International Journal for Multidisciplinary Research (IJFMR)
E-ISSN: 2582-2160 ● Website: www.ijfmr.com ● Email: editor@ijfmr.com

A Comparative Study of Capital Budgeting of Selected NBFC's

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Abstract:
Capital budgeting is a crucial financial management process used by organizations to evaluate, select and prioritize long-term investment projects. These projects often involve significant capital expenditure and have a long-term impact on the organization's profitability and growth. The current study evaluates the investment criteria of selected NBFCs in Karnataka. For the study purpose student selected 5 Non-Banking Financial Corporations and considered PBP and ARR methods for evaluation. For the analysis part Tabulation and Graphical representation methods are useful for interpretation.

Keywords: Capital Budgeting, NBFC's, PBP, ARR, Investment.

Introduction

Capital budgeting is the process by which businesses plan and evaluate potential major investment or expenditure decisions. It involves analyzing and selecting long-term projects that require significant financial resources but are expected to yield returns over a period of years. This process ensures that investments align with the organization's strategic goals and contribute to its overall growth and profitability.

Capital budgeting is a vital process aimed at maximizing shareholder wealth by identifying and prioritizing investment projects that yield the highest returns relative to their costs and risks. It involves assessing the feasibility of initiatives such as expanding production, introducing new products, replacing outdated equipment, or exploring new markets. Capital budgeting decisions are characterized by substantial financial outlays, long-term implications, irreversibility, and uncertainty, with significant strategic importance for a company's competitive position. This process is essential for efficient resource allocation, risk assessment, and driving future growth while ensuring financial discipline. Key steps include identifying opportunities, evaluating proposals using financial tools, selecting projects based on profitability and strategic fit, implementing plans, and monitoring performance to achieve expected returns. Common techniques include Net Present Value (NPV), Internal Rate of Return (IRR), Payback Period, Profitability Index (PI), and Discounted Cash Flow (DCF), all of which help account for profitability, risk, and the time value of money in decision-making.

Statement of the Problem

Despite the importance of capital budgeting in facilitating effective resource allocation and maximizing shareholder value, there exists a gap in understanding the factors influencing capital budgeting decisions and their impact on financial performance within the context of NBFC's. This study aims to address this gap by examining the challenges and constraints faced by the five non-banking finance companies in its capital budgeting process, analyzingthe efficacy of existing capital budgeting techniques, and identifying opportunities for improvement to optimize investment decisions and enhance overall financial performance.

Objectives of the Study

- To analyse the company's investment strategy for a particular period.
- To compare the level of capital budgeting application
- To summarize and to suggest for the better investment proposal.

Review of Literature

Simiso Siziba a, John Henry Hall b(2021): This study examines the evolution of the application of capital budgeting techniques. Previous studies mostly used cross-sectional inquiries to understand the capital budgeting practices of firms. Only a few researchers have undertaken longitudinal studies to generalise the findings of the individual cross- sectional studies to the wider population and to identify She emerging trends in the use of capital budgeting techniques (CBTs).

Sheikh Aamir and Javed Iqbal(2019): The results of the present study shows that every investment is useless unless and until followed by aproper appraisal or decision. Capitalbudgeting isconsidered as the corner stone in the theory offinancial management. Everyfirm in the practice ofmanufacturing or production need to take care of allthe methods fortheir investment evaluation.

Roopali Batra , Satish Verma(2017): The volatility of the global economy, changingbusiness practices, and academic developments have created a need to re-examine Indian corporate capital budgeting practices. Our research is based on a sample of 77 Indian companies listed on the Bombay Stock Exchange. Results reveal that corporatepractitioners largely follow the capital budgeting practices proposed by academic theory.

Paula de Souza Michelon, Rogério João Lunkes, Antonio CezarBornia&Production (2020): The purpose of this article is to identify theresearchopportunities in capital budgeting. Originality: This research contributes to the literature byprovidingamethodology whereresearcherscanpotentiallyidentifygapsfrombudgetingaccording to the existing scientific literature and contributes to the engineering managementpractice by to identifying the difficulties found by engineering managers that interfere in thecapital budgeting process. Research method:

Lakshman Alles, Ruwan Jayathilaka, Nelum Kumari, Taraka Malalathunga, Hashini Obeyesekera & Selvaraj Sharmila (2021): Thispaper examines the extent or usage of capital budgeting techniques in Small and MediumEnterprises (SMEs) and the effect of non-financial factors on the choice of capital budgeting techniques adopted by SMEs. A qualitative research method of content analysis as well as an econometric quantitative analysis have been employedfor this study. The study has been conducted in severaldivisional councils within the district of Colombo, Sri Lanka. Stratified random sampling has been used to collect a sample of SMEs from each divisional council within these divisions.

