*Strategic Management*, 9e: Chapter 10 study guide

Financial projections for case 10.4

*Option 1*

Stop supplying all basic frozen products, including its branded and own brand (i.e., with the retailer’s private brand name) vegetables. Dropping this range would mean that the overhead contribution made by carrying these products would no longer be available to the group. The financial implications are shown in below.

**Financial projection for Option 1 ($ million)**

|  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  | **Projected from company base year in 2003** | | | | | | **Option 1** | | | | | |
| **2003** | **2004** | **2005** | **2006** | **2007** | **2008** | **2009** | **2010** | **2011** | **2012** | **2013** | **NPVa** |
| Sales | 600 | 200 | – | – | – | – | – | – | – | – | – | – |
| Incremental profit impact | 24 | (5) | (8) | (8) | (8) | (8) | (8) | (8) | (8) | (8) | (8) | (48.6)b |
| Capital impact: working capital | – | 10c | 20c | – | – | – | – | – | – | – | – | 26.0d |
| Capital impact: fixed capital | – | – | – | – | – | – | – | – | – | – | – | – |

*Note*: Current position shows the situation for the option only. All other sales and profits operate as previously.

a NPV = Net Present Value at 9 per cent cost of capital 2003 = (5) × 0.917 + (8) × 0.842 + (8) × 0.7721 etc.

b Net effect of lower sales and some lower overheads, but freezer transport and warehousing would still be needed for other products.

c Working capital no longer required to support sales.

d $26 million working capital released from lower sales when discounted back to base year 2003.

*Option 2*

Cancel its current branded range of basic frozen food products such as vegetables but continue to manufacture own brand versions. This would keep some overhead contribution but would have very low added value. At the same time, the company would keep and slowly extend its range of higher-added-value branded items. The financial implications are shown below:

**Financial projection for Option 2 ($ million)**

|  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  | **Projected from company base year in 2003** | | | | | | **Option 2** | | | | | |
| **2003** | **2004** | **2005** | **2006** | **2007** | **2008** | **2009** | **2010** | **2011** | **2012** | **2013** | **NPVa** |
| Sales | 600 | 200 | 200 | 200 | 200 | 200 | 200 | 200 | 200 | 200 | 200 | – |
| Incremental profit impacta | 24 | (5) | (6) | (6) | (6) | (6) | (6) | (6) | (6) | (6) | (6) | (37.6) |
| Capital impact: working capital | – | 18b | 12b | – | – | – | – | – | – | – | – | 17.4 |
| Capital impact: fixed capital | – | – | – | – | – | – | – | – | – | – | – | – |

*Note*: Current position shows the situation for the option only. All other sales and profits operate as previously.

a Highly efficient to deliver own label to few supermarkets with no branded advertising. However, this is offset by the need to continue to deliver branded savoury, meat and fish dishes to all outlets.

b Reduction in working capital proportionately larger on smaller outlets: $17.4 million released.

*Option 3*

Drive hard to redevelop and substantially extend some specialist branded ranges; for example, its range of frozen cakes and gateaux and its market-leader range of meat and fish products. This would take time and resources but would produce higher added value. It would keep its broader range of branded products, including its low-value-added items, as long as they made a contribution to overheads. The financial implications are shown below.

**Financial projection for Option 3 ($ million)**

|  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  | **Projected from company base year in 2003** | | | | | | **Option 3** | | | | | |
| **2003** | **2004** | **2005** | **2006** | **2007** | **2008** | **2009** | **2010** | **2011** | **2012** | **2013** | **NPVa** |
| Sales | 1,105 | 1,150 | 1,200 | 1,250 | 1,300 | 1,350 | 1,400 | 1,450 | 1,500 | 1,550 | 1,600 | – |
| Incremental profit impacta | 80 | (5) | (5) | 4 | 6 | 8 | 10 | 12 | 14 | 14 | 14 | 35.7 |
| Capital impact: working capital | – | (2.5)b | (2.5) | (2.5) | (2.5) | (2.5) | (2.5) | (2.5) | (2.5) | (2.5) | (2.5) | (16.0) |
| Capital impact Fixed capitalc | – | – | (5) | – | (10) | – | – | – | – | – | – | (11.3) |

*Note*: In this option, the current column considers total sales and profits because they will all be affected by the option.

a Net effect of increase in sales less the branded expenditure needed to achieve this.

b Steadily increasing sales so extra working capital required.

c Some new capital investment required in plant and equipment to handle extra sales.

*Option 4*

*Become a specialist producer*. This would be done by dropping almost all its low-added-value basic range, closing several freezer factories, contracting out its freezer distribution, investing heavily in specialist menu ranges, advertising these ranges only. Clearly this is a more radical solution but would emulate the success of several US companies across Europe, such as McCain and Sara Lee. The financial projection for this option is shown below.

**Financial projection for Option 4 ($ million)**

|  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  | **Projected from company base year in 2003** | | | | | | **Option 4** | | | | | |
| **2003** | **2004** | **2005** | **2006** | **2007** | **2008** | **2009** | **2010** | **2011** | **2012** | **2013** | **NPVa** |
| Sales | 1,105 | 900 | 600 | 600 | 650 | 700 | 800 | 850 | 900 | 1,000 | 1,200 | – |
| Incremental profit impacta | 80 | (50) | (100) | (40) | (20) | 10 | 30 | 100 | 225 | 250 | 300 | 258.7 |
| Capital impact: working capital | – | 10 | 30 | – | (2.5) | (2.5) | (5) | (2.5) | (2.5) | (5) | (10) | 19.0 |
| Capital impact: fixed capitalb | – | (50) | (100) | (50) | – | (50) | – | – | – | – | – | (201.1) |

*Note*: In this option, the current column considers total sales and profits because they will all be affected by the option.

a Quite difficult to calculate the profit impact with certainty: need to explore detailed projections for each major product area but not presented above for reasons of space.

b Need to provide for factory closure costs and, in year 2008, for factory reinvestment.

*Option 5*

*Becoming the lowest-cost producer*. This would be done by building on existing sales to all major customers: major investment in new factories, new warehouses and new transport networks would be needed. This would be coupled with major (and largely unknown) manufacturing innovation, all with the aim of reducing costs, so that they would move below those of its competitor, Refrigor. Although this option was available in theory, it was based on three assumptions that carried some risk:

Refrigor would slow down its current rate of investment and allow itself to be overtaken.

Major cost savings of the order of 20 per cent below existing costs were still available in the industry.

Market leadership could be gained through a low-cost route.

For this option, it was recognised that it would also be necessary to provide substantial extra advertising and promotional support to sustain and build the brands. Overall, this was the option with the highest investment with the financial projection being shown below.

**Financial projection for Option 5 ($ million)**

|  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  | **Projected from company base year in 2003** | | | | | | **Option 5** | | | | | |
| **2003** | **2004** | **2005** | **2006** | **2007** | **2008** | **2009** | **2010** | **2011** | **2012** | **2013** | **NPVa** |
| Sales | 1,105 | 1,400 | 1,500 | 1,600 | 1,800 | 2,000 | 2,200 | 2,400 | 2,600 | 2,800 | 3,000 | – |
| Incremental profit impacta | 80 | 5 | 5 | 10 | 12 | 20 | 30 | 40 | 50 | 60 | 70 | 160.0 |
| Capital impact: working capital | – | (15) | (5) | (5) | (10) | (10) | (10) | (10) | (10) | (10) | (10) | (60.7) |
| Capital impact: fixed capitalb | – | (100) | (300) | (150) | (50) | (50) | – | (200) | – | (200) | – | (729.4) |

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