



“A Study on capital budgeting and its impact on company’s Decision-making strategy with reference to Asian Paints”

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ABSTRACT

Capital budgeting is an essential process employed by companies to evaluate and select major projects and investments, such as the establishment of new plants or the acquisition of equipment. This research aims to analyze the capital budgeting practices and their impact on the decision-making strategy of Asian Paints, a leading paint manufacturer in India. The study will examine the various capital budgeting techniques utilized by the company, including discounted cash flow methods like Net Present Value (NPV) and Internal Rate of Return (IRR), as well as techniques like payback period and throughput analyses.

The process of capital budgeting involves analyzing a project's cash inflows and outflows to determine whether the expected return meets a predetermined benchmark or hurdle rate. The research will assess Asian Paints' approach to evaluating and prioritizing investment proposals, taking into account factors such as risk analysis, cost of capital, and strategic fit. Additionally, it will investigate the influence of capital budgeting decisions on the company's overall corporate strategy, including expansion plans, product diversification, and market penetration.

Furthermore, the study will explore the challenges and limitations faced by Asian Paints in capital budgeting processes, such as uncertainty in cash flow projections, changing market conditions, and competitive dynamics. It will also examine the role of organizational culture, management style, and corporate governance in shaping capital budgeting decisions within the company.

By conducting a comprehensive analysis of Asian Paints' capital budgeting practices and their strategic implications, this research seeks to provide valuable insights for both academic and practical purposes. The findings could contribute to the existing body of knowledge in corporate finance and strategic management while offering practical recommendations for enhancing capital budgeting processes and aligning them with overall business objectives.

- Capital budgeting is used by companies to evaluate major projects and investments, such as new plants or equipment.
- The process involves analyzing a project's cash inflows and outflows to determine whether the expected return meets a set benchmark.
- The major methods of capital budgeting include discounted cash flow, payback, and throughput analyses.

KEYWORDS

Capital budgeting, Payback period, Internal Rate of Return

INTRODUCTION

Capital budgeting is a critical process that plays a pivotal role in determining a company's long-term profitability, growth, and competitive position. It involves evaluating and selecting major investment opportunities that align with the firm's strategic objectives. Effective capital budgeting decisions are essential for companies to allocate resources efficiently and maximize shareholder value.

In today's dynamic business environment, characterized by intense competition, technological advancements, and rapidly evolving market conditions, the significance of capital budgeting cannot be overstated. Companies must carefully analyze potential investments, considering factors such as cash flows, risks, and strategic fit, to ensure that the selected projects yield attractive returns and contribute to the overall success of the organization.

The capital budgeting process typically involves various techniques, including discounted cash flow methods like Net Present Value (NPV) and Internal Rate of Return (IRR), as well as payback period and throughput analyses. These methods provide a structured approach to evaluating the financial viability and potential profitability of investment proposals.

Asian Paints, one of the leading paint manufacturers in India, has been a prominent player in the highly competitive paints and coatings industry. As the company navigates through changing market dynamics and explores opportunities for growth and diversification, capital budgeting decisions play a crucial role in shaping its strategic direction.

This research aims to conduct an in-depth study of Asian Paints' capital budgeting practices and their impact on the company's decision-making strategy. By examining the techniques employed, the evaluation criteria considered, and the challenges faced, the study seeks to provide valuable insights into the intricate process of capital budgeting and its implications for corporate strategy.

Furthermore, the research will delve into the influence of organizational culture, management style, and corporate governance on capital budgeting decisions at Asian Paints. Understanding these factors is essential, as they can significantly impact the effectiveness of capital budgeting processes and their alignment with the company's overall strategic objectives.

The findings of this study have the potential to contribute to the existing body of knowledge in corporate finance and strategic management while offering practical recommendations for companies operating in similar industries or facing comparable challenges. By shedding light on the interplay between capital budgeting and strategic decision-making, this research can provide valuable insights for academics, practitioners, and policymakers alike.

