Unit –III Capital-Budgeting

Capital budgeting defines decision making on investment. It is based on the returns which proposed investment will give. Project implementation process, capital financing, allocation functions and well –managed company are the part of capital budgeting process.

Capital budgeting is the allocation of available funds for capital projects. A capital project is a long-term investment on the tangible assets. The tools and principles capital budgeting is applied in different aspects of a business entity's decision making and in security valuation

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Capital Budgeting is a project selection exercise done by the business enterprise. Capital budgeting uses the concept of present value to select and implement the projects.

Capital budgeting uses tools such as payback period, net present value, internal rate of return and profitability index to select projects.

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Nature of Capital Budgeting

capital budgeting is Capital expenditure plans involving a huge investment in fixed assets.

Capital expenditure once approved represents long-term investment that cannot be reserved or withdrawn without sustaining a loss.

Preparation of capital budget plans involves forecasting of several years profits in advance and judge the profitability of projects.

It may be asserted here that decision regarding capital investment should be taken carefully so that the future plans of the company will not affected.

Sources of Capital funds:

Companies also use outside capital in addition to inside capital. The company in cease capital increases the company shares and issues large amount of common stock from outside. The outside sources of capital include equity partners, stockholders, bond holder's banks and venture capitalists and all who expect return on investments.

Procedure for Capital investment:

Capital investment decision in the view of any firm is influence on the entire spectrum of entrepreneurial activities. So the careful consideration should be regarded to all aspects of financial management

In capital budgeting process, main points to be kept in mind are how much money will be needed for implementing immediate plans, how much money is available for its completion and how are the available funds going to be assigned to the various capital projects under consideration

) Investment Proposal for Organisation:

The first step in capital budgeting process is the conception of a profit making idea. The department head collects all the investment proposals and reviews them in the light of financial and risk policies of the organisation and send them to the capital expenditure planning committee for consideration.

2) Screening the Proposals.

The capital expenditure planning committee screens the various proposals within the long-range policy-frame work of the organisation

3)Evaluation of Projects:

The third step in capital budgeting process is to evaluate the different proposals in terms of the cost of capital, the expected returns from alternative investment opportunities and the life of the assets with evaluation techniques.

4) Establishing Priorities:

The profitable projects or the accepted projects are then put in priority.

5) Final Approval:

Proposals which are finally recommended by the committee are sent to the top management along with the detailed report, both of the capital expenditure and of sources of funds to meet them. The management affirms its final seal to proposals taking in view the urgency, profitability of the projects and the available financial resources. Projects are then sent to the budget committee for incorporating them in the capital budget.