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Capital budgeting practices by large Brazilian companies

Prácticas de presupuestación de capital por grandes compañías brasileñas

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Abstract

This article aims to analyze the use of capital budgeting practices by large Brazilian companies. The survey technique was used for data collection in 51 companies traded on the Stock Exchange. Descriptive statistics were applied, aiming to improve the basis for discussions. The correlation was used to assess the theoretical assumptions of the research. The results show that companies adopt especially the Payback Period, the Net Present Value and the Internal Rate of Return in the assessment of capital budgeting, with scenario and sensitivity analyses to examine the investment risk. The assessment of theoretical assumptions developed in the study has shown that there is no relationship of cause and effect among the variables to explain the use of more sophisticated budgeting practices. Based on similar studies, it is concluded that there is a general trend of increasing sophistication in the various stages of investments budget in large Brazilian companies. All Rights Reserved © 2016 Universidad Nacional Autónoma de México, Facultad de Contaduría y Administración. This is an open access item distributed under the Creative Commons CC License BY-NC-ND 4.0.

JEL classification: E22; M21

Keywords: Capital budgeting; Practices of the capital budgeting; Large Brazilian companies; Stock exchange; Investments

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Resumen

Este artículo se propone analizar el uso de prácticas de presupuestación de capital por grandes compañías brasileñas. Se utilizó la técnica de encuesta para la compilación de datos en 51 compañías que se negocian en la Bolsa de Valores. Se aplicaron estadísticas descriptivas, con el propósito de mejorar la base para discusiones. Se empleó la correlación para evaluar los supuestos teóricos de la investigación. Los resultados muestran que las compañías adoptan especialmente el Periodo de Recuperación, el Valor Presente Neto y la Tasa Interna de Rendimiento para la evaluación del presupuesto de capital, con análisis de escenario y de sensibilidad para examinar el riesgo de inversión. La evaluación de los supuestos teóricos desarrollados en el estudio ha mostrado que no hay relación de causa efecto entre las variables para explicar el uso de prácticas de presupuestación más sofisticadas. Con base en estudios similares, se concluye que hay una tendencia general a aumentar la sofisticación en las diversas etapas del presupuesto de inversiones en las grandes compañías brasileñas.

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Códigos JEL: E22; M21

Palabras clave: Presupuestos de capital; Prácticas de presupuestación de capital; Grandes compañías brasileñas; Bolsa de Valores; Inversiones

Introduction

Budgeting has been considered one of the main management tools to guide organizations, measure their performance and motivate people. In addition, it serves as an imperative tool in the stages of planning, execution and control. One of the stages of the budgeting process includes preparation and analysis of capital budgeting, which is the focus of this study.

For Koch, Mayper and Wilner (2009) and Bennouna, Meredith and Marchant (2010), the decisions inherent to capital budgeting are fundamental to the survival and success of the company in the long run. In view of this, the decisions of the investment budget are conceptualized as a difficult type (Carmona, Iyer & Reckers, 2011). The complexity is justified because capital expenditures require significant resources. In addition, companies should determine the best way to get and return these resources. And yet, most of the capital budgeting decisions require a long-term commitment (Chan, 2004; Olawale, Olumuyiwa & George, 2010).

The relevance of the capital budgeting process for the company lies in the fact that a significant amount of money is committed for a long period. This implies that, after the decision to start a project has been made, its reversal would probably culminate in partial or total loss of the amount invested (Hall & Millard, 2010).

In addition, long-term decisions require an assessment of the value of money over time, and a behavior analysis and relevance of costs. In this context, capital budgeting practices are tools that assist managers in making long-term decisions. Such practices that make up the budget are commonly divided into: investment analysis, discount rate setting and risk analysis.

Additionally, Kalhoefer (2010) states that the discussion about the best set of practices to be used in capital budgeting has been extensive and dull. That is because the existence of a single and comprehensive method to be used is questioned.

It turns out that, in fact, the decision maker must often choose among various practices, based on numerous criteria, not always having a dominant option. The manager must not only assess each option and discretion. They must also distinguish the importance related to each option and discretion to make the final assessment (Carmona, Iyer & Reckers, 2011).

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