For simplicity; used $s everywhere instead of £. Find/replace before publisging.

Questiions to the prof:

* Regarding the inventory, do we assume that when inventory was purchased it was capitalized - stored in the BS as inventory for costs to be incurred on the period when used, or was the inventory expenced when originally purchased; such that liquidating it will generate full revenues unaffected by balance sheet write off
* Regarding the machinery, do we assume that the machine had value in the balance sheet and that selling it will generate a balance sheet write off that needs to be considered as an expense?

**Problem Statement**

* Management needs to determine if it makes business sense based on cash flow profitability to outsource some of its non-core business function, more specifically, purchase containers or build them in house, and perform maintenance internally or outsource this activity to Packages.

**Quantitative Analysis**

* Exhibit 1 shows balance sheet write offs (therefore period costs) that will be materialized if the manufacturing is outsourced due to the fact that Materials have been inventorized and that machinery has been capitalized. Over the 5 year period of the potential contract with Packages, these represent an additional $33,820 of annual costs that were omitted by the accountant.
* Exhibit 2 shows a cash flow based revision of the costs of and savings associated with manufacturing/outsourcing containers. Since evaluation criteria of alternatives is purely cash flow based, the value of additional capabilities of administrative staff and savings from not having to staff the new manager position are not taken into consideration. Since savings are almost equal to real costs of outsourcing, details on the 40k$ account labeled “Other Expenses” are required to make a proper decision.
* Exhibit 3 shows a comparative analysis of in/outsourcing maintenance. Clearly the outsourcing alternative makes more financial sense.
* \*Manager’s salary will not be saved if outsourced; it will be re-allocated to the department where he is moving.

 =>Assume “other expenses” was allocated?

Qualitative Analysis

* Closing down a department and laying off employees when the company is not in financial danger is sure to have negative impacts on staff morale, affect productivity and could potentially give the company bad publicity
* Using only cash flows as an evaluation criterion for outsourcing is an extremely summary analysis of a complex business problem. Many critical factors that need consideration in order to make an educated decision are intangible and difficult to financially quantify. The ability to identify and factor in these elements in important decisions is a trait of great managerial skills.

Recommendation

* Since cash flow based analysis of outsourcing reveals that costs and savings are approximately equal, management should not outsource. Instead, the company should focus on process optimization and reducing manufacturing inefficiencies for the next 5 years, while inventory is used up and machinery is depreciated. By then, if manufacturing costs are just as high (or higher), the company should seek a new quotation for a supplier and consider outsourcing before purchasing more GHL and new machinery.

**Exhibit 1: If container manufacturing is to be outsourced, the company can expect a onetime balance sheet write off (period lost) of $169,100**



**Exhibit 2: A comparative analysis of costs of outsourcing contract and savings incurred.**



Exhibit 3: Comparative analysis of in/outsourcing maintenance on the containers

