CHAPTER OVERVIEW

8: Introduction to Capital Budgeting

Learning Objectives

After completing this chapter, students should be able to

- Identify what a capital budgeting project is, provide an example, and discuss why the capital budgeting process is essential to maximizing shareholder wealth
- Explain the difference between independent and mutually exclusive projects
- Identify and explain the relevance of the four key capital budgeting criteria
- Identify whether or not each of the criteria is met by each of the three decision techniques introduced in class (Payback Period, Internal Rate of Return, and Net Present Value)
- Calculate and conceptually explain the concepts of Payback Period (PP), Internal Rate of Return (IRR), and Net Present Value (NPV)
- Adjust for risk differences under PP, IRR, and NPV
- Evaluate independent and/or mutually exclusive projects using each of the three decision techniques in isolation and as a whole
- Explain the flaws and relevance of the PP
- Explain the flaws and relevance of the IRR
- Explain why NPV is the best model
- Explain the concepts of the size problem, reinvestment rate problem, and crossover problem as well as identifying when these problems might be present
- Explain the concept of the NPV profile
- Discuss the survey results of how these methods are applied in practice.

8.1: What is Capital Budgeting?
8.2: Mutually Exclusive vs. Independent Projects
8.3: Capital Budgeting Decision Criteria
8.4: Capital Budgeting Process
8.5: Capital Budgeting Decision Techniques
8.6: Capital Budgeting in Practice
8.7: Key Takeaways
8.8: Exercises
8.9: Problems
8.10: References and Attributions