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An Analysis of Capital Budgeting Practices in Textile Industry

K. Malarkodi[1], A. Anisha[2]

[1]Assistant Professor, Department of Management Studies, M. Kumarasamy College of Engineering, Karur.
E-mail: malarmkce@gmail.com

[2]II-MBA, Department of Management Studies, M. Kumarasamy College of Engineering, Karur.
E-mail: anishaanish7686@gmail.com

ABSTRACT

The purpose of this research is to evaluate the capital budgeting practises used by small, medium, and large-scale organisations in the textile sector of the Indian industry. Organizations are still working to understand appropriate capital budgeting techniques. The methods of investigation used to evaluate the projects. The goal of this study is to observe the company's forecasting decisions using the capital budgeting method, as well as the importance of capital budgeting in an organisation, and to analyse the capital budgeting method to be used by the concern in order to make better investment decision for different industry project.

KEYWORDS

Capital Budgeting, Trend Analysis, Ratio Analysis, Capital Decision, Techniques.

Introduction

As we all know, finance is the lifeblood of any business. The firms have invested in long-term assets in anticipation of a stream of benefits over the capital asset's lifetime. Various capital budgeting techniques or methods are available for evaluating these investments or projects. Long-term capital investments have emerged as a critical issue in today's competitive business environment. Organizations are attempting to determine which capital budgeting techniques are appropriate for their survival. Capital budgeting is more important because the decisions made affect the Organization's direction and opportunity, as well as its future growth. Capital budgeting is the process in a business makes a decision whether or not to make long-term investments. Capital Budgeting project, or prospective long-term investments, is accepted to produce cash flows over time. The decision to accept or reject the Capital budgeting project is based on an analysis of the project's cash flows and costs. Plan on raise huge and long-term sum for long-term asset in plant and equipment more than the longer point of time. The time is then measured in the context of an operating budget. Capital budgets are created using procedure such as Internal Rate of Return (IRR), Net Present Value(NPV), and Pay Back Period (PBP). The capital budget is a set of steps taken to justify the decision to purchase an asset, which typically includes an analysis of the costs, associated benefits, and impact on capacity levels of the prospective purchase.

Scope of the Study

The primary goal of the research is to determine the analysis of various sectors in Capital Budgeting. This study provides insight into the spinning mill's capital budgeting.

Need of the Study

The study's aim is to analyze the most profitable capital budgeting in KKP Spinning Mill Pvt Ltd. The profitability of a business is influenced by the extent of investment made over a long period of time.

Objectives of the Study

An Analysis of Capital Budgeting Practices in Textile Industry.

Secondary

- Determine the factor affect the use of capital budgeting.
- Evaluate the efficiency of capital budgeting procedure in each department.

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- To investigate differences in capital budgeting techniques across industries/sectors in selected units.
- Assessment of proposed capital expenditures.
- Determine the most profitable capital expenditure.

Review of Literature

Gupta and Pradhan (2017) conduct study on capital budgeting decision in India. The study was carrying out on both manufacturing as well as non-manufacturing firm. A questionnaire was distributed to a sample of 250 businesses, only 75 responded. The findings revealed that the discounted procedure are used in the majority of those companies when the social return and accounting are considered as determining project's speed of the return. The findings show that the both manufacturing and non-manufacturing sectors in India use a consistent approach to capital budgeting decisions.

D Jin Yuc (2017) This Spinning mill investigates the outcome of income management on financial control and the relationship is influenced by the institutional situation using a huge panel of 25,777 firm, from 37 countries from 1989 to 2009. To discover that the firms with high earnings management activities (Spinning mill industries) are associated with high financial leverage. More importantly, strong institutional environments dampen this positive relationship. Our findings provide strong support for the notions that(1) Both corporate debt and institutional environments can be used as external control mechanisms to reduce the agency cost of free cash flow; and (2) relying on institutional environments is more cost-effective than debt. Our main conclusions have been confirmed after meticulously addressing potential issues and conducting various robustness tests.

