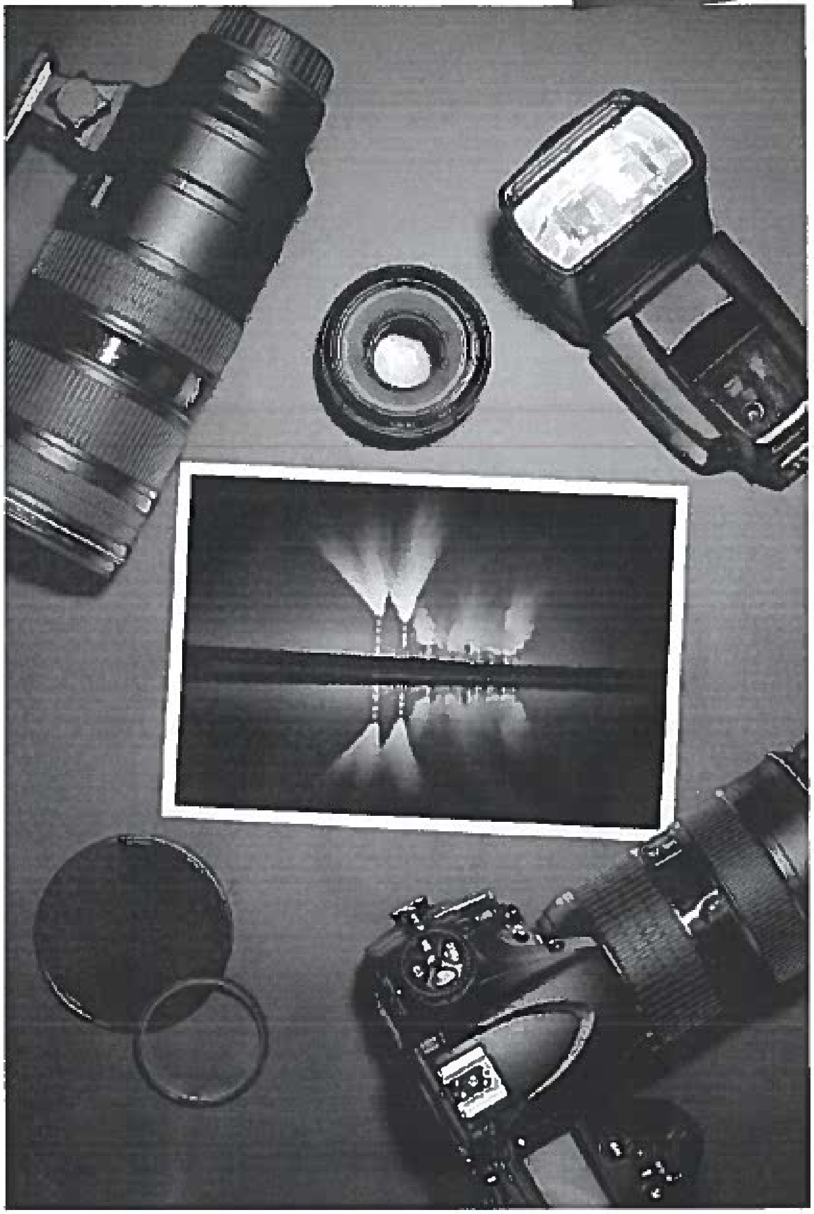
Case Studies

8-1 Image Manufacturing's Rebate Offer

Misuse and abuse of trade discounts infringe on fair trade laws and can cost companies stiff fines and legal fees. One way to avoid misuse is to establish the same discount for everyone and give rebates based solely on volume. Image Manufacturing, Inc., uses this policy for parts sales to companies that manufacture cameras. For example, one digital camera component, a special hinge, sells for $3 to a company buying 15,000 pieces per month. In an effort to run more cost-efficient large jobs and capture market share, Image Manufacturing will give an incentive for higher volume. It offers a 5% rebate on orders of 20,000 pieces per month, or a 17-18 cents apiece rebate for orders of at least 22,000 pieces per month. The increased volume needed for a rebate is determined by market research that tells Image Manufacturing factors such as the volume a customer is capable of ordering per month and the volume and cost of the same part a customer currently buys from other suppliers. The rebate amount is determined by Image Manufacturing's profit margin and the company's ability to acquire sufficient raw materials to produce larger volumes without raising production costs. In some industries this is called a bill-back because the buyer receives credit toward the next order rather than a rebate check.

