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Comparative Capital Budgeting Practices in India

A Case Study of Selected Companies.

ABSTRACT

"Capital budgeting is a long-term financial problem of the small as well as large industrial houses. Present study is taken to assist in project evaluation, considering- risk factor and cost of capital. The study is based on same presumptions, which have been tested, with the help of sample survey".

1. INTRODUCTION

Capital budgeting is a long-term commitment of the huge amount of present resources, so as to get future benefits. It is inevitable, so far the survival and growth of business. It includes the investments for the purpose of replacement, expansion and diversification. It is quite significant due to its irreversibility nature. The very need of proper utilization of the resources has also make it important.

2. OBJECTIVES OF THE STUDY

The major objective of this study is to examine empirically the capital budgeting practices being followed by selected companies in India. There are following specific objectives:

(i) To identify the financial objectives followed by the companies, and to determine their priority,

(ii) To know the number of years ahead the companies do planning and the level at which the capital expenditure proposals originate and are screened,

(iii) To examine the corporate practices regarding the methods of capital budgeting, used in evaluating investment proposals.

(iv) To study the impact of the size of a company and nature of the industry to which it belongs on the methods of capital budgeting and risk handling techniques.

3. HYPOTHESIS OF THE STUDY

The study is based on the following null hypothesis:

H01 : The companies do not aim at achieving a particular financial objective.

H02 : The nature of industry, to which a company belongs does not affect the preference of a company for a particular financial objective.

H03 : The consideration of various financial objectives by companies has identical impact on their financial performance.

H04 : The nature of industry and size of a company do not affect the choice for different methods of considering risk in evaluating investment proposal.

3. RISK IN CAPITAL BUDGETING DECISIONS

It is evident from the study that various companies may perceive risk in different ways and they may choose a method of considering risk in capital budgeting decisions. The companies have been asked to give their views on risky projects and their responses have been presented in the following table:

TABLE
PERCEPTION OF RISK: INDUSTRY WISE CLASSIFICATION

Sl. No.	Reasons	No. of Companies	%
1.	Variation in expected return	40	56.3
2.	Fear of obsolescence due to technological development	23	32.4
3.	Non-recovery of investment	32	45.1
4.	Change in economic, social and Political environment	30	42.3

Source: Annual Reports of Companies for the year 2005-06.

It is clear from the table that more than half of the companies (56.35%) consider risk as the "Variation in expected return", from the investment project. About 45% companies feel the project risky, if there is possibility of 'Non-recovery of investment', while changes in economic, social and political environment is at third place, with 42.3%, respondent companies favouring it.

4. EVALUATION METHODS OF CAPITAL EXPENDITURE

The study also evaluated capital expenditure in the companies under study, using following methods:

(i) 'Internal Rate of Return' is the most popular technique of evaluation of Capital Projects, followed by 'Payback Period' and 'Net Present value'.

(ii) The companies, under study are applying various techniques of evaluation. The results of the study show that findings are broadly in consonance with the other studies in India and Abroad.

5. CONCLUSION

The survey concluded that DCF methods were used by all the respondents, which is a big achievement by the corporate sector in India. The comparison of capital budgeting practices of public sector with those of private sector is not possible due to fact that the decisions on large projects are not taken at government levels.

The study suggested the use of 'Adjusted Present value (APV)' as superior alternative of weighted average cost of capital. It is recommended the techniques such as option pricing, simulation and decision tree for appraisal of investments in R&D and such other areas for combating intense competition due to globalization.

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