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UDC 330.332

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Capital Investment Decisions

Motivation. Of all the decisions that business executives must make, none is more challenging — and none has received more attention —than choosing among alternative capital investment opportunities. What makes this kind of decisions odemanding, of course, is not the problem of projecting return on investment under any given set of assumptions. The difficulty is in the assumptions and in the irimpact

[1]. Evaluating the projects and allocating capital depending on the requirements of the projects are the most important aspects of capital investment decisions. There may be various criteria for selecting the right and appropriate decision for capital investment. For example, a firm may emphasize on the projects that promise for the immediate return while some other firms may insist on the projects that ensure longterm growth. The major goal of capital investment decision is to increase the value of firm by undertaking right project at right time [2].

Research question. The focus of this thesis is on how companies make capital investment decisions. The process of making capital investment decisions is often referred to as capital budgeting, which is planning for investments in long-term assets in a way that returns the most profitability to the company. Capital budgeting is critical to the business because these investments affect operations for many years and usually require large sums of cash. Capital investment decisions mostly are regulated by the procedure of rating and identifying the organization's capital investments. The company ought to decide as to which of the capital investments that are given, would ensure the maximum value to their business and thus they can make their capital investment decision [3].

Research design. The capital investment decisions are mainly governed by the process of ranking and identifying the capital investments of the firm. The firm needs to decide which of the given investments will ensure the most value to the business. The decisions of capital investment of ten suffer from a number of constraints. The amount of capital that a firm collects is limited and it brings down the constraint on the choice of the firm over various project investments. As the debt of the firm is increased, the debt-equity ratio of the firm also gets increased and hence it becomes difficult for the business to raise more debts. The decision of project ranking plays significant role in the decisions of capital investment. Depending on the various projects the firm is having at a certain period of time, the firm prioritizes the projects. The ranking of projects depends on how much a project will return and which project will be able to add maximum value to the business [3].

The first step in the capital investment decisions is to develop strategies. These are the long-term goals of the business, such as expanding international operations or being a value leader in one market while diversifying into other markets. This step is the same for short-term, intermediate, and long-term budgeting. After companies develop strategies, the next steps are to plan and budget for specific actions to achieve those goals. Exhibit 1 illustrates the capital budgeting process.

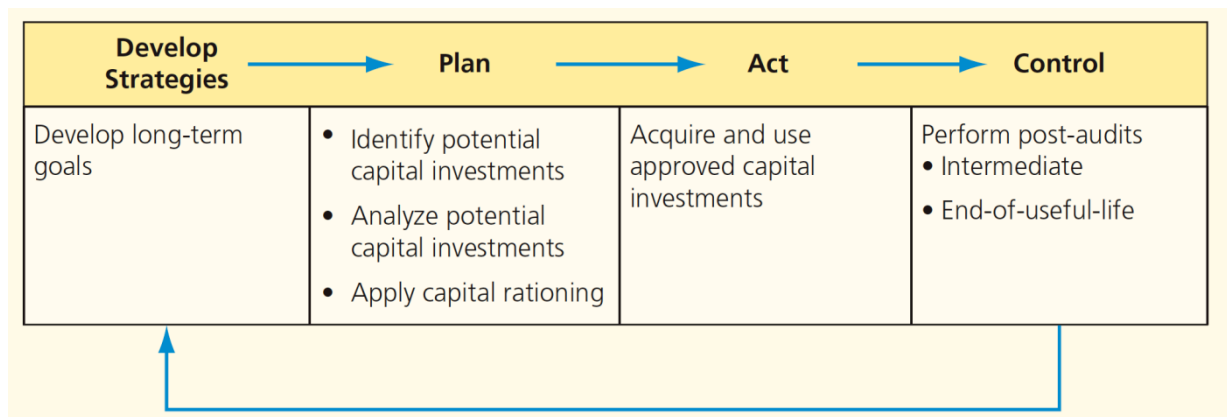


Exhibit 1. Capital Budgeting Process[4].

The second step in the capital budgeting process is the planning process, which has three substeps. The first is to identify potential capital investments—for example, new technology and equipment that may make the company more efficient, competitive, and/or profitable. After identifying potential capital investments, the second substep is to analyze the investments using one or more capital budgeting methods.

