Berkshire Threaded Fasteners Company

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In February 2000, Brandon Cook was appointed general manager by Joe Magers, president of Berkshire Threaded Fasteners Company. Cook age 56, had wide executive experience in manufacturing products similar to those of Berkshire. The appointment of Cook resulted from management problems arising from the death of John Magers, founder and until his death in early 1999, president of the company. Joe Magers had only four years experience with the company and in early 2000 he was 34 years old. His father had hoped to train Joe over a 10-year period, but the father's untimely death had cut this seasoning period short. The younger Magers became president after his father's death, and he had exercised full control until he hired Cook.

Joe Magers knew that he had made several poor decisions during 1999 and that the morale of the organization had suffered, apparently through lack of confidence in him. When he received the income statement for 1999 (Exhibit 1), the loss of over $70,000 during a good business year convinced him that he needed help. He attracted Cook from a competitor by offering a stock option incentive in addition to salary. The arrangement was that Cook, as general manager, would have full authority to execute any changes he desired. In addition, Cook would explain the reasons for his decisions to Magers and thereby train him for successful leadership upon Cook's retirement.

Berkshire Threaded Fasteners Company made only three lines of metal fasteners (nuts and bolts) - the 100 series, the 200 series, and the 300 series. These were sold by the company sales force for use by heavy industrial manufacturers. All of the sales force, on a salary basis, sold all three lines, but in varying proportions. Berkshire sold throughout New England and was one of eight companies with similar products. Several of its competitors were larger and manufactured a larger variety of products. The dominant company was Bosworth Machine Company, which operated a plant in Berkshire's market area. Joe Magers had heard many people describe threaded fasteners as a "commodity" business. But he had also heard a speaker say once that the term is only used by losers in a business.

Price cutting was rare; the only variance from quoted selling prices took the form of cash discounts. Customarily, Bosworth announced prices annually and the other producers followed suit. In the past, attempts at price cutting had followed a consistent pattern: All competitors met the price reduction, and the industry as a whole sold about the same quantity but at the lower prices. Demand was very "inelastic", at least in the short run, for a "derived demand" product like metal fasteners. Eventually Bosworth, with its strong financial position, again stabilized the situation following a general recognition of the failure of price cutting. Furthermore, because sales were to industrial buyers and because the products of different manufacturers were very similar, Berkshire was convinced it could not individually raise prices without suffering substantial volume declines.

During 1999, Berkshire's share of industry sales was 12% for the 100 series, 8% for the 200 series and 10% for the 300 series. The industry-wide quoted selling prices were $2.45, $2.58 and $2.75 per 100 pieces, respectively.

Upon taking office in February 2000, Cook decided against immediate major changes; he chose instead to analyze 1999 operations and to wait for the results of the first half of 2000. He instructed the accounting department to provide detailed expenses and an earnings statement by product line for 1999 (see Exhibit 2). In addition, he requested an explanation of the nature of the costs including their expected future behavior (see Exhibit 3).

To familiarize Joe Magers with his approach to financial analysis, Cook sent copies of these exhibits to Magers. When they discussed them, Magers stated that he thought the 300 series should be dropped immediately, as it would be impossible to lower expenses on 300s as much as 23 cents per 100 pieces. In addition, he stressed the need for economies on the 200 series line.

Cook relied on the authority arrangement Magers had agreed to earlier and continued production of the three lines. For control purposes, he had the accounting department prepare monthly statements using as standard costs the costs per 100 pieces from the analytical profit and loss statement for 1999 (Exhibit 2). These monthly statements were his basis for making minor marketing and production changes during the spring of 2000. Late in July, 2000, Cook received the six months' statement of cumulative standard costs from the accounting department, including variances of actual costs from standard (see Exhibit 4). They showed the first half of 2000 was a modestly successful period.

In July 2000, Bosworth announced a price reduction on the 100 series from $2.45 to $2.25 per 100 pieces. This created an immediate pricing problem for its competitors. Cook forecast that if Berkshire held to the $2.45 price during the last six months of 2000, unit sales would be 750,000 100-piece lots. He felt that if the price were dropped to $2.25 per 100 pieces, the six months' volume would be 1,000,000. Cook knew that competing managements anticipated a further decline in activity. He thought a general decline in prices was quite probable.

Cook and Magers discussed the pricing problem. A sales price of $2.25 would be below cost. Magers wanted $2.45 to be continued, since he felt the company could not be profitable while selling a key product line below cost.

Assignment questions

1. 1.If the company had dropped the 300 series as of January 1, 2000, what effect would that action have had on the profit for the first six months of 2000?
2. 2.In July 2000, should the company have reduced the price of the 100 series from $2.45 to $2.25?
3. 3.Which is Berkshire's most profitable product line?
4. 4.What advice do you have for Mr. Magers?

