Course Code	FINANCIAL MANAGEMENT	L	T	P	C
21E00201		4	0	0	4
Semester			II		

Course Objectives:

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• To impart the decision making skills in acquiring, allocating and utilising the funds of a company.
• To educate on corporate restructures and corporate governance.

*** Standard Discounting Table and Annuity tables shall be allowed in the examination**
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FINANCIAL MANAGEMENT

UNIT-I

INTRODUCTION TO FINANCIAL MANAGEMENT:-

- **Meaning**: - financial management is concerned with the effective utilization of financial organization resources in an organization.
- **Definition**: - financial management is concerned with planning and controlling of firm financial resources.

1.1 NATURE OF FINANCIAL MANGEMENT

- **Financial management and accounting**: - the accounting and financial management are closely related to each other.
- **Financial management and statistics: -** statistics provides details data uncertainty of future events. It helps the financial manager to understand how the variable affects on decision making.
- **Financial management and cost accounting**:- financial management is not only procurement of funds but also effective utilization. Cost department helps the financial manager to era hate how effectively funds are utilized.
- **Financial management and operation research**:- with the help of operation research financial manager find an optional solutions for the particulars problems.
- **Financial management and decision making**:- based on the financial resource available in the organization the financial managers take the decision.
- **Financial management and marketing**:- marketing management provides the information about product demand and supply according financial manager allocate the financial resources.
- **Financial management and production**: - production of products and services required large amount of working capital. This working capital we need to procured from financial manager.

- **<u>Financial management and personal management</u>**: - investment is required to develop human resource (employees) in an organization.
- **<u>Financial management and economics</u>**: - economics provide general economic environment based on that financial manager implement the decision.

<u>2. SCOPE AND FUNCTION OF FINANCIAL MANAGEMENT</u>: -

1. TRADITIONAL APPROACHES **2. MODERN**

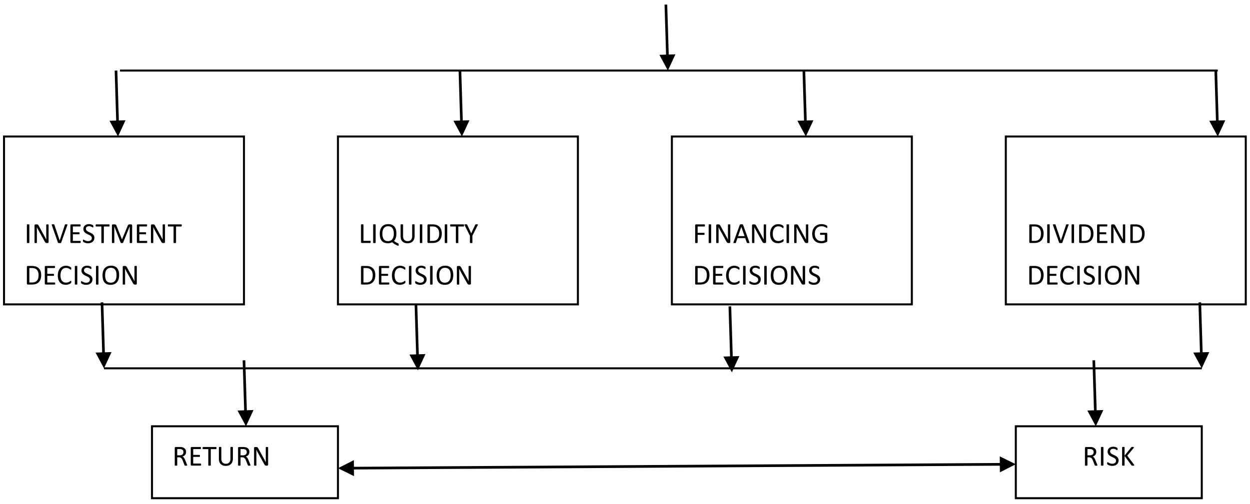
APPROACHES

- **<u>Traditional approaches</u>**: - in the traditional approach finance manager function are not classified and also there is no long term allocation of funds. The traditional approach evolved during the 1920 and 1930.
- **<u>Modern approaches</u>**:-

  a) Executive Finance functions

  b) Routine finance functions

EXECUTIVE FINANCE FUNCTIONS



1. <u>Finance decisions</u>: - In this function the finance manager with look into how to acquire funds, when to acquire fund and which is right time to acquire funds. The main aim of finance manager is to get finance with lowest interest rate.

2. <u>Investment decision</u>: - In investment decision finance manager perform two decisions one is capital budgeting and another is working capital. In this decisions finance manager effectively allocate the long term capital. And also how much funds required for the day to day organization.

3. <u>Dividend decision</u>: - dividend decision classified into two. One is pay out dividend and another one is retain dividend in the above two decision finance manager perform any one based on the situation.

B. ROUTINE FINANCE FUNCTIONS:-

- Supervision of cash receipts and payments.
- Safe custody of securities insurance, policies etc.
- Maintenance of records.

- Reporting to management etc.

3. IMPORTANCE OF FINANCE FUNCTION:-

- It helps to own enterprise smoothly.
- Enhance the credit worthiness.
- Determine the financial soundness.
- It helps organizations to evaluate profitability.
- It is important to management for decision making.
- It provides complete coordination .

4. THE ROLE IN THE CONTEMPORARY SCENARIO:-

Now a day's business is highly dynamic business environment that gives an opportunity to expand global markets.

The present financial management pressure on improving efficiency, cost cutting and timely valuable information.

Greater changes in technology and use of technology given more scope to the companies to capture the market. These all are credit more demand to the financial management.

We have seen major changes in accounting standards. In recent years executive roles have been forced to evolve.

These contemporary scenario drastically changed companies' restrictions their traditional models become faster and more responsive.

Financial management play vital role in restructuring traditional model become core f business operations, and financial integration than ever before.

The financial manager role is not only limited to accounting, financial reporting and risk-management.

In recent years the financial manager roles drastically changed very fast and more responsive.

Financial manager function are play important role in changing traditional functions now a day's functions of financial manager is core business operations and financial integration.

Financial manager play a manager role n driving business to act

As strategic business partner. The financial manager role in the contemporary scenario is more responsibilities, complex and requires constant reinvention of the role.

