

CASE # 4a:**A Steel Deal****Commodity Type: Product – Steel Pipes, USA**

Sarah Slater is a procurement manager for AIR Incorporated, a manufacturer and distributor of industrial gases. In January 2023, she was given the responsibility for Steel Pipes. Her first order of business is to negotiate a proposal for the renewal of a contract with the current supplier, Pacific Pipe Company. AIR Inc. currently purchases 260,000 feet of structural pipe at a price of \$42.50. Based on the new requirements of 300,000 feet, the supplier proposed a price increase to \$55.5 per foot for the new contract beginning February 1, 2023 citing an increase in steel prices. Pacific has been unwilling to give her any cost breakdowns despite repeated efforts on her part. Since this supplier is essential to AIR Inc., Sarah realized that she needs to build a cost model to prepare for her meeting with the salesperson next week. Basic research has turned up the following information:

INDUSTRY CODE: NAICS Code: 331210, Iron & Steel Pipe and Tube
Manufacturing

PRODUCT/PRICE/VOLUME DATA: Part number: OC-584
Nominal Size: 10" pipe
Wall Thickness: 0.500 (1/2")

Sarah developed the following Pacific Pipe's cost profile using Pacific Pipe's Income Statement and the U.S. Annual Survey of Manufacturer's (ASM) Report for iron and steel pipe & tube manufacturing:

TABLE 1: Pacific Pipe's Cost Profile

Element	%
Direct Material	56.7%
Hot Rolled Coil	46.0%
Other	10.7%
Direct Labor	8.3%
Manufacturing Overhead	13.1%
Cost of Goods Sold	78.1%
SG&A & Other Expenses	16.4%
Profit before Tax	5.5%
Price	100.0%

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She then collected the following trend data and other information to make her adjustments:

TREND DATA:

Material Cost Trends

COMMODITY CHART DETAIL

Date Range: 31-01-2022 - 31-01-2023

Currency: US Dollar

Weight Unit: Kilograms

COMMODITIES / CURRENCIES / INDEXES

#	Commodity / Currency / Index	Per	Start	End	Average	Change	Price Change
1	Stainless Steel Hot Rolled Coils 316 (US)	1	5,266	6,402	6,089	1,136	21.6 %

PRICE DEVELOPMENT COMMODITIES AND CURRENCIES



- Above is the trend over the past year for Hot Rolled Steel Coil from the WTP Software.
- The Minimum Advantage Target (MAT) for this commodity is 3.0%.
- General inflation (for other material) averaged 6.35% over the last year.
- Productivity in all materials was estimated to be 1% over the past year.

Labor Cost Trends

- Download the average hourly earnings of production and nonsupervisory employees, foundries from the Current Employment Statistics survey (National) from the Bureau of Labor Statistics (www.bls.gov)
- An analysis of the BLS Industry Productivity Index for fabricated metal products indicates that labor productivity increased by 3.2% over the past year.

Overhead Information

- Manufacturing OH is estimated at 80% fixed and 20% variable.
- GSA and other expenses are 90% fixed and 10% variable.
- The average annual inflation (consumer price index) from January 2022 to January 2023 increased by 6.35%. This rate may be applied to the overhead pool (both fixed and variable).

Additional Investments

- In order to meet the current requirements, Pacific Pipe would need to make an additional investment of \$5,000,000 to upgrade its production lines. The upgrades have a useful life of 5 years.
- From Pacific Pipe's 10-K report Sarah discovered that AIR had, over the past 2 years, on average accounted for 5% of the revenue of the business unit that provides the steel pipes AIR buys.