Zhaojun Yang (2018) Investigate the relationships of savings and financial policy in a self-motivated model for a firm with obtainable assets and development opportunity, everywhere the savings costs are finance with equity and contingent convertible bonds (Weaving). The firm try to enlighten how Weaving affects investment time, the capital structure, shows inefficiencies caused by debt scheme and asset replacement. To reveal that, there is a change ratio (the percentage of equity allocated to Weaving holders upon conversion) that can be used to eradicate inefficiencies. The finding indicates so as to debt leverage decreased with the savings option payoff factor and the average cash flow appreciation rate. In contrast to long-established funding company, which states that the firm value decreased worldwide as business risk also increasing, this model recommend with the purpose of it may first reduce and then increased as asset volatility also increased.

Britzelmaier, Frank, and Schlegel (2016) China iron and spinning mill division has been world's largest, and it has served as the strength of Chinese heavy industry. This industry also consumes significant amount of power, particularly energy. As a outcome, China iron and spinning mill division may be an significant supplier to conservatory gas production as well as other pollutant. to investigate potential for inter-fuel replacement between oil, electricity, gas. the Chinese iron in addition to that Spinning mill division to discover to facilitate these power input are replacement. The discovery of these power source are coal substitute suggest that China has the possible to transition away as of coal and toward cleaner energy sources, thereby retain the flexibility to oil and iron and spinning mill division.

Zhanga, Dayong (2016) Renewable energy investments have increased globally in the new century. The China has been particularly impressive; surpass together the US and the EU in 2013. modern events, on the other hand, have called into issues whether such a flurry of savings in China renewable power sector is balanced. The Spinning intends to supply literature and also discussion in two ways. First, to investigate the over - savings suggestion, which is supported by the most recent investment methodology; second, it investigates the position of capital arrangement in the performance of China renewable power firms. According to experimental findings, there is over investment in the renewable energy division. The issue is further serious in the biomass and wind sector. Downstream firms are found to be more important in terms of capital structure, implying that policymakers may offer to maintain that allow the firms to financing their money from side to side business bonds, credit, or long-term debts.

According to Kengatharan (2016), still contradiction connecting capital budgeting theory and practice. He stated that the behavioral approach is capital budgeting. He also accomplished that the DCF method, the frequently used technique are NPV, IRR, MIR, and DPB, whereas when using NON-DCF method, the most commonly used techniques are PB and ARR. Four criteria were established for conducting this research, which cover the

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methodology, investigate philosophy, approach, strategy, data collection, and analysis. The researcher conduct the study was analyzing articles from various journals published over the last 20 years.

Chaudhary (2016) discovered a significant relationship between capital budgeting techniques in Nepal's beverage sector. Sunrise Nepal Food and Beverages (Pvt) Ltd and Birgunj Pure Drinking Water Udyog are the two beverage companies represented in the sample. To further investigate the study, the researcher divides capital budgeting techniques into certainty, risk, and uncertainty, and finally FDI basis. These three heads are investigated in relation to the NPV, PBP, IRR, PI, and ARR. The researcher develops three hypotheses. Using the chi-square test, the entire set of hypotheses is significant at 3.841 percent. The researcher discovered a significant difference in (actual to NCO), (actual to NPV), and (actual to IRR). According to the PB analysis, SNFBPL is more risky than BPWV. The IRR SNFBPL return was low, but the NPV of SNFBPL was higher, and the PI and ARR SNFBPL returns were good. Finally, it was discovered that NPV, ARR, and PI are the techniques that have a higher return than BPDWU when compared to SNFBPL.

Graham and Sathye (2017) investigate the connection between capital budgeting and national culture. They look for relations in two countries: Indonesia and Australia. The purpose of this research is to examine the relationship and influence of culture, literature, and method. A semi-structured interview was conducted for this purpose. The review included publicly traded companies from both countries. The findings show that uncertainty has an impact on capital budgeting technique (uncertainty includes political, legal, economic, and social influence). They found that the level of uncertainty in Indonesia is higher than in Australia. They specified that techniques are chosen to support size and complexity and are extremely beneficial to a business.

