

Mapping Capital Budgeting in the Private Sector: A Systematic Literature Review and Future Research Study

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Abstract

This research investigates the critical role of capital budgeting in achieving corporate success and sustainability in a dynamic global economy. The main focus is on complex financial evaluation techniques for making long-term investment decisions and their impact on firm performance and growth. In addition, this study analyzes trends in the use of capital budgeting methods in different countries, including the implications of changes in executive compensation contracts. In addition, the challenges faced by companies in evaluating investment projects, including the need for more sophisticated analyses such as real options, are an important focus of this research. Using the systematic literature review (SLR) method, this study identifies and analyzes relevant articles related to the evolution of research publication approaches and various capital budgeting techniques. The results of this study are expected to provide a deeper understanding of the current trends and practices in capital budgeting decision-making in the private sector and formulate relevant research questions to guide future studies in this area.

Keywords: *Capital Budgeting, Investment Appraisal, Private Public, Systematic Literature Review.*



A. INTRODUCTION

In the context of an evolving global economy, capital budgeting is one aspect that is critical to a company's success and sustainability. Capital budgeting is critical in determining the allocation of funds for long-term investment projects that impact the growth and survival of the company. Various studies show that the use of sophisticated financial evaluation tools can improve company performance companies that use these techniques have higher levels of operating profit in addition, changes in executive compensation contracts to focus more on long-term performance can motivate managers to make more capital investments, leading to improved market performance (Haka, 2006). Effective capital budgeting can also help companies make informed decisions regarding which projects to invest in, ultimately maximizing shareholder wealth. By carefully evaluating the potential risks and returns of each investment opportunity, companies can ensure that their resources are utilized efficiently and effectively.

Companies are often faced with the challenge of evaluating investment projects that have high potential while also considering the risks, opportunities, and limited resources of the company. Capital budgeting decisions can be challenging because of the need for more sophisticated analyses of investment options, including real

options and discounted cash flow methods. In Canada, trends show that while many large companies are using DCF, some are not applying it properly, with only 8 percent using real options. Managers should focus on areas such as real options, administrative procedures, and using the weighted average cost of capital (WACC) to improve decision-making (Geoffrey & Teresa, 2010; James, 2021).

In addition, there are several other techniques or methods used in capital budgeting, including Net Present Value (NPV), Internal Rate of Return (IRR), Accounting Rate of Return (ARR), Payback Period (PP), and Profitability Index (PI). Trends in the use of NPV, IRR, ARR, PI, and PP methods show a positive and significant relationship between these methods in UAE companies. Payback period (PB) is used as an initial evaluation technique, while IRR and NPV are used at a later stage for more sophisticated analyses. Companies with a longer operational history tend to use more IRR, NPV, PI, and SA, while new companies have a strong relationship with PB. CFOs with higher education levels tend to use more SA, NPV, and ARR. Quality projects show a negative correlation with most capital budgeting methods. NPV is used as the main criterion for analyzing investment portfolios, while PI is a convenient relative indicator for selecting projects with the same NPV value. The IRR determines the maximum acceptable rate of return for a project. The ARR reflects the minimum rate of return on invested capital (Ahmed, 2013).

On the other side, research on capital budgeting in the private sector has become an increasingly important topic for economic researchers and professionals. A deeper understanding of existing research publication approaches and how techniques in capital budgeting decision making have evolved over time will provide valuable insights for stakeholders at various levels.

Therefore, this study aims to explore the evolution of research publication approaches and investigate the various techniques commonly used in capital budgeting decision making by private firms. Having a good understanding of the current trends and practices in capital budgeting in the private sector can help firms and decision makers make more informed and effective decisions to improve firm performance and achieve long-term business objectives.

