PREFACE

The main objective o this research work is to develop systematically the beginning of and various stages in capital budgeting.

Indeed, the aim is to provide an integrated presentation of capital budgeting and to view the unity of the subject matter in such a way that the questions of “how” and “why” are easily answered.

The topics, sales forecasting (touched briefly) and forecasting of financial requirements as they relate to capital budgeting are covered. The other section of this research work include literature review, research methodology, case study and analysis of data and summary of findings recommendation and conclusion.

The section in literature review is quite extensive when compared to other sections of this research work. it is the intention of the researcher to bring out the essentials that relate to capital budgeting and hint on those that relate to the company under study. It is hope that those that do not elate to the company will find it useful, to students with interest in capital budgeting and who capital budgeting and who carryout their research work on their companies in Nigeria and aboard.

This research work is written in language that will make it easy for many people to read and understand. It is my hope that it will enhance the attractiveness of capital budgeting for a large number of audience.

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CHAPTER ONE

INTRODUCTION

Every business firm normally will like to know how it performed over a period of times, thus leading to the preparation of profit and loss statement. They also ask about their position at a particular point in time which leads them to prepare balance sheet. Finally, they will like to know where they are heading, which has led to the preparation of budgets.

Budget is term used locally by a lay man. Lay man confuse budgeting with planning. A budget is part of a plan. A plan can be expressed in monetary and non-monetary term. Any plan that is qualified in monetary term is a budget. A budget, therefore, can be succulently defined as a statement of intention qualified in monetary term.

In budgeting there are types of budget prepared by firms. Such budgets includes capital budgets, cash budgets, sales budget and so on.

The process of preparing capital budget is called capital budgeting. Capital budgets are long term budgets made for acquisition and expansion of fixed assets. Capital budgets are prepared by many films today. It was originated in the United States of America (USA). In America it was applied by firms before the second world war.

After the second world war many firms saw the need to plan for capital expenditure, hence it is prevalence today.

Nigerian breweries limited, Monarch larger beer and other beverages, are not left out in the train of firms which prepare budgets for its capital expenditure. this is, however, not easy as it is fraught with a lot of problems.

1.2 PROBLEMS STATEMENT

The main purpose of setting up a private firm is to achieve enough sales revenue that will cover fixed and variable costs as well as leave out enough profit to justify its existence.

Nigerian breweries limited being a private enterprise involved in brewing beer has the objective of making huge profits.

Brewers all over Nigeria witness heavy returns on their investments due to export of their products to neighboring African countries as well as the high

consumption rte of beer in the country. This was before the year 1982.
The introduction of many stringent economic measures after the year 1982, aimed at revamping the nations ailing economy, brought with its many problems of which the brewing industry is not left out.
In order to produce, firms in the breweries industry (including Nigerian breweries limited) acquires fixed assets as well as raw materials.
These acquisitions are based one expect demand. The demand for beer cannot now be fairly estimated because of the general rise in prices. General rise has made consumers of beer shift their demand to other goods of necessity thus leading to decrease in demand for beer. The uncertainly surrounding the continuance and rate of which demand for beer decrease has become one of the problems encountered in capital budgeting, especially by Nigerian breweries limited, since capacity to produce is always affected by changes in demand.
Apart from capital budgeting problems caused by uncertainty in demands there is also the problem of tariff or import restrictions on the importation of fixed assets and spare parts. This singular problem has helped in no small measure in fuelling the amber of problems encountered by these firms. It has made firms like Nigerian breweries limited search for alternative sources of obtaining fixed assets necessary for its production operations. Even when these fixed assets are source, there is often an increase in the price paid for them as a result of import tariffs or restrictions. The uncertainly surrounding this has made it a capital budgeting problem.
Increase in price of fixed assets as a result of import restrictions and the small nature of the financial capability have made firms like Nigerian breweries limited to rank the projects they wish to embark upon. There is always the problems of appropriate method of selection that will be peculiar to a given project. Also encountered in the selection of projects is human problem in the organisation which is a function of the state of mind of the individual in charge of the capital budgeting.
Because of the small nature of its financial ability Nigerian breweries limited look for external means of financing its capital projects. These external sources of finance include commercial banks, trade creditors and some financial institutions. Banks and other financial institutions charge interest on the money they lend out. interest charges are based on negotiations or what prevails in the banking industry as directed by the Central Bank of Nigeria. interest charges fluctuates widely with the economic condition. Due to the dynamic nature of the economy and consequent effect on interest rate, it is a problem making cost benefit analysis necessary in capital budgeting.
Even when the above problems are solved to a great extent, there remains the problem of obtaining foreign exchange necessary to remit to exporters exchange rates are never stable. The uncertainty include in this makes it a problem in

capital budgeting.
These problems were what gave rise to the research objectives.

