# Free johnson controls capital investments term paper sample

Business, Company

1. Suggest a methodology to supplement the traditional methods for evaluating the capital investments of Johnson Controls in the emerging markets to reduce risk providing a rationale of how risk will be reduced.

The nature of the specific risk and projects usually determine the methodology to be implemented for the evaluation of capital investments. There are several traditional methodologies that management uses to measure the effectiveness of a specific investment. The three most popular methods for the evaluation of capital investments include; payback period, internal rate of return (IRR), and net present value (NPV). For further specificity, NPV and IRR are usually given greater importance than the payback (Weygandt, Kimmel, & Kieso, 2012). The major reason for preferring NPV and IRR is their greater and widespread applicability compared to the payback period. At Johnson Controls, they use the method of net present value for evaluating capital budget investments. It is not surprising that Johnson Controls has adopted the NPV methodology because it is commonly used by academicians, investors, and financial managers for comparison purposes of various capital budget investment projects. Net present value includes the calculation of the present value of cash flows that would be received in the future. The impact of investment on the future cash flows is determined by the procedure of net present values. The rate of all cash flows is used to discount the present value of the investment. The calculated value at this point is subtracted from the initial investment in order to calculate the net present value of the project. The net present value methodology is preferred over the payback period because the true monetary value of a project can be determined through this method. Furthermore, net present

value also takes into consideration the time value of money because the real value of money depreciates over time.

Internal Rate of Return (IRR) is also a discount rate that is used to cancel the NPV of a cash flow series which has a positive cash flow in contrast to the initial investment. Internal rate of return is a typical decision making tool for investors, and an investment project is selected if the IRR of the particular investment is higher than the expected bank rate.

Investment decisions are not made solely on financial or non-financial reasons. The management takes into consideration several factors before making a decision to invest or not. In other words, a combination of financial and non-financial factors is considered before making a final decision. Financial factors that differentiate one project from another include; net present value, internal rate of return, and payback period as mentioned earlier. If the project is to be selected on the basis of NPV then, the calculate NPV value should be greater than zero otherwise the project would not be feasible. On the other hand, the higher the IRR value, the better the chances of a project to be selected. In contrast, the payback period should be as low as possible because the greater the years of payback, the greater would be a risk associated with the project. Non-financial factors also play an important role in making the final decision and include factors such as the economic situation, competitor analysis, the political environment, and the restrictions imposed by local government. The liquidity, profitability, and risk of the project are often given importance in the project selection process. The liquidity, profitability, and risk play an important role in determining the levels of diversification, growth, and overall business strategy of the

organization. As investment projects, often involve considerable risk, they are often the most difficult decisions to be made and need a complex procedure for their evaluation.

2. Assess the potential impact of inflation on planned capital investments in China and examine approaches for an accurate evaluation of the investments. Suggest how this knowledge may impact management’s decision.

As of the 2012 forecast of Johnson Controls Inc., the company expected to have sales worth 10. 3 billion and the 2013 forecast was even higher than this. The core business of the firm is manufacturing of automobile parts including; batteries and advanced batteries for start and stop vehicles. The parts manufactured by Johnson Control Inc. are in demand in global markets, as well. Johnson Controls Inc. has made forecasts for China and other potential markets around the world; therefore, they want to ensure that all capital investments are made after thorough investigations for a secure investment project. The company wants to take advantage of the growing economy of China because in some parts of the world businesses are not flourishing, and China is an exception. As Johnson Controls Inc. relocated in China, they experienced a 44 percent growth and this is a moment of pride for the company. As the company gained experience by their demographic relocation in China they now want to be the global leader in their industry. The growth of the company can be multiplied if they consider North America as a potential market. The company may have to develop newer and better products for North America, and this would add positively to the company’s image and revenue. If the company is able to use capital budgeting

techniques wisely they may better judge projects that are worthy of their investment and those which are not.

3. Contrast the modification you would make in evaluating the projects to increase internal capacity in North America to evaluating expansion projects in the global market and how this information will impact the decisions made related to expansion.

The monitoring and evaluation of the capacity building are only going to be useful if the purpose of capacity building and the providers and receivers of the capacity building are known clearly. The purpose to build capacity at Johnson Controls is for global expansion purposes. The variance between the internal capacity and the capacity of global markets is the company's aim which they are trying to achieve. The forecasts for 2012 show that Johnson Controls would be able to increase automotive production in China and North America, and this would also increase the revenue of the company as compared to 2011. The possible increase of 2012 is probable because the company has shown consistent increases in every quarter of 2011. However, production in Europe is not forecasted to increase in 2012. In fact, it would remain constant in the following year. The company expects to increase growth revenue up to 6 percent in 2012.

The new business expansion in North America would contribute towards1. 4 billion revenue in the year 2012 (A Global Leader, 2013). The expansion also suggests that the global production of automotive parts would increase for the forecasted year. The company has forecasted on the basis of traditional methods of capital budget investments. If Johnson Control Inc. wants to reduce the risks of traditional methods, the company should use the net

present value or IRR for capital investment evaluation. Through the NPV, the company would be able to avoid risks as it measures the practicality of the investment and takes into account the time value of money (Brigham & Daves, 2012). As the firm is able to determine the actual value of their money in terms of future cash flows, the NPV calculation may help to make a wise and a well-thought decision. Johnson Controls is involved in making global investment decisions related to the expansion; therefore the risk is greater in every aspect for the company. In order to minimize risk, the company needs to take into consideration the risk of changing purchasing power as that would impact the return on investment (ROI).

4. Examine the benefits of using sensitivity analysis in evaluating the projects for Johnson Controls and how this approach can provide a competitive advantage for the company.

One of the greatest problems organizations face is that they become adamant upon forecasts. It is important for companies to understand that projected results are not accurate, and there may be deviancy from the projections. The company should be willing to accept the deviations and find out reasons for the deviations for future improvements. Projected results are the beliefs of forecasters and how they see the impact of external and internal sources upon a particular project. There are several ways to tackle uncertainty and one of the ways is sensitivity analysis. Through sensitivity analysis, the management is able to devise possible variances that may occur when implementing the project. Keeping into consideration the global expansion of Johnson Control Inc., the company should seriously consider using sensitivity analysis. As the expansion is coupled with diverse forms of

risk, it could have a huge impact upon the overall success of an organization, in this case, Johnson Controls. If the company uses sensitivity analysis, they would be able to see the impact of the financial model under varied circumstances. Moreover, sensitivity analysis even provides the company with a competitive advantage (Milligan, 2011).

# References

A GLOBAL LEADER. (2013, December 12). Our Company. Retrieved June 6, 2014, from http://www. johnsoncontrols. com/content/us/en/about/our_company. html

Brigham, E. F., & Daves, P. R. (2012). Intermediate financial management. (11th ed.). -: Cengage Learning..

Kimmel, J., Weygandt, J., & Kieso, D. E. (2012). Managerial accounting (6th ed.). Hoboken, New Jersey: John Wiley & Sons, Inc..

Milligan, J. (2011, August 22). Financial Modeling Techniques: Sensitivity (what-if) Analysis. The Prospectus Investment Banking Musings. Retrieved June 6, 2014, from http://www. wallstreetprep. com/blog/financial-modeling-techniques-sensitivity-what-if-analysis-2/