

CHAPTER 1

INTRODUCTION

A firm is established for the purpose of earning profits, and given the assumptions that the firm is rational, it aims at earning the most optimum monetary profits. These monetary profits could then be translated into shareholders value and it is the objective of the firm to maximise this value.

An investment is a means by which firms attempt to influence their future well-being by the sacrifice of their current consumption. Capital investment for a firm is defined as any long-term allocation of funds made by the firm in order to achieve future benefits. In making capital investment decisions, the utmost objective is towards maximising the shareholders wealth.

Over the years, financial researchers has developed various techniques to evaluate potential capital investments. Some techniques are superior to others, while some are more complicated and requires more information than others. Whatever techniques used, corporate managers must ensure that they could point towards proposals which result in increasing the shareholders wealth.

Tenaga Nasional Berhad (TNB) is an electric utility company operating in Peninsular Malaysia. A privatised company whose shares were traded on the Kuala Lumpur Stock Exchange (KLSE), TNB currently enjoys the monopoly of being the only company to produce and distribute electricity throughout the Peninsular. However, with the Government's recent approval to the setting up of the Independent Power Producers (IPP's), TNB must ensure its future investments would generate optimum returns to be able to stay competitive. To achieve this, TNB must use effective capital budgeting practices to evaluate its potential investment projects.

1 OBJECTIVES OF STUDY

The objective of the study is to evaluate the capital budgeting practices in TNB. More specifically, the study intends:

- i. To examine the current capital budgeting practices of TNB
- ii. To compare current practices to that promulgated by the theory of capital budgeting
- iii. To investigate the rationale of current practices
- iv. To give suggestions to improve the quality of capital budgeting practices such that decisions made would generate optimum returns to the shareholders.

1.2 SIGNIFICANCE OF STUDY

Malaysia is geared to become a developed country by the year 2020 with industrialisation as one of its strategy. With industrialisation, industries are expected to consume 75% share of the nations power needs as compared to the present 50%. This, coupled with the growing population, as well as the changing lifestyles of Malaysians, means there is growing demand for electricity. Load forecast indicated that power demand will increase at a rate of 11.9% annually for the years 1990-1995, 9.4% annually for the years 1995-2000, and 7.9% annually during 2000-2005 (Tenaga Nasional Berhad, 1991).

TNB is an electric utility and has the role of generating, transmitting and distributing electricity throughout Peninsular Malaysia. Being a public utility, TNB must ensure that the energy needs of the country are met. To meet these demands, TNB needs to invest in power development projects and these projects are capital intensive with long term returns. It is of utmost importance that good capital investment decisions are made to select projects of good returns.

With the growing energy needs of the country, it is envisaged that TNB will be investing some RM20 billion in the next five years to meet the electricity demand of the country. With such a huge capital outlay and to ensure investment decisions made are good investment decisions, TNB must adopt highly effective capital budgeting techniques to evaluate investment proposals.

Finally, TNB also has the responsibility to bring good returns to its investors. Good capital budgeting practices would help towards meeting this objective.

1.3 ORGANISATION OF STUDY

The study is divided into six chapters. Chapter 1 gives an overview of the whole study. It explains the objective and significance of the study and elaborates its organisation by giving the gist of each chapter. Chapter 2 contains findings, summaries and conclusions derived from past research in the area of capital budgeting. It reviews various surveys done on actual capital budgeting practices employed by firms around the world.

Chapter 3 introduces Tenaga Nasional Berhad (TNB) which is the executing agency for the supply of electricity in Peninsular Malaysia. It gives some brief background information on TNB, particularly; the regulatory framework within which the firm is bounded, its system of operation and corporate structure.

Chapter 4 explains the methodology of the study. It focuses on how the study was conducted, the type and quantity of data used, the data collection methods and the method of data analysis employed.

Chapter 5 presents results of the study through the examination on four selected projects. These projects were projects implemented by TNB through its four SBU's/Division. The projects were examined via the four stages of the capital budgeting process. Chapter 5 also investigates the existence of any corporate policies on capital budgeting in TNB and traces the administrative procedure of the capital budgeting process in the four SBU's/Division.

Chapter 6 summarises the findings of the study and offers possible rationales or reasons for the deviations. It also gives suggestions for further improvements to the capital budgeting practices in TNB. The chapter finally outlines limitations of the study and recommends areas worthwhile for further research.