5. GOALS AND OBJECTIVES OF FINANCE FUNCTIONS

I. Basic functions
A. profit maximization
B. wealth maximization

II. Other functions

A.PROFIT MAXIMIZATION:-

The basic function /objective of the financial manager is to maintains the liquid assets and maximization of profitability.

Maintain of liquidity assets means the firm has adequate cash in hand to pay his their liabilities.

A. Profit maximization: - profit maximization means maximization of profits decreasing expenditure every company want to set maximum profit from their business operations.

According to profit maximizations increase profits and decrease expenditure.

Profit is the central economic objective of any business enterprise profit maximization will be a motive force to acquire monopoly in the imperfect capital markets. It is the process by which a firm determines the price and output profit maximization covers like short term profits, midterm profit, long term profits and profit over period of time.

LIMITATIONS OF PROFIT MAXIMIZATION:-

- It is vague
- It ignores the risk
- It ignores the timing of return.

B.WEALTHE MAXIMIZATION:-

- A common objective of a firm is to maximization the value of firm or wealth maximization. This represents the market price of the common stock.
- Every company market price of the share devotes company worth and wealth
- Wealth maximization gives future earnings of the company.
- The dividend policy of the firm and many other factors that act as the performance indicators.
- Share price in the capital market largely affect economics condition of the firm.
- Maximization of profit and wealth is the managerial finance decision.
- Wealth maximization gives many advantages to supplies, employees, society and management.
- The main aim of wealth maximization is to maximization management economic welfare.
- Wealth management effectively utilize the resources of the company to create wealth.
- The processes of wealth maximization satisfy the interest of the stock holders and company.

6. PROFIT vs WEALTH MAXIMIZATION:-

- Profit maximization is a traditional and basic approach the main aim of objective is to maximization the business profit.
- Profit maximization required for the business survival and to pay salaries research and development.
- If a business doesn't yield any profit. It can be not possible for the survival of business.

  Wealth maximization is a new and modern approach. The main objective is to maximization the share holder's value and wealth.

  Wealth maximization is only achieved with the regular profit maximization.
- Wealth maximization gives future scope for the business in competition business world.
- Since wealth maximization is based on cash flow it can avoids any ambiguity is accounting profits.

  While profit maximization is based on profit, and sales of the company.
- Wealth maximization is considers risk of a business while profit maximization ignore it.
- Wealth maximization is a long term process and profit maximization is a short term process.
- Short term profit maximization can be achieved by the managers for long term sustainability. Of the business.

Wealth maximization focuses on future cash flows are discounted at an appropriate discounted rate in the present value.

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UNIT -2

THE INVESTMENT DECISON

1) **THE INVESTMENT DECISON**:-Investment decision is the process by which companies allocate funds to various investment projects to achieve profitability and growth.

Investment decision evaluates the future a benefit to the company comports with their cost.

1.1) **Investment decision process/capital budgeting process**:-

Project generations → Project evaluation → Project selection → Project execution/ implements

1) **Project generation**:-
   - ➢ Proposal to add new product to the produce line.
   - ➢ Proposal to expand existing product line.
   - ➢ Proposal to reduce the cost of the output.
2) **Project evaluation**:-
   - ❖ Project evaluation involves the two steps.
   - ❖ Estimation of benefits' and costs .the benefits and costs must be measures in terms of cash flows.
   - ❖ Selections of a best alternative project which will give you high returns.
3) **Project selection:-**
   - ➢ Capital budgeting project selection based on the project generation and evaluation. The final approval of the project may be decided by top management. How even projects are secured at multiple levels.
4) **Project execution**:-
   - ➢ The project executions according to the means implementation projection according to the pre conditions .project excites committee (or) the

management must ensure that the funds are spent in the accordant with appropriations made in the capital budgeting.

2) **<u>CAPITAL BUDGETING METHODS/PROJECT EVALUATION TECNIQUES</u>**:-

Traditional (or) non discounted Cash flow

*** Payback period method**

*** Accounting rate of return method**

modern/discounted cash flow

***NPV method**

***IRR method**

***PI method**

<u>Traditional / non- discounted techniques</u>:-

(a) **Payback period: -** pay back period is one of the most popular and widely recognized techniques of equality investment proposal payback period helps to know the when our investment will recover.

$$\textbf{Payback period} = \frac{\textbf{initial investment}}{\textbf{Annual cash flow}}$$

<u>Example:-</u>

A project requires an initial investment of Rs- 2,20,000 and yield annual cash flow for 5 years .i.e. rs 6000,rs 8000,Rs 5000,Rs 4000 and Rs 4000 respectively .

Find the payback period?

Ans

Years	Cash flows	cumulative cash flow
1	6000	6000
2	8000	6000+8000=14000
3	5000	14000+5000 =19000
4	4000	19000+4000 =23000
5	4000	3000+4000=27000

Payback period = near to pay back period + balance of cash flow

Next year in flow

=3years+1000%4000=3.25years.

20) A present requires an initial investment of R.s 120000 and annual cash inflow of R.s 12000 for 12 years .find the pay back period.

Years	Cash flows	***********
1	12000	
2	12000	
3	12000	Payback period =120000%12000
4	12000	=10 years
5	12000	
6	12000	
7	12000	
8	12000	
9	12000	
10	12000	
11	12000	
12	12000	

21) **Accounting rate of return**:-accounting rate of return method accounting information of as revealed by financial statement to measure the profitability of the investment proposals.

ARR= Average annual earnings after tax (or) pat% original investment *100

*profit after tax

OI= Original investment+ additional NWC + instalsationchanges+transportation charges

(OR)

Average rate of return= average annual EAT % Average investment AI*100

*AI= (Original investment-scrap) 12+additionalNWC+Scrap value

<u>Example</u>:-The working results of two machine and given below. Calculate ARR

	Machine x	Machine y
Cost	45000	45000
Sales per year	100000	80000
Total cost for year	36000	30000
(excluding depreciation)		
Expected life	2 years	3 years

This of the two should be preferred

Sol:-competitive average income.

	Machine x	Machine y
Sales per year	100000	80000
(-)cash per year	36000	30000
(total)	64000	50000
(-)depreciation	2250	15000
Net profit	41500	35000
Average income	41500	35000
Average invest ment	22500	22150

ARR = average income / average investment*100

“x” = 41500/22500*100

=184 %

“y” =35000/22500*100

= 156 %

Machine “x “has high ARR hence, machine “x “should be preferred.

