



A STUDY ON CAPITAL BUDGETING AT SUNDRAM CLAYTON LTD – TVS

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ABSTRACT

The project report based on the capital budgeting in SUNDRAM CLAYTON. The profile of the company given briefly is collected from the official website of the **SUNDRAM CLAYTON** & brochures and the introduction, literature review on topic capital budgeting is text based. The capital budgeting procedure at SUNDRAM CLAYTON is studied and the same is applied with respect to the **Average Rate of Return, Cash Flow, Comparative Statement, And Cash Budgeting** calculated and analyzed. Various tables and charts have been shown in order to compare the increase or decrease of profitability of the project. Capital budgeting is an extremely important aspect of a firm's financial management. Although capital asset usually comprises a smaller percentage of a firm total assets than do current assets are long term. Therefore a firm that makes a mistake in its capital budgeting process has to live with the mistake for a long period of time.

KEYWORDS:

Capital budgeting, Payback Period Method, Net present Value, Accounting Rate Of Return And Internal Rate Of Return.

INTRODUCTION:

Capital Budgeting:

Capital budgeting is a process of evaluating investments and huge expenses in order to obtain the best returns on investment. An organization is often faced with the challenges of selecting between two projects/investments or the buy vs replace decision. Ideally, an organization would like to invest in all profitable projects but due to the limitation on the availability of capital an organization has to choose between different projects/investments. Capital budgeting as a concept affects our daily lives.

OBJECTIVES

- —To study on capital budgeting with special reference to “SUNDARAM CLAYTON-LTD”.

SECONDARY OBJECTIVES:

- To find out the importance of management of capital budgeting.
- To determine the proposal and investments inflows and outflows.
- To evaluate the investment proposal by using capital budgeting techniques.
- To study the effective control of capital expenditure.

SCOPE OF THE STUDY

- This study highlights the review of capital budgeting and capital expenditure management of the company. Capital expenditure decisions require careful planning and control. Such long-term planning and control of capital expenditure is called Capital Budgeting.
- The study also helps to understand how the company estimates the future project cost. The study also helps to understand the analysis of the alternative proposals and deciding whether or not to commit funds to a particular investment proposal whose benefits are to be realized over a period of time longer than one year.
- The capital budgeting is based on some tools namely payback period, Average Rate of Return, Net Present Value, Profitability Index, and internal Rate of Return.

NEED FOR THE STUDY

- A large sum of money is involved which influences the profitability of the firm making capital [budgeting](#) an important task.
- Long term investments, once made, cannot be reversed without a significant loss of invested capital. The investment becomes sunk, and mistakes, rather than being readily rectified, must often be borne until the firm can be withdrawn through depreciation charges or liquidation. It influences the whole conduct of the business for the years to come.
- Investment decisions are the based on which the profit will be earned and probably measured through the return on the capital. A proper mix of capital investment is quite important to ensure adequate rate of return on investment, calling for the need of capital budgeting.
- The implication of long term investment decisions are more extensive than those of short run decisions because of time factor involved, capital budgeting decisions are subject to the higher degree of risk and uncertainty than short run decision.
- The investment becomes sunk, and mistakes, rather than being readily rectified, must often be borne until the firm can be withdrawn through depreciation charges or liquidation. It influences the whole conduct of the business for the years to come.
- Money decisions are the based on which the profit will be earned and probably measured through the return on the capital. A proper mix of capital investment is quite important to ensure adequate rate of return on investment, calling for the need of capital budgeting.

REVIEW OF LITERATURE:

Klammer, Thomas P. (1972) surveyed a sample of 369 firms from the 1969 Compustat listing of manufacturing firms that appeared in significant industry groups and made at least \$1 million of capital expenditures in each of the five years 1963- 1967. Respondents were asked to identify the capital budgeting techniques in use in 1959, 1964, and 1970. The results indicated an increased use of techniques that incorporated the present value (Klammer, 1984).

Fremgen James (1973) surveyed a random sample of 250 business firms that were in the 1969 edition of Dun and Bradstreet's Reference Book of Corporate Management. Questionnaire were sent to companies engaged in manufacturing, retailing, mining, transportation, land development, entertainment, public utilities and conglomerates to study the capital budgeting models used, stages of the capital budgeting process, and the methods used to adjust for risk. He found that firms considered the Internal Rate of Return model to be the most important model for decision-making. He also found that the majority of firms increased their profitability requirements to adjust for risk and considered defining a project and determining the cash flow projections as the most important and most difficult stage of the capital budgeting process.

