Capital Budgeting in Small-Scale Industries

** Vinod Kumar Yadav*

Abstract

The decisions on capital expenditures are very important for every firm, whether it is a small-scale industry or a large firm, because their impact is more or less permanent on the well-being and economic health of the enterprise. Capital budgeting may be more important to the smaller firms than it is to their larger counterparts because of the lack of the diversification in smaller firms. The main objective of this study is to examine the decision-making process followed by small-scale industries to evaluate the purchase of major fixed assets. For this purpose, relevant data were collected through a questionnaire, interviews and personal observations by undertaking an intensive case study of 400 small-scale industries of Haryana. This study found that in the small-scale industries, only large units, in the true sense of capital budgeting, prepared capital budgets for taking long-term capital investment decisions, and comprised of only 12.5% units of the total small-scale industries. In the small-scale industries, the traditional methods of capital budgeting- PBP and ARR -were used for evaluation of projects. It was found that in the small-scale industries, capital budgets were prepared by a committee comprising of both - the owner and the experts. It was also observed that an important aspect of capital budgeting - post audit - was used by only 6% of the sample units.

Keywords : **capital budgeting, priority of the projects, projects evaluation, post- audit, small scale industry**

JEL Classification: G 31

Paper Submission Date : July 7, 2013 ; Paper sent back for Revision : August 2, 2013 ; Paper Acceptance Date : August 24, 2013

Capital budgeting may be defined as the decision-making process by which a firm evaluates the purchase of major fixed assets, including buildings, machinery, and equipment. It deals exclusively with major investment proposals, which are essentially long-term projects and are concerned with the allocation of firm's scare financial resources among the available market opportunities. It is a many-sided activity which includes a search for a new and more profitable investment proposal and the making of an economic analysis to determine the profit potential of each investment proposal. Capital budgeting involves a long-term planning for making and financing proposed capital outlays. Most expenditure for long-lived assets affects a firm's operations over a period of years. They are large, permanent commitments, which influence its long-run flexibility and earning power. It is a process by which available cash and credit resources are allocated among competitive long-term investment opportunities so as to promote the greatest profitability of a company over a period of time. It refers to the total process of generating, evaluating, selecting, and following up on capital expenditure alternatives.

Review of Literature

A number of researchers in finance and accounting have examined corporate capital budgeting practices. But in spite of the importance of small business firms, most of the literature and surveys related to capital budgeting have targeted large firms.

Pandey (1989), in a study of the capital budgeting practices of fourteen medium to large sized companies in India found that all companies, except one, used payback. With payback and/or other techniques, about two third of the companies used IRR and about two fifth used NPV. IRR was found to be the second most popular method. The reasons for the popularity of the payback in order of significance were stated to be its simplicity to use and understand its emphasis on early recovery of investment and focus on risk. Walker, Burns, and Denson (1993) focused on small companies. They noted that 21% of the small companies used DCF. They also observed that within their sample, the smaller the firm, the smaller was the likelihood that DCF would be used. The focal point of their study was why small companies use DCF so much less frequently than large firms. The three most frequently cited reasons, according to the

* *Associate Professor,* Department of Commerce, Maharaja Agrasen College (University of Delhi), Vasundhara Enclave, New Delhi-110 096. E-mail : v.kyadav11@yahoo.com

survey, were - **(a)** small firms' preoccupation with liquidity, **(b)** a lack of familiarity with DCF methods, and **(c)** a belief that small project sizes make DCF not worth the effort.

Dhankar (1995) examined methods of evaluating investments and uncertainty in Indian companies. He selected a sample of 75 firms. His findings revealed that 33% of the firms used non-discounted methods like PBP and ARR, whereas 16% of the companies were using modern DCF techniques. Moreover, almost 50% of the companies incorporated risk by 'Adjusting the Discount rate' and 'Capital Asset Pricing Model'. Rao's (1996) survey of 74 companies revealed that 51% used IRR as a project appraisal criterion. Firms typically use (92% or more) multiple evaluation methods. He found that ARR and PBP were widely used as supplementary decision criteria. A few Indian firms in his survey also used none of the methods listed in the questionnaire. They were using profitability and cash flow analysis for assessing capital expenditure.

