

# DECISION MAKING AND SCENARIOS

## MODULE 1.1 – Why Is Net Present Value Appropriate for Evaluating Projects?

### Introduction

Professor Robert Holthausen  
Professor Richard Lambert



Wharton  
UNIVERSITY of PENNSYLVANIA

ONLINE

# Many Potential Criteria for Selecting Investment Projects

- Methods for selecting investment projects

What are the alternatives?

Return on Investment

Internal Rate of Return

Earnings per Share or Sales Growth

Payback

Market Share

Customer satisfaction

Net Present Value

## Objective Function

- What are you trying to accomplish with the projects you select?

**Maximize firm value**

- Which criterion meets that objective?

**The Net Present Value Rule**

- Maximizing EPS or EPS growth does not necessarily meet that objective, nor do the others like increasing market share or customer satisfaction, payback, etc.

## Key Ingredients for Evaluating Projects Using Net Present Values

- **Time Value of Money**  
\$1 today is worth more than \$1 tomorrow
- **Incremental Analysis**  
Forecast the change in after-tax cash flows of the organization because of the project
- **Cost of Capital**  
Discount cash flows at the opportunity cost of capital





---

ONLINE