Petty J William, Scott David P., and Bird Monroe M. (1975) examined responses from 109 controllers of 1971 Fortune 500 (by sells dollars) firms concerning the techniques their companies used to evaluate new and existing product lines. They found that Internal Rate of Return was the method preferred for evaluating all projects. Moreover, they found that present value techniques were used more frequently to evaluate new product lines than existing product lines.

Gitman Lawrence G. and John R. Forrester Jr. (1977) analyzed the responses from 110 firms who replied to their survey of the 600 companies that Forbes reported as having the greatest stock price growth over the 1971-1979 periods. The survey containing questions related to capital budgeting techniques, the division of responsibility for capital budgeting decisions, the most important and most difficult stages of capital budgeting, the cutoff rate and the methods used to assess risk. They found that the DCF techniques were the most popular methods for evaluating projects, especially the IRR. However, many firms still used the PBP method as a backup or secondary approach. The majority of the companies that responded to the survey indicated that the Finance Department was responsible for analyzing capital budgeting projects. Respondents also indicated that project definition and cash flow estimation was the most difficult and most critical stage of the capital budgeting process. The majority of the firms had a cost of capital or cutoff rate between 10 and 15%, and they most often adjusted for risk by increasing the minimum acceptable rate of return on capital projects.

Kim Suk H. and Farragher Edward (1981) surveyed the 1979 Fortune 100 CFO about their 1975 and 1979 usage of techniques for evaluating capital budgeting projects. They found that in both years, the majority of the firms relied on a DCF method (either the IRR or the NPV) as the primary method and the payback as the secondary method

Marc Ross (1986) In an in-depth study of the capital budgeting projects of 12 large manufacturing firms, he found that although techniques that incorporated discounted cash flow were used to some extent, firms relied rather heavily on the simplistic payback model, especially for smaller projects. In addition, when discounted cash flow techniques were used, they were often simplified. For example, some firms' simplifying assumptions include the use of the same economic life for all projects even though the actual lives might be different. Further, firms often did not adjust their analysis for risk. Surveys results also indicate that project approval at many firms (in eight out of twelve firms studied) follow different criteria depending on the locus of the decision.

Wong, Farragher and Leung (1987) surveyed a sample of large corporations in Hong Kong, Malaysia and Singapore in 1985. They found that PBP was the most popular primary technique for evaluating and ranking projects in Malaysia. In Hong Kong, they found PBP and ARR to be equally the most popular. They concluded that, in contrast to US companies where DCF techniques are significantly more popular than non-DCF techniques as primary evaluation measures, companies in Hong Kong, Malaysia and Singapore prefer to use several methods as primary measures in evaluating and ranking proposed investment projects. It is also observed that companies in Hong Kong, Malaysia and Singapore do not undertake much risk analysis, neither attempting to assess risk nor adjust evaluation criteria to reflect risk. The most popular risk assessment techniques were sensitivity analysis and scenario analysis (high-medium-low forecasts)

Stanley (1990) has studied capital budgeting techniques used by small business firms in the 1990s. According to Eugene Brigham, in his book 'Fundamentals of Financial Management' in the chapter —Capital Budgeting in the Small Business Firms, capital budgeting may be more important to the smaller firm than its larger

counterparts because of the lack of diversification in a smaller firm. He says that a mistake in one project may not be offset by successes in others. His intention of the study is to ascertain where small firms stand today in regard to capital budgeting techniques as opposed to prior decades. He selected 850 small firms out of which he received 232 usable responses to the study. As per his findings, a number of patterns relating to capital budgeting by smaller firms are worthy to note. The firms continue to be dependent on the payback method as the primary method of analysis. This is not necessarily evidence of a lack of sophistication, as much as it is a reflection of the financial pressures put on the small business owner by financial institutions. The question to be answered is not always how profitable the project is, but how quickly a loan can be paid back. Small business owners have increased sophistication as over 27% use discounted cash flow as the primary method of analysis. Stanley opines that their conclusions may, at times, be somewhat misleading due to an inappropriate discount rate. Small firms take risk very seriously which is reflected by a higher required rate of return for risky projects.

