Long-Term Financial Activities — CFIN 6 Review

FILL IN THE BLANK *(note: some terms will not be used)*

capital project	diversification	optimal capital structure
centralized organization	horizontal integration	payback method
complementary projects	intellectual property	sunk costs
cost of capital	internal rate of return (IRR)	vertical integration
cost of debt	joint venture	weighted avg. cost of capital (WACC)
cost of equity	mutually exclusive projects	
decentralized organization	net present value (NPV)	

1. _______________________________ is the discount rate at which the net present value is zero.

2. In a _______________________________ , business decisions are made at lower levels of the organization.

3. With _______________________________, the acceptance of one project does not allow acceptance of others.

4. Two or more projects that are dependent on one another are called __________________________.

5. Expenses that have been incurred and cannot be recovered are called _________________________.

6. _______________________________ is an agreement between two or more companies to share a business project.

7. Business decisions are made at company headquarters in a _______________________________.

8. A(n) _______________________________ refers to the construction or purchase of a long-term asset, such as buildings and equipment.

9. Intangible assets used by companies are called _______________________________.

10. Rate of return required by creditors is the _______________________________.

11. To calculate the _______________________________ of a project, take the present value of cash flows for the project minus the initial investment.

12. Offering of a variety of products or services is referred to as _______________________________.

THINK CRITICALLY

13. Piracy and counterfeiting of software, videos, and other products is a concern of many companies. How are businesses and consumers affected by this illegal activity?

14. Efforts to maximize the value of a company are considered by many to be the major financial goal of business organizations. Describe other business goals, and explain how these other goals are likely to contribute to increased company value.

15. Cash flows can result from reduced operating expenses, in which "money not going out is like money coming in." Explain this idea and give an example of how a capital project could reduce a company's expenses.

16. How might the capital budgeting activities of a nonprofit organization be different from the capital spending decisions of a company?

17. What guidelines would you suggest to managers when they are deciding whether to use debt or equity to finance a capital project?

18. Other than those mentioned in the chapter, what actions might a company take to reduce risk?

EXCEL PROBLEMS
Use Excel to solve the problems below and email the spreadsheet as an attachment.
MAKE SURE TO USE FORMULAS IN YOUR WORK!
(don't just type the answers)

19. For the following situation, what is the payback (in years)?
    Initial cost : $1.5 million
    Cash flows: Year 1 $300,000, Year 2 $400,000, Year 3 $500,000, Year 4 $400,000, Year 5 $300,000

20. What is the net present value (NPV) for the following situation? Should this capital project be accepted? Explain your answer.
    Initial cost: $78,000
    Cost of capital: 8 percent
    Cash flows: Year 1 $28,000, Year 2 $37,000, Year 3 $34,000

21. A company is considering a one-year investment that costs $100,000. The investment would earn $15,000 during that year. What is the internal rate of return on this investment?

22. In the following situation, calculate the weighted average cost of capital (WACC).
    Proportion of debt: 40 percent
    Cost of debt: 6 percent
    Proportion of equity: 60 percent
    Cost of equity: 9 percent