

“IT’S NOT A GIMME!” IMPLICATIONS OF POTENTIAL OFFSHORE PRODUCTION BY A GOLF GRIP EQUIPMENT MANUFACTURER

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After having served as the leader among golf grip equipment manufacturing companies for several years, ProFlight is faced with sales reduction and uncertainty. Increased competition by other grip manufacturers has resulted in ProFlight’s declining market share and failing customer satisfaction. The company is at a pivotable point! In an effort to regain acceptable margins and stimulate future growth, ProFlight has set a goal of \$6,000,000 in annual savings. The most likely source of savings stems from cost reductions associated with direct labor and overhead. Therefore, to achieve an annual savings of this magnitude, ProFlight must consider moving a portion of its production offshore. However, relocation implications may be far greater than the desire for cost reduction.

INTRODUCTION

It was obvious that Tom George, President of ProFlight Golf Grips, Inc., was preoccupied as he walked to the first tee box on one of Pinehurst’s most prestigious golf courses. After a tumultuous year of change in the golf grip industry, Spring of 1995 brought a time for reflection. As he gripped his club and went through his normal process of visualizing the shot he was about to make, he could not help but think about the competition his company now faced – competition that threatened the company, which he led to become the largest manufacturer of golf grips worldwide. As Tom placed his hands around the ProFlight grip manufactured by the company which he ran, he hit a near perfect shot approximately 300 yards straight down the fairway. As he watched the flawless shot bounce on the lush green fairway, he feared the future of his company was in for a challenging ride.

Golf was known as a challenging yet honorable sport. The concept of hitting a small ball with a club may have sounded primitive and easy – yet the game was challenging, full of strategy requiring complete mental focus. Tom was no stranger to the golf industry. He played golf professionally for nearly 15 years until he

decided to retire. His passion for the sport inspired his desire to work in the golf equipment industry where he became a welcome employee to ProFlight – owned by a large conglomerate, Boston Harbour, Inc. Tom loved his visits to Pinehurst, NC where many of his professional rounds were played. However, on this occasion, the competitive pressure was more complicated than the game itself.

THE GOLF CLUB INDUSTRY

A golf club was composed of three parts – the grip, shaft, and head. The golf grip industry was a lucrative one of which the golf grip supply was historically dominated by ProFlight. The golf grip industry had only 3 primary competitors in 1987. ProFlight held 84% of the market, North American competitor Shepard Grips held 7%, and European competitor Nova held 3%.

By the early 1990's the sport of golf had found itself with nearly 28 million players with one goal in mind – improve their scores. As an answer to the interest of golfers to lower their scores (and handicaps), head and shaft component manufacturers set out on a course to develop game improvement clubs. The theory, to satisfy the demand for lower scores, the market of 27.8 million golfers could generate a new demand of potentially 390 million new clubs. In addition, an array of premium prices could be charged to satisfy the improvement needs of golfers. This even more enticing demand meant the threat of greater competition.

THE COMPETITION

One new entrant to the market, Prince Grip Company, brought an increased creative and innovative approach to make a quick entry in the golf grip industry. Instead of tooling a manufacturing facility, Prince developed a marketing arm of only 6 employees (primarily salespeople), and outsourced the manufacturing, warehousing, and shipment of its product sales. Led by professional golfer, Davis Jones as its owner, Prince quickly emerged as a primary player in the golf grip industry in 1993, immediately acquiring 15% of the global market share surpassing former primary competitor Shepard. While struggling from the demands of 84% of golf club assemblers, ProFlight found itself focused on increasing customer satisfaction of meeting demand through increased capacity. Record orders were placed as demand skyrocketed – as Prince enjoyed from the demand as well. To make matters worse, new competitive entrants were offering “customized” products to retain business, which were most satisfactorily received by all but ProFlight. These “custom” designs increased the price of a grip due to the need for hand painting decreasing the standard from 28,000 grips painted by 2 people per shift to 760 painted by one person per shift. The associated cost increases offset the improvements ProFlight made from the introduction of newly automated machines from 1985 – 1990.

THE DILEMMA

While ProFlight enjoyed the increased volume and profits, market share and customer satisfaction continued to fall. By the end of 1994, despite record production and profits, ProFlight experienced a 24% reduction in market share to 64% in 1994 to the emergence of the new competitors. Prince achieved 15% of the global market, while Shepard held at 7%. The remaining seventeen competitors catered the 14% remaining market share. ProFlight's declining position in the market, raised further concern among top executives. Lower priced, foreign produced products marketed during the high demand period of the early 1990's by ProFlight's new competitors led to the call for drastic cost reduction measures to be taken – from both a competitive as well as survival standpoint.

EXHIBIT 1:

ProFlight Sales, Profits, Market Share and Other Market Data 1987-1993 (in million unless otherwise stated)

	<u>1987</u>	<u>1988</u>	<u>1989</u>	<u>1990</u>	<u>1991</u>	<u>1992</u>	<u>1993</u>
Sales	\$35.00	\$37.00	\$43.00	\$49.00	\$55.00	\$60.00	\$63.00
Profit	\$5.95	\$7.03	\$9.03	\$11.76	\$15.95	\$21.00	\$18.27
Market Share %	84%	84%	86%	85%	85%	86%	75%
Golfers	17.5	19.9	21.3	23	24.2	27.8	24.8
Rounds Played	415	419	431	484	469	502	479
Industry (Sales)	\$41.67	\$44.05	\$50.00	\$57.65	\$64.71	\$69.77	\$84.00

Considering the effects of the proliferation of competition and the impact on ProFlight margins, a goal of \$6,000,000 in annual savings was set for the division to achieve to return to acceptable margins from Boston Harbour's (parent owner of ProFlight) standpoint. This \$6,000,000 cost reduction would have to come from direct labor, direct materials, and or overhead.

