INVESTMENT APPRAISAL AND FINANCIAL DECISIONS pdf

1: Qualitative Factors in Capital Investment Decisions | www.enganchecubano.com

*Investment Appraisal and Financial Decisions [Steve Lumby, Christopher Jones] on www.enganchecubano.com *FREE* shipping on qualifying offers. This bestseller offers a complete introduction to financial management and corporate finance modules for a one-year university course.*

Capital Gain or Loss Risk The rate of return on different investment options varies a lot. It is a general phenomenon that more return is expected out of a high-risk investment. Risk means the uncertainty of returns. Statistically, the risk is judged based on parameters like variance, standard deviation, and beta. More a security deviate from its expected outcomes, a risk is considered to be high. Challenge for a finance manager while investing funds is to achieve high returns on investments while keeping the risk at lowest possible levels. Liquidity Liquidity means marketability of an investment. For example, equity shares of a big company can be easily liquidated in the stock markets. On the other hand, money invested in an asset machinery cannot be liquidated as easily as the equity share. An investment is considered highly marketable or liquid it can be easily transacted with low transaction cost and low price variation. A finance manager looks for more liquid investments when the funds are available for the short period. Liquidity is always given a preference because it helps the managers remain flexible. Tax Benefits It is true for some investments and not for all. Most of the countries have tax incentives for particular investments except tax-free countries. So, for investments which have tax benefits, it is an important consideration because taxes form a major part of their expenses. Convenience Convenience means ease of investment. When an investment can be made and looked after easily, we consider it as convenient investing. For example, it is easy to invest in equity shares compared to real estate because real estate involves a lot of documentation and legal requirements. So, the analysis of investments attributes viz. Return, Risk, Liquidity, Tax Benefits and Convenience answers to the central question â€" Which investment alternative should opt? Investment analysis and appraisal are one of the primary jobs of finance managers. It evaluates new investment opportunities for its physical and financial viability. Most important of all is the financial viability because financial survival has to be the first goal for any firm to achieve any other goal. Investment analysis and appraisal is a stepwise decision-making the process to assist managers in deciding about the acceptance or rejection of a project. Essentially, it analyzes the cash flows and other factors of the project to evaluate the financial feasibility. We can follow the step by step process as mentioned below: Investment Analysis and Appraisal Estimate the Cash Flows After coming across an investment project, the first thing that a manager should do is to estimate the cash flows of the project. It is like a base of the building which should be very strong. Estimation of cash flow should be as accurate as possible as they become the foundation for all the further steps of this process.

2: Capital budgeting - Wikipedia

This bestseller offers a complete introduction to financial management and corporate finance modules for a one-year university course. It is a relatively non-mathematical text and its simple explanations of a complex area have made it extremely popular with students.

