Understanding Capital Budgeting Decisions

A Case Study of Du-Pahiya Wala Automotive

Du-Pahiya Wala

(A Multi Brand Two-wheeler Service Station)

Understanding Capital Budgeting Decisions-

This Case was compiled and written by Prof. Himanshu Jain, Panipat Institute of Engineering & Technology, Panipat. It is intended to be used as the basis for classroom discussion rather than to illustrate either effective or ineffective handling of a management situation. This is a fictional Case prepared from the available public information and authors' independent research. Names, characters, businesses, places, events and incidents quoted in this case are either the products of the author's imagination or used in a fictitious manner. Any resemblance to actual persons, living or dead, or actual events is purely coincidental.

Du-Pahiya Wala

(A Multi Brand Two-wheeler Service Station)

Introduction

Jatin Aggarwal, son of a pure baniya family, from the handloom business hub, Panipat, Haryana &

Sunny Chaudhary, son of a Jat family, from the true Jat land, Sonepat, Haryana formally management faculty in a prestigious Business school in NCR, decided to start a multi-brand two-wheeler service station chain.

IDEA GENERATION

This idea came from Sunny Chaudhary’s true love for his Royal Enfield Classic 350. As Sunny used to feel irritated by the service facility available for his Bullet’s maintenance. There were only few options available

- either ***Royal Enfield Service Centre,*** which was a costly affair, once the free service period is over, and
- another was the ***Road-side Repair Wala,*** who were highly untrained and low in service quality.

This irritation made them realized the potential of this market gap and they decided to start ‘Du-Pahiyaa Wala Automotive’.

Du-Pahiya Wala

(A Multi Brand Two-wheeler Service Station)

Service & Spare Parts

Facilities @ Du-Pahiya Wala

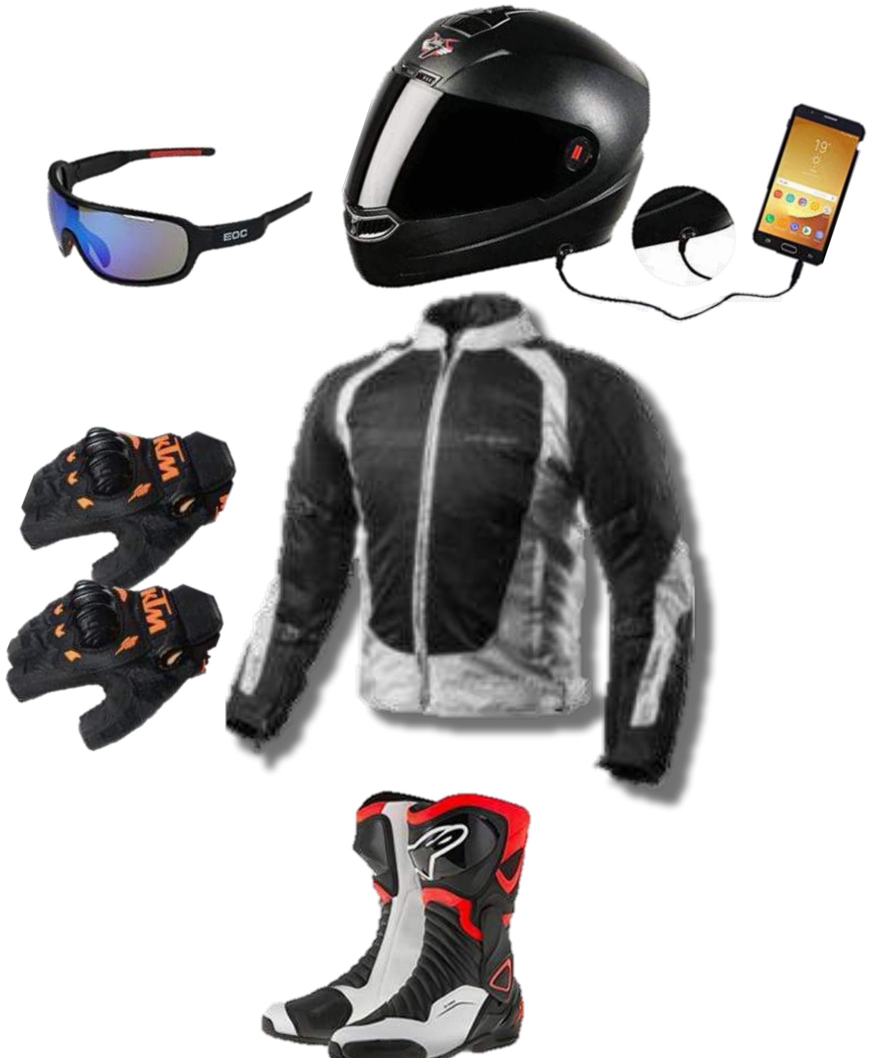
(A Multi Brand Two-wheeler Service Station)