B. METHOD

This research uses a systematic literature review (SLR) method to identify relevant articles related to the evolution of research publication approaches and investigate the various techniques of capital budgeting. The collected articles were then selected and analyzed to extract key findings on capital budgeting. The SLR technique is a systematic and comprehensive approach to exploring and analyzing literature relevant to the research topic. By following certain criteria, researchers can ensure that the research has already gone through a rigorous and systematic review process. A systematic review of the literature has been utilized in business research, strategy research, and human resource management to evaluate data and results. This method helps in analyzing the state of the question, identifying theoretical

frameworks, and understanding antecedents and consequences in various contexts (Vázquez-Carrasco & López-Pérez, 2013) (Rahul et al., 2023).

In addition, systematic reviews also contribute to identifying research gaps and providing evidence-based recommendations for future research. This rigorous approach ensures the reliability and validity of the findings presented in academic research. According to Philipp and Stefan's paper, systematic literature review (SLR) is known for its relatively rigorous, simple, and explicit approach to management research (Philipp & Stefan, 2023). SLRs are essential for synthesizing existing knowledge and providing a comprehensive overview of a particular topic. SLR helps researchers make informed decisions and advance the field through evidence-based practices. As a result, SLR is an appropriate method to use in this research.

Emerald, Elsevier, and Sage databases offer comprehensive coverage of journal publications for the academic community. To find published articles on capital budgeting, the authors searched the Emerald, Elsevier, and Sage databases using specific search phrases. The following terms were used to find related articles in the database: ('capital budgeting' OR 'investment appraisal') AND ('private sector' OR 'private companies') AND ('research publication) AND (approach) AND ('common techniques' OR "popular methods"). The following inclusion and exclusion criteria were used to restrict the search for articles in the database:

Inclusion criteria:

1. Articles and journals
2. Articles were sourced from Emerald, Elsevier, and Sage.
3. The articles must be published in English.
4. The entire text of the article must be accessible.
5. The focus of the research should be on capital budgeting in the private sector.
6. Articles must be published from 2020 to 2024.

Exclusion criteria:

1. Studies that are not relevant to the context of capital budgeting in the private sector.
2. Documents in the form of books or journal reviews that contain non-academic research.
3. Studies are written in a language other than English.
4. Studies that do not provide sufficient or complete information related to capital budgeting in the private sector.

A search for articles relevant to the above topic was conducted in May 2024 and focused on titles, abstracts, and keywords in the research. The search results revealed several articles that met the exclusion criteria. The articles provided information relevant to the context of capital budgeting in the private sector and were written in English. However, some articles did not provide sufficient or complete information on the topic. In addition, research that is not academic in nature has also been excluded from the search. Thus, the articles selected for further analysis met the quality standards.

