Mini chapter10
(solve question e to f and g)

Finance and accounting e Draw NPV profiles for Franchises L and S. At what discount rate do the profiles cross?

When the rate of franchise L is at zero(0%) the Y intercept is 50 while that of X is 40 this are the projects net present value (NPV).

(2)

According to the graph above, if the projects are independent, I think franchise L is best suit to venture in as it expresses a high net present value as compared to the other franchise. The venture would add worth to the firm and, thus, it is the best choice for the investor. If the investment of each project is independent of the other then investing in franchise L is advised. However, if they are mutually exclusive, franchise S would be selected, because it has the higher IRR If the investment is mutually exclusive of each franchise, then it is advisable to invest in franchise S as it shows continued sustainability of survival in the market. As compared to franchise L this will lose its taste among the customers in a few years time S would also be rejected if r were above 23. 6%, this is because it will have a negative factor.

To get an understanding the preference of conflict between NPV over IRR, it is prudent to by and large to recognize that NPV recognizes the " correct" rate. This is the cost of capital, to be discounted to the cash flows, as compared to the " arbitrary" rate. In the arbitrary approach where the IRR, makes assumes NPV to be 0. Supremacy of the Net Present Value rules that the reduction cost on capital procedure inborn in both the Internal Rate of Return and Net Present Value systems absolutely assumes that the reinvestment of the cash flows at any given discount rate is used, either Internal Rate of Return or the cost of capital. In the event that the internal

rate of return is very big as compared to the cost of capital it becomes impractical to presume in undergoing for reinvestment with such high rate of risk. The gradient of the Net Present Value is dependent to the project's timing pattern of the cash flows; long-term projects have high gradients as compared to short-term projects.

2

The Net Present Value technique assumes that the entire cash flows of the project period be reinvested back to the project at the firm's preferred rate of return, on the other hand the Internal Rate of Return technique assumes that these cash flows are possible to reinvested at the Internal Rate of Return. More often, the NPV is assumed to be a better as compared to IRR. The reason being that the project's cash inflows are generally used as substitutes of outsourcing capital, This means that the, projects cash flows replace outside capital and, hence, save the firm the cost of outside capital.

g 1

The Modified Internal Rate of Return (MIRR) is imitative of IRR that keeps away from the latter's problems, and gives a more precise percentage gauge of financial attractiveness. The only difference in the Internal Rate of Return and the Modified Internal Rate of Retrun is the rate of reinvestment of cash flows; this is because under MIRR, it is assumed that the rate of reinvestment will be considered as the cost of capital.

The new MIRR is therefore 6. 43%.

g 2

MIRR is a more accurate measure of the attractiveness of an investment alternative because attractiveness depends not only on the return on the investment itself, but also on the return expected from cash flows, it

generates. Executives seeking to hone their decision-making skills will do well to consider the power of this measure. Therefore, the MIRR is has ever been a little smaller as compared to IRR. In capital budgeting calculations, the joint use of NPV and MIRR will probably result in the most complete, accurate analysis, and the whole question of the reinvestment assumption can be avoided

References List

Pogue, M, (2004) ' Investment Appraisal: A New Approach', Managerial Auditing Journal, Volume19.