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Summary

Over the years, the process of a capital expenditure request has evolved. Today, equipment and projects are more complex than ever. Because of this, the work of both the capex seeker and the approver has become more difficult, forcing them to understand better, the position of their counterpart. With proper understanding of the capital expenditure approval process and what the approvers need, the capex seeker can improve his or her chances of getting the request approved.
Introduction

People that oversee and approve capital expenditures in companies normally get to review the business cases that come with the capital expenditure request. Actually, most companies and organizations do request some kind of business case to be done before giving the green light for any project or capital expenditure that is not pre-approved. Moreover, even when it is pre-approved most people still need to re-justify the capex before they initiate the expense.

If you are part of the approval process of capital expenditures in your company or organization, you know that all these requests come with a reason. People that seek approval of capital expenses use different reasons for their justification and this in itself is probably one of the most important elements of the business case. However, over time the process of capital expenditure approval has seen an increase in the number of reasons used for justifying them, and its adding complexity for everyone involved.

Let us explain

Over the past years, companies have typically spent money for capital expenditures for a number of reasons, such as the need to replace older existing equipment or acquire new equipment to grow their business, or complete some major repairs to a building. Later, when efficiency improvement became more popular (and such equipment became available), companies started to replace current equipment with more efficient ones, in order to gain efficiency by reducing man power (by automating processes), waste, and energy.

These are only a few reasons for spending on capital expenditures but they illustrate that reasons have evolved over the past decades to include new ones. Over many years, companies evolved their justification criteria for spending on capital expenditures. If, one hundred years ago, most capital expenditure were justified by replacing old equipment or doing major repairs, new justifications for capital expenses are much more complex and varied today.
Reasons today, in addition to the previous ones used in the past, now include legislation, insurance, disuse, energy-saving, health and safety, and environment to name only a few. Of course, the traditional reasons such as replacing equipment, which have reach the end of their life, are still popular. Nevertheless, we are seeing new reasons relating to fields such as the environment become more popular these days.

The problem for people in a capital expenditure approval position is that getting to understand the reasons for the capital expenditure demand is also getting more difficult because of the evolving reasons for the request. In addition, without a good understanding of the reason for the capex request, many people can take a fallback position (that may seem risk free) of denying the capex request. After all, if we deny the approval, do we eliminate the possibility that the project or the capital expenditure would have been a bad decision? Moreover, what about the good projects that are being denied simply because the approvers do not fully understand the reason behind the capital expenditure request? Unfortunately, many companies and organizations are missing opportunities because of this.

If replacing an equipment, because it is too old to function properly, is a concept that everyone can understand and are approved without too much pain, getting to replace a perfectly good equipment for another one, which will improve quality, reduce staff and the company’s carbon footprint at the same time is another story.

The same thing applies for retrofit projects whose main purpose is to save energy. Instead of having to simply compare between keeping an old equipment running and purchasing a new one, the capital expenditure approver now has to understand new concepts and see the total effect of a combination of factors. In addition, often the first thing that the approvers will normally do is seek more information before making their decision.

For the person seeking to get a project or purchase approved, it also means that he or she will need not only to answer these questions but to explain in a language that the approver will understand and in the same process, do it in a convincing manner.
Questions from the approvers can be very varied, depending on the nature of the capex request:

- Can you explain how this retrofit project will help us save energy and reduce our carbon footprint at the same time?
- How much of this project is for saving energy, and how much is simply to make us look greener?
- I do not understand this project. How do we measure the immediate benefits for the company?
- Do we do use standard methods such as Payback, Net Present Value (NPV), or Internal Rate of Return (IRR)?
- Can we get grants for the project?
- How much grants are we estimated to receive, and how much are based on internal guesstimates?
- Is this for safety reasons? Why was it safe last year and all of a sudden, it is now not safe? What has changed?
- Are we replacing because of legislation? We just changed the equipment last year; can we continue as we are doing now?
- Insurance wants us to spend for what? Is this an absolute requirement (if we do not do this, do we lose our insurance protection) or another one of their nice to have proposals?
- Is this capex for a production unit for a new client? Do we know for how long we will keep the new client? What happens if we lose the client before the new equipment has been fully paid for?
- What is the lifecycle cost for this equipment, and did we do a lifecycle cost analysis for any other alternatives?
- What is the urgency all of a sudden? Things were working well until today.
- The savings related to this equipment purchase are based on reduction of headcounts. Have we clearly identified whom we will let go, and all the costs associated with this?
- These are only a few examples of questions that come up all the time. These days there are many, many more questions and rightfully so. However, how often are capital requests denied because the approvers did not fully understand the benefits behind the request, or because of a perceived risk attached to these requests?

Because of the explosion of reasons, getting projects approved requires that the initiator of the request do more homework than before. No one really expects the capital expenditure approvers to be experts in all fields such as legislation, health, and safety, energy-saving, insurance, and others, but the approvers need to be able to analyses the capital expenditure requests that are initiated for very various reasons.
How can the initiator of the capital request and the approver get to be on the same level, so that the good capital expenditure requests are approved and those that provide less value, to the company, are rejected? First things first. It is up to the initiator of the capital request to provide enough information for the approver to understand fully what he or she is approving. In the capital expenditure request, the initiator must clearly state at a minimum:

1. **What the expenditure request is about**, providing as much details as possible on the project, the purchased equipment, the cost, timeline and other elements that are associated with the capex request such as warrantee, performance guarantee.

