

Challenges and Opportunities in Adopting Capital Budgeting Practices

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ABSTRACT:

This study aims to examine the obstacles and potential advantages that small and medium firms encounter when using capital budgeting techniques. The present study employs a design that involves doing a comprehensive literature analysis to analyze various papers and prior research. The present study reveals a number of problems encountered by small and medium firms in the process of adopting capital budgeting techniques. One of the most significant obstacles that has a profound impact is the deficiency in understanding capital budgeting. The implementation of capital budgeting procedures is infrequently observed among small and medium firms, resulting in limited impact. Despite the potential benefits it offers to the development of small and medium firms, capital budgeting facilitates crucial decision-making processes pertaining to investments, long-term planning, and investment assessment for business owners. The practical implication of this study suggests that owners of small and medium firms should consider enhancing their financial knowledge or seeking professional experience in the areas of finance and management.

Keywords: **Capital Budgeting Practices; Small and Medium Enterprises; Capital Budgeting Challenges; Capital Budgeting Opportunities**

I. INTRODUCTION

Small and medium-sized enterprises (SMEs) significantly impact fostering innovation, creating jobs, and reducing poverty and wealth inequality (Dzamonda and Fatoki, 2019, cited in Nunden et al., 2022). Small and medium-sized enterprises (SMEs) are critical to the nation's financial system and contribute to economic growth, job creation, and innovation. SMEs make an important contribution to the economy for a number of reasons. First, they create a significant amount of jobs. In Indonesia, 65.4 million small and medium-sized firms (SMEs) employ 114.7 million people, accounting for approximately 56% of the total workforce. Furthermore, according to the MSME Empowerment Report, 2022:5, MSMEs contribute more than 60% of the country's GDP. Compared to larger companies, SMEs often have a higher labor intensity, resulting in employment opportunities for a significant portion of the labor force. This is particularly important in countries with high unemployment or a large informal sector. Due to the enormous number of MSMEs, particularly micro firms, and the massive absorption of

manpower, Indonesia was able to establish a solid national economic foundation. As a result, MSMEs are critical for Indonesia's overall social and economic inclusion (Rinatami et al., 2020).

SME owners also make financing decisions for business investments; however, they often make poor decisions regarding collection, allocation, mortgages, consumption, savings, risk control, and risk assessment due to human bias (Hoque, 2017). Investment decision is important for Small and Medium Enterprises, A good investment decision is still a good deal for business even if not optimally financed, but good financing policy will be bad if the investment decision is wrong (Brealey et al., 2010 as cited in Andres et al., 2015). A capital budget is a tool for making investment decisions. A capital budget organized by all future investment projects (Berk et al. 2015, as referenced in Nguyen, 2019). Capital budgeting can be used as a filter before deciding to spend large sums of money on investment projects that require large sums of money, or it can be used to make a decision about whether or not to make an investment (Nunden, Abbana, Marimuthu, & Sentoo, 2022).

Moreover, lack of professional management and formal planning is one of the major challenges for small and medium-sized enterprises looking to improve their business management (Duchesneau and Gartner 1990; Benzing et al., 2009). To put it another way, greater planning and budgeting are required to improve decision making in Small and Medium Enterprises (Zor et al., 2019). The implementation of the capital budget is also critical, as it is associated with capital activity and large expenditures. A comprehensive capital budget is necessary for small and medium enterprises.

There are not many studies that address how investment plans and methods affect the financial decisions of small businesses. Alles et al., (2021) examined how SMEs can use existing capital budgeting procedures and how nonfinancial factors can influence SMEs approaches. Siziba and Hall (2021) examined how different capital budgeting methods have been used over time. Thus, this study aims to explore the challenges and opportunities for small and medium enterprises from adopting capital budgeting practices.

