

Boeing's, Iridium's, Gillette's and Intel's Capital Budgeting Decisions

Capital budgeting decisions are central to the company's success or failure. Consider Boeing's decision to "bet the company" by developing the 757 and 767 jets. Boeing's investment in these planes was \$3 billion, more than double the total value of stockholders' investment as shown in the company's accounts at the time. By 2002, estimated cumulative profits from this investment were approaching \$10 billion, and the planes were still selling.

Not all capital investments succeed, of course. The Iridium communications satellite system, which offered its users instant telephone connections worldwide, soaked up a \$5 billion investment before it started operations in 1998. It needed 400,000 subscribers to break even, but attracted only a small fraction of that number. Iridium defaulted on its debt and filed for bankruptcy in August 1999. The Iridium system was sold a year later for just \$25 million.

Not all capital investments are for tangible assets. For example, Gillette spent around \$300 million to advertise the launch of its Mach3 razor. This was an investment in an intangible asset—brand recognition and acceptance. Moreover, traditional manufacturing firms are not the only ones that make important capital budgeting decisions. For example, Intel's R&D expenditures in 2001 were more than \$3.7 billion. This investment in future products and product improvement will be crucial to the company's ability to retain its existing customers and attract new ones.

Companies can learn from this example, Iridium's decision to invest in its satellite system and Boeing's decision to invest in a new generation of airliners are both examples of capital budgeting decisions. The success of such decisions is usually judged in terms of value. Good investment projects are worth more than they cost. Adopting such projects increases the value of the firm and therefore the wealth of its shareholders. For example, Boeing's investment produced a stream of cash flows that were worth much more than its \$3 billion outlay.

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