Capital Budgeting

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Meaning

Investment decisions are commonly known as Capital Budgeting or Capital Expenditure decisions.

The process through which different projects are evaluated is known as capital budgeting.

Capital Budgeting means planning for capital expenditure in acquisition of capital assets such as new building, new machinery or new project as a whole.

Definitions:

- "Capital budgeting consists of planning & development of available capital for the purpose of maximising the long term profitability of the concern"

  -Lynch

- "Capital budgeting is long term planning for making and financing proposed capital outlays"-

  -Charles T Horngreen.

Features

a. Potentially large anticipated benefits

b. A relatively high degree of risk

c. Relatively long time period between the initial outlay and the anticipated return

d. Current funds are exchanged for future benefits

e. High risk & uncertainty

Significance of Capital Budgeting

- The success and failure of business mainly depends on how the available resources are being utilised.
- Main tool of financial management
- All types of capital budgeting decisions are exposed to risk and uncertainty.
- They are irreversible in nature.
- Capital rationing gives sufficient scope for the financial manager to evaluate different proposals and only viable project must be taken up for investments.
- Capital budgeting offers effective control on cost of capital expenditure projects.
- It helps the management to avoid over investment and under investments.

Factors Influencing Capital Budgeting

1. Availability of funds
2. Structure of capital
3. Government policy
4. Lending policies of financial institutions
5. Immediate need of the project
6. Return on Capital
7. Economical value of the project
8. Working capital

Thank You