Corporate Practices on Capital Investment Decision Analysis: Their Contribution to Maximizing Company's Value

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Abstract

This study aimed to examine the practices on capital investment decision analysis and sought to determine whether capital investment decision analysis as a company practice has contributed to the improvement of shareholder's value of selected corporations in Region 12. Frequency and percentages were used to analyze data on profile. Mean and standard deviation were used in the analysis of the extent of companies' practice on capital investment decision analysis and on the variables affecting capital investment decision making of companies and the contribution of the practices to company's sales, net profit, and shareholder's dividend. ANOVA and Pearson r were used in analyzing significant difference in the practice among industries and the significant association in the practice and companies' years in corporation. Corporations in Region 12 practiced capital investment decision analysis/capital budgeting. Some companies followed the models specified in accounting text and some did not follow the models suggested by authorities but formulated their own processes. Companies ensured that proposals that were selected met the standards. In evaluating the investment the proposals, they relied more on and based their decision on qualitative factors. Although there were industries that were not benefited much by the practice on capital investment decision analysis, results show that on the average the practice had positive influence on company's sales and profit and on the dividend received by the shareholders indicating enhanced company value. Corporate capital investment decision analysis or capital budgeting along the processes of generation of investment opportunities, project analysis and approval, implementation, monitoring and controlling, and post-implementation audit should be done and implemented by corporations for it can improve the company's value.

Keywords: Capital budgeting, capital investment decision analysis, capital investment practices

Introduction

The process of making decisions about capital investments is called capital budgeting or capital investment decision analysis (CIDA). Capital investment may answer the company's need to install new equipment for the new system, putting up new building or new factory, expansion of production or marketing facilities or acquiring a new company (Dayanada, Harrison, Herbohn, & Rowland, 2002). Capital investment decision analysis is considered as one of the most crucial decisions facing management of corporations and these decisions according to Blocher, Stort, Colsing and Chen (2008) are of strategic concern to organization and affect financial results (returns) of organizations in the future. The capital investment decision is one of the most crucial decisions facing management due to the following reasons (Rachlin & Sweeney, 1993; Dayanada et al., 2002): First, capital investments are generally irreversible, and any mistakes made in the decision process can be very costly on the company. Second, the decision requires substantial financial resources because of the large amount usually connected with capital investments. Finally, it affects the organization's performance over a long period of time because capital budgeting places amounts of resources at risk for a long period and simultaneously affect the future development of the firm. Jain, Peyrard and Yadav (1999) even mentioned that success or failure of the company may depend upon a single or relatively few investment decisions, that is why it requires penetrating analysis and attention by top management. It is needless to mention that incorrect investment decisions can be disastrous because of the inherent threats of endangering the survival even of the well-run large enterprises. A few wrong decisions will be enough recipes for their liquidation or bankruptcy. In contrast, correct and sound investment decisions can fetch spectacular returns and thus can be instrumental in changing the fortunes of even the weak and marginal firms. In short, right capital investment decision is absolutely essential for long-term survival.

Are firms in Region 12 giving importance to this capital investment decision analysis? Do they have their own models or do they follow the same models as suggested by several literatures? Finally, do capital investment decision analysis practices increase company's value in terms of sales, profit and dividend? These are the decisions that need to be answered; thus this study.

Theoretical Background of the Study

Capital investment decisions focus on when and how much to spend on capital facilities. The capital investment decision-making process, often referred to as capital budgeting, consists of identifying the need, preparing reports for management, choosing the best alternative and dividing funds among the competing resource needs (Crosson et al., 2008).

The capital investment decision cycle begins when the need for a facility is identified. A proposal or request is then prepared and analyzed before being subjected to one or two screening processes, depending on the size of the organization. Based on various evaluation methods, the proposal is determined to be either acceptable or unacceptable. If acceptable, the proposal is ranked with all other acceptable proposals. Total pesos available for capital investment are used to determine which of the ranked proposals will be authorized and implemented. The final step is a post-completion audit to determine the accuracy of the forecasted data used in the decision cycle and to find out if some of the projections need correction.

The capital investment decision cycles are vital to the management of an organization. By making correct decisions about capital investments, managers provide for the continued existence of their organization. A series of incorrect decisions about capital investments could cause an organization to fail. The crucial role of the manager is to identify and explain capital investment needs and provides information to arrive at sound capital investment decisions.

Objectives

The study aimed to examine the practices on capital investment decision analysis of selected corporations in Region 12 particularly on the processes of generation of investment opportunities, analysis of project proposals, implementation, monitoring and controlling and in the conduct of the post-implementation audit. Furthermore, it sought to determine whether capital investment decision analysis as a company practice has contributed to the improvement of shareholders' value.