The fourth step in the capital budgeting process is control. In the short-term operational budgeting process, the control step is called variance analysis. After acquiring and using the capital assets, companies compare the actual results from the investments to the projected results. The comparisons are called post-audits, and they help companies determine whether the investments are going as planned and deserve continued support or whether they should abandon the project and dispose of the assets. Notice in Exhibit 1 that the control step loops back to the first step: develop strategies. The post-audits help managers learn from their decisions and make adjustments as needed. The adjustments are then considered when developing new strategies[4].

The analysis of capital investments sometimes involves a two-stage process. In the first stage, managers screen the potential capital investments using one or both of the methods that do not incorporate the time value of money: *payback* and *accounting rate of return*. These simple methods quickly weed out undesirable investments. Potential capital investments that pass Stage 1 go on to a second stage of analysis. In the second stage, managers further analyze the potential investments using the *net present value and/or internal rate of return methods*. Because these methods consider the time value of money, they provide more accurate information about the potential investment's profitability.

The first two methods, payback and accounting rate of return, are fairly quick and easy, and they work well for capital investments that have a relatively short life span, such as computer equipment and software that may have a useful life of only three to five years. Payback and accounting rate of return are also used to screen potential investments from those that are less desirable. Payback provides management with valuable information on how fast the cash invested will be recouped. The accounting rate of return shows the effect of the investment on the company's accrual-based income. However, these two methods are inadequate if the capital investments have a longer life span because these methods do not consider the time value of money. The last two methods, net present value and internal rate of return, factor in the time value of money, so they are more appropriate for longer-term capital investments. Management often uses a combination of methods to make final capital investment decisions.

Some companies can pursue all of the potential investments that meet or exceed their decision criteria. However, because of limited resources, most companies must engage in capital rationing, which is the third substep in the planning process. Capital rationing is the process of ranking and choosing among alternative capital investments based on the availability of funds. Managers must determine if and when to make specific capital investments, so capital rationing occurs when the company has limited cash available to invest in long-term assets [5].

Empirical results. Capital budgeting is not an exact science. Although the calculations these methods require may appear precise, remember that they are based on estimates—predictions about an uncertain future. These estimates must consider many unknown factors, such as changing consumer preferences, competition, the state of the economy, and government regulations. This makes long-term decisions riskier than short-term decisions[6].

The capital investment decisions suffer from a many constraints generally. The sum of capital which an organization collects is restricted and thus it gets the restraint on the firms' choice down to an extent, over several project investments. When the firms' debt is raised, the firms' debt-equity ratio too is increased and thus it gets hard for a business to be able to increase more debts [7].

Making strategic capital investment decisions which are consistent could be so be problematic because a lot of people prefer using capital investment appraisal techniques which increases the chances of having their favourite projects accepted. In a lot of cases, capital investment decisions are reached subjectively and financial techniques are put into use to rationalize, once the capital investment decision has been made [3].

Contribution. The power to study as well as take capital investment decisions permits an individual as the manager or owner of a particular business to make sure that the resources which are limited are apportioned to the project(s) which would best accomplish their strategical goals (thus they also are at times denoted as strategic capital investment decisions). The aim of a business while making capital investment decisions is maximising the wealth of the share holder by acquiring asset and yielding profit and to be able to do this, as the owner of your business, you should be able to find out and determine as to what projects of capital investment would yield a cash flow which is positive and rate the projects in the bases of priority depending on the kind of value they generate [3].

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УДК 330.526.39:061.23

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Податкові перешкоди розвитку корпоративної благодійності в Україні

Сьогодні благодійництво виступає невід'ємним елементом корпоративних фінансів. Набути статусу «соціально відповідального підприємства» прагне будь-яка компанія, що піклується за власний імідж, позиції на ринку та ступінь впливу на певні процеси у державі. Найвищий тип соціальної відповідальності – добровільна, тобто безпосередньо не пов'язана з діяльністю компанії. Фактично це інвестування у суспільно корисні проекти без прямої віддачі такому інвестору, а саме: захист навколишнього середовища, інвестиції в інфраструктуру міста, боротьба з бідністю тощо. Так, відповідно до