International Journal of Advanced Information Science and Technology (IJAIST) ISSN: 2319:2682
Vol.6, No.7, July 2017 DOI:10.15693/ijaist/2017.v6i11.620-623

The Effect of Capital Budgeting Techniques in Aurobindo Pharma Limited

[1]M.Nikhitha, [2]Neeraja
[1]Research scholar, [2] Assistant. Professor
[1,2]Malla Reddy Engineering College (A), Maisammaguda, Dhulapally, Secunderabad

.

Abstract:

Capital budgeting techniques play key role in decision making process as it represents the major commitments of company's resources and have serious consequences on the profitability and financial stability. The main aim of capital budgeting investments is to increase the value of firm to the investors. It helps the firm decides which long term investments to make. The decision to accept/reject a capital budgeting project depends on analysis of cash flows generated by project and its cost. This process involves planning, availability and controlling allocation and expenditure of long term investment funds. In view of this, this study has made an attempt to analyse the efficiency of pharma sectors capital budgeting through their financial statements.

Keywords: Capital budgeting, depreciation, investments, profit, sales

1. INTRODUCTION

The Indian pharmaceutical industry is a success story providing employment for millions and ensuring that essential at drugs at affordable prices is available to the vast population. This industry today is in the format rank of Indians science-based industries with the wide ranging in the complex field of drug manufacturing and technology. It is playing a key role in promoting and sustaining development in the vital field of medicines. Many international companies associated with this sector have stimulated.

DEFINITION:

"Capital Budgeting is a long-term planning to making financing proposed capitals outlays".In other words of Lynch, "Capital Budgeting is concerned with planning and development of available capital for the purpose of the concern".

Capital Budgeting=Investment in long term assets

Capital=Fixed assets used in production.

Budgeting =Plan of in and out-flows during some period.

Capital Budget =A list of planned investment outlays for different project.

Capital Budgeting =Process of selecting viable investment projects.

OBJECTIVES:

The primary objectives of this study are

1. The objective of this paper is to evaluate the investment decisions in the company either to be taken or not.

2. To analyse the projects with the use of capital budgeting techniques of the selected pharma industries.

2. RESEARCH METHODOLOGY

The present study has been conducted to know the capital budgeting techniques which are used in the pharma industries to make appropriate decisions of the investments before investing into the projects these techniques helps for evaluation of the projects.

The data collection methods in 2 types
1) Primary collection method.
2) Secondary collection method.
Primary collection method:
This method includes the data collection from the personal discussion with the authorized
Clerks and members of the aurobindo pharma limited.
Secondary collection method:
The secondary collection methods include the lectures of the superintend of the department of Market operations and so on. Also, the data collected from the news, magazines and different Books issues of this study superintend

3. REVIEW OF LITERATURE:

Bierman (1993): finds that 73 of 74 Fortune 100 firms use discounted cash flow (DCF) analysis, with internal rate of return (IRR) being preferred over net present value(NPV). The pay back period method also remains a very popular method in practice, though not as a primary technique. 93 per cent of the respondents

Use company-wide WACC for discounting free cash flows and 72 per cent use the discount rate applicable to project based on its risk characteristics.

Drury, Braund and Tayles' (1993): survey of 300 manufacturing companies with annual sales exceeding £20 million indicates that payback (86%) and IRR (80%) are the most widely used project appraisal methodologies. The most widely used project risk analysis technique is sensitivity analysis. Forty-nine per cent of the respondents do not use Statistical analysis for risk analysis and 95 per cent of the respondents never use either CAPM or Monte Carlo simulation due to lack of understanding.

Petry and Sprow's (1993) :study of151 firms listed in the 1990 Business Week1,000 firms indicates that about 60 per cent of the firms use the traditional payback period either as a primary or as a secondary method for capital budgeting decisions. Ninety per cent of the firms use NPV and IRR either as a primary or as a secondary capital budgeting decision methodology. Most of the financial managers indicated that either they had not heard of the problems of IRR (multiple rates of return, NPV and IRR conflict) or such problems rarely occurred.