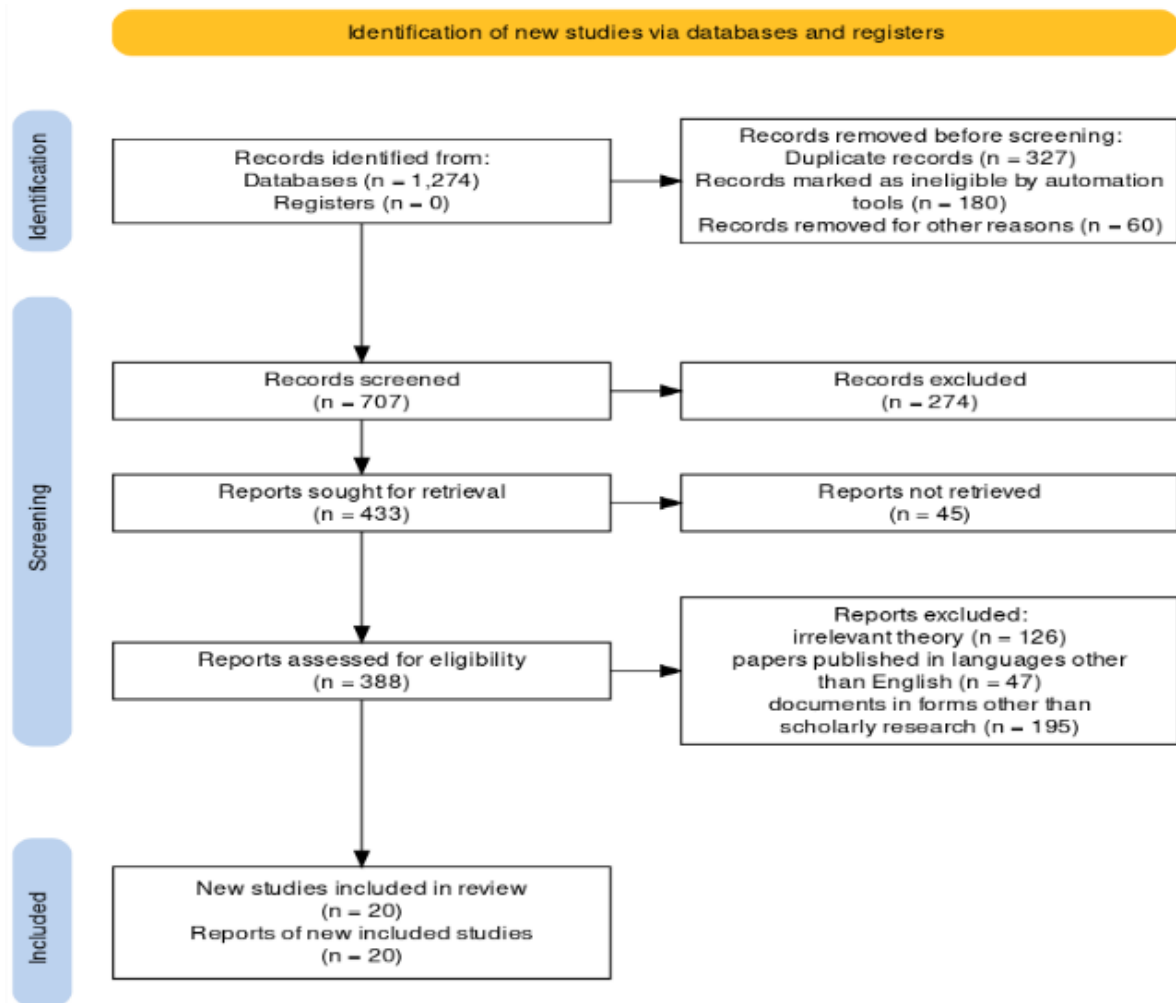


Figure 1. PRISMA Flow: Data Extraction Procedure

Source: Data Process (2024)

The authors conducted a three-stage review of publications on capital budgeting in the private sector using the PRISMA flow diagram. Firstly, identification involved an initial literature search using relevant key terms. The literature search took the form of scientific journals published by Emerald, Elsevier, and Sage. Then, screening was conducted to filter articles based on title and abstract to remove papers that were not relevant to the inclusion criteria. The aim was to filter out the most potentially relevant articles that could be considered for full-text assessment. Finally, in the included stage, the articles that met the inclusion criteria were assessed in full text for inclusion in the paper and further analysis. Twenty articles were selected. These articles then become the subject matter for a systematic review or meta-analysis of the current study.

C. RESULT AND DISCUSSION

Capital budgeting theory has evolved over time; it developed in the early 20th century in line with the evolution of financial management. Early concepts such as net present value (NPV) and discounted cash flow laid the foundation for further developments. In the 1950s and 1960s, investment evaluation methods such as

payback period and internal rate of return were developed. The development of this theory continued along with advances in economics and financial management. 'Capital budgeting theory has evolved over time, with recent studies emphasizing the use of sophisticated methods and tools to incorporate risk. Factors influencing capital budgeting practices vary between developed and developing countries, with behavioral finance playing a role in decision-making' (Esiya, 2016)

