A Meeting of the Overhead Reduction Task Force

Preparation

- ✓ A careful reading of this case is essential.
- ✓ You will be role playing one of the people in this case and will be given additional information on that role.
- ✓ In the next session, you will be a member of a task force consisting of one person from each department. The task force is charged with coming up with cuts that will reduce overhead 20%. Your task will be to both represent your particular area (e.g., production) and also to satisfy Dixon's requirement of meeting the 20% reduction.
- ✓ At the meeting, you must reach an agreement. There will be no further meetings.

Larry Williams, Comptroller for the Countertop Appliances Division of Central Foods Corporation, fretted nervously in his office. It was past five p.m. on a Friday afternoon, but his concerns about the scheduled Monday morning staff meeting had kept him at the plant after hours.

Earlier that afternoon, Mr. George Dixon, the division's new General Manager, had called a meeting of the division's functional managers. Mr. Dixon, who had been at the division for only a week, had begun the meeting by saying that his analysis of the division's financial condition had convinced him that some immediate action was necessary to stop its declining profitability. He added that he was not yet familiar enough with the division's operations to know what was needed to improve long-term profits. However, it was obvious to him that in the short-term, the division's overhead costs had to be reduced immediately or it would lose money in the current year. Mr. Dixon then told the managers he was appointing them members of a task force with the responsibility of determining how the division could cut its overhead 20% within the next four months. He suggested that they schedule a task force meeting first thing Monday morning for their deliberations. He also suggested that the task force consider "overhead" to include all costs except direct labor, direct materials, and plant fixed costs (such as depreciation, energy costs, etc.).

Mr. Dixon had concluded the meeting by saying that he was going on a much-needed two week vacation and was putting Mr. Williams in charge of the task force. Mr. Dixon had made it very clear that he expected to review a completed set of recommendations from the task force on his first day back to work. He then bid the group good day and left the room. The Division's managers, stunned by the announcement, had filed out slowly in disbelief and gone home.

Mr. Williams had lingered behind to reflect on the day's events and Mr. Dixon's sudden announcement and departure. He recalled that Dixon had mentioned to him earlier in the week that the senior management group of the Division seemed somewhat passive and self-satisfied. Williams wondered now what effect Dixon's actions would have on the group and how he, Williams, could cope with it.

Company Background

The Countertop Appliances Division had been formed six years earlier when Central Foods had bought a small, but highly successful, independent manufacturer of kitchen convenience appliances. The original company, Kitchen Help, Inc., had been a long-established firm with a limited but highly respected product line. Kitchen Help's blenders, orange juice makers, coffee grinders and percolators were well known for their high level of technical quality, and the company had developed a national reputation as a top-of-the-line manufacturer. Shortly before its acquisition by Central Foods, Kitchen Help had itself purchased a smaller company that had been one of the first U.S. manufacturers of drip-grind coffeemakers for the home market. The coffeemaker had quickly become a major Kitchen Help product.

The purchase of Kitchen Help by Central Foods had been attractive to both organizations. Kitchen Help's ability to grow had been constrained by lack of financial resources, while Central Foods had been seeking growth and diversification opportunities in markets related to food. Central Foods had identified kitchen convenience appliances as a potential growth area, especially for automatic coffeemakers, food processors, and microwave ovens. Kitchen Help's established quality image for blenders and percolators and its successful new automatic coffeemaker line made it an especially desirable acquisition, since it provided a means for entering the wider counter-top appliances market.

Immediately following the acquisition, Central Foods had quickly expanded Kitchen Help's product lines and sales organization in a major growth effort. Central had retained the Kitchen Help brand name, but had designated the new division the Countertop Appliances Division to reflect its broader product mix. A few of the more experienced Kitchen Help managers were kept with the new Division, but most of the older, senior managers had been replaced by Central personnel.

In spite of the difficulties inherent in adjusting to the Central Foods' way of doing things and in expanding the scope of its business, the Countertop Appliances Division enjoyed a rapid acceleration in sales over the next three years. The Division was able to support this growing demand with the tremendous resources which Central Foods poured into the new project. A plot of land neighboring the plant was purchased and the plant facilities were expanded to include the latest in volume production equipment.

