Widget*

A widget manufacturer currently produces 200,000 units a year. It buys widget lids from an outside supplier at a price of $2 a lid. The plant manager believes that it would be cheaper to make these lids rather than buy them. Direct production costs are estimated to be only $1.5 a lid. The necessary machinery would cost $ 150,000. This investment would be depreciated linearly over 5 years. The plant manager estimates that the operation would require additional working capital of $30,000 but argues that this sum can be ignored since it is recoverable at the end of the 10 years. If the company pays tax at a rate of 40 percent and the opportunity cost of capital is 10 percent, would you support the plant manager's proposal ? State clearly any additional assumptions that you make.

* André Farber prepared this case as a base for class discussion.