



SNS College of Technology

Coimbatore - 35



23BAT611 – Financial Management

Problem Related to Investment Decisions

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Redesigning Common Mind and Business Towards Excellence



Recall



Internal Rate of Return



Topic





Return on Investment





Problem 1

Calculate Return on Investment for Machine A and B from the following.

	Project A	Project B
Original Cost	Rs. 1,00,000	Rs. 1,50,000
Expected Life	5 Year	5 Year

Machine A and B have scrap values of Rs.10,000 and Rs.20,000 at the end of the 5th year



Problem 1

Profit Before Depreciation

Years	Project A	Project B
1	30,000	40,000
2	15,000	45,000
3	40,000	50,000
4	40,000	24,000
5	35,000	71,000
Tax Rate	50%	50%



Solution

Calculate Return on Investment for Machine A and B from the following.

Return on Investment = Average Annual Profit / Original Investment * 100

Depreciation P.A = Cost – Scrap Value / Life of the machine * 100

Depreciation P.A Machine A = 100,000 – 10,000 / 5

Depreciation P.A Machine A = Rs. 18,000

Depreciation P.A Machine B = 1,50,000 – 20,000 / 5

Depreciation P.A Machine B = Rs.26,000



Solution

Profit Before Depreciation Machine A

Years	Machine A Profit before Dep and Tax	Dep	Profit After Dep and Before Tax	Tax @ 50%	Profit After Dep & Tax
1	30,000	18,000	12,000	6,000	6,000
2	15,000	18,000	-3,000	-	- 3000
3	40,000	18,000	22,000	11,000	11,000
4	40,000	18,000	22,000	11,000	11,000
5	35,000	18,000	17,000	8,500	8,500
Total Profit					33,500



Solution

Profit Before Depreciation Machine B

Years	Machine A Profit before Dep and Tax	Dep	Profit After Dep and Before Tax	Tax @ 50%	Profit After Dep & Tax
1	40,000	26,000	14,000	7,000	7,000
2	45,000	26,000	19,000	9,500	9,500
3	50,000	26,000	24,000	12,000	12,000
4	24,000	26,000	- 2,000	-	- 2000
5	71,000	26,000	45,000	22,500	22,500
Total Profit					49,000



Solution

Calculate Average Annual Profit for Machine A and B

Average Annual Profit A = $33,500 / 5 = \text{Rs. } 6,700$

Average Annual Profit B = $49,000 / 5 = \text{Rs. } 9,800$

Return on Investment = Average Annual Profit / Original Investment * 100

Return on Investment A = $6,700 / 1,00,000 * 100$

Return on Investment A = 6.7%

Return on Investment B = $9,800 / 1,50,000 * 100$

Return on Investment B = 6.53%



Assessment





Summarize

Return on Investment





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