Gupta and Pardhan (2017) revealed four factors that influence capital budgeting technique: risk, cost and benefits, trait, and size. They conclude that size, cost, and benefits are all related. Seventy-five business were polled in this investigation. To examine the study use regression and factor analysis.

Research Methodology

“A research design understands the conditions for data collection and analysis in a way that aims to combine relevance to the researcher's intention with efficiency in the process.” It serves as the blueprint for information gathering, measurement, and analysis. In simple terms, the look includes an overview of what the researcher will do, from writing the hypothesis and its operational implications to the final knowledge analysis.

Research Design

Descriptive research is defined as a method of finding that describes the characteristics of the population or phenomenon under investigation. This system emphasizes the "what" of the research subject rather than the "why" of the research subject.

Data Collection
Source of Data

The study is based on secondary data.
Secondary data, have been collected already and is readily available from other sources. The information gathered from the corporate financial reports.

Tools for Data Analysis

Capital Ratios
Trend Analysis

Limitations of the Study

- The financial data needed for the study was obtained from a secondary source. Specifically, the Balance Sheet & Profit and Loss Account.
- The study is limited to the company available accounts and books of accounts.

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- The study is limited to the company financial statements for the previous five years.
- This research provided use of the capital ratio and trend analysis.

Data Analysis and Interpretation

A company's current ratio measures its short-term solvency, or its ability to meet its short-term obligations. It indicates that the rupee value of current assets available for each rupee of current liquidity as a measure of liquidity. The higher the current ratio, it's most secure the funds are for short-term creditors.

$$\text{Current Ratio} = \frac{\text{Current assets}}{\text{Current liabilities}}$$

Table 4.1. Current Ratio

(Rs. in crores)

Year	**Current Assets** Rs.	**Current Liabilities** Rs.	**Ratio** Rs.
2015-16	38265.03	19957.72	1.91
2016-17	30475.56	20428.49	1.49
2017-18	30831.85	21693.25	1.42
2018-19	30820.50	25028.84	1.23
2019-20	33043.37	27601.37	1.19

Source: Secondary Data

Interpretation

The above table shows, that the current ratio in the year 2015-16 was 1.91 and 2016 -17 it moves down 1.49 and its finally in the year 2019-20 it again decreased to 1.19 to Profitability ratios. The normal current ratio is 2:1.

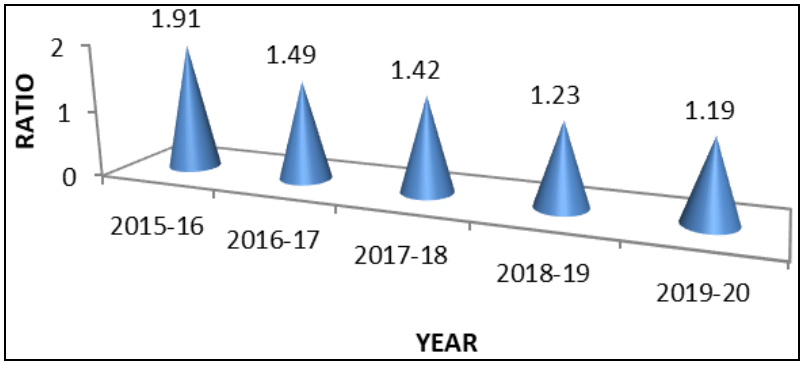

Figure 4.1. Current Ratio

Absolute Liquidity Ratio

Cash, bank accounts, and marketable securities are all included in the absolute liquidity ratio. This ratio is calculated by dividing current liabilities by cash, bank, and marketable securities.

$$\text{Absolute liquidity ratio} = \frac{\text{Cash + bank +marketable securities}}{\text{Current liabilities}}$$

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Table 4.2. Absolute Liquidity Ratio

(Rs. in crores)

Year	**Cash & bank Balance** Rs.	**Current Liabilities** Rs.	**Ratio** Rs.
2015-16	17480.09	19957.72	0.875
2016-17	6415.32	20428.49	0.314
2017-18	3850.35	21693.25	0.177
2018-19	2855.95	25028.84	0.114
2019-20	2305.24	27601.37	0.083

Source: Secondary Data

The absolute ratio for the year 2015 to 2020 shown in the above table above. The absolute liquidity ratio changes over time. In the 2015-16 financial years, it was shown 0.875. In 2017-18, it fell down to 0.177, and then to 0.083 in 2019-20.

