To: Janelle, Kevin and Phillipe, Owners of Jewel of the Nile

From: Haseeb Afridi, Advisor

Re: Production Decision, Carolina’s Design and Fashion bid offer

Dear owners of Jewel of the Nile. I am writing this report for you today regarding Carolina’s Design and Fashion bid offer of purchasing 400 units at $89 per unit. I will be dissecting the current production constraints that your company currently faces and whether it is smart to accept the offer set out by Carolina’s Design and Fashion.

There are two main options that your company can take. The first is that you, the owners of Jewel of the Nile, reject the offer set out by Carolina’s Design and Fashion; producing 400 units at a reduced price of $89 per unit. The second option is to accept the offer set out by Carolina’s Design and Fashion.

**Option 1: Reject the Offer**

The first option would be to reject the offer set out by Carolina’s Fashion and Design.

Outcome:

To begin, we must determine your company’s current financial position. The following figure breaks down the main instruments of your current financial position:

|  |  |  |  |
| --- | --- | --- | --- |
| **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 |  |  |

The above is the current financial position of the company. The derivation of the units and numbers are provided in the index under Figure 1. Here, we can see that the company barely breaks even. This is what the company would look like if you decided not to go ahead and produce for Carolina’s Fashion and Design.

Analysis:

There are a multitude of pros and cons when it comes to rejecting the offer set out by Carolina’s Fashion and Design

Pros:

* Contribution Margin: By rejecting the offer, Jewel of the Nile maintains a higher contribution margin; the contribution margin is 25.78% (28.1/109). This larger contribution margin can be used to show that the company is more effective at producing and selling the products that they create relative to what it may have been if they accepted the offer.
* Current Customers: By accepting the offer, you would be providing our goods at a cheaper price to customers who may or may not be loyal to us. This will be harmful to us if our loyal customers were to learn about this. If our current and loyal customers were to find out, there may be retaliation from the customers who are already paying top dollar, and you may hurt our business and brand image. Declining the offer means that you maintain the positive brand image that you are already upholding.

Cons:

* Forgone Income: By rejecting the offer, you are giving up potential income that could come in handy to you, the owners. Currently, the company barely breaks even at approximately 200 units of sales, which results in an operating income of $20. Carolina’s Fashion and Design is proposing to purchase units at $89 per unit, which will come down to a contribution margin of $18.10 per unit. At 400 units, your company is giving up $7240 of income that it could have otherwise.
* Loss of a Large Customer: Your business is currently producing at 20% of it’s maximum capacity. At 200 units, we can determine that the maximum capacity of the company is 1000 units. By rejecting the offer set out by Carolina’s Design and Fashion, you will be letting go of a potential customer who will be purchasing twice as much goods as what you are already selling. This is detrimental as, being a relatively underproducing company; 20% of maximum production, it would be wise to attract more customers, especially when they are looking to make huge purchases such as that of Carolina’s Design and Fashion.

The above was determined by the information that was provided by yourselves. Donation was 10% of the selling price, which averaged at $109 per unit; donations averaged $10.90 per unit. The web designer was paid $200 per month, which comes out to $2400 per year. Depreciation is $500, but it is not stated whether this is monthly or yearly. It is assumed that the depreciation is for the year. It is indicated that the company barely breaks even, and therefore, the produced units is the fixed costs divided by the contribution margin per unit; 5600/28.1=199.29 or approximately 200 units.