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A STUDY ON CAPITAL BUDGETING

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ABSTRACT:
Capital budgeting is an analysis of long-term investment, which mainly focuses upon acquisition and improvement on fixed assets it is a part of the long-term decision taken by the top management and involves large expenditure.
Capital budgeting's main goal is to identify projects that produce cash flows that exceed the cost of the project for a company the primary objectives of capital budgeting are to maximize shareholder value, evaluate investment opportunities, manage risk, allocate resources efficiently, and plan for the long-term. By achieving these objectives, businesses can make informed investment decisions and ensure their long-term success.

REVIEW OF LITERATURE:

Capital budgeting, which is also called "investment appraisal," is the planning process used to determine which of an organization's long term investments such as new machinery, replacement machinery, new plants, new products, and research development projects are worth pursuing. It is to budget for major capital investments or expenditures.
The capital budgeting decisions procedure basically involves the evaluation of the desirability of an investment proposal. It is obvious that the firm must have systematic procedure for making capital budgeting decisions. The procedure for making capital budgeting decisions must be consistent with objective of wealth maximizations.
The term capital budgeting refers to long-term planning for proposed capital outlays and their financing. Thus, it includes both rising of long-term funds as well as their utilization. It may this be defined as ―The firm‘s decision to invest its current funds most efficiently in the long-term assets in anticipation of an expected flow of benefits over a series of years (I.M.Pandey 2005, p141). It is the decision making process where the firm evaluate the purchase of major fixed assets.

CAPITAL BUDGETING PROCESS

Capital Budgeting is a complex process as it involves decisions relating to the investment of current funds for the benefit to the achieved in future and the future is always uncertain, which may be divided into following phases:

- Identification of potential investment opportunities
- Assembling of proposed investment Decision making
- Preparation of capital budget and appropriations
- Implementation
- Performance review

EVALUATION TECHNIQUES OF CAPITAL BUDGETING

Evaluation Techniques of Capital Budgeting are classified into two types:
1. TRADITIONAL TECHNIQUES:
   - Average rate of return
   - Pay-back period
2. MODERN (OR) DISCOUNTED CASH FLOW (DCF) TECHNIQUES:
   - Net present value (NPV)
   - Internal rate of return (IRR)
   - Profitability index (PI) or Benefit-cost ratio (B/C RATIO)

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NEED FOR THE STUDY

The need of study CAPITAL BUDGETING is the organization understand and allocate substantial amounts of major resources of people, time and technology, intellectual capital and of course, money.
Research and development investments to improve existing technology's as Well as create technical breakthroughs that lead to new products and services. Capital investments in new manufacturing plants and equipment, timed to coincide with market trends.

OBJECTIVES OF THE STUDY

- To understand the need of the organizations to identify and invest in high quality capital projects.
- To prepare a list of the main financial variables required for a project appraisal.
- To evaluate capital projects using traditional methods of investment appraisal and discounted cash flow methods.

RESEARCH METHODOLOGY

The collection of information is done with the help of two principle sources, viz.
1. Primary data.
2. Secondary data

Sources of Primary Data:
Executives and staff of financial and accounts department of Hemadri Cements Limite

Sources of Secondary Data:
The secondary data was collected from already published sources such as Pamphlets of Annual Reports, returns and internal records. The data collection includes collection of required data from annual records of Hemadri Cements Limited.

LIMITATIONS OF THE STUDY

1. Some aspects of financial information were not available because of the confidentiality of Hemadri cements limited.
2. The study was conducted with the data available and analysis was made accordingly.
3. The information provided by the company is not exhaustive. Hence the analysis is also restricted as per the information available

DATA ANALYSIS AND INTERPRETATION:

Average Rate of Return: Operation Level – 30 TNS PER MONTH

AVERAGE RATE OF RETURN (Rs in Mns)						
	Operation Level	**30 Tns per month**				
	Sale price Rs per kg	**900**	**850**	**800**	**750**	**700**
(1)	Avg. Income	136.56	118.56	100.56	82.56	64.56
(2)	Avg. Investment	10.8	10.8	10.8	10.8	10.8
	ARR [(1)/(2)*100]	**1264**	**1098**	**931**	**764**	**598**

