

Muenster Pump Company

The Muenster Pump Company has manufactured high-quality agricultural pumps for over 40 years. The firm's only plant is in the small midwestern city of Muenster. The company is Muenster's largest employer. Bob Dorf, president of the firm, is the grandson of Emil Dorf, the founder. Bob and his family, along with all key personnel, live in or near Muenster. Cordial relations exist between the firm and the city officials.

Since its founding, the firm has always been as self-sufficient as possible. Shortly after setting up the business, Emil Dorf established a foundry to cast pump housings and related items. Today, the foundry provides virtually all the required pump housings.

Bob's cousin, Terri, is the purchasing manager for Muenster Pump. After graduating from State University, Terri worked as a buyer at a large appliance manufacturer in the southwestern corner of the state, but after two years of life in the big city, Terri returned to Muenster. Bob was delighted to have Terri back in town. He established the position of purchasing manager by consolidating the buying functions previously performed by himself and other members of the firm. Terri is an aggressive and conscientious buyer. Materials costs have come down from 60 percent of the cost of sales to 50 percent in the two years since she assumed responsibility for purchasing.

Recently a representative of Union Foundry, a firm in the southeastern part of the state, contacted Terri. The rep was aware that Muenster Pump made its own cast pump housings, but he claimed that new developments in casing pouring allowed his firm to offer extremely attractive prices.

Terri requested a price on the L-1012 case housing, Muenster's most popular size. The L-1012 represents 60 percent of Muenster's demand for casting housings. The pump that incorporated the L-1012 is sold to distributors for \$500. Within a week of the meeting, a letter arrived from Union Foundry, quoting a price of \$90 F.O.B. Muenster. Delivery was promised in 120 days after receipt of the first order. Thereafter, delivery would be made in 60 days after receipt of an order. Minimum orders were established as 100 units. Terri contacted two other foundries and obtained quotations for the L-1012 housing. The prices were \$94 and \$98 F.O.B. Muenster.

Terri met her uncle Ned, discussed her findings with him, and asked how much it cost Muenster to produce the casting housings internally in its own foundry.

Ned Dorf was not at all enthusiastic about Terri's efforts in this area of the business. He said, "Terri, I appreciate your interest and efforts at reducing cost, but a lot more is involved here than meets the eye. We produce a quality housing that is not equaled in the industry. It's one of the primary keys to our success! Furthermore, we can respond to requirements much quicker than those city boys."

Terri responded, "Ned, let's assume that all your doubts could be overcome. How much does it cost us to make the housings?" Ned replied, "Terri, there is something else involved. We have 16 men working in that foundry. If we stop making our own housings, we'll have to close down the foundry, and there's no other place in the firm where these men could work."

At that point, Terri thought that discretion would be the better part of valor. She thanked her uncle Ned for the information and returned to her office.

Later that day, her cousin Bob stopped by. In the ensuing conversation, she learned that the L-1012 housing cost Muenster about \$180. Total overhead at Muenster was calculated to be approximately 200 percent; hence, direct costs for material and labor for the housings would be about \$60. Approximately 70 percent of the overhead is for fixed costs such as depreciation, taxes, and executive salaries. Terri sat in her office debating with herself the political, human, and cost implications of making or outsourcing the casting housing. ■