

Memo

To: All Senior Staff
From: Kristen Huffman, CEO & President
Re: New Strategic Direction

Thank you for attending our annual strategic planning session. Given recent changes in the economy and customer needs, a new direction for our company is necessary. After reviewing how other companies restructured themselves in recent years, we will mirror how UPS® conducts business as a partner/consultant with large customers. For our company, however, we will go a step further and become a warehousing/local just-in-time (JIT) delivery source, instead of providing logistics advice to clients, as UPS® does.

To accomplish this, we must integrate this new direction into our upcoming strategic plan and financial planning. First, I need all department managers to prepare their budgets.

I would also like our accounting department to move ahead on a preliminary set of pro forma statements, even without final budgets, using the following assumptions. They must determine if external funding is needed.

I have attached a summary of assumptions about this new direction.

New Strategic Initiative Assumptions

Huffman may overcome increased competition and economic slowdown by initiating a new strategy; this will turn our company into a one-stop shop and key logistics company. We will provide consulting services, generate revenues, and become a JIT warehouse/delivery source. A local retailer selling products from a distant manufacturing plant, for example, may accept JIT deliveries, instead of 40-foot trailer loads. This would be fulfilled by the local operation.

1. Assume inflation of 4% on expenses, not including depreciation and taxes. This is in addition to the new initiative's costs.
2. Assume the following regarding variables versus fixed-nature-of-income-statement operating expenses for the existing business:
 - a. 80% of wage benefits is variable and 20% is fixed.
 - b. 100% of fuel expenses, purchased transportation, and operating supplies is variable.
 - c. 100% of operating taxes is fixed.
 - d. 20% of insurance and claims is fixed; the balance is variable.
 - e. Assume depreciation, even with new expenditures, is fixed as the retirement of written-off assets, equaling new equipment.
3. There will be new spending areas reflected on future budgets to reflect added satellite warehouse costs and space rental and costs of running the locations.
 - a. In the first year, add \$10 million of inflation, space rental, and operating costs at 25% of revenues from the new initiative.
 - b. In the second year, add \$10 million space rental, with inflation at the same variable percentage of sales.
 - c. In the third year, add \$7.5 million of the variable percentage of sales.
4. In marketing, budget accounts have been added for new incurred costs. We will continue our present promotion and launch a new program, with the assistance of our marketing partner, the ABC Marketing Agency. They will advise us on the type, frequency, and content of new messages. Assume 100% of the existing budget is fixed with respect to volume along with new expenses. We expect incremental expenses, with \$5 million of inflation in the first three years.
5. Our existing sales force, comprised of four national account managers, will call on clients such as Wal-Mart®, Sears®, and Best Buy®. Existing expenses are assumed to be 100% fixed in relation to revenue. To tap into specialized markets, our strategy is aimed at adding four industry-specific managers, each with a salary base of \$50,000 and 2% commission of generated revenues.
6. The human resources budget will not change substantially aside from added hiring, recruiting, training, and drug testing fees. Assume 10% of expenses is fixed; the balance is variable with volume.

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7. Assume current assets and liabilities are variable. Expect an addition of \$10 million to operating property, spent in the first year. Our payment to vendors, suppliers, and taxes will be in thirty-day terms. We expect all payments to be in sixty-day terms.
8. Assume revenue growth from our existing business will grow at 8% versus 10% in past years. Our new strategy, however, adds incremental consulting revenues of \$3.5, \$4.5, and \$6.5 million in the first, second, and third years. New warehousing will add revenue of \$10, \$30, and \$40 million in the first, second, and third years. All new revenue will be subject to commissions for industry-specific managers.