KatrinWeiskirchnerMerter(2022): This study looks at how a company's main office usesa manager's report containing important private information to make decisions about spending money on big projects. It also explores how the manager is paid based on this information. The study finds the best size for investments and how much the manager should be paid. The main office has to balance the benefits the manager gets from making big investments (even if they're not necessary) with making sure the investments areworthwhile.

Tatikonda Neelakantam (2022): This study explores the evaluation of progress in capital budgeting evaluation practices; From,onwards, all points are well analyzed in this study to find the most efficient way of capital investment. The study concludes thatthese modern methodsare usefulincompanies'long-termdecisions.

Lingesiya Kengatharan (2022): This study says over the past two decades, research in finance and accounting has shown that while capital budgeting theory suggests usingcertain methods like NPV, IRR, and others, most companies in both developed and developing countries prefer using more advanced techniques. These include various tools toaccount for risks and different ways to calculate discount rates. This shows that there'soften a gap between what theory recommends and what companies actually do when making capital budgeting decisions.

Scope of the Study

The study on capital budgeting of Non-banking finance companies focuses on evaluating each company's investment decision-making processes. It encompasses an analysis of capital budgeting techniques, decision-making criteria, risk management practices, and their impact on financial performance. Additionally, the study examines alignment with strategic goals, compliance with regulatory standards, and proposes enhancements for optimal resource allocation and decision-making efficiency.

Research Design

To conduct the current study, selected 5 Listed Non-Banking Financial Corporations from NSC. Samples are collected based on the market capitalization in the market. The data was collected through a secondary data collection method for the period of 2019-2023. In the study, the research design consists of a descriptive study, where it describes the state of existence of the things. The study focused on the analysis of tools used by companies such as PBP and ARR and their results individually. It compares different finance companies. Tabulation and Graphical representation is done by using Bar diagram and Pie chart.

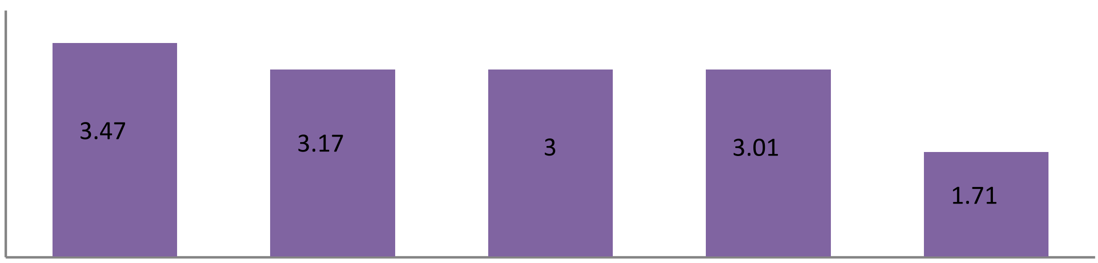
Data Analysis & Interpretation

Calculation of Pay-Back Period:

$$\text{Payback Period} = \frac{\text{Annual Cash Flows}}{\text{Initial Investment}}$$

1. L&T FINANCE COMPANY LIMITED

Year	2023	2022	2021	2020	2019
Paybackperiod	3.47	3.17	3.00	3.01	1.71



Interpretation The above chart illustrates the payback periods for L&T Finance Limited over five years from 2019 to 2023. In 2019: The payback period was 1.71 years, indicatinga relatively quick recovery of investment; Relatively in 2020: The payback period increasedto 3.01 years, showing a significant decline in efficiency. Again 2021:A slightimprovement is seen with a payback period of 3.00 years. In 2022: The period further improves to 3.17 years. Recently in 2023: The payback period extended to 3.47 years, reflecting the slowest recovery within these five years. Overall, the trend indicates a worsening payback period over time, suggesting that it is taking longer for the company to recover its investments year by year.

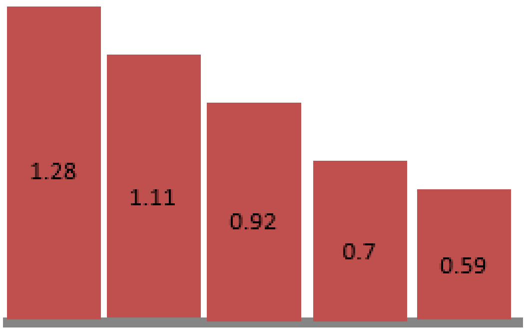
2. BAJAJ FINSERV LIMITED

Year	2023	2022	2021	2020	2019
Pay-backperiod	2.7	2.2	1.99	2.9	1.91

Interpretation: In the year 2019 the payback period was 1.91 years, which shows quick recovery of initial investment compared to remaining years. Payback period shows more fluctuation over the remaining 4 years. The general trend shows that the payback periodhas slightly worsened over the five years, suggesting it is taking longer for Bajaj Finserv.