Jog and Srivastava (1991) provide direct empirical evidence on the capital budgeting process based upon a survey of large Canadian corporations. They explored many issues viz., the use of capital budgeting techniques, cash flow forecasting methods, risk analysis techniques and methods used to estimate the cost of capital and the cost of equity. His findings are most firms used multiple capital budgeting methods to assess capital investments; DCF methods were employed by more than 75% of our respondents to evaluate projects such as expansion-existing operations, expansion-new operations, foreign operations and leasing. It appears that the propensity to use DCF techniques increases with the complexity of the decision of the DCF methods, IRR was used more frequently than NPV in most cases, of the two rules of thumb, he observed little use of ARR. Payback is used much more frequently in conjunction with DCF methods. According to them, the use of DCF methods has become a norm in Canadian firms and that multiple evaluation criteria are being commonly used. Management's subjective estimates are used as often to generate a cash flow forecast as quantitative methods. Sensitivity analysis is the most popular technique among quantitative methods used in cash flow estimation, possibly reflecting the popularity of pc-based spreadsheet programs. The estimation of cost of capital also seems to be based more often on judgment than on any formal models. A significant number of firms use non-standard discount rates, i.e., rates other than the WACC and those using it seem to rely on judgmental or non-standard methods of estimation for their cost of equity, the standard methods being either the CAPM or the dividend growth model. Compared to previous studies, he found the usage rate for DCF methods is higher. However, the use of subjective, judgmental and nonstandard techniques in the estimation of cash flows, risk analysis and the estimation of the appropriate cost of capital continues to be high.

RESEARCH DESIGN

Research design is the arrangement of condition and analysis of data in manner that aims to combine relevance to the research purpose with the company in procedure. Research design is important primarily because of the increased complexity in the market as well as marketing approaches available in the research. A research design specifies the methods and procedures for conclusion a particular study. In simple meaning is blue print of research study.

SOURCES OF DATA:

Secondary data refers to the information or facts already collected such data are collected with the objectives of understanding the part status of any variable or the data collection and reported by some sources is accessed and used for the objective of a study. Normally in research, the scholars collect published data journals annual reports and websites.

The study has been made using secondary data which are obtained from annual reports and statements of accounts.

TOOLS FOR THE STUDY

During the course of research the researcher uses the following financial tools and statistical tool to analysis and interprets the data.

TOOLS:

- Cash flow statement
- ARR (Average Rate of Return)
- Comparative Statement
- Cash Budget.

Cash Flows from Operations = Net income + Noncash Expenses + Changes in Working Capital

ARR = $\frac{\text{Average Accounting Profit}}{\text{Average Investment}}$

SHOWING CASH FLOW STATEMENT (2022-2023)

PARTICULARS	Year Ended		Year ended	
		31.03.2022		31.03.2023
(A) CASH FLOW FROM OPERATING ACTIVITIES				
Net profit before tax		0.84		119.67
Add: Depreciation and amortisation for the year	73.2		60.7	
Provision for employee benefits	1		6	
	2.46		1.34	
Exceptional Income	-		-	
Loss on sale/scraping of property, plant and equipment	-		2.28	
	0.15		0.89	
Profit on sale of property, plant and equipment	-0.14		-	
Unrealised exchange (gain) / loss	0.7		0.68	
	-91.0		-	
Dividend income	4		4	
Interest income	-1.96		-	
Fair value of financial assets & financial liabilities	-1.64		1.26	
Interest expense	33.4		27.8	
	3		4	
		15.17		14.31
Operating profit before working capital changes		16.01		133.98
Adjustments for:				
Inventories	-126.18		1.1	
Trade Receivables	-117.47		17.1	
Other financial assets	-2.94		3	
Other non-current assets	-2.61		8.57	
			-	
			0.46	

Other current assets	- 24.35		- 9.29	
Trade Payables	199.52		25.51	
Other financial liabilities (excluding current maturities of debt)	-1.92		5.01	
Other current liabilities	3.72		-	

			1.93	
		-72.23		45.64
Cash generated from operations		-56.22		179.62
Direct taxes paid		-3.27		-10.58
Net cash from operating activities (A)		-59.49		169.04

(B) CASH FLOW FROM INVESTING ACTIVITIES

Additions to property, plant and equipment (including Capital work in progress)		-260.81		-128.47
Sale of property, plant and equipment		19.15		5.55
(Purchase) / Sale of investments		-38.96		-9.45
Interest received		1.96		1.26
Dividend received		91.04		69.24
Net Cash from/(used in) investing activities (B)		-187.62		-61.87

(C) CASH FLOW FROM FINANCING ACTIVITIES

	Year ended	Year ended
	31.03.2018	31.03.2017
Net Borrowings:		
Term loans availed / (repaid)	152.08	15.37
Short term borrowings availed / (repaid)	36.03	-30.65
Interest paid	-33.43	-27.84
Dividend and dividend tax paid	-30.35	-64.13
Net cash from financing activities (C)	124.33	-107.25

(D) NET INCREASE/(DECREASE) IN CASH AND CASH EQUIVALENTS (A+B+C).

