NOVA INCORPORATED: E-CASE
TWO OPPORTUNITIES

by

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After notifying his management team of their assignments for next week's meeting, Fisher plans a short vacation with the hope of reacquainting himself with the game of golf. As he is preparing to leave, he receives two memos. The first is from Wei Chang, the President of the Asia Pacific region, seeking permission to conduct negotiations that would lead to joint manufacturing and distribution ventures in India and China. The second is from Claudio Spiguel requesting authority to purchase all products for South America from a local source. After reading these memos, he sends copies to his management team asking them for advice, and requesting that they be prepared to discuss both issues at next week's meeting.

Assignment.
Review Chang's and Spiguel's memos which are attached. What recommendations would you give Fisher concerning these proposals? Why? What are the consequences of accepting these plans?
MEMORANDUM

TO: John Fisher, CEO
FROM: Wei Chang, President, Nova Asia Pacific
DATE: June 17, 1995
SUBJECT: Implications For Market Growth Opportunities In The Asia Pacific Region

For the past year you have encouraged me to grow my business substantially. After careful analysis of the opportunities in this region I have concluded that it is possible to dramatically increase sales over the next five years. In fact, I believe it is likely that we can increase business by a factor of 10. While this may sound optimistic, I am confident that we can achieve this level of growth.

I have spent several months making contacts in both India and China and have succeeded in establishing appropriate government and industry ties in both countries. As I toured these countries, I found that there is an enormous requirement for our products driven by the explosive growth in construction in both countries.

Two reasons make it possible for us to penetrate these markets. First, the local production of widget equivalents is limited, since the technology for modern widget manufacturing is not known in these places. The out-dated production
methods, which are both capital and labor intensive, have made growth in domestic production capacity appear unprofitable. Thus the governments are eager for us to provide our products to them. Second, the quality of the present local supply is very poor. Where the domestically produced widgets are used, their reliability and durability are a source of great concern to their users. In fact, there have been numerous accidents that have resulted from the poor product design and manufacturing processes. Our reputation for high quality is therefore a major source of competitive advantage for us.

To date, our major competitors have not succeeded in penetrating these markets, in spite of several concerted attempts to do so. I suspect that their lack of success so far is due to their failure to appreciate the distinctive cultures of these countries, and how business must be transacted within them. Nonetheless, our competitors are active and their products are also well-regarded.

For us to compete successfully in these markets, we must have technical support, low prices (much lower than our current ones), and high quality and reliable supply. Furthermore, it is important to understand the limitations of the logistics infrastructure in these countries. The major consumers of widget are not located in places that can be reliably resupplied from port cities or by air.

I believe that for us to compete, we must undertake joint ventures for manufacturing and distribution in both countries. The reason for this is twofold: first, to be price-competitive we must take advantage of the low labor costs that are available in both India and China, and we must avoid the tariffs and overheads associated with transporting and importing products from London or Cincinnati. The second reason that we must have a manufacturing presence is to gain access to distribution channels. Both governments are looking for technology transfer, and have made it clear that without licensing our product and process technologies to a locally-owned partner, they will be of little help in
providing market access. It would, of course, be folly for us to attempt to build a marketing, sales and distribution infrastructure from scratch, and totally on our own. Accordingly, I have begun preliminary discussions with the appropriate government and industry officials and have identified potential joint venture partners.

I have also gathered preliminary cost data, and estimate that we can produce and sell products with a 40% margin at a cost basis equal to 60% of the current transfer price. I have taken the cost of capital, labor, transportation facilities and land into account when making these calculations. I estimate that our RONA will be approximately 55%.

This is an opportunity that we cannot ignore. We must act soon or others will seize the it. I would like permission to pursue detailed negotiations so that we can begin production within a year. Of course, I will submit a CAR for formal approval once you agree in principle with the project. I will also need technical support from both Julie Anderson and Jerry Jackson to set up the manufacturing and technical information system, and assistance from our legal department in working out the licensing agreements.

I look forward to seeing you at our next meeting, and to discussing my idea with you in greater detail at that time.
MEMORANDUM

TO: John Fisher, CEO

FROM: Claudio Spiguel, President, Nova South America

DATE: June 18, 1995

SUBJECT: Maintaining Customer Service and Improving Nova Profitability

Attached is a copy of your recent memo on Customer Service and Cost as well as a copy of Larry Judge’s memo on Lean Production. Sometimes it takes a combination of reminders like this to shake us loose from old habits . . . to drive home the point that we can’t make marginal changes if we seek major improvements. Let me explain.

