

## The idea's source of investment decision in manufacturing companies (Alfapipe Ghardaia as a model)

مصدر فكرة قرار الاستثمار في المؤسسات الانتاجية (Alfapipe Ghardaia كنموذج)

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### الملخص :

ركزت الدراسة على مصادر فكرة قرار الاستثمار في المؤسسات الإنتاجية وتم أخذ مؤسسة غرداية للأنايب كنموذج، اعتمدت الدراسة على وثائق المؤسسة بالإضافة إلى المقابلة مع مراقب التسيير في المؤسسة لجمع البيانات. أظهرت الدراسة أن مؤسسة غرداية للأنايب تحصلت و طبقت فكرة قرار الاستثمار من محيطها الخارجي و بالتحديد من زبونها- الزبون الرئيسي- ولأن هذا الاستثمار يتطابق مع استراتيجية المؤسسة. الكلمات المفتاحية: قرار الاستثمار، مصدر فكرة الاستثمار، مؤسسة غرداية للأنايب.

تصنيف JEL: G310, G390

### Abstract :

The study focuses on the idea's source of investment decision in manufacturing companies and we take ALFAPIPE GHARDAIA as a model. The study based on the documents of the company in addition to an interview with the manager control of the company in collecting data.

The study shows that ALFAPIPE GHARDAIA receives and applies an idea of investment decision from its external environment and more precisely from its client-the main one- because this investment fits its strategy.

Key words: investment decision, idea's source of investing, Alfapipe Ghardaia Company.

JEL Classification: G310, G390.

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## **1. Introduction :**

The aim of any company is to maximize the wealth of its shareholders or we can say to maximize its value, for this reason companies are obliged to look for the best way to reach its objectives, by making several decisions.

Companies make many decisions, some of them are routine decisions, others are tactical ones and others are strategic decisions, the latter category is very important because of its characteristics and we cannot go back when we take it. Investment decision is one of the strategic decisions in the company.

Companies must invest for many purposes, sometimes invest to renew its machines and equipment to keep the level of production or increase it, sometimes must replace its fixed assets when the replacement is necessary, and sometimes must expand its real assets to meet the demand for its clients, or to invest for other purposes.

Investment decision is so important, simply because; investment requires a huge capital, investment is to take risk and investment affects the value of the firm.

Generally, the idea of investment project comes from two major sources, the first one is from the company itself (managers, workers, engineers and so on), from the internal environment, the second one is from its market and here we mean specially its clients or we can say from the external environment.

**Do companies receive and accept investment project's idea from its clients? If it is, does the company apply it?**

### **The importance of the article :**

The article brings its importance from many points, some of them are:

- The article focuses on the idea of investment which comes from the external environment of the firm because some managers ignore totally the environment of their companies.
- Some managers ignore the satisfaction of their customers and their wants.
- The major managers concentrate on the financial performance and do not care about the vision of the enterprise if there is a vision.
- The majority of studies focus on the financial evaluation of investment projects.

### **Objectives of the article:**

We can summarize the objectives of the article in the following points:

- Presentation of investment decision, definitions, its characteristics, and importance.
- Determine different sources of investment's idea.
- Check whether the ALFAPIPE GHARDAIA accept and apply ideas from its market or not.

To reach the article goals and answer its questions, the article is divided into two parts; the first one is about the literature review, whereas the second one is about the idea's source of investment in ALFAPIPE GHARDAIA.

The article ends by a conclusion that contains results about the idea's source of investment decision in ALFAPIPE GHARDAIA.

**Tools of collecting data:**

The researcher based on company's documents in addition to an interview with the manager control of the enterprise in collecting data.

**2. Literature review :**

**2.1 Definition of investment :** there are enormous definitions of investment, we find the financial definition, the economic, and the accounting definition, but I think that the financial definition is the suitable one in this article.

Investment decision, sometimes referred to as the capital budgeting decision, is the decision to acquire assets. Most of these assets will be real assets employed within the business to produce goods or services to satisfy consumer demand. Real assets may be tangible (e.g. land and buildings, equipment) or intangible (e.g. trademarks, and know-how).<sup>1</sup>

A basic definition of a capital investment is an investment in a real asset that is expected to generate a future return. For the firm, this can for instance be an investment aiming to increase capacity, improve product quality or contribute to a more efficient utilization of resources.<sup>2</sup> We can classify investment into several types, according to many criteria, for example according to the kind of assets, we find two categories of investments, and there is financial investment which is concerned in investing in stocks and bonds and the second one is real investment which is concerned in investing in fixed assets like machines and equipment.

The most common type of investing for the manufacturing firms is in fixed assets, these assets, often referred to as earning assets; generally provide the basis for the firm's earning power and value.<sup>3</sup>

**2.2 The importance of capital investment :** capital investment is very important for the company; we can illustrate its importance as below:<sup>4</sup>

- Investments effect operations and cash flows of firms for long period of time.
- Capital investment decisions are also stated as an important means for implementing strategies and ensuring performance.
- Making investment decisions is a matter for making decisions on resource allocation; however, since firms generally have limited available resources, making allocation decisions, such as investment decision is fundamental.