Investment appraisal is a collection of techniques used to identify the attractiveness of an investment. General The purpose of investment appraisal is to assess the viability of project, programme or portfolio decisions and the value they generate. In the context of a business case, the primary objective of investment appraisal is to place a value on benefits so that the costs are justified. There are many factors that can form part of an appraisal. An investment decision may be justified because it reduces risk. A financial appraisal is the most easily quantifiable approach but it can only be applied to benefits that produce financial returns. The simplest financial appraisal technique is the payback method. The payback period is the time it takes for net cash inflow to equal the cash investment. This is a relatively crude assessment and is often used simply as an initial screening process. However, this has the disadvantage of not taking into account the timing of income and expenditure. This makes a significant difference on all but the shortest and most capital-intensive of projects. In most cases, discounted cash flow techniques such as net present value NPV or internal rate of return IRR are appropriate to evaluate the value of benefits and alternative ways of delivering them. NPV calculates the present value of cash flows associated with an investment; the higher the NPV the better. This calculation uses a discount rate to show how the value of money decreases with time. Appraisal of capital-intensive projects and programmes should take into account the whole-life costs across the complete product life cycle as there may be significant termination costs. In the case of the public sector, where income is usually zero, it is common practice to identify the option with the lowest whole-life cost as the option that offers the best value for money. The appraisal on less tangible and non-financial factors is more subjective. In some cases, a financial value may be calculated by applying a series of assumptions. For example, work that improved staff morale may lead to lower staff turnover and reduce recruitment costs. A financial appraisal of this benefit would have to include assumptions about the numerical impact of increased morale on staff turnover and the estimated costs of recruitment. Where benefits cannot be quantified then scoring methods may be used to compare the subjective value of benefits. Project Stand-alone projects will use investment appraisal to compare alternative approaches to achieving the required benefits. Wherever possible, the project should use techniques that are the organisational, programme or portfolio standard approach. Where a project is part of a programme, the initial investment appraisal may be performed by the programme management team. That does not exempt the project management team from being familiar with the content of the appraisal or the techniques used to perform it. It will still be responsible for keeping the business case up to date and this will involve repeating the investment calculations to account for changing circumstances. Where a project is undertaken by a contracting organisation, the financial appraisal is relatively straightforward as it will simply be a comparison of costs with the fee paid by the client, probably using a discounted cash flow technique. Programme Programmes are usually defined to bring about organisational change. This inevitably gives rise to a higher proportion of intangible and non-financial benefits being included in the business case. Commercial programmes must be careful not to be overly dependent on non-financial benefits, as anything can be justified through subjective views of value. The programme management team must set out standards for the appraisal of the component projects and their associated benefits. Consistent and compatible techniques must be used across the programme so that individual project business cases can be aggregated and summarised in the overall programme business case. Portfolio In the definition phase of a portfolio there may be many ideas and suggestions for projects and programmes to meet the strategic objectives. The portfolio management team must establish a system for capturing and screening these ideas. This is where broad-brush techniques such as payback may be used. A criterion may be set that requires payback within the financial planning cycle. Any projects or programmes that do not provide payback in that period are discarded. As the higher-potential ideas are captured, they will be subject to more detailed, analytical techniques. The prioritisation and balancing phases of the portfolio will rely heavily on how investment appraisal has built the business cases of the component projects and programmes. It is essential that the portfolio management team establishes standard methods and consistent approaches across the portfolio to ensure reliable decision-making. The team should also provide specialist advice and guidance on the use of appraisal techniques to all project and programme teams. The portfolio management team must also ensure that investment appraisals consider potential investments in the context of the existing and planned projects and programmes. For example, to identify opportunities for reuse of components and avoid double counting of benefits.

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3: - Investment Appraisal and Financial Decisions by Steve Lumby

Investment appraisal is a collection of techniques used to identify the attractiveness of an investment. General The purpose of investment appraisal is to assess the viability of project, programme or portfolio decisions and the value they generate.

Investment Appraisal Introduction A company may decide to invest in a long-term project if the future return is likely to be achieved. This is known as investment appraisal. Investment appraisal is crucial to a business due to: Large sums are necessary to invest in projects and therefore care needs to be taken with the decisions, as they are difficult to reverse. It is difficult to estimate the potential future return of long-term investment so investment appraisal techniques need to be used to assess the risk and uncertainty of projects. Before any investment decisions can be made, the following need to be considered: Initial Investigation â€" Feasibility of project eg Do we have enough resources. Monitoring project â€" Analyse the progress of the project and reassess forecasts. Investment Appraisals To measure whether the benefits of a project exceed the cost of investment, various investment appraisal techniques are available namely discounted and non-discounted cash flow techniques. Non-discounted Techniques Non-discounted cash flows do not consider the time value of money Inflation but are useful techniques for the analysis of projects. Payback Period A non-discounted technique that gives an estimation of the amount of time it will take to cover costs of investment, usually expressed in years. Advantages Simple method to understand. Takes no consideration of the time value of money. Provides an estimation based upon cash flows for businesses that value short-term cash flow more than longer-term cash flow. Ignores the fact that some of the projects with longer payback periods have a greater level of return. This technique takes into account the amount of capital investment necessary to back-up the project. Note it uses profits rather than cash flows. Advantages Simple method to understand and calculate. Fails to consider the timings of cash flows. Allows share option availability to employees as an incentive. Public companies have to meet certain regulatory requirements and accepted standards of corporate governance. Discounted Cash Flow Techniques Discounted cash flow takes into account the time value of money Inflation and therefore is a more accurate measure of appraisal. Net Present Value NPV The net present value takes into account the profitability by analysing cash flows over the life of the project. It uses the cost of capital to discount the cash flows. Advantages Takes into account the time value of money so makes it more accurate. There may be difficulties in determining an appropriate cost of capital. Fails to consider the risk and uncertainty factors involved in a project. Takes into account the time value of money. Public companies have to meet certain regulatory requirements and accepted standards of corporate governance.. Taxation and Inflation It is important to be aware of the appraisal techniques that consider the effects of taxation and inflation. Most businesses in practice will do so as this will affect the accuracy of appraisals. Nominal method is used when a project has actual cash flows. Normally used when project includes both tax and inflation. Normally used for annuities and perpetuities. Taxation Taxation has to be taken into consideration when making investment decisions. Tax is assumed to be paid a year in arrears when doing discount cash flow analysis. Note it is important to consider the tax consequences of projects in particular: Capital Allowances v Depreciation.