Drury and Tayles (1996) focused on some of the unresolved issues on capital budgeting in UK and examined the impact of company size on the use of financial appraisal techniques. They conducted a postal questionnaire survey which could provide an overview of current management accounting practices in UK companies. The sample included in this survey included responses from a wide range of organizations of different sizes. Most of organizations used a combination of appraisal techniques. 86% of those organizations that 'often' or 'always' used the unadjusted payback method combined it with a discount method. The survey findings also indicated that non discounting methods continued to be used by both smaller and large organizations. The survey also sought to ascertain the approaches that were used for dealing with project risks. Sensitivity analysis was 'often' or 'always' used by 82% of the larger organizations as compared with 30% of the smaller organizations. The survey findings suggested that theoretically, sound capital budgeting techniques are more likely to be used by larger organizations rather than by the smaller organizations. The impact of company size on the use of investment appraisal techniques had been examined, and the survey findings suggested that many firms appear to deal with inflation incorrectly when appraising capital investments. This survey provided useful attention-directing information by identifying topics that require most in-depth research. They suggested that in order to understand the role financial criteria play in capital investment decision-making process, future studies should widen the scope beyond economic rationality and examine the broader political and social roles that financial information plays within organizations in the investment decision-making process.

Block (1997) studied capital budgeting techniques used by small business firms in the 1990s. As discussed by Brigham (1977) in his book *Financial Management : Theory and Practice*, capital budgeting may be more important to the smaller firms than it is to its larger counterparts because of the lack of diversification in a smaller firm. He said that a mistake in one project may not be offset by successes in others. His intention of the study was to ascertain where small firms stand today with regards to capital budgeting techniques as opposed to prior decades. A questionnaire survey with 232 small business respondents indicated that the payback method is still the preferred approach by 42.7% of the firms. Unlike many large firms, their time horizon is often the period over which a financial institution will extend them funding. In any event, the “average” minimal payback period in the survey averaged 2.81 years, a time period far shorter than the useful life of the asset, and the one that would indicate a required return far higher than most firms anticipate. Somewhat encouraged was the increased use of discounted cash flow methods (27.6%), which is the higher rate of utilization than that indicated in other surveys of small firms over the last few decades.

Jain and Kumar (1998) in a comparative study of capital budgeting practices in the Indian context observed that 25% of the sample companies invested for expansion and diversification, and firms were making regular investments for replacement and maintenance. The selected companies' preference for evaluating capital budgeting projects were PBP, due to its simplicity, easy understanding, less cost and less time, followed by NPV and IRR. Graham and Harvey's (2001) pointed out that small firms are more likely to use simple rules such as payback, whereas large firms are more likely to rely upon NPV and /or IRR. These findings confirmed the earlier results found by Runyon (1983). Several years ago, Runyon studied 214 firms with net worth ranging from $ 500,000 to $ 1,000,000. He found that almost 70% of the firms relied upon payback or some other questionable criteria. Only 14% of the firms used a discounted cash flow analysis. Lazaridis (2004) conducted a survey of capital budgeting practices of the firms in Cyprus. He found that only 30.19% of the sample firms used capital budgeting techniques for all their investment decisions, while 50.94% of the firms used the evaluation method for only some type of investments above a certain cost level. Unfortunately, 18.99% of the companies did not use any evaluation method for their investment projects. The survey showed that 54.43% of the projects' evaluation was done by a simplified evaluation technique and that

36.71% of the companies used the PBP technique. Among the methods that took into account the time value of money, the NPV method was the one that was preferred by most companies (11.39 %). The survey, with respect to the cost of capital, an important element in the use of the capital budgeting techniques, showed that it is determined basically according to the cost of borrowing (30.95 %), while 3.57 % of the companies believed that determining the cost of capital does not affect their profits. He concluded that SMEs in Cyprus did not follow scientific evaluation techniques for their investment projects probably due to lack of familiarity with such methods. These findings indicate the need for training and educating the managers of the firms in the capital budgeting area of financial management.

Gupta, Batra, and Sharma (2007) made an attempt to explore which capital budgeting technique was used by industries in Punjab, and the influence of factors such as the size of capital budget, and the education and experience of the CEO in capital budgeting decisions. They found that majority of the sample companies still used non-discounted cash flow techniques like PBP and ARR. Only a few companies used DCF, and among them, negligible numbers used the NPV technique to evaluate a new project. Lam, Wang, and Lam (2008) highlighted the capital budgeting practices used by contractors in the construction industry of Hong Kong SAR, China. The study indicated that the most popular capital budgeting practices were the pay back period and the accounting rate of return. Furthermore, the study also showed that NPV and IRR were not the predominant techniques for capital budgeting as claimed in the literature.

