Directions: This part contains questions based on case-based scenarios. Each of the questions or incomplete statements is followed by four suggested answers or completions. Select the one that is best in each case and then fill in the corresponding space on the answer sheet.

Questions 31-34 are based on the following.

Drinks Incorporated (DI) is considering launching a new product, a high-energy drink. The market research commissioned for this product at a cost of $150,000 has shown that this is a growth segment in the stagnant domestic soft-drink market. In estimating the project's net cash flows, the company is assuming that it will utilize its unused plant space that could have been rented for $75,000 per year. The capital assets needed to go forward with the launch have a 5-year MACRS classification, although some managers have insisted that the assets should be depreciated on a straight-line basis in order to maximize income from the project. Also, the estimated salvage value for the equipment is quite high, since it can be typically sold overseas at favorable prices.

The company estimates that the new high-energy drink will have a cannibalization effect on its current sports-drink line. The estimates place this loss of sales on the existing line at $420,000 per year. However, the soft-drink market is considered to have an oligopolistic structure, since five firms control over 80% of the market share. Thus, DI is well aware that industry giants are very likely to launch their own brand of high-energy drinks.

The pricing of the product has been a matter of intense discussion at the company's strategic meetings. The market study revealed that the demand for this type of drink is highly inelastic at this time. Furthermore, the product development team is somewhat anxious about the inherent risk of the project. As a new product launch and given the potential for strong competition, the project is classified as an above-average risk project and would be subject to a 4% risk adjustment to the company's weighted average cost of capital of 12.6%.

In calculating the project's net cash flows, a number of considerations have surfaced.

I. The cost of the marketing study must be included in calculating the project's outlays.
II. The use of the company's own plant space constitutes an opportunity cost that must be included in calculating the project's operating cash flows.
III. Capital assets should be depreciated using the straight-line method in order to enhance the project's income.
IV. Cannibalization may be disregarded, given the competitive nature of the market.

31. There are other issues concerning pricing and risk that the product team is considering. Which of the following would most likely lead to the best outcome for the new product?

(A) A low-price strategy would maximize revenues by significantly increasing sales.
(B) Pricing the product at the high-end of the soft-drink pricing scale would enhance revenue and the product's image.
(C) The project's hurdle rate should be 8.6%.
(D) Since the market structure is conducive to constant price changes, the price of the product should be increased regularly.

32. The MACRS depreciation allows for a more rapid write-off of cost, as opposed to straight-line. In both cases, the full cost of the capital assets would be depreciated over the five years. What effect would the use of MACRS depreciation, as opposed to straight line, have on the average net income over the five years, and on the break-even point in the first year?

	Average net income	Break-even point in year one
(A)	No effect	No effect
(B)	No effect	Increase
(C)	Increase	No effect
(D)	Increase	Increase

33. Before finalizing a decision to enter the market with the new energy drink, DI conducted a second analysis of the soft-drink industry. Several top managers concluded that the competitive forces were too strong to justify entering the market at this time; others argued that the situation was just the reverse; that is, that the competitive forces barring market entry were very weak. Which of the following, if true, would lead to the conclusion that there are few or no significant barriers to market entry?

(A) The needed technology and specialized know-how to compete successfully is difficult to access.
(B) Retailers are very reluctant to grant shelf space to a new entrant.
(C) Those firms already in the market are very able and willing to cut prices to maintain their market share.
(D) The market is in a state of rapid growth.

34. After introducing the new energy drink, the company did not realize its anticipated IRR of 19%, so company officials proposed a dramatic reduction in the product's price. The most likely effect of this action would be which of the following?

(A) Increased revenue
(B) Decreased revenue
(C) Decreased market share
(D) Increased market share

Questions 35-39 are based on the following.

You have been hired to do a financial analysis of the MNO Company, a maker of gardening products for consumers. In order to do this, income statements and balance sheets were collected for the last four years. Various financial ratios were calculated from those sources. An industry average for the last year was also obtained. This information is presented in the table below.

