

THE CRIMSON PRESS CURRICULUM CENTER THE CRIMSON GROUP, INC.

Tru-Fit Parts, Inc.

Tru-Fit Parts, Inc., manufactured a variety of parts for use in automobiles, trucks, buses, and farm equipment. These parts fell into three major groupings: ignition parts, transmission parts, and engine parts. Tru-Fit's parts were sold both to original-equipment manufacturers (the "OEM" market) and to wholesalers, who constituted the first link in the channel of distribution for replacement parts (the "after-market" or "AM").

As shown in Exhibit 1, Tru-Fit had a manufacturing division for each of its three product groupings. Each of these divisions, which were treated as investment centers for management control purposes, was responsible not only for manufacturing parts but also for selling its parts in the OEM market. Also, each manufacturing division sold parts to the fourth division, AM Marketing. This division was solely responsible for marketing all Tru-Fit parts to AM wholesalers. It operated several company-owned warehouses in the United States and overseas. AM Marketing was also treated as an investment center.

Before elimination of intracompany sales, the sum of the four divisions' sales was about \$1 billion a year. Of this, approximately \$260 million was attributable to the Ignition Parts Division, \$200 million to the Transmission Parts Division, \$180 million to the Engine Parts Division, and \$360 million to AM marketing. After elimination of intracompany sales from the manufacturing divisions to AM Marketing, outside sales constituted almost one-third of the manufacturing divisions' volume. Top management's goal was to increase to 50 percent the AM portion of outside sales from the present level of 45 percent.

Within each manufacturing division each plant also was treated as an investment center. OEM sales were credited to the plants, which maintained finished goods inventories; shipments to OEM customers were made directly from the plants. A plant's ROI target was based on budgeted profit (including allocations of division and corporate overhead and an imputed income tax) divided by actual beginning-of-year "net assets" (defined to be total assets less current liabilities). Actual ROI was actual profit divided by actual beginning-of-year assets.

The reason that the profit figure allocated overhead and taxes was so that the figure would correspond to the manner in which profit was calculated for shareholder reporting purposes. According to top management this gave a plant manager a clearer perspective of the plant's contributions to the corporate "bottom line".

Beginning-of-year net assets was used because added investment in a given year might result in little, if any, incremental profit in that year, but rather would increase later years' profits. Top management felt that such investments might not be proposed if investment center managers were penalized (in the form of lower ROI) in the first year of the new investment. Because the investment base for the year was "frozen" at the beginning-of-year level, maximizing profits during the year was equivalent to maximizing ROI. (AM Marketing's ROI was measured in the same manner as was the plants' ROI.)

The OEM sales department in each manufacturing division was responsible for working with OEM company engineers to develop innovative and cost-effective new parts and for servicing customer accounts for parts already being supplied the OEM by Tru-Fit. Each of these OEM sales departments was treated as a revenue center. Because of the differing nature of OEM and AM marketing, top management did not want to consolidate AM and OEM activities in a single organization. Even OEM marketing was not consolidated, because each division's OEM marketers tended to work with different people within a given customer's organization. Moreover, two of the three manufacturing divisions had been independent companies before being acquired by Tru-Fit, and so there was a tradition of their doing their own OEM marketing.

This case was prepared by Professor James S. Reece. It is intended as a basis for class discussion and not to illustrate either effective or ineffective handling of an administrative situation.

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