

Ruth Landis was carefully considering the firm's sales prospects for 2013. Her firm, located in Southern California, did slightly over \$100 million in sales. She and her husband, Jim, started the women clothier's company two decades ago and has watched it grow from five employees to over 500. Ruth was the CEO and Jim was the chief financial officer. Landis produced its own brand of dresses, sweaters, and other apparel, and also sold brands licensed by Tommy Hilfiger, Givenchy, Espirit, and others. Landis' dress manufacturing plants were located in Southern California, South America, and Asia.

Among the many hundreds of decisions Ruth and Jim Landis had to make was what customers were acceptable for credit extension. In the retail fashion business, virtually no customer paid cash, so the extension of credit to retailers was critical in doing business.

A potential account has been brought to their attention by the credit department.

On routine decisions the credit department determined what accounts were acceptable, but on more involved situations the final call rested at the top with Ruth and Jim Landis.

The Potential Account

The account under consideration was Monique Fashion Stores. They were asking for \$1 million for credit purchases. Based on Monique's Dun & Bradstreet rating and other industry data, there appeared to be a five percent probability of non-payment if credit were extended. The collection costs to service the account were four percent of sales and the production and selling costs were 85 percent of sales. Any profits would be taxed at a 35 percent rate. Ruth and Jim determined that accounts receivable turnover would be three times. The firm had a required return on investment of 14 percent.

- Using techniques similar to that under "An Actual Credit Decision" in Chapter 7 of the Block, Hirt, and Danielson text, determine the "Annual Incremental Income after Taxes," from making the sale to Monique Fashion Stores.
2. Assume the only new investment would be in accounts receivable. Based on the turnover ratio of three times, what would the investment in accounts receivable be?
 3. Compute the return on accounts receivable based on your answers to questions one and two.
 4. Given that the firm has a required return on investment of 14 percent, should Landis Apparel Co. sell to Monique Fashion Stores?
 5. If the accounts receivable turnover ratio were four times and the other percentages were the same, should Landis Apparel Co. make the sale?
 6. Now assume that \$200,000 in inventory must be maintained throughout the year in addition to the accounts receivable balance you computed in question 5. Should Landis Apparel Co. make the sale?
 7. Continue to assume the same facts in question 6, but with one other change. By manufacturing the merchandise overseas, Landis Apparel Co. can cut back production and selling costs to 75 percent of sales. Now recompute "Annual Incremental Income after Taxes." Then divide the number by the total investment found in question 6. Should Landis Apparel Co. make the sale?