Truong G., Partington and Peat M. (2006) :surveyed Australian firms which revealed that real options techniques have gained a toehold in Australian capital budgeting but are not yet part of the mainstream. Projects are usually be evaluated using NPV, but the company is likely to also use other techniques such as the PBP. The project cash flow projections are made from three to ten years into the future. The project cash flow will be discounted at the WACC as computed by the company, and most companies will use the same discount rate across divisions. The discount rate will also be assumed constant for the life of the project. The WACC will be based on target weights for debt and equity. The CAPM will be used in estimating the cost of capital, with the T-bond used as a proxy for the risk free rate, the beta estimate will be obtained from public sources, and the market risk premium will be in the range of 6% to 8%. Asset pricing models other than the CAPM will not be used in estimating the cost of capital. However, consistent with recent overseas studies, Graham and Harvey (2001) and Bruner, et. Al. (1998) the CAPM is the most popular method used in estimating the cost of capital in Australia. Kester et al (1999) found that 73% of companies surveyed in six Asia Pacific countries, used CAPM. Compared to two previous surveys of US companies, Gitman and Mercurio (1982) and Gitman and Vandenberg (2000), increasing popularity of the CAPM model is apparent.

Lord Beverley R. and Boyd Jennifer R. (2004): surveyed half of the New Zealand local authorities to find out how they undertook capital budgeting. This study was later extended to all New Zealand local authorities. Results of the two surveys show that 75% of local authorities use cost-benefit analysis and NPV in financially evaluating capital investments. However, compared to studies of the private sector, there is a greater focus on qualitative aspects of decision-making. Post-audits were also highly used, but with a focus on quantitative information.

HYPOTHESIS FORMULATION:

Having identified the objectives of this study, the following hypotheses have been formulated and tested during the period of study:

H_0_ There is no significance difference beetween fixed investments and the selected internal factors (sales, profits, depreciation) is not significant.

Data collection methods:

1) Primary collection method:

This method includes the data collection from the personal discussion with the authorized clerks and members of the Aurobindo pharma limited.

2) Secondary collection method:

The secondary collection methods include the lectures of the superintend of the department of market operations and so on. Also, the data collected from the news, magazines and different books issues of this study superintend.

4. DATA ANALYSIS:

Fixed investment Analysis Statement: During the study period, the purpose of investments of this company is for capacity expansion/up-gradation and R&D. We observe that out of 5 years, investments have been financed by internal sources for 5 years. Besides the internal sources, this company have also raised funds from external sources to finance their additional fixed investments during 2013-2017

Trends in Fixed Investment: In order to discover the fixed investment trend of this company, the rate of increase in fixed assets during the year has been computed. In the process of classification, these rates are classified into two categories by taking normal business practices into consideration and the findings of empirical analysis.

Regular/routine Investments:

Company invests less than 10 per cent of investments as regular/routine investments for maintenance and replacements and

B. Growth / expansion oriented Investments:

Company invests more than 10 percent consider as growth and expansion.

Fixed Investment table

Table1

Year	Fixed Assets Beginning	Assets Increase During The Year	% Of Increase	Classification
2013	7531.64	828.4804	9.0909	R
2014	7,709.91	848.0901	9.4549	R
2015	8,890.4	977.944	10.654	G
2016	8999.56	989.9516	11.4532	G
2017	9321.45	1025.3595	11.596	G

As we can see form the table 1, the annual rate of growth in fixed statements and their classification. In the year2013-17 the investments represents routine investments category for normal maintenance and replacements whereas the rest of the years reliable to growth and expansion. The amount of incremental investments increased its height in 2017 with Rs9321.45crs. The highest rate of growth is found in the same year with 11.596 per cent. Overall trend of fixed investments during the study period is found to be increasing with an annual average investment.

Accountable Factors for Fixed Investment: The purpose of Investments differs one to another firm. For example, the purpose of expansion is to meet the growing demand for products; the purpose of modernisation helps to reduce the cost through new production processes; and diversification helps to additions to existing product line. All these forms help to increase the sales, in turn to increase profits of the company's overall. In this study, we have tried to correlate each internal factors such as sales, profit and depreciation charges with fixed investments.

Fixed Investments and sales: Trends of fixed investments and the sales show the same trend but the per cent of changes are vary during the study period.

