

RISKS AND UNCERTAINTIES IN CAPITAL BUDGETING DECISIONS

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ABSTRACT

Investment decision is concerned with allocation of funds. Since financial management deals with mobilization and deployment of funds, equal importance must be given to both the functions. Funds are mobilized through long term, medium term and short-term sources. The main aim of such investment is to get proper yield from the project, so that it can recover the cost associated with each source of funds and earn required amount of profit to compensate the risk involved in the business. Equity has the cost of dividend, debenture has the cost of interest, and preference share has the cost of dividend. All these costs must be recovered through the judicious allocation of available funds. This is a risky decision to be taken by managers, as they have to forecast the anticipated profit which is based on several uncertainties. Thus this is a decision based on risk and uncertainty. The firm has to evaluate the investment proposals in relation of their expected returns and risk to determine whether the investment is feasible or not. The process through which different projects are evaluated is known as capital budgeting.

KEYWORDS: Deployment of funds, Mobilization, Risk, Yield