# MBA 613 ~ CHAPTER 7 HANDOUT

**Sycamore Sams manufactures a single product that sells for $440 per unit and has total variable costs of $176 per unit. The company targets an annual pretax income of $1,100,000. Assume that fixed costs are $664, 400.**

**a.)** Compute the unit sales to earn the required pretax income.

**b.)** Compute the dollar sales to earn the required pretax income.

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**Consolidated Industries is studying the addition of a new valve to its product line that would be used by manufacturers of irrigation equipment. The company anticipates starting with relatively low sales volume and then boosting demand over the next several years. A new salesperson must be hired because Consolidated's current sales force is working at capacity. There are two different compensation plans that are being considered:**

**Plan A: Annual salary of $22,000 plus a 10% commission on gross dollar sales.**

**Plan B: Annual salary of $60,000 and no commission.**

**Consolidated will purchase the valve for $50 and sell it for $80. Anticipated Y1 demand is 6,000 units.**

**a.)** Compute the break-even point in Units for Plan A and Plan B (ignore income tax).

**b.)** Analyze cost structures for both plans at the anticipated 6,000 units. Which of the two plans has a higher operating leverage?

**c.)** How would profitability be impacted by an economic recession for highly automated manufacturers? Relate this to risk and the operating leverage question above.