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A STUDY ON CAPITAL BUDGETING WITH REFERENCE TO AJUTE INTERNATIONAL PVT LTD

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Abstract

The key function of the financial management is the selection of the most profitable assortment of capital investment and it is the most important area of decision making of the financial manger because any action taken by the manger affects the working and the profitability of the firm for many years to come. The objective of the research is to study on the company's forecasting decision through Capital budgeting technique through which the importance of capital budgeting in an organization and to analyze the capital budgeting process to be adopted by the company in order to take better investment decisions for various business projects. Further, it caters information about cash inflows and outflows of various years. Thus the comparison provides clear idea about investments and return on the same which can be helpful for the years to come.

The analyses have been done by the data collected from income and expenditure statements and separate investment report. Capital budgeting techniques like Net Present Value method, Rate of Return method and Payback Period method are used to analyze the collected data. Some other forecasting tools like standard deviation, Correlation analysis and trend analysis are used in this study.

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CHAPTER I

INTRODUCTION TO THE STUDY

Capital budgeting, which is also called "investment appraisal," is the planning process used to determine an organization's long term investments. Capital budgeting involves choosing projects that add value to the firm. Businesses, specifically corporations, are typically required, or at least recommended, to undertake those projects which will increase profitability and thus enhance shareholders' wealth.

When a firm is presented with a capital budgeting decision, one of its first tasks is to determine whether or not the project will prove to be profitable. The net present value (NPV), internal rate of return (IRR) and payback period (PB) methods are the most common approaches to project selection. Although an ideal capital budgeting solution is such that all three metrics will indicate the same decision, these approaches will often produce contradictory results. There are common advantages and disadvantage associated with these widely used valuation methods.

The firm's capital budgeting decision may be comprised of a number of distinct decisions. A capital budgeting is a set of assets that are contingent on one another and are considered together. This capital project entails acquiring land, building facilities, and purchasing production equipment. And this project may also require the firm to increase its investment in its working capital -- inventory, cash, or accounts receivable. Working capital is the collection of assets needed for day-to-day operations that support a firm's long-term investments.

Nature of Capital Budgeting:

Capital budgeting is the process of making investment decisions in capital expenditures. A capital expenditure may be defined as an expenditure the benefits of which are expected to be received over period of time exceeding one year. The main characteristic of a capital expenditure is that the expenditure is incurred at one point of time whereas benefits of the expenditure are realized at different points of time in future.

CHAPTER II

1.2 INDUSTRY PROFILE

The manufacture of jute fibres into coarse cloth by hand-spinning and hand- weaving was a very old industry in India. The fibre was spun into twist or yarn, and worked up as required into string or rope, or was woven into gunny cloth or bag. The first power loom was established in 1859 at Chennai . In the beginning, the progress was very slow so much so that between 1854 to 1863—64, only one more mill was built. From 1863—64 onwards, however, growth of the industry was fairly rapid, occasional set-backs notwithstanding, jute was the monopoly of India, and in this, the Chennai industry "furnished with the best mechanical appliances moved by steam" had a strong advantage. From 1900 onwards, the industry again grew at a fairly rapid pace and by 1913—14, the number of jute mills had risen to 64 with 36,000 looms and employing 2.16 lakh workers.

The First world war created a large demand for sand-bags and other jute manufactures. The shipping difficulties were so acute that between 1917—19, even exports of just manufactures was prohibited except under license. In 1919, the industry comprised 76 mills which employed 2.76 lakh workers. In addition, there were 211 jute presses in which 33,316 persons were employed. It is worth noting that the jute growers of Chennai did not share this prosperity of the industry. On the contrary, export markets having been closed by the war and there being acute shipping shortage, the farmer was forced to dispose of his crop at whatever prices the industry chose to pay.

