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CHAPTER

Investment Decisions

MULTIPLE CHOICE QUESTIONS

1. A capital budgeting technique which does not require the computation of cost of capital for decision making purposes is:

(*a*) Net present value method
(*b*) Internal rate of return
(*c*) Modified internal rate of return
(*d*) Payback period method

2. If two alternative proposals are such that the acceptance of one shall exclude the possibility of the acceptance of another then such decision making will lead to:

(*a*) Mutually exclusive decisions
(*b*) Accept reject decisions
(*c*) Contingent decisions
(*d*) None of the above

3. In case a company considers a discounting factor higher than the cost of capital for arriving at present values, the present values of cash inflows will be:

(*a*) Less than those computed on the basis of cost of capital
(*b*) More than those computed on the basis of cost of capital
(*c*) Equal to those computed on the basis of the cost of capital
(*d*) None of the above

4. If the cut off rate of a project is greater than IRR, we may:

(*a*) Accept the proposal
(*b*) Reject the proposal
(*c*) Be neutral about it
(*d*) Wait for the IRR to increase and match the cut off rate

5. While evaluating capital investment proposals, time value of money is used in which of the following techniques:

(*a*) Payback period method
(*b*) Accounting rate of return
(*c*) Net present value
(*d*) None of the above

6. IRR would favour project proposals which have:

(*a*) Heavy cash inflows in the early stages of the project
(*b*) Evenly distributed cash inflows throughout the project

(*c*) Heavy cash inflows at the later stages of the project
(*d*) None of the above

7. The re-investment assumption in the case of the IRR technique assumes that:
(*a*) Cash flows can be re-invested at the projects IRR
(*b*) Cash flows can be re-invested at the weighted cost of capital
(*c*) Cash flows can be re-invested at the marginal cost of capital
(*d*) None of the above

8. Multiple IRRs are obtained when:
(*a*) Cash flows in the early stages of the project exceed cash flows during the later stages
(*b*) Cash flows reverse their signs during the project
(*c*) Cash flows are uneven
(*d*) None of the above

9. Depreciation is included as a cost in which of the following techniques:
(*a*) Accounting rate of return
(*b*) Net present value
(*c*) Internal rate of return
(*d*) None of the above

10. Management is considering a ₹1,00,000 investment in a project with a 5 year life and no residual value. If the total income from the project is expected to be ₹60,000 and recognition is given to the effect of straight line depreciation on the investment, the average rate of return is:
(*a*) 12%
(*b*) 24%
(*c*) 60%
(*d*) 75%

11. Assume cash outflow equals ₹1,20,000 followed by cash inflows of ₹25,000 per year for 8 years and a cost of capital of 11%. What is the Net present value?
(*a*) (₹38,214)
(*b*) ₹9,653
(*c*) ₹8,653
(*d*) ₹38,214

12. What is the internal rate of return for a project having cash flows of ₹40,000 per year for 10 years and a cost of ₹2,26,009?
(*a*) 8%
(*b*) 9%
(*c*) 10%
(*d*) 12%

13. While evaluating investments, the release of working capital at the end of the project's life should be considered as:
(*a*) Cash inflow
(*b*) Cash outflow
(*c*) Having no effect upon the capital budgeting decision
(*d*) None of the above

14. Capital rationing refers to a situation where:

(*a*) Funds are restricted and the management has to choose from amongst available alternative investments

(*b*) Funds are unlimited and the management ahs to decide how to allocate them to suitable projects

(*c*) Very few feasible investment proposal are available with the management

(*d*) None of the above

15. Capital budgeting is done for:

(*a*) Evaluating short term investment decisions

(*b*) Evaluating medium term investment decisions

(*c*) Evaluating long term investment decisions

(*d*) None of the above

16. Capital Budgeting deals with:

(*a*) Long-term Decisions

(*b*) Short-term Decisions

(*c*) Both (*a*) and (*b*)

(*d*) Neither (*a*) nor (*b*)

17. Capital Budgeting Decisions are:

(*a*) Reversible

(*b*) Irreversible

(*c*) Unimportant

(*d*) All of the above

18. Which of the following is not a relevant cost in Capital Budgeting?

(*a*) Sunk Cost

(*b*) Opportunity Cost

(*c*) Allocated Overheads

(*d*) Both (*a*) and (*c*) above

19. Cash Inflows from a project include:

(*a*) Tax Shield of Depreciation

(*b*) After tax Operating Profits

(*c*) Raising of Funds

(*d*) Both (*a*) and (*b*)

20. Which of the following is not true for capital budgeting?

(*a*) Sunk costs are ignored

(*b*) Opportunity costs are excluded,

(*c*) Incremental cash flows are considered

(*d*) Relevant cash flows are considered

21. Savings in respect of a cost is treated in capital budgeting as:

(*a*) An inflow

(*b*) An Outflow

(*c*) Nil

(*d*) None of the above

22. _______ is a project whose cash flows are not affected by the accept/reject decision for other projects.