2) Modern techniques /discounted cash flow techniques:

(A) net present value method (NPV):- The net present value method is one of the discounted is one of the discounted cash flow methods .it is also knows discounted benefit cost ratio method .it is the process of calculating present values of cash inflows using cost of capital as a appropriate rate of discounted and subtract present value ,which may be positive (or)negative .present positive net present value occurs when the present value of cash inflows is higher than the present value of cash outflows and vice versa.

(2) A choice is to be made between the two competing proposals which require an equal investment of R.S 50000 AND ARE Expected to generate net cash flows as under.

Years	Project – A	Project – B
1	25000	10000
2	15000	12000
3	10000	18000
4	NIL	25000
5	12000	8000
6	6000	4000

Cost of capital of the company is 10% the following are the present value factor as 10 % pique.

YEARS	1	2	3	4	5	6
P.V factor@10%	0.909	0.826	0.751	0.683	0.621	0.564

SOL:-Comparative statement of NPV

YEARS	PV factor@10 %	Project A		Project B	
		Cash in flow	Present value	Cash in flow	Present value
1	0.909	25000	22725	10000	9090
2	0.826	15000	12390	12000	9912
3	0.751	10000	7510	18000	13518
4	0.683	NIL	NIL	25000	17075
5	0.621	12000	7452	8000	4968
6	0.564	6000	3384	4000	2256

Total present value : 53461
56819
Less : initial investment : 5 0000
50000
NPV : 3461
6819

Since project B has the highest NPV, project B Should be selected.

1) **Initial rate of return (IRR):-**This method IRR Is that rate at which the sum of discounted cash inflow. (DCF) equals the sum of discounted cash outflow. It is the rate at which the net present value of the investment is zero , is called internal rate of return because it depend mainly on the outing and proceeds associated with the project and not on any rate determine outside the investment.

The following particulars submitted to you advice we the project can be accepted (or) not by the followers IRR method.

Initial investment 180000 cut of 5:1 expected cash flows of the project dairy the life time are as under.

Year	1	2	3	4	5	6
Cash in flows	30000	45000	30000	75000	30000	15000

<u>SOL: - Calculating average annual cash flows</u>:-

To the cash inflows/no of years
=30000+45000+30000+75000+30000+15000=225000,

Payback period=initial investment/average annual casinflows

=180000/37500

=48%

= 4:8 years

<u>Note:-</u>for 4:8 years referring a table for 6 years the payback period 7%and 8%.

Years	Present value @7%discount rate			Present value @8%discount rate		
	Cash inflow	p.v@7/%	Present value	Cash inflow	p.v@8%	Present value
1	30000	0.935	28050	30000	0.926	27780
2	45000	0.813	39285	45000	0.857	38365
3	30000	0.816	24480	30000	0.794	23820
4	75000	0.763	57225	75000	0.735	55125
5	30000	0.713	21390	30000	0.681	20430
6	15000	0.666	9490	15000	0.630	9450
Present value of in flow			180420			175170
(-)less initial investment			180000			180000
Net present value			420			-4830

Profitability index method:-

Problem: - a machine costing R.S 100000 is estimated to work for 5 years with scrap values of R.S 50000 the expected cash flows during its life time and present value of R.S 1 @10% are given below. Calculate profitability index and common up on the same.

Years	1	2	3	4	5	6
p.v @10%	0.909	0.826	0.751	0.683	0.621	0.621
Cash flows	50000	40000	30000	30000	20000	50000

SOL:-

YEARS	CASH FLOWS	P.V@10%	PRESENT VALUE
1	50000	0.909	40450
2	40000	0.826	33040
3	30000	0.751	22530
4	30000	0.683	20460
5	20000	0.621	12420
6	50000	0.621	31050
Total			164980

Profitability index method =p.v inflows/initial investment

=164980/100000

=1.64%

NPV V/S IRR DEBATE:-

NPV	IRR
• Net present value is the difference between the present value of cash inflows and the present value of cash out flows over a period of time	• Internal rate of return is a calculation used to estimatation the profitability of potential investment
• The net present value method is generally used for the purpose of evaluating projects to continue for a long term	• IRR method is more often used for the purpose of evaluating project to continue for a shorten period
• Discount rate is know as factor in NPV method	• Discount rate is unknown factor is IRR method
• It assumes that the cash inflows can be re invested at the cash of capital in the new projects	• It assumes that the cash inflows can be re invested at the IRR rate in the new process
• NPV provides net return qualitively	• Initial rate of return provides percentages

