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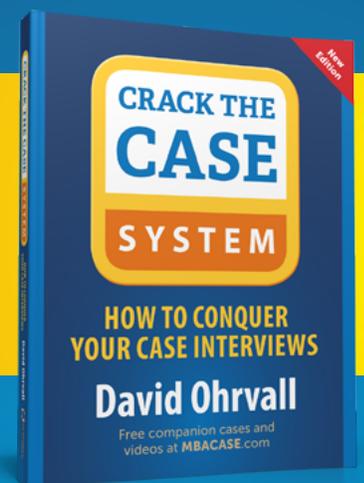
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CASE **507**

*Kryptonite
Toys & Parts*

David Ohrvall

FOUNDER OF MBACASE.COM



Kryptonite Toys & Parts

Taipei, Taiwan

Kryptonite thought they were on top of the world, but customers think their service is plummeting. Can you save the day before Kryptonite loses its power over competitors?

507
FULL
★★★

TAIPEI CITY FACTS

- ▶ Taipei is regarded as the cultural, economic, and political center of Taiwan
- ▶ Nickname: The City of Azaleas
- ▶ The city of Taipei is home to 20 university campuses



TRAIN Profile

Type	Region	Analysis	Industry	Number
	<p>TAIPEI, TAIWAN Population: 2.6M Currency: New Taiwan Dollar (TWD)</p>	<p>Change Price</p>	<p>Manufacturing</p>	

Solo Practice with Video Assist

1. Find your videos
2. Set up
3. Listen to question
4. Recap
5. Create your plan
6. Present your plan
7. Stop and study
8. Reinforce



30 minutes

Partner Practice

1. Set up
2. Present the case question
3. Recap
4. Create your plan
5. Present your plan
6. Stop and study
7. Reinforce

Interview Guide

Case Situation and Question

Kryptonite Toys & Parts (KTP), a \$250M manufacturer of handheld game components, has recently received complaints from several long-time customers. The customers are having trouble securing consistent global prices with Kryptonite. When one KTP location promises a favorable price, other KTP manufacturing locations will not support that price. From the customers' perspective, KTP is acting more like a consortium of different companies than a unified global entity. KTP's management has reviewed the problem, but does not have a clear solution. Several executives believe the problem stems from the company's internal transfer pricing policies. **How would you dissect this problem? What solutions can you offer management?**

Case Twist

If management does want to create a global pricing approval process, what other options are there for solving this problem? How would you implement a new global pricing policy if you only had two months to do it?

Feedback

Physical Skills	Weak	Strong
Body Language	①	② ③
Verbal	①	② ③
Listening	①	② ③
Thinking Skills		
Hypothesis Generation	①	② ③
Comfort with Ambiguity	①	② ③
Initial Plan & Output	①	② ③
Data Analysis	①	② ③
Basic Business Intuition	①	② ③
Integration	①	② ③
2nd Level Insights	①	② ③
Creativity	①	② ③

Total Score _____ / 33

Intro Facts (Tell the Candidate if Asked)

Locations: Kryptonite has divided the world into four major regions: North America (NAM), Latin America (LAM), Europe (EU), and Asia Pacific (AP).

Manufacturing: Most electronic parts are made in LAM and AP because of low labor costs and cheap raw materials. They are then sold to manufacturers who use the parts to make finished handheld products.

Shipping: Some parts are shipped to various customer facilities in NAM and EU and then put into finished handheld products.

Distribution: Some KTP parts are sold to distributors or outsourced assemblers.

Deal Sheets: Sales people in every region fill out "deal sheets" for potential sales with customers. These sheets capture overall margin for the deals and determine whether or not they should be approved. Historic policy requires every deal to generate "net 15%" (net margin) by region.

Key Insights (Do Not Tell the Candidate)

General Tips: This case has several interesting elements: basic accounting, historic policy review, and policy enforcement. Most candidates will piece together the transfer pricing transaction flow, but will struggle with the dollar impact (the "so what?").

Net 15 policy is hurting the company: By requiring that every region involved in a deal must achieve a net 15% profit on the transaction, many deals are being eliminated that could benefit the company overall.

Decentralized decision making: Present decision making is decentralized, which is one of the root causes of the poor management. Centralized decision making would promote deals that benefit the whole company.

Regional profitability—If changes are made to the net 15% policy, some regions will look less profitable than they do today. A new internal accounting system would minimize this effect.

Mid-case Data (Tell Only at Appropriate Time)

Give the following information if asked about how big the problem is:

Number of deals lost to pricing disputes: 322 deals in the first year; the second year is expected to be higher.