Specifically, the research addressed the following questions:

1. To what extent do companies practice capital investment decision analysis with respect to:
   a. Generation of Investment Opportunities
   b. Project Analysis and Approval
   c. Implementation, Monitoring, and Controlling, and
   d. Post Implementation Audit?
2. Is there a significant difference in the practice of capital investment decision analysis among industries?
3. Is there a significant association in the practice of capital investment decision analysis and the companies' years in operation?
4. What variables influence the capital investment decision making of companies?
5. What is the contribution of the practice to the company's sales, net profit, and shareholder's dividend?

Methodology

The research is descriptive in that it describes the existing company practice on capital investment decision analysis. It is also correlational because the significant differences and significant association between the practices of capital investment

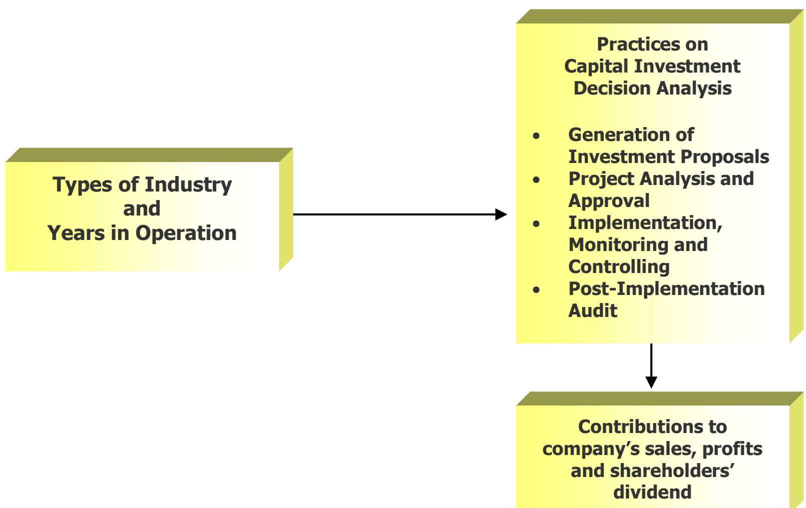

Figure 1. The Schematic Diagram of the Conceptual Framework of the Study

decision analysis and the nature of companies and years in operation were determined.

The method of collecting data was through a survey using a validated survey questionnaire which was personally distributed and collected by the researcher and answered by the company administrators of 46 corporations in Region 12, who were involved or familiar with CIDA processes. The validation was done by presenting the papers to three experts, and the comments were consolidated and incorporated into it.

The study used a self-made four-block survey-questionnaire. The first part was designed to draw out the personal circumstance of the respondent where respondent's designation, educational attainment, length of service and trainings on capital budgeting were asked. It also asked the respondent to indicate how long the company is in operation, type of industry, CIDA model used, and the reason for not adopting any of the models. The second block dealt on the practice of capital investment decision analysis among corporations particularly finding investment opportunities, project analysis and approval, implementation, monitoring and controlling, and post-implementation audit. The third block listed the variables that might have affected corporate capital investment decision making. The last determined the contribution of CIDA on company's sales, profit, and dividend of the shareholders.

ANOVA and Pearson r were used to determine the significant difference in the practice among industries and to indicate significant association in the practice and companies' years in operation, respectively. Mean was used to determine the contribution of capital investment decision practice to sales, profit and the dividend.

Findings

Based on the results of the study undertaken, the following findings are arrived at:

Profile of the Respondents

The respondents were composed of chief executive officer, general manager, vice presidents (63%), accounting head, accountant and accounting staff, accounting information administrator (15%), administrative, marketing, personnel, account receivable and finance officers (15%), and finally, assistant manager, sales executives and senior personnel banker (7%). The nature of business engaged by the respondents' companies were as follows: companies were from agriculture, fishing, mining, and forestry; banking services; communication; construction; consultancy; electricity, gas and power; hospital; hotels and restaurants; lending; manufacturing, and wholesale and retail services. Almost all of the respondents' companies have been operating for more than five years. Out of 46 companies, only 30 percent practiced the capital investment decision analysis for less than five years, and the remaining 70 percent practiced it for more than five years. This is an indication that more companies in Region 12 have seen the value of practicing CIDA. Results show that 11 companies followed Model A; five companies, Model 5; three for both Model C and E. Reasons mentioned for not adopting any models were as follows: suggested models were too detailed, not practical, time consuming, not one of the models works for their company, and suggested models were expensive to follow.