1.3 COMPANY PROFILE

History & Growth

Ajute International Pvt Ltd has an experience of 30 years in manufacturing and marketing a diverse range of jute products, comprising traditional jute items as well as diversified modern jute products. The company's continued commitment to R&D, customer oriented approach and quality control measures have enabled them to offer this golden fibre for multi dimensional use to many satisfied customers.

Mission Statement

The mission of Ajute International Pvt Ltd is to be the leading jute products manufacturer in terms of quality, efficiencies and margins by managing our partners, customers and associates in a productive and efficient manner.

Vision Statement

Our vision is to reach a wide array of quality Jute products to newer markets and regions of the world, to popularize the use of this eco-friendly versatile fibre and to take it to the prominent position it truly merits.

Management

Efficient management of a continuously running jute mill demands judicious manpower planning, selection of qualified and experienced personnel and an appropriate organisation structure, clearly defining the function and responsibilities of managerial and supervisory staff in such diverse areas as administration, finance and budgetary control, purchase and sales, operation and maintenance, quality control, personnel management, plant security, etc.

CHAPTER III

REVIEW OF LITERATURE

CONCEPTUAL REVIEW

Capital as Limited Resource

The foremost importance is that the capital is a limited resource which is true of any form of capital, whether it is raised through debt or equity. The firms always face the constraint of capital rationing. This may result in the selection of less profitable investment proposals if the budget allocation and utilization is the primary consideration. So the management should make a careful decision whether a particular project is economically acceptable and within the specified limits of the investments to be made during a specified period of time. This, in essence, is the basis of capital budgeting.

In the form of either debt or equity, capital is a very limited resource. Commercial banks and other lending institutions have limited deposits from which they can lend money to individuals, corporations, and governments. Having limited resources to lend, lending institutions are selective in extending loans to their customers. But even if a bank were to extend unlimited loans to a company, the management of that company would need to consider the impact that increasing loans would have on the overall cost of financing. In reality, any firm has limited borrowing resources that should be allocated among the best investment alternatives. Even the best known firm in an industry or a community can increase its borrowing up to a certain limit.

JOURNALS

A Review of the Literature on Capital Budgeting and Investment Appraisal: Past, Present, and Future Musings

Abstract

This chapter provides a historical appraisal of the development of current capital budgeting practices and reviews capital budgeting academic research. In the late eighteenth and early nineteenth centuries, the industrial revolution was instrumental in creating demand for capital budgeting processes and techniques. Academic research, beginning in the late 1940s and early 1950s, is categorized by its focus on appraisal techniques, individual decision-maker effects, organizational issues, and environmental factors. Experimental, analytical, agency-based, survey-based, and case-based research is reviewed. The chapter concludes with a compilation of issues identified by academic research and a set of questions that have not yet been addressed.

THEORIES

For example, stewardship theory does not support the view that individuals are utility maximisers and also does not support the assertion that all business decisions are based on economic considerations only. It asserts that some business decisions are based on non-economic returns such as those related to social status in the community. The core of stewardship theory is about how individuals rank their social needs in a community, such as being accepted and valued by their peers and supervisors.

CHAPTER IV

RESEARCH METHODOLOGY

OBJECTIVES

Primary Objective

To study the performance of capital budgeting and to evaluate the data of capital budgeting techniques in Ajute International Pvt Ltd.

Secondary Objective

- To study and ensure planning for future by setting up various budgets.
- To know the budgeting operation in the company.
- To analyze the elimination of wastages and increase in profitability.
- The analyze the correlation between Revenue and Sales.
- To find out the standard deviation for Total assets.

Evaluation of past projects and investment may cater valuable information to be adapted in the future. Thus, planning for forthcoming days becomes easy. A clear view of work done by different departments in the organization can be observed.

