Chapter Preview: Chapter 8

Answer the following questions briefly:

1. Explain following terms:

Capital budgeting:

The process of predicting the future of each decision to determine the projects and investments to be undertaken in the following year.

Depreciation:

Depreciation is a standard accounting method that lets businesses divide the upfront cost of physical assets across the number of years they expect to use them.

Opportunity costs:

The opportunity cost of using a resource is the value it could have provided in its best alternative use. Because this value is lost when the resource is used by another project, we should include the opportunity cost as an incremental cost of the project.

Cannibalization:

It means that the launch of a new product adversely affects the sales of its existing products.

Sunk costs:

Sunk costs refer to the time, money, and effort already invested in the project. Some investors may not stop investing in unprofitable projects because they are concerned about sunk costs.

Free cash flow:

Tax loss carryforwards/ carrybacks:

Tax loss carryforward is a tax system that allows net operating losses in the past to be deducted from taxable income that occurs later.

Tax loss carryback is a system that can receive a tax refund by deducting net operating losses incurred in the current fiscal year from pre-tax profits in the previous year.

1. What is the project’s break-even point?

The break-even point of the project is the point at which NPV becomes 0. In other words, the break-even point is the point at which all investments so far can be recovered from sales revenue. At the break-even point, it can be seen that the company has not generated any damage or profits.