Bike Styling

Facilities @ Du-Pahiya Wala

(A Multi Brand Two-wheeler Service Station)

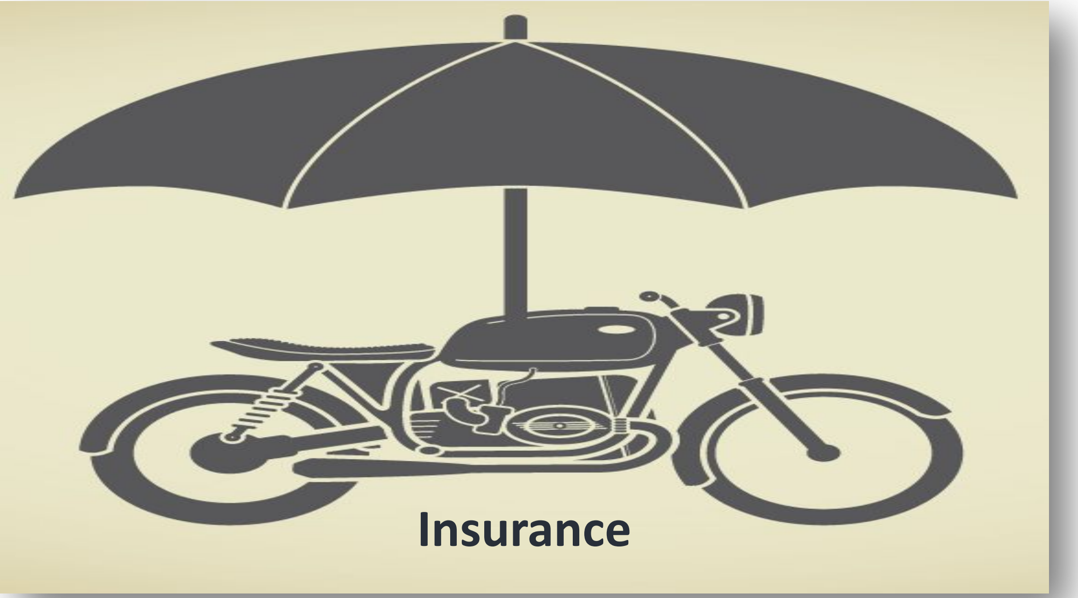
Bike Styling…



Washing & Polishing

Insurance & Sales/ Purchase Finance/ Re-finance

Facilities @Du-Pahiya Wala
(A Multi Brand Two-wheeler Service Station)



Du-Pahiya Wala
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Target Market

Total Available Market:

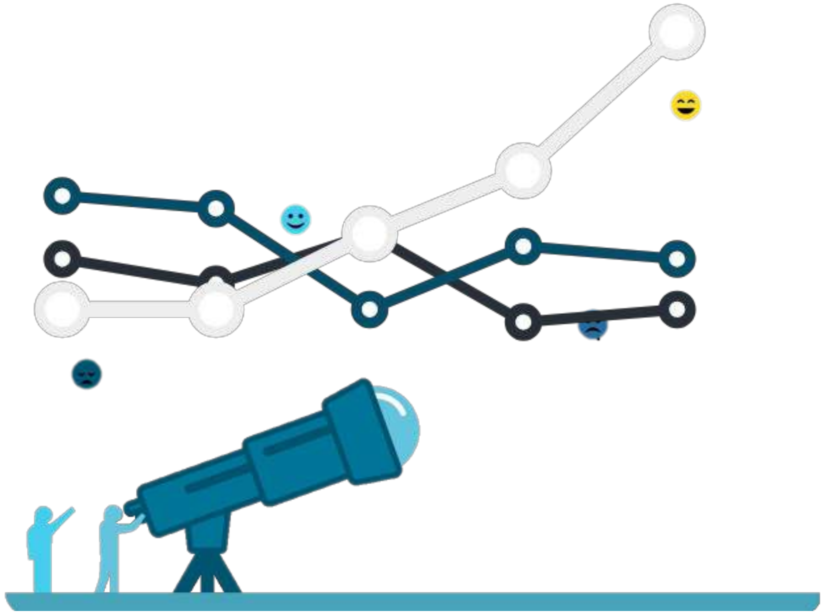
25000

Target Market:

