10 Lecture - MGT201

Important Subjective

1. **What is the difference between sunk costs and opportunity costs in project cash flows?**
Answer: Sunk costs are costs that have already been incurred and cannot be recovered, while opportunity costs are potential benefits that are lost when one alternative is chosen over another.

2. **Why is it important to consider the timing of cash flows in capital budgeting?**
Answer: The timing of cash flows is important because money received or paid out at different times has different values. It is necessary to adjust for the time value of money to ensure that cash flows are comparable and reflect their true value.

3. **What is the difference between the net present value and the internal rate of return methods for evaluating projects?**
Answer: The net present value (NPV) method measures the present value of future cash flows, while the internal rate of return (IRR) method calculates the discount rate that makes the NPV equal to zero. NPV is better for comparing different projects, while IRR is better for ranking projects in terms of profitability.

4. **What is the payback period method and how is it calculated?**
Answer: The payback period method is a capital budgeting technique that calculates the length of time it takes for a project to recover its initial investment. It is calculated by dividing the initial investment by the annual cash inflows.

5. **How does sensitivity analysis help in evaluating project risk?**
Answer: Sensitivity analysis involves testing the effect of changing certain assumptions or variables on the project's net present value or internal rate of return. It helps identify which assumptions or variables have the greatest impact on the project's profitability, and thus helps evaluate project risk.

6. What is the difference between the profitability index and the net present value methods?
Answer: The profitability index (PI) is calculated by dividing the present value of future cash flows by the initial investment, while the net present value (NPV) method calculates the present value of future cash flows minus the initial investment. PI is useful for comparing projects with different initial investments, while NPV is better for comparing different projects.

7. **How is the modified internal rate of return (MIRR) different from the regular internal rate of return (IRR)?**
Answer: The modified internal rate of return (MIRR) takes into account the reinvestment rate of the project's future cash flows, while the regular internal rate of return (IRR) assumes that future cash flows are reinvested at the same rate as the project's initial investment. MIRR is considered a more realistic measure of a project's profitability.

8. **How can the profitability of a project be improved through the use of accelerated depreciation?**
Answer: Accelerated depreciation allows for a larger portion of the initial investment to be

written off in the early years of a project, reducing taxable income and increasing cash flow. This increased cash flow can improve the project's profitability.

9. **What is the difference between mutually exclusive and independent projects?**
   Answer: Mutually exclusive projects are projects where only one can be accepted, while independent projects are projects that can be accepted or rejected independently of each other.

10. **Why is the cost of capital an important factor in capital budgeting decisions?**
    Answer: The cost of capital represents the opportunity cost of investing in a project, and thus is used as the discount rate in net present value and internal rate of return calculations. The cost of capital is important in determining whether a project will generate returns greater than its cost, and thus whether it is a good investment.