

Ncb office products
inc. case analysis
essay sample



**ASSIGN
BUSTER**

NCB is a manufacturer and distributor of a wide range of office products. In Canada, NCB uses several distributors in different regions. One of the major distributors is Harrison Stationary and Office Supply LTD. Harrison had distributed NCB'S products for over 50 years and NCB was the largest supplier of Harrison. In January 2003 Harrison was acquired by the president of the company and four senior officers. Most of the acquisition cost was financed by bank loans. Since the acquisition, Harrison had difficulties to pay NCB for the goods and the account receivable reached to unacceptable level. In September 2005 the Harrison account was 156 days old and amounted to \$ 4. 4 million. In addition, NCB's credit management tried to receive financial information from Harrison's management without great success. After 14 months of avoiding the requests of NCB's credit department, Harrison's management released the financial statements. The financial statements of Harrison revealed a very risky financial situation.

The company had substantial losses and had an equity deficit position. Tutlte, NCB's credit manager recommended to stop shipments to Harrison immediately and let them get bankrupt. However, Pam Bookman, vice-president sales had a different opinion. She was afraid to lose market share because the company didn't have a contingency plan for another distributor. Now, NCB's management is facing a big dilemma concerning this issue and must decide how to handle this situation. MNC's decision will have a great impact on both companies. 1: stop doing business with Harrison by cutting off all credit This action may cause serious consequences on both companies. Harrison will face bankruptcy and we need to estimate how it will impact NCB. The debt of Harrison to NCB is currently amounted to \$ 4. 4

million and we need to estimate how much debt can be recovered. In order to estimate the amount we can recover, we applied the liquidation process based on 3 assumptions: 1. 75% of Harrison's account receivable will be saved.

2. 50% of Harrison's inventory will be saved.

3. 75% of Harrison's property.

Harrison's account receivable: $6832,000 * 0.75 (+)$

Harrison's inventory: $9632,000 * 0.5 (+)$ Property, plant and equipment +

land: $3,295,000 * 0.75$ Liquidation value: \$ 12,276,000 (-) Harrison's bank

loan (operating): \$ 5,199,000 Harrison's bank loan (term): \$ 4,550,000

The amount left for paying the account payable: \$ 2,528,000 $2,528,000 /$

$9,462,000(AP) = 0.27$ (27 Cent per 1 \$).

$4,400,000 * 0.27 = \$ 1,188,000$ (AR amount that can be recovered after liquidation process). A. Finding A New Distributor

In addition to the losses on the Harrison's account receivable, MNC's management may face more losses because they didn't have a contingency plan for a new distributor. In 2004 the amount of sales to Harrison amounted to \$10,000,000. Based on our estimation, if MNC will switch to another distributor they may lose 15% of their market share (\$1,500,000). $\$ 10,000,000 - \$ 1,500,000 = \$ 8,500,000$ (estimated sales amount for the next year). Due to that, profit margins will probably decline. In 2004 the average trading profit margin to Harrison was 22.3% (based on sales level of \$ 10,000,000). $\$ 10,000,000 * 0.223 = \$ 2,230,000$ (2004)

$\$ 8,500,000 * 0.223 = \$ 1,895,500$ (2005)

$\$ 2,230,000 - \$ 1,895,500 = \$ 334,500$.

In conclusion, if Harrison will get bankrupt, MNC will lose at least: 1. $\$ 4,400,000 - \$ 1,188,000 = \$ 3,212,000$ (AR - liquidation value). 2. $\$ 334,500$ (decline in profits).

3. Estimated increase in shipping and administrative costs (1% for each). 1% of $\$ 8,500,000 = \$ 85,000 * 2 = \$ 170,000$ Total estimated losses: $\$ 3,716,500$

B. Starts Its Own Distribution Company

Another option for NCB is to start its own distribution company. This option will require a significant capital investment in addition to the losses due to Harrison's bankruptcy. If we look at the balance sheet of Harrison we can see that Net PP&E + Land amounted to $\$ 3,295,000$. If NCB will decide to take this option, it must invest a similar amount. In addition, inventory investment is required and will be at minimum $\$ 500,000$. Total initial estimated investment: $\$ 3,795,000$.

According to the income statement of Harrison, the average administration cost for a year is amounted to $\$ 2,425,000$. The new company will handle NCB's products only therefore administration costs will be lower (around $\$ 1,500,000$). The initial investment and the yearly administrative cost are needed before even the new company is starting to generate revenues. Harrison had average net sales for the last 4 years of $\$ 34,097,000$.