Examining the use of discounted cash flow (DSF) techniques and non-financial measures in capital budgeting, Chen (2008) found that the DCF techniques were more important in capital budgeting than in non-financial measures. The findings indicated that non-financial measures are used as a substitute for the DCF technique, when the DCF analysis is less efficient. Analyzing the capital budgeting practices of Australian listed firms, Truong, Partington, and Peat (2008) found that net present value, internal rate of return, and pay back period were the most popular evaluation techniques used by Australian listed firms. Real options (RO) gained some popularity in capital budgeting, but they had not yet become a part of the main stream.

Shinoda (2010) conducted a survey in the form of a questionnaire sent to 225 people in-charge of capital budgeting at firms listed on the Tokyo Stock Exchange, with a focus on capital budgeting practices. The study showed that Japanese firms managed their decision making by a combination of the pay back period method and the net present value method, while financial managers mostly utilized multiple tools in the capital budgeting process. A study done by Olawale, Olumuyiwao, and George (2010) involving small manufacturing companies in South Africa revealed that most of the surveyed companies did not use sophisticated methods when evaluating their projects. EI-Sady, Hamdy, and Sultanova (2011) investigated capital investment practices in the Gulf Cooperation Council markets. They found that net present value (NPV) and pay back period (PBP) were the most popular capital budgeting techniques used to evaluate capital investment among Kuwait corporations included in the study, while the advanced capital budgeting techniques were showing no significant use by the Kuwaiti corporations. The evidence from Swedish companies studied by Daunfeldt and Hartwig (2012) indicated that larger companies tend to use capital budgeting methods more often when deciding on investment decisions. The choice of capital budgeting methods is also influenced by financial leverage, growth opportunities, dividend payout policies, choice of target debt ratio, degree of management ownership, foreign sales, education, and other individual characteristics of the CEOs.

Objective of the Study

The main objective of the study is to examine whether small-scale industries used capital budgeting techniques for their long-term capital investment decisions.

Research Methodology

The present study is based on primary data. The data was collected through a questionnaire, interviews, and observations. The primary data were the main base of the study. For this purpose, I undertook intensive case studies of 400 small-scale industries of Haryana during the year 2011-12. While selecting these units, I took enough care to see that these are representative of all type of industries and all districts in Haryana. For the said purpose, I divided all the industries into six categories such as Garments, Auto-parts, Electronics, Metal Products, Rubber and Plastics, and Others (Table 1). It was not possible to cover all the States in India due to time and financial constraints. However, I believe that the findings of the study will have equal applicability for the enterprises in other States also, since there is much similarity among the small-scale industries with respect to size, structure, operations, and management.

Table 1. Sample Size

Name of the Industry	Sample
1. Garments	80
2. Auto-parts	40
3. Electronics	60
4. Metal Products	78
5. Rubber and Plastics	56
6. Others	86
(Machinery parts, Paper products, Chemical products, etc.)	
Total	**400**

Source: Compiled by the Author

Table 2. Capital Budgeting in Small-Scale Industries in Haryana

Name of Industry	Yes		No		Total
	No.	%	No.	%	No.
1. Garments	8	10.0	72	90.0	80
2. Auto-parts	7	17.5	33	82.5	40
3. Electronics	9	15.0	51	85.0	60
4. Metal Products	6	7.7	72	92.3	78
5. Rubber & Plastics	8	14.3	48	85.7	56
6. Others	12	14.0	74	86.0	86
Total	**50**	**12.5**	**350**	**87.5**	**400**

Source: Primary Data

Capital Budgeting in Small-Scale Industries

The decisions on capital expenditure are very important for every firm, whether it is a small-scale industry or a large firm because its impact is more or less permanent on the well-being and economic health of the enterprise. However, in small-scale industries, this important technique is used by a very limited number of industries. There are various reasons for not using this important technique for taking capital decisions. Among them, the most important reasons are as follows :

(a) In small firms, comparatively less amount is invested in fixed assets;

(b) Most of/all the decisions in small firms are taken by the owners who do not have proper skills required for capital budgeting;

(c) Small firms cannot hire the services of experts for capital budgeting;

(d) Required funds are not easily available for capital investments.

Due to the abovementioned reasons, in small firms, capital decisions are taken without proper exercise of capital budgeting. It may be one of the reasons for sickness in the small scale sector industries.

