Decision-making with a strategic emphasis: earth baby, inc.

Environment, Earth

Decision-Making & Strategic Analysis

A common problem in companies today is the tendency of top decision-makers to neglect the long-term strategicgoalsand focus on short-term goals and profit. Although decision-makers must consider both short-term and long-term effects in making sound business decisions, relevant cost analysis and strategic analysis are significant aspects of the decision-making process (Blocher, Stout, & Cokins, 2010, p. 430). Without careful strategic analysis, decision-makers could mistake a positive relevant cost analysis as a business advantage, while overlooking the potential negative impact on the company’s image and its sales. It is important for decision-makers to think and plan strategically, and to start with specific strategic goals in all decision-making situations. It is important for companies to consider strategic factors when performing a relevant cost analysis for special-order decisions. A special-order decision occurs when a company has a one-time opportunity to accept product or service orders on special terms. To illustrate, consider the special-order situation facing Earth Baby, Inc. (EBI). Earth Baby, Inc.

Earth Baby, Inc. produces organic babyfood, clothing, and toys forhealth-conscious parents. With its introduction of a new line of premium organic baby foods and its excellent reputation for superiority, EBI is able to sell its products at prices higher than those of their rivals. The company distributes these products through high-end grocery stores, pharmacies, and specialty retail baby stores. The founder and CEO of EBI recently received a proposal from the vice president of Great Deal, Inc. (GDI), a large discount retailer.

The vice president proposed a joint venture between his company and EBI, citing the growing demand for organic products and the superior distribution channels of his organization. Under this venture EBI would make some minor changes to the manufacturing process of some of its best-selling baby foods, which would then be packaged and sold by GDI. Under the agreement, EBI would receive $3. 10 per jar of baby food and would provide GDI a limited right to advertise the product as manufactured for Great Deal by EBI. Initial calculations determined that the direct materials, direct labor, and other variable costs needed for the GDI order would be about $2 per unit as compared to the full cost of $3 (materials, labor, and overhead) for the equivalent EBI product. The CEO must decide whether or not to accept the proposed venture from GDI. Case Analysis

The CEO of Earth Baby, Inc. should realize that the $3. 00 full cost for its product includes $1. 00 of irrelevant fixed overhead. The fixed overhead costs are irrelevant in the decision-making process because they will remain the same whether or not EBI accepts GDI’s proposal. Thus, there is no longer any discretion regarding these costs. In this case, only the variable costs of $2. 00 per unit are particularly relevant. Variable costs are typically more relevant in decision making than fixed costs because they have not yet incurred. From this perspective, accepting GDI’s proposal appears to be reasonable and profitable for EBI since there would be a contribution of $1. 10 ($3. 10 price less $2. 00 relevant cost) per unit sold. However, EBI should consider other strategic factors besides product distribution and the short-term versus long-term effects for the entirefamilyof products in its value stream. Accepting this proposal could negatively impact EBI’s brand and target market since their reputation is built upon product quality and superiority, qualities which sets it apart from its competitors. A company's brand distinction differentiates it from business rivals and in return, they become market leaders providing more value for the consumers (Borth, 2011). EBI's premium organic baby products and food for health-conscious parents is its marketing niche and the foundation of its success and longevity. To sell its products through GDI, a discount retailer, compromises EBI's image and its products. The end result would be a market share loss through their normal distribution channels in high-end grocery stores, pharmacies, and specialty retail baby stores. Consumers have a tendency to associate quality foods with brand name outlets and GDI may not fit this image. For this proposal to fully benefit EBI, the company's business strategy should encompass strategic partners and distributors who are better aligned with their overall corporate strategy (Borth, 2011). Conclusion

It is important for decision-makers to think and plan strategically, and to start with specific strategic goals in all decision-making situations. Without the benefit of foresight, decision-makers tend to focus on short-term goals and ignore long-term strategic goals of the company. With foresight, EBI will realize that the use of relevant cost analysis in special-order decisions can be effective; however, it is not linked to corporate strategy and is quantitative in nature. The proposed joint venture focuses more on the financial aspect (irrelevant fixed overhead) and not the long-term effects on EBI's stellar reputation in the organic baby food industry. If EBI were to go forward with the proposal, GDI would have a limited right to market some of the organic baby foods as manufactured by EBI. EBI must re-evaluate this " limited right" strategically. Would the joint venture continue to be customer focused? Is the new proposal aligned with the company’s long-term strategy? These are some strategic factors EBI must consider before risking their reputation.

References

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