Total Equipment Hire Ltd (TEH) hires out plant and equipment to construction companies and small building firms. The company has a high level of debt. **Company background** TEH has three product lines:

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| **Product line** | **Examples** | **Customer type and period of hire** | **% of revenue** |
| *Heavy equipment* | Bulldozers, cranes, diggers, excavators and concrete pumping vehicles (includes trained operator) | Large construction companies for periods of over a month | 70% |
| *Small tools and equipment* | Hand tools and small items of plant, such as generators and pumps | Small building firms for periods of less than two weeks | 20% |
| *Scaffolding* | Scaffolding | Existing customers who will also hire large or small equipment at the same time as scaffolding | 10% |

Each product line is run as a separate division, although all equipment is stored and maintained at one site, so many of the costs are incurred jointly. TEH’s equipment is of good quality, reasonably new and well maintained. The company’s support service is also good, with prompt and efficient delivery to the customer’s site for all items. As a result, the business is perceived as being above average quality and hire charges therefore include a price premium over many rivals.

Total revenue was £240 million in the year ended 31 December 2008, but is estimated to fall to around £180 million in the year ending 31 December 2009. The reduction is reasonably evenly spread, in proportionate terms, across the three divisions and is due to both volume reductions and price discounts.

**Impact of the recession**

The building and construction industry has suffered in the recession. As a consequence, demand for equipment hire has reduced very significantly in 2009 compared to 2008. There has been a significant reduction in the number of days hiring, but also there is fierce competition in the industry resulting in downward pressure on hire charges.

The key industry benchmark is a utilisation rate of 90% (i.e. equipment is being hired out nine working days in every ten) but, up to the end of 2008, TEH operated with a utilisation rate of around 80%. This lower utilisation rate was due to TEH holding a wide variety of equipment to satisfy customers’ occasional needs for infrequently used equipment. Customers were therefore attracted to TEH for all their equipment needs as a comprehensive service was provided. In 2009 TEH’s utilisation rate has fallen to 70%, compared to an industry average of 78%.

TEH estimates that it will make a loss for the year ending 31 December 2009. Operating cash flows have been negative and the company is unable to borrow further. As a result, there is doubt over whether the company will be able to make the half yearly interest payment of £15 million that is due on 1 January 2010. A board meeting has recently taken place.

**The board meeting**

Helen Chen, the finance director, opened the meeting: “We need to generate cash quickly by selling some of our equipment. I know we will make a loss on sale, but I think we need to sell off about 20% of our equipment in order to generate cash of around £60 million. Where we have more than one item of the same type of equipment we could sell off one, so we maintain our product range. We also need

to cut costs. We spend far too much on customer service and delivering equipment promptly. We need to reduce our labour and transport costs, even if the service to customers deteriorates.”

Paula Penny, a non-executive director, interrupted: “I agree that cash needs to be generated from selling equipment, but we should be more focused on closing down one division: either small tools or scaffolding. The performance of these divisions needs to be measured to decide which one to close.”

Frank Fitt, the operations director, was furious with these suggestions: “If we sell off that amount of equipment we will destroy our whole strategy, as we will lose customers who want a complete product range from one hirer. During the recession, we know we will also only raise cash for about half what the equipment is worth.”

The *managing director,* Jeff Jones, joined in: “I prefer not to sell equipment. Instead, I have entered into some tentative negotiations with a multinational shipping and transport company, International Transport and Trading plc (ITT). A central African country is having a major dam constructed and it has an urgent, but temporary, need for heavy plant and machinery. ITT has suggested a joint venture whereby, under a three year contract, we would make available up to 40% of our heavy plant and machinery.

“According to the proposed contract, this equipment needs to be available for immediate transport to Africa on request. ITT would transport the equipment to Africa and deal with the customers in return for 50% of the rental fee. ITT would collect the fees directly from the client and then pay TEH its share. It is estimated that the gross rental fees would be about 75% of the equivalent hires in the UK, but utilisation will be near 100% for requested items during their time in use on the project in Africa. ITT has offered, on signing the agreement, to make an upfront payment of £10 million to TEH in respect of our share of future hirings on the project, to help us with our short-term liquidity problem.”

**Requirements**

(a) Explain the potential impact on TEH’s strategy and operations which could arise from Helen Chen’s proposals for divestment of equipment and cost reduction. **(8 marks)**

(b) Discuss the issues to be considered in measuring the financial and non-financial performance of the small tools and scaffolding divisions in order to determine which division should be considered for closure, in accordance with Paula Penny’s suggestion. **(8 marks)**

(c) Evaluate the benefits and problems of Jeff Jones’ proposed joint venture arrangement with ITT. Identify any matters that need to be clarified between TEH and ITT before a decision on whether to proceed with it can be made**.**

**(9 marks)**

**(25 marks)**