3. MUTOOT FINANCE LIMITED

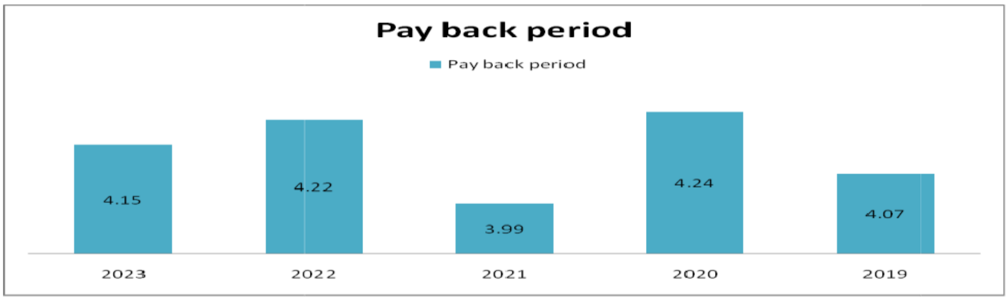
Year	2023	2022	2021	2020	2019
Paybackperiod	1.28	1.11	0.92	0.70	0.59



Interpretation: The decreasing trend in the payback period over the years suggests that MuthootFinance Limited's investments have been increasingly efficient in generating cash flowsand recovering initial costs.A decreasing payback period typically indicates improved profitability, efficiency, or risk management in investment decisions.

4. MAHINDRA AND MAHINDRA FINANCE LIMITED

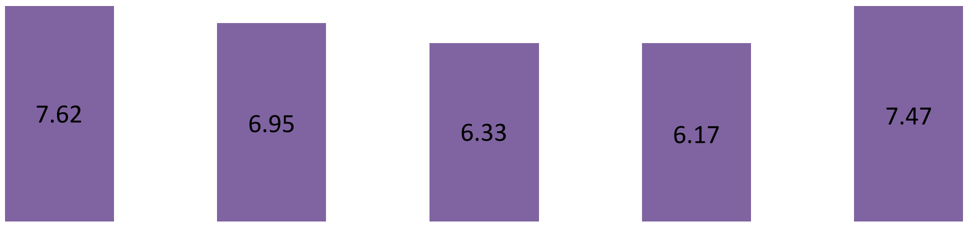
Year	2023	2022	2021	2020	2019
Paybackperiod	4.15	4.22	3.99	4.24	4.07



Interpretation: Overall, analyzing the trend of the payback period over these years can provide insights into the efficiency of Mahindra & Mahindra Financial Services Limited in generating returns on its investments and managing its cash flow. It also helps inassessing the company's investment strategies and financial performance over time.

