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**PHASE THREE [NEW00142.GIF](INTRODUCTION.docx)**

**EXERCISE SEVEN-A** House Information

**This exercise should be answered using the Phase 3 Variables Worksheet**

**[](variables3.xlsx)**

**Evaluating a New Location for *The House***

Currently *The House* is located on the Town Square of Hamilton and draws customers from a three-mile radius that encompasses the entire community.

Fred and Anne are considering opening a second store at the edge of town across the street from the Wal\*Mart Discount Department Store. The Wal\*Mart attracts people from the local community and the surrounding five smaller towns which are within a 15-mile radius of the Wal\*Mart. The population density within this 15-mile trade area averages 24.6 households per square mile.

The building Fred and Anne are considering leasing is 4500 square feet. Hours of operation would be 10 a.m. to 8 p.m., Monday-Saturday.

They expect fixed operating costs to be $175,200 for the year comprising of:

Supervisory Salary - $30,000

Other Salary - 38,000

Salary fringe benefits - 17,000

Rent - 31,000

Utilities fixed - 6,200

Depreciation - 18,000

Maintenance - 5,000

Insurance - 6,000

Interest ( 8% on loan for new assets) 24,000

Variable operating costs are expected to be the same percentages of sales as for the original store except that advertising is expected to be 4.40% of sales.

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They expect that the average transaction size will be $ 47.24. This is considerably lower than their main store because they believe that most customers will be attracted to shop at the

store while they are making a trip to Wal\*Mart. Thus, they believe most purchases will be fill-in purchases and not as a result of a destination visit to the store to purchase specific merchandise.

The cost of merchandise sold and therefore the gross margin percent is expected to be the same as for the main store of *The House*.

Virtually all of the visits will be due to intercepting traffic from the Wal\*Mart across the street. They estimate that the Wal\*Mart has a 90% penetration level and an average shopping frequency of 14. Fred and Anne estimate that their penetration the first year will be 36% and the average shopping frequency will be 2.5 times per year. In the second year they expect the penetration to rise to 42% and average shopping frequency to rise to 3.0 times per year. For both years they estimate closure will be 65%.

Approximately $88,000 will need to be invested in leasehold improvements and fixtures and $164,000 in inventory. They will also plan to have $48,000 in cash available when they start business for unexpected expenses or losses. The new store will be cash only so there will be no accounts receivable. Thus, they expect their total assets to be $300,000.

The Variables Worksheet you will need to run this simulation can be reached by clicking the red “3” above. You will need to enter the changes on the Input Form one at a time. The financial statements and ratios will automatically be updated and shown on the bottom of the input form. You must then copy the revised income statement and ratios to the scenario columns on the Answer Sheet. This process will have to be repeated if there is more than one scenario described in the exercise. Instructions for use of the Variables Worksheet can be reached by clicking on the “Help” button at the top right of the worksheet.

Note that many changes must be made to the baseline amounts to reach the adjusted amounts as described above. The simulation must be run twice for both the first and the second year of the new store’s operations.

Be sure to save your work and print a copy once you are satisfied with its correctness. After you complete your simulation there are questions you need to answer. These can be answered by typing your responses below the questions, saving your work, printing a copy, and handing it in to the instructor if required

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**EXERCISE SEVEN-A**

**QUESTIONS**

1. Is the proposed new location for *The House* economically viable? Explain.

1. Do you have any suggested strategies that would make *The House* more profitable in the first year of operation?

1. Should a decision on opening a new store location be based on the projected results of the first two years? Why or why not?
2. Opening a new store is fraught with risk and needs to be considered in great depth before the decision is made. What are some of the things that could go wrong and cause a new store location to fail?