Corporate Practice on Capital Investment Decision Analysis

Generation of Investment Opportunities. All six conditions cited by the study in terms of identifying investment opportunities are all practiced by the company respondents at a varying degree. These findings support the observation of Gitman (2000) that most of the companies use formal mechanism to assure that the best of the proposed investments are evaluated, selected, and implemented.

Project Analysis and Approval. Conditions that are given importance and extensively practiced are as follows: careful scrutiny of proposals requiring large capital outlays, and consideration of how proposals contribute to company's objective. Results further indicate that proposal goes through a preliminary screening because the company respondents ensure that proposals should first satisfy the company standards. These findings support the observation of Needles (1999) that many investments cannot go through the rigorous project analysis process. The identified investment opportunities have to be subjected to a preliminary screening process by management to isolate the marginal and unsound proposals. The methods used in the project evaluation are both quantitative and qualitative. The quantitative method in analyzing and screening proposal is used but not as extensive as the qualitative method. Of those methods cited, analyzing using profitability index and payback period seemed to be popular to the companies than the other methods. This finding is not consistent with the idea of Horngreen, Datar and George (2006) who stated that when different methods lead to ranking the projects, finance theory suggests that more weight be given to NPV method. That is because the assumptions made by the NPV method are most consistent with making decisions that maximize the company's value.

Implementation, Monitoring and Control. Results reveal that during implementation of the projects, corporation in Region 12 monitored their projects constantly, then made adjustments as the need arises by cutting costs, improved benefits or possibly terminated the project if the actual deviates from the original plan and CEOs and implementers were made to explain the causes of the problem. The results are consistent with the views of Needles et al. (1999), Gitman (1999), and Cabrera (2000) who stated that an integral part of the project implementation is the constant monitoring of project progress with a view of identifying potential bottlenecks, thus allowing early intervention and taking corrective actions when needed.

Post Implementation Audit. Corporations used similar techniques in the project acceptance and in comparing the actual with the expected results, and if there were major variances project implementers were requested to explain. The results are consistent with the views of Brewer, Garrison, and Noreen (2005) who advised that the same technique should be used in the post audit as used in the original approval process.

Differences in the Practice of Capital Investment Decision Analysis among Industries

The result of ANOVA shows that there is no significant difference in the practice of capital investment decision analysis among industries. Therefore, there are no significant differences in the practice of capital investment decision analysis when these corporations are classified into nature of business/by industry.

Association between the Practice of Capital Investment Decision Analysis and the Company's Years in Operation

The corporations identified in Region 12 have been in operation for many years. It is interesting to determine if there is association between the practice of capital investment decision analysis and companies' years in operation. There is no significant association in the practice of corporate capital investment decision analysis and the companies' years in operation using Pearson r.

Variables Influencing the Capital Investment Decision Making

All variables cited high degree of influence on the corporate practice of capital investment decision analysis. Specifically, consideration of the proposal's contribution to the achievement of the corporate goals and direction highly influence the decision making of the administration indicating that the proposals with major contributions might be formed by decision makers. This supports the theories of Dayanada et al. (2002) that all activities should be anchored on the goal of the corporation.

Contribution of CIDA to the Wealth of the Corporation in Terms of Sales, Profit, and Dividend

In terms of contribution to sales, profit, and dividend, the practice of capital investment decision analysis has benefited much the companies engaged in wholesale and retail and those in the banking services but not much for those engaged in construction.

Conclusions

Based on the findings of the study, it can be concluded that corporations in Region 12 practice capital investment decision analysis or capital budgeting. Some companies follow the models specified in the accounting text. The result of ANOVA shows that there is no significant difference in the practice of capital investment decision analysis among industries. Therefore, there are no significant differences in the practice of capital investment decision analysis when these corporations are classified into nature of business/by industry.

The corporations identified in Region 12 have been in operation for many years. It is interesting to determine if there is association between the practice of capital investment decision analysis and companies years in operation. There is no significant association in the practice of corporate capital investment decision analysis and the companies' years in operation. Although there are industries that are not benefited much by the practice on capital investment decision analysis, results show that on the average the practice has a positive influence on company's sales and profit and on the dividend received by the shareholders which is an indication of enhanced company value.

Corporate capital investment decision analysis or capital budgeting along the processes of generation of investment opportunities, project analysis and approval, implementation, monitoring and controlling and post-implementation audit should be done and implemented by corporations, for it can improve the company value. The study may be replicated. Recommendations for further study are correlation study on the capital investment decision analysis model use and the increase of company value and impact of CIDA practice on employees' attitude and quality of work.

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