Made-to-measure in New York

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ABSTRACT

Thoughtfully engaging students on social issues is an end in itself and also a means to inject critical thinking into business courses. The case concerns Christopher Demos, the proprietor of a shop that sells made-to-measure shirts. Facing increasing pressure from local competitors and online businesses, Christopher must decide whether to continue a longstanding relationship with a local manufacturer or to outsource production abroad. Students are asked to advise on the decision, drawing on their knowledge of accounting, operations and strategy.

Keywords: accounting, ethics, outsourcing, gross profit, minimum wage, contribution margin, strategy
INTRODUCTION/ TEACHING NOTE

The case concerns Christopher Demos, the proprietor of a shop that sells made-to-measure shirts. Facing increasing pressure from local competitors and online businesses, Mr. Demos must decide whether to continue a longstanding relationship with a local manufacturer or to outsource production abroad. Students are asked to advise on the decision, drawing on their knowledge of accounting, operations and strategy.

The case is intended to help students draw connections between “important” accounting measures such as gross profit (Horngren, 2014, pp. 304-308) and ethical issues such as outsourcing and the federal minimum wage (see e.g. “Destination Unknown”, 2015; Korkki, P., 2014; “Minimum Wage”, 2015; “Special Report”, 2013; Yardley, J. 2013). Students have the opportunity to view these issues through the eyes of a business owner who needs to make a decision in the face of “incomplete or contradictory information in the same way they are likely to be asked to do in their working lives” (Rippin, 2002, p. 439).

The instructor may wish to ask students to model out the business’s net income under different gross profit assumptions. Students already proficient in accounting and financial concepts may be asked, “What is the value of a relationship?” The appropriateness of a C corporation as a business structure may also be queried.

For more advanced students, the instructor should consider supplementing the case with a reading on absorption and variable costing (see e.g. Garrison, 2010). The instructor may ask how GAAP would treat sales commissions to flush out differences between contribution margins and gross profit. The issue is important because management decisions based on erroneous costing information can “lead to bad competitive strategy” (Cooper, 1988). Differences between practices used for internal decision-making and financial reporting can be highlighted.

The case has been intentionally kept brief so that the instructor has the option of assigning it during class time. The case has also been successfully used as an essay prompt.

QUANTITATIVE DATA FROM USE OF CASE WITH STUDENTS

The case makes for lively discussion: 40 undergraduate students were surveyed after reading the case and asked whether the protagonist should continue to send orders to the domestic factory. 16 students (40%) elected the status quo, while the remaining 24 students (60%) chose to begin sending orders abroad. Students were also asked to rate how comfortable they were with their decision, with 1 being “extremely comfortable” and 5 being “extremely uncomfortable.” The median response by students was 3, suggesting the facts of the case elicit a fruitful uncertainty among the participants. Many students (as many as 30%) changed their initial opinion during the ensuing discussion in response to arguments made by their peers.

The case begins on the next page, so that it may be printed for students without the introductory note.
BACKGROUND

It’s 10:00AM on a Sunday and Christopher Demos boards the N-train at Ditmars Boulevard on his way to work. He unbuttons his suit jacket, takes a seat, and unfolds Friday’s edition of the Wall Street Journal, which he hasn’t yet had time to read. He begins scanning an article about the debate over the federal minimum wage (Morath, 2015) but is soon lost in his own thoughts. Demos is about to celebrate his 55th birthday and has big decisions to make about the future.

For the last three decades, Christopher’s store in Midtown Manhattan has sold made-to-measure dress shirts, primarily to local businessmen. Customers visit the store and select a fabric. Christopher takes their measurements and sends the order to a factory in Queens (“the factory”) where the shirts are made.

Christopher has established a reputation for quality among his wealthy customers. He generally sells shirts for about $100 each (prices vary depending on the fabric selected and other considerations). Last year was typical for Christopher’s business. He sold 6,500 shirts, paid $100,000 in rent, $60,000 for salaries and wages and $50,000 in other expenses. Christopher’s store is organized as a C corporation, and its income tax rate is 30%.

The factory charges Christopher $52 for each shirt he makes, sometimes a little more or less depending on the fabric. Christopher knows that the factory is struggling and doesn’t believe it could offer a better price. The factory takes three weeks to complete an order, at which time the customer returns to Christopher’s store to pick up perfectly fitted shirts.

THE FACTORY

The factory is owned by Miguel Coser, who is 30 years old. The factory was built from the ground up by Miguel’s mother, Minerva. Minerva and Christopher were close childhood friends and enjoyed a long and successful business relationship. When Minerva passed away several years ago, Miguel took over the business.

Christopher has known Miguel to be reliable, and Christopher and Miguel get along fine. However, their relationship isn’t warm. Christopher also knows many of the factory workers and considers them highly skilled craftspeople. His relationship with some of the workers extends more than twenty years, and occasionally Christopher and the long timers go out for lunch together and have nostalgic discussions about how much everything’s changed since they were young. Recently they met in a crowded bar to watch a soccer match.

INCREASING COMPETITION

Christopher’s business has come under increasing pressure from new stores that have opened nearby. Christopher is concerned about a place a few blocks away that sells made-to-measure shirts for as little as $64. There’s also an online website that sells a similar product for $56. Christopher doesn’t believe he’s lost business to the internet because his customers like visiting the store and receiving the personal touch. But he worries about the future, especially if others are selling product similar to his for less.
THE OFFER

A few days ago, Christopher was approached by Lirong Wu, a businesswoman representing a manufacturer in Southeast Asia. Lirong claims that her craftspeople can make shirts “as good as he currently sells” for $47 each, including shipping. It would take approximately six weeks from the time the order was placed until delivery.

Christopher remembers reading a newspaper article that described labor conditions in Southeast Asian factories as very bad (Ng, 2014). He’s concerned about this for two reasons. First, he has a deeply held ethical belief that it’s wrong to mistreat workers. Second, he’s worried that if it ever came to light that the shirts were made in a sweatshop, the reputation of the store might suffer and he could lose business.

Christopher doesn’t always trust what he reads in the newspaper, and ideally he’d fly to Southeast Asia to see for himself. Unfortunately such a trip is impractical because Christopher is busy running the business and travel is expensive.

Christopher isn’t Miguel’s only customer, but he’s concerned about how the loss of his business would affect the factory in Queens and the people who work there.

CHALLENGE QUESTION

Christopher has just hired you as his advisor. What do you recommend he do?

BIBLIOGRAPHY