LITERATURE REVIEW

Capital budgeting is one of the most important decisions faced by the financial Management of any organization (Batra & Verma, 2014). It is a planning mechanism used by an Organization to make evaluation decisions on how to allocate resources among investment projects (Al-Mutairi et al., 2018) and assessing the investment projects that will create benefits for periods of over one year and that will assist the company to obtain revenues or reduce future costs (Khamees et al., 2010).

Capital budgeting is a tool that can be used for very simple operational decisions such as equipment replacement or more complex strategies such as the construction of a new plant (Leon et al., 2008). In any case, when considering the importance of capital investment decisions, it is imperative that managers use the appropriate practice to ensure a sound decision (Toit & Pienaar, 2005).

More sophisticated capital budgeting practices are Discounted Cash Flow (DFC) practices that take into account the value of money over time, namely: Net Present Value (NPV), Internal Rate of Return (IRR). Among the simplest are Payback (PB) and Accounting Return Rate (ARR) (Leon et al., 2008; Brijlal & Quesada, 2009; Hall & Mutshutshu, 2013).

The interest in understanding the capital budgeting practices used by companies was first observed in the beginning of the 1960s. Evidence from the 60s and 70s reflected a certain managerial trend to gradually use models that were theoretically superior based on discounted cash flows (Andrés et al., 2015). The fields of engineering economics and finance have long stories of research on how to choose an interest rate for an investment project or capital budgeting problem (Eschenbach & Cohen, 2006).

According to Mao (1970), since the 60s, the literature on capital budgeting has been characterized by an increase in the application of such analytical techniques. There are modern budgeting techniques that can be used in investment decision making, but managers seem not to have adopted new techniques at a large scale.

The literature still tries to explain why the gap between what is indicated by the theory and what is actually practiced still exists (Bennouna et al., 2010). Most explanations are related to the culture, preferences and

limitations of the managers (for example, Hall & Millard, 2011; Andrés Et al., 2015; Souza & Lunkes, 2016). While various methods have been proposed in the literature, Subjective approaches have gained less attention (Toloo et al., 2018).

Capital budgeting refers to the financial assessment of the capital investment proposals of a company (Al-Mutairi et al., 2018). In other words, capital budgeting involves assessing whether the future cash flows resulting from a suggested investment justify whether it should be made, considering the risks and uncertainties (Leon et al., 2008).

Budgeting is considered as one of the most important decisions faced by the financial manager (Ryan & Ryan, 2002). The efficiency of the capital budgeting process of an organization and the respective financial analysis methods depend, ultimately, on how it influences the behavior of the managers to allocate scarce resources across competing investment alternatives (Pike, 1988; Pike & Ooi, 1988).

When making investment decisions, the managers make a series of subjective calls (Pike, 1983). Also, the profile of the managers is considered as a factor that may influence capital budgeting practices used by the companies (Andrés et al., 2015). In addition, different organizations use different decision-makers to adopt the decisions related to the referred budgeting (Brijlal & Quesada, 2009).

Firstly, the capital investment decision significantly influences the growth rate of an organization; making a wrong decision may ruin the company. Secondly, such decisions require large amounts of funds. Finally, they are amongst the most complex decisions in terms of uncertainties in relation to future cash flow estimations, as well as in relation to the social, Technological, economic and political impacts on the estimations, which increases their complexity (Egbide et al., 2013).

Assessing the capital budgeting proposals is part of the decision to make investments (Arnold & Hatzopoulos, 2000). Within that context, the financial management and the capital investment decision-making are fundamental for the survival and success of the company in the long term (Bennouna et al., 2010).

OBJECTIVES

- 1. To study the Long-term Implications**
- 2. To study the Involvement of large amount of funds**
- 3. To study the irreversible decisions**
- 4. To study the risk and uncertainty**

METHODOLOGY

To conduct a comprehensive analysis of capital budgeting practices and their impact on decision-making strategies at Asian Paints, a mixed-method research approach will be employed. This approach will involve both qualitative and quantitative data collection and analysis techniques, allowing for a holistic understanding of the research problem.