Now, with the help of the Table 2, we can see that in small firms, just 12.5% of the units were preparing capital budgets for taking long-term investment decisions. In this category, most of the units were bigger units, registered as public ltd. companies, which could afford the services of experts required for properly preparing capital budgets. The Table 2 shows that in Auto-parts industry, 17.5% of the units were preparing capital budgets for taking decisions regarding capital investments. In addition to the size of the units, the other reason for preparing capital budgets is the intense competition in the Auto-parts industry, which requires new technology to be used to survive in the market. Next, in the category is the Electronics industry, where 15.0% units were using capital budgeting techniques. The main reason for this is that new electrical equipments are coming in the market every day, which require new technology ; also, for using and implementing new technology, additional capital investments are required. Shortage of funds in

small firms make it more important that capital investment decisions are taken judiciously. In the Rubber and Plastics industry, 14.3% units, followed by the Others industry (14% units), Garments industry (10% units), and (the least) the Metal Products industry (7.7% units) were using this technique for taking capital investment decisions. On the other hand, the Table 2 shows the percentages and the number of industries not preparing capital budgets. It can be observed that 87.5% of the surveyed industries were not preparing capital budgets. However, this does not mean that these units took decisions without any consideration for capital investments. The maximum numbers of units that fell in this category were those which did not invest much amount in fixed assets after starting their operations. In addition, some of the units were considering some aspects of capital budgeting before capital investments, but did not prepare proper capital budgets. In this category, the maximum percentage belonged to the Metal Products industry, where 92.3% of the units did not prepare any capital budgets. The main reason for this was their small size. In the remaining industries also, 82.5% to 90.0% of the units did not prepare any proper capital budgets.

Who Prepares Capital Budgets in Small-Scale Industries ?

The capital expenditure schemes of a business firm are largely determined by the investment decisions of the top management. The senior management must specify and clearly state the financial policy to be pursued. The policy should give general guidance about the minimum rate of return expected on capital projects. The minimum rate should reflect a realistic assessment of the firm's liquid and financial position. This will help the persons - who are responsible for the financial analysis of the project - to prepare an accurate report of the same.

The analysis of the project proposal can be made by the capital expenditure sanction committee, or any other organization; it is necessary to sort out the projects at the executive level on the basis of priority. For priority purposes, projects can be classified into those **(a)** requiring prompt and immediate attention; these cannot be postponed, **(b)** which can be postponed without any loss or deterioration, **(c)** which can be postponed with some loss of opportunity. The personnel of this committee or any other capital expenditure budgeting organization should include an economist, management accountant, financial expert, tax expert, mathematician, and the marketing and technical executives. However, in the small firms, it is not financially viable to have all these personnel in the organization as permanent employees. However, when the need of capital budgeting arises, their services may be hired.

Table 3. Responsibility of Preparing Capital Budgets In Small-Scale Industries In Haryana

Name of Industry	Self/Owners		Experts		Committee including both		Total No.
	No.	%	No.	%	No.	%	
1. Garments	-	-	-	-	8	100	8
2. Auto-parts	-	-	-	-	7	100	7
3. Electronics	-	-	-	-	9	100	9
4. Metal Products	-	-	-	-	6	100	6
5. Rubber & Plastics	-	-	-	-	8	100	8
6. Others	-	-	-	-	12	100	12
Total	**-**	**-**	**-**	**-**	**50**	**100**	**50**

Source: Primary Data

As explained earlier in Table 2, in small-scale industries, only 12.5% of the industries prepared the capital budgets. The Table 3 shows that in all of these industries, capital budgets were prepared by a committee constituted for this purpose. This committee included experts and owner(s) - both were constituted when the need arose. On the other hand, in industries which were not preparing proper capital budgets for capital investments, decisions were mainly taken by the owners on the basis of their personal knowledge about the project. In some industries, experts were also consulted, but no formal capital budgeting process was exercised.

Deciding the Priority of Projects in Small-Scale Industries

Obviously, the small-scale industries will not encounter as many of these reasons as the larger and more complex

firms; nevertheless, managements of the smallest firms find that they, too, invest for a variety of reasons. While the classification of investments according to reasons is important, it is believed that a classification of "projects" according to priority is of greater benefit to smaller companies, since they usually have a constant capital rationing problem.

