KITCHEN ESSENTIAL PRODUCTS, INC. – QUESTIONS

Write a report to the upper management of Kitchen Essential Products Inc. that explains what happened in the First-Class product line. Use the report writing guide from the course website. Explain the decision made and the basis of the decision. To support your conclusions in the report, perform the analysis and answer these questions:

Q. 1. Prepare a budgeted income statement for First-Class Ovenware for 2007 if the engineers’ redesign efforts had worked as originally planned. Use these assumptions:

* 1. First quarter sales of 1,500,000 units will be achieved each quarter in 2007.
  2. The selling price for 2007 will remain 10% below the price charged from 2002-2006, and there were no sales price increases during the 2002-2006 period.
  3. The variable cost of goods sold averaged about $5.55 per unit of ovenware from 2002-2006.

* 1. Variable production costs will be reduced by 35% due to the new design.
  2. The fixed cost of production in 2006 contained one-time, increased costs (about $4,000,000) for the design changes. For 2007, fixed costs are expected to be about 3.5% higher than in 2005.
  3. Marketing costs contain both fixed and variable elements, however, it is budgeted based on spending 7% of expected sales revenue.
  4. Other fixed costs are expected to increase by about 2.5% over 2006.

Would the product manager have met his profit target of a 25% return on sales in 2007 for the product line with the redesign?

Q. 2. Prepare the budgeted 2007 income statement for First-Class Ovenware that the production, quality, and product managers considered when they discussed the first option available to them.

a. Under that option, the shipment would be delayed and about one third of the year’s sales of 6,000,000 units would be lost.

1. The product would be sold at the 10% price reduction but produced under the old cost structure for six months (variable production costs of $5.55 per unit). After the six months, the variable cost savings of 35% would be achieved.
2. Assume that recycling the current production would add $500,000 to the fixed production costs originally budgeted for 2007. In addition, the product line will incur an additional $2,000,000 in design engineering to solve the problem within a 6-month period (this will involve the use of overtime and consultants).
3. Other cost items would stay as originally budgeted for 2007.

What would the product line’s profit be under this alternative? What would the return on sales for the product line be?

Q. 3. The production, quality and product managers considered their second option to be producing and selling flawed units for 6 months while engineers corrected the problem. Under this option, the company would not disclose the problem and hope for the best. Perhaps none of the product claims would involve any injury; only product replacement would be required at a cost of about $12 per unit.

a. Adjust the 2007 budget for an assumed defect rate of .25% for 6 months of production. (Note this is a defect rate in addition to the normal rate faced in each year, 2002-2006, which is already accounted for in marketing cost.)

b. Adjust the fixed production cost for 2007 for an additional $2,000,000 in design engineering to solve the problem within a 6-month period. (This will involve the use of overtime and consultants).

What would the budgeted profit and return on sales be if option two were selected?

Q. 4. Assume Mrs. Kinsley has filed a suit against Kitchen Essential Products Inc. for the injuries that she sustained under the theory of strict product liability. Assume further that Mrs. Kinsley would prevail in a cause of action against Kitchen Essential Products Inc. under strict product liability. Is she likely to recover punitive damages?

Q. 5. Based on your knowledge of ethics indicate if you think Kitchen Essential acted ethically when it shipped out the defective ovenware. Also, indicate if you think the engineer who finally reported that the original tests had been altered acted ethically. In your answer consider which stakeholders were affected by both decisions and what ethical guidelines were used in each decision.

Before answering this question, please read “Only the Ethical Survive” found at <http://www.scu.edu/ethics/publications/iie/v10n2/ethical-surv.html>.