Cash and cash equivalents at the beginning of the year				
Cash and Bank balances	1.61		1.35	
Cash credit balance	- 66.76	- 65.15	- 66.42	- 65.07
Cash and cash equivalents at the end of the year				
Cash and Bank balances	1.95		1.61	
Cash credit balance	- 189.88	- 187.93	- 66.76	- 65.15

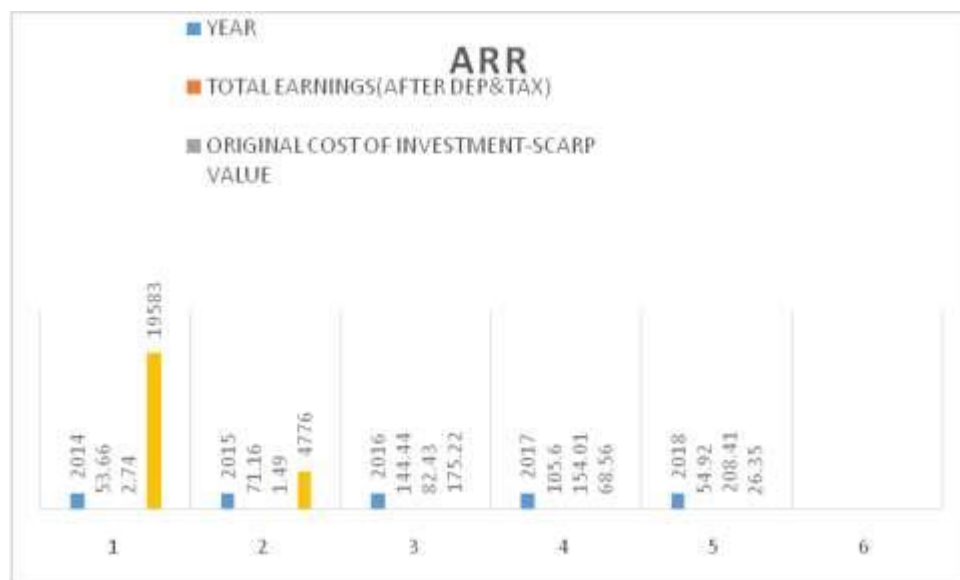
INFERENCE:

From the above cash flow statement, it shows the value in the year 2022, -187.93 and in the year 2023, the value was -66.15. When compared to previous year the current year value increased by -187.93

SHOWING AVERAGE RATE RETURN OF (ARR)

YEAR	TOTAL EARNINGS (AFTER DEP&TAX)	ORIGINAL COST OF INVESTMENT-SCARP VALUE	ARR
2019	53.66	2.74	19583
2020	71.16	1.49	4776
2021	144.44	82.43	175.22
2022	105.6	154.01	68.56
2023	54.92	208.41	26.35

SHOWING AVERAGE RATE OF RETURN (ARR)



INFERENCE:

From the above table, it is inferred that the Average rate of return in the year 2018 the value is 26.35, in 2017 the value is 68.56, in 2016 the value is 175.22, in 2015 the value is 4776 and in 2004 the value is 19853 and ARR value is decreased in the current year when compared to previous year.

SHOWING COMPARATIVE STATEMENT (2022-2023)

PARTICULARS	2022	2023	AMOUNT	PERCENTAGE
Net sales	1517.2	1589.7	-72.5	-4.778539415
Less: Cost of goods sold	1414.8	1515.4	-100.6	-7.11054566
GROSS PROFIT (A)	102.4	74.3	28.1	27.44140625
OPERATING EXPENSES				
Administration	0.06	1472.8	-1472.74	-2454566.667
Selling	29.75	0.028	29.722	99.90588235
TOTAL OPERATING EXPENSES (B)	29.81	1473.08	-1443.27	-4841.563234
OPERATING PROFIT (A-B=C)	72.59	-1398.78	1471.37	2026.959636
NON OPERATING EXPENSES				
Interest	36.32	28.6	7.72	21.25550661
Income tax	5.83	6.53	-0.7	-12.00686106
TOTAL NON OPERATING EXPENSES(D)	42.15	35.13	7.02	16.65480427
NET PROFIT (C-D)	30.44	-1433.91	1464.35	4810.611038

INFERENCE:

From the above comparative statement, it shows the value in the year of 2016, (30.44) and in the year of 2017, the value was (1433.91). When compared to previous year 2017, the current year value was increased by (1433.91).

