Investment Appraisal

A2 Business

Investment Appraisal

- Investment Appraisal are all financial calculations that are used by businesses to decided whether to invest in a project or not.

Different Investment Appraisal Techniques

1. Payback Period
2. Accounting Rate of Return / Average Rate of Return
3. Net Present Value

4. Internal Rate of Return

Payback Period

- The amount of time it takes a project to recover its initial investment expense.

Accounting Rate of Return (ARR)

- Calculates the percentage of investment that a business earn in term of profit every year over the life of project.

1. ***ARR = Average Annual Profit / Investment * 100***
2. ***Average Annual Profit = Total Cash Inflows – Cash outflows / Life of Project***

Net Present Value

- It shows the total value of a project in terms of present value.
- The project with higher NPV will be preferred over a project with lower NPV.

Internal Rate of Return (IRR)

- It is the rate of interest at which the Net Present Value of a project is zero.
- If the cost of borrowing (rate of interest at which the bank is offering loan) is lower than the IRR then the NPV will be positive and therefore the business should take up the project.
- On the other hand if the cost of borrowing (the interest rate offered by the bank) is higher than the IRR you do not select the project

because the NPV will be negative which means the business wil make a loss.