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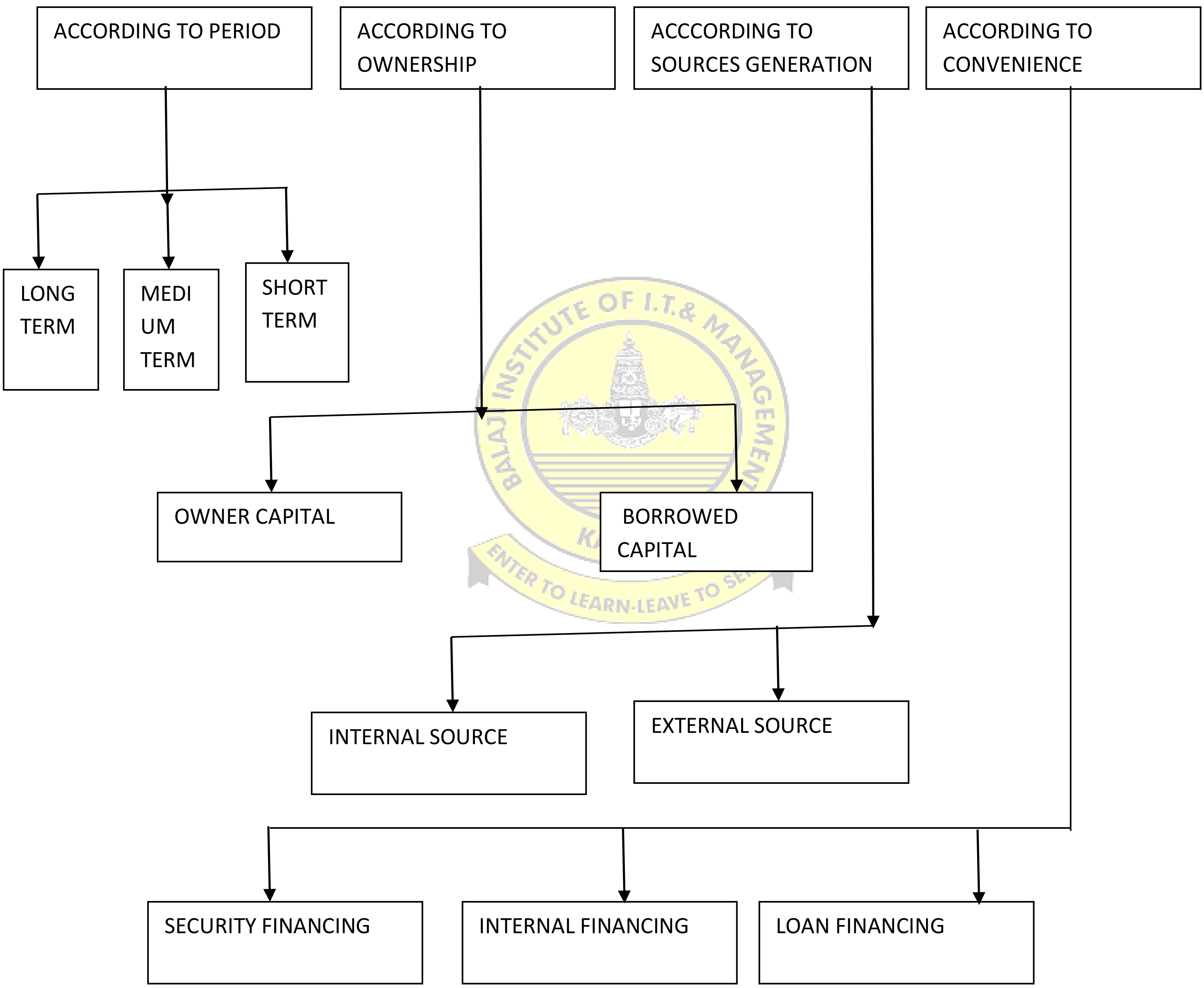
UNIT-3
THE FINACIAL DECISION

SOURCES OF FINANCE



I. **ACCORDING TO PERIOD:**

a) Long term: the long term sources finance means the duration of repayment period is more than 10 years is called long term sources of finance this type of finance taken purchase of assets like machineries and other assets.

Ex: Equity shares, preference shares, debentures and long term unsecured loans.

b) Medium term sources: medium term sources of finance s used for repayment of bank borrowings and payment to sunders creditors etc.

Ex: Bank borrowing and advance from customers.

c) Short term sources: A short term source is used for to meet the working capital need and days to day expenses.

Ex: short term borrowings and bank OD.

II. **ACCORDING TO OWNERSHIP**:

a) Owned capital: in owned capital the owners of the company will bring the amount to run business operations this is called owned capital.

b) Borrowed capital: Borrowed capital means getting money from the outside person through the debentures loans from bank and other financial institution.

III**. ACCORDING TO SOURCES OF GENERATIONS**:

a) Internal sources: to general finance to the company when ever required the company may also go for internal sources of finance. Internal source means collecting on producing from employee, friends and relatives etc.

b) External sources: external sources means getting on collecting finance from the outside the company getting finance through issue of shares and debentures companies generate external finance.

IV. **ACCORDING TO CONVRNIENCE**:

a) Security financing: security financing to means by keeping some document in the banks and getting money is called security finance.

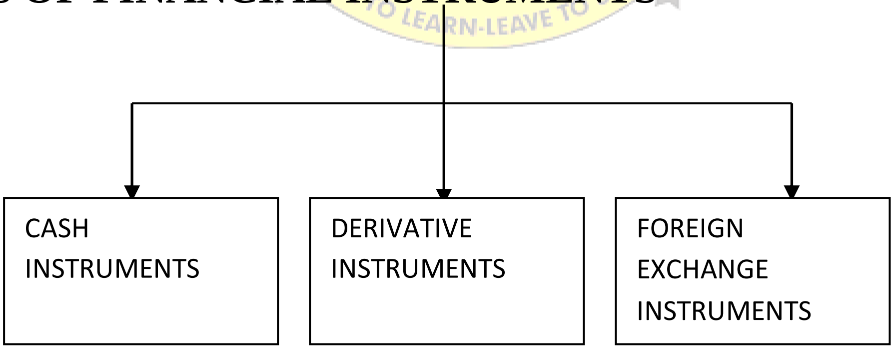
b) Loan financing: loan financing means getting means from through bank to meet company needs.

2. A BRIEF SURVES OF FINANCIAL INSTRUMENTS:

Financial instruments is defined as a contract between parties that holds a money values

Ex: examples of financial instruments are cheques shares, stocks, bonds, futures and options Contracts.

TYPES OF FINANCIAL INSTRUMENTS



1. **CASH INSTRUMENTS**: Cash instruments are securities and deposits and loans these instruments help to get finance to the company when even needed.
2. **DERIVATIVE INSTRUMENTS:** Derivative instruments are currency, bonds, stocks, and stock index.

The most common derivatives instruments are agreements, forwards, futures, options and swaps.

3. FOREIGN EXCHANGE INSTRUMENTS: Foreign exchange instruments are currency agreements and derivatives.

Financial instruments are helping company to fulfil the financial needs and expanding the business operations.

The business cannot run efficiencies they if it does not have adequate finance to meet its financial requirements of a business.

The above financial instruments are very vital and necessary in the present competitive business world. To sustain and develop the business this era.

3. THE CAPITAL STRUCTURE DECISION IN PRACTICE:

Capital structure includes only long term sources of founds turns capital structure is a part of financial structure.

The capital structure decision involves rising of funds into organization by using different alternative sources which are available to the company.