4: Economic & Financial Appraisals

The importance of investment appraisal practices A major problem for decision makers in enterprises is the appraisal of potential investment projects that can absorb capital assets. This evaluation, also known as investment appraisal, is really crucial for the future of any firm, since it determines the financial sources of.

Wrapping It All Up Capital budgeting is a step by step process that businesses use to determine the merits of an investment project. However, what rate of return is deemed acceptable or unacceptable is influenced by other factors that are specific to the company as well as the project. For example, a social or charitable project is often not approved based on rate of return, but more on the desire of a business to foster goodwill and contribute back to its community. Capital budgeting is important because it creates accountability and measurability. Any business that seeks to invest its resources in a project, without understanding the risks and returns involved, would be held as irresponsible by its owners or shareholders. Furthermore, if a business has no way of measuring the effectiveness of its investment decisions, chances are that the business will have little chance of surviving in the competitive marketplace. Businesses aside from non-profits exist to earn profits. The capital budgeting process is a measurable way for businesses to determine the long-term economic and financial profitability of any investment project. Capital budgeting is also vital to a business because it creates a structured step by step process that enables a company to: Develop and formulate long-term strategic goals â€" the ability to set long-term goals is essential to the growth and prosperity of any business. Seek out new investment projects â€" knowing how to evaluate investment projects gives a business the model to seek and evaluate new projects, an important function for all businesses as they seek to compete and profit in their industry. Estimate and forecast future cash flows â€" future cash flows are what create value for businesses overtime. Capital budgeting enables executives to take a potential project and estimate its future cash flows, which then helps determine if such a project should be accepted. Facilitate the transfer of information â€" from the time that a project starts off as an idea to the time it is accepted or rejected, numerous decisions have to be made at various levels of authority. The capital budgeting process facilitates the transfer of information to the appropriate decision makers within a company. Creation of Decision â€" when a capital budgeting process is in place, a company is then able to create a set of decision rules that can categorize which projects are acceptable and which projects are unacceptable. The result is a more efficiently run business that is better equipped to quickly ascertain whether or not to proceed further with a project or shut it down early in the process, thereby saving a company both time and money. Unlike other business decisions that involve a singular aspect of a business, a capital budgeting decision involves two important decisions at once: By taking on a project, the business has agreed to make a financial commitment to a project, and that involves its own set of risks. Projects can run into delays, cost overruns and regulatory restrictions that can all delay or increase the projected cost of the project. In addition to a financial decision, a company is also making an investment in its future direction and growth that will likely have an influence on future projects that the company considers and evaluates. So to make a capital investment decision only from the perspective of either a financial or investment decisions can pose serious limitations on the success of the project. That acquisition was a capital budgeting decision, one in which ExxonMobil made a huge financial commitment. But in addition, ExxonMobil was making a significant investment decision in natural gas and essentially positioning the company to also focus on growth opportunities in the natural gas arena. That acquisition alone will have a profound effect on future projects that ExxonMobil considers and evaluates for many years to come. The significance of these dual decisions is profound for companies. Executives have been known to lose jobs over poor investment decisions. One can say that running a business is nothing more than a constant exercise in capital budgeting decisions. Understanding that both a financial and investment decision is being made is paramount to making successful capital investment decisions.