Need for the study

If the investment decision taken up on a project is not worth undertaking, the amount invested on a particular project would not generate profit or value rather it creates loss to the firm. Hence, to increase wealth and profit of the firm or to avoid loss, a sound procedure is needed. Capital budgeting or investment decisions are of considerable importance to the firm, since they tend to determine its value by influencing its growth, profitability and risk. The process of allocating budget for fixed investment opportunities is crucial because they are generally long lived and not easily reversed once they are made. So we can say that this is a strategic asset allocation process and management needs to use capital budgeting techniques to determine which project will yield more return over a period of time.

There are two types of data to be collected

- Primary data
- Secondary data

Primary data are those which are collected afresh and for the first time and thus happen to the original in character.

Secondary data, the data that are already available, it refers to the data which have already been collected and analyzed by someone else. The secondary data recollected from company profile and website. Mostly the data used for the project are secondary data

TOOLS USED FOR ANALYSIS:

1. Net present Value (NPV)
2. Payback Period (PBP)
3. Average rate of return (ARR)
4. Profitability Index (PI)
5. Correlation analysis
6. Standard Deviation
7. Mean
8. Trend Analysis

DATA ANALYSIS AND INTERPRETATION

PAY BACK PERIOD

The **payback** measures the length of time it takes a company to recover in cash its initial investment. This concept can also be explained as the length of time it takes the project to generate cash equal to the investment and pay the company back. It is calculated by dividing the capital investment by the net annual cash flow. If the net annual cash flow is not expected to be the same, the average of the net annual cash flows may be used.

Payback Period =	Initial Investment
	Cash Inflow per Period

CALCULATION OF ANNUAL CASH INFLOW

Year	**2018**	**2019**	**2020**	**2021**	**2022**
Total Sales	1606310970	1952574983	2062496269	2177381956	2371633523
Less: Costs	1555885007	1815614157	1961324252	2068196415	2286017710
EBDT	50425963	136960826	101172022	128327364	85615818
LESS: Depreciation or other exceptional items	-	967090	-	10393113	12541810
EBT	**50425963**	**135993136**	**101172022**	**117934251**	**73074008**
LESS: Tax	17100966	100752605	(22354952)	38433857	26851541
PAT (Annual Cash Inflow)	**33324997**	**35241131**	**123526969**	**79500394**	**46222467**

Payback Period Analysis

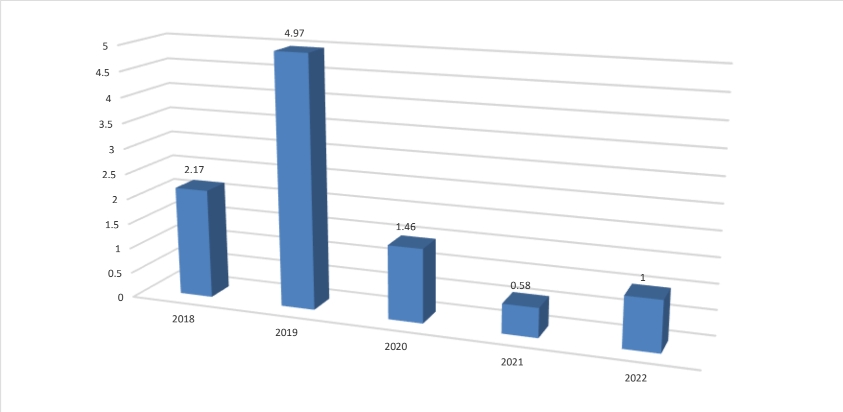
Year	**Initial investments**	**Annual cash Inflow**	**Payback period**
2018	72368453	33324997	2.17
2019	175080399	35241131	4.97
2020	180236203	123526969	1.46
2021	46246000	79500394	0.58
2022	46246000	46222467	1.00

INTERPRETATION

The shorter the payback period, the sooner the company recovers its cash investment. Whether a cash payback period is good or poor depends on the company's criteria for evaluating projects. From the above it is inferred that the company have its highest pay back on 2019 with 4.97 or 5 years.