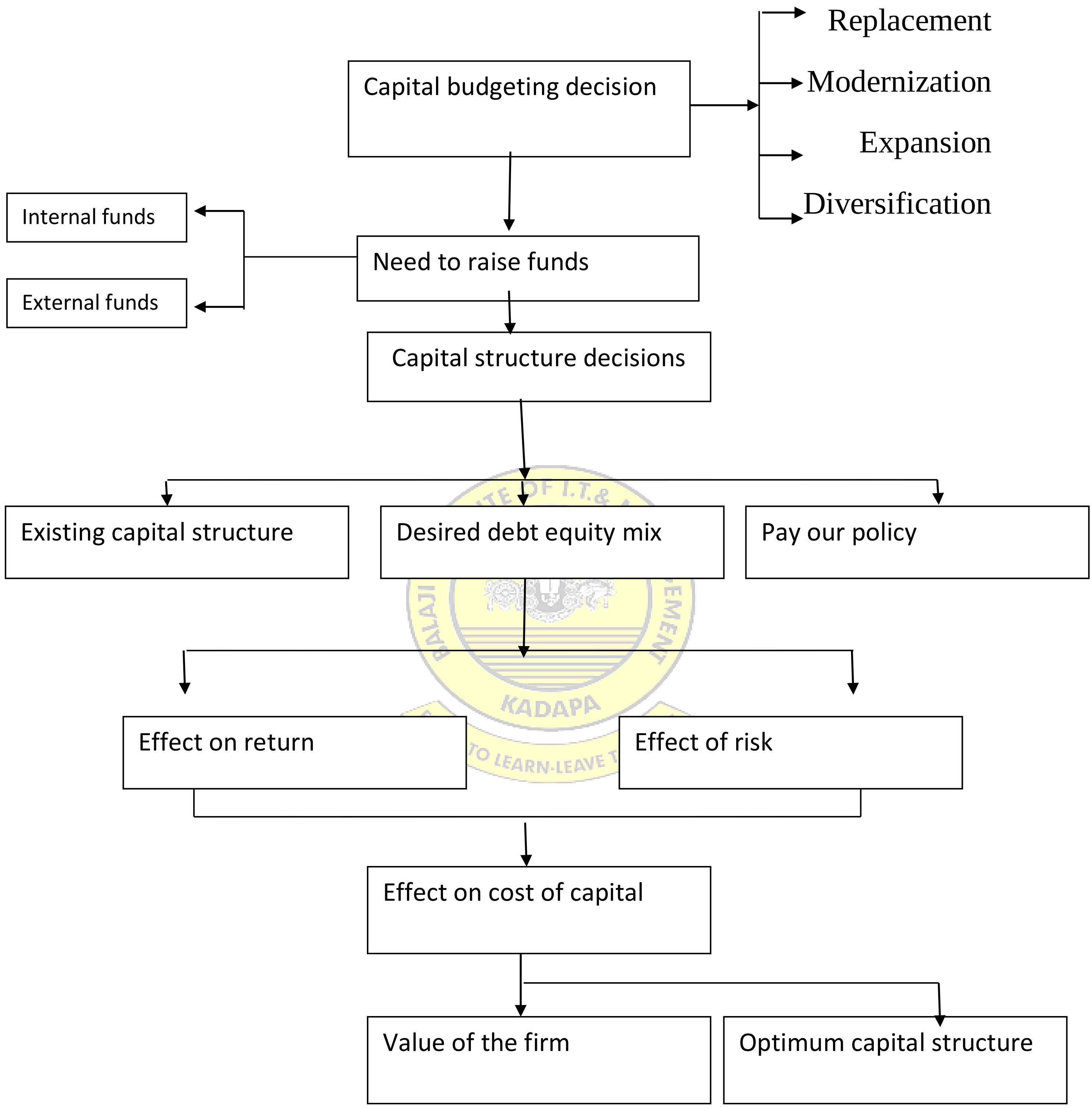
In capital structure decision the proportions of debt and equity included for getting optimum profit.

The main aim of capital structure decision to maximization of firms profit and wealth maximization.

Capital structure decisions will play a vital role to meet the financial manager objective. So financial manger has to construct optimum capital structure.

Optimum capital structure means the combination of debt and equity which will maximize the firm's value.

CAPITAL STRUCURE DECISIONS



Step 1: capital budgeting decision will be taken for replacement or expansasion or modernization and diversification of the business.

Step 2: raise of funds through internal or external sources of funds.

Step 3: capital structure decisions may be existing capital structure, (on desired debt equity mix or payout policy).

Step 4: step 3 gives effect on return or risk.

Step 5: cost of the capital impact on value of the firm that leads to optimum capital structure

The effective capital structure decision gives between scope for the business to develop and increase the value of the firm. Through the capital structure decision.

EBIT – EPS Analysis

It is one of the basic objective of financial management to design an appropriate capital structure which can provide highs EPS over the expected manage f EBIT – EPS to evaluate the firm performance for the infesters.

EPS in an important financial measure, which indicates the profitability of a company. It is calculated by dividing the companies not income with its total number outstanding shares.

EBIT analysis examines the effect of financial leverage on the EPS with varying levels of EBIT.

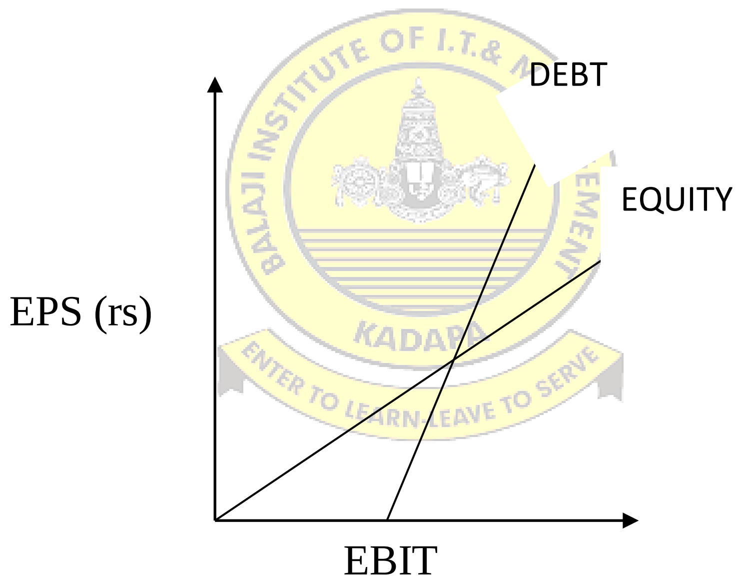
EBIT – EPS analysis helps to study financial planning, comparative analysis, and performance evaluation and determine optimum mix.

$$\text{EBIT} = \frac{\text{EPS Number of common shares outstanding}}{(1 - \text{Tax rate})} + \text{Interest expenses}$$

$$\text{EPS=} \frac{[(\text{EBIT} - \text{Interest expenses})*(1\text{-tax rate})]}{\text{Number of common shares outstanding}}$$

Indifferent point analysis:

- When two alternative financial plans to produce the same level of EBIT where EPS is same this situation is referred to as indifferent point level.
- In case the use of debt finance would be advantage to maximization the EPS.
- Therefore indifference point may be defined as the level of EBIT beyond which the benefits to operate with respect to EPS.