Harrison has a loyal customer base built in its 80 years of existents. It will be very hard to enter the market because the new company doesn't have a customer base yet. We estimate the new company can generate

approximately \$ 5, 000, 000 in net sales for the first year. Estimated losses from liquidation of Harrison: \$ 3, 716, 500 (+) Initial estimated investment: \$ 3, 795, 000 (+) Estimated administration cost: \$ 1, 500, 000 (+) Estimated profit margin decrease:

$\$ 10, 000, 000 * 0. 223 = \$ 2, 230, 000$ (2004)

$\$ 5, 000, 000 * 0. 223 = \$ 1, 115, 000$ (2005)

$\$ 2, 230, 000 - \$ 1, 115, 000 = \$ 1, 115, 000$ Total estimated cost: \$ 10, 126, 500 2. NCB Keep Doing Business with Harrison

If Harrison can recover from its financial problem, it is desirable to keep Harrison as a distributor. The average trading profit margin to Harrison was 22. 3% and it was stable over time. The two companies had a longstanding friendly relationship and Harrison provided good service and has the best distribution coverage of the area. Cutting ties with Harrison may badly effect NCB's reputation and may create very strong rival if Harrison managed to recover. A. Do Nothing

This option will probably be taken because: average profit margin of Harrison account was stable (22. 3%), NCB was the largest supplier of Harrison, Harrison was responsible for 95% of sales in Atlantic Canada and Harrison had a very loyal customer base (over 500 customers). In addition, NCB was determined to maintain and grow their market share, so doing nothing will maintain high sales level. In this situation Harrison will probably get bankrupt and NCB probably will lose all the \$ 4, 400, 000 of the account receivable, or lose part of the account receivable after liquidation process is over (\$ 3, 212, 000 estimated). Then, NCB will have to find another way to distribute its

products such as other distributor or even starts a new company (costs estimates are in previous sections). B. Reduce Harrison's Credit Limit

Reducing the credit limit for Harrison will decrease NCB's exposure because Harrison may become more solvent. Although this action may badly affect the good relationship between the companies, it can also decrease the risk of Harrison getting bankrupt. NCB account payable = 156 days average Harrison accounts payable = 103.9 days According to the data above, Harrison is making a slow payment to NCB compared to the other creditors. Decreasing Harrison's credit limit can protect NCB from not being paid for the goods and at the same time will force Harrison to sell their inventory and prevent from ordering excess inventory. This situation also requires from Harrison's management a declaration concerning the issue of late payments to NCB.

C. Ship Goods to Harrison on a Consignment Basis

This option requires a separated bonded warehouse facility, it is costly and very difficult to administer. Outsourcing this project can reduce initial investment costs, reduce operational costs and can be terminated easily. A logistic company will provide the warehouse, the manpower, the equipment and will be responsible for shipping the goods in and out. Yearly bonded warehouse contract (fixed cost): \$ 400, 000

Shipping costs 2% of sales (small and frequent shipments are more expensive). Administrative costs 9% of sales.

Assuming NCB can maintain the same sales level to Harrison (\$10, 000, 000) the costs will be: \$ 400, 000 + \$ 200, 000 + \$ 900, 000 = \$ 1, 500, 000

(estimated cost). On the same level of sales our profits will decline by \$ 1, 500, 000. D. Work with Harrison to Reduce Inventory

Senior NCB'S sales manager indicated Harrison had an inventory of NCB products at August 31, 2005 of about \$1, 956 million. Sales from NCB to Harrison in 2004 amounted to \$10 million. For the first eight months of 2005, sales amounted to \$6. 701 million (243 days). So we can calculate how many days it takes to Harrison to sell its inventory of NCB's products, or in other words the inventory turnover. $(\$1. 956 \text{ million} / \$6. 701 \text{ million}) * 243 \text{ days} = 71 \text{ days}$.

These 71 days means that it takes 71 days for Harrison to manage their inventory into goods sold during a period of 243 days. As of the year 2004 Dec 31, NCB's inventory of all goods is 102 days of purchased. We know that NCB sold products globally through related distribution companies. These 102 days are the average of the NCB's distributors how well they manage their inventory. Comparing these two numbers, (71 days and 102 days) we see that Harrison was doing well in previous time with management of their inventory. But now Harrison carrying a large amount of inventory and owes NCB \$4. 4 million for the inventory. We may ask why Harrison carrying a large amount of inventory. Here are some reasons: 1. Forecasting problems – not knowing what the customers need. This may also result in some obsolescence. 2. Forecast Bias – Just keeping the forecasts high generally on everything. 3. Sudden Demand reduction due to market place volatility or losing a key customer. 4. Inventory management problems

5. Volume discounts

If days in inventory were reduced by 10 days, we can calculate how much savings Harrison will generate. $(10 \text{ days} / 71 \text{ days}) * \$6.701 \text{ million} = \$943,802.82$

According to the income statements of Harrison, administrative cost of Harrison in 2005 amounted to 8.8% of sales. In 2004, Harrison's administrative cost is 7.4% of sales and in 2003 it was 6.9% of sales.

Harrison operated as wholesale distributor, with sales of approximately \$40 million in 2004. Reducing operating costs by 2% of sales is a feasible goal (8.8% - 6.8%). It can be achieved by stop using the new computer system which is expensive and effect the operating margin. By doing that, Harrison could save approximately \$800,000 annually and get out from its financial crisis ($0.02 * \$40 \text{ million} = \$800,000$). Conclusion

We believe that working with Harrison to reduce inventory levels and reduce operating expenses will generate the best outcome for both companies.

Harrison will overcome its financial problems, and at the same time NCB will enjoy financial stability at its larger distributor. As a result, MNC's profit margin and sales levels will remain stable or even grow in the future.