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Capital Investment Decisions of Micro, Small and Medium Enterprises: The Case of Digos City

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ABSTRACT

This paper examined the capital investment decisions of micro, small and medium enterprises, with the aim of assessing its current levels and its conditions across industries in Digos City. Questionnaires measuring the four phases of capital investment decisions were administered to a stratified random sample of 125 owners or managers of micro, small and medium enterprises while further in-depth interviews were done to extract explanatory factors of capital investment decisions that were not accounted in the quantitative phase. Non-parametric test of association revealed no significant association of capital investment decisions and nature of industry being engaged by MSME owners/managers. Pearson r correlation test revealed that generation of investment opportunities, project analysis and approval, and post-implementation audit have significant relationship with years of operation. Further qualitative analysis of interviews revealed that the influential factors affecting financing decisions of MSME’s owners include sources of finances, entrepreneurs’ prior experiences, business trends, and diversification of investments.

Keywords: capital investment decision, MSME, sequential-explanatory design, Digos City, Philippines

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INTRODUCTION

One of the most important strategic business decisions is in respect of the investment of funds. As capital investment plays a vital role in the existence of one’s business as it is one of the engines of the day to day running of an organization that leads to success. The goal of investing is not just to earn profit in a short span of time but to invest funds expecting a higher return, as investing requires scrutiny. However, people in the society are having a hard time to think how to invest their funds to achieve the desired outcome where in fact they do not know how to invest wisely their capital.

Capital investment decision is defined as the process by which firms determine how to invest their capital (Emmanuel, Harris & Komakech, 2010; Bakke & Whited, 2010; Gervais, 2009). This process includes decisions in the investment to new projects, reassessment of the amount of capital that has already been invested in existing projects, allocation and rationing of capital across divisions, acquisition of other firms, among others. The essence of capital budgeting process is definitive of the size of a firm’s real assets, which are responsible in the generation of cash flows that determine a firm’s profitability, value, and viability (Viviers & Cohen, 2011; Okafor, 2010; Dayananda, 2002). Hence, capital investment decisions involve a company making decisions about large investment outlays in return for a stream of benefits in future years (Bierman Jr & Smidt, 2012; Levy & Sarnat, 1994; Northcott, 1992).

Several studies highlighted capital budgeting decisions to possess distinguishing activities that delineates future benefits over time (Dimov & Gedajlovic, 2010; Denison, 2009; McNichols & Stubben, 2008; Agarwal & Taffler, 2008; Anderson & Garcia-Feijoo, 2006). This is why investment decisions must be a subject of analysis of current and future risks that are fundamentally responsible in some changes of investment decisions (Arrow & Lind, 2014), since these are strategic in nature and may improve the strategic position of the company for the foreseeable future if addressed properly. Basically, risk is unavoidable, thus requires personal managerial conviction in the part of the entrepreneur.

Making a capital investment decision is one of the most important policy decisions that a firm makes (Bierman Jr & Smidt, 2012; Nazir & Afza, 2009; Pike & Neale, 2006), given that a firm that does not usually invest in long-term investment projects since it does not maximize stakeholders’ investment interests and wealth for a desirable period (Denis & Sibilkov, 2010; Zellweger, 2007; Kor & Mahoney, 2005). Because of this barrier, there is a need to do optimal decisions in capital investment with the primary intention of optimizing a firm’s main objective – maximizing the shareholders’ wealth – and also help the firm to remain competitive in its
growth and expansion. These decisions are some of the integral parts of corporate financial management and corporate governance.

A company grows when it invests in capital projects, such as plant and machinery, to generate future revenues that are worth more than the initial cost. Once wrong capital investment decisions are made, they are not easily reversible, and if the firm insists and reverses them, they are costly (Shivakumar, 2014; Kalyebara & Islam, 2013; Boyarchenko & Levendorskii, 2007). Therefore, a company’s future direction and the pace of future growth start with capital budgeting decisions which involve investing in viable long-term assets to generate future revenue. Hence, capital budgeting is the most critical decision of any organization that plans to grow, adequately compete and thrive for a long time (Hull, 2014; Berk, Stanton & Zechner, 2010).

