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Bank envelope

Topic	Difficulty	Style
Pricing, Profitability analysis	Beginner	Candidate-led

Case Prompt

Your client, Customlope, is the leader in the US **secure envelope** manufacturing industry. Banks buy these envelopes for operations such as money deposits and high value transactions.

Next year, a **new digital technology** will reduce the overall number of **units sold** in the industry by **25%**.

In the **short term, o**ur client wants to **maintain** his **current profit level without investing** in the **new technology**.

How can you help him?

Overview of all exhibits

Costs breakdown

	Costs ($m)
Labor	11
COGS	18
SG&A	3
R&D	1
Marketing	2

Table 1 – Customlope's cost break down (present)

Market share

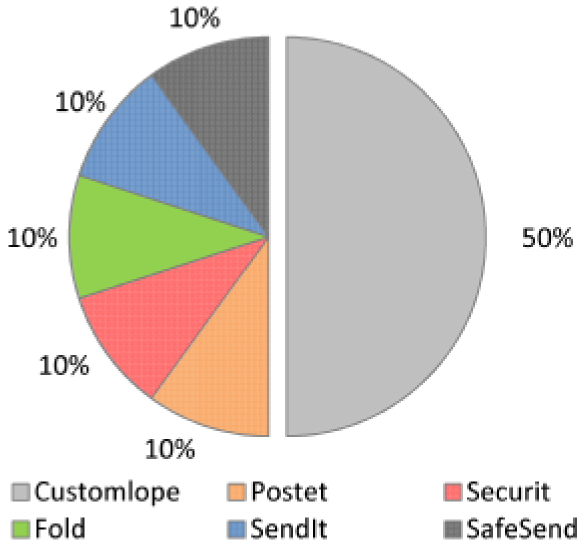

Diagram 2 – Market share

Sample Structure

The following structure is used as approach for the problem:

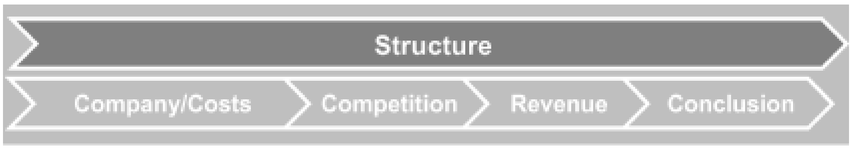

Diagram 1 – Case structure

I. Company / Costs

Additional Information

Note for Interviewer

Share **Table 1** (Customlope's **cost break down)** if the interviewee inquires **additional information**. (COGS: Costs of goods sold)

Costs breakdown

	Costs ($m)
Labor	11
COGS	18
SG&A	3
R&D	1
Marketing	2

Table 1 – Customlope's cost break down (present)

Information that can be shared on the interviewee's inquiry:

- Customlope only sells ONE type of product Price: $1/unit.
- This year, Customlope sold 50 million units.
- Costs have already been reduced as much as possible.
- Customlope has excess capacity. It can produce at least double the amount of units per year at similar or lower unit costs.

- Customlope’s products are similar in quality and price to their competitors’ products.
- This year, 100 million secure envelopes will be sold. Next year, this total will shrink by 25%.

Solution

Initially, the interviewee should outline the profitability equation:

Profit = **Revenue** – **Costs**

The interviewee should ask for the following information:

- **Type** of **products** sold
- **Number** of **units** sold
- **Price** of **units** sold
- **Cost** breadkdown

The candidate should calculate the costs per envelope and the candidate should calculate last year’s profit because the client wants to maintain profit at that level.

Costs per envelope

$$\frac{\textbf{Costs}}{\textbf{Envelope}} = \frac{\text{Total costs}}{\text{\# sold envelopes}} = \frac{\$(11 + 18 + 3 + 1 + 2)\text{m}}{50\text{ m}}$$

$$= \frac{\$35\text{ m}}{50\text{ m}} = \mathbf{0.7}\ \frac{\$}{\textbf{Envelope}}$$

Profit

$$\textbf{Profit} = \text{Revenue - Costs} = \text{\#Units sold} * \left(\frac{\text{Revenue}}{\text{unit}} - \frac{\text{Costs}}{\text{unit}}\right)$$

$$= 50\text{m} * \left(\frac{\$1}{\text{unit}} - \frac{\$0.7}{\text{unit}}\right) = 50\text{m} * \frac{\$0.3}{\text{unit}} = \mathbf{\$15m}$$

II. Competition

Additional Information

Note for Interviewer

Share **Diagram 2** (**market share overview)** if the interviewee inquires information about the market.