	Year 1	Year 2	Year 3	Year 4	Industry Average for Year 4
Current Ratio	1.04	1.09	1.11	1.12	1.5
Quick Ratio	0.44	0.46	0.45	0.44	0.6
Debt Ratio	65.79	65.72	66.42	67.04	60
Long-Term Debt Ratio	32.89	31.76	31.08	30.42	35
Times Interest Earned	1.50	1.83	2.07	2.25	3
Total Asset Turnover	1.32	1.38	1.46	1.54	2.5
Fixed Asset Turnover	2.00	2.20	2.40	2.60	3.5
Gross Profit Margin	35.00	40.00	44.17	47.69	40
Operating Profit Margin	15.00	20.00	24.17	27.69	25
Pretax Profit Margin	5.00	9.09	12.50	15.38	10
Net Profit Margin	3.00	5.45	7.50	9.23	5
Days in Inventory	54.00	55.64	57.00	58.15	70
Days in Receivables	36.00	37.64	36.15	35.03	45
Days in Payables	36.00	39.27	42.00	44.31	30

35. Based on the information, which of the following statements is true?

(A) MNO is more liquid than other companies in the industry.
(B) MNO has a serious solvency problem.
(C) MNO is good at controlling expenses.
(D) MNO uses its assets well compared to the industry average.

36. The MNO Company uses which of the following assets poorly?

(A) Inventory
(B) Accounts receivable
(C) Current assets
(D) Fixed assets

37. MNO has marketed a line of lawn mowers for several years. To improve its products, management wants to study what types of problems consumers experience while using lawn mowers. Which of the following research methods would best identify consumer usage problems with lawn mowers?

(A) A survey that concentrates on the associated activity of mowing lawns, including any problems encountered in the process
(B) A survey that concentrates on the activities and problems associated with purchasing lawn mowers
(C) A survey that starts with a list of problems, and asks respondents to identify which brands of lawn mowers are associated with those problems
(D) A survey that measures how lawn mowers reduce or arouse consumer emotions

38. MNO's lawn mowers are quieter than competing brands. MNO wishes to induce a search for product information by consumers who have not been seeking information, because management believes that they can entice the informed consumer to purchase, once the benefit of the low sound level is known. Which of the following marketing campaigns would be most effective for capturing new customers?

(A) Reinforce the features and benefits of MNO lawn mowers in mass media advertising messages.
(B) Emphasize a recent product improvement in advertising messages and point-of-purchase displays to attract attention to the features and benefits of MNO lawn mowers.
(C) Maintain product quality and distribution, and provide feature and benefit information on MNO lawn mowers at point-of-purchase displays and on the company Web page.
(D) Communicate the features and benefits to retailers, advertise through mass media, the company Web page, and point-of-purchase displays, and offer a cash incentive to buyers who test the mowers.

39. Which of the following strategic recommendations is best supported by the financial data?

(A) Additional product lines should be introduced to increase revenue levels.
(B) Expansion into new markets is recommended to take better advantage of the high liquidity.
(C) Additional equity or long-term debt should be considered to support future growth and improve the management of working capital and short-term liabilities.
(D) Due to the existing financial concerns, no expansion or additions to products or services should be considered.

Questions 40-44 are based on the following.

Northern National Trucking (NNT), a large national trucking company with headquarters in the northeastern United States, has approximately 30% of the nation's freight-hauling market. Its major competitor, Southway Trucking, headquartered near the Gulf of Mexico, has a market share of approximately 35%.

NNT has a significant share of the Canadian freight-hauling market, so it has considerable experience with international freight hauling. With the signing of the North American Free Trade Agreement (NAFTA), NNT saw a significant opportunity to grow its business with Mexican firms selling products to the United States, and with United States companies doing business with Mexico.

Initially, NNT planned to build an entirely new, state-of-the-art trucking facility in Texas or Arizona. However, after considerable research, NNT concluded that it would be more cost-effective to acquire one or more small, southwestern trucking companies that already had experience dealing with the southwestern market. After some negotiating, NNT purchased all the assets of T&B Trucking, a regional trucking firm with a large facility in Texas.

To integrate the T&B organization into the NNT structure and make the Texas operation profitable as soon as possible, NNT recruited and hired Jesse Grunder as a senior-level manager. Grunder, a Texas native, is fluent in Spanish and has considerable experience in the trucking industry obtained at his former employer, Southway Trucking.

When T&B was acquired by NNT, most of the experienced managers left T&B for other area trucking companies and/or took early retirement. The few remaining managers were young and very new to T&B, and had little management experience in the trucking business. To Grunder, they seemed unsure of themselves and reluctant to perform their new jobs.

40. Which of the following would be the best leadership style for Grunder to adopt?

(A) Telling: provide specific instructions and closely supervise the managers' performance.
(B) Selling: explain his decisions and provide opportunities for clarification.
(C) Participating: share ideas and facilitate decision making with the managers.
(D) Delegating: turn over to the managers responsibility for making decisions and implementing those decisions.