In most of the small firms, there is a scarcity of funds. Therefore, grouping according to priority would assist management in allocating funds to the areas of greatest need. Projects may be classified as **(a)** Not postponable, **(b)** Postponable without deterioration, and **(c)** Postponable, but with some loss of opportunity. Such a classification system will greatly aid the management in selecting investments that will provide continuity to the firm's life. It should be pointed out that the use of this system may permit an investment that will produce lower yields in the short-run, but if the management has effectively classified projects, investment in the long run should be optimized.

Table 4. Priority of the Projects : Fixed or Not in Small-Scale Industries In Haryana

Name of Industry	Yes		No		Total
	No.	%	No.	%	No.
1. Garments	7	87.5	1	12.5	8
2. Auto-parts	6	85.7	1	14.3	7
3. Electronics	7	77.8	2	22.2	9
4. Metal Products	4	66.7	2	33.3	6
5. Rubber & Plastics	6	75.0	2	25.0	8
6. Others	10	83.3	2	16.7	12
Total	**40**	**80.0**	**10**	**20.0**	**50**

Source: Primary Data

The Table 4 shows that in small-scale industries, which were preparing capital budgets, 80% of the industries fixed the priority of the projects on the basis of the category - postponable or not postponable projects. In this category, the maximum percentage is of the Garments industry (87.5% units), followed by the Auto-parts industry (85.7% units), Others industry (83.3% units), Electronics industry (77.8% units), Rubber & Plastics industry (75.0% units), and the least was in the Metal Products industry (66.7% units). The reason put forth by the industries classified into the group of non-fixing priority was that they considered only one project at a time to take a decision - whether it would be profitable or not. Only 20% industries that fell in this category were preparing capital budgets without fixing a priority among various available projects for capital investments. The reason given by these industries was that they considered only one project at a time to decide whether or not it would be profitable. The maximum number of units adopting such a strategy were in the Metal Products industry (33.3% units), followed by the Rubber & Plastics industry (25% units), Electronics industry (22.2% units), and 12.5% - 16.7% units in rest of the industries, which were not fixing any priority of the projects while taking capital investment decisions.

Projects' Evaluation in Small-Scale Industries

A number of alternative capital expenditure proposals compete for allocation of funds. The main task is to rank the different proposals, delineate the funds for each, and then take the decision. The problem of ranking different proposals depends upon the availability of systematic statistical data. The management accountant uses his/her judgement and skills to analyze this data and on the basis of such analysis, he/she often tenders his/her opinion to the top management. There are various methods of project evaluation that have been developed on several basis. These methods can be grouped into the following two categories:

(1) Traditional Methods: (a) payback period, and **(b)** average rate of return,
(2) Time-Adjusted Methods: (a) net present value, **(b)** internal rate of return, and **(c)** cost-benefit ratio or profitability index.

It should be realized that different firms may use different methods. Which method is appropriate for a particular

purpose of the firm will depend upon the circumstances. A large company may use more than one technique to appraise each of its investment projects, while a small firm may contend with using only one technique which involves minimum funds and time. However, to avoid confusion, the same method or same methods should be used uniformly for every project undertaken by the firm. Though these appraisal techniques will help the managements in making decisions objectively, but they must still exercise their common sense and judgement while taking the decisions.

Table 5. Project Evaluation Method Used By Small-Scale Industries in Haryana

Name of Industry	Traditional ARR Method		Methods PBP Method		Total		Other Method		Total No.
	No.	%	No.	%	No.	%	No.	%	
1. Garments	3	37.5	5	62.5	8	100	-	-	8
2. Auto-parts	1	14.3	6	85.7	7	100	-	-	7
3. Electronics	2	22.2	7	77.8	9	100	-	-	9
4. Metal Products	1	16.7	5	83.7	6	100	-	-	6
5. Rubber & Plastics	2	25.0	6	75.0	8	100	-	-	8
6. Others	4	33.3	8	66.7	12	100	-	-	12
Total	**13**	**26.0**	**37**	**74.0**	**50**	**100**	**-**	**-**	**50**

Source: Primary Data

The Table 5 shows the methods of project evaluation used by small-scale industries. It is clear from the table that all the industries in the small-scale sector - who were preparing capital budgets - were using traditional methods for appraisal of the projects. As discussed earlier, in the traditional methods category, there are two methods - the payback method and the average rate of return method. In the small-scale industries, the payback method is the most popular method for evaluating proposed capital expenditure. That is why 74% of the sample industries were using this technique while making capital budgets for evaluation of projects. In the Auto-parts industry, 85.7% units followed by the Metal Products industry (83.7% units), Electronics industry (77.8% units), Rubber and Plastics industry (75% units), Others industry (66.7% units), and 62.5% units in the Garments industry were using this method for project evaluation. The main reason of using this method by most of the industries in the small- scale sector is its simplicity to understand and use the same. In time-adjusted methods, there are tedious calculations, which are difficult to comprehend.

