Jewel of the Nile

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Section V
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To: Janelle, Kevin and Phillipe
From: Haseeb Afridi, Advisor
Re: Production Decision

You are faced between the decision to accept or reject the offer made by Carolina's Design and Fashion; 400 units priced at $89 per unit. I recommend that you accept the offer with the following reasons.

1. *Additional Income* – Currently, you are producing at break-even with only 20% of your production capacity being used. This means that, for the 10 hours of work per week that each of you input into the business, you do not get to draw any salary because there is nothing to take out. With the accepted offer, the three of you will be able to split $7260 between the three of you for your efforts.
2. *Production Capacity* – Currently, you are producing at 20% capacity. This means that you are not capitalizing on your business' potential for producing income. Accepting the offer will allow you to fully utilize the money invested into operations. Not only will you receive higher income, your business will look more attractive.
3. *Potentially New Customer* – Not only will you be earning more income, you will be building relations with a customer that will be purchasing most of the goods you produce; 400 units of a potential total of 600 units; 66.67% of total sales. Large customers tend to provide income at lower fixed and variable costs, as this can be seen through the delivery costs of providing goods to Carolina's Design and Fashion; $800 for 400, or $2 per unit, rather than $10 per unit. The large order saves your company $3200 in variable costs.

Although there are many positives with providing goods to the new customer, there are some potential negatives with providing goods at a lower price.

1. *Existing Customer Expectations* – Existing customer are purchasing goods at $109 per unit. If they were to learn that a new customer is being provided the same goods at $20 cheaper, there would be a negative impact on sales from existing customers as well as a potential impact on the brand image on your company.
2. *Increased Dependence* – By accepting the new offer, Carolina's Design and Fashion will be purchasing 2/3 of your business output. This may force you to become dependent on their company for sales as they are purchasing a large percentage of the products that you produce. This can open your business up to complications in the future if Carolina's Design and Fashion chooses to use this information as a tool.

Although negatives do arise with the acceptance of the new contract, your business relatively underperforms as a business; you produce net incomes of next to nothing, produce at only 20% of your potential production and do not get to net any salary from your business. Initiating the deal with Carolina's Design and Fashion will bring new life and hope to your business and will potentially open your business up to new possibilities in the future.

Figure 1: Business Prior to Carolina's Design and Fashion; Rejecting the Offer

Selling Price	$109.00	per unit	
Variable Cost			
Royalty to Designer	$10.00	per unit	
Donation	$10.90	per unit	
Labour Cost	$50.00	per unit	
Shipping Costs	$10.00	per unit	
Total Variable Cost	$80.90	per unit	
Contribution Margin	$28.10	per unit	
Fixed Costs			
Rent, Utilities, etc.	$1,700	per year	
Web Designer	$2,400	per year	
Staff Accountant	$1,000	per year	
Depreciation	$500	per year	
Total Fixed Costs	$5,600	per year	
Produced Units	199.28826	or	200
Operating Income	$20		

Notes:

- Donation is 10% of the Selling Price, as per case facts
- Web Designer is paid $200 per month, which comes out to being $2400 for the year
- Depreciation is assumed to be annually, as it is not indicated in the case facts
- Break-even is at 199.29 units; the company barely broke even, and therefore it is safe to assume that they produced 200 units to produce $20 in net income
- Note that the company produces at 20% of maximum production, and therefore the inference can be made that, because the company currently produces 200 units, at 100%, the company would produce 1000 units.

Figure 2: Business After Accepting Carolina's Design and Fashion Order; Accepting the Offer

Carolina's Design and Fashion		
Selling Price	$ 89.00	per unit
Variable Cost		
Royalty to Designer	$ 10.00	per unit
Donation	$ 8.90	per unit
Labour Cost	$ 50.00	per unit
Total Variable Cost	$ 68.90	per unit
Contribution Margin	$ 20.10	per unit
Produced Units	400	units
Contribution to Income	$ 8,040.00	
Previous Customers		
Selling Price	$109.00	per unit
Variable Cost		
Royalty to Designer	$10.00	per unit
Donation	$10.90	per unit
Labour Cost	$50.00	per unit
Shipping Costs	$10.00	per unit
Total Variable Cost	$80.90	per unit
Contribution Margin	$28.10	per unit
Produced Units	200	units
Contribution to Income	$5,620.00	
Fixed Costs		
Rent, Utilities, etc.	$ 1,700.00	per year
Web Designer	$ 2,400.00	per year
Staff Accountant	$ 1,000.00	per year
Depreciation	$ 500.00	per year
Shipping Expense	$ 800.00	per year
Total Fixed Costs	$ 6,400.00	per year
Operating Income	$ 7,260.00	

Notes:

- Similar to figure 1, donation is 10% of sales price
- Because the new order will only need a lump-sum shipping fee of $800, the fee is indicated under the fixed cost section rather than the variable cost; therefore, the shipping expense is solely the result of the new order that is being shipped to Carolina's Design and Fashion