

CONGLOMERATE, INC.

Your Role

You are in charge of corporate investments. You have only two opportunities that are feasible now. You must make a decision today. Corporate management has said that only one of these investments can be funded.

The Situation

Conglomerate, Inc. has stated its objective is “to maximize profits” and you agree with this. The company currently has three major products, Cup, Sunbars, and Digits.

- Cup has a very large market share (10 times the market share of its leading competitor), and it has a large sales volume. However, it is in a market that is growing at only two percent per year.¹ It produces about \$2,000,000 US in cash flow and profits are about \$1,600,000 after taxes.
- Sunbars has a modest current sales volume ($\frac{1}{4}$ that of Culp), a relative market share of 1.5 (versus its leading competitor), and it is in a market that is growing 20% a year. Cash flow from Sunbars is currently negligible. Sunbars produces an after-tax profit of \$500,000 per year. Future prospects for Sunbars are good.
- Finally, Digits, while also having a modest sales volume, is in a market that is not growing at all, and it has a small market share, about $\frac{1}{5}$ of the leading competitor. Digits has barely adequate profits of \$50,000 per year and it has negligible cash flow.

Recently, an inventor has found a better way to make Digits. He has come to your company with a proposal. It calls for an investment of \$1,500,000. The forecasts are that, while this invention would not affect final demand, it would produce cost savings after taxes of about \$500,000 per year for the next ten years. After the initial outflow of \$1,500,000, the invention would yield a net cash flow of \$500,000 per year. Your sales forecasts for Digits show it holding steady for the next ten years. You are highly confident about both the cost and sales forecasts.

The Sunbars division also has an opportunity it feels would strengthen its position in the market. It proposes a new advertising campaign. Since Sunbars are sold by direct mail, initial small-scale mailings have given you an excellent idea of its success. The \$1,800,000 investment would generate after tax profits of \$400,000 the first year, \$300,000 the second, then \$100,000 per year for the next eight years. Cash flow would be approximately the same as profits.

After thorough investigation, you are convinced that these investments would not adversely affect the community, the employees, the customers, or the retailers. In other words, there are no negative side effects. The two investment possibilities have no impact on other products in this firm.

¹ Growth rates are in constant or real dollars (after adjusting for inflation).

Decision

My decision is to:

Invest in Sunbars

Invest in Digits

Reason for my decision: