Finance essay example

Business, Marketing

Capital Budgeting

Answer 1)

Change in Interest Rates:

No, finance costs related to one particular project, should not be considered while estimating the incremental cash flows of the project. Hence, all the expenses related to financing, i. e. interest expenses should be ignored. Important to note, if the manufacturer wishes to include debt financing, the cost of the same shall be reflected in the cost of capital/discount rate that is used to discount the cash flows calculated.

Answer 2)

Sunk Cost

The cost of studying the golf clubs will be categorized as sunk costs and hence, this cost will not be included at the time of evaluation of the project. This is because at the time of evaluation of the project only incremental cash flows should be considered and incremental cash flows never includes sunk costs. Some of the other example of sunk costs is the fee paid to other consultants to estimate the demand of the golf clubs prior to taking decision on the project.

Answer 3)

Opportunity Cost

In the given situation where the manufacturer could also rent his factory, the proposed amount of $80000 per year will be considered as opportunity cost. Important to note, opportunity costs are cash flows that a firm will lose by undertaking the project under analysis. The opportunity cash flows are generated through an asset owed by the firm that would be used while undertaking the project. Hence, the amount of $80000 will be included at the time of evaluation of the project.

Answer 4)

This will be an effect of cannibalization and should be included at the time of considering the cash flows. Important to note, cannibalization is the negative externality when a new project takes sales from an existing product. For instance, here the introduction of golf clubs is likely to affect the sales of refrigerators. Hence, when considering the project, loss in sales of existing project should be considered.

Works Cited

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