Case 4: Orrington Office Supplies (OOS)

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Case Question

- Our client, OOS is a leading manufacturer of office products in 1992, with sales of $275M in 1991. They have strong brands, invest heavily in marketing / advertising, and have grown through prod. line extensions and four key acquisitions
- OOS is organized into 5 autonomous divisions, but shares manufacturing and marketing functions. Shared costs (45% of total) are allocated on a % of sales method. There are three plants running at a current capacity utilization is 50%
- Analysts predict OOS is a potential acquisition target given its strong balance sheet but weakening earnings. They are publicly traded and have little long-term debt. As a potential investor, how would you improve its profitability.

6
Quants.

7
Structure

CPG

Profit Imp.
Cap. Exp.

Case tracker

- **Industry:**
  Consumer Products
- **Level of Difficulty:**
  Medium/Hard
- **Case format:**
  Improving profitability
- **Concepts being tested:**
  - Capacity expansion /contraction

Fit Questions

Spend first 15 min on fit

- Name a time when you have caved under pressure. How did you recover?
- Describe a time you have disagreed with your supervisor.
- How do you keep abreast of current events?

Guide to interviewer

- This case combines public math with key qualitative insights. At it's core, this is a case about rapidly declining profitability and finding ways (i.e. plant consolidation) as a way to improve its future performance.
- The interviewee should recognize that this is a performance improvement case and will look for ways to improve profitability. They will have to use the information provided up front to determine that capacity contraction is the prime means to improve profitability.
- Because there are many potential avenues to explore, the interviewer may need to nudge along the interviewee.

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Clarifying answers and case guide

Clarifying answers to provide

Industry trends

- U.S. Office supplies market grew at 5% CAGR historically. In 1990 and 1991, the market declined at 5%/yr.
- Superstore channel is becoming increasingly critical
  - Gained 10 share pts in past 2 yrs
  - Typically discount products 30% to small retailers/dealers
- Superstores are aggressively substituting private label products for traditional brand names

Client Characteristics

- Broader product line than competitors (12.5K SKUs vs. 4-5K for competitors)
- Distribution: 75% wholesalers, 15% superstores, 10% end customers
- Most profitable product is a high-end branded stapler
- Staples, Inc. is OOS's largest customer

Guide to case / Guide to handouts

A sample case structure would include the following:

1) Examination of OOS's recent performance to deep-dive declining profits.
2) Discussion of potential for potential for plant consolidation.
3) A profitability analysis of plant consolidation.

Exhibit 1– Hand out after interviewee asks about profitability

Exhibit 2– Hand out after interviewee concludes that plant consolidation is a worthy area for a "deep-dive." This should be evident from the case introduction, but provide hints if necessary.

Exhibit 3– Following the discussion of plant closures, the interviewee should ask about the cost structures about the various plants.

- If interviewee asks about revenues, gently suggest to calculate on a per SKU basis (*e.g.*, total sales / total SKUs = $22K / SKU).

Key elements to analyze

Profitability

- Using Exhibit 1, have a discussion about why the slopes for sales and profits differ as time elapses

Capacity utilization

- Using Exhibit 2, qualitatively discuss the potential options for plant consolidation.

Plant closures

- Using Exhibit 3, crunch the numbers on the profitability of a possible plant closure?

Notes to interviewer

- Exhibit 1 - interviewee should not only be able to interpret the data on this slide, but also come up with two insights:

  1) the fact profits have been declining more steeply than sales reflects the fixed-cost nature of this business, and

  2) the reason that sales did not grow at a faster clip than profitability during the 1980s likely reflects a strategy to grow through acquisitions, which prevented OOS from seeing the gains through economies of scale that one would normally expect in a business such as this

Notes to interviewer

- Interviewee should recognize the Chihuahua plant is close to having capacity to produce OOS's 12.5K SKUs. Either OOS can close that plant and move all production to the US, or it could close the US plants, discontinue 500 SKUs and move production to Chihuahua.
- Insightful interviewees will note that Chihuahua is the most feasible strategy, but will ask to see fixed and variable cost data; if so, then produce Exhibit 3.

Notes to interviewer

- They should have identified that the Chihuahua plant is the most feasible, but there are some key considerations.
- **Key questions to ask:**

  How would this change revenues? (currently $275M / year)

  How would this change production costs? What are they now?

  How would this change pre-tax profits (currently $25M /year?)