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Worksheet 2: Cost Element Calculations

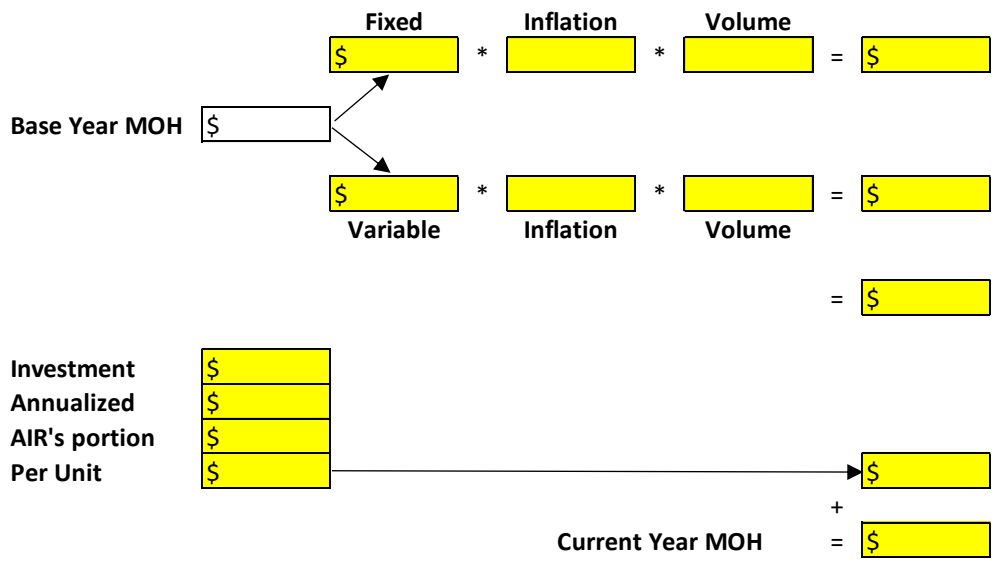
Cost Element	% change	Calculation
Hot Rolled Sheet (price)		
Direct Labor (wages)		

Worksheet 3: Price Adjustment Factor Calculation for Direct Material and Labor

Price Adjustments	Cost Element % change	MAT	Productivity	Price Adjustment Factor
Direct Material				
Hot Rolled Sheet				
Other				
Direct Labor				

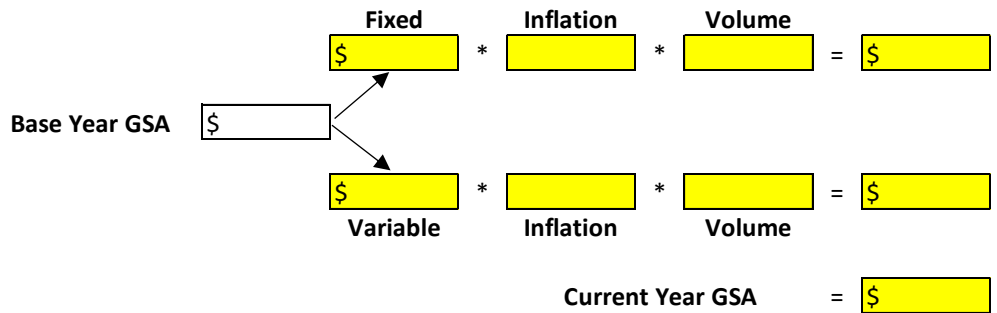
Worksheet 4: Price Adjustment Factor Calculation for MOH and GS&A

Manufacturing Overhead Calculation



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GSA & Other Expenses Overhead Calculation



Worksheet 5: Price Discipline (New Fair Price calculation)

<i>Cost Element</i>	Base Year (\$)	Price Discipline New Proposed (\$)	Adjusted for -
Direct Material			
Hot Rolled Sheet			changes in price, MAT, and productivity
Other			inflation and productivity
Direct Labor			changes in wage rates and productivity
Manufacturing OH			inflation, volume and investment
COGS			
GSA & other exp.			inflation and volume
Profit before tax			Use your discretion
TOTAL	\$42.50		

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Based on the results of the above worksheet, please answer the following questions:

1. How would you negotiate the new contract with Pacific Pipe?
2. Assume Pacific Pipe has spare capacity over the short run and you have bought and paid for the 300,000 feet. You need 25,000 *extra feet*, what price would you be willing to offer per *extra foot*? Explain.
3. What price would you negotiate in case Pacific Pipe had to run the *extra 25,000 feet* using overtime? Assume that the firm operates two shifts and there is no spare capacity on those shifts. Also, running overtime to fill your order will not affect the production schedule on regular runs in the near future.
4. List additional costs that constitute the Total Cost of Ownership for this scenario (e.g. cost of installation)