Review Questions: Net Present Value

1. You work for Microsoft, and you're trying to decide whether Microsoft should spend $20 million (today) on a new advertising campaign for the Xbox. Your assistants have done research to show that a 3-year campaign would increase Microsoft profits of Xbox units and games by $8 million each year. After 3 years, Microsoft is coming out with a new version of the Xbox, so no additional benefits of the campaign will occur after the third year. The discount rate the Microsoft uses for determining advertising projects is 10%, compounded annually. Does your data suggest that Microsoft should launch this campaign?

2. Nordstrom is considering the placement of a department store in Tokyo. It would cost $75 million today to build the store, but they project cash flows of $7 million starting next year and growing at 4% after that (every year). If Nordstrom's opportunity cost of capital for this project is 12%, should they build this store?