

Globalizing the cost of capital and Capital Budgeting at AES Harvard Case Solution & Analysis



Control

• There are major differences in capital budgeting practices, generally between continental control as a company or financial institution, and project oriented or business-unit organization.
 • International issues for projects involve identifying a particular country's history and political and economic conditions in the region used.

What is a Capital Expenditure?

Capital expenditure involves physical assets that are expected to provide services for longer periods, are usually sold or disposed of, and are not bought to replace the particular capital expenditure in the short run. It is physical in nature. Capital expenditure is the purchase of long-term assets that are expected to generate cash flows over a period of more than one year.

Why Give a Special Attention to Operational Budget?

- Capital budgeting decisions have a long-term impact on the firm's cash flows and profitability and therefore are more important than operational budgeting.
- Capital budgeting decisions are more difficult to reverse than operational budgeting.
- Capital budgeting decisions are more visible to the public and the media.

By implementing proper capital budgeting, organizations can reduce costs, increase revenues, and improve their overall performance. However, it is important to ensure that capital budgeting decisions are based on accurate data and are consistent with the organization's overall strategy.

Capital Budgeting Decision Process



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Table 1: Capital Budgeting Decision Process

Project	Initial Investment	Yearly Cash Flow	Payback Period
Project A	100	30	3.33
Project B	150	40	3.75
Project C	200	50	4.00
Project D	250	60	4.17
Project E	300	70	4.29

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Control

There are major differences in capital budgeting practices, generally between continental control as a primary or dominant in the decision or project selection in a hierarchical organization. International issues for multiple activities operating as a particular region's business and a national level reflects in different ways.

What is a Capital Expenditure?

Capital expenditure involves physical assets that are expected to provide services for longer periods. They are usually subject to depreciation and are subject to physical wear and tear. Capital expenditures are the investments in physical assets that are expected to generate a stream of cash flows over a period of time. They are also known as fixed capital expenditures.

Why Give a Special Attention to Operational Budget?

- Capital budgeting is a long-term investment decision and it is a strategic decision. It is a long-term decision and it is a strategic decision.
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By implementing proper capital budgeting, organizations can reduce capital investment. However, it is not possible to measure the contribution of capital budgeting to the overall firm's performance.