In the above indifference point analysis on x axis EBIT earning before interest and tax taken and y axis earning per shares (EPS) is taken debt finance is advantage to maximize the earning per share.

UNIT-3
THE FINACIAL DECISION

4. COST OF CAPITAL:

Cost of capital is the minimum required rate of on investment.

Cost capital also defines as average required rate of return on investment.

4.1 COST OF CAPITAL CONCEPTS:

A firm raises funds from various sources, which are called the components of capital.

The cost of each source is the specific cost of that source, the average of cost of capital which gives the over cost for acquiring capital.

The company invests the founds in various assets. So it should each return are higher than the cost of rising the founds.

It means the minimum returns firm earns must be equal to the cost of rising the founds.

MEASUREMENT OF COST OF CAPITAL

5. ELEMENTS OF COST OF CAPITAL

1. **COST OF EQUITY**: The funds required for the project is to raised from equity share holders. These funds need not be repayable during the life time of the company. Hence the cost of equity is the permanent sources of funds.

Cost of equity may be defined as the minimum rate of return that a company that must even on it equity finance.

2. METHODS OF VALUATION:

- DIVIDEND YIELD METHOD
- DIVIDEND GROWTH MODEL
- DIVIDEND EARNING MODEL
- CAPITAL ASSET PRICING MODEL

II. COST OF RETAINED EARNTITY: Cost of retained earnings are the founds accumulated over the years these retained profits are now distributed to the share holders.

Company can use these funds for further profitable investment opportunities the cost of retained earnings is an equal to the income that they obtain.

Retained earnings are distributed to the equity share holders will attract personal taxation.

III. COST OF PREFERENCE SHARES: The cost of preference shares is the cost of return that must be earned on preference capital finance investments. To keep unchanged the earning available to equity share holders.

Cost of irredeemable preference shares the cost of irredeemable preference share capital is the rate of preference dividend.

IV. COST OF DEBT: The cost of debt is the effective interest rate that a company pays on its debts. Such as bonds and loans the cost of debt can refer to the before tax cost of debt which is the companies cost of debt before taking tax's into account or the after tax cost of debt.

V. WEIGHED AVERAGE COST OF CAPITAL: The weighted average cost of capital is the rate that a company is expected to pay on average to all its security holders to finance its assets.

The weighted average cost of capital is commonly referred to as the firms cost of capital.

<u>6. COMPONENT COSTS AND WEIGHTED AVERAGE COST</u>:

Component cost means the price for each component as agreed to between the parties during the quarterly pricing process.

Weighted average cost represents a firm's average after tax cost of capital from all sources. Including common stock, preferred stock, bonds, and other forms of debt.

WACC is a common way to determine required rate of return because it expresses in a single number. The return that both bond holders and share holders demand to provide the company with capital.

Firms WACC is likely to be higher if its stock is relatively risk or if its debt is seen as risk because investors will require great returns.

6.1 DETERMINATION OF WEIGHTED AVERAGE COST OF CAPITAL

WACC Formula = Ke*W1+KD*W2+KP Xw3

Alternatively WACC is also computed with the lobular format.

- **USING BOOK VALUE FORMATE:**

SOURCES (1)	BOOK VALUE (2)	BOOK VALUE WEIGHTS (3)	AFTER TAX COST (%) (4)	WEIGHTED COST (%) (5)=4X3
Equity shares	Xxx	Xxx	Xxx	Xxx
10% preference share	Xxx	Xxx	Xxx	Xxx
Retained earnings	Xxx	Xxx	Xxx	Xxx
12% debentures	Xxx	Xxx	Xxx	Xxx
12% loans	xxx	Xxx	Xxx	Xxx

- **USING MARKET VALUE FORMATE**:

SOURCE (1)	MARKET VALUE (2)	MARKET VALUE WEIGHT (3)	AFTER TAX COST (%) (4)	WEIGHTED COST (5)=4X3

Equity shares 10% preference share Retained earning 12% debentures 12% loans	Xxx xxx xxx xxx xxx	Xxx xxx xxx xxx xxx	Xxx xxx xxx xxx xxx	Xxx xxx xxx xxx xxx

6.2 DATA BELOW SHOW THE VARIOUS SOURCE OF FINANCE USED IN THE CAPITAL STRUCTURE OF COMPANY

SOURCE	BOOK VALUE	MARKET VALUE
Equity share (10%) expected dividend	40000	70000
Retained earnings	10000	Nil
10% preference shares	20000	15000
debentures	30000	35000
	100000	120000

The after tax cost of retained earnings 10% and debentures 8%

Your ask to

1) Calculate weighted cost of capital using book value weight and market value weight copulation of weighted average cost of capital using book value weights.

Solution:-

Source	amount	weights	After tax	Weighted cost

Equity share Retained earnings Preference share debentures	40000 10000 20000 30000	0.4 0.1 0.2 0.3	10% 10% 10% 8%	4% 1% 2% 2.4%
	100000	1.00		9.4%
		Weighted average cost of capital		9.4%

Computation of weighted average cost of capital (Ko) using market value weighted.

