

Enterprise Budget Homework Exercise (KEY)

Harold “Handy” Browning owns Handy’s Hardware Store. Handy has several different divisions (or enterprises) in his store. He sells hardware (nuts/ bolts, etc.), power tools, hand tools, lawn & garden equipment, and building supplies (lumber, paint, etc.). Handy is concerned that his lawn & garden division is not as profitable as he wants it to be. But he doesn’t know how to analyze its profitability. So he has asked you to help him develop an enterprise budget for the lawn & garden division. Here’s the information that he gave you:

Insurance	\$1,500/year
Depreciation	\$9,000/year

Riding Mowers Sold	100 mowers at \$1,500/mower	
Push Mowers Sold	150 mowers at \$400/mower	
String Trimmers Sold	200 trimmers at \$350/trimmer	

Cost of buying his inventory:

Riding Mowers	100 mowers at \$1,200/mower	
Push Mowers	150 mowers at \$300/mower	
String Trimmers	200 trimmers at \$300/trimmer	

Property Taxes	\$3,000/year
Office Expenses	\$2,500/year
Interest on his operating expenses	5% of total operating expenses for 4 months/year
Interest on his term loans	\$4,000/year
Hired Labor	\$8,000/year
Owner Labor	\$5,000/year
Legal & Professional Fees	\$2,000/year

1. Use this information to develop an enterprise budget for Handy’s lawn & garden division. All of the expenses represent the portion that is associated with just the lawn & garden division. Please use the attached budget form.

2. Using your lawn & garden enterprise budget, should Handy keep operating this division for the next several years? Please explain how you got your answer.

Yes, Handy’s RATC for this enterprise is greater than zero. He should keep operating this division.

3. Use Handy's Power Tool enterprise budget that is on the spreadsheet. Let's look at the impact of some management decisions on the profitability of this enterprise. **Reset the spreadsheet to the original numbers after each question.**

a. Handy thinks he was too optimistic in his projection of sales of riding mowers. He thinks he will only be able to sell 75 riding mowers. How will this impact Handy's Return Above Total Costs?

His initial Return Above Total Costs is \$16,250.

This will drop to \$9,250 if he can only buy & sell 75 riding mowers.

b. Reset the number of Riding Mowers sold to 100. Handy has been looking at what his competitors are charging for riding mowers – they are selling the riding mowers at an average price of \$1,300 each. If Handy drops his riding mower price to \$1,300 each, will this lawn and garden division be profitable for the next several years? What is his expected Return Above Total Costs?

If he can only charge \$1,300/mower, his RATC will decrease to negative \$3,750.

c. Reset the Riding Mower price to \$1,500. Due to the economy, the cost of purchasing the lawn & garden equipment has increased as follows:

Riding Mowers – Handy will purchase them for \$1,350 each

Push Mowers – Handy will purchase them for \$350 each

String Trimmers – Handy will purchase them for \$325 each

Handy doesn't think he can increase his prices at all. If he does he will lose customers. What is the impact of these higher purchase costs of the lawn & garden equipment on Return Above Total Cost?

RATC will decrease to negative \$11,708.33

Handy's Hardware Store

Lawn & Garden Enterprise

		Quantity	Units	Price/Unit	Total	
Revenues						
	Riding Mowers	100	units/year	\$1,500.00 /unit	\$150,000.00	
	Push Mowers	150	units/year	\$400.00 /unit	\$60,000.00	
	String Trimmers	200	units/year	\$350.00 /unit	\$70,000.00	
	Other				\$0.00	
	Total Revenues				\$280,000.00	/year
Operating (Variable) Costs:						
Cost of Goods Sold:						
	Riding Mowers	100	units/year	\$1,350.00 /unit	\$135,000.00	
	Push Mowers	150	units/year	\$350.00 /unit	\$52,500.00	
	String Trimmers	200	units/year	\$325.00 /unit	\$65,000.00	
	Interest on Operating Expenses	5%	4 months	\$252,500.00 /year	\$4,208.33	
	Total Operating Costs				\$256,708.33	/year
	Return Above Operating Costs				\$23,291.67	/year
Overhead Costs						
	Depreciation - equipment		1 year	\$9,000 /year	\$9,000.00	
	Interest on term loans		1 year	\$4,000 /year	\$4,000.00	
	Office expenses		1 year	\$2,500 /year	\$2,500.00	
	Legal & Professional Fees		1 year	\$2,000 /year	\$2,000.00	
	Insurance premiums		1 year	\$1,500 /year	\$1,500.00	
	Property Taxes		1 year	\$3,000 /year	\$3,000.00	
	Hired Labor		1 year	\$8,000 /year	\$8,000.00	
	Owner Labor		1 owner	\$5,000 /year	\$5,000.00	
	Total Overhead Costs				\$35,000.00	/year
	Total Costs				\$291,708.33	/year
	Return Above Total Costs				(\$11,708.33)	/year

Handy's Hardware Store

Power Tool Enterprise

		Quantity	Units	Price/Unit	Total
Revenues					
Power Saws		100	units/year	\$600.00 /unit	\$60,000.00
Planers		50	units/year	\$375.00 /unit	\$18,750.00
Drill Presses		35	units/year	\$325.00 /unit	\$11,375.00
Other					\$0.00
Total Revenues					\$90,125.00 /year
Operating (Variable) Costs:					
Cost of Goods Sold:					
Power Saws		100	units/year	\$350.00 /unit	\$35,000.00
Planers		50	units/year	\$275.00 /unit	\$13,750.00
Drill Presses		35	units/year	\$200.00 /unit	\$7,000.00
Interest on Operating Expenses	6%	4	months	\$55,750.00 /year	\$1,115.00
Total Operating Costs					\$56,865.00 /year
Return Above Operating Costs					\$33,260.00 /year
Overhead Costs					
Depreciation - equipment		1	year	\$3,000 /year	\$3,000.00
Interest on term loans		1	year	\$800 /year	\$800.00
Office expenses		1	year	\$2,000 /year	\$2,000.00
Advertising		1	year	\$1,500 /year	\$1,500.00
Insurance premiums		1	year	\$1,200 /year	\$1,200.00
Office rent		1	year	\$7,000 /year	\$7,000.00
Hired Labor		1	year	\$5,000 /year	\$5,000.00
Owner Labor		1	owner	\$8,000 /year	\$8,000.00
Total Overhead Costs					\$28,500.00 /year
Total Costs					\$85,365.00 /year
Return Above Total Costs					\$4,760.00 /year