Rebecca Himelfarb
Case Study 1 Analysis

SUPER PROJECT

1. Recommendation/ Opening:

After careful consideration of a variety of factors, it is in the best interest of General Food Corporation to **launch** the Super Project. The following information provides an in depth analysis of the financial conditions that support this decision.

2. Business & Operational Fit Discussion:

The decision to launch the Super Project is strongly influenced by its alignment with General Food Corporation's existing operation and product line. As an established company in the instant dessert market, the company already possesses the necessary knowledge to launch the project. Further, the market for instant desserts is expected to expand significantly in the coming years, presenting the company with the opportunity to capture a large market share by leveraging its existing brand to gain a competitive advantage over other companies. As such, the decision to launch the project is supported by its compatibility with General Food's current business model.

3. Operational Fit Discussion

As an established company in the instant dessert market, the company already possesses the necessary labor, technology, and capacity. General Food Corporation's infrastructure and resources that are already in place allow for the project to begin immediately. These advantages, paired with a skilled workforce familiar with the production process should indicate there will be no expected delays in the startup of the project. Given the existing capabilities, technology, and labor, the risks associated with launching the Super Project are minimal.

4. NPV/Cash Flow Analysis:

The NPV and Cash Flow Analysis can be found in a separate excel spreadsheet.

5. Financials:

The data below highlights some of the key financial considerations and outcomes of launching the Super Project.

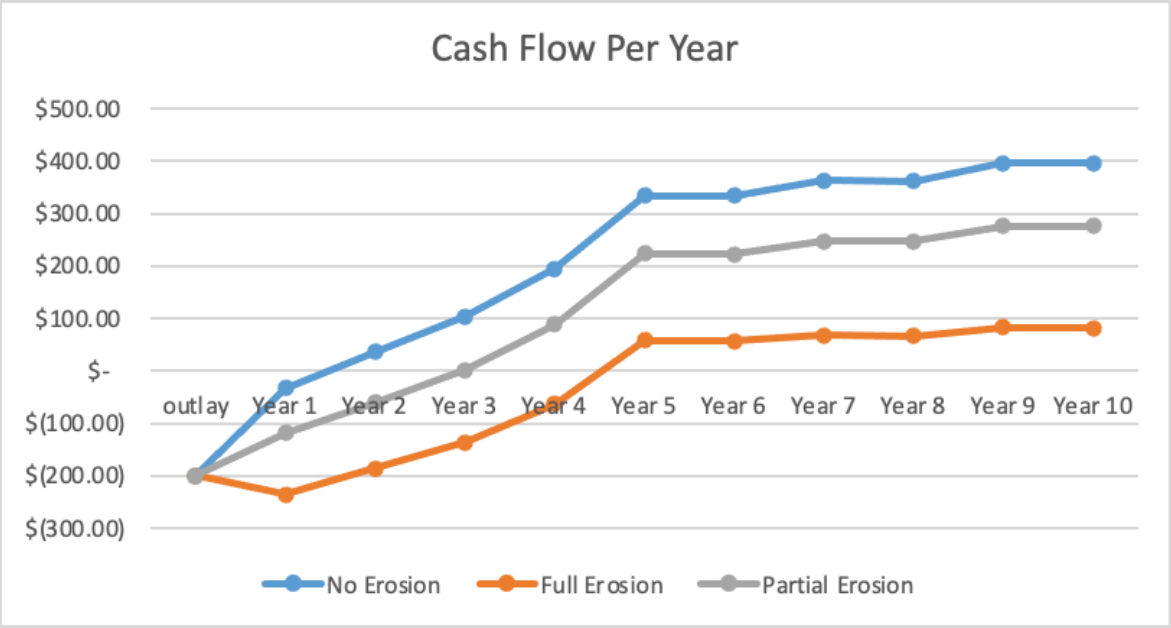


Figure 1: The graph represents the company's cash flow for the first 10 years following the launch of the Super Project, accounting for no erosion, full erosion, and partial erosion.