Market share

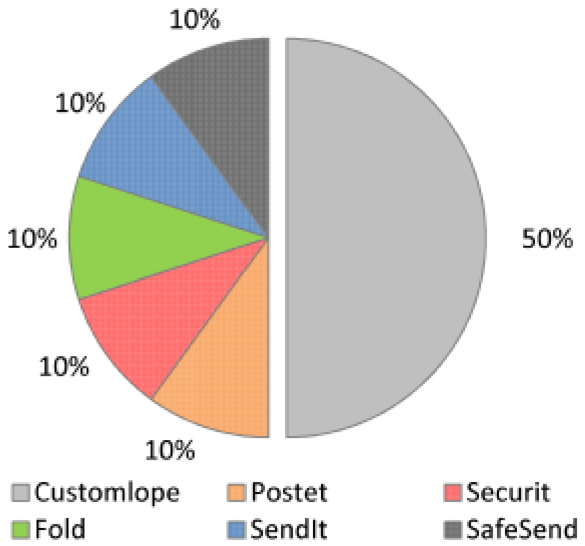

Diagram 2 – Market share

Information that you can share on the interviewee's inquiry:

- Since competitors do **NOT** benefit from Customlope's **economies of scale**, their **unit cost** this year is **$0.90 per envelope** (Customlope's is $0.70).
- **Competitors CANNOT** further **decrease** their **unit cost**.

Solution

The interviewee should ask for the following **information**:

- **Main competitors**
- Competitor’s **size**
- Competitor’s **cost structure**
- Competitor’s **products**

Key insights

Now that the interviewee knows more about the client and the client’s competitors, the **interviewee** should **consider** ways to **help** the client **maintain** his current **profit level**.

III. Revenues

Solution

Since **cost**s are already **optimized**, the **only way** to maintain the **current profit level** is to **increase revenue**.

Increase price

- This will probably **NOT work** because the **product** is **commodity-like**.
- Now that a **new substitute** has appeared, it is even more **unrealistic** to **raise prices**.

Increase market share

- Customlope could **decrease** its **price** to **steal market share** from its competitors.
- We assume that **competitors** will **leave** the **market** if they **cannot** be **profitable**. Thus, if **Customlope decreases** its **price** to **$0.90** (their competitor’s per-unit manufacturing costs), Customlope should obtain **100% market share**.

New profit:

$$\textbf{Profit} = \#\text{New units sold} * \left(\frac{\text{New price}}{\text{unit}} - \frac{\text{Costs}}{\text{unit}}\right)$$

$$= \text{New market share} * \#\text{Total units} * \left(\frac{\text{New price}}{\text{unit}} - \frac{\text{Costs}}{\text{unit}}\right)$$

$$= \text{New market share} * \#\text{Total units} * (100\% - \text{Market decr.}) * \left(\frac{\text{New price}}{\text{unit}} - \frac{\text{Costs}}{\text{unit}}\right)$$

$$= 100\% * 100\text{ m} * (100\% - 25\%) * (\$\,0.9 - \$\,0.7) = \mathbf{\$15\text{ m}}$$

Key insights

Customlope can **maintain** its **current profit** level by reducing its **per-unit price**. The **market share** and **revenue** gained is **greater** than the **loss** from lower profit margins.

IV. Conclusion

Solution

Although there is no right answer, it seems that the client could benefit from a **short-term price war** because its **costs** are **lower** than its **competitor's** costs.

Possible answer:

The client should initiate a **price war** and **decrease** the **price** of the customized envelopes to **$0.90** or to **slightly less** than that.

Key insights

- **Increasing** the **price** is **NOT** an **option** because the envelope is a commoditized good.
- **Decreasing** costs is **NOT** an option because **costs** are **already optimized**.
- The only way to **maintain** current **profit** levels (without investing in the new technology) is to **increase market share** by **decreasing per-unit price.**
- By taking **advantage** of its **lower costs**, Customlope can **push** other **competitors out** of the **market** because the competitors cannot make a profit on their envelopes.
- The **objective** of **maintaining** the current **profits** would be **met**, as proved previously.

Further considerations

Before implementing this strategy, the **following points** should be **taken** into **consideration**:

- There could be **market regulations** against a **monopoly**. However, since the **company** would **not** be **selling** their **products** at a **loss**, competitors **cannot accuse** Customlope of **price dumping**.
- **Some competitors** might **remain** active in this market even if they have to **sell** at a **loss**. For example, they might use their market presence to **cross-sell different product**s to banks.
- **Thus, Customlope may** not obtain 100% market share.
- In the **long run**, the client should **invest** in and **implement** the **new technology**. The client can do this via **R&D** or by **acquiring** one of the **new competitors** and its technology.

Further Questions

Apart from banks, can you think of other potential markets for secure envelopes?

How would you enter these new markets?

Solution

<u>**Possible answer:**</u>

- Companies that deal with high confidentiality
- Government

First, we should look at the **attractiveness** of the **industry:**

- Market **growth**
- **Profitability**
- Competitive **landscape** (is the market **fragmented** or **concentrated**)

Second, we should take a look at our **ability** to **win** in this market:

- Can we easily **adapt** our **existing** bank envelope **technology** to the needs of these new customers?
- Do we have the **competence** and the **distribution channels necessary** to thrive in this new market?

Note for Interviewer

More questions to be added by you, interviewer!

If the interviewee solves the case very quickly, you can come up with **more challenging questions** to ask them.