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**PHASE ONE [NEW00142.GIF](INTRODUCTION.docx)**

**EXERCISE TWO-B** House Information

**This exercise should be answered using the Phase 1 input sheet**

**[](variables1.xlsx)**

**The Impact of Different Marketing and Financial**

**Strategies on Store Performance**

*The House* is considering handling a line of higher priced women's dresses. They believe that these higher priced dresses ($95-$295) will result in a sales increase of 3%. To provide a proper merchandise assortment, an additional investment in inventory of $42,000 would be required. It is expected that as a result of this 7% sales increase, due to the higher margin on the sale of higher priced dresses, the storewide cost of product would decrease to 58.00% of sales resulting in an increase in the overall gross margin percent of 0.5%.

Total assets at year-end 2010 were $685,100, which included $98,700 in cash and $451,200 in inventory (at cost). *The House* could finance the additional inventory with a combination of cash and trade credit. If this strategy is pursued then total assets will remain at $685,100 but cash on hand will decline by the amount of the inventory increase.

However, Anne and Fred are concerned that the company have an adequate level of cash on hand for emergencies or opportunistic buys. As a result, they are considering taking out a revolving line of credit for the additional $42,000 causing an overall increase in the assets of the *The House*. If this strategy is pursued then total assets would rise by $42,000. Additionally, they will have to pay interest of 10% on the $42,000 line of credit.

What will happen to financial performance if they invest the additional $42,000? Should they borrow the money or finance the added inventory with a revolving line of credit?

The Variables Worksheet you will need to run this simulation can be reached by clicking the red “1” above. You will need to enter the changes on the Input Form one at a time. The financial statements and ratios will automatically be updated and shown on the bottom of the input form. You must then copy the revised income statement and ratios to the scenario columns on the Answer Sheet. This process will have to be repeated if there is more than one scenario described in the exercise. Instructions for use of the Variables Worksheet can be reached by

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clicking on the “Help” button at the top right of the worksheet. Be sure to save your work and print a copy once you are satisfied with its correctness. After you complete your simulation there are questions you need to answer. These can be answered by typing your responses below the questions, saving your work, printing a copy, and handing it in to the instructor if required.

**EXERCISE TWO-B**

**QUESTIONS**

1. Which alternative should be used to finance the increased inventory investment? Why?
2. What are some of the other factors that need to be considered when making this decision? Please explain.
3. What are the risks to a small business in having a minimal amount of cash on hand? What are the benefits?
4. What are the risks to the Harriots in borrowing through a revolving line of credit*oH?* What are the benefits?