

Genuine motor products essay sample



**ASSIGN
BUSTER**

Genuine Motor Products, located in Northern Ohio, manufactures precision measuring devices to monitor exhaust emission systems for new and used automobiles. Its products are sold worldwide. The firm hired Mike Anton in January of 1999 as vice president in charge of manufacturing operations. Mike had a bachelor's degree in industrial engineering from Case Western Reserve University and an MBA from Ohio State University. He had spent the last 15 years working for General Motors (Arlington, Texas division), Toyota Motor Corp. and Volvo. At age 38, he had established a good reputation for innovation within the auto and auto parts industry. Upon being hired, he began looking over the financial statements, particularly the balance sheet as of December 31, 1998 and the pro forma income statement for 1999 as shown in Figure 1 and 2, respectively.

His immediate reaction was that the firm had not made the move to automation that others in the industry had. The company's manufacturing process was highly labor intensive as indicated by the fact that fixed assets (net plant and equipment) represented only \$8 million out of total assets of \$24 million (Figure 1) and that variable costs per unit were \$25 in comparison to a sales price of \$30 per unit (Figure 2). Although he thought the pro forma income statement for 1999 as shown in Figure 2 looked reasonably good, he believed returns could be better if the firm went to greater automation and was less dependent on labor and expensive materials.

When he shared his thoughts with Harry Engle, the chief financial officer, the response he received was lukewarm. Harry had been with the firm in good times as well as bad over the last 20 years and was quick to point out the

advantages of not being tied up with a lot of fixed costs and debt during a slowdown in sales in the auto industry. As Harry was fond of saying, “Genuine Motor Products does not have a labor union and when business is bad, we lay people off. By gosh, you can’t lay machinery and equipment off.”

In spite of Harry’s arguments, Mike Anton was determined to show the impact of both operating and financial leverage on Genuine Motor Products operations. He reconstructed the year-end balance sheet for 1998 (previously shown in Figure 1), and the results are shown in Figure 3 based on the following assumptions.

1. That the firm would increase fixed assets by \$14 million dollars.
2. That \$10 million of the \$14 would be funded through long-term debt in the form of additional bonds payable at an interest rate of 10.75%.
3. The remaining \$4 million would come from the sale of additional common stock at a net price to the corporation of \$12.50. This would require the issuance of 320,000 new shares ($\$4 \text{ million} / \$12.50 = 320,000 \text{ shares}$).

The impact of these values on the balance sheet in Figure 3 shows substantially greater leverage both on the asset and liability side.