

HOW TO SPEND MONEY (CAPITAL BUDGETING TOOLS)

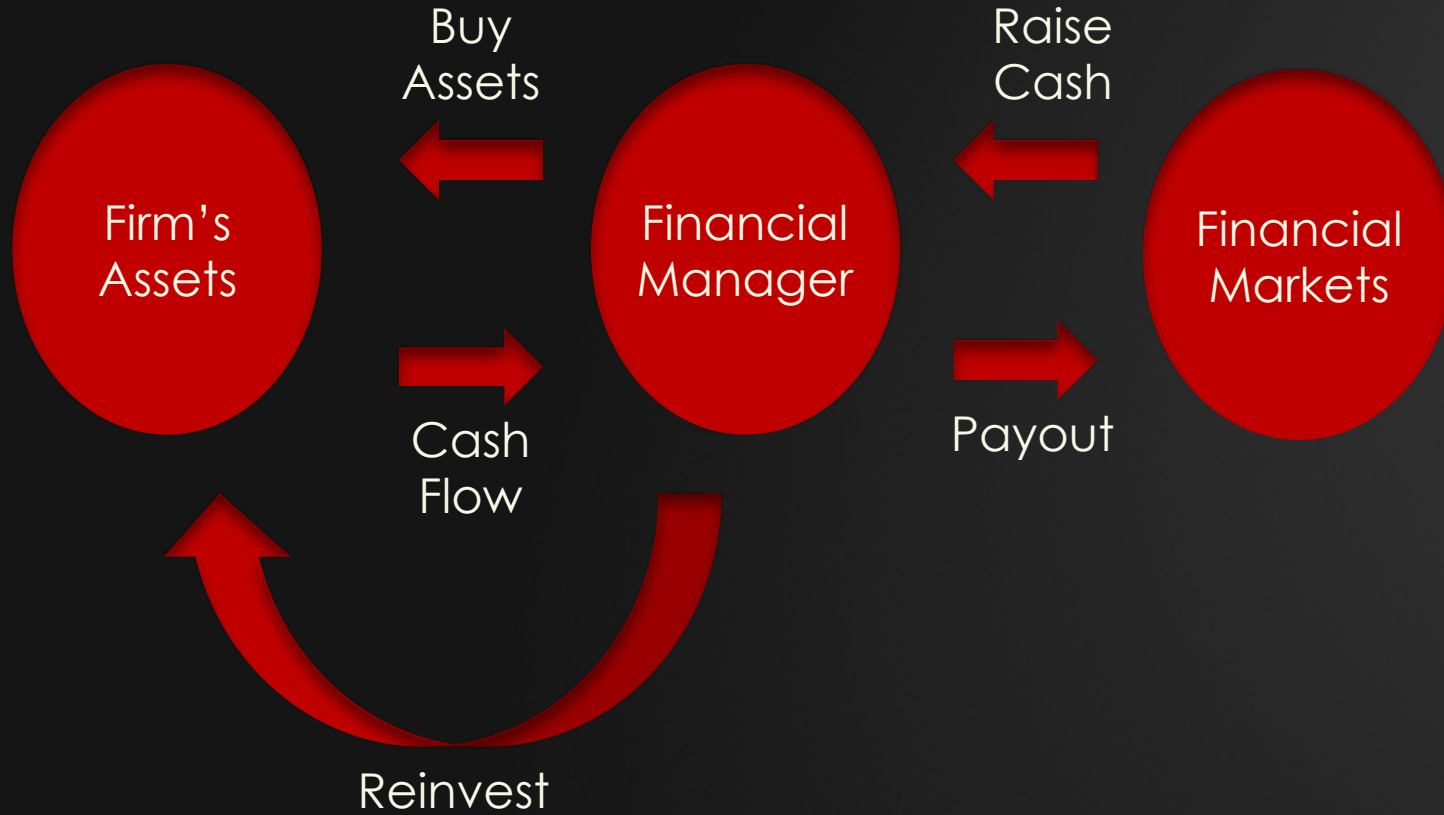
Overview of the Capital Budgeting Process

James P. Weston

Professor of Finance

The Jones School, Rice University

CAPITAL BUDGETING PROCESS



CAPITAL BUDGETING

You have to pay for other peoples' money

Implicitly, you pay them r

How should we decide the how, when,
and where of how to spend money?

CAPITAL BUDGETING

Similar to an individual investor:

1. Timing
2. Risk
3. Opportunity Cost

Risk vs. Return over time

CAPITAL BUDGETING

Best practices:

Arms-length

Objective

Transparent

CAPITAL BUDGETING

- ▶ Accept or reject
- ▶ Best of a set
- ▶ Rank different projects

When are benefits $>$ costs

Obvious but very tricky!

CAPITAL BUDGETING

- ▶ Review tools
- ▶ Understand tradeoffs
- ▶ Metrics in perspective
- ▶ Sensitivity analysis
- ▶ Putting it all together