2. **The reason or reasons behind the expenditure**. This is mainly providing information on the benefits that the expenditure will bring (help to increase production, reduce costs, comply with legislation, save energy, add security to workers…etc.).

3. **Any explanation on why the capex needs to be approved** now can be useful. A request for capital either triggers an event (the company wants to invest in a project or machinery) or it is triggered by an event regardless if the event happened suddenly (an equipment broke down) or over time (the entire roof needs to be changed). In any event, the capex seeker will need to explain why now.

4. **The total cost**, meaning the cost and all potential additional costs that may arise. This is normally a good time to include any element of risk in terms of potential cost overruns. If the capex request is a simple equipment purchase this can be simple to isolate, but if the capex is for the expansion of a manufacturing plant and includes process equipment as well as the building, there might be multiple sources of potential cost increase.

5. **The other risks (all of them)**. Capital request that are for more complex equipment or projects should include information on the potential risks, this shows the approver that homework has been done. For example, if there is a risk that the new equipment the capex request is seeking may take more time to install and get running up to the desired production speed, there might be production downtime because of this and it should be considered in the analysis. Risks can be obvious (ex: delay in equipment installation can cause delay to production, which in turn can cost the company mon-
ey), but they can also be less obvious. For example, if the purchase of a new equipment is meant to replace employees, have the costs of terminating the employees and the risks associated (being sued by the employees or problems with unions) been fully evaluated?

6. **The benefits to the company/organization.** These include the standard financial benefits (payback, NPV, IRR), quality (improvement of production quality), and health, safety, cost reduction, marketing/sales/image benefits (if the project helps the environment for example). The benefits and the reason normally go hand-in-hand; although, some capital expenditure might not have much benefit. For example, if a new municipal law requires a company to install something new, say a fence, while this new law will be the reason for the capex request but it might not bring any benefit for the company (apart from getting the city off the company's back).

7. **The downside of not doing the project.** If there are benefits to the capital expenditure that is requested, there is probably a downside by not doing it. It is important to outline the downside or potential consequence or loss of opportunity that would result from not getting the capex approved. This can range from government penalty (suppose the company does not approve a capex request that was for something related to legislation) to loss of insurance coverage (supposing the request is from the insurance company as is mandated to keep the coverage).

Finally, it can also lead to public negative news (suppose the capex request was for replacing a chimney that emitted pollution next to a residential area). These are simply examples and there are many other potential downsides. The important part is to provide the information on the capital expenditure request for the approvers to understand fully the consequences of not approving the capex. However, it is up to the people seeking to get the capex approved to highlight the consequences (if any) of not pursuing a capital expenditure.

8. Depending on the nature of the capex request, a description of how, who will implement the project, component, or work, and when. While this might be straightforward if the capital expenditure is for the acquisition of a forklift, if the capex request is for a building expansion or a new production unit, there might be many elements to consider here.
9. **Information on alternatives.** Since the vast majority of capital expenditures have alternative solutions, it is best to be well prepared and have a number of alternatives in terms of what to do, what other vendor to consider or other potential equipment to purchase. Showing to the approvers that some alternatives were considered shows that homework was done and will help avoid some of the questions such as, “What are the alternatives?”

Alternatives can be other type of equipment, other vendors but they can also be other forms of getting an equipment. For example, an alternative to purchasing an equipment might be to lease it. An alternative to replacing an equipment might be to overhaul it. An alternative to buying new might be to buy second hand. Whatever the nature of the capital expenditures, there are often alternatives that can be found.

10. **Any technical information that the approver needs** to understand should be presented in a clear way so that the person (or persons) in the position of approving the capital expenditure can take a sound decision. The more information and explanation that is provided, the more the approvers will understand what the request is about and in many cases, the more they can tend to be favorable to the request (if the request already meets the company’s criteria of course).

**Conclusion**

The process of capital expenditure has evolved, significantly, over the years. Today, there are more reasons to initiate a request for capital than there used to only a few years ago, and this tendency is probably going to continue in the future.

People seeking to get their capital expenditure approved should consider that the multiple reasons available for their capital expenditure justification only makes the work of the approvers more complex and therefore, they should provide them with as much information as possible in order for the approvers to take decisions that make great business sense for their companies or organizations.
About Almiranta

Almiranta Corporation markets an online (SaaS) business productivity suite of software under the name ExPlan Suite, which helps companies plan capital expenditures, manage real estate leases, and reduce their energy consumption.

Almiranta Corporation’s CapExPlan is a complete capital expenditure planning and tracking software that enables companies and organizations to reduce their capital expenditures by helping them better plan, approve their capex requests and track expenditures.

See the full product features at [https://www.almiranta.com/capexplan.php](https://www.almiranta.com/capexplan.php)

For more information contact us at info@almiranta.com or visit our site at [http://www.almiranta.com](http://www.almiranta.com)

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