[Summary]

Financial Analysis Using Discounting and Non-Discounting Techniques - II

Subject:	Business Economics
Course:	B. A. (Hons.), 5th Semester, Undergraduate
Paper No. & Title:	Paper – 551 Elective PaperP1 – Project Management
Unit No. & Title:	Unit – 2 Financial Analysis Using Discounting and Non-Discounting Techniques
Lecture No. & Title:	Lecture – 2 Financial Analysis Using Discounting and Non-Discounting Techniques- II

Summary

NPV, IRR and profitability index are the discounted techniques which are superior to the non discounted techniques of capital budgeting.

In most cases firms do not have access to unlimited amounts of funds or financial managers do not have access to additional funds, which might mean that some acceptable capital budgeting projects are not chosen. If the amount of funds that is invested in capital budgeting projects is constrained, then capital rationing exists. In such situations, the firm should invest in the combination of projects that provides the highest combined NPV— that is, that increases the firm's value by the most.

When evaluating capital projects, companies can evaluate capital projects in nominal or real (i.e. inflation adjusted) terms. Real cash flows are based on purchasing power at the time the decision to invest is made.

Commonly, capital projects are analyzed in nominal terms, so the discount rate applied is inclusive of expected inflation; however actual inflation may change direction from expectations and inflation may impact the different project variables in different ways.