Average revenue per deal: \$54,000

Estimated net profit per deal: 22%

Recent comments from the Regional Leaders (RL):

"If the European sales guys weren't so expensive and greedy, we wouldn't have so many pricing disputes." Asia Pacific

"Asia is always complaining about price. They just don't know how hard and expensive it is to scare up business here." Europe

"What pricing problem?" North America

"The heart of the issue is communication. We need more." Latin America

See the Mine for the Answer Section later in this case for additional questions and answers. Please review these before giving the case.

Case Flow and Milestones

1 Present Main Question

Candidate takes notes, asks for a minute, forms a plan and presents it.

2 Answer Any Basics

Transfer pricing can be confusing, so make sure you have reviewed the handouts. It is important for the Candidate to understand the net 15% rule.

3 Ask for Clarification

Be sure to make him explain anything you do not fully understand. Look for clear connections between each part of the plan and an understanding of how each part contributes to the whole. Look for solid logic on how this plan will get some answers.

4 Guide Discussion

Expect questions about deals and historical pricing transactions. Your goal should be to hand out the two transfer pricing handouts (A and B) and then ask any questions about the volume of deals. Look at the additional info section below.

5 Get Recommendation

Ask the Candidate to create a solution to the problems. Options include:

- Create a new global pricing review process to ensure that deals exceeding net 15% globally are accepted.
- Develop a global accounting system so that regions share the value of deals equally.

Handout and Data Guide

Handout A:

Candidate: Do you have any data on failed price quotations?

Interviewer: Here's an example of a deal that did not go through in one of KTP's manufacturing locations. Why do you think the deal was rejected?

Insight: Each region must achieve 15% net margin on every deal. This deal fell short at 12%.



Handout B:

Candidate: Do you have any examples of other deals that did not go through?

Interviewer: Here's the matching deal sheet on the US side. Why do you think this deal was rejected?

Insight: Even though the Indiana plant's margin was well over 15%, they were denied. It looks like the US tried to get the customer to pay more, but the customer refused.



Re-routers

Questions to Keep Things on Track

- **What profit goals does each region have to meet?**
 - ▶ Net 15% on every deal, no exceptions
- **Why would a company have such a rule?**
 - ▶ To ensure that regions do not take low-margin deals and then hope to make up losses with high-margin deals later.
 - ▶ To provide a simple control that any employee can understand
- **What additional data would you like to see?**
 - ▶ How can you make your answer more quantitative?
 - **What are some simple ways that KTP can encourage the management team to adopt a more global focus?**
 - ▶ Develop more global infrastructure and information sharing, e.g. international sales teams or global pricing approval.
 - ▶ Revise incentive programs to reward global profitability and reduce the "penalty" incurred by deals with lower local margins.

Additional Info

Below is a recommended approach to solving the analytics. Give hints if necessary:

Review the slides: It is clear that Japan rejected the deal due to margin shortfall. Even though the US plant was well over 15% and could make up Japan's 3% shortfall (15%–12%), the deal was cancelled.

Calculate global value to KTP: Killing deals that could profit the global entity does not make sense. To determine what the margin would be on the global deal, create the following table:

Units:	10,000
Global Revenue:	\$4.10
Direct Costs:	\$1.12
Gross Profit:	\$2.98
Gross Profit Margin:	73%
Selling and Service:	\$1.30
Admin:	\$0.61
Net Profit:	\$1.07
Net Margin:	26%

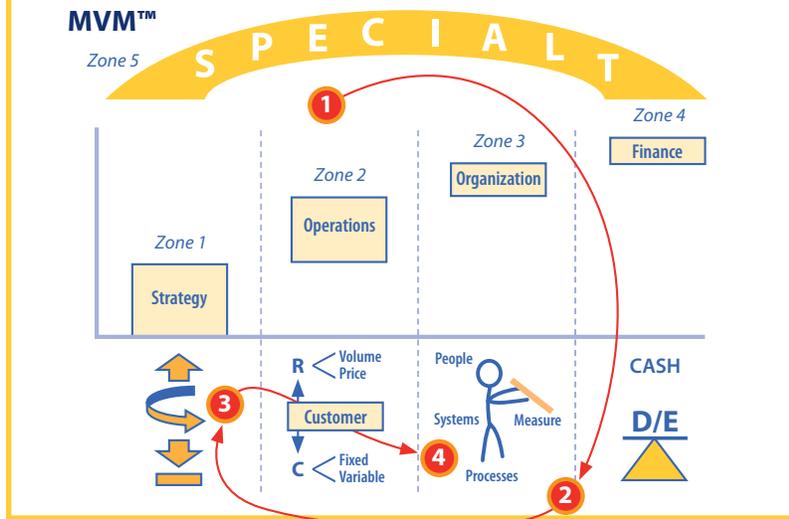
From a global perspective, the deal offers a net margin of 26%! Certainly, this is a good deal to pursue!