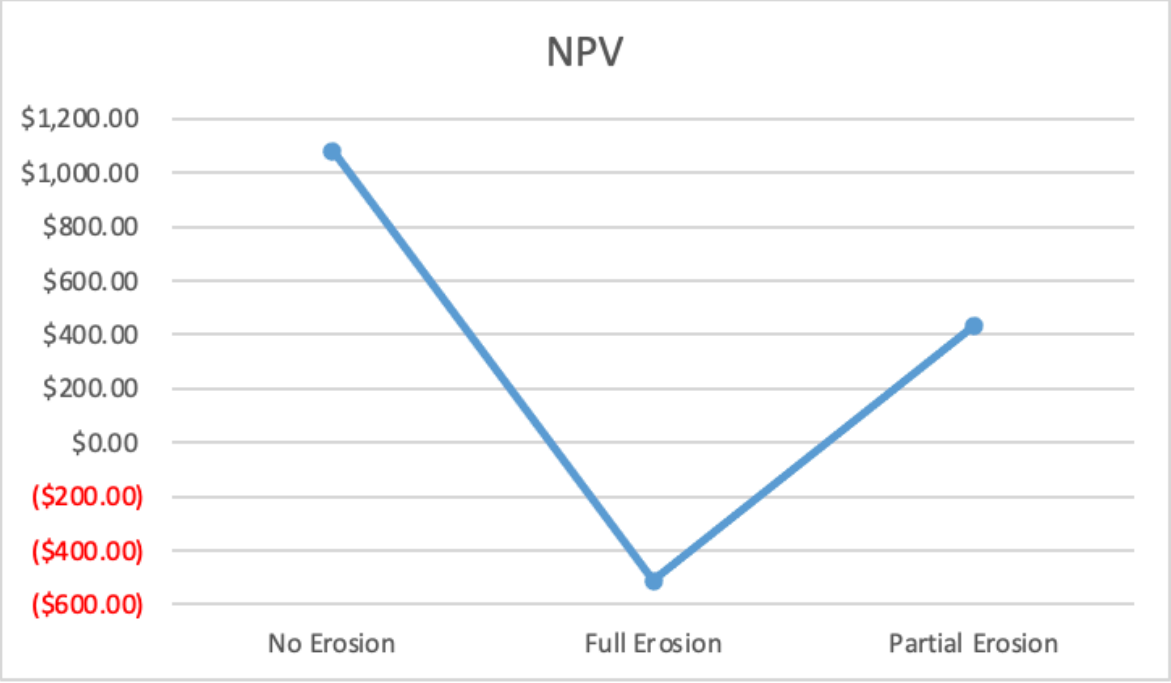


Figure 2: This graph shows the Net Present Value (NPV) after 10 years of operating the Super Project, with a distinction between there being no erosion, full erosion, and partial erosion.

