CHAPTER - VIII
CHAPTER VIII

RECOMMENDATIONS

Based on the analysis and conclusions given in the previous chapters, the following recommendations are made in this chapter for the improvement of capital expenditure practices in companies - especially in public sector companies.

8.1.0 Recommendations to improve capital expenditure decision.

[1] There should be clear thinking and understanding during planning of capital expenditure.

[2] Capital expenditure items proposed by the various department should not be a 'wish list', but it is to be practical and supported by facts and figures.

[3] No muscle power of department head is to be used in getting the capital expenditure plan approved.

[4] The request for financial approval should find proper answer to questions like;
   [a] What is the need for this expenditure?
[b] Why is it now?
[c] How it will be done?
[d] Who will be responsible?

[5] Detailed bar chart/PERT should follow every request for financial approval.

[6] The time of completion should be the time committed by the project team.

[7] Delay in all levels should be avoided to avoid further price rise.

[8] Liquidity damage clause should be included in all purchase orders.

[9] The review meeting should follow a proper agenda and man-bound and time-bound action plan. Action plans for follow up are to be very specifically mentioned and meticulously followed.

[10] All departments concerned like {i} Engineering [civil, mechanical, electrical and instrument], {ii} Materials [stores, purchase and traffic] and {iii} Accounts [material receipt, bill passing and cash] should have very close coordination.

8.2.0. The following ideal process chart developed for systematic preparation of capital expenditure, if followed will make the system more effective and meaningful.
Capital Expenditure is a process involving various activities. If the process can be defined, the implementation becomes easy and effective. The basic three steps in the preparation of capital expenditure are the following:

1. Identification of capital expenditure projects
2. Preparation of Annual Capital Expenditure Plan
3. Preparation of Request for Financial Approval (RFA)

IDENTIFICATION OF CAPITAL EXPENDITURE PROJECTS

Exhibit 8.1 shows the various steps involved in identification of capital expenditure (CAPEX) projects. The need for a project may come either from the market demand or from the growth/improvement plan of the company. Projects coming from these two areas are to be revalidated with the strategic plan of the company. Another source from which a capital expenditure plan can emerge is the pain area of the company/plant. Ideas coming from these three areas can be converted into projects. A preliminary feasibility report for each project is to be prepared for understanding the project in depth. Projects coming out from here are to be considered for the annual capital expenditure plan of the company.

PREPARATION OF ANNUAL CAPITAL EXPENDITURE PLAN

Exhibit 8.2 shows the steps involved in the preparation of annual capital expenditure plan of the
EXHIBIT - 8.1
IDENTIFICATION OF PROJECTS FOR CAPEX

START

RESTUDY MARKET DEMAND

REVALIDATE GROWTH/IMPROVEMENT

PAIN AREA OF PLANT

REVALIDATION OF STRATEGIC PLAN

CONVERT THE PLAN TO DIFFERENT PROJECTS

PREPARE FEASIBILITY REPORT

INCLUDE PROJECTS IN CAPEX LIST
EXHIBIT 9.2
PROCESS OF CAPEX PREPARATION

RECEIPT OF INFORMATION FOR CAPEX PROPOSAL

REFER STRATEGIC PLAN

IDENTIFY MAJOR PROJECTS

ANALYSE COST/BENEFIT

TO BE INCLUDED IN THE CAPEX PLAN

REFER SHORT TERM PLAN

IDENTIFY SHORT PROJECTS

FORMULATE THE REQUIREMENTS BY DEPT S

DISCUSS WITH ALL DEPARTMENTS

REVIEW

NO

YES

FINALISATION OF CAPEX PLAN

FORWARD FOR APPROVAL

YES

NO

QUERIES?

FINAL CAPEX PLAN READY
company. This process normally follows the previous process of identification of projects. The identified projects of each department or section are referred to the strategic plan or short term plan of the company. Based on the strategic plan or short term plan, the projects can be identified as major projects or short/minor projects. For major projects cost benefit analysis is to be prepared. But in case of short/minor projects the various departments' requirement are to be formulated and discussed with all departments. The outcome of these discussions along with the major projects supported by the cost benefit analysis can be the final list of capital expenditure (CAPEX) plan of one particular plant. This can be forwarded to corporate office, if a separate corporate office exists, for the final capital expenditure plan approval by the chief engineer, chief finance officer and chairman and or managing director of the company, before the beginning of a financial year.