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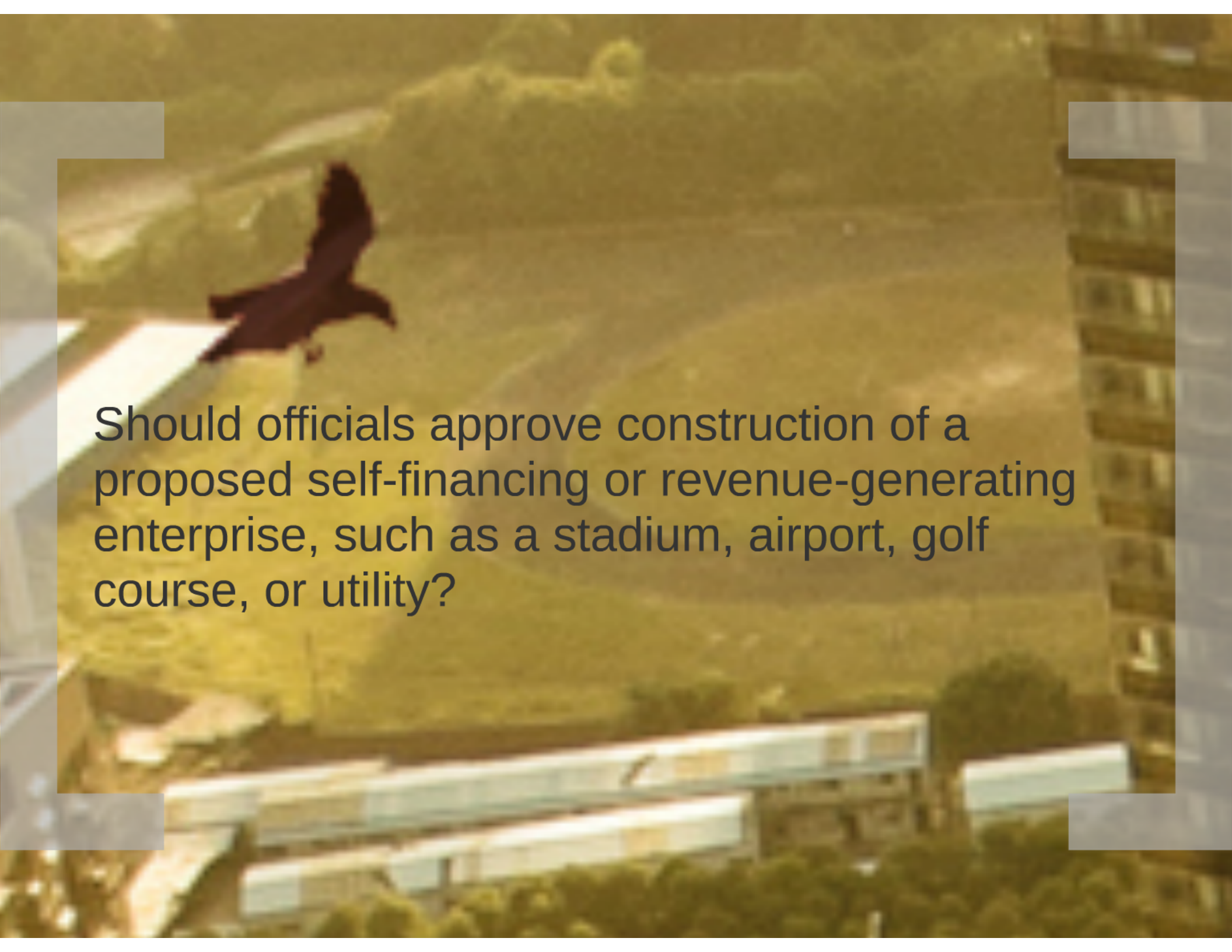
Table 1: Capital Budgeting Decision Process

Project	Present Value	Net Present Value
Project A	100	100
Project B	100	100
Project C	100	100
Project D	100	100
Project E	100	100

What is a Capital Expenditure?

Capital expenditures purchase physical assets that are expected to provide services for several years; the outlay will yield benefits in the future without having to repeat the purchase. Capital improvements or rehabilitation of physical assets that extend or enhances the useful life of these assets (as distinct from the operating expenditures for repair or maintenance expenditures which assure functionality during the expected life of the asset) (Mikesell 2011, 288).




An aerial photograph of a large stadium under construction. The stadium's seating bowl is visible, surrounded by greenery and trees. In the foreground, there are several long, rectangular buildings, likely temporary structures or offices. A large bird is captured in flight in the upper left quadrant of the image. The overall scene is set against a backdrop of a hilly, green landscape.

Should officials approve construction of a proposed self-financing or revenue-generating enterprise, such as a stadium, airport, golf course, or utility?

Why Give it Special Attention from Operational Budget?

- Capital asset decisions can have future impact and thus merit extraordinary care.
- Capital assets usually have high price tags and their purchase may destabilize the finances of government.
- Capital asset purchases tend to occur at irregular intervals and may need special attention in regard to scheduling.

