

12 Lecture - MGT201

Important Subjective

1. **What is the difference between the NPV and IRR methods? Which method would you prefer when investing in a new project and why?**

Answer: The NPV method calculates the net present value of cash inflows and outflows, while the IRR method calculates the rate of return that equates the present value of cash inflows with the present value of outflows. I would prefer the NPV method when investing in a new project because it takes into account the time value of money and provides a more accurate picture of the project's profitability.

2. **How can a company decide which projects to invest in when there is limited capital available?**

Answer: The company can use various techniques such as ranking projects by their profitability index (PI) or by their NPV per dollar of investment. This will help the company to choose the projects that provide the highest return on investment with the limited capital available.

3. **How do sunk costs and opportunity costs affect capital budgeting decisions?**

Answer: Sunk costs are costs that have already been incurred and cannot be recovered, and should not be considered when making capital budgeting decisions. Opportunity costs are the costs of the next best alternative foregone, and should be taken into account when making capital budgeting decisions.

4. **What is the difference between mutually exclusive and independent projects? How would you choose between two mutually exclusive projects?**

Answer: Mutually exclusive projects are projects where choosing one project precludes the selection of other projects. Independent projects are projects that can be selected regardless of the choice of other projects. To choose between two mutually exclusive projects, we would select the project with the highest NPV.

5. **What is the difference between the payback period and discounted payback period? Which method do you think is better and why?**

Answer: The payback period is the time required for the initial investment to be recovered from the cash inflows. The discounted payback period takes into account the time value of money. I think the discounted payback period is better because it accounts for the time value of money and provides a more accurate picture of the project's profitability.

6. **How does sensitivity analysis help in capital budgeting decisions?**

Answer: Sensitivity analysis helps in assessing the risk associated with a project by determining the effect of changes in key variables on the project's profitability. This helps in making more

informed decisions by identifying the most critical variables and the extent to which they affect the project's profitability.

7. What is the difference between capital budgeting and operational budgeting? How are they related?

Answer: Capital budgeting involves making long-term investment decisions, while operational budgeting involves planning short-term operational expenses. The two are related because operational budgets are used to forecast cash inflows and outflows for capital budgeting decisions.

8. How can a company deal with uncertainty in capital budgeting decisions?

Answer: A company can deal with uncertainty by using techniques such as scenario analysis, sensitivity analysis, and real options analysis. These techniques help in identifying potential risks and uncertainties associated with a project and provide a more accurate picture of the project's profitability.

9. What are the advantages and disadvantages of using the modified internal rate of return (MIRR) method over the traditional IRR method?

Answer: The advantage of using the MIRR method is that it assumes that cash inflows are reinvested at a rate equal to the cost of capital, which is more realistic than the IRR method, which assumes that cash inflows are reinvested at the IRR rate. The disadvantage of using the MIRR method is that it can be more difficult to calculate than the IRR method.

10. How can a company determine the optimal level of capital investment in a given period?

Answer: A company can determine the optimal level of capital investment by comparing the expected return on investment to