Capital Budgeting Decision

**Which option should the company accept? Assume that price and operation and manufacturing cost increase at 5% annually after one year of operations.**

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| **Income As per NPV Method for 6 Years** | **AMT** |
| Option 1 | ₹ 2,14,05,865.01 |
| Option 2 | ₹ 2,10,07,997.74 |
| Option 1 when 5% inc. in SP & OPC | ₹ 3,08,15,767.05 |
| Option 2 when 5% inc. in SP & OPC | ₹ 3,38,39,682.34 |

I've used the NPV method to gauge the future cash flows over six years. The table compares two options: Option 1 and Option 2. It showcases their income under two scenarios: one where prices and costs remain constant and the other where they increase by 5% annually.

Upon analysis, Option 1 proves more profitable when prices and costs are stable. However, as prices and costs rise by 5% each year, Option 2 emerges as the more lucrative choice. This underscores the significance of considering potential changes in market conditions when making strategic decisions.

Therefore, if we have to choose between the two options, I would recommend going with Option 2. It offers greater profitability, especially in scenarios where there's an increase in both prices and costs over the six-year period. This underscores the importance of selecting a strategy that accounts for potential market fluctuations to maximize returns.

**Why do you think that the method chosen by you is the most suitable method in evaluating the proposed investment? Give the computation of the alternative methods?**

I opted for the NPV method because it effectively considers the time value of money, acknowledging that money today holds more value than the same amount in the future due to factors like inflation and market fluctuations. By discounting future cash flows to their present value, NPV ensures that all future earnings are accounted for in today's terms. This method offers a straightforward decision criterion: if the investment generates more value than its cost, it's considered a favorable decision.

While NPV is my preferred method, there are other approaches like Internal Rate of Return (IRR) and Payback Period. IRR calculates the discount rate at which the NPV becomes zero, representing the project's expected rate of return. On the other hand, Payback Period measures how long it takes for the investment to recover its initial cost through cash inflows. Despite these alternatives, NPV stands out for its comprehensive consideration of future cash flows and their present value, aiding in informed investment decisions.