Problems

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eXcel

PROBLEM 12–14 Return on Investment (ROI) and Residual Income [LO 12–1, LO 12–2]
"I know headquarters wants us to add that new product line," said Fred Halloway, manager of Kirsi Products' East Division. "But I want to see the numbers before I make a move. Our division's return on investment (ROI) has led the company for three years, and I don't want any letdown."

Kirsi Products is a decentralized wholesaler with four autonomous divisions. The divisions are evaluated on the basis of ROI, with year-end bonuses given to divisional managers who have the highest ROI. Operating results for the company's East Division for last year are given below:

Sales	$21,000,000
Variable expenses	13,400,000
Contribution margin	7,600,000
Fixed expenses	5,920,000
Net operating income	$ 1,680,000
Divisional operating assets	$ 5,250,000

The company had an overall ROI of 18% last year (considering all divisions). The company's East Division has an opportunity to add a new product line that would require an investment of $3,000,000. The cost and revenue characteristics of the new product line per year would be as follows:

Sales	$9,000,000
Variable expenses	65% of sales
Fixed expenses	$2,520,000

Required:

1. Compute the East Division's ROI for last year; also compute the ROI as it would appear if the new product line is added.
2. If you were in Fred Halloway's position, would you accept or reject the new product line? Explain.
3. Why do you suppose headquarters is anxious for the East Division to add the new product line?
4. Suppose that the company's minimum required rate of return on operating assets is 15% and that performance is evaluated using residual income.
   a. Compute the East Division's residual income for last year; also compute the residual income as it would appear if the new product line is added.
   b. Under these circumstances, if you were in Fred Halloway's position would you accept or reject the new product line? Explain.

PROBLEM 12–15 Comparison of Performance Using Return on Investment (ROI) [LO 12–1]
Comparative data on three companies in the same service industry are given below:

	Company		
	A	B	C
Sales	$4,000,000	$1,500,000	$?
Net operating income	$ 560,000	$ 210,000	$?
Average operating assets	$2,000,000	?	$3,000,000
Margin	?	?	3.5%
Turnover	?	?	2
Return on investment (ROI)	?	7%	?