Review Questions: Capital Budgeting with Risk

1. Chris at Norwest Financial comes to you with a capital budgeting problem: Norwest is considering opening a new branch in South Bend, Indiana because Notre Dame fans fit their customer profile. Norwest's return on equity is 20%, its return on debt is 8% and its capital structure is 30% debt. What discount rate should Chris use for this decision?

2. Your company has two divisions. One sells software and the other manufactures and sells computers through the direct retail channel. You feel that Dell is a comparable publicly traded company for your computer sales division. If Dell's beta for its common stock is 1.68 and its debt is 10% of its capital structure. What is the appropriate discount rate for projects in your computer sales division? Assume a risk free rate of 5% and a risk premium (market return minus risk free rate) of 9%.