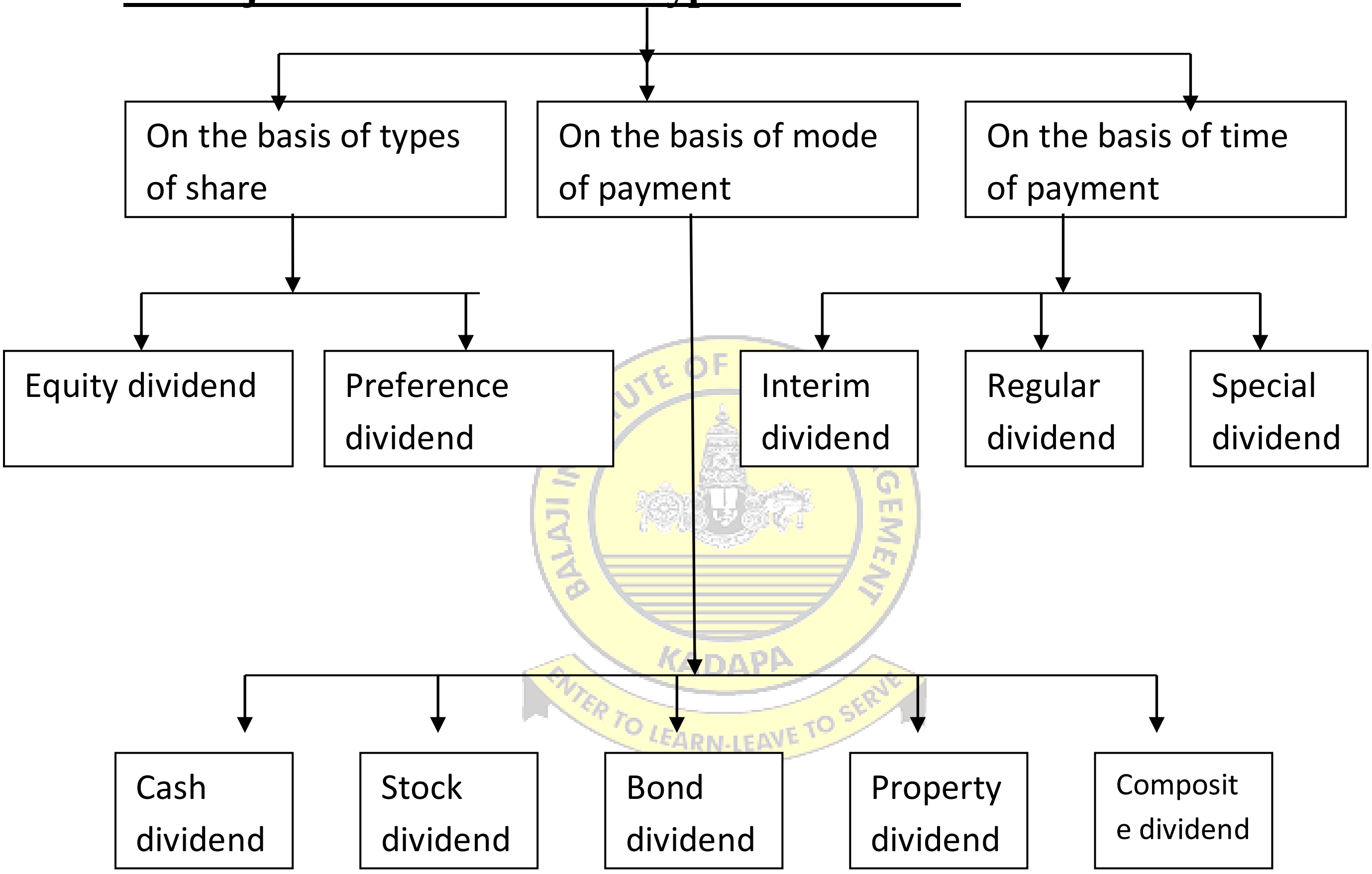
Source (1)	Amount (2)	Weights (3)	After tax Cost (%)	Weighted (%)=3X4
Equity shares Preference shares debentures	70000 15000 35000	0.58 0.13 0.29	10% 10% 8%	5.8% 1.3% 2.32%
	120000	1.00		9.42%
Weighted average cost of cost capital				9.42%

7. Dividend decision:-

The term dividend is a part of profit of a company it is the reward of the share holders for investment made by them in the shares for the company.

Dividend is distributed to share holder at the end of every financial year.

7.1 major forms of dividend /types of dividend



I. on the basis of types of shares:

a) Equity dividend: equity dividend given to the equity share holder this dividend given to the equity share holder at the dividend given only companies in profits only.

b) Preference dividend: preference dividend paid to the preference share holders irrespective of company profits. Preference share holders get the preference dividend at the end of the financial year with a fixed rate of dividend preference share holder having a right to get dividend even company in losses.

II. ON THE BASIS OF MODE OF PAYMENT:

a) **Cash dividend**: payment of dividend to the share holders in the form of cash is called cash dividend.

b) Stock dividend: some times company gives dividend in the form of stock.

c) Bond dividend: share holders normally get the dividend in cash but company can give dividend in the form of property also based on the situation company cash also right to give property dividend

d) Composite dividend: composite dividend paid in the form of cash and above other forms also it is a combination of cash and other forms.

III. ON THE BASIS OF TIME OF PAYMENT:

a) Interim dividend: interim dividend paid at quality or half year or when every cost is sufficient at the time share holders get this dividend.

b) Regular dividend: regular dividend given to the share holders at the end of every financial year.

c) Special dividend: special dividend given to the share holders at special occasions or if the company got high returns.

Course Code	FINANCIAL MANAGEMENT	L	T	P	C
21E00201		4	0	0	4
Semester			II		

Course Objectives:

- To explain the importance of finance function and goals of financial managers.
- To impart the decision making skills in acquiring, allocating and utilising the funds of a company.
- To educate on corporate restructures and corporate governance.

*** Standard Discounting Table and Annuity tables shall be allowed in the examination**

Course Outcomes (CO): Student will be able to

- Learn the roles and goals of finance manager in a corporate structure business.
- Acquire decision making skills regarding financing, investing, and corporate restructuring in the present competitive business environment.
- Analyse the impact of capital structure on wealth maximization of owners and value of the company.
- Manage current assets and current liabilities of the company in an effective and efficient way.

UNIT - I Lecture Hrs:08

The Finance function: Nature and Scope. Importance of Finance function – The role in the contemporary scenario – Goals of Finance function; Profit Vs Wealth maximization (Only theory).