5: Investment Appraisal-8 non-financial factors that every accountants and managers should consider -

Investment decision Introduce to investment decision The investment decisions are made by corporate manager to maximize the value of the firm. According to a survey by Truong, Partington and Peat (), NPV investment rule is the most popular rule that used in investment decision.

Capital investments -- whether large, one-time purchases of facilities or productive equipment, investments in labor or assets purchased for profitable appreciation -- are generally driven by quantitative factors, such as price and an expected return on investment. However, managers today must consider a range of qualitative factors when making capital investment decisions. Ethics, safety, company culture and environmental concerns can affect the decision to purchase capital resources. Understanding these types of qualitative factors is part of making well-informed capital-investment decisions. Company Culture Capital investments can have an impact on the way work is performed in an organization. Adding a second office complex in another city, for example, may change the way communication and information flow between teams, or it may affect reporting relationships. Adding automation into a small-business production line, as another example, can change the team dynamic on a factory floor. Cultural considerations can be expected to come into play more heavily with physical productive resources than financial investments. This being the case, the quality of capital resources can directly affect the quality of goods or services. This is one area in which quantitative and qualitative factors can be at odds, as the least expensive options in the marketplace can generally be expected to yield the lowest quality. Purchasing the cheapest vehicles for on-site technicians, for example, can lead to service interruptions due to vehicle breakdowns. Purchasing low-quality kitchen equipment in a restaurant, as another example, can diminish the consistency of prepared food. Environmental Concerns Capital investments can have varying degrees of impact on the environment, and the more financially appealing options frequently have greater impacts than costlier options. Because of this, the quantitative factor of price can be at odds with the qualitative factor of environmental responsibility. A manager must consider the impact that any capital investment will have on the environment. When purchasing new trucks for a delivery fleet, for example, she should balance affordability and environmentally conscious design. Ethical Considerations Ethical concerns can inject a host of qualitative considerations into a capital-investment decision. Such considerations as employee safety, local employment and local air quality can all be affected by investments in new facilities and equipment, regardless of the financial benefits. Overhauling a production facility to automate manufacturing tasks while drastically reducing the staff, for example, can introduce greater cost efficiency and public animosity at the same time. Installing low-quality fire protection systems, as another example, can unnecessarily endanger employees on the job. References 2 Monash University: As a small-business owner, Ingram regularly confronts modern issues in management, marketing, finance and business law. He has earned a Bachelor of Arts in management from Walsh University.

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6: Investment Appraisal - Knowledge Grab

Investment appraisal is crucial to a business due to: Large sums are necessary to invest in projects and therefore care needs to be taken with the decisions, as they are difficult to reverse. It is difficult to estimate the potential future return of long-term investment so investment appraisal techniques need to be used to assess the risk and.