41. NNT should focus its strategic analysis for business expansion in the short-term primarily on

(A) opportunity alternatives
(B) threat seriousness
(C) weakness reduction
(D) capability-based strengths

42. When two companies are merged, as in the case of NNT and T&B Trucking, two accounting methods can be used to account for the event. They are called the purchase method and the pooling of interests method. Which of the following best evaluates the methods?

(A) The pooling method is preferred, since it shows higher profitability.
(B) The pooling method is preferred, since the assets of the acquired company are marked to market value.
(C) The purchase method is preferred, since the balance sheet more closely represents current values.
(D) The purchase method is preferred, since it gives increased liquidity.

43. To evaluate the performance of employees in the newly acquired T&B Trucking Company, which of the following methods would be the most appropriate for Grunder to use?

(A) Zero-based budgeting: all performance is tied to financial measures that must be evaluated and justified on the basis of current market and the financial condition of the company and its competitors.
(B) Objects-of-expenditure: current performance is measured using the same or very similar criterion to that used to evaluate T&B prior to National's acquisition.
(C) Suspension of evaluations temporarily until he gets to know the managers and how they fit in the organization
(D) A balanced scorecard evaluation based on four areas, some of which are financial, some nonfinancial

44. Which statement of corporate strategy best describes the philosophy of NNT?

(A) Searching for strategic fit that attempts to use horizontal integration relationships
(B) Spreading business risk through corporate diversification to make it less dependent on the initial business
(C) Seeking portfolio restructuring strategies to return the company to an initial standard of profitability
(D) Applying the advantages of vertical integration to strengthen the new acquisition

Questions 45-48 are based on the following.

The Caribou Club, a philanthropic organization, would like to hold a fund-raising banquet and golf tournament to benefit a youth shelter in the community. Initial community support has been enthusiastic and the event is being called "Tee-Off for Kids." The planning committee reported to the club's officers that it has narrowed the possible locations that have adequate facilities to two local country clubs. The details of the cost for each country club are summarized below. In addition, both alternatives include a local band at an additional cost of $1,400. Tickets are expected to sell for $50 per person, with the additional possibility of direct corporate donations.

<u>Foothills Country Club</u>

Country club rental cost:	$2,500
Catering costs:	$15 per person
Decorations and cleanup:	$300
Greens fee and related charges:	$18 per person
Banquet seating capacity:	700

<u>Par Country Club</u>

Country club rental cost:	$3,600
Catering costs:	$12 per person
Decorations and cleanup:	$200
Greens fee and related charges:	$20 per person
Banquet seating capacity:	710

45. If selling the least number of tickets needed to break even were the major concern, which of the following should you recommend?

(A) Foothills Country Club
(B) Par Country Club
(C) Either country club, since the break-even points are almost the same
(D) A recommendation cannot be made; insufficient information is provided for break-even analysis.

46. Both non-profit and for-profit organizations require effective managerial practices to assure continued success. If the executive director is to be held accountable for both the work of the salaried and the volunteer workers at the Caribou Club, which management structure or practice would be most effective?

(A) Volunteer workers and salaried employees should report directly to the executive director.
(B) The budgetary planning process should first allocate funds needed to support the volunteer workers' efforts and then allocate funds to the salaried employees.
(C) A policies and procedures manual should be developed for all Caribou Club employees.
(D) A leader for the volunteer workers should be selected from the group of volunteers so they will be more motivated to succeed.

47. Amy Ansyer, one of the officers of the Caribou Club, was not sure that the $50 charge for the golf outing was a high enough price to cover the costs of the outing and also provide enough money for the charity. She suggested that the club conduct a marketing research study to find out what donors would be willing to pay for the outing. In formulating the research problem, Amy is really trying to find out which of the following?

(A) The price elasticity of demand
(B) The strength of the charitable draw
(C) How to maximize the number of donors
(D) How to determine the price flexibility of tiering donors

48. John Thorough, one of the officers of the Caribou Club, thought a golf outing was fine but said more options should be considered for raising money. In an effort to complete his thoughts, John put together a preliminary plan for the Club that included money-raising events, donor clubs, grants, and assistance from state and local governmental agencies. Which of the following best describes John's plan?

(A) Strategic implementation
(B) Opportunity analysis
(C) Situation integration
(D) Core-business distinctiveness

Questions 49-53 are based on the following.

