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Capital Budgeting Decision: Financial Management

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ABSTRACT:

Capital budgeting decision is very important in the area of financial management. All the businesses get the success or fails only the reason of financial management. This study, help to provide you the information related to capital budgeting. Every business wants to increase their profit and wealth maximization that is possible when we are invested the money in the right place at right time. Every business work for increase their profit when we make a plan and then we will invest money so that is very good for our business. We are investing in long term assets so it's very valuable decision for us. When we are doing any wrong work so that is very harmful and this is the reason of loss. It involves decisions to commit the firm fund to long term assets. This study helps to introduce the benefits of the capital budgeting and techniques that's helps to take decision related to select any long-term assets.

Keywords: Capital budgeting, Net Present Value, Internal Rate of Return, Profitability Index, Payback.

Introduction:

Capital budgeting decision is very important in every business. in this, we are investing our fund in long term assets that helps to achieve the best profit and wealth maximization. Every business wants to invest in a best project because they have limited fund. they select the projects and long-term assets that provide the benefit under the budget line. When we are put our fund in right place so we will get profit and market shares value is also increase. Every business growth is depended on the capital budgeting decision. This help to complete successful and maintain its market share. We need to achieve the minimum requirement rate of return because our cost of capital is the burden on the firm. So, every business selects those option that's provide the maximum output and increasing rate of return. When we are investing in any project or long-term assets so it's very risky for us because they provide me loss or profit all are depend on the future. We don't know about future but some techniques help to provide the information that's helps to minimize loss and invest in the best project. When we are investing in any project so we not be reverse and re-invest in any other project. So that's why capital budgeting decision is very complex. In the long-term assets, we are investing too much money that's is the reason of our success or failure. Internal rate of return, net present value, profitability index, net present value both are discounted cash flow and payback, accounting rate of return both are non-discounted cash flow so these techniques help to increase our profit and take a better decision. all the expenses, dividend and interest are the cost of capital when we achieve the output then we will pay this cost so all the business activates related to dividend distribution, debts payments, interest and all other depend on the future cash inflow. We are estimated of cash flows in these techniques. This help to provide the information cash inflow and outflow. What the amount we are invest and after some time what the amount we will get. With the help of these are consider the time value of money. In this we see what the time effects on the money we are invest in any project.

Literature review:

Many scholars provide the information related to these capital budgeting techniques that all are help to take decision before investing money in a specific project. Arya., 1998; Swain & Haka, 2000; they says that the importance of capital budgeting decision in financial management. They say that every financial manager is important to take decision very nice before investment because financial manger provide the output or loss. Kwak. (1996) this person says that in market many opportunities we pick those they provide the best output and increase the profit and wealth. When we are investing in the good Longterm assets so we easily compete in the market. Srivastava, 1995; Pike, 1996 they tell that in the world all the successful companies use the techniques and after that they achieve the best position in the market. Without better decision in capital budgeting no anyone achieve the profit. Major international research focuses on the capital adequacy practices of large companies. There is little research for small and medium-sized enterprises (Rossi, 2014). this study tells that every business in different so every business budget and investment opportunities is different so they consider the market and after that invest. Evey countries and every industry is different from each other so they invest according to their need. Kester. (1999) these help to provide the information related to capital budgeting with time value considered. These help to provide the best information according to this scholar internal rate of return and net present value these both the techniques are very helpful and that's provide the information about the future. These are very helpful in uncertain future. This is very best techniques to find out the cash flow in the future. Hatfield. (1998). The importance of PP, ARR, IRR and NPV capital investment techniques was assessed for the performance and size of the company's value. All are very common and most useful in every firm. This is very best techniques every business uses these techniques to achieve the best output. Every financial management is important to know all these techniques without using these techniques no anyone achieve the highest profit. Block (1997) focuses on capital budgeting applied by small businesses. 232 small-business samples were tested. Research shows that 42.7% of companies are still the most favorable way of returning. After the survey they think that without net present value and other techniques they don't achieve the success and not get the benefit.

Stages of capital budget decisions:

1. *Identifying investment opportunities*
2. *Generation and evaluating alternative*
3. *Selection and authorization*
4. *Implementation and control*

Explain:

Stage1. Identifying investment opportunities:

In this we see the opportunities related to our business. This is very important to all the businesses. Firstly, we see the opportunities for our company because every industry and every country is different so we adjust and pickup any opportunities according to our business and we also see the budget line. Every business selects long term according their business. We want to increase our business profit and wealth. When our profit and wealth is increase so our shares value is also increase. Every business financial manger first decision to identifying the investment opportunities related to their business and collect the data of all opportunities related to their business.

***Stage2.* General and evaluation alternatives:**

After getting the information related to opportunities available in the market. We are seeing that what is the opportunities for us and what is the best opportunities in the market. We are investing in more than one project or purchase more than one long term assets. So, it's very important to evaluation of all the alternative. We are making report and compare in the market opportunities after that we will give the rank all the opportunities because that's helps to select or reject any opportunities and that's are every easy to understand the qualities of the projects.

Stage3. Selection and authorization:

After give the rank all the projects we are see the budget line. We consider what the amount we have and how many projects are purchase. That is the final stage of purchasing decision so it is very important part of financial manager. When financial manager takes this decision wrong it is the reason of business failure. When we are select best project so it's very valuable for us. At the final we are select those projects that's are top ranking and very beneficial for us. we are taking decision to purchase any long-term asset related to business, purpose to achieve high profit.

