Free essay on capital budgeting techniques

Business, Company

INTRODUCTION

Conch Republic Electronics is a medium sized electronic manufacturing organization. The company has been operating over the last 70 years and during this time period; it has expanded its product range. The company also manufactures Smartphone. The previously introduced Smartphone has been highly successful in the market and therefore the management is planning to decide whether to invest in the new Smartphone or not. For this purpose, this report uses different capital budgeting techniques to analyze whether the company should accept the project and start manufacturing new Smartphone or not. Different capital budgeting techniques have been applied such as payback period, profitability index, internal rate of return and net present value to analyze whether the project is feasible or not.

Payback period of the project

Payback period of the project shows the time in which the project would recover its total investment. The lower the payback period, the more feasible project is (Khan, 1993). Payback period of the project is calculated below:
As the payback period of the project is found to be 2 years and 11 months and as the investment of the project would be recovered quickly therefore the project is considered to be acceptable from the perspective of payback period.

Profitability index

Profitability index is the other technique that has been used to analyze whether the project yields sufficient returns at its present value in comparison to the total investment (Bodie, Kane, and Marcus, 2004).

Profitability index of the project is calculated below:

The profitability index of the project is found to be 1. 32 and therefore the value of PI is greater than 1, so the project should be accepted.

Internal rate of return (IRR)

Internal rate of return shows the return at which the present value of the future cash flows would be 0 (Bodie, Kane, and Marcus, 2004). IRR of the project is:

The internal rate of return is found to be 22. 16% and the required rate of return is 12%. So as the required rate of return is less than the internal rate of return, therefore the project should be accepted.

Net present value (NPV)

Net present value of the project shows the value of the future cash flows at the present time (Besley, & Brigham, 2007). The net present value of the project is as follows

As the NPV of the project is found to be positive and very high, therefore the project should be accepted.

CONCLUSION

The report analyzes whether Conch Republic Electronics should introduce and manufacture the new Smartphone or not and for this purpose, capital budgeting techniques have been used. All the four techniques applied reveal that Conch Republic Electronics should invest in the new Smartphone.

References

Besley, S., & Brigham, E. (2007). Essentials of Managerial Finance, 14 edn. USA: Thomson Higher Education.

Bodie, Z., Kane, A., and Marcus, A. (2004). Essentials of Investments, 5th ed. London, McGraw-Hill Irwin.

Khan, M. (1993). Theory & Problems in Financial Management. Boston: McGraw Hill Higher Education.

Appendix