Essay on different business objectives in capital budgeting

Business, Company

CORPORATE FINANCE

Primary objective of any business is to maximize shareholders wealth; market price of shares of public corporation reflects the value of corporation as seen by its owners and also takes into account the complexity and complications of the real business risk (Fam, 2012). The unifying objective of the corporate finance is to maximize the share value of the company (Van, 2006). Therefore the decision makers of the company always take the decision that will maximize the above objectives.

In capital budgeting the finance managers usually chooses the investment with the highest return which in turn will leads to an increased value of the company. When evaluating investments projects, finance managers only consider the net present cash flows of the company but they do not put into consideration other objectives and goals of company. Capital budgeting usually ignores all other objectives of the firm and only focuses on the share holders' wealth.

In the recent past many firms have broadened their focus to include the interest of other stakeholders such as; their employees, customers, tax authority and the community where the firm operates (Meggison, 2009). The firm with stakeholders focus will always avoid actions that will harm the stakeholders and if it is really inevitable they usually consider ways of compensating them handsomely for any harm that the action of the firm has caused to them. In this case the firm will not only maximize the shareholders wealth but also tries to secure the interest of stakeholders (Deb, 2009).

Limitation of capital budgeting is its assumption that the firm's only objective is maximization of returns which in turn increases shareholders value. But some firms' objective is to maximize revenue by increasing sales not necessarily maximizing profit which in turn will lead to increased shareholders value. Such firm will therefore not necessarily choose the project which has high net present value but they will go for the project which they believe will increase the company's revenue.

Some business goals are not only to generate profits but to provide basic services to the public; such business includes public sectors which are operated by the government, with the aim of providing basic social amenities to the people but not to maximize profit. This kind of business therefore does not use capital budgeting method to make its investment decision rather they will look at the need of the public to evaluate whether they will invest or not.

Charitable organization also does not base their decision on wealth maximization but rather on their stand and beliefs (Lumberg and jones1997). Their main objective is to help the needy and provides voluntary services to them, therefore they will not be driven by the amount of profit they will get but rather by the need of the people they have decided to serve.

Most Private hospitals and schools main objective are also to provide quality services to its client. They mainly focus on the quality of the service they provide than the returns they get from the project, they usually believes that the quality of services is more important than the return as they will be able to attract many clients in the long run and also enhance customers loyalty.

Goals of a business may be also to create a good working condition for its employees so as to increase employees' morale and also creates a good public image. Such firms will mainly focus on the interest of its employees rather than the value of the firm. They may ignore a project with a high net present cash flow if the management is of the view that the project will put an additional burden on its employees or it will affect its employees negatively. The business will always choose the project which will safeguard its employee's interest even if it is a project with is small return.

A reasonable profit and legal business is considered as " halal" by the Muslim. They are against overcharging which they regard as antisocial (Deb, 2009). Therefore the prices of their goods and services will not be determined by law of supply and demand but rather they will set the price based on the initial cost and reasonable profit. This kind of business will also not evaluate the intended project based on the market return but on the return which they feel is reasonable to them.

Corporate social responsibility of the business should not be left out when making decision. Companies should ensure that their activities not have negative externalities to the community leaving around the firm. Projects with minimal air and sound pollution should be selected. The business should also strive hard to promote good working conditions with the society because its long run success depends on the cooperation of the society living around the firm.

Every business whether it is big companies or small firm has a national obligation of achieving the countries goals, this can be through; payment of taxes, promoting social justice, innovation of cheaper and high quality substitute to the import and also increasing export so as to increase foreign exchange reserve (Moggison, 2009).

B. Tumbuhan PLC Fertilizer Company Appraisal Analysis.

The performance of any firm is judged by the contributions it makes to protect the environment and not just by the profits it makes. In such scenarios, the effect for accounting and feedback on environmental issues have greatly been felt by organizations that directly interact with the environment like soil, water, air and livelihood at large. (Phillips, R. 2003).

Many traditional investment analyses overlook the issue of environmental degradation by the business they only deal with the direct cost that the company incurred without including the indirect cost due to environmental pollution (Deb, 2009). But in the recent years many companies are integrating environmental cost and benefits into their project appraisal method.

The procedure of including environmental cost and benefit into the project analysis starts with identification of all direct and indirect cost that involved in the implementation of the projects. Some of these indirect cost involved are; Liability cost, increased medical cost of staff, regulatory fees whereby the concerned bodies may impose a lot of fees so as to discourage the business from undertaking the project (Van, 2006).

After identifying all the indirect cost involved the organization should also measure the cost involved to reduce the environmental degradation, this may involve cost like proper waste management (Maggison, 2009).

The business will then quantify some of the cost like air pollution and water pollution into monetary terms by using the services of the expert to do so.

The benefits that are brought about by the new project should also be identified. And in our case some of the benefits that will come with the implementation of new investment includes; employment to the local people and also increased revenue for the firm. All this benefits should also be quantified into monetary terms so that they can be effectively used in project appraisal (Lumberg and Jones, 2003).

After the cost and benefit of the project have been analyzed the company should now estimate the time horizon of the project so as to estimate any benefit or cost which may arise during the lifetime of the project. Some of the costs that may arise include fines by the regulatory organization, damages to personal property and liability from personal injury. Some of the benefits include increased revenue of the firm, better public image and reduced medical cost in long run (Deb, 2009).

Finally the company can now use the cost and benefits to calculate the expected cash flow of the project and then use the discounted methods like net present value(NPV) internal rate of return (IRR) and profitability index (PI) to analyze the investment (Magisson, 2009).

Employees and the communities living around the factory are the stakeholders who will be affected by the decision of the company. The employees are exposed to health risk and therefore a high medical allowance should be awarded to them. Adequate compensation should be given to the people who live around the factory for any damage that they will suffer.

In conclusion the inclusion of environmental cost and benefit does not mean that the company should not exercise its social responsibilities such as building social amenities for the affected community. And in order to increase its public image and avoid any resistance the company should compensate handsomely all the stakeholders who are affected by the companies operation.

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