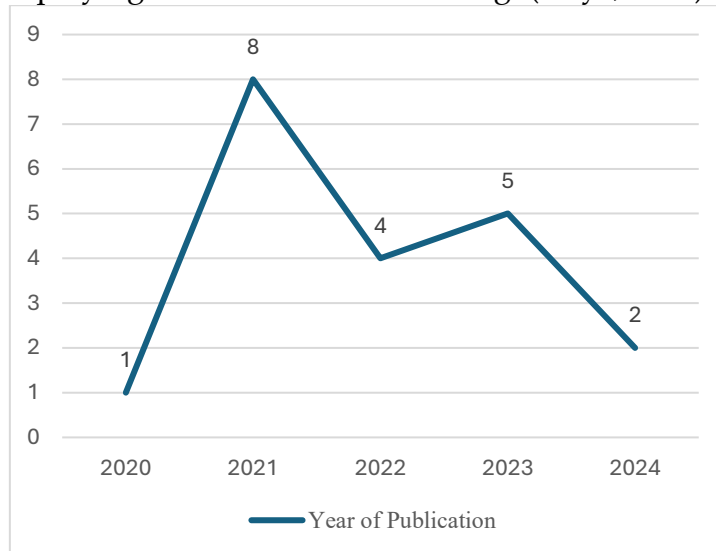


Figure 2. Publication Year

Source: Processed by the Authors (2024)

The distribution of publications per year that discuss the topic of capital budgeting is shown in Figure 2. The impact of the COVID-19 pandemic is probably what has people paying extra attention to 2021, where the number of published research articles peaked in the previous five years. The global health crisis has caused major changes in the global economy, forcing companies to readjust their capital allocation. Amidst this economic uncertainty, researchers' interest in exploring aspects of capital budgeting in the private sector is increasing, as companies strive to maintain sustainability and overcome the crisis.

Figure 3 shows the geographical distribution of the study population. The country of origin of the articles also varies, with a significant number coming from other countries. The diverse research population and data sources indicate that there is global interest in capital budgeting practices. Researchers can gain greater insight into capital budgeting from various cultural, economic, regulatory, resource availability, and geographical perspectives. In addition, the COVID-19 pandemic is one of the factors in the evolution of the development of capital budgeting theory in the private sector.

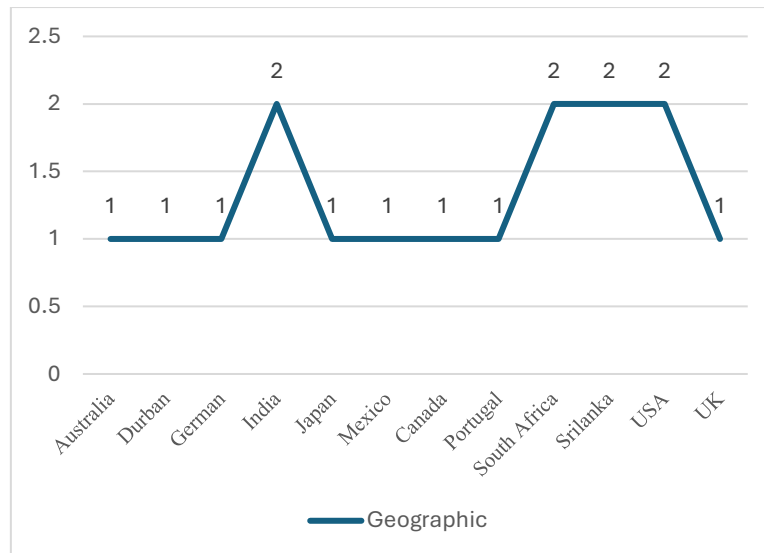


Figure 3. Geographical Location Data Collection

Source: Processed by the Authors (2024)

Figure 4 illustrates the downward trend in the number of authors involved in publications, with the current trend towards research conducted by two authors. This shift demonstrates the importance of collaboration in conducting research, which allows various perspectives to be brought together, resulting in more comprehensive and in-depth research related to capital budgeting. This phenomenon reflects the need for a multidisciplinary approach and the incorporation of expertise from different fields to address the complexity of this topic. With the increased emphasis on collaboration, it is expected that knowledge of capital budgeting in the private sector will further develop in depth and breadth. This highlights the importance of understanding and harnessing the power of collaboration to expand our insights and understanding of this topic in the future.