Judy Montoya, marketing manager for a United States consumer goods manufacturer, believes that her company's products would do very well in the Japanese market, but that it would only be profitable to sell in that country if it can be done through the company's Web site, which is already doing well in the United States. In her preliminary research, Ms. Montoya discovered that Japan lags behind most other countries in the growth of E-commerce. There are many reasons for this slow growth of E-commerce in Japan, including the high communications charges in the country, few merchants offering attractive products and reasons to buy online, ineffective strategies by E-commerce companies, cultural issues such as the reluctance of consumers to use credit cards instead of cash, and an economic structure that does not encourage entrepreneurship.

Ms. Montoya further learned that recently there have been attempts to increase the Japanese presence in E-commerce. Some Japanese entrepreneurs have solved the problem of the limited use of credit cards by completing the order online but then letting the customer pick up the goods and pay for them in cash at their local conbini (convenience store) or even at a gas station. An organization in Tokyo, Bit Valley, brings entrepreneurs together regularly to build Japan's Internet economy. The purpose of this group is to allow Japan's entrepreneurs to trade business tips and attract venture capital. In another positive move, Japan approved a plan to extend more grants and financing to new ventures. However many E-commerce ventures in Japan are finding it difficult to gain adequate financing because of costly regulations on private enterprises, and the structure of the Japanese stock market.

Ms. Montoya is still convinced that Japan offers opportunities for her company and has discussed her idea with people within the marketing department, as well as others throughout the organization. She has company support to find out more about this potential opportunity for the company. Ms. Montoya knows that before she can go any farther with this project she must have some research conducted.

49. If research shows that Japan is a viable market for the company's products, which of the following ways to communicate about the company's Web site would best target the potential market?

(A) A major national advertising campaign on Japanese television and radio
(B) Advertising in many of the local newspapers and Japanese magazines
(C) Banner ads on Japanese Web sites
(D) Poster advertisements in or near convenience stores and gas stations

50. If the product launch in Japan were successful, which of the following would be the LEAST likely source of concern for the management of the company?

(A) Distribution and product delivery to customers
(B) Long-term financing
(C) Inventory management
(D) Accounts receivable management

51. Recognizing that Japanese tastes differ from those of United States consumers, Ms. Montoya wants to ensure that the products offered meet the needs of Japanese consumers. To help accomplish this, she should first do which of the following?

(A) Design and conduct experiments to evaluate what product attributes are preferred.
(B) Conduct focus groups.
(C) Design and conduct a survey.
(D) Design a process-control system to ensure reliable products.

52. Which of the following is a strategic "external threat" to expansion into Japan?

(A) Japanese government monetary grants for new ventures
(B) The company's need to upgrade its computer system for the added Web traffic
(C) Japanese government regulations restricting foreign imports
(D) The lack of employees fluent in Japanese

53. As her strategic plan develops, Ms. Montoya is considering posting a consumer survey concerning certain aspects of her plan on the company Web site. She believes this feedback could be valuable. What is the biggest limitation she is likely to face when analyzing the results of the survey?

(A) The sample size is likely to be small.
(B) The sample is likely to be biased.
(C) The respondents have insufficient experience with the Web.
(D) The survey questions are likely to seem hypothetical to the respondents.

Questions 54-57 are based on the following.

Millions of consumers start their day with milk or juice poured from a paperboard carton. Polyethylene, however, has replaced paraffin-coated paperboard in many of the world's markets that sell to beverage packagers. Nobel Paper Products (NPP) is an international manufacturer of paperboard cartons. The management of NPP is deciding how to recapture market share lost to polyethylene. At the least, it would require a substantial increase in promotional costs, rescaling production operations, and reconfiguration of the manufacturing system to accommodate new carton designs. To limit its risk, the management proposes to manufacture both milk and juice cartons, but to commit the majority of its new-product development resources to juice cartons. The latter, per the data below, has the higher profit margin, using traditional absorption costing, and management believes the greatest market share is with juice containers.

Per Lot (10,000 units) for the Gallon-size Container

	Milk Carton	Juice Carton
Direct materials	$1,900	$2,200
Direct labor	400	400
Production overhead	1,100	1,000
Selling price per lot	3,500	3,800

Overhead costs are approximately 70% fixed and 30% variable. NPP has some product variability that results in defective units that are scrapped, but this is typically less than 0.01% for milk cartons and 0.03% for juice cartons.