Under the direction of John Pero, the first Division General Manager, the various functional managers were permitted to add freely to their staffs in order to meet the growing deluge of orders. The Marketing Department undertook a massive, national, prime-time advertising campaign which used well-known national personalities to introduce the new Kitchen Help products. The Product Development group expanded its efforts and began turning out new designs for more technically complex products such as microwave ovens, food processors, and electric skillets. These efforts, combined with the Kitchen Help brand's reputation for dependability, had been very useful in establishing the Division as a major factor in the countertop appliance market.

During the three-year period after the acquisition, sales grew from around $30 million, where they had been for the previous five years, to over $100 million. The number of persons employed by the Division grew from 100 to 500. In the two years immediately prior to Mr. Dixon's replacement of Mr. Pero, however, the Division's sales had tapered off and profits had begun to sink drastically. It was in response to this trend and to Mr. Pero's apparent inability to reverse it that Mr. Dixon was sent to "turn the Division around." A summary of salient financial statistics for the Division over the last six years is shown in the Exhibit.

Two factors had contributed to the Division's leveling off in sales. First was the introduction by a major competitor of two significantly improved products. The competitor began marketing a household coffeemaker that sold for about the same price as the Kitchen Help household line (average retail price was $35.00) but was able to make anywhere from two to ten cups of coffee without a change in taste, something Kitchen Help had so far been unable to do. The other machine was able to brew tea, and in light of the uncertainty surrounding coffee prices, many Countertop executives thought this was a significant advantage. In previous years Kitchen Help's coffee maker line had supplied about 30% of division revenues and about 35% of profits, but this had dropped to 19% and 22% respectively. Pero had felt that coffeemaker sales were also hurt by the explosive increase in the price of coffee. In the past two years, coffee prices had climbed from about seventy-five cents a pound to over four dollars a pound. Pero believed that the increased prices at the consumer level meant that American coffee drinkers were drinking less coffee and therefore had less interest in coffeemakers and coffee grinders.

The second competitive innovation was an improved microwave oven. While Kitchen Help's oven was one of its most profitable lines (contributing 10% of sales and 18% of profits, a year earlier) the competitor's new product line had severely cut into current oven sales at Countertop. As yet, the Product Development Department had not been able to design an oven that would match the new competing machine.

The other major factor affecting sales had been a move on the part of some competitors to price their products about ten percent below the comparable Kitchen Help products.

of these competitors manufactured their products in the United States, several of them had begun importing appliances that had been manufactured by overseas plants and licensees primarily in the Far East. The management at Countertop had resisted price competition in the belief that competitors were selling below cost and would have to increase their prices soon or be faced with continuing losses.

Kitchen Help's established reputation for quality products, its well-known name, its aggressive marketing program, and a reluctant willingness to increase volume sales discounts had allowed the Division to maintain sales at approximately the same level for the last three years. However, profits had deteriorated drastically, and Central Foods management had removed Mr. Pero when it became apparent that he was unable to rectify the Division's poor financial performance.

Mr. Pero's successor, George Dixon, had a reputation in Central Foods for being a tough, competent manager. He had spent the past three years "turning around" another large division in Central Foods. The Division had been in serious financial difficulty and Dixon had succeeded in making it profitable, thereby earning the respect of Central Foods senior management. In that situation Dixon had sold off an unprofitable product line, cut back several others, and introduced a line of new products. Mr. Dixon's entire career had been with Central Foods, primarily in manufacturing and marketing assignments.

Preparation for the Task Force Meeting

As he thought about these issues, Mr. Williams sketched out summaries of the various departmental budgets and organizations. These summaries are shown in the exhibit. Mr. Williams also wrote down a preliminary analysis of the impact of a straight 20% reduction on all departmental payrolls. He noted that if 20% of each department's budget were taken out of payroll, some departments would be completely eliminated. This brief analysis is also shown in the exhibit.

Income statement and Hiring Record Summary ($ in thousands)

