The super project case

Super project Case Study

What are the relevant cash flows that General Foods should use in evaluating the Super Project? In particular, how should management deal with such issues as Test-market expenses?

Overhead Expenses?

Erosion of Jell-O contribution margin?

Allocation of charges for the use of the excess agglomerator?

The relevant cash flows that General Foods should use in evaluating the Super Project are considered Incremental cash flows and are “ the changes in the firm’s cash flows that occur as a direct consequence of accepting the project”. Incremental cash flows include changes in working capital; cost of project, overhead expenses, erosion of Jell-o margin, opportunity cost (allocation of charges for the use of the excess agglometor), net proceeds and tax savings from the sale of old assets. General Foods Accounting and Financial Manual specified that capital project request be prepared on an incremental basis.

Although Super Project incurred an expense of testing the market, this expense must not be included in the cash flow analysis because it can be considered a sunk cost. General Foods expected Super to capture a 10% share of the total desert market. This expense is required for conducting market research and will not be recovered.

Sources of cash flow include, Overhead expenses, which must be included in the cash flow analysis. The estimated expansion of the Super Project to

capture 80% of the market will require extra capital and extra labor force to sustain the increasing demand for the product.

Super project case solution

The erosion of Jell-O Sales must also be included in our cash flow analysis because it affects the rest of the firm. An economics hit that Jell-O sales will receive due to erosion will be significant. Erosion might occur naturally due to competition, but judging by Table A in the Super Projectcase studywe can determine that erosion due to competition is extraneous and assumes a very low probability. However, based on prediction Super Project will eat into the Jell-O Sales and this must be taken as a cost for the project when making the final decision.

Allocation of charges (Super project's share $453K) for the use of the excess agglomerator and the existing building has no direct impact. The super project's share of the building and agglomerator capacity must not be considered as relevant cash flow, the expense of the building and machinery was already included when estimating costs for the Jell-O project and thus incurred cost must not be counted twice.

As the firm plans to use the existing facilities for launching the Super project, it should deduct from the cash flows the opportunity cost of using the facilities because the management might have used the facilities in a best alternative way. For example, the management might have rented or sold the existing unused facilities or it might have produced the existing or new product using the facilities. Super Project's share of the building and use of the agglomerator will not be included in the cash flow analysis.