

# 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**, our 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

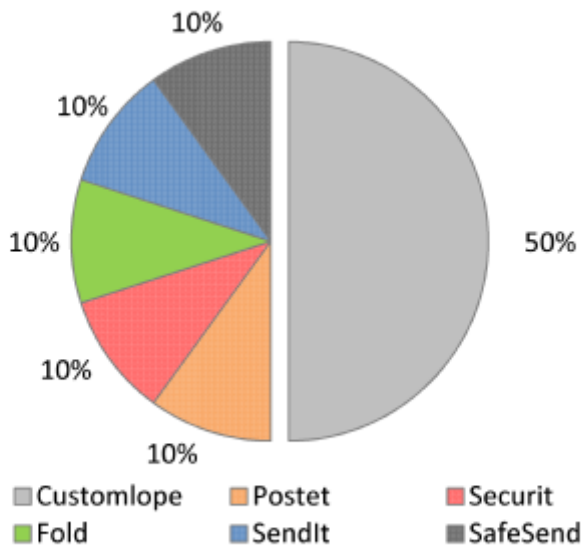


Diagram 2 – Market share

# Sample Structure

The following structure is used as approach for the problem:

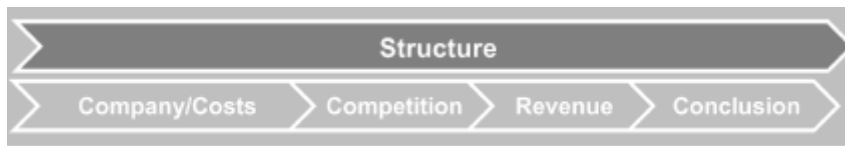


Diagram 1 – Case structure

## 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:

$$\mathbf{Profit = Revenue - Costs}$$

The interviewee should ask for the following information:

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

**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

$$\begin{aligned} \frac{\mathbf{Costs}}{\mathbf{Envelope}} &= \frac{\mathbf{Total\ costs}}{\mathbf{\#\ sold\ envelopes}} = \frac{\mathbf{\$(11 + 18 + 3 + 1 + 2)m}}{\mathbf{50\ m}} \\ &= \frac{\mathbf{\$35\ m}}{\mathbf{50\ m}} = \mathbf{0.7} \frac{\mathbf{\$}}{\mathbf{Envelope}} \end{aligned}$$

### Profit

$$\begin{aligned} \mathbf{Profit} &= \mathbf{Revenue - Costs} = \mathbf{\#Units\ sold} * \left( \frac{\mathbf{Revenue}}{\mathbf{unit}} - \frac{\mathbf{Costs}}{\mathbf{unit}} \right) \\ &= \mathbf{50m} * \left( \frac{\mathbf{\$1}}{\mathbf{unit}} - \frac{\mathbf{\$0.7}}{\mathbf{unit}} \right) = \mathbf{50m} * \frac{\mathbf{\$0.3}}{\mathbf{unit}} = \mathbf{\$15m} \end{aligned}$$

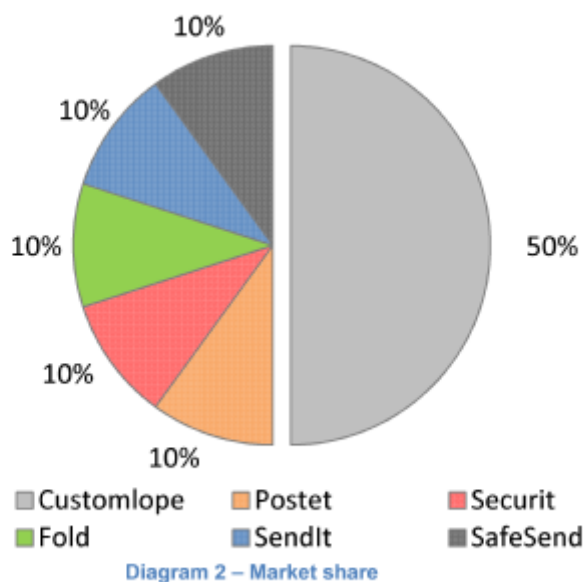
## II. Competition

### Additional Information

#### Note for Interviewer

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

#### 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 **costs** 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:**

$$\begin{aligned}
\text{Profit} &= \# \text{New units sold} * \left( \frac{\text{New price}}{\text{unit}} - \frac{\text{Costs}}{\text{unit}} \right) \\
&= \text{New market share} * \# \text{Total units} * \left( \frac{\text{New price}}{\text{unit}} - \frac{\text{Costs}}{\text{unit}} \right) \\
&= \text{New market share} * \# \text{Total units} * (100\% - \text{Market decr.}) * \left( \frac{\text{New price}}{\text{unit}} - \frac{\text{Costs}}{\text{unit}} \right) \\
&= 100\% * 100 \text{ m} * (100\% - 25\%) * (\$ 0.9 - \$ 0.7) = \text{\$15 m}
\end{aligned}$$

### 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 products** 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

### **Possible answer:**

- 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.