A REVIEW OF CAPITAL BUDGETING TECHNIQUES PRACTICES

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Abstract:

This chapter presents introduction of the capital budgeting decision. This chapter has been divided into four sections. Section I discusses the different types of investment projects and different stages of capital budgeting process. Section II discusses the capital budgeting techniques available for investment evaluation and other issues like discount rate used, cash flow estimation, NPV-IRR conflict etc. Section III presents a discussion on the aspect of risk, various risk factors and capital budgeting techniques for incorporating risk. The last section i.e. Section IV deals with the methods used to calculate cost of capital and cost of equity capital.

KEYWORDS: Budget, Capital, Discounted,Payback,securities etc

INTRODUCTION

Capital Budgeting Decision making process may also vary depending on the nature of the investment project, i.e. whether it is an expansion or a diversification or a replacement and modernization project. *Expansion projects* are those which invest in additional assets to expand existing product or service line or increase the capacity to cater to growing demand. *Diversification projects* on the other hand are those in which investment is aimed at producing new products or services or entering into new production activity or new business. It can also be defined as expansion of new business. *Replacement and Modernizations Investment* is meant to replace outdated and obsolete equipment or assets with new efficient and economical assets so as to reduce operating costs, increase the yield and improve the operating efficiency.

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Stages of Capital Budgeting Process

1) Strategic planning

Strategic planning can be defined as an organization's process of defining its strategy by setting its policies, directions, priorities and specifying the structural, strategic and tactical areas of business development that would facilitate achievement of the corporate goal.

2) Identification of investment opportunities

This means developing a mechanism wherein the investment suggestions coming from inside the firm, such as from its employees, or from outside the firm, such as from a firm's advisors are 'listened and paid attention to' by the management.

3) Preliminary screening of projects

This step is undertaken to avoid unnecessary wastage of resources like time, money and effort, these identified investment opportunities are subjected to a preliminary screening process by management i.e. to isolate the marginal and unsound proposals.

4) Financial appraisal of projects

Financial appraisal of projects involves the application of cash flow forecasting techniques, project evaluation or capital budgeting techniques, risk analysis techniques and even mathematical programming techniques so as to determine whether the proposed investment project would add value to the firm or not.

TRADITIONAL METHODS: -

1. **Average Rate of Return:**

The common charge of return (ARR) approach of evaluating proposed capital expenditure is also recognize because the accounting fee of go back technique. It is based upon accounting statistics rather than cash flows. There is no unanimity recording the definition of the rate of go back.

$$ARR = \frac{\text{Average annual profits after taxes}}{\text{Average investment over the life of the project}} \times 100$$

.Pay Back Period:

The Pay Back technique is the second traditional technique of capital budgeting. It is the handiest and, the most widely hired quantitative technique for apprising capital expenditure choices. This technique solutions the query.

$$\frac{\text{Investment}}{\text{Constant Annual Cash Flow}}$$

Net Present Value Method:

The internet gift cost is a modern technique of evaluating investment proposals. This method takes into attention the time fee of cash and attempts to calculate the go back on investments by means of introducing the factor of time element. It acknowledges the fact that rupee earned today is really worth more than the equal rupee earned tomorrow

Internal Rate of Return:

The 2nd discounted coins float or time-adjusted method of appraising capital investment decisions is the internal price of return technique. This technique is also referred to as yield on investment, marginal performance of capital, marginal productiveness of capital, rate of return technique

Profitability Index:

The time adjusted capital budgeting is Profitability Index (P1) or Benefit Cost Ratio (B / C). It is similar to the approach of NPV. The profitability index method measures the existing price of returns according to rupee invested, even as the NPV is primarily based on the differences between the prevailing cost of destiny coins inflows and the present cost of coins outflows.

OBJECTIVES OF THE STUDY

- To know about the planning process of the BevconWayors future activities they related to expect economic, technical, competitive and social environment.
- To know about the financial statements, cash budgets and operating budgets.

RESEARCH METHODOLOGY

RESEARCH DESIGN

There are many definitions of research design, but no single definition imparts the full range of important aspects.

- Research design constitutes the blueprint for the collection, measurement, and analysis of data.

  - **Sources of data**
  - Primary source and
  - Secondary

Primary Source:

Primary source is used to collect initial material during the research process. Primary data is the data that the researcher collects himself using methods such as surveys, direct observations, interviews, as well as logs.

Secondary Source:

Secondary sources are edited primary sources, second-hand versions. They represent thinking of someone else. Secondary data are data that were collected by persons or agencies for purposes other than solving the problem at hand

DATA ANALYSIS AND INTER PRETATIONS:

Payback Period:

Project1:

As the project doesn't get equal cash inflow, cumulative cash inflows are taken as under.

Years	Cash inflows(cr)	Cumulative Cash inflows(cr)
1	11	11
2	12	23
3	13	36
4	16	52

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Payback period: Base year+ (required cash inflows/next yearcashinflows).

PBP=3+ (4/16).

=3+(0.25)

=3.25years.

Project - 2:

As the project doesn't get equal inflow, cumulative cash inflow, cumulative cash flows are take as under

Years	Cash inflows(cr)	Cumulative cash inflows
1	12	12
2	13	25
3	14	39
4	16	55
5	15	70

Pay back period: Base year+(required cash inflows/next Yearcashinflows)

PBP= 3+(11/16)years

= 3+0.6875years

= 3.6875year

FINDINGS

The findings are showed with statistical tools in the following

Tool	Project -1	Project – 2
1.Payback period	3.25years	3.6875years
2. Net Present value	60,20,000	2,40,30,000

SUGGESTIONS

As seen from the above ranking of the projects, project 2 is more preferable than the other in the since that it has a better internal rate of return and net presser value than the project

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1. Since both the projects are in software development the most appropriate criteria in decision making is NPV and IRR. Because the investor would look to get more returns

CONCLUSION:

The fundamental difference between the classical approach to project capital investing and budgeting, with its emphasis on form as described by King, and contemporary practices, is the recognition of the need to employs that underpin the delivery of shareholder value.

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