5000

Making Financial Projections

Infrastructure



They had planned for their capital investment wherein they estimates that their first workshop that they planned to open in HUDA, Panipat, later on they will create it as franchises based system in other cities too. They will need a ***capital investment worth INR 24 lakh,*** which would cover investment for the ***infrastructure.***

Making Financial Projections…

Working Capital

Du-Pahiya Wala
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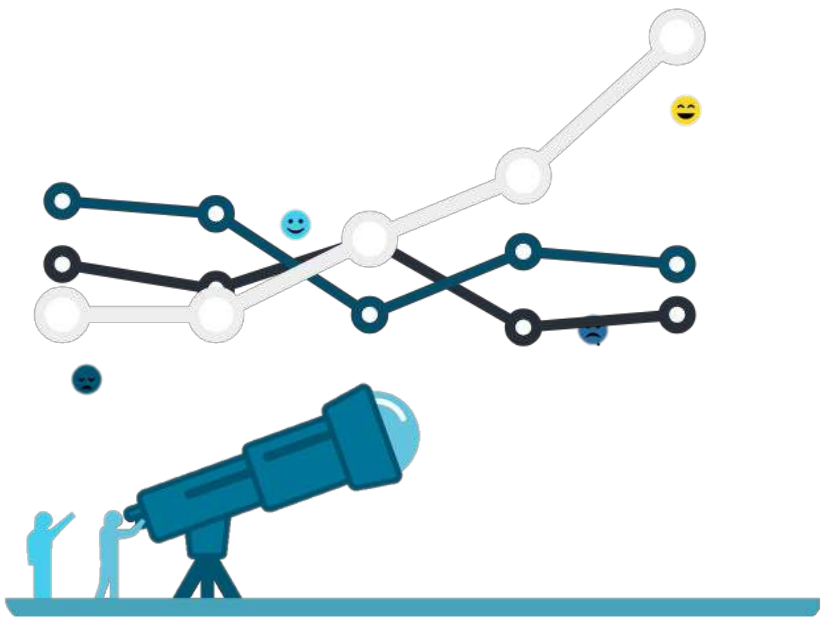


They plan to hire the space on ***lease rent*** of ***INR 35,000 pm*** near Mittal Mega Mall, Panipat.

Their other monthly expenses included – ***salary for the staff, electricity bills, transport and telephone bills*** and the cost of ***raw material.***

These expenses average out ***to INR 90,000 pm.***

Making Financial Projections…
Promotion

Du-Pahiya Wala
(A Multi Brand Two-wheeler Service Station)

Online Mode

- Facebook
- Instagram
- Blogs

- Search Engine Optimization
- SMS
- Mobile App

Making Financial Projections…
Promotion

Offline Mode

- Advertisement Hoarding
- Tie-up with Two-wheel dealers

Marketing campaign is going to cost 50,000/- per month for first 3 months and Rs 15,000/- for every month after the initial period of 3 months.

Making Financial Projections…

Promotion

They also had plans to ***promote*** the business using social media platforms like ***Facebook, Instagram, LinkedIn*** and will also use promotion through ***Hoarding*** and ***newspaper insertion*** in nearby area to make it talk of the town. which is going to cost 25,000/- per month.

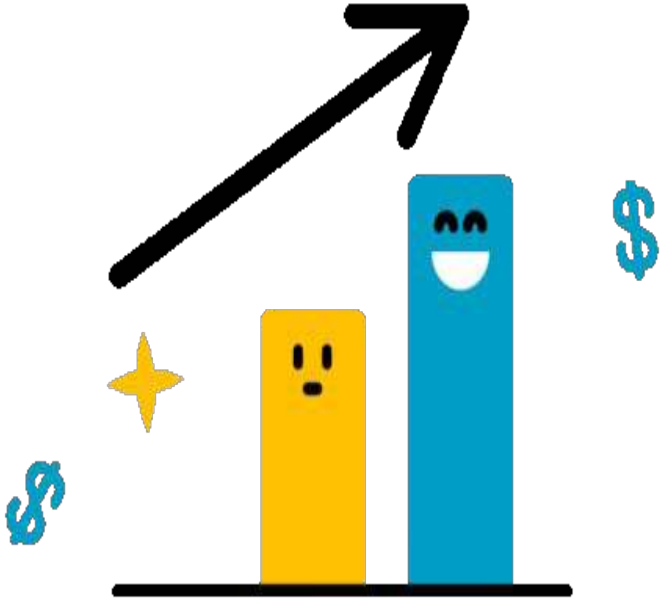
Making Financial Projections

Revenue

Their estimates of revenue were based on demographic factors and geographic location of their workshop.