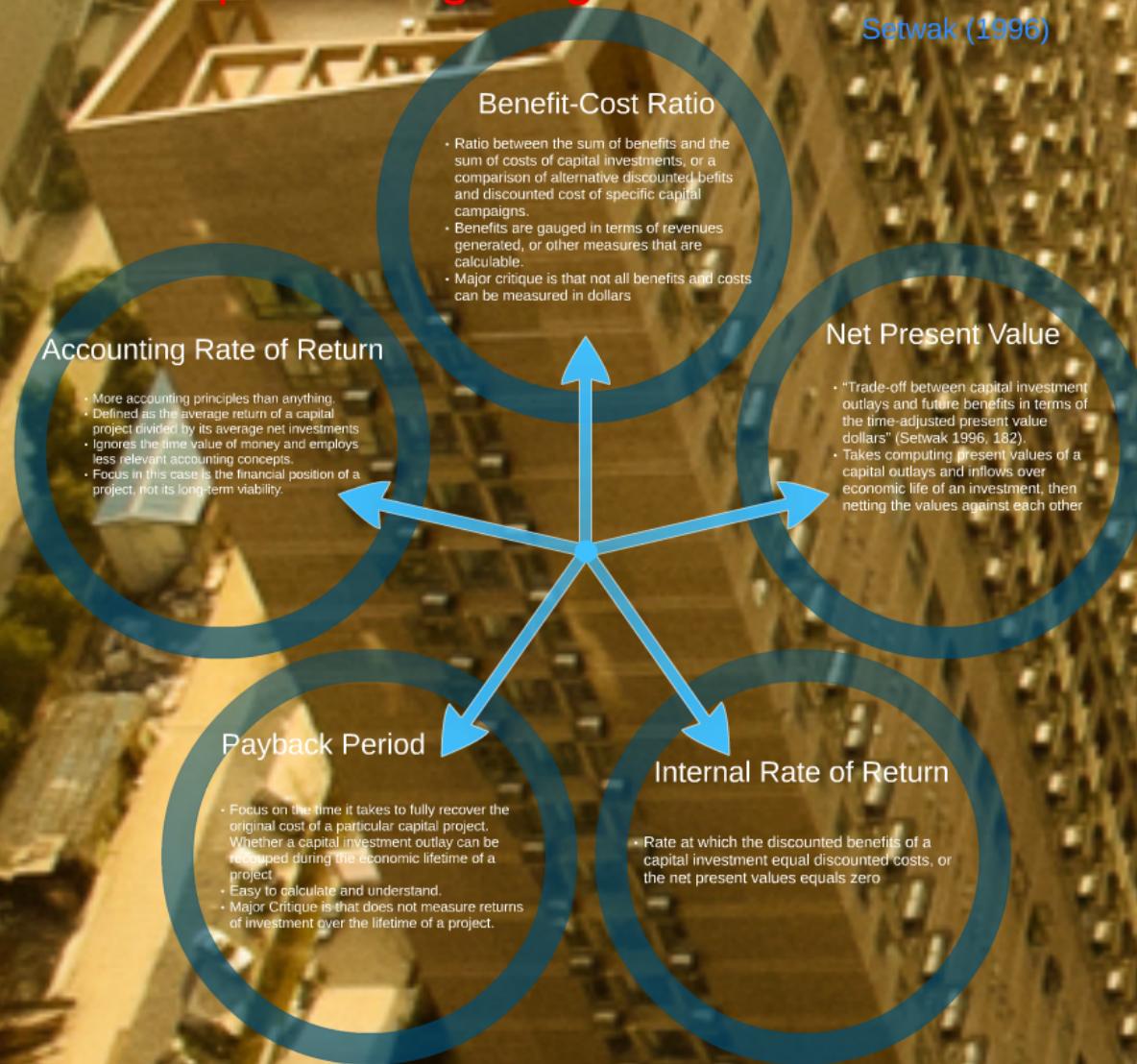


An aerial photograph of a city street, overlaid with a semi-transparent blue filter. The street is lined with trees and buildings, and several cars are visible on the road. In the upper left corner, two birds are captured in flight against the sky. The text is centered on the left side of the image.

By implementing proper models, governments can facilitate capital investment decisions. However, there is no ignoring controls and constraints in project selection that complicate things for state and local governments.

Capital Budgeting Decision Models

Setwak (1996)



Capital Budgeting Decision Models

Setwak (1996)

Benefit-Cost Ratio

- Ratio between the sum of benefits and the sum of costs of capital investments, or a comparison of alternative discounted benefits and discounted cost of specific capital campaigns.
- Benefits are gauged in terms of revenues generated, or other measures that are calculable.
- Major critique is that not all benefits and costs can be measured in dollars

Accounting Rate of Return

Net Present Value