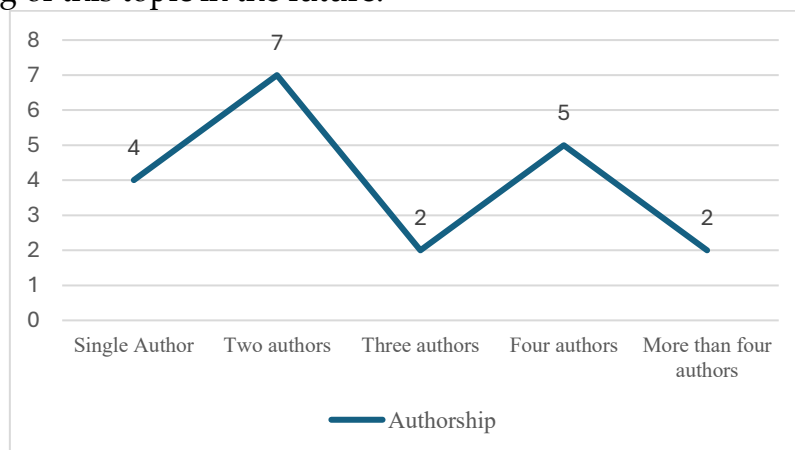


Figure 4. Authorship

Source: Processed by the Authors (2024)

The Research Publication Approach to Capital Budgeting in The Private Sector

To further explore the aspects of capital budgeting in the private sector, it is crucial to understand the trends in the approaches that are frequently used. Figure 5

represents the most frequently used approaches in research on the topic of capital budgeting in the private sector. In the figure, we have analyzed 20 publications that illustrate the evolution of approaches over time. This trend analysis provides valuable insights into how research practices and methodologies in this domain have evolved. With a deeper understanding of the most used approaches, researchers can direct efforts to identify knowledge gaps that need to be filled and design more relevant and useful research to improve understanding of capital budgeting in the private sector.

Recent studies have shown a trend towards using more sophisticated capital budgeting methods and tools to incorporate risk, especially in developed countries. However, there is a distinction between developed and developing countries in terms of capital budgeting practices. More extensive studies are needed to enhance our understanding of capital budgeting theory and practice in the current environment. The research also highlighted factors influencing the choice of capital budgeting practices and the need for behavioral finance and event study methodologies (esiya., 2016).

It is crucial for companies to adapt their capital budgeting practices to the specific economic and financial environment in which they operate. Developing countries may face unique challenges such as political instability, currency fluctuations, and limited access to financial resources, which can impact their capital budgeting decisions. By conducting further research and incorporating behavioral finance and event study methodologies, we can gain a deeper insight into the factors influencing capital budgeting practices and improve decision-making processes for companies worldwide.

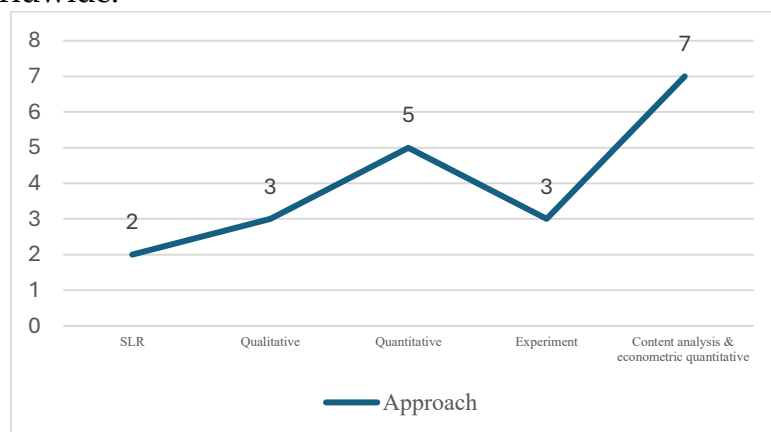


Figure 5. Approach

Source: Processed by the Authors (2024)

