[Frequently Asked Questions]

Investment Decision

Subject:	Business Economics
Course:	B. A. (Hons.), 3rd Semester, Undergraduate
Paper No. & Title:	Paper – 303 Business Finance
Unit No. & Title:	Unit – 2 Investment Decision
Lecture No. & Title:	Lecture – 1 Investment Decision Part - 1

Frequently Asked Questions

Q1. Explain the concept of cash flows

A1. The concept of cash flows includes only cash expenses and incomes and does not involve any non cash items. Cash flow ignores depreciation since it is a non cash item and includes cash paid for capital expenditures.

Q2. How the concept of cash flow is different from accounting profit

A2. Cash flow is not the same as accounting profit for the two reasons- Accounting profit is based on accrual concept. In accrual concept, revenue is recognised when it is received rather than when actually received and expense is recognised when incurred rather when actually paid. Accounting profit includes the non cash incomes and expenses.

Q3. Explain the concept of incremental cash flows

A3. All additional cash flows those are directly attributable to the investment project should be considered. Only those related to the project should be considered. When two projects are compared by subtracting cash flows of project B from the project A, the difference would suggest how much more cash flow is generated by project A relative to project B.

Q4. Discuss the various components of cash flows

A4. There are three components of cash flows: Initial investment, Annual net cash flows, and Terminal Cash Flows. Initial investment is the net cash outlay in the period in which an asset is purchased. The cash flows should be estimated on an after tax basis. When the last year has additional cash flows like salvage value, increase or decrease in working capital.

Q5. Discuss the concept of conventional and non conventional cash flows

A5. Conventional cash flows are those cash flows which involves cash outflows followed by cash inflows.

Non Conventional cash flows: It refers to the cash flow pattern in which an initial cash outlay is not followed by a series of inflows.

Q6. Discuss the various kinds of capital budgeting decisions

A6. There are basically three kinds of capital budgeting decisions like Independent decisions or Accept reject decisions, mutually exclusive decisions and replacement decisions.

Q7. Explain the concept of capital Rationing

A7. Capital Rationing is the situation which arises when the firm has limited funds and cannot invest in all the projects which meet the minimum criterion. Thus capital rationing refers to a situation in which a firm has more acceptable investments than it can finance.

Q8. Discuss the concept of replacement decisions

A8. Replacement decisions are those decisions which are related to replacing of a fixed asset as fixed asset's economic life is expired or it has become obsolete. Such decisions improve the operating efficiency and helps in the reduction of cost.