Several studies (Chronopoulos, 2011; Prather, Topuz, Benco & Romer, 2009; Claessens & Tzioumis, 2006; Genus & Coles, 2006; Bardy, 2006) averred that capital investment decisions are among the most important choices leadership makes for a business enterprise to increase shareholder value. The decisions commit substantial resources for an extended time. Leadership must make the correct investment decisions to support the overall corporate, business and functional level strategies to improve its opportunities for success (Zellweger, 2007; Kleinnmuntz, 2007; Székely & Knirsch, 2005; Mankins & Steele, 2005). Also, internal challenges force management to blend science and art in making a capital investment decision as well. Lack of comparable options, data bias (optimism or pessimism), managerial talent, and acceptance to change by the workforce, are all unknown conditions that management must consider when making a capital budgeting decision (Alghamdi, Wagih, Alzahrani & Attia, 2016; Alzahrani, 2014; 2006).

This paper seeks to examine the practices on capital investment decisions of micro, small and medium enterprises in Digos City. Specifically, the study seeks to find (1) the extent of MSMEs’ practice capital investment decisions in generation of investment opportunities, project analysis and approval, implementation, monitoring and control, and post-implementation audit; (2) the significant association between capital investment decisions among the MSMEs with nature of industry and years in operation; and (3) the other possible factors that may be necessary in the practice of capital investment decision of MSMEs.

**METHOD**

**Participants**

The study involved owners and managers of micro, small and medium enterprises in Digos City. Primary data were gathered both by survey involving \( n=125 \) owners/managers of micro, small and medium enterprises, and subsequent interviews involving \( n=8 \) informants. The list of the MSMEs was secured from the Provincial Department of Trade and Industry.
**Instruments**

The study used a structured questionnaire adopted from Yee (2010). The questionnaire is adopted because it is of the similar context of the study’s intent. Part I asks the business (institutional) profile and Part II instructs the respondents to rate the items on the four scales representing the capital investment decisions of micro, small and medium enterprises.

Face validity of the questionnaires was reviewed by three (3) experts in the field of research, who are either holders of master’s degree or doctoral degree holder of business administration. A validation sheet was provided to each of the three evaluators to evaluate the appropriateness of the items and the appearance, style and content of the questionnaire. As with the questionnaire’s response method, a 5-point Likert attitudinal scale was used. The 5-point scale anchored on the semantic differential pairs of “Strongly Disagree to Strongly Agree”.

**Procedure**

In the gathering of the necessary data of the study, necessary approval was secured by the researchers in writing. A letter requesting for approval in the conduct of the study was addressed to the Provincial Director of the Department of Trade and Industry, noted by the Head of the Business and Accounting Education Program and the Assistant Vice-President of UM Digos College. After securing the approval of the communication, the researchers had the instrument validated first by the experts. The College’s approved validation sheet was used. After refinements were made by the adviser and the validators, sample size of the respondents was determined based on the masterlist provided by the DTI Provincial Office.

Upon approval, the researchers proceeded in the distribution of the questionnaires to the micro, small and medium enterprises identified. Part of the questionnaire contained the freedom to choose to participate in the study or decline in the participation to assure ethical standards. The distribution and retrieval of questionnaires was done for two weeks. Questionnaires were retrieved immediately after the respondents will answer them. The responses were then analyzed using the appropriate statistical procedures, with which results were presented in tabular manner and then interpreted.

Means and standard deviations as well as reliability values were computed for the four variables. The four capital investment decisions were correlated with years of operation using Pearson \( r \) and tested for association with the nature of industry using nominal-by-interval association (\( \eta \)). Qualitative analysis was done through vignettes as suggested by Burnard, Gill, Stewart, Treasure & Chadwick (2008).

