

Chap 9 – Capital Budgeting

Key Sections:

- **Explain Payback period, NPV and IRR**
- **Evaluate advantages, disadvantages of each and determine project acceptability**
- **Compute payback, NPV and IRR (with projects with irregular cash flows)**
- **Understand capital rationing and disparities**

Budgeting Criteria

- **Capital Budgeting – decision process relative to investing in fixed assets or other long-term investments in a new product or line of business.**
- **Focuses on after-tax cash flows resulting from a project. Should it be undertaken?**
 - **Compare returns relative to costs**
- **Criteria: NPV, IRR and payback period**

Payback Period

- How many years to recover the initial outlay? Does it meet the minimum period?
- Main weakness – ignores TVM
 - But we could PV each cash flow to show TVM
- Problems: period is arbitrary and ignores later cash flows
- Advantages: understandable, early cash flows more certain