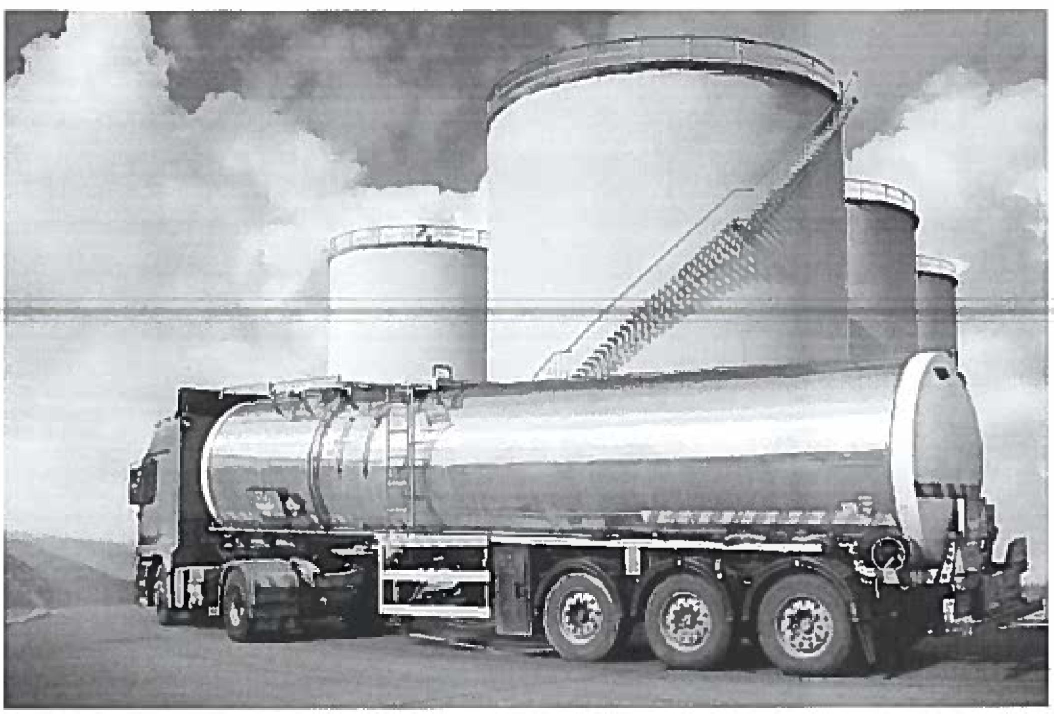


1. Complete Cameras, Inc. currently orders 15,000 hinges per month from Image Manufacturing at $3 each, which is about half of what they buy each month from other suppliers. If they move 5,000 pieces per month from another company to Image Manufacturing, what will be their rebate on the total order? What will be the discounted cost per piece?
2. If Complete Cameras, Inc. increases its order to 22,000 pieces per month and negotiates an 18 cents-per-piece trade discount, what will be the rebate? What is the percent of the discount?
3. In addition to the 18 cent-per-piece trade discount, Complete Cameras, Inc. also receives a 2% cash discount (10 days, net 30). Calculate the rebate and cash discount on a 30,000-piece-per-month order, and then find the net price. Cash discount of 2% is taken after the rebate is applied.
4. Another company currently orders about 6,000 hinges per month from Image Manufacturing at $3 each. Image Manufacturing's marketing manager believes this

company is capable of expanding its business to 8,000 pieces per month and recommends a rebate of 17 cents per piece if they do so. Rounded to the nearest tenth of a percent, what is the rebate percentage? Do you think this trade discount violates fair trade laws? Why or why not?

