
CAPE CHEMICAL: CAPITAL BUDGETING ISSUES

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CASE DESCRIPTION

The primary subject matter of this case concerns the issues surrounding evaluation of capital expenditures. Case provides a systematic approach to evaluating capital expenditures including a review of alternative capital budgeting methods and the relationship between the cost of capital and capital budgeting. The case requires students to have an advanced knowledge of accounting, finance and general business issues thus the case has a difficulty level of four (senior level) or higher. In particular, an understanding of capital budgeting practices and cost of capital issues is necessary to solve the case. The case is designed to be taught in one class session of approximately 1.25 hours and is expected to require 3-4 hours of preparation time from the students.

CASE SYNOPSIS

The case tells the story of Ann Stewart, President and primary owner of Cape Chemical. By most measures, the performance of Cape Chemical has been very good over the last three years. Double-digit sales growth has been achieved, new product lines have been added and profits have more than tripled. The growth has required the acquisition of equipment, expansion of storage capacity and increasing the size of the work force.

The unexpected withdrawal of one of Cape Chemical's competitors from the region has provided the opportunity to increase its blended packaged goods sales. However, Cape Chemical's blending equipment is already operating at capacity. To take advantage of this opportunity, additional equipment must be obtained, requiring a major capital investment. It is estimated that Cape Chemical must increase its annual blending capacity by 800,000 gallons to meet expected demand for the next three years. Annual capacity of 1,400,000 gallons is necessary to meet projected demand beyond the next three years. The firm has no systematic capital expenditure evaluation process.

INSTRUCTORS' NOTES

Case Use

The case as written includes discussion questions to aid the student in their analysis of Cape Chemical's current financial position. The case can be made more difficult by omitting the discussion

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