Sample size

Sample size used for the current research study is 37

Primary Data

New data gathered to help solve the problem at hand. As compared to secondary data which is previously gathered data. An example is information gathered by a questionnaire. Qualitative or quantitative data that are newly collected in the course of research, Consists of original information that comes from people and includes information gathered from surveys, focus groups, independent observations and test results.

Secondary Data

Information that already exists somewhere, having been collected for another purpose. Sources include census reports, trade publications, and subscription services. Data that have already been collected and published for another research project (other than the one at hand)

TOOLS FOR DATA COLLECTION

The main tool used for collection of data for the current study is through primary data source which contains the questionnaire about the capital budgeting practices followed by the company.

PLAN OF ANALYSIS

The data collected were analyzed on various parameters and presented with the help of Pie charts and bar graphs

FINDINGS

1. Out of the total respondents chosen for the current research study a major number of respondents were male respondents and a few respondents were female.
2. We spoke to mostly mid level employees who could give us the proper information about the capital budgeting decision process system in the company. However we also spoke to employees who were junior level and senior level.
3. The respondents we chose for our research study had a minimum of 5 years to about 8 years of work experience in the company as they will be better equipped to answer the capital budgeting related queries. However we spoke to some respondents who had less than 5 years of experience.
4. We mainly spoke to employees who were permanent employees of the company as they will have full knowledge about the investment decisions made in the company. However we also spoke to some of the contract employees also who had a little bit of idea about capital budgeting process.

5. The respondents of our survey research study said that they have worked in other companies also before starting to work with Asian Paints company. Only a very few employees were freshers who started with the company
6. Asian Paints company uses mostly APM as the sophisticated tool for computing the capital budgeting. However some of the respondents said that the company uses CAPM also for this purpose.
7. Risk is something that weighs a financial decision heavily and Asian Paints company is no exception. Financial risks involved in any capital budgeting issue will definitely be taken into consideration before deciding on the investment
8. Internal rate of return (IRR) is the most favored method for the Asian Paints company while deciding investment project to choose. However some respondents did say that NPV is also used which means the company at times use both the methods
9. Cash flow statement is very much important for the Asian Paints company while deciding on the financial statements to use while calculating the NPV or the IRR
10. Asian Paints company normally uses Weighted average cost of capital (WACC) to determine the minimum acceptable rate of return to evaluate potential capital investment project. However cost of debt and cost of equity capital are also used sometimes
11. The company officials in a big number said that the company employs Modified Internal Rate of Return (MIRR) almost all the times while deciding on investing in a particular project.
12. Asian Paints company employs Discounted Payback Period (DPBP) also several number of times for the decision making process in capital budgeting investments as opined by a major number of respondents.
13. Accounting Rate of Return (ARR) is also very important while deciding on the investment projects.
14. Experience and competency is one of the factors that influences the company capital budgeting methods. Experience always gives us the edge needed while making big financial decision in any company.
15. Sometimes while making decision about investment in any capital projects, top management familiarity is one of the factors that influences the company capital budgeting methods.
16. Most of the respondents agreed that the company while computing IRR or NPV, deduct interest and others financing cost from revenue to find out cash flows. However there were a good number of respondents who said either did not know or were not very sure.
17. When asked about the capital budgeting practices of the company several respondents chose to stay neutral as they were not very much comfortable answering this question. However several officials did say that they were happy

CONCLUSION

Capital budgeting is one of the important techniques of Financial Management to evaluate the project efficiency. So that purchasing of new machinery, starting business, expansion, replacement of old machinery with new etc. Comparatively modern method is more effective over the traditional method because the modern method is considering the time value of money. Capital budgeting has its own disadvantage but its advantages overshadow its disadvantages with its usage. But in India capital budgeting technique is not properly utilized in corporate as well as government administrative level.

After studying this topic, I realize the importance of capital budgeting. I feel this that capital technique can be utilized in corporate as well as government administration project such as public utility service, public transportation service etc.

I personally feel that due to lack of knowledge public is not willing to utilize this technique in the prospective way. Capital budgeting can be utilize from domestic level to MNCs and this sentence can express the importance of capital budgeting.

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