5. ADITYA BIRLA FINANCE LIMITED

Year	2023		2022	2021	2020	2019
Paybackperiod	7.62		6.95	6.33	6.17	7.47

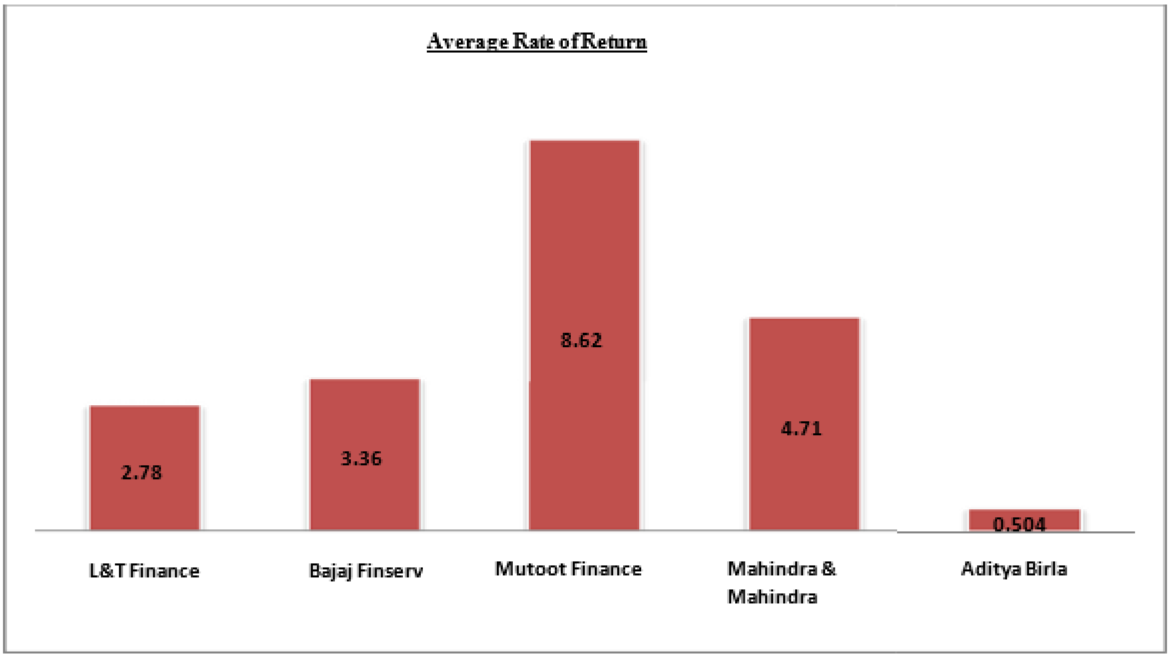


Interpretation: In summary, while there has been an overall trend of decreasing payback periodsfor Aditya Birla Finance Limited from 2019 to 2022, the slight increase in 2023 suggests a potential deviation from this trend.

Calculation of Average Rate of Return:

$$\textbf{Average Rate of Return}=\frac{\textbf{Average Annual Income}}{\textbf{Average Investment}}$$

Company Name	**L&T**	**Bajaj Finserv**	**Muthoot Finance**	**M& M**	**Aditya Birla**
ARR	**2.78**	**3.36**	**8.62**	**4.71**	**0.504**



L&T Finance Limited (2.78%):

Interpretation: With an ARR of 2.78%, L&T Finance Limited's average annual return on investment is relatively low. This indicate conservative investment strategies or low-risk, low-reward projects.

Bajaj Finserv Limited (3.36%):

Interpretation: Bajaj Finserv Limited has a slightly higher ARR of 3.36%. While still modest, this suggests a better performance than L&T Finance Limited, potentially with a balanced risk-return approach.

Mutoot Finance Limited (8.62%):

Interpretation: With an ARR of 8.62%, Mutoot Finance Limited shows a significantly higher average rate of return. This indicates a strong performance and suggests that the company is achieving high profitability on its investments, possibly due to higher risk investments that are yielding substantial returns.

Mahindra & Mahindra Financial Services Limited (4.71%):

Interpretation: Mahindra & Mahindra Financial Services Limited has an ARR of 4.71%. This is a moderate return, suggesting a relatively healthy performance. It indicates the company is performing better than the lower end companies but not as high as Mutoot Finance Limited.

Aditya Birla Finance Limited (0.504%):

Interpretation: Aditya Birla Finance Limited has the lowest ARR of 0.504%. This very low return suggests that the company's investments are either very conservative or not performing well, indicating potential areas for improvement in their investment strategy By this we can observe Mutoot Finance Limited stands out with the highest ARR, suggesting it is either taking on higher risks for greater returns or is more efficient in its investment strategies.

Overall, the ARR provides a quick snapshot of how effectively each company is turning its investments into profit, with higher percentages generally indicating better performance.

Findings:

An analysis of five Non-Banking Financial Companies (NBFCs) over five years (2019-2023) revealed key trends in their payback periods and Average Rate of Return (ARR). In L&T Finance Limited, the payback period increased consistently, reflecting declining efficiency in investment recovery. Bajaj

Finserv Limited showed fluctuations but experienced a slight overall worsening. Conversely, Muthoot Finance Limited demonstrated consistent improvement with a decreasing payback period, indicating enhanced efficiency. ARR analysis showed Muthoot Finance Limited leading with 8.62%, reflecting strong profitability likely from higher-risk investments. Bajaj Finserv Limited followed with 3.36%, signifying a balanced risk-return approach, while Mahindra and Mahindra Finance Limited had a moderate ARR of 4.71%, suggesting healthy performance. L&T Finance Limited's ARR stood at a conservative 2.78%, possibly due to low-risk projects, while Aditya Birla Finance Limited recorded the lowest ARR at 0.504%, indicating either highly conservative strategies or underperformance, highlighting areas for improvement.

Conclusion:

The comparative analysis of capital budgeting practices among five NBFCs from 2019 to 2023 highlights varying trends in payback periods and Average Rate of Return (ARR). Some companies, like L&T Finance Limited and Aditya Birla Finance Limited, showed worsening payback periods and low ARR, indicating inefficiencies and areas for improvement. In contrast, Muthoot Finance Limited emerged as a top performer with the highest ARR, reflecting strong profitability and efficient strategies. These findings emphasize the need for robust risk management, proactive market analysis, and strategic decision-making to optimize returns and drive sustainable growth in a dynamic financial landscape.

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International Business and FinanceFull length ArticleImpact of capital budgeting decisions on financial performance of Small and Medium Enterprises (SME's): A case study of SME's of Jammu and Kashmir Sheikh Aamir1 and Javed Iqba International Journal of Advanced Scientific Research and Management, Volume 4 Issue 5, May 2019 www.ijasrm.com ISSN 2455-6378 ons to raise from outside.