II. LITERATURE REVIEW

A. Definition of Capital Budgeting

The corporation employed a capital budgeting process as a planning mechanism to make evaluation judgments regarding the optimal allocation of resources to investment projects. This approach aids in assessing the feasibility of projects. The process entails the acquisition of a costly, durable asset that will have a significant impact on the future prosperity of the firm. According to Mollah et al. (2021), the capital budgeting process is a method employed to facilitate the identification and evaluation of investment projects that are both economically viable and practical. This process encompasses a range of activities. The range of actions encompasses planning, reviewing, evaluating, selecting, implementing, and conducting follow-up procedures. The evaluation also encompasses examining the proposed project's cash flow to assess the uncertainty and risk associated with the project (Mollah, Rouf, & Rana, 2021). Furthermore, capital budgeting is a strategic process utilized to select the optimal investment option. In order to achieve optimal corporate performance, it is imperative to implement efficient capital investment strategies (Puwanenthiren, 2022).

B. Importance of Capital Budgeting Practices for SMEs

Capital budgeting techniques are very important for SMEs because they help them make good decisions about long-term investments and how to use their resources. First, optimal Allocation of limited resources; Small and medium-sized enterprises (SMEs) use capital budgeting to evaluate different investment opportunities and select the one that offers the best chance for success and growth. Using capital budgeting techniques such as payback period, internal rate of return (IRR), and net present value (NPV), small and medium-sized enterprises (SMEs) can rank investment projects in order of importance and use their resources wisely. Second, Long-term planning; The implementation of capital budgeting methods facilitates small and medium-sized enterprises (SMEs) in their endeavours of engaging in long-term planning and formulating strategic initiatives. Through the evaluation of the financial feasibility and inherent risks associated with investment initiatives, small and medium-sized enterprises (SMEs) are able to make well-informed determinations regarding the future trajectory of their firm. The practice of capital budgeting allows small and medium-sized enterprises (SMEs) to effectively coordinate their investments with their strategic goals and objectives. This ensures that the selected projects align with the firm's overall growth and long-term viability.

Third, Risk assessment and mitigation. Allocating resources to new ventures or expanding business operations is fraught with uncertainties and potential hazards. Investment appraisal methods provide small and medium-sized enterprises (SMEs) with a systematic framework for evaluating and managing these risks. SMEs can evaluate investment projects' profitability and potential risks by considering many elements, including market demand, competition, technological improvements, and regulatory changes. Applying this risk assessment helps small and medium-sized enterprises (SMEs) make informed decisions and implement risk mitigation measures to minimize potential financial setbacks. Fourth, Improved financial performance; The use of efficient capital budgeting procedures has been shown to positively impact the financial performance of small and medium-sized enterprises (SMEs). Small and medium-sized enterprises (SMEs) can potentially increase revenues and profitability by allocating resources to initiatives with a positive net present value or return on investment. Investment appraisal plays a critical role in enabling small and medium-sized enterprises (SMEs) to identify projects that add value and make a significant contribution to the long-term financial well-being of the business.

Moreover, Competitive advantage; The use of capital budgeting methods has the potential to confer a competitive edge upon small and medium-sized enterprises (SMEs) operating within the market. Small and medium-sized enterprises (SMEs) can establish a competitive advantage and exploit market prospects by allocating resources towards initiatives that improve operational efficiency, technological capabilities, or the quality of their products or services. The utilization of capital budgeting allows small and medium-sized enterprises (SMEs) to discern and evaluate strategic expenditures that provide them with a distinctive selling offer and a competitive advantage within their own industry. Lastly, Adaptation to changing business environment; The dynamic nature of the business environment necessitates that small and medium-sized enterprises (SMEs) embrace adaptability to maintain competitiveness. The utilization of capital budgeting procedures allows small and medium-sized enterprises (SMEs) to evaluate the financial consequences associated with shifts in market conditions, the introduction of novel technology, or alterations in regulatory frameworks. By integrating these variables into their assessment of capital budgeting, small and medium-sized enterprises (SMEs) may strategically make investment choices that enable them to thrive in a dynamic and evolving business environment.

C. The adoption of capital budgeting practices by small and medium-sized enterprises (SMEs)

According to Nunden et al. (2022), the responsibility for capital budgeting decisions in small and medium-sized enterprises lies with owners rather than managers. During the process of preparing capital budgeting, owners work with external parties who have expertise in capital budgeting. What is the reason that owners seek the advice of experts? According to Nunden, Abbana, Marimuthu, and Sentoo (2022), it is a common observation that owners of small and medium enterprises often lack the necessary skills and training to effectively carry out the capital budgeting process.

