Richard Ivey School of Business
The University of Western Ontario

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AI LI INDUSTRIAL COMPANY LTD.

Joanna Wong, Frederick Chan and Ileana Funez wrote this case under the supervision of Professor Peter Bell solely to provide material for class discussion. The authors do not intend to illustrate either effective or ineffective handling of a managerial situation. The authors may have disguised certain names and other identifying information to protect confidentiality.

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Jing Zhang, head of the key account team at Ai Li Industrial Company Ltd. (Ai Li)[1] was contemplating a call she had just received from a major North American department store. Ai Li, a manufacturer of premium colour cosmetics, specialized in the sale of individual cosmetic items, such as eyeshadows and lipsticks, through distributors and wholesalers. However, Ai Li's chief executive officer (CEO), Lin Wong, had recently decided on a strategic shift for the company. He believed the company needed to focus on the growing cosmetic kits segment and to develop closer relationships with end buyers.

Zhang had just been on the telephone discussing the possibility of bidding for a new account with a major North American department store. The account would involve the manufacture of compact cosmetic kits for the upcoming holiday season. Although the potential benefits from the considerably large order would be significant, it would require one-third of Ai Li's nearly full manufacturing capacity. Jing Zhang wondered whether bidding on the order was worthwhile.

AI LI INDUSTRIAL COMPANY LTD.

Ai Li had been in operation for 10 years and had enjoyed considerable success, with products being exported to more than 30 countries. When it first began operations, Ai Li had a sales office in Hong Kong and a production facility in Dong Guan on the south coast of China. This facility was capable of handling the entire production procedure, including in-bound logistics, quality control, assembly, packaging and out-bound logistics. With increased demand after seven years, Ai Li added a new support facility in Huizhou that was responsible for raw materials handling and partial assembly of goods. Although the new facility was located in inner China, far from the south coast, the reduced labour costs offset the increased transportation costs required to ship materials to Dong Guan to be finished. One year after the introduction of the Huizhou facility, Ai Li acquired a third facility in Liuzhou, which functioned similarly to the Huizhou facility.

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[1] *This case describes a real situation but has been disguised at the request of the firm.*

Papel reciclado

During the past year, Ai Li had been working near full capacity but Wong believed increased profitability was possible through a re-evaluation of current strategy. He noticed that the industry was shifting its focus to cosmetic kits and away from individually packaged items. Wong had already been contacted several times throughout the year by purchasing offices of renowned worldwide retailers seeking direct contracts. Because of these new developments in the industry, Wong decided to set up a key account team to manage potential orders and to try to shift the company's focus from selling individual items through distributors, to selling kits directly to retailers. Jing Zhang, a newly graduated MBA student was assigned to head this team.

THE COLOUR COSMETICS INDUSTRY

The colour cosmetics industry had recently achieved tremendous growth in the North American market, and the trend was expected to continue. New product launches were very successful, with consumers responding favourably to colour variety and product diversification. In particular, North American consumers were responding to the convenience of compact colour cosmetic kits. These kits were usually small in size and contained all the éssential make-up items necessary for the day, such as eyeshadow, mascara, eyeliner, blush and lip gloss. Consumers enjoyed the idea of being able to slip their compact kits into their purses in the morning and conveniently pulling them out for touch-ups during the day. These compact kits also had the added advantage of colour coordination, as consumers were able to choose kits that were specially suited for their skin tone and/or eye colour. Retailers had begun merchandising these kits as holiday gifts to take full advantage of the trend..

THE NEW ACCOUNT OPPORTUNITY

The potential client, a major North American department store, wanted to offer two different kits, as described in Exhibit 1. Kit A was to provide a complete make-up solution for the day and would include one eyeshadow, one tube of mascara, one eyeliner pencil, one blush and one lip gloss. Kit B was to provide only an eye make-up solution and would include one eyeshadow, one mascara and one eyeliner. In order to produce these kits, each item would have to be manufactured at either the Dong Guan, Huizhou or Liuzhou facility, and the individual items would then have to be shipped to the Dong Guan facility for assembly into kits.

