

Chapter 11

The Basics of Capital Budgeting

LEARNING OBJECTIVES

After reading this chapter, students should be able to:

- Define capital budgeting, explain why it is important, and state how project proposals are generally classified.
- List the steps involved in evaluating a capital budgeting project.
- Calculate payback period, discounted payback period, Net Present Value (NPV), and Internal Rate of Return (IRR) for a given project and evaluate each method.
- Define NPV profiles, and explain the rationale behind the NPV and IRR methods, their reinvestment rate assumptions, and which method is better when evaluating independent versus mutually exclusive projects.
- Briefly explain the problem of multiple IRRs and when this situation could occur.
- Calculate the Modified Internal Rate of Return (MIRR) for a given project and evaluate this method.
- Identify at least one relevant piece of information provided to decision makers for each capital budgeting decision method discussed in the chapter.
- Identify and explain the purposes of the post-audit in the capital budgeting process.
- Identify a number of different types of decisions that use the capital budgeting techniques developed in this chapter.