**RESULTS**

Most of the respondents of micro, small and medium enterprises in Digos City engage in wholesale and retail representing 33.6%, followed by
the service industry (15.2%), hotel and restaurant (11.2%), financing (9.6%), agriculture (7.2%), hospital and health services (4.8%), communication and electricity, gas and power (1.6%) and banking and finance (0.8%).

Years in operation pertains to the activities that a business and its employee engage in on daily basis for the purpose of generating profit and increasing the inherent value of the business going concern. Most of the respondents had been operating below 5 years (38.4%), followed by those operating for 6 to 10 years (36.8%), 10.4% operating for 11 to 15 years, 8.8% in operation for 16 to 20 years, and 4.8% operating for 21 years and above. Average years of operation is 2.04 years (SD=1.136)

Table 1 shows the mean scores and standard deviations for the four capital investment decisions in the micro, small and medium context. The mean scores showed that the managers/owners of these enterprises have agreed on the practice of generation of investment opportunities (\(M=4.07\)), project analysis and approval (\(M=4.16\)), implementation, monitoring and control (\(M=4.02\)), and post-implementation audit (\(M=4.12\)). Internal consistencies of the four scales were found to be high, ranging from 0.710 to 0.826.

<table>
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<tr>
<th>Table 1</th>
<th>Mean and Standard Deviation of the Variables</th>
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<tr>
<td>Generation of Investment Opportunities</td>
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<tr>
<td>Project Analysis and Approval</td>
<td>4.16</td>
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<tr>
<td>Implementation, Monitoring and Control</td>
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<tr>
<td>Post-Implementation Audit</td>
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To test whether capital investment decisions of managers and owners of micro, small and medium enterprises are associated with the nature of industry they are operating in, a nominal-by-interval test of association was conducted (Table 2). Based on the test, the four capital investment decision measures were found to have no significant and directional association with nature of industry, vis: generation of investment opportunities (\(\eta=0.239\)), project analysis and approval (\(\eta=0.277\)), implementation, monitoring and control (\(\eta=0.301\)) and post-implementation audit (\(\eta=0.249\)), having \(p\)-values greater than 0.05. The non-significant \(\eta\) values of the nominal-by-interval test of association may mean that the four practices do not have something to do with the nature of industry the managers or owners are into. We also suspect that nature of industry is not a differentiating condition for capital investment decisions to vary among entrepreneurs. This may also suggest that there might be no variations on the levels of these measures when nature of industry as taken into consideration.
Pearson $r$ test of correlation was used to test whether capital investment decisions of managers and owners of micro, small and medium enterprises significantly relate with the MSME’s number of years in operation (Table 3). Of the four capital investment decisions, three were found to have significant and positive relationship with firms’ years of operation: generation of investment opportunities ($r=0.269$, $p<0.05$), project analysis and approval ($r=0.254$, $p<0.05$), and post-implementation audit ($r=0.228$, $p<0.05$). Only implementation, monitoring and controlling was not significant. The significant values of the correlation may mean that the three practices may improve as the enterprise gets older.

Table 3  
Test of Relationship between Capital Investment Decision and Years of Operation

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<th>Years of Operation</th>
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<tr>
<td>Generation of Investment Opportunities</td>
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<td>Project Analysis and Approval</td>
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<td>Implementation, Monitoring and Control</td>
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<tr>
<td>Post-Implementation Audit</td>
<td>.228*</td>
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Note: *= $p<0.05$, **= $p<0.01$, ***= $p<0.001$. N=125 for all analyses.

Other possible factors necessary in the practice of capital investment decision of micro, small and medium enterprises in Digos City were also explored using semi-structured in-depth interviews with eight informants. The purpose of the interview is to explore a rich discussion from the informants of what was not accounted for in the prior quantitative phase of data-gathering. Vignettes were used in displaying the essential statements that came out in the qualitative phase. Based on the interview conducted by the researchers, a number of factors have been shown to influence financing decisions of MSME’s owners, which include (1) sources of finances, (2) entrepreneurs’ prior experiences, (3) business trends, and (4) diversification of investments.
**Sample Interview Response for Theme 1**

The age and size of firm are important considerations in getting for sources of funding for growth, other than the attitude towards debt financing. These are basic considerations looked by investing firms when funding for a business. As a representative of a financing firm, the age and size of the firm reflect from the business goals of the owner/s and the life-cycle issues it has faced through the years.

