

8.3 PLANNING CASH FLOWS

Cash flows are the key element in the evaluation of project capital expenditures. The cash flow stream of a project has three basis components.

1. Initial Investment

It is the after-tax cash outlay or capital expenditure and net working capital when the project is set up.

2. Operating Cash Inflow

These are after-tax cash inflows resulting from the operations of the project during its economic life.

3. Terminal Cash Inflows

These are after-tax cash flow resulting from the liquidation of the project at the end of its economic life.

8.3.1 Project Life

The project life for estimation of cash flows is taken the minimum of the following.

(i) Physical Life of the Plant

The number of years the plant would perform the function for which it has been acquired. This concept is useful for determination of depreciation charge but not for making investment decisions.

(ii) Technological Life of the Plant

The period of time for which the present plant would not be rendered obsolete by a new plant. It is very difficult to estimate this life but an estimate has to be made.

(iii) Product Market Life of the Plant

The period for which the product of the plant enjoys a reasonably satisfactory market.

(iv) Investment Planning Life by the Firm

The period for which a firm wishes to use for investment analysis. It will depend upon the complexity and size of the plant. For small investments this period may be 5 years. For medium investment, it may be 10 years and for large investments, it may be 15 years.

8.3.2 Basic Principles