Present value

Business, Company

Selling price

The selling price would equal to the sum of the potential profits realizable by the purchased asset. In order to present a proper amount withrespectto the time value and including the market risk and risk premium, the profits have to be discounted to the present value using the appropriate discount rate. The sum of the discounted cash flows for the next two years of the asset's useful life is $299, 021. 75. The same number represents a fair price for purchasing the asset, as it includes potential benefits realizable by the investment, as well as accounts for the possible risks on the basis of the fixed discount rate.

Price adjustment under higher rates and inflation

The higher inflation rate would require the appropriate price markup. Market interest rates as well as the risk rates are higher under the growing inflation. Therefore, the price of the asset will be increased, by marking the adjusting the dollar value using the appropriate inflation rate.

Location

If the asset would be located in the area with unstable governmental and economic situation, it would cost less. The unexpected and sharp market prices fluctuations could alter the projected profit margins. The implementation of long-term contracts would be under a threat. However, with only two years of potential profits, the latter argument does not represent the most critical issue in determining the price level. The risks associated with the potential benefits are significantly higher than in the case of operating in a stable economy. Consequently, the asset would lose some of its value, and its selling price would be lower.

Bonds

The goal of the firm is to maximize present shareholder value. This goal implies that projects should be undertaken that result in the positive net present value, that is the present value of the expected cash inflow less the present value of the required capital expenditures. Using net present value as a measure, capital budgeting involves selecting those projects that increase the value of the firm because they have a positive NPV. The timing and growth rate of the incoming cash flow is important only to the extent of its impact on NPV. The increase in the net present value means the decrease in the discount rate. This data can be observed in the financial plan section, using cash flows, where the present value of a cash flow stream is equal to the sum of the present values of the individual cash flows. Moreover, in determination of the net present value cost of capital percentage can be used.

The cost of capital for any investment is the rate of return capital providers would expect to receive if they would invest their capital elsewhere (opportunity cost). The annual financial reports for the two companies suggest at a first glance that Cisco systems would be a more sound investment, as it represents a more favourable income statement balance. General Motors Company shows very low profits for the last periods, however its profit margins are steadily growing. A significant loss, which negatively affects the current credit rating of the company, is realized in prior periods due to discontinuing operations and losses on requisitions. However, the company's liquidity shows a close to industry's median value. General Motors shows a more confident overall stability of business operation, while

Cisco system greatly depends on innovation and research and development, which is associated with greater costs and bigger risk involved.

However, the business indicates less dependency on fixed costs, which allows to attain not only technological or innovative advantage on the market, but also to win better trading bargains offering more favourable prices to customers. The business operations of Cisco largely depend on the appropriate timing and immediate reaction. Cisco should have a higher discount rate than General Motors, because it requires a more profound analysis for determining the potential performance of the company. The higher risks associated with the investment should be accordingly accounted for including the calculation of the market rate and the risk premium. General Motors offers lower returns but higher stability, which means less risk. Making a long term investment in bonds with the same pay rate would be more sound and reasonable for General Motors Company, as it provides a less risky opportunity of return. However, its benefits are limited compared to the potential suggested by the Cisco systems company.