ADVANCED CAPITAL BUDGETING DECISIONS

CLASS 7-HW-Q13

Topic Certainty Equivalent

Question 13:

If Investment proposal costs ₹ 45,00,000 and risk free rate is 5%, calculate net present value under certainty equivalent technique.

Year	Expected cash flow (₹)	Certainty Equivalent coefficient
1	10,00,000	0.90
2	15,00,000	0.85
3	20,00,000	0.82
4	25,00,000	0.78

(Source: ICAI)

ANSWER:

$$\text{NPV} = \frac{10{,}00{,}000\times(0.90)}{(1.05)} + \frac{15{,}00{,}000\times(0.85)}{(1.05)^2} + \frac{20{,}00{,}000\times(0.82)}{(1.05)^3} + \frac{25{,}00{,}000\times(0.78)}{(1.05)^4} - 45{,}00{,}000$$

= ₹ 5,34,570