The Most Common Technique Used in Capital Budgeting Decisions by Private Companies

Table 1 provides an overview of the most common techniques used in capital budgeting judgments and the findings of the studies that have been conducted. Of the 20 papers analyzed, only 5 papers specifically mentioned the techniques used in capital budgeting decisions by private companies. The payback period is the dominant technique in capital budgeting in SMEs, consistent with the findings by

Mota & Moreira (2023), and Alles et al. (2021). In line with previous research, Brijlal & Quesada (2009) noted that payback period and net present value are frequently used, while large firms are more likely to use IRR and NPV than small firms. However, according to Sizibaa & Hall (2021), based on their research results, Net Present Value, Internal Rate of Return, Payback Period, Accounting Rate of Return, Return on Investment, and Real Options Valuation are popular methods. These methods are known to help in making favorable decisions. In addition, there are some papers that do not disclose the capital budgeting calculation techniques used, highlighting the diversity of practices in the field.

Overall, it is important for firms to carefully consider which capital budgeting techniques are most suitable for their specific needs and circumstances. By utilizing a combination of methods and staying informed about industry trends, companies can make informed decisions that lead to long-term success and profitability. Moreover, staying up to date with the latest advancements in option valuation can give companies a competitive edge in the market. By understanding the various methods available and incorporating them into their decision-making process, firms can better assess risk and make strategic investment choices. Ultimately, the key to successful capital budgeting lies in adapting to changing market conditions and utilizing a combination of techniques to maximize returns and ensure sustainable growth.

Table 1 Capital Budgeting Techniques

No	Author	Title	Capital Budgeting Techniques	Result
1	Simiso Sizibaa and John Henry Hall	The evolution of the application of capital budgeting techniques in enterprises	NPV, IRR, PBP, ARR, ROI, and ROV	<ul style="list-style-type: none"> NPV, IRR, PBP, ARR, ROI, and ROV are popular techniques. ROI and ROV methods were excluded due to insufficient data.
2	Morales Burgos, J.A., Kittler, M. and Walsh, M	Bounded Rationality, Capital Budgeting Decisions and Small Business.	Didn't mention	<ul style="list-style-type: none"> Entrepreneurs' capital budgeting decisions are influenced by bounded rationality and context. Role of context in investment decisions varies across regional contexts.
3	Ika Sari Wahyuni TD	Challenges and Opportunities in Adopting Capital Budgeting Practices	Didn't mention	<ul style="list-style-type: none"> Small firms lack capital budgeting understanding, hindering investment decisions. Owners seek expert advice due to lack of necessary skills.

				<ul style="list-style-type: none"> • Small businesses face challenges due to limited financial knowledge
4	Jorge Mota and António Carrizo Moreira	Capital Budgeting Practices: A Survey of Two Industries	Payback period	<ul style="list-style-type: none"> • The footwear industry prefers payback period; metalworking industry favors net present value. • Metalworking industry uses capital budgeting practices more than footwear industry. • Managers have knowledge but lack resources to apply capital budgeting practices
5	Lakshman Alles, Ruwan Jayathilaka, Nelum Kumari, Taraka Malalathunga, Hashini Obeyesekera, & selvaraj Sharmila	An investigation of the usage of capital budgeting techniques by small and medium enterprises	Payback period	<ul style="list-style-type: none"> • Payback Period is the dominant capital budgeting technique in SMEs. • NPV is preferred in foreign SMEs and those operating 11-15 years. • Factors affecting capital budgeting include education level and ownership form.
6	Naresh Nunden, Sharanam Abbana, Ferina Marimuthu, and Naresh Sentoo	An assessment of management skills on capital budgeting planning and practices: evidence from the small and medium enterprise sector	Didn't mention	<ul style="list-style-type: none"> • Owners and managers lack financial skills and decision-making abilities. • SMEs face challenges in obtaining credit for capital budgeting
7	Brijlal, P. & Quesada, L.	The use of capital budgeting techniques in businesses: a perspective from the Western Cape	<ul style="list-style-type: none"> • Payback period and net present value are commonly used methods. • Large businesses favor IRR and NPV over small businesses 	<ul style="list-style-type: none"> • Payback period and net present value are commonly used methods. • Large businesses favor IRR and NPV over small businesses. • Project definition is crucial in the capital budgeting process.

