Investo: A New Business Opportunity for Mutual Fund Services Corporation[1]

Mutual Fund Services Corporation (MFS) is a major supplier of financial data and computer software to the financial services industry. Investo is a new venture in the area of mutual fund compliance software. Investo needs to raise new capital, and has offered a 30 percent interest in the value of Investo and an exclusive marketing agreement for Investo's product to MFS in exchange for $10.5 million.

Derrick Bond, President and CEO of MFS, is considering the proposed investment in Investo. The investment would provide MFS with an equity interest in the value of a company with a new product with growth potential. The investment would also give MFS exclusive marketing rights for Investo's product. MFS would be able to utilize its strong marketing clout and sales force to market the new product. However, Bond is also concerned with the riskiness of the $10.5 million investment. The size of the market for the product is uncertain, there is substantial competition from other companies, and production costs are uncertain.

To obtain the required funding, John Donnelly, CEO of Investo, has hired a venture-capital consultant. The consultant brought the deal to MFS. The consultant acknowledged that he had already approached several investment banks with the proposal, but had not had success. Investo's proposal to MFS is to give them 30 percent of Investo's equity and the rights to market Investo's products through MFS' international distribution system. In exchange, MFS would pay Investo $10.5 million. Under the agreement, MFS would become the sole purchaser and marketer of the Investo product. Investo would produce the product and sell it to MFS at a pre-determined transfer price. Investo's pro forma income and cash flow statements are shown for a base case, most likely scenario in Exhibit 1 (see exhibits spreadsheet).

Regarding the marketing opportunity, MFS would provide its name, sales force, and advertising in exchange for a mark-up over the transfer price. Pro forma projections for the marketing agreement are shown for a base case, most likely scenario in Exhibit 2. Part of the SG&A expenses is the sales force provided by MFS. Sarah Collins, VP of Sales for MFS argued that there is an opportunity cost of using the MFS sales force to market the Investo product. She estimates that the new product will take up 2 percent of the sales force's time at a cost of $150,000 per year. This opportunity cost is included each year in the SG&A projections in Exhibit 2 (see exhibits spreadsheet). Derrick Bond is unsure of this allocation. MFS would not need to hire any new salespeople to sell the Investo product. However, selling the new product would take away some of the salesperson's time available to sell other MFS products. However, Bond believes that any erosion of current product sales would be made up through increased sales of service and supplies that accompany the Investo product. He is inclined to argue that these

[1] This case was prepared for classroom discussion by Professor Emery A. Trahan. It is based on the Cyberlab Case.

competing effects are a wash, and that the sales force's time should not be included as an expense in the analysis.

Bond needs to make a quick decision if he wants to invest in the Investo deal. He has asked Sharon Tewes, CFO of MFS to conduct a detailed capital expenditure review of the proposal. He would like to see the following:

1. An estimate of the value of the investment to MFS.
2. What is the value of the investment if the costs of the MFS sales force are included in the analysis? What if the costs are excluded? Should these costs be included or not? Based on this analysis, what do you recommend Derrick Bond do about this project?
3. A sensitivity analysis that examines the impact on NPV of varying market share, cost of goods sold, and market growth.
4. Submit your report summarizing this analysis and addressing the following questions, then go to the online discussion and discuss the following. Post your initial response and then respond to the postings of others.
    - What do you recommend on the treatment of the MFS sales force costs? Why?
    - What is the key driver of the value of this project?
    - What do you recommend MFS do with this project? Should it be accepted or rejected? If you recommend rejection, can the terms be renegotiated? What factors can be renegotiated? How do they impact the value of the project to MFS?
    - What is your final recommendation?