Case study on new heritage doll company capital budgeting

Business, Company

1. Set forth and compare the business cases for each of the two projections under consideration by Emily Harris. Which do you regard as more compelling and worthwhile?

Emily Harris is tasked with determining which of two presented projects would be considered for investment by the New Heritage Doll Company, a successful toy manufacturer competing in the US$ 1. 6 billion toy doll market. The two projects are Match My Doll and Make Your Doll, a new and ground-breaking concept aimed at expanding the company's target clientele. Because of the limited room for capital investments and set criteria that New Heritage uses to evaluate projects, Harris is tasked to evaluate, select and propose the project with the best possible benefits for the company.

Match My Doll is an expansion of an existing product line. Having been successful for several seasons, the product manager of the line believes that it is ripe for an expansion to take advantage of its current popularity. Make Your Doll will be the company's bold attempt at mass customization, taking advantage of technology to reel new customers and re-engage existing ones. Heritage uses several risk criteria to evaluate new projects and how both projects fare in the table below. Both projects are promising, with one being more " risky" in the sense that it is new. If the financial projections show that the rewards are commensurate to the risks, then Heritage could consider investing in a new product line that will diversify and expand their market share.

Table 1 Comparison of the Match My Doll and Make Your Doll Projects

Business Considerations

Acquisition of new customers

An expansion of its current customers

Is seeking to acquire new customers through the use of new media

Heritage is seeking to expand its market, which it will only get through an introduction of a new product line

Application of new technology

No new technology employed

Although existing, the technology that will be employed has not been used a medium for the company's retailing

More and more businesses are looking at e-commerce to expand their business reach.

Increased fixed capital costs

No new capital assets to procure

Capital equipment to be purchased from 2010 to 2011, at significant discount if purchased on 2010

Investment I capital, while tying up more cash has always been the more conservative approach to growing business.

Sensitivity of product prices to macroeconomic conditions

Low, product line returns are known to the company

Unknown. Price sensitivity analysis is not possible due to insufficient data

Price competitiveness

High, given the product lines popularity

Unknown. Price competitiveness analysis is not possible due to insufficient data

Financial Metrics

Discussed below

Discussed below

2. Use the operating projections for each project to compute a net present value (NPV) for each. Which project creates more value?

Using Net Present Value calculations, the project that creates more value is the Match My Doll project. Using the cash flows calculated from the provided tables, the project creates positive NPVs using the hurdle rates for different risk scenarios, as shown below.

Capital expenditures

Net operating profit

Project cash flow

3. Compute the payback period (PP), discounted payback period (DPP), internal rate of return (IRR), modified internal rate of return (MIRR) and profitability index (PI) for each project. How should these metrics affect Harrises deliberations? How do they compare to NPV as tools for evaluating projects? When and how would you use each?

The Payback Period, Discounted Payback Period, Internal Rate of Return and Profitability Index for the Match My Doll project is shown below. These calculations are based on the data presented in the case.

The calculations show that the superior project is the expansion of Match My Doll. It has a high IRR versus a negative IRR for the Make Your Doll project, the payback period is only 5. 23 compared to that of make your Doll and a 7. 89 year discounted payback versus the Make Your Doll project that cannot recover investments in 10 years. The modified IRRs at different risk levels, given a reinvestment rate of 12% looks favorable for Matchy My Doll but not for Make Your Doll. Lastly, the profitability index is more than 1 for Match My Doll, a clear “ go-ahead” signal to invest in the project.

4. What additional information does Harris need to complete her analyses and compare the two projects? What specific questions should she ask each of the project sponsors? Explain.

The calculations herein were conducted in a state of imperfect information. In real life, Harris would look at the affectivity of mass-customization, as a way of reaching out to a different segment of the market. She should ask the product manager of the Make Your Doll project what the price premium of providing a mass-customization service is. The calculations here showed that there is no price difference between traditional selling media and newer, value-adding approaches but in real life, there may be increased product value hence better cash flows. She should also ask the product manager the volume of dolls that are expected to be sold, since the target clients are a different demographic and may have a volumetric impact causing a rise in possible revenues.

However, based on the information provided in the case and the calculations derived, sticking to the traditional business selling approach and expanding an already proven product line is the prudent choice.

5. If Harris is forced to recommend one project over the other, which should she recommend? Why?

Harris will have to recommend expanding the Match My Doll product line because of the following reasons:

a. The project adheres to the 15% EBITDA criteria which Hertiage has followed to steadily grown its company, since its inception;
b. The project has lower conceivable levels of business risks, such as the production and sale of a product that the company is familiar with. The company also has a better handle of the price sensitivities and competitiveness of the product line versus other brands; and
c. The project has favorable financial returns based on NPV, IRR, MIRR and DPB and PI.