Calculations

Math questions

1. How would consolidating to Chihuahua change revenues? (currently $275M / year)
2. How would this change production costs? What are they now?
3. How would this change pre-tax profits? (currently $25M /year)

Calculations

1. Revenues: Each SKU earns annual revenues of $22K ($275M divided by 12,500 SKUs)

   therefore, eliminating 500 SKUs will decrease annual revenue by $11M, or 4%

2. Prod. costs: Each plant currently has the following annual costs, totaling to $136M

   Chihuahua: $20M + ($4K * 4.5K SKUs) = $20M + $18M = $38.0M

   Michigan: $15M + ($7.9K * 5K SKUs) = $15M + $39.5M = $54.5M

   New Jersey: $18M + ($8.5K * 3K SKUs) = $18M + $25.5M = $43.5M

   Consolidating revenues to Chihuahua will reduce annual costs by 50% to:

   Chihuahua: $20M + ($4K * 12K SKUs) = $20M + $48M = $68.0M

3. Profits: We have reduced costs by $68M and lowered revenues by $11M, thus increasing profits by $57M, to a total of $82M, which more than triples them.

Solution and recommendations

Solution & Recommendations

- Overall, our client should eliminate 500 SKUs and consolidate all production to the Chihuahua plant to raise annual profits from $25M to $82M.
- The client should also consider several qualitative issues:
  - Implementation Timeframe: Will not be done tomorrow.
  - Relationships with Union: If organized labor is part of our production employee pool in the two plants that we are going to close, we will need to address that situation.
  - Changes in Distribution and Warehousing: We will need a carefully-developed transition plan.
  - Purchasing: We will need to transition to a strong central purchasing department, rather than smaller local ones.
  - Culture: Communicating the change properly is key, and we will need to ensure that morale does not take a “nosedive”

Bonus/Guide to an Excellent Case

- Excellent interviewees need to recognize what macroeconomic issues are beyond the scope of the client’s control and then quickly dive into the plant consolidation, then analyze the cost structures
- Additionally, common sense and basic familiarity with manufacturing operations should guide the successful interviewee to some or all of the qualitative issues provided

