Target case ananlysis

RECOMMENDATION

The Barn was my first choice because it had the highest IRR and second highest NPV given a not so large investment. Whalen Court has the highest NPV and offers favorable market share opportunities and demographics. These first two are considered good options to continue Targets growth. Gopher Place has attractive IRR and NPV comparable to the prototype, while giving Target market share. Also the population growth and median income demographics are favorable.

The next opportunity is in the mediocre category, Stadium remodel, with the 3rd highest IRR and 4th NPV, but has higher risks as the store is deteriorating and has sales declines, which could hurt brand image. Also the stores have been remodeled twice already. This investment might be a good idea to keep the store afloat or it might have to be closed. Finally Goldie's Square has the lowestNPV and IRRof the projects, declining market share, and the impact of the project won't be seen till the third year.

BACKGROUND

It is November 2006, and CFO Doug Scovanner has to review five projects along with other members of the Capital Expenditure Committee, after five projects have already been accepted. Targets management has an overarching goal to create 100 new stores a year while maintaining their strong brand image and reputation. The investment decisions should be ranked according to their value to Target, 1-5. The analysis should include review of P/L, NPV, IRR, demographics, market share, sensitivity and variance to the prototype

ANALYSE

As the case states, the intense competition in the retail market and has led to prices being driven down to almost cost, resulting in very small margins. This causes the companies to focus on every part of their business, including how they want to brand themselves to consumers.

This chart above gives a brief look at that picture. Sales growth stem from creation of new stores and organic growth through existing stores. Though new stores are expensive to build, they are needed to access new markets and represent profit potential. Walmart Operates store formats similar to Target, and most Target stores operate in areas where one of more Walmart store is located. Also, the merchandising assortment overlaps on many of the same items, such asfood, commodities, electronics, toys and sporting goods.

The success of Walmart is attributed to the “ every day low price” pricing strategy, which also drove local independent retailers out of business. CostcoCostco attracts a customer base that overlaps with Target’s core customer. However, there is less overlap withrespectto trade area and merchandising between Costco and Target than Walmart and Target. Costco also requires a membership to shop in the store, where Target and Walmart do not. Costco provides discount pricing for its members who all buy in bulk for membership fees in return. In 2005 the fees equaled 2% of total revenue and 72. % of operating income. This shows how important those fees can be in a high competition and low margin market. Target Target emphasizes the customer experience and has the slogan “ Expect more. Pay less. ” They have been promoting their brand awareness through large advertising campaigns. The advertising expenses in 2005 were 2% of sales of 26. 6% of operating profits. Brand and store/product quality play a larger role for Target than Walmart. Target also offers a credit card, which accounted for 14. 8% of targets operating earnings and is important in the evaluation of each project.

PROJECT ANALYSIS AND SUMMARY

The Barn The project has the highest IRR, 16. 4% and the second highest NPV of $20, 500. The NPV on this project is not highly sensitive. The location offers the incentive of have no nearby stores, creating a new market for Target. Additionally it requires the smallest investment amount out of the five projects. However, the market doesn't have the ideal target demographics with only 17% of adults have earned a college degree, slow general population growth and lower income individuals Whalen Court

The project gives target the opportunity to move into an urban center, where it will not have to compete directly with other Target stores, coinciding with managementsgoals. The project has the highest NPV at $25, 900. The project has the second lowest IRR, of 9. 8% and needs 1. 9% more sales in order to reach the total store prototype. On the other hand this project requires the largest investment of $119M (which would need board approval). This cost would be offset by the brand image to an urban area with a lot of people. Finally the building would be leased instead of owned, which might have long tern consequences.

Gopher Place The project has the second highest IRR of 12. 3% relative to all of the capital project requests. The NPV of the project is above the prototype and represents an investment of $23M. The demographics in this area are attractive with 27% population growth and a median household income of

$56, 000. Transfer sales or cannibalization is estimated at 19% of sales from the proposed area, as there are other Target stores in the areas. There are also two new Walmart Super Stores in the area, which could pose as threat to competition and prices.

Additionally the effects of the project wouldn't be felt until the third year, where incremental sales would increase significantly. Stadium Remodel The store has been in place since 1972 and has a very affluent market, where the median income is $65, 921. About 42% of the market have taken 4+ years of college, which is the second highest of the projects. The $17m investment would lift the lagging sales about 17% and potentially increase the brand image. On the other hand, the store has been remodel twice since 1972. The NPV is also very sensitive to sales decline, as can be seen in the sensitivity analysis graph.

Goldie's Square The area is considered a key strategic location for many retailers. Population growth is moderate at 16% with a median income of $56, 000 and a quarter of the people holding a college degree. The project also has a low NPV sensitivity. However, a 45. 1% increase in forecasted sales is required to meet the prototype. The project also has the lowest NPV and IRR of all the projects being considered. Additionally, there are 12 existing Target stores operating in the market, which could potentially lead to high cannibalization.

Transfer sales or cannibalization is estimated at 19% of sales from the proposed area. As a result of this competition, low sales forecasts are projected.

SENSITIVITY ANALYSIS

Other than that, the projects seem to have to same negative and positive implications given a change in sales.

QUESTIONS

- If all else equal, and you have to decide between two projects one with a higher IRR and the other with a higher NPV, which would you favor?
- How have population growth, income, and college degrees impacted your analysis of the projects?
- How would different discount rates for store and credit card CF affect your recommendations?