(*a*) Mutually exclusive project

(*b*) Independent project

(*c*) Inter-dependent project

(*d*) Replacement project

23. The term mutually exclusive investments mean:

(*a*) Choose only the best investments
(*b*) Selection of one investment precludes the selection of an alternative
(*c*) The elite investment opportunities will get chosen
(*d*) There are no investment options available

24. Which of the following statements is true about mutually exclusive projects?

(*a*) They are not in direct competition with each other.
(*b*) They are in direct competition with each other.
(*c*) They are not evaluated based on shareholder wealth.
(*d*) They are never evaluated.

25. A project whose cash flows are more than capital invested for rate of return then net present value will be:

(*a*) positive
(*b*) independent
(*c*) negative
(*d*) zero

26. An increase in the discount rate will:

(*a*) Reduce the present value of future cash flows.
(*b*) Increase the present value of future cash flows.
(*c*) Have no effect on net present value.
(*d*) Compensate for reduced risk.

27. Machine Z purchased at year zero for ₹5,00,000 which will be depreciated @ 25% for 5 years on written down value basis and then will be sold at ₹70,000. Capital gain tax rate is 35% while corporate income tax rate is 40%. What is the present value of cash flow of machine at 5th year if cost of capital is 12%?

(*a*) ₹68,326
(*b*) ₹39,690
(*c*) ₹49,345
(*d*) ₹87,028

28. Using profitability index, the preference rule for ranking projects is:

(*a*) the lower the profitability index, the more desirable the project.
(*b*) the higher the profitability index, the more desirable the project.
(*c*) the lower the sunk cost, the more desirable the project.
(*d*) the higher the sunk cost, the more desirable the project.

29. Profitability index is actually a modification of the -

(*a*) Payback period method
(*b*) IRR Method
(*c*) Net present value method
(*d*) Risk premium method

30. Criterion for IRR (Internal Rate of Return):

(*a*) Accept, if IRR > Cost of capital
(*b*) Accept, if IRR < Cost of capital
(*c*) Accept, if IRR = Cost of capital
(*d*) None of the above

31. Internal Rate of Return is defined as -

(*a*) The discount rate which causes the payback to equal one year.

(*b*) The discount rate which causes the NPV to equal zero.

(*c*) The ROE when the NPV equals 0.

(*d*) The ROE associated with project maximization.

32. The return after the pay off period is not considered in case of ________

(*a*) Payback period method

(*b*) Interest rate method

(*c*) Present value method

(*d*) Discounted cash flow method

33. An uncovered cost at start of year is ₹200, full cash flow during recovery year is ₹400 and prior years to full recovery is 3 then payback would be:

(*a*) 5 years

(*b*) 3.5 years

(*c*) 4 years

(*d*) 4.5 years

34. The shorter the payback period -

(*a*) The more risky is the project

(*b*) The less risky is the project

(*c*) Less will the NPV of the project

(*d*) More will the NPV of the project

35. Which of the following is demerit of payback period?

(*a*) It is difficult to calculate as well as understand it as compared to accounting rate of return method.

(*b*) This method disregards the initial investment involved.

(*c*) It fails to take into account the timing of returns and the cost of capital.

(*d*) None of the above

36. What are the two drawbacks associated with the payback period?

(*a*) The time value of money is ignored. It ignores cash flows beyond the payback period.

(*b*) The time value of money is considered. It ignores cash flows beyond the payback period.

(*c*) The time value of money is considered. It includes cash flows beyond the payback period.

(*d*) The time value of money is ignored. it includes cash flows beyond the payback period.

37. As per discounted payback period method, a project with -

(*a*) More discounted payback period will be selected

(*b*) Less discounted payback period will be selected

(*c*) Zero discounted payback period should be selected

(*d*) None of the above

38. In capital budgeting, the term Capital Rationing implies:

(*a*) That no retained earnings available

(*b*) That limited funds are available for investment

(*c*) That no external funds can be raised

(*d*) That no fresh investment is required in current year

39. In case of divisible projects, which of the following can be used to attain maximum NPV?

(*a*) Feasibility Set Approach
(*b*) Internal Rate of Return
(*c*) Profitability Index Approach
(*d*) Any of the above

40. In case of the indivisible projects, which of the following may not give the optimum result?

(*a*) Internal Rate of Return
(*b*) Profitability Index
(*c*) Feasibility Set Approach
(*d*) All of the above

Answer Key

1. (*d*)	**2.** (*a*)	**3.** (*a*)	**4.** (*b*)	**5.** (*c*)	**6.** (*a*)	**7.** (*a*)	**8.** (*b*)	**9.** (*a*)	**10.** (*b*)
11. (*c*)	**12.** (*d*)	**13.** (*a*)	**14.** (*a*)	**15.** (*c*)	**16.** (*a*)	**17.** (*b*)	**18.** (*d*)	**19.** (*d*)	**20.** (*b*)
21. (*a*)	**22.** (*b*)	**23.** (*b*)	**24.** (*b*)	**25.** (*a*)	**26.** (*a*)	**27.** (*c*)	**28.** (*b*)	**29.** (*c*)	**30.** (*a*)
31. (*b*)	**32.** (*a*)	**33.** (*b*)	**34.** (*b*)	**35.** (*c*)	**36.** (*a*)	**37.** (*b*)	**38.** (*b*)	**39.** (*c*)	**40.** (*c*)