**----------------------------------------------------------------------------------------------------------------INTRODUCTION**



*The House*

Anne and Fred Harriot are owners and operators of *The House*. *The House* is a family boutique apparel store in Hamilton, a small midwestern community of 6,860 households (excluding college students) comprising 18,180 permanent residents. Hamilton is located at the crossroads of State Highway #43 and #62. In addition to the permanent residents there are 2,800 full-time students who attend a small private college. These college students, many of whom have roommates, occupy 1,650 separate apartments, dormitory rooms, or other residences that are separate from the permanent resident population. Thus, the total households consist of 6,860 permanent and 1,650 nonpermanent, or college student households, for a total of 8,510 households. The total population is 20,980, which consists of 18,180 permanent residents and 2,800 college students.

**Background**

Hamilton is centrally located near several other communities. The next largest town is Troy, which is 39 miles to the east and has a population of 44,675. However, there are five smaller towns within a 15-mile radius and range in size from 1,400 to 4,100 and have a total

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population of 17,900. Anne and Fred took over the management of *The House* after Ann's father, the founder of the store, retired in 2010. Anne's father, Bill Henderson, started *The House* in

1973 after he graduated from the local college. Initially, *The House* was a menswear store with college men as its target market. However, over the years, Bill Henderson found that the college men's market was too thin to support a store and thus in 1976 Bill added women's apparel targeted at college females. In 1982 Bill, once again, broadened *The House’s* target market and added apparel to appeal to all age groups including children.

Anne and Fred had been married for five years when they moved to Hamilton in late October 2010 to take over management of *The House*. At the time, Fred was an assistant store manager at a JC Penney store in Cleveland and Anne was a registered nurse at a Cleveland hospital. Anne found the pressure of nursing in a big city hospital too demanding and she looked favorably upon the idea of returning to Hamilton. She recalled fondly where she grew up and the idea of managing the family business sounded appealing. Fred was also excited about managing and owning his own store.

**Purchase of Business**

Mr. Henderson offered to sell *The House* to Anne and Bill for the book value of its cash, receivables, fixtures, equipment and inventory which totaled $700,000. The fixtures and equipment were valued at $90,000. *The House* occupies a 7,000 square foot Victorian style house on the Town Square in Hamilton. The building is owned by Mr. Henderson who agreed to lease the building to Anne and Bill for $3,500 per month. In addition, he agreed to take a downpayment of $100,000 on the $700,000 purchase price and to finance the remaining $600,000 on a three year 6% interest only note with interest of $3,000 due the first of each month. At the end of three years Anne and Bill will need to obtain permanent financing from a source other than Mr. Henderson.

After some serious thought Anne and Fred agreed to purchase *The House* from Anne's father. They took possession of the store on November 1, 2010 just in time for the Christmas season. In 2010 sales were $1,590,040 and of this amount $417,840 occurred during November and December. Total assets at year-end 2010 were $685,100, which included $98,700 in cash, $45,200 in accounts receivable, $451,200 in inventory (at cost) and the $90,000 worth of fixtures.

*The House* is open Monday through Wednesday from 10:00 a.m. to 6 p.m. and on Thursday through Saturday from 10 a.m. to 9 p.m. *The House* is closed on Sunday and also on Thanksgiving Day, Christmas and New Years Day. Fred and Anne work in the store daily. However, Friday and Saturday are their busiest days. They have four full-time salespeople, four part-time salespeople, one full-time janitor, one bookkeeper, an accounts payable and accounts receivable clerk, a secretary who also serves as a receptionist, and a full-time buyer who buys

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womenswear and children's apparel. Mr. Henderson, in addition to running the store the last thirty-seven years, also served as the menswear buyer. He has agreed to continue to perform this activity for the next 12 months for a retainer of $15,000 and to take Fred along on three buying trips. After the 12-month transition, Fred will perform the buying function for the menswear line.

**Operating Characteristics**

*The House* has 40% of its sales in menswear, 35% in womenswear, and 25% in children apparel. In total, *The House* has 1,765 stockkeeping units (SKUs). Due to the variety of merchandise, prices vary considerably. In 2010 the average transaction size was $59.44 (before sales tax) which included on average 5.0 items. However, prices for any single item can vary from $1.79 to $459.00. The permanent residents of Hamilton seem to enjoy shopping at *The House* as evidenced by the fact that 65% of Hamilton's total households visited *The House* at least once during 2010. These households visited the store an average of 7.8 times in 2010. Importantly, not all store visits result in a purchase. In 2010 the closure rate (the percentage of store visits that resulted in a purchase) was only 62%.

*The House* has been operating on a 38% gross margin and Fred and Anne expect this to continue for 2011. They have carefully analyzed their expected costs for 2011 and estimate fixed operating costs per month at $31,550 and variable operating costs at 11.2% of sales. The fixed operating costs include a $2,500 monthly salary each for Fred and Anne. Variable operating costs include advertising costs of 3.2% of sales. The baseline financial information can be found by following this [link](file:///M:\The%20House%202009\baseline%20phase%201.xlsx).

**Retail Environment**

The retail environment of Hamilton is typical of small college towns. There are five gasoline stations, two pharmacies, two supermarkets, a bakery, a butcher shop, a womenswear store, a Dollar General department store, a jewelry and gift store, a television and home appliance store, a furniture store, an office supply and equipment store, a True Value Hardware store, and a Wal\*Mart. There are also a dry cleaner, two Laundromats, three banks, a travel agency, six churches, one funeral home, two used car dealers, a Chevrolet Dealership, a Ford Dealership, a farm and feed supply store, a movie theater, two real estate agencies, three insurance agencies, five barbers/beauticians, six fast food restaurants, two grills that cater to college students, two family style cafes, an optometrist, four family physicians, a pediatrician, and three dentists. *The House* is located on the Town Square where a bank, county government offices, one of the family style cafes, the womenswear store and the Dollar General department store are located. There are also two vacant stores on the Town Square, which have been vacant for 18-24 months. Also on the town square is an insurance agent, real estate agent, barber, travel agent, and two law offices. At the eastern edge of town there is an eight year old, 85,000 square

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foot Wal\*Mart discount department store. The local college is a half-mile north of downtown Hamilton.

**Special Note**

You will probably find it helpful to reread this brief description of *The House* before you begin each exercise. Data is provided in this description which can be used to help solve some of the exercises.

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