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UNDERSTANDING CAPITAL BUDGETING DECISION OF "AGAAZ E BHARAT"

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ABSTRACT
This case was written and compiled by Prof. Rohit Garg and Mr. Paras Batra. It is intended to be used as the basis for classroom teaching. This is a fictious case prepared from the available public information and author's independent research. Names, business, place, incident and events used in this case study are products of author's imagination.
This case is an attempt to emphasize on capital budgeting decision of "Agaaz e Bharat" famous hotel of Karol Bagh, New Delhi established in 2014 by two young entrepreneurs. It is very important for a company to accept right investment decision which would help in achieving expected flow of benefits in coming time. Owners of "Agaaz e Bharat" have decided to move for renovation of their hotel which requires huge source of funds. This case study attempts to study further investment into this business is fruitful or not using techniques of capital budgeting.
Keywords: *Capital Budgeting, Investment, Case Study Method*

1. Introductory Case

Two friends, Saksham Chugh, post graduate in management from FMS, University of Delhi and Dilip Jain, son of baniya family graduate from Hindu College, University of Delhi opened a restaurant "Agaaz e Bharat" in Karol Bagh, New Delhi in 2014.
In initial phase they have constructed one office room, three types of rooms for customers and one conference hall with a capacity of 75 members.

S.No	Room type	No of Rooms	Tariffs (per day)
1	Office room	1	NA
2	Non a/c	5	Rs 700
3	A/c	10	Rs 1,100
4	Executive suit	6	Rs 2,300
5	Convention hall	1	Rs 11,000 (7 hrs)

Both the owners used to take active participation in hotel business, right from the inception of their business and they never had any bad remarks. They have provided the best services in town with special offers & rebates on every occasion. They have earned goodwill in the market. From inception of their hotel, they had never renovated their rooms. This results into gradual decrease of occupancy rate in their hotel from past 3 months. They have observed that 25% of the customers are not willing to stay after looking condition of their rooms and reception area. So they have decided to renovate their complete building in 2023. But they could not able to find the best alternative location to shift their hotel for few months, as renovation takes 4-6 months easily. On an average, rooms used to be occupied for 22-25 days and the hall for 10 days (hall occupied maximum on weekends).

S.No	**Room type**	**Estimated expenses (per room)**	**Total expenses**
1	Office room	1,24,000	1,24,000
2	Non a/c	91,000	91,000 * 5 = 4,55,000
3	A/c	1,07,000	1,07,000 * 10 = 10,70,000
4	Executive suit	1,36,000	1,36,000 * 6 = 8,16,000
5	Convention hall	3,65,000	3,65,000

(Maintenance expenses used to be Rs 28,30,000)

An idea came in mind of dilip, that investment into this project would be suitable or not. Dilip and saksham have consulted "Shree Ganesh Financial Services" a leading financial consulting company working from previous 9 years. They met Mr. Shivam (research analyst) regarding renovation of this project. After having several meetings and discussion, it was decided to use technique of capital budgeting for "Agaaz e Bharat". Using historical data, predictions would be done for next few years. Mr. Shivam guided that if projections shows positive graph in financials, then they would proceed for expansion of this project otherwise not.

2. Capital Budgeting Decision of "Agaaz e Bharat"

Capital budgeting is the technique of making decisions for investment in long term projects. A process of deciding whether investment should be made or not in a particular project. It involves planning and utilization of funds for the purpose of maximizing the profits and profitability of the firm.

Now a day's, risk involved in business is increasing at an alarming rate due to extensive competition, which requires proper execution and investment strategies in every business. Capital budgeting is one of technique which is being used by dilip and saksham for their business expansion. In this case we are using "net present value" method of capital budgeting.

3. Data Analysis and Interpretation

Existing Project

S.No	Type of room	Tarrif	Total no of rooms	Total Income (per day)	Total Income (per year)
1	Non a/c	Rs 700	5	3,500	1,22,500
2	A/c	Rs 1,100	10	11,000	40,15,000
3	Executive suit	Rs 2,300	6	13,800	50,37,000
4	Convention hall	Rs 11,000 (7 hrs)	1	11,000	10,15,000
			Total	**39,300**	**1,01,89,500**

Note:

1. It is assumed that 55% of capacity is utilized, hence total income (per day) will be 55% of 39,300 is 21,615 and total income (per year) will be 55% of 1,01,89,500 is 56,04,225.
2. Expenses incurred are assumed to be around 30% of computed receipts i.e 30% of 56,04,225 are 16,81,267.50

Proposed Project

S.No	Type of room	Tarrif	Total no of rooms	Total Income (per day)	Total Income (per year)
1	Non a/c	Rs 950	5	4,750	17,33,750
2	A/c	Rs 1,350	10	13,500	49,27,500
3	Executive suit	Rs 2,600	6	15,600	56,94,000
4	Convention hall	Rs 12,500 (7 hrs)	1	12,500	45,62,500
			Total	**46,350**	**1,69,17,750**

Note:

1. It is assumed that 55% of capacity is utilized, hence total income (per day) will be 55% of 46,350 is 25,492.50 and total income (per year) will be 55% of 1,69,17,750 is 93,04,762.50
2. Expenses incurred are assumed to be around 30% of computed receipts i.e 30% of 93,04,762.50 are 27,91,428.75
3. Net income would be 65,13,333.75

Hence, incremental cash flow is Rs 37,00,537.50
(Net cashflow of proposed project – Net cashflow of existing project)
(93,04,762.50 - 56,04,225)

Calculation of Depreciation

Asset	Rate of depreciation
Building	10%
Furniture & fixture	14%
Computer & peripherals	23%
Office equipment	14%
Electrical installation	14%

Asset	Share in total investment	Amount
Building	55%	1,32,00,000
Furniture & fixture	14%	33,60,000
Computer & peripherals	9%	21,60,000
Office equipment	11%	26,40,000
Electrical installation	11%	26,40,000

(Note: Right now, in 2023 the net worth of hotel is Rs 2,40,00,000 including building, furniture & fixture, office equipments, electrical appliances and computer peripherals)

Note: For calculation of depreciation, we are using written down value method (WDV).

