

CONTENTS

Preface	11
Green Content	19
CHAPTER 1	27
Introduction to Engineering Economy	27
1.1 Introduction	28
1.2 The Principles of Engineering Economy	29
1.3 Engineering Economy and the Design Process	32
1.4 Using Spreadsheets in Engineering Economy	41
1.5 Try Your Skills	41
1.6 Summary	42
CHAPTER 2	47
Cost Concepts and Design Economics	47
2.1 Cost Terminology	48
2.2 The General Economic Environment	54
2.3 Cost-Driven Design Optimization	64
2.4 Present Economy Studies	69
2.5 Case Study—The Economics of Daytime Running Lights	76
2.6 Value Engineering	77
2.7 In-Class Exercise	80
2.8 Try Your Skills	81
2.9 Summary	82
CHAPTER 3	91
Cost-Estimation Techniques	91
3.1 Introduction	92
3.2 An Integrated Approach	94
3.3 Selected Estimating Techniques (Models)	102
3.4 Parametric Cost Estimating	106
3.5 Case Study—Electric Vehicle Battery Recovery	117
3.6 Electronic Spreadsheet Modeling: Learning Curve	119

3.7	In-Class Exercise	121
3.8	Try Your Skills	122
3.9	Summary	124

CHAPTER 4

The Time Value of Money **132**

4.1	Introduction	133
4.2	Simple Interest	134
4.3	Compound Interest	135
4.4	The Concept of Equivalence	135
4.5	Notation and Cash-Flow Diagrams and Tables	138
4.6	Relating Present and Future Equivalent Values of Single Cash Flows	142
4.7	Relating a Uniform Series (Annuity) to Its Present and Future Equivalent Values	148
4.8	Summary of Interest Formulas and Relationships for Discrete Compounding	158
4.9	Deferred Annuities (Uniform Series)	159
4.10	Equivalence Calculations Involving Multiple Interest Formulas	161
4.11	Uniform (Arithmetic) Gradient of Cash Flows	167
4.12	Geometric Sequences of Cash Flows	172
4.13	Interest Rates that Vary with Time	177
4.14	Nominal and Effective Interest Rates	179
4.15	Compounding More Often than Once per Year	181
4.16	Interest Formulas for Continuous Compounding and Discrete Cash Flows	184
4.17	Case Study—Understanding Economic Equivalence	187
4.18	In-Class Exercise	190
4.19	Try Your Skills	190
4.20	Summary	199

CHAPTER 5

Evaluating a Single Project **215**

5.1	Introduction	216
5.2	Determining the Minimum Attractive Rate of Return (MARR)	217
5.3	The Present Worth Method	218
5.4	The Future Worth Method	225
5.5	The Annual Worth Method	226
5.6	The Internal Rate of Return Method	231
5.7	The External Rate of Return Method	242
5.8	The Payback (Payout) Period Method	244
5.9	Case Study—Data Center Establishment Project	247

5.10	Electronic Spreadsheet Modeling: Payback Period Method	249
5.11	In-Class Exercise	251
5.12	Try Your Skills	252
5.13	Summary	258
Appendix 5-A	The Multiple Rate of Return Problem with the IRR Method	268

CHAPTER 6

Comparison and Selection among Alternatives 272

6.1	Introduction	273
6.2	Basic Concepts for Comparing Alternatives	273
6.3	The Study (Analysis) Period	277
6.4	Useful Lives Are Equal to the Study Period	279
6.5	Useful Lives Are Unequal among the Alternatives	296
6.6	Personal Finances	309
6.7	Case Study—Ned and Larry's Ice Cream Company	313
6.8	Postevaluation of Results	316
6.9	Project Postevaluation Spreadsheet Approach	316
6.10	In-Class Exercise	319
6.11	Try Your Skills	320
6.12	Summary	330

CHAPTER 7

Depreciation and Income Taxes 347

7.1	Introduction	348
7.2	Depreciation Concepts and Terminology	348
7.3	The Classical (Historical) Depreciation Methods	351
7.4	The Modified Accelerated Cost Recovery System	356
7.5	A Comprehensive Depreciation Example	365
7.6	Introduction to Income Taxes	369
7.7	The Effective Corporate Income Tax Rate	372
7.8	Gain (Loss) on the Disposal of an Asset	375
7.9	General Procedure for Making After-Tax Economic Analyses	376
7.10	Illustration of Computations of ATCFs	380
7.11	Economic Value Added	392
7.12	In-Class Exercise	394
7.13	Try Your Skills	394
7.14	Summary	397