Exhibit 1
Income Statement - Year ended December 31, 1999
(000)

Net sales			$10,434
Cost of goods sold			6,511
Gross margin			3,923
Less:	Selling expense	$1,839	
	General administration	653	
	Depreciation	1,359	3,851
Operating income			72
Less:	Interest expense		145
Loss before taxes			($73)

Exhibit 2
Analysis of Profit and Loss by Product - Year Ended December 31, 1999

	100 Series		200 Series		300 Series		Total
	$000	per 100	$000	per 100	$000	per 100	$000

Labor	1,293	0.61	610	0.59	688	0.70	2.591
Raw materials	1,340	0.63	774	0.75	795	0.81	2,909
Power	23	0.01	25	0.02	30	0.03	78
Repairs	18	0.01	15	0.01	10	0.01	43
Rent	186	0.09	157	0.15	187	0.19	530
Other factory costs	140	0.07	110	0.11	110	0.11	360
Total	3,000	1.42	1,691	1.63	1,820	1.85	6,511
Selling expense	911	0.43	458	0.44	470	0.48	1,839
General Administration	345	0.16	130	0.13	178	0.18	653
Depreciation	565	0.26	428	0.42	366	0.37	1,359
Interest	52	0.02	40	0.04	53	0.05	145
Total cost	4,873	2.29	2,747	2.66	2,887	2.93	10,507
Sales (net)	5,168	2.42	2,598	2.52	2,668	2.70	10,434
Profit (loss)	$295	0.14	($149)	(0.14)	($219)	(0.23)	($73)
Unit sales (100 pcs)	986,974		1,029,654		986,974		
Quoted selling price	$2.45		$2.58		$2.75		

Note: Per unit amounts are rounded here and in Exhibit 4 to simplify the presentation.

Exhibit 3
Accounting Department's Commentary on Costs

Labor: Variable. Union shop at going community rates of $4.20 per hour. (including social security taxes/compensation insurance/fringe benefits). Labor cost includes maintenance, set-up, and inspection as well as direct and indirect production workers.

Raw Materials: Variable. Ehibit 2 figures are accurate. Includes allowances for normal waste. Purchases are at marked prices.

Power: Variable. Rates are fixed. Use varies with activity. Averages per Exhibit 2 are accurate.

Repairs: Variable. Varies as volume changes within normal operation range. Lower and upper limits are fixed.

General Administrative and Selling Expenses: These items are almost nonvariable. They can be changed, of course, by management decision.

Rent: Nonvariable. Lease has 12 years to run. The lease rate, $5 per square foot (net, net, net) per year, is competitive for the area even though the plant is rented from a trust set up for the heirs of John Magers.

Other Factory Costs: This includes building service, property insurance, property taxes, light, heat and factory management. These items are nonvariable.

Depreciation: Nonvariable. Fixed dollar total. The machinery is depreciated over a 20 year life using straight line rates. About half the equipment in use is over ten years old and about half represents equipment purchased in the past ten years. The average age of the equipment is about ten years.

Interest: Nonvariable. Interest expense reflects the annual charge on equipment loans at rates averaging 6%

Exhibit 4
Profit and Loss by Product (at Standard with Variance) from January 1 to June 30, 2000

	100 Series		200 Series		300 Series		Total		Variance
	Standard per 100 pcs.	**Total $ at Standard**	**Standard per 100 pcs.**	**Total $ at Standard**	**Standard per 100 pcs.**	**Total $ at Standard**	**Standard $000**	**Actual $000**	**Favorable = + Unfavorable = -**
Labor	0.61	604	0.59	422	0.70	349	1,375	1,382	-7
Raw materials	0.63	627	0.75	535	0.81	404	1,566	1,543	23
Power	0.01	10	0.02	17	0.03	15	42	42	0
Repairs	0.01	8	0.01	10	0.01	5	23	25	-2
Rent	0.09	88	0.15	109	0.19	95	292	261	31
Other factory costs	0.07	65	0.11	76	0.11	56	197	180	17
Total	1.42	1,402	1.63	1,169	1.85	924	3,495	3,433	62
Selling expense	0.43	426	0.44	317	0.48	239	982	983	-1
General administrative	0.16	161	0.13	90	0.18	90	341	328	13
Depreciation	0.26	264	0.42	296	0.37	186	746	681	65
Interest	0.02	25	0.04	28	0.05	27	80	73	7
Total cost	2.29	2,278	2.67	1,900	2.92	1,466	5,644	5,498	146
Sales (net)	2.42	2,416	2.52	1,797	2,70	1,355	5,568	5,568	0
Profit (loss)	0.13	138	(0.15)	(103)	(0.22)	(111)	(76)	70	146
Unit sales (100 pcs.)	996,859		712,102		501,276				
Quoted selling price	$2.45		$2.58		$2.75				