Income Statements	Year 0		Year 1		Year 2		Year 3		Year 4		Year 5	
	$	%	$	%	$	%	$	%	$	%	$	%
Sales	$32,402	100	$55,350	100	$81,974	100	$100,548	100	$106,802	100	$105,790	100
Less discounts	$986	3	$1,838	3	$3,136	4	$4,286	4	$5,326	5	$6,468	6
Net sales	$31,416	97	$53,512	97	$78,838	96	$96,262	96	$101,476	95	$99,322	94
Cost of goods sold	$24,286	75	$38,434	69	$55,284	67	$68,114	68	$74,822	70	$77,134	73
Sales and Administration	$3,758	12	$8,518	15	$14,392	18	$19,952	20	$21,980	21	$20,848	20
Gross Profits	$3,372	10	$6,560	12	$9,162	11	$8,196	8	$4,674	4	$1,340	1.3
Taxes	$1,518	4	$2,964	5	$4,058	5	$3,836	4	$2,080	2	$614	0.6
Net Income	$1,854	6	$3,596	7	$5,104	6	$4,360	4	$2,594	2	$734	0.7
Number of employees												
White males	72	65	144	65	161	63	272	56	325	54	319	53
White females	36	33	71	32	84	33	160	33	199	33	198	33
Minority males	2	2	7	3	8	3	39	8	60	10	59	10
Minority females	0	0	1		3	1	15	3	19	3	25	4
Total	110		223		256		486		603		601	

Year after acquisition

Summary Budget	Overhead	20 % of overhead	# of employees	Ave. Salary (000)	Payroll as % of budget	% of current staff to equal cut
General Manager's office	$100					
Controller's office	$1,046	$209	29	$28.3	78%	26%
Personnel Office	$420	$84	12	$31.7	90%	22%
Production Dept. (overhead)	$15,720	$3,144	115	$39.7	29%	69%
Marketing Department	$7,926	$1,585	18	$26.7	6%	330%
Product Development	$4,870	$974	27	$50.0	28%	72%
Sales Department	$5,906	$1,181	105	$37.0	66%	30%
TOTAL	$35,988	$7,197	306			
Note Production is 20% of indirect labor only						
Overhead	$35,988,000	Targeted Reduction (20%)	$7,197,600			

Sales budget

Salaries, Benefits, Bonuses	$3,886
Travel expenses	$1,306
Entertainment	$184
Transportation equipment	$400
Administrative expenses/supplies	$130
TOTAL	**$5,906**
105 EMPLOYEES	

Personnel

Salaries	$380
Supplies	$30
Tavel	$10
TOTAL	**$420**
12 employees	

Product Development

Salaries	$1,350
Supplies/Subcon.	$2,720
Equipment	$800
TOTAL	**$4,870**
27 employees	

Division Controller

Salaries	$820
Computer Time Sharing	$160
Supplies	$45
Travel	$10
Telephone and Supplies	$11
TOTAL	**$1046**
29 Employees	

Marketing

Salaries	$480
Supplies	$20
Telephone	$10
Travel	$16
Advertising	$7,400
TOTAL	**$7,926**
18 employees	

Production

Direct Labor	$12,416
Direct Materials	$44,136
Overhead	
Indirect Labor	$4,560
Indirect Materials	$11,160
Total Overhead	**$15,720**
Depreciation	$4,862
Bldg./Grounds	**$84**
TOTAL	**$77,218**
416 Employees	

William's Preliminary Analysis of Financial Trends

1. In the first year after the acquisition there was a rapid jump in overhead. It jumped from 12% to 15% and increased steadily thereafter.
2. The percentage of discounts to large retailers steadily rose from year zero. If it had stayed at 3%, then it might be assumed that the remaining 3% would be profit. It requires a greater sales and marketing effort, however, to achieve these sales to the smaller retailers or non-discounted market.
3. There was a large jump in the employment in year one mostly in sales and administration

Preparation

- ✓ You have been assigned this role. Please study your role very carefully.
- ✓ At the meeting, you must reach an agreement; there will be no further meetings.