Total value of this problem to KTP: \$54k (average deal revenue) x 22% (average net margin) x 322 (year 1 deals killed) = \$3.8M.

$\$3.8M / (\$250 \times \text{net } 15\%) = 10\%$ of total net profit. This is a big issue.

Additional Study Using the FRAME Method

F – Form a Plan



- 1. Start in Zone 5, External Factors:** This case starts off with customers complaining about their supplier (KTP). KTP has failed to keep up with an industry shift toward global pricing. Why is the company lagging behind?
- 2. Move to Zone 3, Organization/ Processes:** What is happening with the pricing approval process today? How is it integrated with the sales approval process? Is there any data on why the deals are rejected, and, how many are rejected?
- 3. Move to Zone 2, Revenue/ Price:** How do the regions set pricing policy? Is this an internal problem, or is it being driven by some external market factors?
- 4. Finish in Zone 3, Organization/ Systems:** How can the deal approval process be changed? What changes in regional and global accounting need to happen? What are the rollout implications?

M—Mine for the Answer

The key to this case was discovering how pricing quotes were rejected and approved. Other critical areas to drill into are global unity and regional differences. With any potential change, it is also good to get a perspective on what that change will do to the organization.

Deal Rejections	Global View	Performance
<ul style="list-style-type: none"> How many deals are rejected per year because one region won't support them? <i>233 price quotes were cancelled last year due to "regional disagreement."</i> What are the reasons for not supporting the price? <i>One region is either not achieving enough margin on the deal, or has limited capacity. Thus, priority is given to high margin deals.</i> Do we have regional policy on profit margin and deal approval? <i>Each region must make net 15% on every transaction. Sales people can approve/reject deals.</i> Do we have a global policy? <i>No global policy. Each region has veto power.</i> 	<ul style="list-style-type: none"> How do the different regions work together? <i>Cooperation is based on transactions; the manufacturing region transfers parts to the assembling region.</i> Where do the regions typically have disagreement with one another? <i>Disagreement is almost always based on profitability and who will make more by region.</i> How does KTP resolve regional differences when they arise? <i>KTP lets the regions resolve their own disputes.</i> 	<ul style="list-style-type: none"> What global policies or systems has KTP rolled out in the past? <i>SAP (global computer information system) was rolled out 2 years ago. There have been no other global rollouts.</i> What were the reasons for their success or failure? <i>SAP succeeded somewhat, but there were many disputes over universal standards.</i> What is leadership's attitude (by region) toward change? <i>Each region wants to roll out their own policies; they seldom want to explore policies developed in other regions.</i>

A - Anchor a Hypothesis

So where could you build some initial hunches?

Here are some examples:

Communication

"My hunch is that the procedures are probably appropriate, but communication is breaking down for some reason."

Incentives

"People are wallet-driven, looking to fill their own pocket as much as possible. The leaders in the company are doing things that suit their own best interests."

E - End the Case

Kryptonite is turning down a large number of profitable deals every year. In fact, the total average net profit from all rejected deals amounts to about 10% of total net profit. To capture some of this money in the bottom line, we need to think differently about our structure. Decentralizing the decision-making for global price quotes and sticking to the 'Net 15' rule for every deal doesn't make sense anymore. I recommend we automate an approval system and have "close call" deals reviewed by senior management. KTP should put a team in place to monitor the rollout of this new process.

Post Case Review

Case Insights & Takeaways

- Deals that would be profitable to the global company are rejected if they don't meet the net 15% rule at every single region.
- One sample (shown on the handouts) indicates that Kryptonite rejected a 26% margin opportunity (using a global perspective).
- Lost profits from this policy add up to about \$3.8M or 10% of net profit.

Options for solving the problem include:

- Create a new global pricing review process. This process would ensure that the deals that benefit KTP and exceed net 15% globally are accepted.
- Develop a new, global accounting system to support the new policy. Through an internal set of accounting "books," regions share the value of deals equally. This approach encourages participation in global deals.

Math & Logic Tips

- When reviewing several handouts, be prepared to do a new calculation on a separate piece of paper.
- Create sample tables or charts whenever possible to show your interviewer as you are integrating your findings (see the table under Additional Info).

What to Expect with Cases Like These

- Even though transfer pricing may be a new concept to you, the math is simple. Many cases with unusual concepts will have straightforward math.
- Feel free to interact with your interviewer over new concepts and ask questions when something is unclear.
- When making new calculations, show your work and explain what you are doing.
- To solve a case like this you may have to try several options. Don't be shy about working through your thoughts out loud.