				<ul style="list-style-type: none"> • The implementation stage is challenging for the manufacturing sector. • The cost of a bank loan is a common basis for capital budgeting.
8	Pratheepkanth Puwanenthiren	National development level effects on capital budgeting practices: a comparative study of nature vs nurture	Didn't mention	<ul style="list-style-type: none"> • Australian firms use models with good predictive power, unlike Sri Lankan firms. • Significant differences in capital budgeting practices between Australia and Sri Lanka. • No significant differences in estimating cost of capital between Australia and Sri Lanka
9	Riya Sureka, Satish Kumar, Sisira Colombage, & Mohammad Zoynul Abedin	Five decades of research on capital budgeting – A systematic review and future research agenda	Didn't mention	<ul style="list-style-type: none"> • Identified prevalent issues and gaps in capital budgeting literature. • Developed a conceptual framework for research on capital budgeting. • Proposed 11 actionable future research directions to advance the field.
10	Weixiang Huang	Public service provision with a limited budget: Service design, privatization and subsidies	Didn't mention	Throughput subsidies more effective than capacity subsidies for public service. Identifies conditions for complete privatization or privatization with regulation.
11	Akira Kamiguchi, & Toshiki Tamai	Public investment, national debt, and economic growth: The role of debt finance	Didn't mention	<ul style="list-style-type: none"> • Debt-financed public investment affects growth based on economic efficiency.

		under dynamic inefficiency		<ul style="list-style-type: none"> • Debt financing can decrease growth in efficient economies. • Growth affects large public capital productivity. • Existing generations prefer debt financing for public investment. • Chaotic equilibrium dynamics with low productivity
12	Devinder Singh Hooda, & Pooja Kataria	The gender-responsive budgeting: an approach of handling gender inequalities	Didn't mention	<ul style="list-style-type: none"> • Pro-women allocation dominates gender budgeting with 80% share. • Women-specific programs are less than 1% of country's GDP. • Gender budgeting can enhance women's development outcomes significantly
13	Anthony D. Nikias, Steven T. Schwartz, & Richard A. Young	The effect of information transparency on capital budgeting with privately informed agents: short research note	Didn't mention	<p>High transparency led to increased budget requests and rejections by superiors. Subordinates submitted significantly higher budget requests in high transparency treatment.</p>
14	Lakshman Alles, Ruwan Jayathilaka, Nelum Kumari, Taraka Malalathunga, Hashini Obeyesekera, & Selvaraj Sharmila	An investigation of the usage of capital budgeting techniques by small and medium enterprises	Payback period	<ul style="list-style-type: none"> • Payback Period is the dominant capital budgeting technique in SMEs. • NPV is preferred in foreign SMEs and those in business for 11-15 years. • Factors affecting capital budgeting include education level and business experience. • SMEs with less than 10 years' experience favor Payback Period.