Exhibit 1: OOS Sales / profit trend

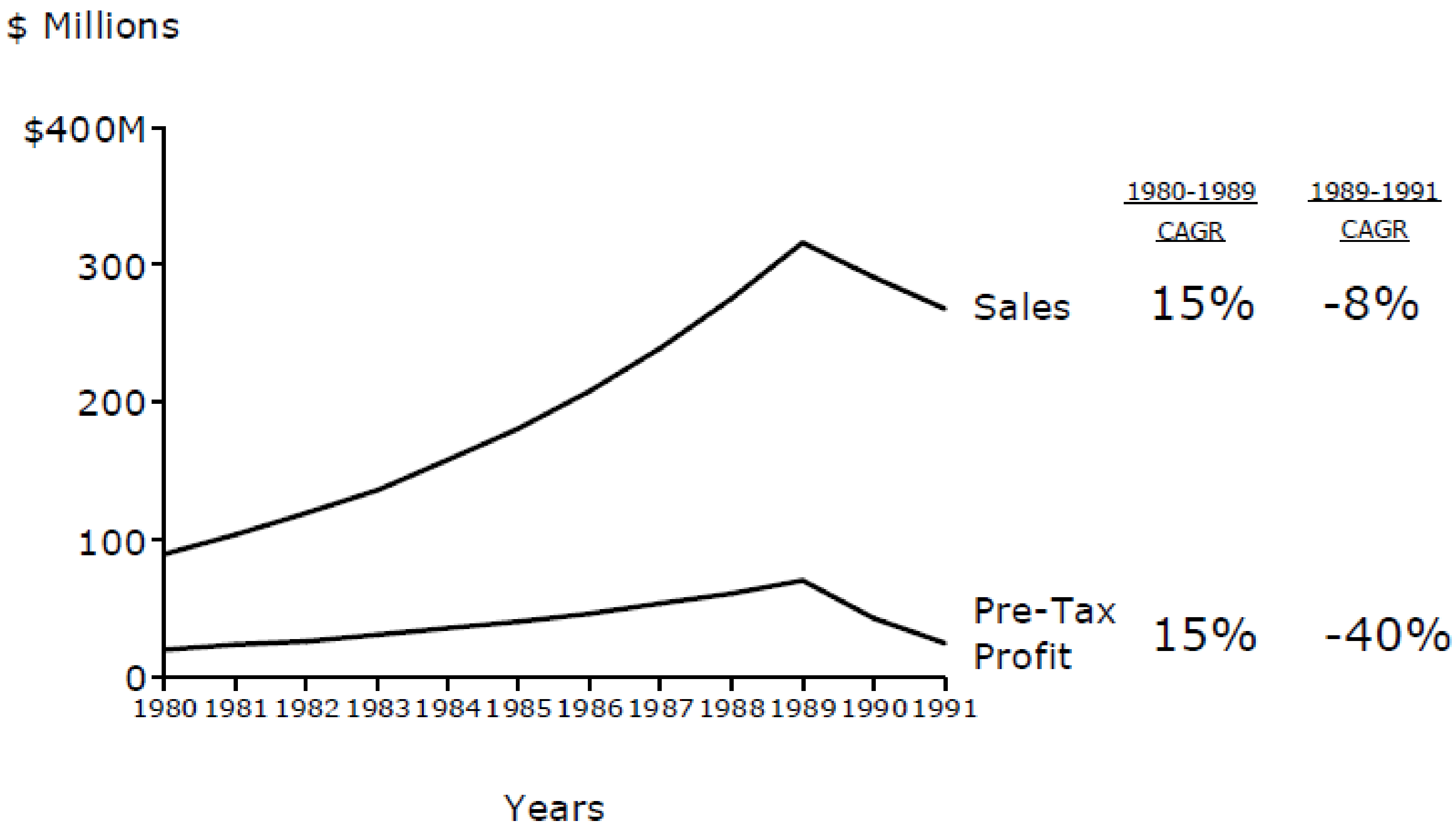

Exhibit 2: Overview of OOS production plants

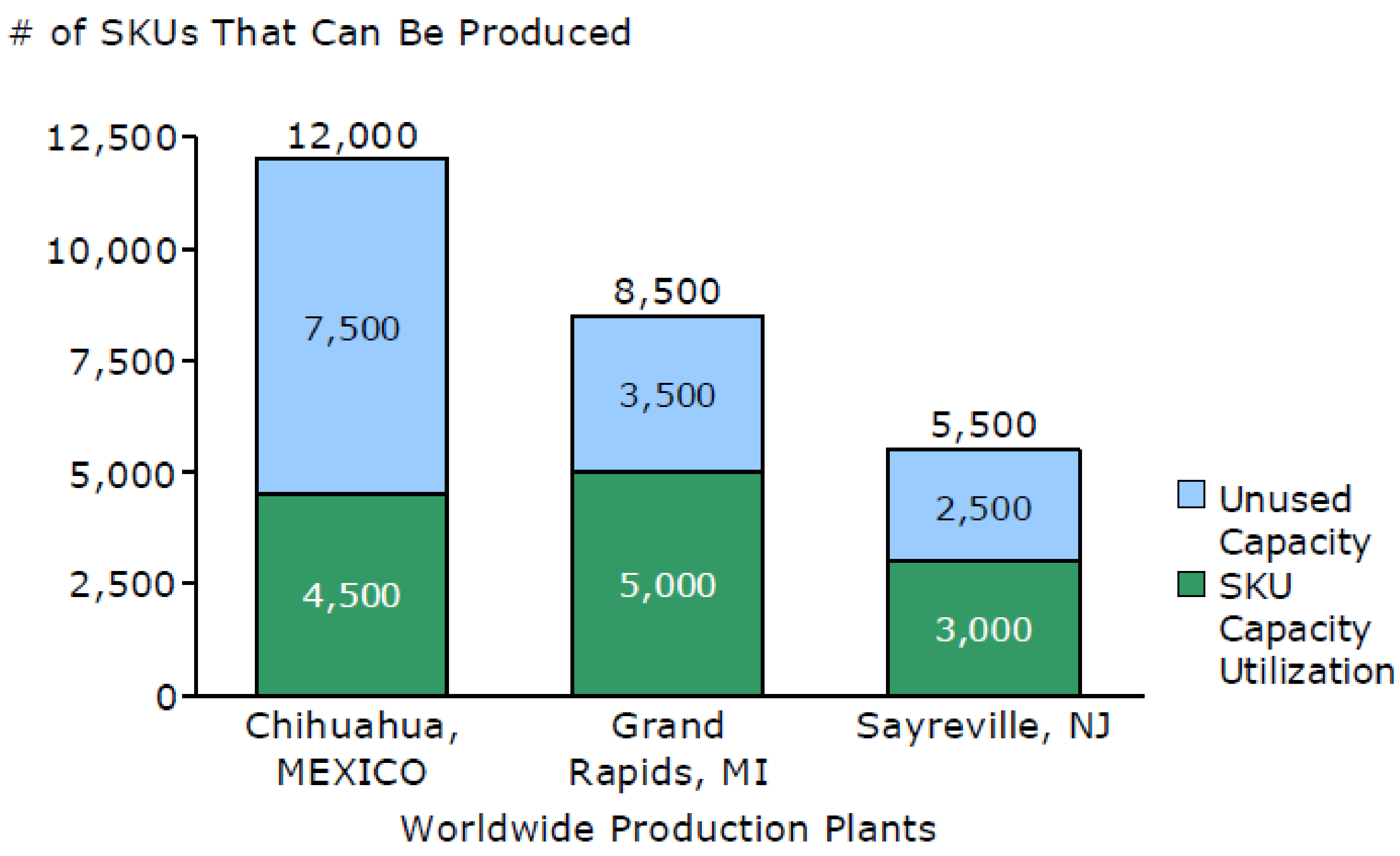

Exhibit 3: Plant operating costs