The investment decisions in both current and fixed assets are of most important for any firm to achieve its goal of maximizing shareholders wealth.<sup>5</sup>

As its importance, investment decision requires the participation of all functions in the company:<sup>6</sup>

- Production
- Commerce
- Purchasing
- Finance
- Staff

- Research and development
- General direction.

**2.3 Characteristics of investing in real assets :** there are four basic characteristics of investing in real investment they are:<sup>7</sup>

- Initial investment or capital expenditure,
- Period of life of the investment,
- Salvage value,
- Cash flow.

**2.4 Basic motives for investing in real assets :** there are many motives that drive a firm to invest in fixed assets, some of them are:<sup>8</sup>

- **Replacement proposals** are justified primarily by the need to replace assets that are nearly exhausted or have excessively high maintenance costs. Little or no improvement may be expected from the replacement, but the expenditure is essential to maintain the existing level of capacity or service.
- **Cost reduction proposals** (which may also be replacement proposals) are intended to reduce costs through addition of new equipment or modification to existing equipment.
- **Expansion or improvement proposals** relate to existing product, and are intended to increase production, service and distribution capacity, to improve product quality, or to maintain and improve the firm's competitive position.
- **New product proposals** refer to all capital expenditures pertaining to the development and implementation of new products.
- **Strategic proposals** are generated at senior management level and involve expenditure in new areas, or where benefits extend beyond the investment itself. A project may appear to offer a negative net present value and yet still create further valuable strategic opportunities.

In the preceded motives, I think that the last three motives – expansion, new product and strategic proposal are the highest in the degree of risk among the other motives, because the company is not sure about the expected quantity demanded of the product in the future, whereas the first two motives the company knows its market.

**2.5 The objectives of investment :** there are many objectives of investment, but the most common objectives are:<sup>9</sup>

- Maximizing profits.
- Maintaining its market position.
- Stabilizing company structure with respect to assets and liabilities.

Before the company decide to invest it must take into consideration:<sup>10</sup>

- Study the investment's return.
- Take the risk into account.

But also the company must make sure that the investment fits the strategy and the financial constraints of the company.

**2.6 The idea's source of investing in real assets :** generally, there are two major sources of the idea of investment in fixed assets, internal source and external source. The first one includes managers (managers may introduce new ideas because they know situation of the firm.) engineers (they have the ability to propose new ideas as a result of their knowledge about machines and equipment used in the firm.) and workers (may suggest renewing a machine because of their interaction with machines and equipment). And so on, and here we mean anyone who is under control of the firm. The second one is the external source (here we mean the market of the firm), we find the clients and the salers of fixed assets. The later may introduce and suggest new machines or equipment with high capacity or more developed. Whereas the first may demand a special product; the later may lead the firm to invest or to add new line of product.

A good investment planning process requires a continuous flow of ideas to regenerate the organization through the exploitation of new opportunities.<sup>11</sup>

**2.7 Investment appraisal :** any company must evaluate its investment projects. The evaluation concentrates on different aspects, legal, social, marketing, technical, and financial aspect. The later is the most important because investment decision based on it, there are many financial criteria used in this field. Using these criteria make the company avoids useless projects.

Companies use different criteria in evaluating projects, the use of any criterion depends on the economic situation. The later is classified into three situations, certain situation, risk situation and uncertain situation. In the first situation companies can use for example, the internal rate of return, the payback period, the net present value, profitability index, or the internal rate of return. In the second case, companies may use standard deviation, or decisions tree, whereas in the last case, companies can use several criteria like Maximax, Maximin, Minimax, Hirwiks, or Laplace criterion.

### **3. The idea's source of investment decision in ALFAPIPE Ghardaia**

**3.1 Presentation of the company :** The ALGERIAN Company of Pipe Manufacturing ALFAPIPE specializes in production of large diameter pipes for the transport of hydrocarbons (gas and oil) as well as the transfer of water from dams.

ALFAPIPE was created in 2006 following the merger between EPE ALFATUS J.S.C. a subsidiary of SIDER Group operating since 1969 and EPE PIPEGAZ J.S.C, a subsidiary of ANABIB Group in production since 1977. It has been attached to IMETAL Group since January 2016. Its capital is 250000000000 DZD.

#### **Units of ALFAPIPE:**

**Annaba Pipe Mill**

**Ghardaia Pipe Mill**

Ghardaia Pipe Mill is located in the INDUSTRIAL ZONE BOUNOURA with an area of 24 hectares. It employs about 830 workers.

**3.2 Products :** Spiral welded pipes for hydrocarbons transport ( liquid and gaseous) of a diameter from 16 to 64 inches, thickness from 6 to 15 mm and length from 7 to 13 m, in accordance with API 5L and API Q1 standards.

Its production capacity is 200000 tons/ year.

**3.3 Main customer :** The main customer of the company is SONATRACH TRC, and these are the main projects performed with it.

