintenance by 7. 000 Euros, this result in increasing the operating margin by 2. 45%.

The overall S&A expense variance is unfavourable but some of it is contributed due to the increase in sales volume. Pierre needs to have a better control on some costs like the administrative salaries and expenses as it should not have increased by the current rate. The selling expenses increased by close to 10% whereas total sales grew by only 1. 2%. he is not accountable for the unfavourable variance in the allocated central office expenses as it is the same for all regions and it is fixed by the company’s central office. The overall outcome of Pierre performance was good.

The Ice Cream Transfer

After analysing Exhibit 5, it is clear that Jean, the manger of the French region, has considered COGS, other costs, depreciation and S&A expenses with a profit margin of 5% for calculating the selling price of the ice cream. Adding COGS and other costs was fair on Jean’s part as these are variable costs and are bound to increase with the increase in production. Jean added 0. 04 Euros per litre under S&A expenses which corresponds to allocated central office expenses. It is unjustified to add it because this cost is fixed by the company’s central office and is equally incurred by all the divisions. In addition, Jean could have added the depreciation cost because it would have remained the same even if Spain had not imported ice cream from French region. By adding the depreciation cost to the cost of ice cream transferred, Jean’s depreciation cost went down and his profit was increased considerably. So this way worked somewhat in favour of the French region. France benefited from it by increasing sales volume at a lower fixed cost (depreciation and central office expense added to the selling price) and Spain enjoyed the advantage by satisfying its volume deficit at a cost lower than its own selling price in the Spanish market even after a price cut. That is why it can be said that the ice cream transfer was a win-win situation for Spain and France regions.

The Spanish Region

2009 was a problematic year for the Spanish region for many reasons. The following points specify the main 3 factors that worked against Spain and how much did it cost Andres.

1- Too low temperature: according exhibit 6, for the first time Spain had encountered such low temperature in the last 7 years. Last time the temperature had gone below 28 C, Spain had experienced only 3. 5% volume growth. Moreover, in 2001, when Spain had experienced 28 C, the volume growth rate had dropped down -2. 1%. If we follow Jacques' thumb rule, then predicted volume growth should be only 4. 9% instead of the planned 10%. However, it was better than that as it comes out to be 6. 8% (see table 1). So it can be said that Andres performed well against the nature's odds by maintaining a higher volume growth than that predicted by Jacques' thumb rule.

Table 1 (The Spanish Region)

Expected sales for 2009

4. 094

Proposed increase

10%

Sales for 2008

*3. 722

Actual sales for 2009

3. 975

Rise in 2009

253

% Rise in 2009

6. 80%

* Sales for 2008= expected sales for 2009/ (1+propesed % increase)

2- Machinery problem: Spanish division faced the machinery problem. Due to which, it had to import ice cream from France at a higher variable cost. Andres also had to swallow the surplus cost of supervision, energy, and maintenance due to the continuous repair and adjustment work in the machines. This increased his cost of production by 21. 000 Euros which normally should have gone down because of lower production in his manufacturing unit.

3- Price cut by competitor: the problem for Spain did not stop here. Due to price reduction by competitor, the company had to cut its price by 1. 5% and lost some of sales revenue in this process.

But, Andres's decision to import ice cream from France came out to be fruitful as he was able to satisfy its volume deficit. In spite of the fact that he had to buy ice cream at a higher variable cost, but still it was cheaper than his own selling price (after price cut). This contributed 178. 000 Euros to his profit (see table 2).

Table 2 (The Spanish Division)

Per unit cost

Total in ' 000 Euros

Notes

Cost charged by France

3. 53

2. 126

Subcontracted transportation

*0. 13

77

Incurred due to import from France

Delivery expenses

**0. 19

115

These are not completely fixed costs and depend on sales volume. Higher the sales higher the expense

Selling expenses

***0. 20

119

These are not completely fixed costs and depend on sales volume. Higher the sales higher the expense

Total cost

4. 05

2. 437

Selling price

4. 34

2. 616

Profit

0. 29

178

*subcontracted transportation cost per unit = total subcontracted transportation cost / total volume transferred

**delivery expense per unit = actual delivery expense / actual volume

*** selling expense per unit = actual selling expense / actual volume

Overall, it can be said that due to few unavoidable circumstances, Andres had to face losses which ruined the performance of his division.

The French Region

France seems to be the best performer but by a close look at exhibit 2, it is evident that Jean's performance was poor because of 3 major reasons. First, Jean employed a major workforce on an hourly basis to supervise the production and maintain the machines. This increased the supervision, energy, and maintenance costs by 118. 000 Euros which reduced his operating margin significantly. Secondly, Jean added the depreciation and central office expenses to his selling price for ice cream transfer to Spain. This is unjustified as these expenses are fixed costs and would have remained the same even if Spain had not imported from France. However, including these expenses worked well for Jean as his fixed costs was distributed by a higher sales volume and increased his profit by 79. 000 Euros (Depreciation + S&A, from exhibit 5). Thirdly, it should not be forgotten that 603. 000 litres of his sales volume came from transferring ice cream to Spain and 79. 000 Euros of sales revenue from distribution business. Therefore, his actual total sales revenue from the company's core business was only 21. 256. 000 Euros (from exhibit 2). This is 1. 36% less than the estimated sales revenue in the profit plan, and that is why Jean was not able to meet his projected target. In addition, if we remove the profit earned from export i. e. 180. 000 Euros and distribution business 29. 000 Euros, then his actual profit comes down to 1. 033. 000 Euros which is just 0. 58% above budget (see table 3). However, Jean's decision to invest in distribution business was profitable to the company because he increased the revenue by 79. 000 Euros. Assuming that the negative variance of 3. 000 Euros as truck depreciation and 47. 000 Euros as delivery expenses is due to the new business yet Jean managed to account a profit of 29. 000 Euros in the first year itself.

Table 3 (The French Region)

Estimated profit in 2009

1. 027

Total actual profit in 2009

1. 242

Profit from ice cream export

*180

Profit from distribution export

**29

Profit from ice cream business excluding export and distribution

1. 033

Profit above estimated

6

% profit above estimated

0. 58%

*profit from ice cream transfer = total actual profit –

**profit from distribution export = revenue from distribution – (variance in delivery expense + variance in depreciation of trucks).

Conclusion and Recommendations

After investigating the case, it is evident that Andres can not be blamed totally for the depressing performance of Spain. Spain suffered from multiple bad circumstances in 2009, and Andres applied every trick to overcome it. In spite of Jean’s decision of the distribution business was profitable to the company but his overall performance was below the expectations. Consequently, Pierre comes out to be the best performer out of the 3 regional managers. So, it is significant to keep certain factors in mind when deciding the compensation of a manager. In order to keep employees motivated to perform better, their compensation bonus should be directly linked to their own division’s profit. Jacques should decide a ratio of percentage of corporate and regional profits depending on his company’s budget for bonus. For example, he should give 1% of corporate profits plus 3% of regional profits. In this way even if the company’s overall profit went down due to poor performance of a particular region, a manger's bonus would be affected only by the percentage allocated to corporate profit. He can still enjoy the percentage of his division's profit which is normally should have performed well.

Another factor to determine the compensation would be the company's strategic goals and manager's performance in achieving these goals. In order to motivate employees to exceed the expected revenues in profit plan, Jacques should give a higher percentage of the value by which the manager surpasses the expected profit. This would keep the manager motivated in undertaking the challenging opportunities to contribute to the company's growth.