

# Managerial accounting case: wyndham stores essay sample

[Finance](#), [Investment](#)



## Introduction

Wyndham Stores operates a regional chain of upscale department stores. They plan to open another store in a prosperous and growing suburban area. The company's Vice President of Marketing is in favor of buying the new building site and building a new building on the property. The projected cost for the new building is \$14 million, according to the vice president of marketing. The problem with the vice president's proposal is that he does not take into account time value of money. The Executive Vice President has an argument for the vice president of marketing, stating that Guardian Insurance is willing to purchase the building site, construct the building, and install all fixtures to Wyndham Store's specifications for \$20 million; which results in a \$1 million a year lease payment. Wyndham would be required to pay the first lease payment of \$1 million immediately.

If the building and building site were purchased by Wyndham Stores, the total of the funds that would be used to purchase the building and the building site would be \$6 million upfront, and pay off for the remaining \$8 million would spread out over four years. This would be a total of \$2 million a year for four years. Additional costs if the building site was leased from Guardian Insurance would include a \$400, 000 security deposit that Wyndham would not recoup until the end of the lease. If Wyndham would lease from Guardian, Guardian would handle the insurance costs and pay the property taxes, however, Wyndham would be required to cover the maintenance costs of \$50, 000 per year.

### Net Present Value, Question One

Wyndham Stores should evaluate two options prior to making a decision on the new facility for the upscale department store. The two options are to either lease or purchase the facility. Wyndham Stores has determined that they will keep the site for 20 years. It is important to remember that Wyndham Stores has a 12% before-tax required rate of return. Wyndham Stores could purchase a new department store, and have everything completed and ready for operation with an investment of \$14 million. Annual fees would consist of \$200, 000. These fees cover property taxes, insurance, maintenance, and repairs for the building. After 20 years, this would be a total of \$18 million. The property would have a resale value of \$5 million dollars. This provides an assumption that the total costs would total \$13 million. Below, table 1 demonstrates the total financial investment if Wyndham Stores were to purchase the department store building using the net present value approach.

#### Table 1 Present Value Buy Option

Wyndham Stores also has the option of leasing the facility for the upscale department store. If Wyndham Stores chooses this option, they would be required to provide a \$400, 000 security deposit up front. The first year's rent of \$1 million would also be required up front. Wyndham Stores would also be responsible for the annual maintenance and repair fee of \$50, 000.

Table 2 below demonstrates the total financial investment Wyndham Stores would make if the company were to lease upscale department store facility using the net present value approach.

#### Table 2 Present Value Lease Option

Through the above analysis it can be determined that the total financial investment if the property is purchased would be \$13,047,800. If the property were leased, the total financial investment would be \$9,097,850. This is a difference of \$3,949,950. The analysis is favorable for leasing the upscale department store. Therefore, it can be determined that Wyndham Stores should lease the facility.

#### Future Sales Value, Question 2

If the vice president of marketing would bring up the issue of the building's future value, it would be important to ensure that he is aware that the present value of \$5 million in 20 years is only \$520,000. Those funds could be invested with the potential to earn a return of 12%. Money that is to be received so far in the future is worth very little in present value when the discount rate is high. The facility's future value would need to be more than \$37,980,000 ( $\$3,949,950 / 0.104$ ), which is higher than the vice president of marketing has assumed. The value would have to be significantly higher to overturn the decision to lease the facility.

#### Conclusion

In conclusion, our analysis of this case study determines that the option of leasing is the most favorable outcome for Wyndham stores. This was

determined by the using the net present value method which consists of comparing the present value of the cash inflow to the present value of the cash outflow which will determine if the option of leasing or purchasing is the acceptable financial solution for Wyndham. The option of leasing is supported or determined as being acceptable because its returns are greater than the required rate of return. As the analysis showed that there would be a positive difference in the option of leasing to a savings of almost \$4 million dollars. Even though the option of purchasing is attractive in the short-term, the longevity of the business should not be underestimated. The best option for Wyndham to increase their ability to be financially stable and profitable, leasing, as shown in the previous tables, is by far the more attractive solution for Wyndham.