

Chapter 6 Homework

2. Evans Knitwear's president is convinced that the company must lengthen the credit period it offers to its customers, upscale menswear retail stores. She suggests to the credit executive that the stores have become less liquid and more indebted and need longer to pay their bills. As the analyst assigned to "run the numbers," you have determined that such a move will increase sales from \$100 million to \$105 million per year. The VCR is 0.65 and will not change, and the credit and collection expenses will increase from 2% to 2.5% under the proposal. DSO under the present 30-day terms is 42 days; under the proposed 45-day terms it will be 52 days, according to your best estimate. The bad-debt loss rate is 2.5%, and it will not change for the additional sales. The company's annual cost of capital is 12%.
- Calculate the decision's 1-day change in value.
 - Calculate the decision's NPV.
 - Do you recommend lengthening the credit period?
 - If the bad-debt loss rate under the new credit terms is higher (3.5% versus 2.5%), does this change your recommendation?
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