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NPTEL ONLINE CERTIFICATION COURSE

Project Management for Managers

Lec – 28

Abandonment Analysis

Dr. M.K. Barua

Department of Management

Indian Institute of Technology Roorkee

Every project has a useful life, after which it is expected to end. But, sometimes, a project is ended before its useful life is over. Deciding to abandon the project before its planned life is called abandonment. This can be due to various reasons. The reasons are generally related to variables of project life, selling price, selling quantity, raw material availability and its price, salvage value, expected rate of return, etc

Product may loose charm- sale may decline- customer taste or some other reasons like competition or regulations.

Raw material non availability – spectrum , import regulations, reduced cultivation.

Offered price for the project may be lucrative for the project owner to abandon the project and he may feel beneficial to sell the project instead of continuing with it.

An <u>increase in expected return</u> also leads to abandonment. The increase in expected returns may be due to increased rate of interest or availability of better prospects for investment.

For example, a company expects a return of 14% from a project and the expected return <u>was 12%,</u> it will be a beneficial project but if due to some economic conditions like **increase in interest** rate which results in increase in expected **returns (16%),** then the project loses its feasibility and the firm may decide to abandon the project

Another common reason is availability of more <u>lucrative project </u>with higher returns. For example, an investor has invested money to yield a return of 10% with a bank and another bank offers 12% return.

There are some other reasons for abandonment. For example, a firm may decide to decrease its product line to concentrate on fewer products.

The question arises, when should a firm abandon a project or how to evaluate whether abandonment should be done?

We can certainly apply NPV method to evaluate the various alternatives and take the right decision.

The simple rule is, consider the offered abandon price as investment and consider only future cash flows of remaining project life and apply the current expected return as discounting factor.

The resultant NPV, if positive, means that the project should be continued rather than abandoned and vice versa. The past data should be ignored in abandonment analysis