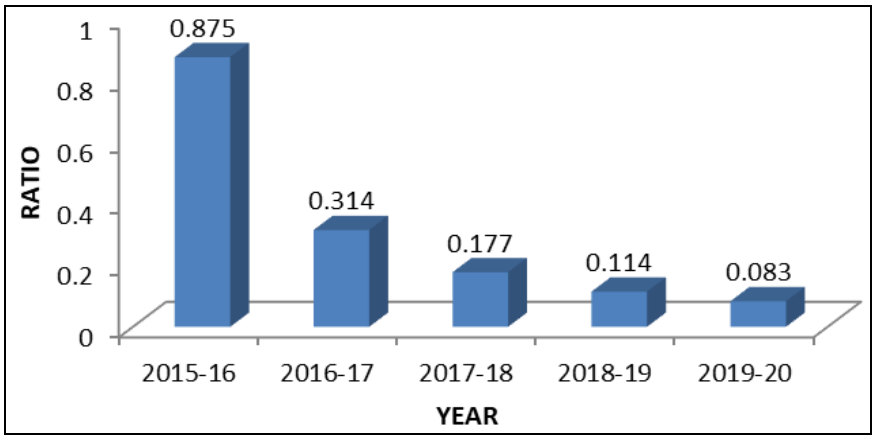

Figure 4.2. Absolute Liquidity Ratio

Earnings per Share Ratio

The earnings per share (EPS) ratio work out the portion of a company net income i.e., tentatively available for sharing to common stockholders. A company with high earnings per share can either pay a large dividend to shareholders or invest the profit to expand it further. In case, a high ratio point out a potentially profitable asset, depending on the stock market price.

The EPS ratio is helpful in favour of calculating the amount of capacity a business has to increase its current share amount of an shareholder is mainly involved in a balanced flow of income. However, simply reviewing a company history of altering its share is a enhanced indicator of the real size of upcoming dividend. In certain cases, a business with a high ratio may pay no dividend to all, prefer to provide the money in the business to finance future growth.

Table 4.3. Earning per Share (EPS)

(Rs.in crores)

Year	**Net income** Rs.	**Average outstanding shares** Rs.	**EPS** Rs.
2015-16	9,051.18	4130.40	2.19
2016-17	7,545.31	4130.53	1.82
2017-18	5,349.77	4130.53	1.29
2018-19	5,758.80	4130.53	1.39
2019-20	5,674.65	4130.53	1.37

Sources: Secondary Data

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Interpretation

The above table shows, that the EPS ratio in the company. 2015-16 EPS ratio is 2.19 and it was decreased from 2018-19 is 1.39. The net income level is very low in the year 2019-20.

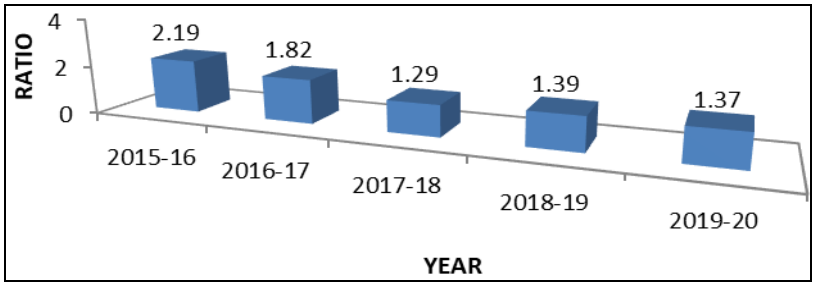

Figure 4.3. Earning per share (EPS)

Interest Coverage Ratio

As compared to an organization with an unstable and limited ability to build cash inflows, a company with a greater and more reliable cash flow can use more debt in its capital structure. Related to the fixed payment of interest and principle, debt financing involves the risk of a fixed charge. When an organization wants to raise additional capital, it has to forecast and predict the anticipated cash inflow so that the coverage ratio can be determined.

