

# Topic: finance essay

[Business](#), [Accounting](#)



Topic: finance Introduction: This paper seeks to answer four sets of questions regarding how to apply capital budgeting techniques. Any assumptions made if any are disclosed to illustrate answers and conclusions based on analysis from the four sets of questions. Each question is supported by worksheet and the questions are actually answered by what are asked.

Explanations follow each worksheet. 2. Questions and Answers: 2. 1

Questions 1 Requirements and Answers;(a) Suppose the equipment overhaul is treated as a tax-deductible expense in the period in which it is incurred.

Should the proposal proceed? Proposal to manufacture is better is for the first four years except on the fifth year only because of higher repairs thus bringing up the cost on the said year. But as whole proposal to manufacture should proceed.

See Appendix A.(b) Does your answer to (b) change if each equipment overhaul is amortized over the following five years? Explain. No, the answer in a will not change. In fact it would be better because the expenses will be spread over the years. . See Appendix A. (c) Suppose an investment of \$100, 000 per year in tax-deductible overheads results in direct costs falling to \$0. 34 per unit.

Should the proposal proceed? (Assume each equipment overhaul is treated as an expense in the period in which it is incurred). With more reason that proposal to manufacture should proceed because of lower direct cost per unit. If under the first assumptions the long run affect was more

advantageous, the lowering of the cost would give more reason to proceed. There will be greater savings. See Appendix A.

2. 2 Question 2 Requirements and Answers -(a) What is the net present value of the proposed venture? Should you proceed? The net present value of the proposed venture is negative \$16.1 million.

This indicates that the venture should not proceed. See Appendix A.(b) Your proposal hinges upon you competing on price. What is the net present value of the proposal if rather than cutting your price in years four and five you hold your price constant at \$2,800, with the result that your market share drops to 25% in each of these years? The net present value of the proposal if rather than cutting your price in years four and five, this paper will hold price constant at \$2,800, with the result that your market share drops to 25% in each of these years is negative \$15.6, hence it is also not acceptable to pursue the venture. See Appendix A.(c) Suppose your original proposal holds (as per (a)), but consultation with a recent graduate of one of these programs reveals that the business could proceed with a lower level of working capital without impacting adversely on the business. What is the impact on the proposal if working capital is instead equal to 15% of revenues?(You know, from experience, that it will be at least one year before the universities can get academics and administrators to agree on a meeting time to review their pricing policies.

) The impact on the proposal if working capital is instead equal to 15% of revenues is still net present of negative \$10.9 million. See Appendix A It would appear therefore that it is not advisable to pursue the proposal under

all the above given assumptions. See Appendix A2. 3 Question 3

Requirement and Answers:(a) If the required real rate of return is 10% and inflation is expected to be zero, what is the minimum price that can be set for the product? The minimum price that can be set for the product is \$ 3,065.71 per unit to be made in Year 5.

See Appendix A.(b) What is the minimum price that needs to be set for the product if the required real rate of return is 10% and inflation is expected to be 5% per annum? Assume you are setting the price as part of a contract that requires the price be fixed over the five year life of the product. The minimum price that can be set for the product is \$ 3,371.43 per unit to be made in Year 5. See Appendix A.(c) Assume inflation is 5% per annum and the price for the product in year one is set at \$3,200 per unit. At what percentage rate will you need to increase the price each year to ensure the firm earns the minimum required rate of return? The price increase will be about 4.0% per year if the starting price in year 1 is \$3,200 per unit.

See Appendix A. 2. 4 Question 4 Requirements and Answers:(a) Calculate the NPV average accounting rate of return for each project. Which project would you select based on each of these criteria? Since project B has higher NPV, I would select the same over project A.

See Appendix A.(b) Calculate the IRR and modified internal rate of return for the projects, where for the latter it is assumed that cash flows are reinvested at an annual rate of 12% per annum. Which project would you select according to the IRR criteria? Discuss.

(the table please use the format like below and add explanation ) To estimate IRR , there is a need to set NPV at zero at a given discount rate. Since making the discount rate at .001 will still yield negative figure of (10,074,815.

38), it would mean that the IRR and Modified IRR of project A is negative, hence the project is not acceptable. See Appendix A. 3.

**Conclusion** In making a decision involving capital budgeting techniques, one that should give the higher profitability should be the guide but this must be backed by the used of net present value methods or IRR since the latter considers the time value of money Brigham and Houston (2002) over the accounting rate of return. Appendix A- Computations supporting all the answers to the four sets of questions. See Excel file. References: Brigham and Houston (2002) Fundamentals of Financial Management, Thomson South-Western, USA.