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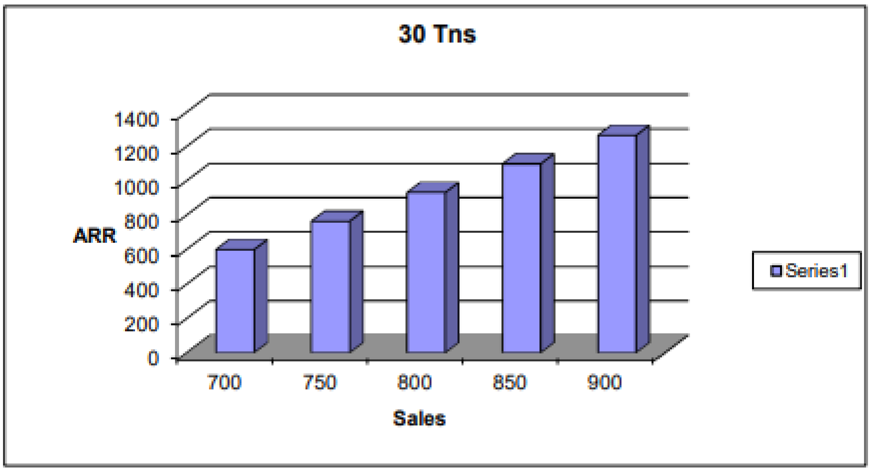

Graph 1: Average Rate of Return for 30 Tons per Month

INTERPRETATIONS:

The ARR more than the pre-specified rate of return is accepted. The company requires a rate of return of 20%. Therefore, ARR of the project, which is greater than 20% as specified by management, is accepted but most viable is at a price of Rs.900 with respect to quantity of 30 Tns per month or 360 Tns per annum.

FINDINGS

- Average Rate of Return: As per the management, the minimum rate of return expected is 20%. The project showing ARR greater than 20% is accepted with respect to operation level 30 Tons or 20 Tons or 10 Tons per month variation in sales price.
- Pay Back Period: The project is accepted when Pay Back is less than 3 years which is standard payback period set by the management. The project, which gives lesser payback period among difference in sales price and quantity to be produced, is accepted and it is at price of Rs.900 whether the quantities are 30 Tons or 20 Tons or 10 Tons.
- Net Present Value: The net income of the project is discounted at the minimum required rate of return – 9% and NPV is positive for different sales price and at different operational levels.
- Internal Rate of Return: The capital invested is getting return of more than 40%, which is greater than 9% (cost of capital).
- Profitability Index: The project showing PI more than 1 and also where NPV is positive is taken up.
- As sales price rises, demand factor also needs to be taken into consideration

SUGGESTIONS

1. Budgeting in Hemadri Cements Limited is mainly a performance based i.e., based on the performance, whereas zero-based budgeting is ideal for the company like Hemadri Cements Limited. There should be an effective coordination between the different departments like Production, sales, Purchase, Finance, Marketing etc., this will enhance the efficiency of the organization.
2. There should be a proper budgeting control system. A thorough review of operations on frequent intervals is required. These reviews should be made with the request to changing environment.
3. Orders received should be dispatched at proper time.
4. Job sequencing should be pre-determined & should follow up the sequential process, until the end of the job. Thus the lead-time can be reduced. There should be proper communication between various departments and responsibility centers. There should be well-organized manpower planning, especially with regard to production.
5. Education about the importance of budgeting should be communicated to all concerned authorities those who will be involved directly or indirectly and to work according, for the growth of the company.

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CONCLUSION:

NPV of the project is considered as better because of its higher Net Present Value. The IRR of the project is giving more than 40% Rate of Return whatever be the sales price and operational level. The PI more than 1 and where project shows NPV as positive is given first preference. The company has to sell at lesser price for more quantity produced and sell at higher price for less quantity produced

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