

Carribean internet cafe

Business, Industries



Assignment

Caribbean Intern Cafe

Date: November 14, 2012

1. There are many issues that Mr. Grant should consider before proceeding with the CIC. There are several things that Mr. Grant should examine before even looking at the projections given to him. Total capital is \$2, 250, 000, \$1, 000, 000 in investments and \$1, 250, 000 in the form of a long-term loan. \$1, 573, 000 is immediately spent leaving \$677, 000. If he has no customers, he can afford to remain open for 3 months. As well, they are not attractive to individuals who seek to use the Internet for longer periods of time and the customer base that they are attempting to attract is the more affluent and educated of the population. They are also the most likely to either already own a computer or will be purchasing a computer in the near future. Mr. Grant must have a business plan that is either for the short-term or able to readily adapt to future circumstances as he expects private usage to increase in 3 years. Mr. Grant should also examine factors external to his business. These issues include his mention of the relatively low demand for coffee in Jamaica as well as changes in levels of private Internet usage. His management plan should include contingencies to replace coffee if it is not making a profit as well as plans for the computer area when future demands for Internet cafes start to decrease. A final issue that Mr. Grant should also examine is the terms of agreement for the long-term loan. If CIC is very profitable they may want to pay off the loan as quickly as possible instead of incurring unnecessary interest.

2. The fixed costs remain constant within a relative range of finished products produced. The fixed costs amount to an annual rate of \$2, 479, 400 and the break down of each fixed cost is shown in Appendix 1. The fixed costs include the manager, employees, rent, telephone and utilities, link to the Internet, insurance, advertising, interest on the loan, and miscellaneous administration and maintenance fees. The start-up costs amount to a one-time fee of \$1, 573, 000 and the breakdown of each cost is shown in the Appendix.

3. It should be noted that in all cases start-up costs were amortized in the first year. The variable costs are those that are accrued on a per-customer basis and are shown in Appendix

4. This amounts to a weighted average Variable Cost of \$104 per customer.

5. The costs of the first customer may be calculated by adding the fixed costs, start-up costs, and variable costs for the first customer. The variable cost was calculated using a weighted average based on the estimated usage of the Internet. Assuming that the fixed costs are calculated on an annual basis and are set for the entire year then the cost for the first customer will be \$4, 052, 504. The contribution margin may be calculated for each customer as $C/M = R - VC$. A weighted average was used because it is estimated that 40% of the customers will use the computer thereby increasing variable profit by \$60 (\$120 revenue, \$60 variable cost). A breakdown of the variable costs and revenue are shown in Appendix

6. The contribution margin is \$144 per customer.

7. In order for the CIC to break even, they must cover their fixed costs, variable costs, and start-up costs. This can be solved using the formula: $B/E \text{ Pt.} = (\text{Fixed cost} + \text{Start-up cost}) / \text{contribution margin}$
 $B/E \text{ Pt.} = (2479400 + 1,573,000) / 144$
 $B/E \text{ Pt.} = 28,142$
 Therefore, they will need to have 28,142 customers that at minimum meet their average consumption expectations of computer usage, food, and beverages in order to reach their break-even point in the first year.

8. Using the same formula as question except that there are no longer any start-up costs but fixed costs (\$2479400) and contribution margin (\$144) remain the same so Mr. Grant will require 17,219 customers in order to reach his break-even point for the second year. Based on the projected given to him we can calculate the expected contribution from each scenario.

(Table 1).

	Scenario	Customers
Optimistic	50000	\$7,200,000
Realistic	24,000	\$3,456,000
Pessimistic	12,000	\$1,728,000

As Internet usage becomes more common competition will increase and his business plan will most likely have to be reviewed. Therefore, in the first

three years, Mr. Grant should expect to make a significant profit in these years for the project to be worthwhile.

Projected net profits (losses) for each scenario are shown in Table 2.

Scenario	Year 1 (\$)	Year 2 (\$)	Year 3 (\$)	Total (\$)
Optimistic	3, 147, 600	4, 720, 600	4, 720, 600	12, 588, 800
Realistic	596, 400	976, 600	976, 600	1, 356, 800
Pessimistic	2, 324, 400	751, 400	751, 400	3, 827, 200

Table 2 shows the net profit (loss) for the first 3 years based on each scenario. All start-up costs are paid for in full in the first year only. Based on these scenarios Mr. Grant would have a very difficult decision to make.

Firstly, the net profit does not take into account the \$500, 000 investments that were made by both Mr. Grant and JTL. Secondly, the terms of the long-term loan are not made clear nor did the negotiations include an amortization schedule. As well, a long-term plan has not been made based on expected increases in private Internet usage. Finally, the probability of each scenario being realized is a very important tool to determine the expected value of Mr. Grant's decision. If each scenario is equally likely to occur than Mr.

Grant will have an expected profit of \$3, 372, 800. 01. Although simplistic, we can determine that the CIC has made an expected \$1, 122, 800 in three

years if the loan is fully paid off years and all investments are recuperated. If the CIC were to then dissolve, each investor would make a profit of \$561,400 a return on investment rate of 28.52% compounded annually as well as revenue generated from the sale of capital (excluded from further analysis for simplicities sake). In conclusion, based on the information available, unless Mr. Grant can find another investment that will provide a greater return on investment than 28.52% compounded annually for the next 3 years, he should give the CIC the green light.

Appendices Appendix 1: Fixed Costs Expense

	Cost per year (\$)
Manager	480000
Rent	360000
Telephone and utilities	180000
Link to internet	120000
Insurance	120000
Advertising	120000
Employee Wage	374400
Misc. admin and maintenance	600000

Interest on loan	125000
Total	2479400

Appendix 2: Start-up Costs Expense

	Cost (\$)
Telephone and utilities	7, 000
Advertising	20, 000
Other up-front costs	120, 000
Equipment costs	1, 426, 000
Total	1, 573, 000

Appendix 3: Variable Costs Expense

	Cost (\$ per customer)
Food	50
Beverages	30
Internet Usage	60
Total Average Variable Cost	104

*Calculated using a weighted average based on the assumption that 40% of customers will use the Internet for 1-hour

Appendix 4: Variable Revenue Revenue

	Revenue (\$ per customer)
Food	60
Beverages	140
Internet Usage	120
Total Average Variable Revenue	248

Calculated using a weighted average based on the assumption that 40% of customers will use the Internet for 1 hour.