				<ul style="list-style-type: none"> • Business experience <10 years positively related to PBP technique usage.
15	Riya Sureka, Satish Kumar, Deepraj Mukherjee, & Christina Theodoraki	What restricts SMEs from adopting sophisticated capital budgeting practices?	Didn't mention	<ul style="list-style-type: none"> • AHP methodology ranked barriers, inherent barriers were top priority. • Knowledge barriers and organizational barriers were also identified as significant. • Lack of financial education and computation technology were key sub-barriers. • Receptive barriers had minimal impact on SMEs' capital budgeting practices.
16	Douglas Cumming, Satish Kumar, Weng Marc Lim, & Nitesh Pandey	Mapping the venture capital and private equity research: a bibliometric review and future research agenda	Didn't mention	<ul style="list-style-type: none"> • Identifies foundational themes in venture capital and private equity research. • Presents insights on current trends and future directions in financing research
17	Maren Hartmann, & Barbara E. Weißenberger	Decision-making in the capital budgeting context: effects of type of decision aid and increases in information load	Didn't mention	<ul style="list-style-type: none"> • Perceived task complexity increased with general principles and high information load. • Decision accuracy was not significantly affected by experimental conditions.
18	Geoffrey Frost, & James Rooney	Considerations of sustainability in capital budgeting decision-making	Didn't mention	<ul style="list-style-type: none"> • Decision-makers adapt sustainability concepts in capital budgeting. • Sustainability is an optional consideration in capital budgeting submissions.

				<ul style="list-style-type: none"> Organizations face challenges integrating sustainability into capital budgeting processes
19	Patrick R. Martin	Corporate social responsibility and capital budgeting	Didn't mention	<ul style="list-style-type: none"> Managers act on CSR preferences despite financial incentives. Honesty decreases willingness to act on CSR preferences. Strong CSR preferences can lead to higher firm profit.
20	Ben Charoenwonga, Yosuke Kimurab, Alan Kwanc, & Eugene Tan	Capital budgeting, uncertainty, and misallocation	Didn't mention	<ul style="list-style-type: none"> Capital budgeting reduces productivity losses by 41% and 17%. High-productivity firms face disadvantages in information acquisition. Information is a factor of production benefiting higher productivity firms
21	Ahmed Imran Hunjra, Murugesh Arunachalam, Peter Verhoeven, Sisira Colombage and Elie Bouri	The interplay of CSR, stakeholder interest management, capital budgeting, and firm performance	Didn't mention	<ul style="list-style-type: none"> The beneficial effects of CSR and stakeholder management on firm performance diminish if the capital budgeting as a mediator, indicating a managerial inclination towards instrumental motives over broader societal and stakeholder considerations. The financial tools such as capital budgeting can be redesigned to consider the benevolent motives of corporate managers

Source: Research Result (2024)

D. CONCLUSION

This study conducts a systematic literature review on capital budgeting in the private sector. The authors have identified, selected, and analyzed 20 papers relevant to the topic, sourced from Emerald, Elsevier, ScienceDirect and Sage. Through a rigorous filtration and selection process. By collecting literature on capital budgeting, this article can contribute to providing an overview of complex financial evaluation techniques in making long-term investment decisions, and their impact on firm performance and growth. This study also illustrates the trend of using various approaches in capital budgeting research in different countries.

This study has some limitations, so further research is needed. Firstly, this study only uses three literature sources: Emerald, Elsevier, and Sage. It is anticipated that future studies will be able to expand the database coverage with a wide range of results. Secondly, the literature examined consisted only of scientific papers. It is anticipated that future studies could involve other sources of information to gain a more comprehensive understanding. Thirdly, the subjectivity of the authors and previous literature was used to determine which papers were included or excluded and coded. Future studies are expected to be more objective by choosing quantitative, qualitative, or mixed methods as research methods.

For a sustainable study, future research could expand the scope by considering additional factors that influence capital budgeting decision-making in the private sector. This could include more in-depth analyses of how macroeconomic factors, such as global market fluctuations or government policy changes, affect firms' capital budget strategies. In addition, future research could explore the use of new technologies, such as artificial intelligence and big data analysis, in the capital budget decision-making process. The use of these technologies can assist firms in identifying better investment opportunities and better accounting for risks.

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