

Danforth donnalley laundry products company integrative problem

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DANFORTH AND DONNALLEY COMPANY (Finance and Accounting Case Study)
of (affiliation) DANFORTH AND DONNALLEY COMPANY

The proposed new product of Blast, a stronger form of liquid detergent to be launched by the company, should be charged for the use of the excess production facilities and also unused building space within the company premises once plans push through and production starts. This is because a similar facility would usually cost \$2 million to rent out from another company. The reason for this is to fully reflect all the costs associated with a certain product using the full-cost accounting method, in which all costs are imputed into the cost of production, and hence, pricing of the final product. If the company will not assume or include the \$2 million rental cost, it will understate the cost of Blast, and give an erroneous costing, and so also on the final price. This is usually done through the so-called “ shadow pricing” method, in which the impact of any project is fully reflected in its valuation. This will also give a more accurate idea of the project viability. Shadow pricing is a very useful tool in cases where there is no definite market price yet.

From the viewpoint of the project feasibility evaluation, the hypothetical and additional cash inflows from the erosion of sales from current laundry detergent products should not at all be included in the projected cash inflows, as shown in Table 1 (Titman, Martin & Keown, 2011, p. 411).

Including these cash flows gives a wrong impression that the proposed project is viable, when in fact, it might not be that feasible because from the standpoint of the company, there are no new cash inflows coming in (no net addition to sales revenue). In marketing industry parlance this is merely a “

cannibalization” of an existing product, or transferring monies from one pocket to the other pocket, to use an analogy. But on the other hand, if there is a distinct possibility that competitors will introduce a product similar to Blast, then that would impact on the project as it can introduce other factors into the equation, such as grabbing or retaining market share.

Reference

Titman, S., Martin, J. D. & Keown, A. J. (2011). Financial management: Principles and applications (11th ed.). Upper Saddle River, NJ, USA: Prentice Hall.