**FY SEM – II**

**MODULE IV**

INSTRUCTIONS: Given below are statements that are TRUE. Study them well along with those given in the book. They can be asked in some form or the other for MCQ’s and True / False and will help in revision.

**Ch: 9 Capital Budgeting**

* Capital budgeting involves the process of making investment decisions based on future profitability.
* Capital Budgeting is also called- Fixed Asset Management, Project Evaluation, Project Appraisal, Investment Appraisal
* Capital Budgeting is vital for a business enterprise as the amount of capital any business has available for new projects is limited and hence management uses capital budgeting techniques to determine which projects will yield the best return over a given time period.
* Capital budgeting decisions are often irreversible
* It mainly deals with fixed assets of a firm
* Investments undertaken have a long gestation period- i.e. the time period between investing the money and gaining the returns is long
* First step of capital budgeting is to determine the project cost
* The Present value of cash flows needs to be found by discounting future cash flow value due to the difference in the value of money due to time. ( Eg- The value of ₹100 today is very different from the value of ₹100 in 1975)
* Investment appraisal is done by comparing present value of future cash flows with the cost of the project- If Present value > Cost of project = Investment should be undertaken
* Pay back period (PBP) calculates the time taken to recover the original investment
* PBP gives a lot of importance to quick return of the initial investment and doesn’t consider the money received after that.
* PBP is not an adequate measure of profitability of investment
* Net Present Value (NPV) method of capital budgeting is based on the principle of discounting i.e. it finds out the present value of the sum of money that the investment would yield in the future.
* In NPV is positive- project is profitable. Higher the NPV, better is the project
* If NPV is negative- project will reap losses and hence it will be rejected
* Internal rate of return (IRR) is also called yield on investment, marginal efficiency of capital, discounted cash flow rate of return, economic rate of return, etc
* It involves finding the rate of return at which present value of future cash flows is equal to the initial investment.
* IRR is the rate at which NPV is 0
* Internal rate of return is used to evaluate the attractiveness of a project or investment. If the IRR of a new project exceeds a company’s required rate of return or the market rate or interest, that project is desirable. If IRR falls below the required rate of return, the project should be rejected.
* Higher the IRR more desirable is the project
* NPV is positive when IRR is greater than marginal cost of capital used by the firm
* If NPV and IRR provide opposing or contradictory results, then the project with higher NPV is chosen