Economic consequences

Economics

In cost and benefit analysis, the benefits of a given investment are added and then the related costs are deducted. The investors would want to know if the total revenues or benefits form the purchase of a new equipment would be more than, equal to or less than the cost of buying such high value Asset. It can also be used to add value to intangible investments. E. g. a firm will not invest in machinery that costs $150, 000 and gives a return of $90, 000. Cash flows, financial liquidity of assets, stock of cash and the structure of the balance sheet of a firm influences investments.

Some companies are more vulnerable to changes in interest rates and so will have a greater impact of changes in monetary policies. The investor's ability to pay and his/her income influence capital investment decisions as well. Government regulations play an important role in influencing investment decisions. Firms will have to abide by new legislative laws regardingpollution, laborhealthand safety. Appropriate investments will have to be made to handle the new government issues so that the firm is not taken to court and penalized in the form of fines.

Therefore, the company must invest in equipments that would help keep the company's wastes from polluting theenvironmentand in safety gadgets to protect workers. To strive in this fiercely competitive corporate environment, it is important for organizations to keep pace of the fasttechnologyadvances. If the competitor has brought in a new technology that has not only increased efficiency and speed of work but also the quality then the firm will have to buy the new technology too so it can maintain its market share.

Although it is important to cope with the changes being adopted by the competitor, it does not always prove to be beneficial. The firm might lack the expertise needed for the new technology which makes the firm better off without the new technology. Manufacturing firms need to invest to improve existing working conditions. These can be in the form of better technology, better working environment, better ventilation system etc. Better working conditions also result in a boost of morale of employees. They are more motivated to work and their productivity automatically increases.

“ The most efficient portfolio, defined as those portfolio that provide the highest expected return for any degree of risk, or the lowest degree of risk for any expected return. ” (Brigham, Earnhardt 2002: 247). Therefore an investor’s desire to balance the assets in his/her portfolio also influences capital decisions. The investor has to determine what percentage of the total investment needs to be kept as cash, what percentage as securities and what percentage in shares. Therefore asset allocation which itself is dependent on individual needs, investment time frame may influence the investment decisions.

A diverse portfolio helps investors spread investments among various classes of assets (e. g. , stocks, bonds and cash equivalents), so that the investors risk is spread over a larger number of investment. Also a fall in the return by one investment can be compensated by a high return on the other investments in the portfolio. Investors see to the diversification factor which has a great impact on the capital investments and plays a significant role in balancing out large fluctuations and protecting against market volatility.

Unbalanced portfolio will expose the investor to unnecessary risks. However diversification may even lower the likely returns of market highs. Investments decisions are also made based on the economic situations.

Investors are more likely to invest when the economy is doing well and there are chances of a better return. On the other hand investors would be reluctant to invest when the economy is doing badly or there is a downturn due to fluctuation in interest rates, political turmoil, wars and recession. Some investments will perform better than other as the economy changes overtime.

Growing economy proves to be profitable for company profits and so its stocks whereas rising interest rates may curb bond prices. Another important factor that influences investment decision is risk. " All financial assets are expected to produce cash flows and the risk of an asset is judged in terms of the risk of its cash flows. " (Brigham, Earnhardt 2002: 200). The two types of risks, systematic and unsystematic risks are kept in mind before making investments. Factors like age, income, employment and financialgoalsdetermine how much risk the investor is willing to take.

An investor can either be a risk taker or a risk averse. The greater the risk involved in an investment, the more risk averse the inverse, the lesser will be the investments. Capital investments vary from individuals to individuals and individuals' capital investment decisions change with time, objectives, personal circumstances and economic trends. Capital investment is a vital activity which if not done carefully and economically can lead to vast sums ofmoneyto be wasted. It requires a systematic approach that involves the formulation of goals, estimation of future cash flows and careful monitoring of the investments.

Valid and correct information to make sound decisions with the usage of correct tools like NPV and analysis of economic trends is very important for individuals, organizations and governments. Ideally businesses should pursue investments that enhance shareholder value. However, at any given time capital available for investments are limited and so popular methods of capital budgeting and analysis should be thoroughly done so as to avoid risks that would lead to losses.

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