**Inf_027_Finance**

**Sample Interview Responses for Theme 2**

This business has been our family’s business since then. My grandparents started a small catering business which our parents continued. Since we were young, we are being trained to follow what our grandparents have started. Continuing their legacy is a big challenge since then, and by experience, making the business grow and sustaining it further is even more difficult.

**Inf_056_Restaurant**

The last job that I have taught me in baking. I capitalized from that experience.

**Inf_004_Restaurant**

**Sample Interview Response for Theme 3**

Trends give me an idea on what business to deal with. As we observed from people, especially teenagers of today’s generation, they are fund of treating their hair, that’s why I put up this business. No one will invest in your business if you do not know what the people need, which is shown by what’s trending.

**Inf_114_Service**

**Sample Interview Response for Theme 4**

Never put your eggs in one basket. You need to diversify because what might be good today will not be the same tomorrow. You need to anticipate for risks.

**Inf_066_Service**

**DISCUSSION**

The nature of industry of micro, small and medium enterprises is not a discriminating factor towards their level of capital investment decisions, as reflected in the four essential indicators. This means that generation of investment opportunities, project analysis and approval, implementation, monitoring and control, and post-implementation
audit do not vary among managers and owners with respect to their industry engaged with. Such pronouncement implies that capital investment decisions can be attributed by institutional and personal indicators, rather than their nature.

On the other hand, an increase of years of operation is significantly correlational with investment opportunities, project analysis and approval, and post-implementation audit, which purports that these decisions improve through time. This is evident in the work of Agarwal and Taffler (2008), who posited that capital budgeting decisions involve certain activities such as exchange of funds for future benefits, investment of funds in long-term activities and occurrence of future benefits that might evolve over a series of years. Moreover, an entrepreneur needs to learn how to manage investment risks by learning from the operations through time, which then becomes a regular basis for decision-making (Vuković & Mijić, 2011). The number of years of operations is tangential to realizing that risks are unavoidable and unpredictable. Time is an important element of capital budgeting decisions (Bierman & Smidt, 2012).

Capital investment decisions are also defined as to the managers’ ability to pool in funds to finance its operations. This has also posted the biggest obstacle to entrepreneurs of all types of business, including micro, small and medium enterprises due to guaranteeing requirements needed to secure funding, resulting in reliance of the entrepreneurs to own venture capital money (Long, 2017). With this circumstance, micro, small and medium enterprise owners to engage in learning the art of preparing business proposals by doing market research in order to convince funding agencies to finance their operations. Funding agencies also need assurance of return of their investments by looking at the long-term commitment of the entrepreneur to sustain its operations and maximize its value over time.

Moreover, prior experience is helpful for any entrepreneur in engaging business. Experience may facilitate the acquisition of entrepreneurial knowledge (Sorensen & Sharkey, 2014) and increase entrepreneurial performance (Campbell, Ganco, Franco & Agarwal, 2012; Franco & Filson, 2006).

It is also essential for entrepreneurs to consider what the market wants at a certain time. Following what’s trending is giving your operation a boost and may be seen by venture capitalists as a potential for increasing your firm’s value because they see it as a response to need. It is high time to consider that the market is far from being fully-formed or matured. The crucial importance of trend directs the industry’s trajectory to maximize income-generating opportunities.

Lastly, micro, small and medium enterprises (MSMEs) are not perfect as they are vulnerable to both anticipated and unanticipated risks. The external and internal business issues are even continually challenging the seasoned professionals when making capital investment
decisions. With this turmoil, the need to anticipate external market changes, such as, competitor response, environmental uncertainties, political interruptions, technology changes and more, require management to blend art and science in the decision-making process (Zeller & Stanko, 2011).

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