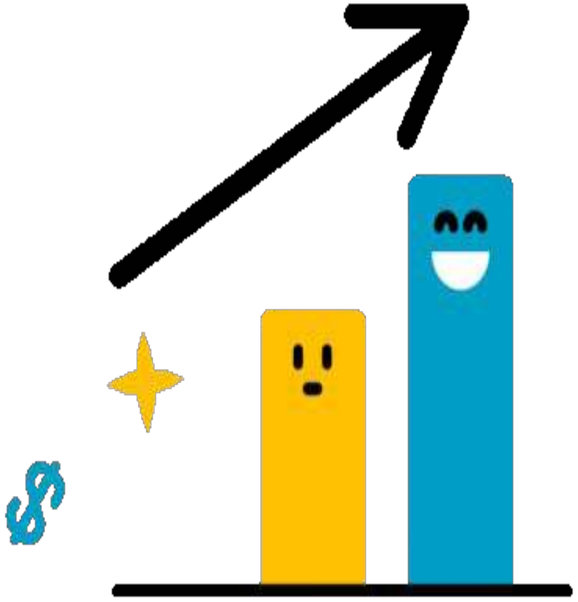
They believed that they would have positive cash flows from 3rd year onwards and will be able to earn a monthly revenue of INR 60,000 per month in the third year.

Growth Estimate



- They estimate the average growth potential in their business for the first few years at 50% pa.
- On an average they thinks their monthly revenues would be INR 36,00,000, INR 54,00,000, INR 70,20,000 and INR 84,24,000 for the second, third and fourth years respectively.
- The estimated expenses were likely to increase @10% inflation rate. Hence, the lease would cost INR35,000, INR40,000 and INR45,000 for the second, third and fourth years respectively.
- They estimated the opportunity cost of capital to be nothing less than 15% p.a.

Growth Estimate



Year	Expected Growth in Revenue	Revenue	One Time Exp	Expected Growth in Yearly Exp	Yearly Exp	Total Cash Outflows	Cash Inflows
T0			2,900,000				-2,900,000
1st Year (T1)	-	3,600,000	100,000		4,200,000	4,300,000	-700,000
2nd Year(T2)	50%	5,400,000	50,000	10%	4,620,000	4,670,000	730,000
3rd Year(T3)	30%	7,020,000	50,000	10%	5,082,000	5,132,000	1,888,000
4th Year (T4)	20%	8,424,000	520,000	10%	5,590,200	6,110,200	2,313,800
5th Year (T5)	20%	10,108,800	20,000	10%	6,149,220	6,169,220	3,939,580
6th Year (T6)	10%	11,119,680	20,000	10%	6,764,142	6,784,142	4,335,538
7th Year (T7)	10%	12,231,648	20,000	10%	7,440,556	7,460,556	4,771,092
8th Year (T8)	10%	13,454,813	520,000	10%	8,184,612	8,704,612	4,750,201
9th Year (T9)	10%	14,800,294	20,000	10%	9,003,073	9,023,073	5,777,221
10th Year (T10)	10%	16,280,323	20,000	10%	9,903,380	9,923,380	6,356,943

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The Decision Dilemma

- Should they go ahead with investment decision for Du-Pahiya Wala Automotive?
- How should they evaluate her capital investment plan?

Assignment Questions

Du-Pahiya Wala
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- What is a payback period?
- What is Present Value of Money?
- What is Net Present Value (NPV)?
- Discuss the systematic approach towards building a good capital investment plan for Du-Pahiya Wala Automotive.

Wrapping Up

- The choice of Payback Period or NPV depends on whether a firm is looking for time to recovery of capital or net monetary addition to its capital.
- Most Startups are keen on achieving a faster breakeven. Hence, they concentrate on faster payback.
- However, the net present value is the most critical parameter to estimate the profitability of newly established business as it.
- Capital budgeting decisions are one of the most important areas of financial management for any form or scale of business. It is a scientific process by which the managers have to take a decision in today’s terms for a project whose cash flows will follow over a long period of time in future.
- With accurate estimation of costs and revenues it becomes possible decide whether the company should pursue or drop the project to avoid possible losses.