My Takeaways

To build skills and improve, you must apply what you learned to future cases. Take a few moments and review the interviewer feedback and jot down some key insights about your performance in the space below.

Thinking Skills

My top 2 strengths are:

My top 2 soft spots are:

To address these problems I'll begin to:

My Performance During the Case

Add up your points. → Total Score: _____ / 15

F	Form A Plan	R	Read My Audience	A	Anchor a Hypothesis	M	Mine for Answers	E	End the Case
points	<ul style="list-style-type: none"> ③ Structured, clean ② Somewhat organized and logical ① Messy, overlapping ideas 	points	<ul style="list-style-type: none"> ③ Good back & forth, caught clues ② Awkward, trouble with interviewer style ① Interviewer not interested, couldn't follow 	points	<ul style="list-style-type: none"> ③ Solid hunch, pursued clue ② Partial direction ① No hypothesis at all 	points	<ul style="list-style-type: none"> ③ Specific questions, solid analysis ② Missed some questions, some math mistakes ① Vague questions, weak math, no linkages 	points	<ul style="list-style-type: none"> ③ Used facts and data, connected the dots ② Some data, mostly understood connections ① No data, no passion, no connections

REJECTED

Kyoto Japan Plant Deal Sheet (proposed quotation)

Customer: Hand Glove Toys
 Part #: 590234PLU4492
 KJP Sales Rep: Shinju Mori
 Customer Contact: Roy Headstrong (KTP Indiana)

Per unit costs		
Units		10,000
Revenue – Transfer Price	\$	1.75
Direct Costs	\$	1.12
Gross Profit	\$	0.63
Gross Profit Margin		36%
Selling and Service	\$	0.25
Admin	\$	0.17
Net Profit	\$	0.21
Net Margin		12.0%

*amount
requested by
Indiana USA
plant*

Indiana USA Plant Deal Sheet (proposed quotation)

Customer: Hand Glove Toys
 Part #: 590234PLU4492
 KJP Sales Rep: Roy Headstrong
 Manufacturing Contact: Shinju Mori

DENIED

JAPAN NOT MEETING MARGIN, TALK TO MORI
 -SAN 6/17/06

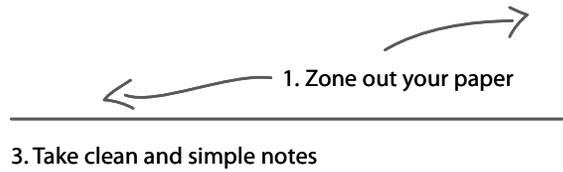
Per unit costs

Units		10,000	
Revenue (tp / sales price)	\$	4.10	CUSTOMER WON'T BUDGE ON PRICE 6/23/06
Direct Costs	\$	1.75	
Gross Profit	\$	2.35	
Gross Profit Margin		57%	
Selling and Service	\$	1.05	
Admin	\$	0.44	
Net Profit	\$	0.86	
Net Margin		21.0%	

Today's date:

2. Be original with your data

4. Leave ample room for a structure and additional notes as the case progresses



How fix transfer pricing?

Rev. - \$250M

Costs - no data

Profit margin - no %, no \$

What's the goal financially?

- Handheld game components
- Customer complaints
- Global prices ??
- Regions - not same price
- Transfer pricing problems

Pricing Policy

What's the pricing method today?

How are they approved by region?

Baseline data. Do we have examples of bad decisions?

Industry / Competitors

Have they not adopted industry trends?

What are competitors doing?

Who has power to impact price? Suppliers? Distributors?

Measurement

How do they work in each region?

What is the global goal?

What do the customers want? How do we measure success with them?

Options Forward

How can we change it going forward?

How quickly can we make the change?

What will be the impact on the products and the organization?

HUNCH: out of date policies that need to be revamped.



Voiceover

"To better understand the pricing issue, I would like to know how prices are defined and approved by region. I'll be looking for data that shows where the lack of coordination is a problem. Second, I want to know whether there are any industry pricing trends that KTP has not adopted. Or perhaps they are following an industry standard that does not work for their customers. Third, I'd like to understand how they measure success and failure today. You mentioned the regions. What specifically are the customers complaining about their interaction with the regions. Finally, I'd like to put together some options and discuss how those changes will affect the organization. I'd like to start with the internal deal approval process, unless you'd prefer me to start elsewhere."

Click or scan QR to see video.

Additional Study: For more questions to consider, review Section 13: Roadmaps.