On the other hand, in the remaining 26% small-scale industries, the average rate of return method was used for project evaluation. In this category, the maximum percentage was in the Garments industry (37.5% units), followed by the Others industry (33.3% units), Rubber and Plastics industry (25.0 % units), Electronics industry (22.2 % units), Metal Products industry (16.7 % units), and the Auto-parts industry, where 14.3% of the units were using this method. This method is also simple to understand and is easy to calculate. It is also regarded useful because it takes into consideration all the profits expected over the project life (in contrast to the payback period method, which ignores all cash flows beyond the payback period).

The Post-Audit in Small - Scale Industries

An important aspect of the capital budgeting process is the post-audit, which involves **(a)** comparing actual results with those predicted by the project's sponsors, and **(b)** explaining why any differences occurred. The post audit is not a simple process, and a number of factors can cause complications. Because of these difficulties, some firms tend to play down the importance of the post-audit. However, the post-audit is regarded as one of the most important elements in a good capital budgeting system.

The Post-audit is not very common in small firms, which are using capital budgeting techniques for long-term investment decisions. The Table 6 shows that only 6% of the industries preparing capital budgets were using post-audit techniques to compare the actual results with those predicted by the project's sponsors as it requires the operating divisions to send a monthly report for the first six months after a project goes into operation, and a quarterly report thereafter, until the project's results are up-to the expectations. From then on, reports on the project are reviewed on a

Table 6. Post - Audit of Projects in Small-Scale Industries in Haryana

Name of Industry	Yes		No		Total
	No.	%	No.	%	No.
1. Garments	1	12.5	7	87.5	8
2. Auto-parts	1	14.3	6	85.7	7
3. Electronics	-	-	9	100.0	9
4. Metal Products	-	-	6	100.0	6
5. Rubber & Plastics	-	-	8	100.0	8
6. Others	1	8.3	11	91.7	12
Total	**3**	**6.0**	**47**	**94.0**	**50**

Source: Primary Data

regular basis like those of other operations. All this requires sufficient amount of funds to be spent on the subject matter expert, which is not possible in small-scale industries. Hence, it was observed that only 14.5% units in the Auto-parts industry, 12.5% units in the Garments industry, and 8.3% units in the Others industry were conducting a post audit of projects. In Electronics, Metal Products, and Rubber & Plastics industries, not even a single unit was carrying out the post audit of the projects.

Suggestions

During the study, I observed that many of the business owners and decision-makers did not have formal business training or education, and their small firms had incomplete management teams. Thus, formal capital budgeting activity was limited. Hence, it is recommended that the key to improving the processes would be by ensure that proper training for these decision makers is available.

Capital budgeting decisions are vital to a firm's financial well being and are among the most important decisions that owners or managers of the firms must take. Hence, every firm must take the opinion of the experts before making capital investments.

Conclusion

It was observed in this paper that in the small-scale industries, only 12.5% units, mainly large units, registered as ptv/public ltd. companies prepared capital budgets for taking long-term investment decisions. However, this does not imply that in the remaining units, capital investment decisions were taken without any consideration. Most of the surveyed units (after starting the business) did not make much investment in fixed assets. And the remaining units considered some aspects of capital budgeting, but did not prepare (technically) proper capital budgets. It was also observed that in the small-scale industries, capital budgets were prepared by a committee, which included experts and owner(s) both. In 80% of the small-scale industries, which prepared capital budgets, the priority of the projects was fixed on the basis of the category - postponable and not postponable projects. For evaluation of projects in the small-scale industries, the traditional methods – PBP and ARR were used. Three fourth units used the PBP method, and the remaining one fourth units used the ARR method for evaluating capital budgeting projects. The main reason of preference for these non-discounted cash flow techniques is their simplicity to understand and apply them. An important aspect of the capital budgeting process is the post-audit. But due to shortage of funds in small-scale industries, only 6% of the surveyed units, which prepared capital budgets, were using post-audit techniques to compare the actual results with those predicted by the project's sponsor(s).

