**Capital Budgeting**

Managers at companies such as Target, Honda, Sony, and Gap face challenging investment decisions. There are several capital budgeting methods used to evaluate long-term investment projects. These methods help managers choose the projects that will contribute the most value to their organizations.

**Stages of Capital Budgeting**

**Capital Budgeting** is the process of making long-run planning decisions for

investments in projects. In much of accounting, income is calculated on a period-by-period basis. In choosing investments, however, managers make a selection from among a group of multiple projects, each of which may span several periods.

Capital budgeting is both a decision-making and a control tool. Like the five-step decision process that we have emphasized throughout this book, there are five stages to the capital budgeting process:

**Stage 1: Identify Projects** Identify potential capital investments that agree with the organization’s strategy.

***Stage 2: Obtain Information*** Gather information from all parts of the value chain to evaluate alternative projects.

**Stage 3: Make Predictions** Forecast all potential cash flows attributable to the alternative projects. Capital investment projects generally involve substantial initial outlays, which arerecouped over time through annual cash inflows and the disposal values from the terminationof the project. As a result, they require the firm to make forecasts of cash flows severalyears into the future.

***Stage 4: Make Decisions by Choosing Among* Alternatives** Determine which investment yields the greatest benefit and the least cost to the organization. Using the quantitative information obtained in stage 3.

**Stage 5: Implement the Decision, Evaluate Performance, and Learn** Given the complexities of capital investment decisions and the long time horizons they span, this stage can be separated into two phases:

\_ Obtain funding and make the investments selected in stage 4*.*

\_ Track realized cash flows, compare against estimated numbers, and revise plans if necessary. As the cash outflows and inflows begin to accumulate, managers can verify whether the predictions made in stage 3 agree with the actual flows of cash from the project.