GR7 (339 km)	ENC 0H3
GR 6 (538 km)	0Z2 (833km)
GR 5 (786 km)	G02 (534km)
RGG 1 (255 km)	TRC GK3-2 (245km)
Haoud Elhamra – Skikda (509 km)	Gazoduc Tam (400km)
Hassi R'mel –Arzew 1 and 2 (990 km)	GZ3 and 4 (269km)
Gazoduc Centre (513 km)	GR 1 (748km)
GPL (510.7 km)	OK 1 (248km)
SONELGAZ GK2 (560 km)	GK 3 (214km)

The following table shows the total sales of the company, the sales to SONATRACH and its ratio during the period from 2012 till 2016.

**Table 1. The company's sales to SONATRACH and its ratios. (in KDZD)**

	<b>2012</b>	<b>2013</b>	<b>2014</b>	<b>2015</b>	<b>2016</b>
<b>Total sales</b>	6731259	18575860	6714546	18164105	6359751
<b>Sales to sonatrach</b>	6615797	18416366	6542646	17931617	6245576
<b>Ratio of sales to sonatrach %</b>	98.28	99.14	97.43	98.72	98.2

**Source:** prepared by the researcher based on the documents of the company.

We notice from the above table that the ratios of sales to SONATRACH during the period 2012-2016 is more than 98% except in 2014 it was 97.43%. From these ratios we can conclude that SONATRACH is the principal client of Ghardaia Pipe Mill, and the latter should take into consideration SONATRACH suggestions and propositions concerning the investment plans.

**3.4 Competitors of the company :** ALGERIA'S ANABIB is the only competitor at the national level, the latter is under control. Whereas the company does not care about the international level, because its strategy based on controlling the internal market and maintain its clients.

**3.5 The idea of the investment project :** SONATRACH – the principal client of GHARDAID Pipe – used to use pipes of a diameter from 16 to 64 inches and thickness of iron from 6 to 15mm, but in 2016, SONATRACH wanted and demanded pipes with

thickness more than 20.6mm as a result of its project RGG5, this demand caused the GHARDAID Pipe to think in investing in a new machine – iron welding machine - to produce the pipes demanded by SONATRACH, because the existing machines cannot produce the demanded types of pipes.

The idea of the investment project comes from the market of the company from a client of the enterprise, SONATRACH, Which is the principal one.

In theory, companies must evaluate the investment project before it takes it and there are many financial criteria are used in this purpose. But the question is, does GHARDAID Pipe evaluate the operation of investing or not?

The researcher in an interview with the manager control of the enterprise asks this question. The answer was that the company does not evaluate this investment but it based in accepting this investment on the purpose of meeting the customer requirements, especially when the customer is the principal one among our clients.

The researcher ask another question which is does this investment fit the strategy of the company?

The answer was "one of our goals is to maintain and satisfy our customers especially our principle customer which is SONATRACH, because our sales to SONATRACH is about 98% from our total sales."

**3.6 The motives that lead the enterprise to accept this investment project :** There are many motives that lead the company to accept this idea some of them are:

- Add production lines that did not exist before.
- Attempting to raise profit.
- To maintain the clients of the company especially the principal one and this point is in line with the strategy of the enterprise.
- To satisfy its customers especially the one who suggest the idea of the investment project.

We can classify this project as an expansion proposal because it contributes to:

- Increase production.
- Improve product quality.
- Maintain and improve the firm's competitive position.

And we can also classify this project as a new product proposal because:

- It allows developing and implementing new products.

And we can also classify this project as a strategic proposal because:

- It extends benefits and keeps its competitive position.

#### **4. Conclusion :**

Investment decision – investing in fixed assets – is one of the most important decisions in companies especially the manufacturing one. Manufacturing firms take this decision in order to renew, replace, expand, or for other purposes. All these categories of investing in

real assets are made to reach the aim of the company which is the maximization of shareholders' wealth

Companies receive investment ideas from different sources, one of them is from clients, and here firms must not ignore this source of ideas simply because clients and their satisfaction is a major target in successful companies.

ALFAPIPE GHARDAIA is a manufacturing company that receives in 2016 an investment idea from its principle client which is SONATRACH. ALFAPIPE GHARDAIA decides to apply this idea of investing in "welded machine" in order to maintain and satisfy its principle client. In addition to that this investment fits the strategy of the company and its vision.

ALFAPIPE GHARDAIA does not use any criterion in evaluating this project but the only criterion used is to maintain and keep its clients especially the principle one.

### **Findings of the study:**

According to the study we can summarize the major results as below:

- ALFAPIPE GHARDAIA receives the idea of investing in welded machine from its market and more precisely from its principle customer which is SONATRACH.
- ALFAPIPE GHARDAIA according to this idea tries to meet the requirements of its principle client.
- ALFAPIPE GHARDAIA applies the idea of investing in the second mid of 2016.
- The new welded machine begins into production in the end of 2016.
- ALFAPIPE GHARDAIA does not use any financial criterion to support its investment decision's choice.

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