54. Consider the following statements about activity-based costing.

    I. It would include costs that are typically treated as nonproduction costs as costs of production.
    II. Activities would be segregated into discretionary costs that can be controlled by management and committed costs over which management has nominal control.
    III. It would aid in identifying those activities that add value to the product and those that do not.
    IV. It would shift costs away from the lower-contribution margin product, milk cartons, to the higher-contribution margin product, juice cartons.

    In which of the following ways could activity-based costing provide more accurate costing information to Nobel Paper Products?

    (A) I and II only
    (B) III and IV only
    (C) I, II, and III
    (D) II, III, and IV

55. Early production testing indicates that the new type of paraffin needed for juice carton production is not being applied evenly. As plant manager, you should ensure that which of the following is completed?

    (A) Design of experiments on the machine settings and paraffin
    (B) Implementation of statistical process control of production
    (C) Analysis of the reliability of the cartons
    (D) Redesign of the production process

56. Overhead costs were broken down into fixed and variable portions by use of the high-low method; overhead was determined to be approximately 70% fixed and 30% variable at a normal production volume of 5,000 lots per month. If the number of lots produced is increased from 5,000 to 6,000 per month, what will happen to the percentage breakdown of fixed and variable overhead costs?

	Fixed	Variable
(A)	Increase	Increase
(B)	Decrease	Decrease
(C)	Decrease	Increase
(D)	Increase	Decrease

57. Assume that Nobel is currently operating at full capacity: market demand for the milk cartons exceeds Nobel's capacity. Nobel has received a special order for a modification of the milk carton. The modification would increase variable production costs by $350 per lot. In order to maximize profits, what is the lowest price per lot at which Nobel should accept the special order?

(A) $2,660
(B) $3,400
(C) $3,750
(D) $3,850

Questions 58-60 are based on the following.

United Retail Products, Inc. (URPI) was established twenty-seven years ago and has been the largest major product retailer in South America for the past fifteen years. During this period, URPI has aggressively sought new small-business markets, which has resulted in raising its total revenues by over 300%, even though this increased the number of sales transactions by twice that percentage. While URPI has experienced some short-term negative cash flow during the past two years, all performance and profitability ratios still seem to be strong.

In view of its major share of the market and its past successes, URPI launched two new major initiatives this year: (1) to expand to at least one new international location each year for the next five years, and (2) to establish a new major Internet sales division.

The table below shows several of URPI's relevant financial ratios (in five-year increments).

	1985	1990	1995	2000
Net Profits / Sales:	3.8%	4.9%	4.4%	4.3%
Cost of Sales / Sales:	62.1%	65.5%	68.5%	69.7%
Working Capital / Sales:	23.7%	24.1%	20.7%	18.3%
Return on Assets:	17.5%	21.1%	20.6%	20.1%
Return on Equity:	26.3%	30.9%	28.4%	26.7%
Debt/Worth:	0.69	0.69	0.69	0.69

58. Everything else being equal, which of the following actions would improve the company's return on equity?

(A) Taking actions so that the debt/worth ratio becomes 0.50
(B) Taking actions so that the net profit/sales ratio becomes 3.5%
(C) Taking actions so that the working capital/sales ratio becomes 20%
(D) Taking actions so that the cost of sales/sales ratio becomes 70%

59. URPI's new Internet sales division managers plan to enter on-line marketing by pilot testing one type of product; however, they need to decide where to start. They think it would be best to start with a product that would have the lowest risk of failure when distributed over the Internet. Which of the following products should URPI start with in launching its on-line marketing initiative?

(A) Books
(B) Clothing
(C) Groceries
(D) Athletic shoes

60. To limit risk with the two new initiatives, product distribution centers will be kept primarily in South America. However, new retail outlets in areas outside South America will have specific distribution centers designated to service them. With Internet sales it is expected that sales will be too widespread to justify a distribution center for any particular location at this point in developing the initiative. Since distribution centers are located outside the country of the new retail outlets and those outlets are in "cyberspace," what two key financial factors will impact the reported earnings for the new outlets and thereby the company's financial ratios?

(A) Any restrictions imposed by countries on the transferring of profits outside the country and level of deposits a company must hold in local banks
(B) Tax requirements of the host country and intercountry transfer prices set between the distribution center and point of sale
(C) The economic development of the country and infrastructure that is available
(D) The use of variable costing and the level of capital investment in new outlets