The capital budgeting and planning process in small and medium enterprises (SMEs) requires the acquisition of various information from managers and owners (Awinja and Fatoki, 2021, cited in Nunden et al., 2022). This information includes factors such as potential risks and the net return on the capital budget (Sacks et al., 2018 cited in Nunden et al., 2022). Small and medium enterprises usually refrain from using capital budgeting techniques due to factors such as financial feasibility, lack of available funds for investment, and insufficient understanding of capital budgeting (Egbide et al., 2019 cited in Nunden et al., 2020).

III. METHODS

According to McCusker, K., & Gunaydin, S. (2015), qualitative methods are used to answer questions about "what", "how", or "why" about a phenomenon, while The "how much (how much)" quantitative approaches answer question. The choice to apply qualitative methodologies in regard to study goals is made to comprehend how communities or individuals perceive a specific problem, claim McCusker, K., and Gunaydin, S. (2015). Given that they will be interpreting the data gathered, it is crucial for researchers to utilize qualitative methodologies to assure the quality of the study process. This study is using literature review from many resources to discuss the objectives of topic.

IV. RESULTS

A. The Obstacles Encountered by Small and Medium Enterprises in Implementing Capital Budgeting Practices

Small firms and large businesses differ in their capital investment decisions in various ways. Initially, it is observed that small business owners exhibit a higher propensity to prioritize independence rather than the maximizing of wealth, a factor that may influence their investment decisions. Additionally, small business proprietors may require assistance in acquiring funding, a factor that could potentially influence their decisions about liquidity management and the maintenance of financial reserves. Furthermore, small business proprietors may encounter challenges in effectively assessing potential investments as a result of workforce constraints and limited expertise in investment evaluation (Nunden et al., 2022).

Certain small and medium-sized enterprise (SME) owners encounter difficulties when attempting to execute the intricate capital budgeting process due to their limited knowledge and skills in this area. In small and medium-sized enterprises (SMEs), the owners, rather than the management, are responsible for making critical decisions on capital budgeting. It has been observed that individuals who possess ownership either engage in the capital budgeting process independently or seek consultation from external capital budgeting experts. (Nunden

et al., 2022) Many small and medium-sized enterprise (SME) owners might benefit from acquiring additional skills and education in order to effectively carry out the capital budgeting process. The research conducted by Essel et al. (2019), as referenced in Nunden et al. (2022), revealed a correlation between the educational attainment of entrepreneurs and the level of success achieved in their company ventures. The observed association indicated a positive relationship between the level of qualification had by an entrepreneur and their degree of business success. According to Asgary et al. (2020, as referenced in Nunden et al., 2022), the results were characterized by intuitive decision-making, effective marketing strategies, convenient financial accessibility, and customer satisfaction.

Some small and medium-sized enterprise (SME) owners may not have formulated a comprehensive long-term strategy for ensuring business continuity. This could be attributed to the tendency of small business owners to prioritize independence over the pursuit of maximizing wealth.

The advantages of capital budgeting can be realized when it is effectively executed and progresses through the proper phases. Decisive strategic planning is identified as a pivotal stage within the capital budgeting process. Strategic planning refers to the systematic process by which a corporation determines its desired strategy or direction and efficiently allocates its available resources to effectively accomplish this strategy. Multiple studies have revealed that a significant number of Small and Medium-sized Enterprises (SMEs) commence their operations without adequately considering the long-term allocation of capital and resources.

B. Opportunities for SMEs from the Adoption of Capital Budgeting Practices

Capital budgeting is a process that involves assessing the risks and potential losses associated with a specific project or investment, and determining the precise financial requirements of a corporation.

1. Earning the confidence of potential investors

Small and medium-sized enterprises (SMEs) can cultivate confidence among prospective investors, promoters, and employees by incorporating capital budgeting practices into their organizational procedures. Small and medium-sized enterprises (SMEs) typically possess predetermined objectives and strategies for the necessary capital quantity and allocation. Accurate and detailed information regarding the required capital plays a crucial role in attracting potential investors to participate in small and medium enterprises (SMEs), hence facilitating the acquisition of necessary funds for the smooth operation of their business activities.