The coefficient of correlation between sales and fixed investments is found to be 0.765 (see table 3) which is statistically significant at 5 per cent level of significance, suggesting that the relationship between the variables is moderate. Capital budgeting decisions may increase the sales through increased production, and promotion programmes provides the demand for the product goes up in the market. This has been proved by this company as it occupies the good position in the market. From the analysis, the fixed investments and sales have the close and direct relationship between each other.

b. Fixed investments and profit: As we mentioned above, increase in fixed investment is to enhance the earning capacity of the company. It is clear from the table 3 where we can find a shift from loss into profit. There are number of fluctuations with substantially high and low levels of the fixed investments and profits during the study period. The coefficient of correlation between profits and fixed investments is found to be 0.393(see table 3) which is statistically significant at 5 per cent level of significance, indicating poor association between the variables. This is mainly due to inefficient utilisation of fixed investments. Hence the management has to improve its utilisation of fixed assets

Statement of Descriptive Statistics & Selected variables

Table2:

Year	Investments	Sales	Profit	Depreciation
2013	1125.9	45405.56	1082.2	2005.3
2014	1920.5	57831.2	3741.0	2487.4
2015	1025.9	80384.8	15325.2	3125.3
2016	2356.8	120432.3	21678.6	3326.1
2017	3925.65	136506.1	27224.6	3926.3
TOTAL	10354.75	440560	69051.6	14870.4
MEAN	2070.95	88111.99	13810.32	2974.08
SD	1175.745	39328.96	11264.37	746.4752

c. Fixed investments and depreciation charges: This is another important internal factor considered to be associated with fixed investments. In our study, we found that very poor relationship between the variables (0.607) and this coefficient is statistically insignificant at 5 per cent level of significance. Normally, more the investments in fixed assets, the higher will be the depreciation charges which help the company for additional investments in fixed assets. An appropriate method of depreciation on fixed assets not only helps the company to retain the profits and for a proper tax planning. But this company's utilisation is very poor.

Simple correlation analysis

FIG (3)

Variables between	corralation®	t value for r	table value @5%	D.F	RESULTS
INVESTMENTS &SALES	0.821709277	-5.0143394	2.776	4	Ho rejected
INVESTMENTS &PROFIT	0.737863449	-2.517488	2.776	4	Ho rejected
INVESTMENTS & DEP	0.768357767	-2.627152206	2.776	4	Ho Accepted

5. FINDINGS:

The incremental investments in fixed investments show an increasing trend during the study period with an average of Rs. 2070.95 crs and standard deviations of Rs. 1175.745. However the investments are not uniform throughout the study period. In this study, we found that the coefficient of correlation between incremental fixed assets and sales to be positive and significant. Similarly, the coefficient of correlation between fixed investments and profit have the moderate relationship and statistically significant. However, the relationship between the fixed investments and depreciation have the poor relationship and statistically insignificant. About, the sources of funds towards the fixed investments for this company are internal sources. In order to maintain the market position with its products, every company must produce product as good as, or better than its competitors. This leads to fixed investments decisions which can be classified into two: routine and expansion. Every company has to make routine
investments continuously whereas growth investments are made intermittently.

6. CONCLUSION:

The basic challenging task of fixed investment decisions lies in the search for lucrative opportunities and to derive the benefits in the uncertainty environment in quantitative terms. From the empirical Analysis, this company's fixed investments decisions are wise and shows better fund management.

REFERENCES:

1) Bierman H J (1993), Capital Budgeting in 1992:A Survey, Financial Management, Vol.22,p.24
2) Drury C,Braund S and Tayles M (1993), A survey of Management Accounting Practices in UK Manufacturing Companies, ACCA Research Paper 32, Chartered Association of Certified Accountants.
3) Petry Glenn H and Sprow James (1993), The Theory of Finance in 1990s, The Quarterly Review of Economics and Finance, pp 359-381
4) Truong G., Partington and Peat M. (2006), " Cost of Capital Estimation and Capital Budgeting practice in Australia,"
5) Lord Beverley R. and Boyd Jennifer R.; Capital Budgeting in New Zealand Local Authorities: An Examination of Practice, Accepted for Presentation at the Fourth Asia Pacific Interdisciplinary Research in Accounting conference, 4 to 6July 2004, Singapore, www.smu.edu.sg/events/apira/2004/Final Papers/1176-Lord.pdf.