The current year (2022) PBP is found to be 1 year. This shows that the company recovers its investment in 1 year

Payback Period Analysis



ACCOUNTING RATE OF RETURN (ARR)

ARR method uses accounting information as reveals by financial statements, to measure the profitability of the investment proposals. It is also known as the return on investment. Sometimes it is called as the Average rate of return.(ARR)

$$\text{Average Rate of Return (ARR)} = \frac{\text{PAT}}{\text{Original Investment}} * 100$$

Year	PAT	Initial investments	Average Rate of Return
2018	33324997	72368453	0.46
2019	35241131	175080399	0.20
2020	123526969	180236203	0.68
2021	79500394	46246000	1.72
2022	46222467	46246000	1.00

Inference:

The chart shows that, in the year 2019 the company had lower expected rate of return than the minimum rate so the investment on the particular project can be reduced. In the year 2021 the project has a higher rate of return than the minimum rate. Higher rate of return indicates that investment made in the particular year has higher cash inflow in the future. The Average rate of return for the year 2022 is reduced to 1 year.

FINDINGS

1. The current year (2022) PBP is found to be 1 year. This shows that the company recovers its investment in 1 year
2. The Average rate of return for the year 2022 is reduced to 1 year the Net Present Value for the five years from 2018 to 2022 is **(17, 08, 88,234.5).** A negative NPV indicates that the project will probably be unprofitable and therefore should be adjusted, if not abandoned altogether.
3. PI is lesser than 1 so Reject the proposal. It indicates that for every one rupee investment there will be 0.579 loss
4. The current year (2022) PAT is decreased to 4.622 when compared to the previous year (2021) with 7.950.
5. The Standard Deviation for PAT is 3.425679518 and Variance for PAT is 11.73528016
6. In the year 2022 the Investment has been decreased to 4.625.
7. The standard deviation of Investment is 6.089. The Variance is 37.071
8. Revenue is high in 2022 with 23.716 when compared to the previous year 2021 with 21.965.
9. The Standard Deviation for Revenue is 14.25665841. The Variance is 203.252309
10. There is a high degree of correlation between Revenue and EBIT as the correlation value **0.449147** is more than 0.05. It measures the closeness of relationship between Revenue and EBIT and they both have a positive correlation.

SUGGESTIONS

1. The shorter the payback period, the sooner the company recovers its cash investment. Whether a cash payback period is good or poor depends on the company's criteria for evaluating projects. Higher rate of return indicates that investment made in the particular year has higher cash inflow in the future.
2. A negative NPV indicates that the project will probably be unprofitable and therefore should be adjusted, if not abandoned altogether.
3. NPV enables a management to consider the time value of money it will invest. This concept holds that the value of money increases with time because it can always earn interest in a savings account. Therefore, any other investment of that money must be weighed against how the funds would perform if simply deposited and saved.
4. The PAT trend is decreasing so the company should take necessary steps to increase the profit of the company by decreasing the expenses and debtors
5. The EBIT trend is decreasing in 2022 this may due to increase in the expenses and high interest. So the company should take necessary actions to decrease the expenses.

CONCLUSION

Capital budgeting or investment appraisal is the planning process used to determine whether 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 budget for major capital, or investment, expenditures. It is a process used to determine whether a firm’s proposed investments or projects are worth undertaking or not. The process of allocating budget for fixed investment opportunities is crucial because they are generally long lived and not easily reversed once they are made. So we can say that this is a strategic asset allocation process and management needs to use capital budgeting techniques to determine which project will yield more return over a period of time.

Through this study it is very clear that capital budgeting essentially involves evaluation of the worth of capital investment proposals based on estimates of cash inflows and outflows. The study emphases that efficient allocation of capital is the most important finance function in the modern times. Thus, capital budgeting or investment decisions are of considerable importance to the firm, since they tend to determine its value by influencing its growth, profitability and risk. The analysis of payback period and Average Rate of Returns conclude that management should take efforts to perform the capital budget in efficient manner.

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