Interest coverage ratio = Earnings before interest & taxes /fixed interest charge

Table 4.4. Interest Coverage Ratio

(Rs. in crores)

Year	**EBIT** Rs.	**Fixed interest Charges** Rs.	**EPS** Rs.
2015-16	9,051.18	474.77	19.06
2016-17	7,545.31	677.70	11.13
2017-18	5,349.77	747.66	7.15
2018-19	5,758.80	967.64	5.95
2019-20	5,674.65	1,454.23	3.90

Sources: Secondary Data

Interpretation

The leverage position of the company's interest covering ratio was really high in 2015-16, as shown in the table above, at 19.06. In 2019-20, it started to fall down to 3.90. The company's leverage analysis gives the impression that the spinning mill industry was less risky.

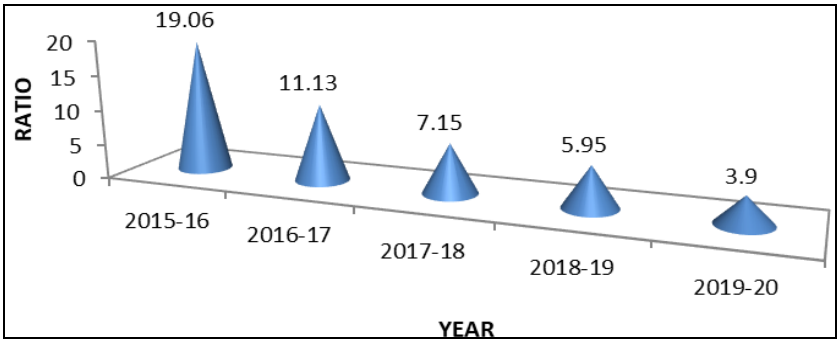

Figure 4.4. Interest Coverage Ratio

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Payback Period

The time value of money is not taken into account using the payback period model. To obtain the low-cost payback period, businesses started to change the process by adding up the value of capital. Discounted project's cash inflows to use the selected concession rate (cost of capital), and to estimate the payback period as reasonable.

Payback Period = Amount to be Initially Invested / Estimated Annual Net Cash Inflow.

Net Present Value

The discounted amount of all cash flows obtain from the project is used to calculate the present value of an investment use the Net Present Value (NPV) formula.

$$NPV = -C_0 + \frac{C_1}{1+r} + \frac{C_2}{(1+r)^2} + ... + \frac{C_T}{(1+r)^T}$$

$-C_0 = Initial\ Investment$
$C = Cash\ Flow$
$r = Discount\ Rate$
$T = Time$

Accounting Rate of Return (ARR)

The accounting rate of return (also known as the simple rate of return) is the ratio of a project's total accounting benefit to its average investment. In investment valuation, the ARR is used.

The following formula is used to measure the Accounting Rate of Return (ARR)

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

The estimate mean of accounting income expected to be earn during each year of the project lifetime WAS measured to as the average accounting profit. The number of the project start and ending with book values divided by two returns the average investment. Instead of using the average investment, another aspect of the ARR formula uses the initial investment.

Internal Rate of Return (IRR)

The rate of Return in which the net present value of all cash flows from a plan or asset equals zero is known as the Internal Rate of Return (IRR).

The internal rate of return is used to measure a project or investment' attractiveness. A new project is attractive its IRR exceed a company requisite rate of return.

The formula for *IRR* is

$$0 = P_0 + P_1/(1+IRR) + P_2/(1+IRR)_2 + P_3/(1+IRR)_3 + \ldots + P_n/(1+IRR)_n$$

where P0, P1,..., Pn denote cash flows of periods 1, 2,..., n, and IRR describes the project's internal rate of return.