Research Implications

Results of my the present study are consistent with the results of many researchers such as Graham and Harvey (2001), Lazaridis (2004), Gupta, Batra, and Sharma (2007), and Lam et al. (2008). This indicates that small firms are much more likely to use the unsophisticated and most popular capital budgeting practices such as pay back period and accounting rate of return.

In the beginning of the study, it was believed that the findings of the study would have equal applicability for the small-scale industries in other States of India also. But after the study, it can be said that apart from the 'size' of the business, there are several other important factors which determine the applicability of the findings of the present study - such as organizational structure, business age, employment, sales, growth, decision maker's education, decision maker's age, investment activities, source of investment funds, and capital rationing.

References

Brigham, E.F. (1977). *Financial management: Theory and Practice*. Hinsdale, III: Dryden Press.

Block, S. (1997). Capital budgeting techniques used by small business firms in the 1990s. *The Engineering Economist, 42* (4), 289-302. DOI:10.1080/00137919708903184

Chen, S. (2008), DCF techniques and non-financial measures in capital budgeting: A contingency approach analysis. *Behavioral Research in Accounting, 20* (1), 13-29. DOI: http://dx.doi.org/10.2308/bria.2008.20.1.13

Daunfeldt, S. O., & Hartwig, F. (2012). *What determines the use of capital budgeting methods? Evidence from Swedish listed companies*. HUI Working Paper 57, HUI Research, Stockholm. Retrieved from https://www.google.co.in/#psj=1&q=What+Determines+the+use+of+Capital+Budgeting+Methods%3F

Dhankar, R. S. (1995). An appraisal of capital budgeting decision mechanism in Indian Companies. *Management Review, 7* (2), 22-34.

Drury, C., & Tayles, M. (1996). UK capital budgeting practices: Some additional survey evidence, *European Journal of Finance, 2* (4), 371-388. DOI:10.1080/13518479600000015

EI-Sady, H.M., Hamdy, H.I., & Sultanova, V. (2011). Capital investment practices: A survey of large corporations in a developing market. *Global Review of Accounting & Finance, 2* (2), 39-60.

Graham, J. R., & Harvey, C. R. (2001). The theory and practice of corporate finance: Evidence from the field. *Journal of Financial Economics, 60* (2-3), 187-243.

Gupta, S., Batra, R., & Sharma, M. (2007). Capital budgeting practices in Punjab based companies. *The ICFAI Journal of Applied Finance, 13* (2), 57-70.

Jain, P. K., & Kumar, M. (1998). Comparative capital budgeting practices: The Indian context. *Management and Change, 2* (1), 151-171.

Lam, K.C., Wang, D., & Lam, M.C.K. (2008). Practices of Hong Kong building contractors in strategic asset allocation process: Longitudinal Approach. *Journal of Financial Management of Property and Construction, 13* (3), 176-186.

Lazaridis, I. T. (2004). Capital budgeting practices: A survey in the firms in Cyprus, *Journal of Small Business Management, 42* (4), 427-433. DOI: 10.1111/j.1540-627X.2004.00121.x

Olawale, F., Olumuyiwao, O., & George, H. (2010). An investigation into the impact of investment appraisal techniques on the profitability of small manufacturing firms in the Nelson Mandela Bay Metropolitan Area, South Africa. *African Journal of Business Management, 4* (7), 1274-1280.

Pandey, I. M. (1989). Capital budgeting practices of Indian companies. *MDI Management Journal, 2* (1) 36-48.

Rao, C. U. (1996). Capital budget practices: A comparative study of India and selected South East Asian Countries. *ASCI Journal of Management, 25* (1), 30-46.

Runyon, L.R. (1983). Capital expenditure decisions making in small firms. *Journal of Business Research, 11* (3), 389-397.

Shinoda, T. (2010). Capital budgeting management practices: A focus on the use of capital budgeting methods. *Economic Journal of Hokkaido University, 39* (6), 39-50.

Truong, G., Partington, G., Peat, M. (2008). Cost-of-capital estimation and capital budgeting practices in Australia. *Australian Journal of Management, 33* (1), 95-121.

Walker, J., Burns, R., & Denson, C. (1993). Why small manufacturing firms shun DCF. *Journal of Small Business Finance, 3* (3), 233-249.