First, I am sure that my South America operations were a significant contributor to your memo on recent improvements in customer service. For the past six months, we have been maintaining generous amounts of finished goods inventory in an attempt to provide superior service to our customers. Moreover, deliveries from Cincinnati and London are now more reliable. As a result, we have been able to provide excellent customerservice, which has led to a substantial growth in our business. While I knew at the time that I decided to increase my cycle stock and safety stock levels that costs would rise, I believed that it was the right thing to do for our customers.

Then later, Larry Judge’s memo on RONA arrived. It reminded me that customer service was not the only goal for Nova managers. Making a "fair profit" for our shareholders on the assets they had provided us with was also important.
Since inventories are the greatest of the assets under my local control and their holding costs contribute heavily to our operating expense, inventory reduction is my key lever for RONA improvement. I am torn between the goals of reducing inventory and maintaining a high level of customer service. When I improve one the other gets worse.

When I shared this dilemma with a cousin who runs a manufacturing firm here in Sao Paulo, he asked for a sample of each of the products that Nova sells in South America. After reverse engineering our ten products, he designed a manufacturing process to build each and lined up a set of local suppliers. He has now offered me the following contract. If I guarantee to purchase all Nova products sold in South America during the next 5 years from him, he will make the capital investment required to manufacture them. He will sell them to us at our current Nova transfer price, quoted in dollars to eliminate Nova's exposure to Brazilian currency fluctuation, and he will guarantee the price for the next 3 years (which Cincinnati will not do for me). Moreover, he will require no minimum order size and he will guarantee 1 day delivery of any order quantity up to 2% of annual demand. Finally, he will pay all transportation costs and will guarantee that product quality will meet or exceed Nova's existing standards.

This is the answer to a prayer. He will own the pipeline stock, and I will need only 2 days of safety stock and about 1 day of cycle stock. My fill rates will remain very high and my transportation costs will be negligible. From your perspective, the risk of profit erosion from the wild currency fluctuations that we have experienced in recent years will be eliminated. I estimate that my RONA bonus will exceed 40%, and he feels that he will make an acceptable profit. This is a win-win-win situation.

Do I have your approval to sign the contract and proceed with this new alliance?
Attachment 1

NOVA MANUFACTURING, INC.
"Your Global Assembly Supplier"

MEMORANDUM

TO: All Nova Distribution Center Managers
FROM: John Fisher, CEO
DATE: June 1, 1995
SUBJECT: Customer Service and Cost

In the last two weeks I ran into a board member and then a college classmate, who each informed me that during the past 6 months their companies had increased their purchases of our products. They were amazed at the increase in our ability to serve them given that in the past we always were late and erratic in our shipping performance. Without having details on products, regions and dates, they assured me that what was a problem was now a real strategic advantage for us. They wondered how we moved from last to first as a reliable supplier to the industry.

While you all should be commended for following my instructions to improve customer service, recognize that our costs have risen to the point where the increased demand and service reduces profitability. Let me be blunt. Unless we can maintain the improved service levels at substantially lower operating costs, we will be out of business. You must reduce your costs - transportation, holding, and other overhead costs. At the management committee meeting this month, we will review your plans and progress.
MEMORANDUM

TO: All Nova Distribution Center Managers
FROM: Larry Judge, CFO
DATE: June 8, 1995
SUBJECT: Lean Production

To survive in our increasingly competitive business environment, it is imperative that we all strive continuously to improve financial performance. Return on net assets, RONA, is a traditional and important measure of the effectiveness with which productive assets are deployed by a company's management. I have therefore decided to establish last year's RONA numbers as a benchmark for company performance. Hereafter, monthly RONA numbers at each location will be used as a barometer to measure performance improvement as we move forward during the year.

I have calculated your 1994 RONA and will tie your compensation to your ability to improve it in 1995. The company improvement goal of 10% must be met by all locations. Managers who exceed this goal will receive a salary bonus percentage equal to twice their percentage improvement beyond 4%. I know you will each do the right thing.