**Pringly Division**

A meeting of senior managers at the Pringly Division has been called to discuss the pricing strategy for a new product. Part of the discussion will focus on estimating sales for the new product. Over the past years, a number of new products have failed to meet their sales targets. It appears that the company’s profit for the year will be lower than budget and the main reason for this is the disappointing sales of new products.

This time a range of possible sales targets - rather than only one goal - will be established and evaluated.

The first strategy is to set a selling price of $170 with annual fixed costs at $20,000,000. A number of managers are in favor of this strategy, as they believe it is important to reduce costs.

The second strategy is to increase spending on advertising and promotions and set a selling price of $220. With the higher selling price the annual fixed costs would increase to $25,000,000. The marketing department is adamant that increased emphasis on advertising and promotions is essential.

The table below shows three probable levels of customer demands. The likelihood of reaching a certain level is indicated by the estimated probability. Note that it is not necessary to create a complex model based on probabilities. However, the probability distribution provides some guidance for the managers. Don't forget that the company has certain minimum expectations of a new product.

|  |  |
| --- | --- |
| Estimated demand (units) | Estimated probability (units)\* |
| 150,000 | 0.25 |
| 180,000 | 0.5 |
| 200,000 | 0.25 |

\*Estimated probabilities are given to assist in making a final recommendation. These probabilities don't have to be incorporated into a model, just considered in the final recommendation.

**Additional information:**

* The estimate of variable cost per unit is $35.
* The probability of the new product achieving break-even is very important. A profit greater than $4,000,000 is expected.

**Case Assignment**

**Required:**

* Compute break-even at each level.
* Is the company likely to achieve its desired target profit of $4,000,000 or more? Support your discussion with financial analysis.
* Compute the margin of safety and explain the meaning of the number derived.
* Should the company go ahead with the new product?
* Would this type of analysis be useful to a large company with a wide range of products?
* ROI (return on investment) and residual income are two other methods that can be helpful for this type of decision. Could they be applied in this situation? Support your answer with financial analysis.

**HINT:** Don't forget to use the variable costing approach for your analysis.

**Assignment Expectations**

It is important to answer the questions as posed. The discussion should be 4 to 6 pages and written in a clear and concise manner. Support your discussion with references in APA format. You are

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