CHAPTER 8

Price Changes and Exchange Rates

408

8.1	Introduction	409
8.2	Terminology and Basic Concepts	410
8.3	Fixed and Responsive Annuities	416
8.4	Differential Price Changes	421
8.5	Spreadsheet Application	423
8.6	Global Exchange Rates and Purchasing Power Concepts	425
8.7	Case Study—Selecting Electric Motors to Power an Assembly Line	430
8.8	In-Class Exercise	433
8.9	Try Your Skills	433
8.10	Summary	435

CHAPTER 9

Replacement Analysis

444

9.1	Introduction	445
9.2	Reasons for Replacement Analysis	445
9.3	Factors that Must Be Considered in Replacement Studies	446
9.4	Typical Replacement Problems	449
9.5	Determining the Economic Life of a New Asset (Challenger)	452
9.6	Determining the Economic Life of a Defender	456
9.7	Comparisons in Which the Defender's Useful Life Differs from that of the Challenger	459
9.8	Retirement without Replacement (Abandonment)	462
9.9	After-Tax Replacement Studies	463
9.10	Case Study—Replacement of a Hospital's Emergency Electrical Supply System	471
9.11	In-Class Exercise	475
9.12	Try Your Skills	475
9.13	Summary	476

CHAPTER 10

Evaluating Projects with the Benefit–Cost Ratio Method

484

10.1	Introduction	485
10.2	Perspective and Terminology for Analyzing Public Projects	486
10.3	Self-Liquidating Projects	487
10.4	Multiple-Purpose Projects	487
10.5	Difficulties in Evaluating Public-Sector Projects	490
10.6	What Interest Rate Should Be Used for Public Projects?	491
10.7	The Benefit–Cost Ratio Method	493
10.8	Evaluating Independent Projects by B–C Ratios	499

10.9	Comparison of Mutually Exclusive Projects by B–C Ratios	501
10.10	Case Study—Rural Broadband Internet Expansion	506
10.11	Try Your Skills	508
10.12	Summary	509

CHAPTER 11

Breakeven and Sensitivity Analysis **515**

11.1	Introduction	516
11.2	Breakeven Analysis	516
11.3	Sensitivity Analysis	523
11.4	Multiple Factor Sensitivity Analysis	529
11.5	Case Study—If You Build It, They Will Come	533
11.6	Try Your Skills	534
11.7	Summary	535

CHAPTER 12

Probabilistic Risk Analysis **544**

12.1	Introduction	545
12.2	Sources of Uncertainty	546
12.3	The Distribution of Random Variables	546
12.4	Evaluation of Projects with Discrete Random Variables	550
12.5	Evaluation of Projects with Continuous Random Variables	559
12.6	Evaluation of Risk and Uncertainty by Monte Carlo Simulation	564
12.7	Performing Monte Carlo Simulation with a Computer	568
12.8	Decision Trees	572
12.9	Real Options Analysis	577
12.10	Case Study—Retirement Balance	580
12.11	Summary	583

CHAPTER 13

The Capital Budgeting Process **590**

13.1	Introduction	591
13.2	Debt Capital	593
13.3	Equity Capital	594
13.4	The Weighted Average Cost of Capital (WACC)	597
13.5	Project Selection	601
13.6	Postmortem Review	605
13.7	Budgeting of Capital Investments and Management Perspective	606
13.8	Leasing Decisions	607
13.9	Capital Allocation	609
13.10	Summary	615

CHAPTER 14

Decision Making Considering Multiattributes

620

14.1	Introduction	621
14.2	Examples of Multiattribute Decisions	621
14.3	Choice of Attributes	623
14.4	Selection of a Measurement Scale	623
14.5	Dimensionality of the Problem	624
14.6	Noncompensatory Models	624
14.7	Compensatory Models	629
14.8	Summary	637
Appendix A	Accounting Fundamentals	644
Appendix B	Abbreviations and Notation	654
Appendix C	Interest and Annuity Tables for Discrete Compounding	658
Appendix D	Interest and Annuity Tables for Continuous Compounding	677
Appendix E	Standard Normal Distribution	681
Appendix F	Selected References	684
Appendix G	Solutions to Try Your Skills	688
Appendix H	Answers to Selected Problems	730

Index

734

CHAPTER 10

Evaluating Projects with the Benefit–Cost Ratio Method

484

10.1	Introduction	485
10.2	Perspective and Terminology for Analyzing Public Projects	486
10.3	Self-Liquidating Projects	487
10.4	Budgeting of Capital Investments and Management Problems	487
10.5	Difficulties in Evaluating Public-Sector Projects	490
10.6	What Interest Rate Should Be Used for Public Projects?	491
10.7	The Benefit–Cost Ratio Method	493
10.8	Evaluating Independent Projects by B–C Ratios	499