RAMA UNIVERSITY

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FACULTY OF COMMERCE AND MANAGEMENT

COURSE: B.COM V SEM.

SUBJECT: INTRODUCTION TO FINANCIAL MANAGEMENT

SUBJECT CODE: BCH 505

LECTURE: 11

NAME OF FACULTY: DR. PALASH BAIRAGI

LECTURE-11

2.1 CAPITAL BUDGETING:

Introduction: Capital Budgeting is the process of making investment decision in capital expenditure. It involves the planning and control of capital expenditure. It is the process of deciding whether or not to commit resources to particular long-term projects whose benefits are to be realized over a period of time.

According To Charles T Horngreen: "Capital Budgeting is the long term planning for making and financing proposed capital outlays"

According To Lynch: "Capital Budgeting consists in planning development of available capital for the purpose of maximizing the long term profitability of the concern"

From the above definition, it may be concluded that it is the process by which the companies allocate funds to various investment projects designs to ensure profitability and growth.

2.1.1 Features of Capital Budgeting

Exchange of funds for future benefits:

The future benefits are expected to be realized over a period of time.
The funds are invested vested in long-term activities.
They have a long term and significant effect on the profitability of the concern,
They involve huge funds.

2.1.2 Importance of Capital Budgeting

Large Investment: Capital budgeting decision involves large investment of funds. But the funds available with the firm are always limited and the demand for funds far exceeds the resources. Hence it is very important for a firm to plan and control its capital expenditure.

Long Term Commitment of Funds: capital expenditures involves not only large amount of funds but also funds for long term or permanent basis. The long tern commitments of funds increases, the financial risk involved in the investment decision. Greater the risk involved, greater is need for careful planning of capital expenditure i.e. Capital Budgeting.

Irreversible Nature: The Capital expenditure decision is of irreversible nature. Once the decision for acquiring a permanent asset is taken, it becomes very difficult to dispose of these assets without incurring heavy losses.

Long term Effect on profitability: Capital budgeting decisions have a long term and significant effect on the profitability of a concern. Not only the present earnings of the firm are effected by the investments in capital asserts but also the future growth and profitability of the firm depends upon the investment decision taken today. An unwise decision may prove disastrous and fatal to the very existence of the concern.

Difficulties of investment Decisions: The long tern investment decision are difficult to be taken because decision extends to a series of years beyond the current accounting period, uncertainties of future, higher degree of risk.

National Importance: Investment decision though taken by individual concern is of national importance because it determines employment, economic activities and growth.