8-2 McMillan oil & Propane, LLC

Rob McMillan finished reading the article in the local paper, “Fuel Prices Expected to Increase into Summer.” The article cited major factors in the crude oil spike such as Iran’s nuclear program and overall Mideast instability. Rob, an independent fuel oil and propane distributor in rural Virginia, thought this wasn’t good news. It had been a moderate winter, but wholesale fuel prices were starting to increase. Rob grabbed the last invoice from his supplier and saw that fuel oil was priced at $2.353 per gallon, with trade discounts of 7/5/2.5 available. It seemed like those discounts were not as good as in the past. McMillan Oil offers its own customers credit terms of 2/15, net/30, with a 1% service charge on late payments. Of the $25,000 in average fuel oil sales per month, normally half of Rob’s sales are paid within the discount period, and only 5% incur the monthly service charge. Rob is concerned because a number of his fuel oil customers are behind in their payments, and he is considering some changes.



1. Using the starting price of $2.353 per gallon, what is Rob’s net price after applying the 7/5/2.5 trade discount series using the net decimal equivalent?
2. Rob is considering purchasing his fuel oil from a new supplier offering fuel oil at $2.493 per gallon, but with a better trade discount series of 10/7/4. Compared to your answers in Exercise 1, which supplier would be a better deal for his company?

3. Using the average monthly sales of $25,000, what is the total savings enjoyed by those fuel oil customers who normally pay within the discount period? What is the total penalty paid by those that are delinquent over 30 days?
4. Currently, only 25% of the sales volume is paid by customers who are taking advantage of the discount, and 20% of the sales are over 30 days. Using these figures, how does that change your results from Exercise 3 above? Because your answers show that Rob is presently making more money (at least he should), why should he be concerned about the current situation? What suggestions do you have?

8-3 The Artist's Palette

The Artist's Palette sells high-end art supplies to the art students at three regional art and design schools in Philadelphia, Washington, D.C., and Baltimore. It carries paints, brushes, drawing pads, frames, charcoal, pastels, and other supplies used in a variety of artistic media. Because its clientele is very discriminating, The Artist's Palette tends to carry only the top lines in its inventory and it is known for having the best selection on hand. It is rare that an item is out of stock. Artists can visit the store, purchase from The Artist's Palette catalog, or buy from the secure web site.

1. The Artist's Palette purchases its inventory from a number of suppliers and each supplier offers different purchasing discounts. The manager of The Artist's Palette, Marty Parma, is currently comparing two offers for purchasing modeling clay and supplies. The first company offers a chain discount of 20/10/5, and the second company offers a chain discount of 18/12/7 as long as the total purchases are $300 or more. Assuming Parma

purchases $300 worth of supplies, what is the net price from supplier 1? From supplier 2? From which supplier would you recommend Parma purchase her modeling clay and supplies?

2. What is the net decimal equivalent for supplier 1? For supplier 2?
3. What is the trade discount from supplier 1? From supplier 2?
4. The Artist's Palette recognizes that students may purchase supplies at the beginning of the term to cover all of their art class needs. Because this could represent a fairly substantial outlay, The Artist's Palette offers discounts to those students who pay sooner than required. Assume that if students buy more than $250 of art supplies in one visit, they may put it on a student account with terms of 2/10, n/30. If a student purchases $250 of supplies on September 16, what amount is due by September 26? How much would the student save by paying early?
5. Assume that if students buy more than $250 of art supplies in one visit, they may put the charge on a student account with terms of 2/10 EOM. If a student makes the purchase on September 16, on what day does the 2% discount expire? If the purchase is made on September 26, on what day does the 2% discount expire? If you were an art student, which method would you prefer: 2/10, n/30, or 2/10 EOM?