Stage4. Implementation and control:

When the company feel that a plan has been selected by it, it is now implemented. He is given approval and work is done accordingly so that there is no mistake in any work and work can be done easily. There should be no loss of any kind and we should get good output from all sides. The decisions taken by us need to be tracked frequently and we should keep on comparing between the standard result and the result we got from the project and we also have to see that whatever our money has been invested is in the right direction or not. We cannot withdraw this money again, but it can be made successful by tracking some decisions or making some changes in it.

Capital investment appraisal techniques:

Net present value:

In this, it is seen by us that the money which is being invested by us today, how much benefit will it provide in the future because out of that money we have to pay dividend as well. We also have to pay interest and also invest to grow our business in future, so it is very important for us to see how much cash flow we will have in future. Considering cash flow is very important and net present value only teaches to consider cash. It tells us that money is being invested by us today. If you invest it in some other place then how can we benefit from it. The performance of our business and the profit earning by our business increase the value of our share. If we don't make profit then our share value will go down.at that time people do not like to bow down with our business and there is a lot of risk in our business. We want to make maximum profit in minimum race. Our relationship should also become very less and by investing all the money, we can earn maximum volatility because we need minimum rate of requirement. If we take money less then minimum rate of requirement then our business is jeopardy. We have to balance these two keeping in view the minimum requirement rate and keeping this in mind so that maximum profit can be earned. This method helps to select a best project. 90% business adopted this because this is very helpful to select a minimum risk and maximum output project selection.

(Present value) $V_0 = \dfrac{FV_n}{(1+K)^n}$

$$NPV = \frac{FV_1}{(1+K)} + \frac{FV_2}{(1+K)^2} + \frac{FV_3}{(1+K)^3} + \dots\dots\dots + \frac{FV_n}{(1+K)^n} - I_0$$

Here I0 represents the investment outlay and FV represents the future values received in years1 to n. The rate of return K is the return available on a security in financial markets of equivalent risk. We will select those projects which will give us the highest rate and from which we will be able to earn maximum profit, all the rest we reject the below projects which will be the top-quality projects. All of them will be selected.

Internal rate of return (IRR)

In this we are consider the cash flow in the business because we are investment in too much amount in different – different projects so it is important for us what is the best time to invest money in any project. This technique is also considered the period and the profit. Some business uses this technique to achieve the high profit because this helps to provide the data related to our risk and return. Because some projects are very risky and some projects are haven't any risk but their profit is low. So, this technique helps to select those projects they provide us maximum profit in minimum risk. In this technique we are measure our future profit and estimate the future cash inflow and this is very helpful to select a best project. Sometime company select two and more project so that time this technique is very helpful to get the best decision related to selection of any project.

Profitability index:

In this technique we see the future profit because we are investing too much amount so what the amount we will get in future? This is the first question in every people mind who are want to join business. So, every financial manager is very important to use this method this helps to tells the profit achieving in the future because without profit our business is not grow and our share Value is also down without any profit. So, profit is very important for Evey business. Without profit business is not stable long time. When our profit is increase as compare to requirement rate of return so we will select and when it is not providing the profit more than requirement rate of return so we will reject those projects. Some time we see that requirement rate of return is equal to future profit so we will be select or not. When we find that this is increase the profit in future so will select and we also consider the minimum risk with high and high return is also cause of the loss some time. So, it is very important to every fiancé manger to select a suitable project because all the business success or failed is depend on the future profit.

Payback:

This method helps to provide the information related to the return of all those amounts we are invested in any project. We are selected those projects that's provide our money beck in minimum time. This is very helpful techniques. When we will get back money fast so we will invest again in another project. So, this technique not consider the profit this technique helps to consider the return time period and consider the risk in the project. This is very useful some small, micro and medium business us this technique but last few days some large businesses are also us this technique because this is very helpful to provide the information related to money back in short period. If this meets the driving time criteria, it is also acceptable if NPV is negative. Sometime this technique is very harmful for businesses because this technique not provide the profit data. This helpful to achieve the amount back in sufficient time.

Object of the study:

- This is very helpful to select a best project of every business. This helps to provide you best information related to select any project.
- It is helpful all the persons who want to select any project and those people whose work as finance manager in any business.
- This provides the information related to future output this provide the information related to cash inflow and outflow.
- Without capital budgeting techniques its very dangerous for every business. It's very risky to select any project.

Conclusion:

At the end we say that capital budgeting is very important to all the businesses without capital budgeting decision we not bet achieve the success so this is very important to us select a suitable technique and after that we are compare all the opportunities available in the market. At the end we make a list of those select project that provide us benefit. And after that we are adjust according to their output and rate of return. So, at the end we select those project that helps to provide the best output in the market. We are select those that's are fulfill our need. We are also seeing the risk also before selecting any project. Or one best decision increases the profit and wealth maximization. It also increases the share value. When are invest in best opportunities so people consider this and invest in our business. So that is very good for us. This is very important to under all the finance mangers because their one decision is very important and related to all the activities related to this important decision. We also consider the minimum requirement rate of return because every business give interest and dividend so it's very important to achieve the best the best position in the market that is possible with the help of capital budgeting and important to take best capital budgeting decision.

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