2. The objective of profit maximization

Given that the fundamental goal of a company is to generate profits, it is imperative for small and medium-sized enterprise (SME) owners to engage in capital budgeting. This process necessitates the development of a strategic plan for the allocation of funds and the ability to forecast the financial returns derived from capital investments. Profit is attained when the income generated from the operational activities of a firm exceeds the costs incurred in carrying out those activities. Small and medium-sized enterprises (SMEs) have the potential to enhance their profitability through the implementation of capital budgeting strategies aimed at minimizing non-business-related expenditures. Additionally, facilitating the process of securing bank loans can contribute to this objective.

Financial institutions, such as banks, frequently serve as a viable option for small and medium-sized enterprises (SMEs) seeking to secure business financing. Nevertheless, acquiring a loan from a financial institution can prove challenging due to the prevalent practice of imposing exorbitant interest rates on small and medium-sized enterprises (SMEs). Financial institutions are confronted with a significant level of vulnerability in relation to the potential occurrence of refund defaults by small and medium-sized enterprises (SMEs). Small and medium-sized enterprises (SMEs) may choose to employ capital budgeting techniques as a means to persuade financial institutions of their ability to meet debt obligations in a timely manner. To achieve this objective, SMEs could furnish the bank with empirical information demonstrating their proficient capital planning practices. Furthermore, it is possible that the bank could decrease its lending rates specifically for small and medium-sized enterprises (SMEs).

V. DISCUSSION AND CONCLUSION

There are notable differences in capital budgeting processes between large corporations and small and medium-sized organizations. Large companies tend to use more sophisticated methods when it comes to capital budgeting, while small and medium-sized companies tend to use simpler strategies or do not engage in capital budgeting at all.

This study's results suggest that using capital budgeting techniques can potentially facilitate the expansion of small and medium-sized enterprises (SMEs) by enabling informed investment decisions. According to Puwanenthiren (2022), the capital budgeting process has contributed to improving the quality and implementation of investment decisions. Nevertheless, there are many obstacles in small and medium enterprises when it comes to implementing capital budgeting processes. The main obstacle in business operations is a lack of knowledge, especially related to financial and resource management. Knowledge is widely regarded as the most important asset in business. The limited understanding of small and medium enterprises (SMEs) owners and management regarding control mechanisms contributes significantly to the challenges associated with the implementation of investment accounting. In addition, resource constraints are a significant obstacle for small and medium-sized enterprises (SMEs) in implementing capital budgeting methods, as these methods require extensive information for in-depth analysis. The final challenge relates to the owner's view of investment needs and business objectives. In order to make informed decisions, it is necessary to consider the owner's perspective, which plays an important role in the decision-making process. If the owner does not see the need for investment, it is very likely that investment appraisal will not be carried out.

The most important means of overcoming the challenges faced by small and medium enterprises in implementing capital budgeting is to conduct training programs or courses aimed at improving the understanding of finance and capital budgeting. Today's environment is characterized by significant advances in technology, resulting in an abundance of educational media. Managers and owners of small and medium enterprises need to develop strategic approaches aimed at increasing motivation levels to achieve budget goals (Nunden, Abbana, Marimuthu, & Sentoo, 2022). The obstacles faced by small and medium enterprises can be gradually overcome as the business expands. According to a previous study by Mendes, Serrasqueiro, and Nunes (2014), there is a positive correlation between sales growth and investment decisions. The upward trend in sales is assumed to affect both income and profits, increasing the likelihood that investments will be made to promote business growth. As the complexity of the business increases, so does the demand for a greater allocation of resources, including both skilled labor and financial capital. Owners have the option to engage the

services of professionals to improve their financial performance to ensure accountability within the company. This research is subject to several limitations. The challenge is to find research and papers that are relevant to the topic under study. The author conducts a comprehensive analysis by examining articles on the implementation of investment appraisal in small and medium enterprises.

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