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Trend Analysis for Current Assets to Current Liabilities

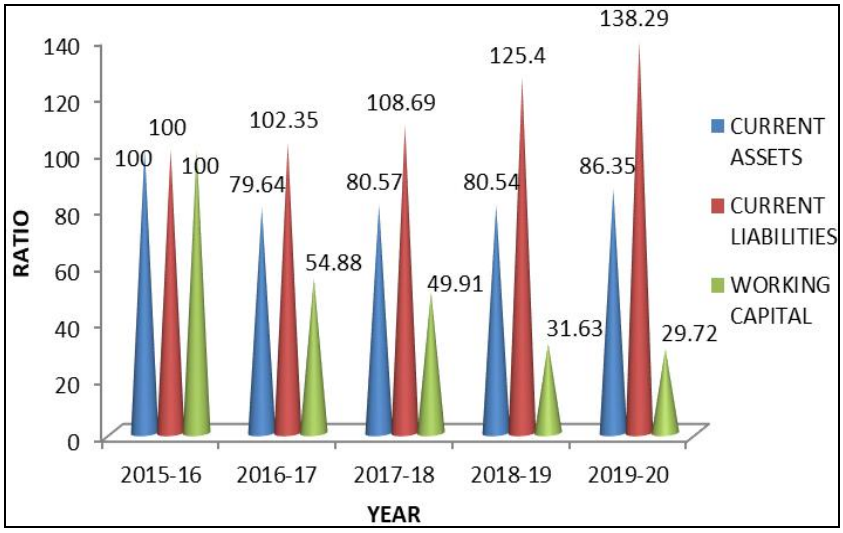
CURRENT ASSETS			CURRENT LIABILITIES		WORKING CAPITAL	
YEAR	**AMOUNT Rs.**	**TREND %**	**AMOUNT Rs.**	**TREND %**	**AMOUNT Rs.**	**TREND %**
2015-16	38265.03	**100**	19957.72	**100**	18307.31	**100**
2016-17	30475.56	**79.64**	20428.49	**102.35**	10047.07	**54.88**
2017-18	30831.85	**80.57**	21693.25	**108.69**	9138.60	**49.91**
2018-19	30820.50	**80.54**	25028.84	**125.40**	5791.66	**31.63**
2019-20	33043.37	**86.35**	27601.37	**138.29**	5442.00	**29.72**

Source: Secondary Data

Interpretation

In the 2019-20 financial years, the percentages for existing assets, current liabilities, and working capital were above 100%. In the year 2019-20, the current assets were normal at 86.35, while the current liabilities were normal as 138.29. In the year 2019-20, the working capital trend percentage declined to 29.72 percent.

Trend Analysis for Current Assets to Current Liabilities



Findings

- The current ratio was 1.91 in 2015-16, 1.49 in 2016-17, and eventually 1.19 in 2019-20.
- The current ratio was 1.91 in 2015-16, 1.49 in 2016-17, and gradually 1.19 in 2019-20. The amount of net income in 2019-20 is net income level is low
- The company's debt position is very high in 2015-16, with a 19.06 interest covering ratio. In 2019-20, it began to fall to 3.90. The company's leverage analysis gives the impression that the spinning mill industry is less risky.
- For the study period of 2015 to 2020, the absolute rate was determined. The absolute liquidity ratio begins to decline. In the 2015-16 financial year, it was 0.875. Then, in 2017-18, it declined to 0.177, and gradually, in 2019-20, it decreased to 0.083.
- In the financial year 2019-20, the percentages of current assets, current liabilities, and working capital were all above 100%. In the year 2019-20, the current assets were normal at 86.35, and the current liabilities were normal at 138.29. In the year 2019-20, the working capital trend ratio was decreased to 29.72.

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Conclusion

The decision on capital budgeting is a comprehensive and time-consuming task. It is a cyclical process that begins with proposal generation and ends with proposal monitoring and ongoing revaluation. The study revealed flaws and pitfalls at different levels of capital budgeting decisions. The capital investment approach and project formulation are centralized. A typical investment or capital budgeting decision leads to a number of resources being willing to sacrifice now in exchange for an uncertain but hopefully wider knowledge of resources in the near or future. Capital budgeting is the most crucial decision among the four finance functions since it influences a company's growth, profitability, and risk, determining its value. This decision, if made wisely, contributes to the benefits of wealth maximization not only for the concerned organization and industry, but also for the economy as a whole.

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