Capital budgeting projects are classified as either Independent Projects or Mutually Exclusive Projects. Thus, all Independent Projects which meet the Capital Budgeting criterion should be accepted. Mutually exclusive projects are a set of projects from which at most one will be accepted. For example, a set of projects which are to accomplish the same task. Thus, when choosing between "mutually exclusive projects", more than one project may satisfy the capital budgeting criterion. However, only one, i. As we shall see, only the net present value decision rule will always lead to the correct decision when choosing among mutually exclusive projects. This is because the net present value and internal rate of return decision rules differ with respect to their reinvestment rate assumptions. Since each project is likely to have a different IRR, the assumption underlying the net present value decision rule is more reasonable. Internal rate of return[edit] Main article: It is a commonly used measure of investment efficiency. The IRR method will result in the same decision as the NPV method for non-mutually exclusive projects in an unconstrained environment, in the usual cases where a negative cash flow occurs at the start of the project, followed by all positive cash flows. In most realistic cases, all independent projects that have an IRR higher than the hurdle rate should be accepted. Nevertheless, for mutually exclusive projects, the decision rule of taking the project with the highest IRR - which is often used - may select a project with a lower NPV. The IRR exists and is unique if one or more years of net investment negative cash flow are followed by years of net revenues. But if the signs of the cash flows change more than once, there may be several IRRs. The IRR equation generally cannot be solved analytically but only via iterations. One shortcoming of the IRR method is that it is commonly misunderstood to convey the actual annual profitability of an investment. In a budget-constrained environment, efficiency measures should be used to maximize the overall NPV of the firm. Some managers find it intuitively more appealing to evaluate investments in terms of percentage rates of return than dollars of NPV. Equivalent annuity method[edit] Main article: Equivalent annual cost The equivalent annuity method expresses the NPV as an annualized cash flow by dividing it by the present value of the annuity factor. It is often used when assessing only the costs of specific projects that have the same cash inflows. In this form it is known as the equivalent annual cost EAC method and is the cost per year of owning and operating an asset over its entire lifespan. It is often used when comparing investment projects of unequal lifespans. For example, if project A has an expected lifetime of 7 years, and project B has an expected lifetime of 11 years it would be improper to simply compare the net present values NPVs of the two projects, unless the projects could not be repeated. The use of the EAC method implies that the project will be replaced by an identical project. Alternatively the chain method can be used with the NPV method under the assumption that the projects will be replaced with the same cash flows each time. To compare projects of unequal length, say 3 years and 4 years, the projects are chained together, i. The chain method and the EAC method give mathematically equivalent answers. The assumption of the same cash flows for each link in the chain is essentially an assumption of zero inflation , so a real interest rate rather than a nominal interest rate is commonly used in the calculations. Real options analysis Real options analysis has become important since the s as option pricing models have gotten more sophisticated. The discounted cash flow methods essentially value projects as if they were risky bonds, with the promised cash flows known. But managers will have many choices of how to increase future cash inflows, or to decrease future cash outflows. In other words, managers get to manage the projects - not simply accept or reject them. Real options analysis tries to value the choices - the option value - that the managers will have in the future and adds these values to the NPV. Ranked projects[edit] The real value of capital budgeting is to rank projects. Most organizations have many projects that could potentially be financially rewarding. Once it has been determined that a particular project has exceeded its hurdle, then it should be ranked against peer projects e. The highest ranking projects should be implemented until the budgeted capital has been expended. Funding sources[edit]

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Capital budgeting investments and projects must be funded through excess cash provided through the raising of debt capital, equity capital, or the use of retained earnings. Debt capital is borrowed cash, usually in the form of bank loans, or bonds issued to creditors. Need[edit] A large sum of money is involved which influences the profitability of the firm making capital budgeting an important task. Long term investments, once made, cannot be reversed without a significant loss of invested capital. The investment becomes sunk, and mistakes, rather than being readily rectified, must often be borne until the firm can be withdrawn through depreciation charges or liquidation. It influences the whole conduct of the business for the years to come. Investment decisions are the based on which the profit will be earned and probably measured through the return on the capital. A proper mix of capital investment is quite important to ensure adequate rate of return on investment, calling for the need of capital budgeting. The implication of long term investment decisions are more extensive than those of short run decisions because of time factor involved, capital budgeting decisions are subject to the higher degree of risk and uncertainty than short run decision.

7: What is investment appraisal? | APM

What non-financial factors are considered important in investment evaluation, especially in strategic investment decision? Do organisations use conventional appraisal techniques for evaluation of strategic investment projects or prefer using recently developed strategic analysis tools in order to evaluate?

8: Capital Budgeting: The Importance Of Capital Budgeting

Capital Budgeting and Investment Decisions: The case of investment, cash flows, risk, financial techniques, capital investment appraisal. This is for the.

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