The Division Sales Manager- Mort Burns

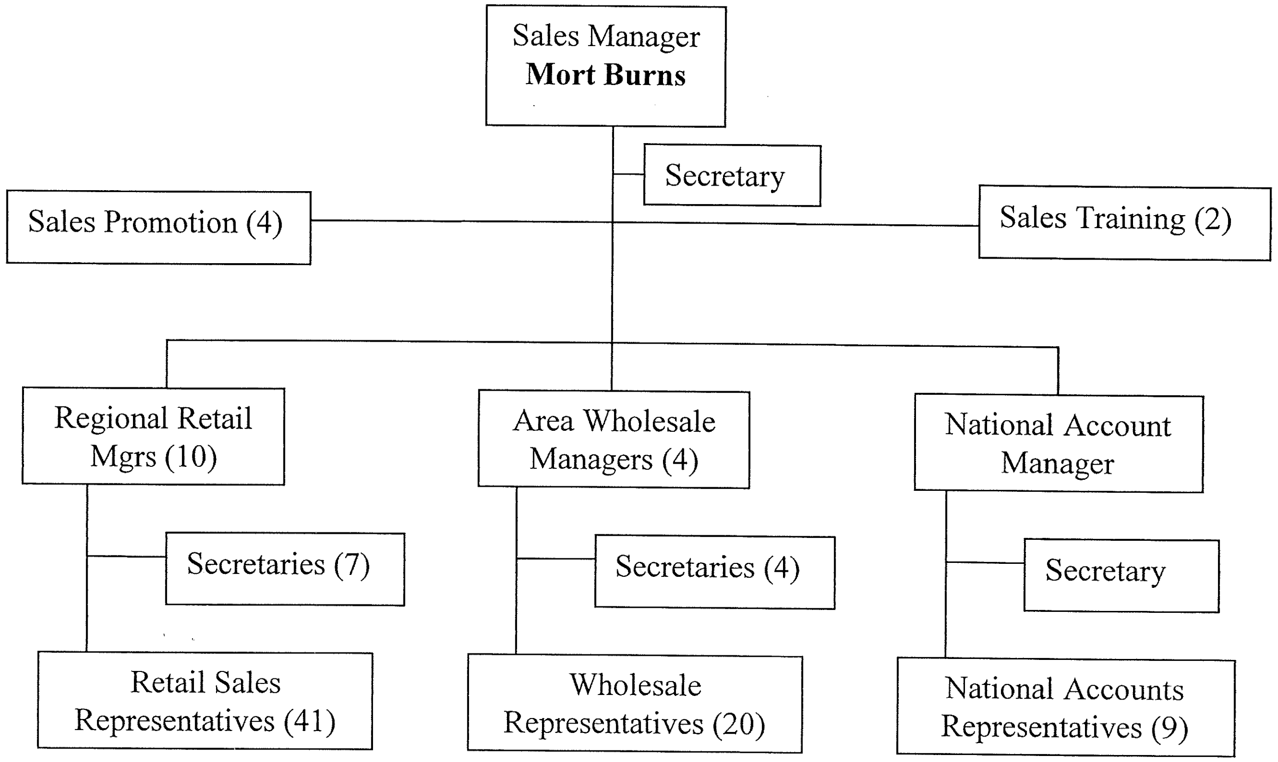
Age: 40
Education: BA, MBA
Years Employed: Central (3); Countertop (1)

You had been with Central Foods for two years before accepting your current assignment a year earlier. You have an MBA and have worked for several different companies in both consumer and industrial sales. At Central Foods you had been a National Account Sales Manager at another large division prior to coming to Countertop. You are viewed by most people as being a very experienced and capable sales manager. The top sales position at Countertop was clearly a promotion for you and you feel you need to perform well, particularly since you have accepted the assignment with the understanding that you will improve the division's sales.

You have estimated that approximately half of the Division's sales come from direct requests for your products. You think that the balance of the sales derive from shelf-side decisions as consumers compare the Kitchen Help machines with others in the retail stores. Most countertop appliances are sold through large discount houses, smaller general purpose stores, and appliance/hardware stores. (The remaining small percentage of sales are to institutional customers like hospitals and restaurants.) Countertop employs national account representatives to service the large discount chains. Retail sales representatives work with smaller store managers as they make shelf space allocations. You feel that the Division's salesmen have little impact on the more independent appliance and hardware store owners, who account for about 15% of final demand. Actual sales to these stores and to the smaller discount houses are routed through large, nationwide distributors, while the large chains buy directly from the Division.

You have organized your sales force into three parallel wings, one each to serve the national chains, the smaller local department stores and discount houses, and the wholesalers. The need to manage national, local, and wholesale aspects of the distribution process complicates your job, but you aren't certain that a smaller sales force could not fill all three roles adequately.

As the Division Sales Manager, you have responsibility for supervising the work and the training of the Division's direct sales representatives both to the retail outlets and to the wholesalers. You also work closely with the Marketing Manager on cooperative advertising programs for the large discount houses. generally cordial although you have disagreed on several occasions over routine matters.


Sales Manager
Mort Burns
Secretary
Sales Promotion (4)
Sales Training (2)
Regional Retail Mgrs (10)
Secretaries (7)
Retail Sales Representatives (41)
Area Wholesale Managers (4)
Secretaries (4)
Wholesale Representatives (20)
National Account Manager
Secretary
National Accounts Representatives (9)