

The Headquarters Building

Topic: Capital Budgeting

Characters: John, financial analyst at a small bank
The president of a small bank

“These numbers are not what I expected, John. Are you sure they’re correct?”

John wasn’t. You could never be sure with capital budgeting. You just made your best estimates, even though you knew any one of the dozens of forecasted numbers could turn out to be different by a hundred percent or more. “I think everything here is realistic, sir. The new headquarters building doesn’t seem to be a good idea right now.”

“Is your growth estimate high enough? After all, we’ve been growing over 10 percent per year for the last five years.”

John had assumed a 12 percent growth rate for the next ten years. It was optimistic, to say the least, but not out of the question. “I suppose I could make the growth rate a little higher, sir. Things really are looking good for the bank.”

“They certainly are, John. They certainly are,” said the president. “Our stock price has doubled in the last six months, and our stockholders are happier than they’ve ever been.” The president turned back to the architectural drawings and carpet samples that covered his desk

John went back to his office. Plugging in a higher growth rate wouldn’t be difficult; however, he knew it would take a 20 percent growth rate for ten years to make the building look feasible. This was dearly unattainable--at that rate, the bank would end up with all the deposits in the entire county. But who really cared? The bank was sitting on a mountain of surplus cash, and the construction would give a real boost to the downtown area. There wasn’t much chance the board of directors would spot the questionable assumption. They usually spent most of their meetings arguing about the hours of the drive-up window. The board didn’t really need to do much, though. The president was a sharp manager and had single-handedly brought the bank its unprecedented success. Still, John really didn’t like playing with the numbers.

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