Ai Li was already working near full capacity, consequently pursuing this new opportunity would require that it forfeit sales from existing accounts and reject all new accounts for the next four months. These losses would still occur even if the bid was not won, because resources would need to be focused on preparing for the bid. According to a reliable source, Ai Li had an 80 per cent chance of winning the bid, although it was well known that companies had lost bids in the past due to quality concerns. In order to analyze the risks and benefits, Zhang decided to examine data both from the past four months and from future production plans (see Exhibits 2, 3, 4 and 5). The options seemed clear: Ai Li could either maintain the status quo and plan its production without the new account, or it could plan production with the new account, recognizing that some existing orders would have to be abandoned or outsourced.

Exhibit 1

PROPOSED KITS

Kit A	Kit B
Eyeshadow - Mudslide Mascara - Ebony Eyeliner - Cocoa Blush - Peach Lip gloss - Mocha	Eyeshadow - Snowflake Mascara - Ebony Eyeliner - Midnight
Package: $1 Packing labour 0.1 hrs	Package: $0.50 Packing labour 0.1 hrs

Note: All figures are in Hong Kong dollars (HKD). As of May 9, 2007, 1HKD = Cdn$0.141407.

Exhibit 2

AI LI INDUSTRIAL COMPANY LTD.: PRODUCT DATA

Name	Unit Price	Monthly Volume	Labour Hours per Unit	Material Cost per Unit
Eyeshadow - Mudslide	$7.15	114,000	0.82	$3.19
Eyeshadow - Smoke	$7.15	87,000	0.82	$3.02
Eyeshadow - Snowflake	$7.15	208,000	0.77	$3.15
Mascara - Ebony	$8.00	72,000	0.74	$3.82
Eyeliner - Midnight	$4.60	91,500	0.4	$0.62
Eyeliner - Cocoa	$4.60	110,000	0.4	$0.66
Blush - Peach	$6.50	180,000	0.79	$2.54
Blush - Rose	$6.50	64,000	0.79	$2.62
Lip gloss - Cherry	$6.00	470,000	0.58	$2.76
Lip gloss - Mocha	$6.00	303,000	0.58	$2.80

Exhibit 3

TRANSPORTATION COSTS PER ITEM FROM HUIZHOU OR LIUZHOU TO DONG GUAN

Product	Huizhou	Liuzhou
Eyeshadow - Mudslide	0.21	0.25
Eyeshadow - Smoke	0.21	0.25
Eyeshadow - Snowflake	0.21	0.25
Mascara - Ebony	0.34	0.45
Eyeliner - Midnight	0.14	0.18
Eyeliner - Cocoa	0.14	0.18
Blush - Peach	0.21	0.34
Blush - Rose	0.21	0.34
Lip gloss - Cherry	0.29	0.36
Lip gloss - Mocha	0.29	0.36

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Exhibit 4

PRODUCTION CAPACITIES AND LABOUR COSTS PER PLANT

	Dong Guan	Huizhou	Liuzhou
Capacity (units/month)	450,000	400,000	250,000
Labour cost/hour	4.80	3.80	3.00

Exhibit 5

AI LI'S EXISTING MONTHLY PRODUCTION PLAN

	Dong Guan	Huizhou	Liuzhou
Eyeshadow - Mudslide	–	114,000	–
Eyeshadow - Smoke	87,000	–	–
Eyeshadow - Snowflake	–	208,000	–
Mascara - Ebony	72,000	–	–
Eyeliner - Midnight	16,000	–	75,500
Eyeliner - Cocoa	–	–	110,000
Blush - Peach	21,600	158,400	–
Blush - Rose	37,200	26,800	–
Lip gloss - Cherry	470,000	–	–
Lip gloss - Mocha	–	–	303,000