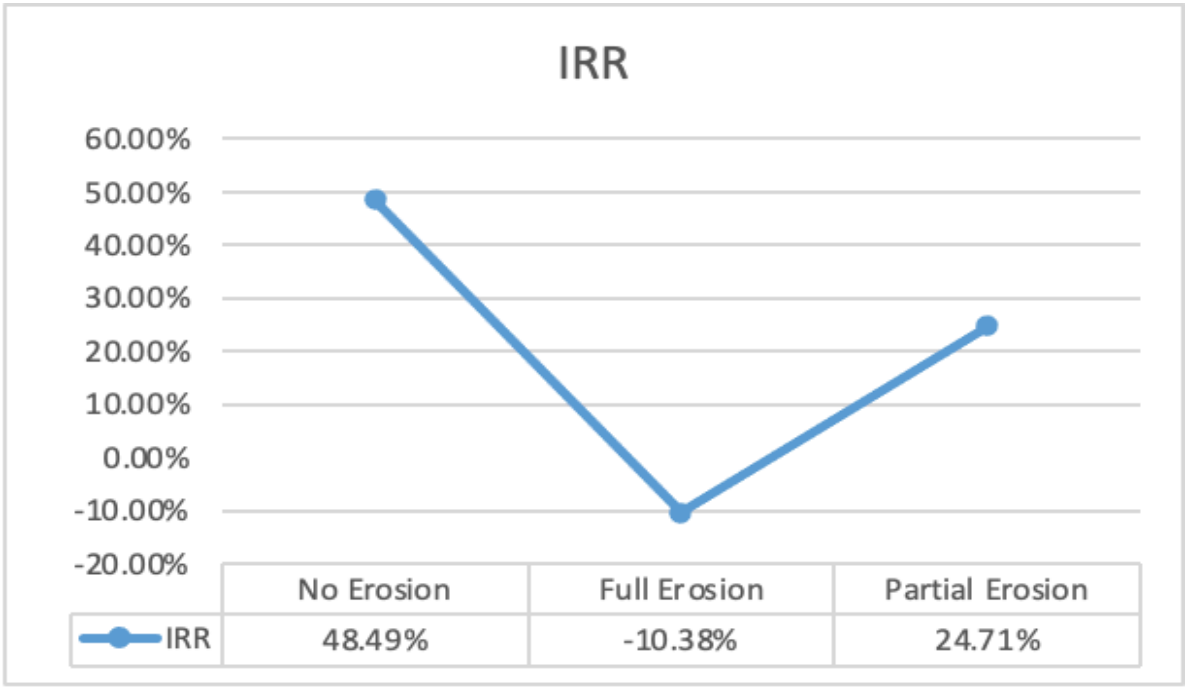


Figure 3: This graph shows the internal rate of return (IRR) after 10 years of operating the Super Project, with a distinction between there being no erosion, full erosion, and partial erosion.

6. Discussion of Erosion Issue:

When making business decisions, it is necessary to consider erosion, as the presence of erosion can affect a company's cash flow estimates, NPV, and IRR, among other factors. Erosion refers to the reduction in a company's existing profits due to the introduction of a new project or product. As demonstrated in Figure 1, if a new product is expected to draw customers away from the company's current offerings, such as Jell-O, the net gain in revenue might be lower than anticipated. Further when calculating the NPV and IRR, shown in figures 1 and 2 respectively, erosion should be factored into the cash flows to gain a realistic projection of the project's profitability. Erosion reduces cash inflows, as it accounts for the profit already being generated by existing products, which results in a lower NPV, making the project less attractive. Erosion also decreases the IRR, which can make the project less likely to meet the hurdle rate and ultimately unsuccessful.

All that being said, there are limitations to how much erosion should be considered, as failing to offer customers new products allows competing companies the opportunity to gain market share. If General Food Corporation does not launch new products regularly, due to erosion concerns, competitors may step in and capture the market. Further, sometimes, a new project might initially cannibalize existing products but ultimately open up new customer segments or markets. As previously mentioned, the instant dessert market is expected to expand significantly in the coming years, making it essential for the company to offer updated products to customers and

remain competitive in the market. Ultimately, the company should consider that it's better to introduce the new product and manage the erosion internally rather than let a competitor take advantage of a new product themselves and capture General Food Corporation's current customers.

After weighing all of the factors, it can be concluded that the company should **partially** consider erosion, using the hybrid accounting method. This allows General Food Corporation to be realistic about their future cash flows, while understanding the importance of keeping up with the competitors in the industry. Figure 1 demonstrates that even when partially considering erosion, the company will maintain a positive cash flow, and Figures 2 and 3 show that the NPV and IRR are still favorable.

7. Test Marketing/ Sunk Costs:

The expenditure on test marketing, which amounted to $360,000, is important to recognize in terms of future decision-making. However, it should not be incorporated into the current decision making process, as it is considered a sunk cost. Sunk cost can be defined as a cost that has already been incurred and cannot be recovered by additional spending or investments. The $360,000 spent on test marketing was an investment that has already been made and can not be retrieved, therefore, it should not influence the analysis of the project's profitability, nor should it be a factor in whether the project should be launched. Doing so could lead to a phenomenon known as "sunk cost fallacy", resulting in irrational decision making, and should therefore not be included in the analysis of the Super Project.

8. Choice of Hurdle Rate:

When determining the hurdle rate, it is important to consider the risk associated with the project. That is, if the project is deemed a high risk investment, that typically requires a high hurdle rate to compensate for potential loss, while less risk can allow a lower hurdle rate due to the stability of the investment. As discussed in sections 2 and 3, the risks in launching the project are minimal. This suggests an appropriate hurdle rate of 10%. A 10% hurdle rate acts as a benchmark aligning with the expected returns on the company's investment. By requiring a return of 10%, the company ensures that only high-quality, profitable projects are carried out, which will translate to overall profitability while meeting investor expectations.

9. Summary:

In summary, based on the financial information and analysis presented above, it is evident that it would be beneficial for General Food Corporation to launch the Super Project. Given the advantageous business and operational fit of the investment, indicated by their existing presence in the market as well as the strong market conditions, the investment in the Super Project poses

minimal risk, allowing for a hurdle rate of just 10%. After partially considering erosion and neglecting the sunk costs, it is necessary for the company to launch the project to remain competitive in the instant dessert market. By analyzing the positive cash flows, net present values, and internal rate of return, it can be concluded that the Super Project should be launched.