PREPARATION OF REQUEST FOR FINANCIAL APPROVAL

Once the annual capital expenditure plan is approved generally before the beginning of the financial year, a project execution plan is to be prepared. Project execution plan is the plan made at every plant clearly denoting who will execute which project and what is the time frame etc. Then the project leader has to prepare the request for financial approval.
Exhibit 8.3 shows the Macro process chart for the preparation of request for financial approval and also the Micro process chart giving the details of the request for financial approval.

The first step in the Micro process chart is to study the requirement for which investment is called for. The second step is to identify the alternatives or different routes available for meeting the requirement. Then quotations are to be invited for getting the material/equipment or for getting the job done. A comparative statement of different quotations are to be made. Once the comparative statement is studied by making use of capital expenditure evaluation methods the final source of supply and the course of action can be identified. After this is done the final request for approval showing details like what is this investment, why it is required, why it is required now, how it will be done, who will do it, what are the alternatives studied, what is the financial justification, what are the details of cost, what is the impact of this investment on environment etc., can be sent to the concerned authority depending upon the investment for approval. Once the request gets the approval the execution of the project can be started.

This type of clear identification and understanding of various steps involved in the preparation of capital expenditure proposal will avoid unnecessary queries from different angles and hence will avoid unnecessary delay in getting the proposal approved.
EXHIBIT - 8.3
PROCESS OF RFA PREPARATION

START

RECEIPT OF APPROVED CAPEX PLAN

GIVE COPY TO HOD

PREPARE PROJECT EXECUTION PLAN

INITIATE REQUEST FOR FINANCIAL APPROVAL

FORWARD FOR APPROVAL

YES

QUERIES ?

NO

GET THE APPROVAL

EXECUTE THE PROJECT

START

STUDY OF REQUIREMENT FOR WHICH INVESTMENT IS CALLED FOR

DEFINE THE ROUTES BY WHICH THIS CAN BE ACHIEVED

GET QUOTATIONS & PREPARE COMPARITIVE STATEMENT

STUDY ALTERNATE PROPOSALS

FINALISE THE QUOTATION

INITIATE FINANCIAL REQUEST FOR APPROVAL

SENT THE REQUEST FOR APPROVAL
8.3.0. Review and / or reporting of the progress of capital expenditure is very important for the successful implementation. The bigger the report, lesser is the attention given by senior executives for reading and commenting. Therefore the reporting of the progress is to be done systematically. The following format is developed to improve the effectiveness of reporting of the progress of capital expenditure.

[a] The first chapter of the report should give an executive summary of the whole report.

[b] The second chapter is to be devoted for project control with subtitles like;

[i] Progress - to be given in few words but supported by progress chart which shows where the project stands now, where it should have been, where it will be in the next reporting time. Progress (S) chart which is also called as `S' chart is a chart showing the relationship of time and job expressed as percentage.

[ii] Cost - here again overall cost chart is to be attached which will give a clear picture of cost planned and the actual cost incurred and the variance.

[iii] Changes - This is to include the description of any proposed and approved changes with clear mention about cost impact and time delay.
[iv] Procurement - materials and equipment are the live wire for any capital expenditure project. Procurement of these at the scheduled time, at the specified quality at reasonable price is very important. The time is important because if the materials/equipment are procured earlier, interest is lost till they are used. At the same time delay in getting the materials/equipment will definitely delay the project and hence will result in increase in cost. Therefore the actual status against the material planning is to be explained with the help of a chart.

[c] Safety - chance for injury or accident, and dangerous occurrence or hazardous incident is very high in project site. Therefore training on safety awareness is to be imparted to all those concerned in the capital expenditure projects. Personal protective equipments are to be properly used. Monitoring and recording of safety activities should find a place in reporting.

[d] Area of concern and corrective action - this section should give a correct picture about the concern and it should also give the proposed corrective action. The impact of these in cost and time is to be clearly mentioned.