The material content of a grip produced to ProFlight standards was fixed. Cost reduction from the substitution of inferior materials was out of the question and price reductions were achieved annually as a practice. New labor reduction processes had already been enforced; therefore, labor reduction at the Andersen facility, from an efficiency standpoint, had been considered and implemented. Throughout the successful years, ProFlight shared their profitability with their employees by increasing the base wage above the local average in hopes of retaining skilled labor. By 1994, the average wage at ProFlight was \$10.41 per hour plus a 45% fringe benefit rate. Therefore, the cost of direct labor amounted to \$15.09 per actual direct labor hour (see Exhibit 2).

EXHIBIT 2:

ProFlight Employees and Hours Wages for 1995 Estimated Employees Required

	Wage per		Total	Total Annual	
	<u>Hour</u>	<u>Benefits</u>	<u>Hourly Wage</u>	<u>Employees</u>	<u>Payroll (000's)</u>
Mixing	\$10.92	\$4.91	\$15.83	15	\$475,020.00
Molding	\$12.01	\$5.40	\$17.41	225	\$7,836,525.00
Painting	\$9.40	\$4.23	\$13.63	340	\$9,268,400.00
Finishing	\$10.32	\$4.64	\$14.96	318	\$9,517,104.00
Total	\$42.65	\$19.19	\$61.84	898	\$27,097,049.00
Average	\$10.41	\$4.68	\$15.09		

THE PLAN

To determine exactly what potential savings and impact would be required of the Andersen facility, all aspects of the production process were examined. Four major processes were identified in the production of a golf grip – mixing, molding, painting, and finishing. While the mixing and molding operations were high skilled requiring fewer employees, painting and finishing were very labor intensive and required two thirds of the operations employee base. (see Exhibit 2).

Considering all major cost components plus the fact that costs were rising from the demand for customized painting, ProFlight concluded when looking for permanent cost reduction ideas to the magnitude of \$6,000,000, the initiative must be centered on reduced cost of direct labor and overhead. This in short meant relocation of processes and job losses for employees. Mexico was immediately a prime choice for relocation due to experience by other Fortune 500 companies with cost savings primarily related to labor and fringe expenses. Upon further study, average hourly wages for average skill levels in Mexico were found to be \$3.00 per hour (translated from the legal Mexican currency - pesos). While this was a huge cost reduction, the Mexican fringe benefit rate exceeded 235% of the wage base making the total cost of labor per hour \$10.06 (see Exhibit 3, next page).

Other costs incurred included building depreciation, indirect labor, salary labor, and supplies. While these costs are incurred, there are cost eliminations in Andersen for each as well in accordance with the relocation. Exhibit 4 (next page) shows the increased costs incurred, as well as the cost savings from relocation from Andersen.

EXHIBIT 3:
Comparison of US vs. Mexican Wage Rates

	Avg Labor in Andersen	Avg Labor in Reynosa, MX
Wage Per Hour	\$10.41	\$3.00
Fringe Benefits per Hour	\$4.68	\$7.06
Cost of Labor Per Hour	\$15.09	\$10.06

EXHIBIT4:
Additional Costs and Cost Eliminated for ProFlight Relocation of Painting and Finishing Operations to Mexico

Additional Indirect Cost -	Additional Costs	Cost Eliminated	Additional Cost
<u>Reynosa</u>	<u>Reynosa</u>	<u>Andersen</u>	<u>(Savings)</u>
Building (Annual Depreciation)	\$74,074	-\$79,250	-\$5,176
Indirect Labor (plus Fringes)	\$600,000	-\$1,250,000	-\$650,000
Salary Labor	\$400,000	-\$800,000	-\$400,000
Importation / Exportation Fees	\$39,000	\$ -	\$39,000
Transportation	\$288,912	\$ -	\$288,912
Supplies	<u>\$1,250,000</u>	<u>-\$1,211,000</u>	<u>\$39,000</u>
Total Costs (Savings)	<u>\$2,651,986</u>	<u>-\$3,340,250</u>	<u>-\$688,264</u>

ProFlight would also experience one-time unavoidable quantitative costs to relocate (Exhibit 5, next page)

As Tom walked the fairway to his ball, he pondered the future of his company and the implications of relocating the manufacturing facility to Mexico. What options did he have to become a stronger competitor, maintain the ProFlight market brand, improve customer satisfaction, and save his company? If he chose to relocate the company would the investment meet the company’s 20% hurdle rate (internal rate of return) and 2-year payback period requirements? Aside from the quantitative issue of relocation, what qualitative issues would Tom and ProFlight face from a relocation?

EXHIBIT 5:

Unavoidable Costs of Relocation 1996-1997

<u>Cost of Relocation</u>	<u>1996</u>	<u>1997</u>
Severance	\$7,714,023	\$2,500,242
Machinery Movement and Setup	\$250,000	\$20,000
Training	\$160,000	\$120,000
Increased Inventory	\$1,226,682	\$502,730
Additional Cost of Quality	<u>\$3,116,619</u>	<u>\$1,120,899</u>
Total Unavoidable Costs	<u>\$12,467,323</u>	<u>\$4,263,871</u>