Calculation of Depreciation for next 5 years using Discounted cash flow model technique:-

Year	Amount	Depreciation	Balance
1	1,32,00,000	13,20,000	1,18,80,000
2	1,18,80,000	11,88,000	1,06,92,000

3	1,06,92,000	10,69,200	96,22,800
4	96,22,800	9,62,280	86,60,520
5	86,60,520	8,66,052	77,94,468

(Building @ 10%)

Year	**Amount**	**Depreciation**	**Balance**
1	33,60,000	4,70,400	28,89,600
2	28,89,600	4,04,544	24,85,056
3	24,85,056	3,47,907.84	21,37,148.16
4	21,37,148.16	2,99,200.74	12,37,947.42
5	12,37,947.42	1,73,312.63	10,64,634.79

(Furniture & fixure @ 14%)

Year	**Amount**	**Depreciation**	**Balance**
1	21,60,000	1,94,400	19,65,600
2	19,65,600	1,49,904	18,15,696
3	18,15,696	1,63,412.64	16,52,283.36
4	16,52,283.36	1,48,705.5	15,03,577.86
5	15,03,577.86	1,35,322	13,68,255.86

(Computer & peripherals @ 9%)

Year	**Amount**	**Depreciation**	**Balance**
1	26,40,000	2,90,400	23,49,600
2	23,49,600	2,58,456	20,91,144
3	20,91,144	2,30,025.84	18,61,118.16
4	18,61,118.16	2,04,723	16,56,395.16
5	16,56,395.16	1,82,204.46	14,74,190.7

(Office equipments @ 11%)

Year	**Amount**	**Depreciation**	**Balance**
1	26,40,000	2,90,400	23,49,600

2	23,49,600	2,58,456	20,91,144
3	20,91,144	2,30,025.84	18,61,118.16
4	18,61,118.16	2,04,723	16,56,395.16
5	16,56,395.16	1,82,204.46	14,74,190.7

(Electrical installation appliances @ 11%)

Year wise Depreciation of "Agaaz e Bharat"

Year	Building	Furniture & fixture	Computer & peripherals	Office equipment	Electrical installation	Total
1	13,20,000	4,70,400	1,94,400	2,90,400	2,90,400	25,65,600
2	11,88,000	4,04,544	1,49,904	2,58,456	2,58,456	22,59,360
3	10,69,200	3,47,907.84	1,63,412.64	2,30,025.84	2,30,025.84	20,405,72.16
4	9,62,280	2,99,200.74	1,48,705.5	2,04,723	2,04,723	18,19,632.24
5	8,66,052	1,73,312.63	1,35,322	1,82,204.46	1,82,204.46	15,39,095.55

Projections of upcoming 5 years of "Agaaz e Bharat"

Year	Incremental cash flow	Depreciation	PADBT (profit after dep, before tax)	Tax @ 15%	PADAT (profit after dep and tax)	PATNBD (profit after tax but before dep)
1	37,00,537.50	25,65,600	11,34,937.5	1,70,240.625	9,64,696.875	35,30,296.8
2	37,00,537.50	22,59,360	14,41,177.5	2,16,176.625	12,25,000.875	34,84,360.8
3	37,00,537.50	20,40,572.16	16,59,965.34	2,48,994.801	14,10,970.539	34,51,542.6
4	37,00,537.50	18,19,632.24	18,80,905.26	2,82,135.789	15,98,769.471	34,18,401.6
5	37,00,537.50	15,39,095.55	21,61,441.95	3,24,216.29	18,37,225.66	33,76,321.15

Discounting factor is **10%**, using this factor, expected earnings of next five year as follows:

For first year: 35,30,296.8 / .909 = 38,83,713
For second year: 34,84,360.8 / .826 = 42,18,354
For third year: 34,51,542.6 / .751 = 45,95,928
For fourth year: 34,18,401.6 / .683 = 50,04,980
For fifth year: 33,76,321.15 / .621 = 54,36,909
Sum up of earnings = 2,77,35,812 – Initial Outlay (28,30,000) = 2,49,05,812

Conclusion: We can conclude from this case study that hotel business which was started in year 2014, by two young enterpreneurs is extremely working well from past few years, but customers always demand innovative services. In order to rennovate the hotel, there is requirement of funds of approx 29 lacs (including interest) and will give good returns in next 5 years. As per calculations using net present value method, value is positive and quite large. As per discussion with financial experts, it is advisable to move for this project, still this project can be failed if there is compromise in quality and services of hotel. It is very much essential in case of services, if these are delivered poor for the first time, there can be negative consequences.

4. Teaching Notes:

Now a day's companies and business always look for ways to grow their business. Capital budgeting is a decision making process that helps managers to select suitable projects that are beneficial for the company. It involves planning of expenses for assets and future returns. It generally includes expansion, modernisation and replacement of long term assets.
Capital budgeting proposal is found to be clear and comprehensive in this case. Making optimal capital budgeting decision requires accurate accounting procedures.

5. Questions

1. Explain the concept of NPV method of capital budgeting.
2. Discuss the systematic approach towards building a capital investment plan for new hotel by dilip and saksham.
3. Should they renovate the building by incuring a huge additional investment or run the business in same condition?

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