SHOWING CASH BUDGETING (2019-2023)

PARTICULARS	2019	2020	2021	2022	2023
Opening balance of cash	5.42	2.1	139.85	65.07	1.16
ADD RECEIPT OF CASH					
Cash sales	1245.1	1376	1527.94	1515.35	1672.29
Cash from debtors	203	220	607.63	622.83	278.07
Total Receipts (A)	1453.52	1598.1	2275.42	2203.25	1951.52
Payment					
Creditors for purchase	455	476	66.42	66.76	305
Wages Current	124	148	166.73	173.21	1404.47
Arrears	0	0	0	0	0
Sundry expenses	1178	1320	13086.3	14195	2880.46
Income tax	53.66	71.16	472.4	547	46.96
Dividend	122.15	149	1.17	1.42	30.35
Total payments (B)	1932.81	2164.16	13793.1	14983.5	4667.24
Closing balance of cash (A-B)	3386.33	3762.26	-11518	-12780	-2715.7

INFERENCE:

From the above table, it is inferred that the Cash Budgeting in the year 2018 the value is -2715.7, in 2017 the value is -12780, in 2016 the value is -11518, in 2015 the value is 3762.26 and in 2014 the value is 3386.33 and Cash Budget is decreased in the current year when compared to previous year.

FINDINGS

- It is found that the value in the year 2020, -187.93 and in the year 2019, the value was -66.15. When compared to previous year the current year value increased by -187.93.
- It is found that the value in the year 2020, -63.81 and in the year 2021, the value was -138.61. When compared to previous year the current year value decreased by -63.81.
- It is found that the value in the year 2019, -120.62 and in the year 2020, the value was -208.95. When compared to previous year the current year value decreased by -120.62.
- It is found that the Average rate of return in the year 2018 the value is 26.35, in 2022 the value is 68.56, in 2016 the value is 175.22, in 2019 the value is 4776 and in 2004 the value is 19853 and ARR value is decreased in the current year when compared to previous year.
- It is found that the value in the year of 2019, -147.49 and in the year of 2015, the value was -148.10. When compared to previous year 2022, the current year value was increased by -148.10.
- It is found that the value in the year of 2020, (2544.10) and in the year of 2021, the value was (30.44). When compared to previous year 2022, the current year value was decreased by (30.44).
- It is found that the value in the year of 2021, (30.44) and in the year of 2022, the value was (1433.91). When compared to previous year 2022, the current year value was increased by (1433.91).
- It is found that the value in the year of 2022, (-1433.91) and in the year of 2023, the value is (-1752.16). When compared to previous year 2023, the current year value was increased by (-1752.16).
- It is found that the Cash Budgeting in the year 2018 the value is -2715.7, in 2022 the value is -12780, in 2021 the value is -11518, in 2020 the value is 3762.26 and in 2019 the value is 3386.33 and Cash Budget is decreased in the current year when compared to previous year.

SUGGESTIONS

- The company may fix the time period for the capital budgeting for replacement.
- The company may effectively use the available resources for attaining maximum profit.
- The company has to analyze the proposal for expansion or creating additional capacity.
- The company may plan and control its capital budgeting.
- The company has to ensure that the funds must be invested in long term project or not.
- The company may evaluate the estimation of cost and benefit in terms of cash flows.

LIMITATIONS OF THIS STUDY

- Capital budgeting decisions are for long-term and are majorly irreversible in nature.
- Most of the times, these techniques are based on the estimations and assumptions as the future would always remain uncertain.
- Capital budgeting still remains introspective as the risk factor and the discounting factor remains subjective to the manager 's perception.

A wrong capital budgeting decision taken can affect the long-term durability of the company and hence it needs to be done judiciously by professionals who understands the project well.

CONCLUSION

In the present study I have analyzed the Capital Budgeting of Sundaram Clayton-Ltd. The study involves practical and conceptual over view of decision concerning the capital budgeting based on cash flow statement, Average rate of return and comparative statement of Sundaram Clayton Ltd. And complete synchronization and co-ordination among the capital budgeting components which shall contribute to optimum level of operation in a Sundram Clayton-Ltd.

The capital budgeting limits would be considered only after the project nearing completion and after ensuring control over the financial analysis. The capital budgeting is a great Sundaram Clayton Ltd and it needs proper procurement.

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