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

**EXERCISE TEN-A** House Information

**This exercise should be answered using the Phase 5 Variables Worksheet**

**[](variables5.xlsx)**

**Evaluating the Impact of a Price Increase**

Fred and Anne have built a very loyal group of customers that patronize *The House*. Although only 62% of visitors actually make a purchase, they purchase an average of five items. These items have an average item price of $11.89, which results in an average transaction size of $59.44. The cost of merchandise sold, including freight and inventory shrinkage, is 62% of sales and the gross margin return on sales is 38%. Anne has argued that they should be less concerned with closure and more concerned with higher prices and thus a higher gross margin percent. She has proposed that they raise prices by 10%. Under this scenario the product cost of goods sold as a percent of sales would be 53.18%, the freight cost as a percentage of sales would be 1.82%, and the inventory shrinkage cost would be 1.36%. It is expected that the gross margin return on sales would be 43.64%.

Fred has argued that if they raise prices by 10% that average items sold per customer would drop 20%. On the other hand, Anne argues that their customers are not that aware of prices and that although some customers will decide not to buy due to the higher prices, that this will not be large. She believes that a 10% price increase will result in a 12% drop in average items purchased.

The Variables Worksheet you will need to run this simulation can be reached by clicking the red “5” 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 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.

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**EXERCISE TEN-A**

**QUESTIONS**

1. Should prices be raised by 10%? Explain.

1. Are there other parameters in the model that might be influenced by the price increase? Explain.

1. What risk does *The House* take by raising prices in order to increase profits?
2. What steps must *The House* take to change its image if it takes the strategy of raising prices?