1.3 OBJECTIVES OF THE STUDY

The objectives of this study were to find out the following:-

a) Factors responsible for the demand for beer and the effect demand has on capital budgeting, other operations of the company and its existence.
b) The capital budgeting process in Nigerian breweries limited
c) Why external sources of finance is used instead of floating stock of shares given its financial constraints and high interest rate on external financing.
d) Ways in which purchased capital assets are paid for (example, through letters of credit, documentary bills for collection, open transfers etc).
e) The effects delaying arrival of ordered assets or pays for them have on the production of beer.
f) The effects over or under – investment have on the firm.
g) How they forecast sales or demand given its fluctuation as a result of general rise in prices.

In connection with the above objectives was the necessity to formulate hypothesis.

1.4 HYPOTHESIS

The following hypothesis were formulated with respect to this study. In other words the following were tested.

i) Fluctuations in demand has no effect on capital budgeting and other operations of the firm.
ii) There are no problems in the capital budgeting of Nigeria breweries limited.
iii) The company does not seek floatation of stock in the stock exchange because it does not want external in both its operations and management.
iv) There is no problem encountered so far as the method used for payment of capital assets purchased.
v) Delays in arrival of ordered fixed assets have no effect on the production of beer.
vi) Over-or under-investment in fixed assets has little or no effect on the financial position of the company.

These hypothesis were what the researcher examined in the course of this investigation of capital budgeting in Nigeria breweries limited.
Academic enquiry on capital budgeting is not without limitations.

1.6 SIGNIFICANCE OF STUDY

A lot of factors make capital budgeting very important in productive and commercial spheres of any economy. These factors include' loss of flexibility.

Some of the information on this were taken from "essentials of management finance” by J. F. Weston and E. F. Brigham after commitment of funds to projects, the relationship between asset expansion and sales, proper phasing of the availability of capital assets and the quality of assets purchased, substantial expenditures which funds are not often automatically available and failure of firms as a result of the little equipment.

Capital budgeting is an important aspect of strategic decision involving financial management. In purchasing fixed assets, firms commit large amount of capital. The result of this capital commitment continue over a long time with subsequently loss of flexibility in decision making.

For example firm ABC limited commits funds on equipment X with an economic life of six years. The expenditure takes a long time before starting to yield good fruits and during which the firms is held hostage to future events both in technological developments in the general economy.

Apart from loss of flexibility and hostage to future events, expansion of fixed assets are always related to future sales, future sales are always forecast. Acquisition of an asset with a fire year economic life means a forecast of sales to be made over the same period of time.

Therefore, failure to forecast accurately results in over or under investment in fixed assets.

Over investment in fixed assets often lead to unnecessary heavy investment, when fund the firm should have employed profitably in other income yielding ventures such as securities. It is often difficult for a firm to forecast its optimum investment accurately with the result that there is another extreme of investment in fixed assets which may lead to enable it complete very well with rivals in the production of goods. A firm can also lose a portion of its share of the market as a result of inadequate capacity or under investment. To regain the profit of its share of the market lost often involves huge expenses in selling and sometimes reduction in selling price or both.

Availability of capital asset if properly phased helps the firm to buy equipment necessary to take care of intermittent spurts in demand for its production. This is so in that an increase in demand in excess of firms. Capacity often leads to turning away of orders. Excessive demand and pressure on firms make them rent additional equipment and buildings in order to produce goods that will meet the mounting demand. On getting these facilities ready, firms discover that demand for their products have leveled off and not as before.

Capital budgeting for asset expansion is also significance in that it involves a substantial outlay of funds. This makes it necessary for a firm to plan how to raise the needed funds as they are not always automatically available in order to be sure of funds when its expansion is embarked upon.

Finally, most firms which failed did so not because of over investment but because they had too little capital equipment. their failure is as a result of rival companies installing automated and more efficient equipment capable of producing a higher quantity of the goods currently produced. Also these goods are produced at a relatively shorter time at reduced price. Having stated the significance of this study of capital budgeting, the researcher found it important to define some words or terms used which she felt would make the understanding of this study easy for its readers.

1.6 DEFINITION OF TERMS

i) Capital budgeting; this is a long-term plan made for expenditures necessary to buy fixed assets for production of goods.

ii) Finance; This is a term used to denote the acquisition and expending of funds to meet an economic units objectives.

iii) Cash-inflow; It is used to means flow of cash into a firm such as revenue from sales.

iv) Capital assets; They are assets of long term nature used in the production of goods.

v) Outlay of funds; Expending of money, Terms were defined in order to make readers understand the subject under discussion.

Knowledge is cumulative and text books already write on the subject serve as a precedent for the work. it was in purist of more knowledge in capital budgeting that the researcher reviewed literatures written by several authors on the subject.

CAPITAL BUDGETING IN THE PRIVATE SECTOR (A CASE STUDY OF THE NIGERIAN BREWERIES)