

# capital budgeting

[Business](#), [Accounting](#)



The most important capital budgeting decision an organization may make is an investment of a merger or acquisition. Mergers or acquisitions of a capital expenditure are often analyzed by using various capital budgeting tools such as the net present value, internal rate of return, profitability index, payback period, discounted payback period, and modified internal rate of return (Keown, 2014). Capital budgeting projects expected cash flows of a firm's long-term investment. An important managerial tool, it allows the company to determine whether the long-term investment will be worth pursuing. Evaluating and comparing the borrowing resources to allocate the best investment alternatives will help decide if the investment is economically acceptable.

#### Capital Budgeting in Technology

IBM's ' cloud expansion' will include 15 data centers covering 15 countries extending the company's worldwide total to 40. IBM is investing in high growth areas including the Middle East and Africa. Jennifer Booton of Fox News reports that IBM has been " building its cloud portfolio through acquisitions, data centers and patents." This will be the first major expansion since IBM acquired SoftLayer in June, 2013, for \$2 billion and will invest another \$1. 2 billion in the ' cloud expansion' project, adding to the \$7 billion since 2007. As a result of such an undertaking, shares of IBM rose from 0. 55% to \$189. 84 with a debt/equity ratio of 1. 82, and a net profit margin of 15. 92%; thus the income growth is 4. 70% (MSNMoney).

#### Capital Budgeting in the Oil Industry

In addition to the three projects in the Gulf of Mexico, U. S oil firm Chevron Corp planned to spend \$39. 8 billion on projects in 2014 with huge developments to take place in the Central North Sea (rigzone. com). The company had begun its joint venture with the Rosebank and had reached its final decision for Alder gas field off the coast of Great Britain. Alder, located in Central North Sea will begin producing facilities designed to handle 110 million cubic feet of gas and 14, 000 barrels of condensate per day.

With new technologies to enhance development, Chevron’s overall liquefied natural gas (LNG) is expected to double the oil equivalent of 460, 000 barrels per day (boepd) in 2017. Analyzing a potential project helps a firm to determine the average cost of capital to finance the new project, and if the project is profitable. In this case, the new project and joint venture will help boost the investment in the region and add to its future production outlook.

#### Capital Budgeting in Retail

On January 14, 2014 JC Penny announced that the “ company would be cutting 2000 jobs and closing 33 stores,” saying the “ move will save \$65M annually beginning in 2014” (Peterson, 2014). The use of capital budgeting by retailers to reduce expenses in a still struggling U. S. economy has been a practice since the economic crisis began in 2008 with many company’s no longer in existence. JC Penny also reversed the previous decision of a former CEO that ended commission sales positions within the departments of jewelry and home furnishings.

The position that will return to commission sale position will affect 3000 employees, changing the earnings for the 3000 in a difficult economy.

According to (Keown, Martin, & Petty, 2014, p. 305) “ Without question it is easier to evaluate profitable projects or investments in fixed assets, a process referred to as capital budgeting, than it is to find them.” If it is harder to find the profitable project for a company, it is equally harder to try to sustain a losing investment. While unfortunate for the employees to lose their job and for the communities that relied on the revenue from JC Penny, new budgetary decisions had to be made.

### Conclusion

Capital budgeting decisions are quite imperative to the successfulness of an organization. There are goals that need to be set to determine how capital is spent on projects, especially projects that will have a slightly high return on investment. This is a way of providing leadership with an insight on how to explore prospective business opportunities. Capital budgeting tools such as Net present value (NPV) represents the capital budgeting projects impact on the value of the business.

While some projects can have a positive NPV and increase value, others can have a negative NPV and decrease the value of the organization. Payback period shows how long it will take the capital budgeting project to pay back its initial cost. It also provides awareness on the Sales and Operations of the organization and what areas need room for improvement. This has proven to be prevalent for most organizations to take their business to the next level.