UNIT - II Lecture Hrs:12

The Investment Decision**:** Investment decision process – Project generation, Project evaluation, Project selection and Project implementation. Capital Budgeting methods– Traditional and DCF methods. The NPV Vs IRR Debate. (Simple Problems)

UNIT - III Lecture Hrs:12

The Financing Decision: Sources of Finance – A brief survey of financial instruments. The Capital Structure Decision in practice: EBIT-EPS analysis. Cost of Capital: The concept, Measurement of cost of capital – Component Costs and Weighted Average Cost. The Dividend Decision: Major forms of Dividends . (simple problems on only weighted average cost of capital)

UNIT - IV Lecture Hrs:12

Introduction to Working Capital: Concepts and Characteristics of Working Capital, Factors determining the Working Capital, Working Capital cycle-Management of Current Assets – Cash, Receivables and Inventory, Financing Current Assets (Only Theory)

UNIT - V Lecture Hrs:12

Corporate Restructures: Corporate Mergers and Acquisitions and Take-overs-Types of Mergers, Motives for mergers, Principles of Corporate Governance.(Only Theory)

Textbooks:

- Financial management –V.K.Bhalla ,S.Chand
- Financial Management, I.M. Pandey, Vikas Publishers.
- Financial Management--Text and Problems, MY Khan and PK Jain, Tata McGraw- Hill

Reference Books:

1. Principles of Corporate Finance, Richard A Brealey etal., Tata McGraw Hill.

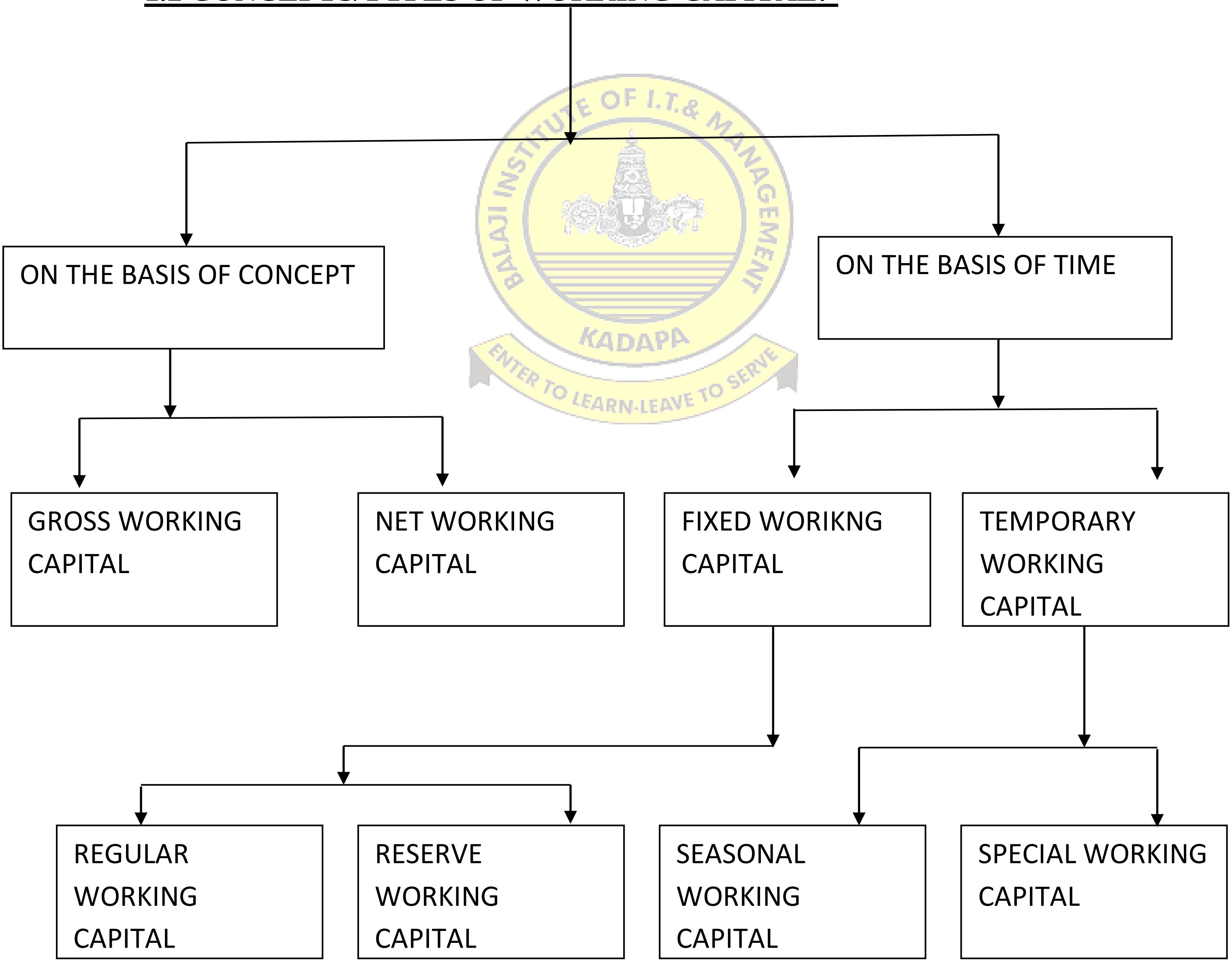
UNIT – IV

INTRODUCTION TO WORKING CAPITAL

1. WORKING CAPITAL: - Working capital means funds available to the day to day operations

Working capital = current assets – current liabilities

1.2 CONCEPTS/TYPES OF WORKING CAPITAL:-



I. ON THE BASIS OF CONCEPT:-

- **GROSS WORKING CAPITAL**: - The amount of funds invested in the current assets is called gross capital total amount kept in current also called gross working capital.
- **NET WORKING CAPITAL:** - Net working capital is the excess of current assets over the current liabilities. Is called net working capital.

II. ON THE BASIS OF TIME:-

- **PERMANENT WORKING CAPITAL**: - The minimum amount which is required for effective utilization of fixed facilities is called permanent working capital. The minimum level of current assets which is continuously required for the business.
- **REGULAR WORKING CAPITAL**: - The amount of working capital required for the continuously operations of a company. The excess of current assets over current liabilities is also called regular working capital.
- **RESERVE WORKING CAPITAL**: - Reserve working capital is the excess amount over the requirement for regular working capital which may provide for future uncertainty.

B. TEMPORARY WORKING CAPITAL: - The working capital which is required to meet the seasonal diamonds' and some special situation this working capital is required.

- **SEASONAL WORKING CAPITAL**: - Seasonal working capital required meeting the seasonal needs of the enterprise.

  EX: - Textile dear required large funds at festival seasons.
- **SPECIAL WORKING CAPITAL**: - The working capital which is required to meet special emergency such as launching of marketing camp for conducting research etc.

2. CHARACTERISTICS OF WORKING CAPITAL:-

1. **AN ELEMENT OF PERMANENCY**: - Working capital is used for short term needs but working capital is required always for smooth run of the business operations.
2. **CIRCULAR MOVEMENT**: - Working capital is stents with purchase of raw material to sales and bills receivable. After end of bills receivable again we purchase raw material so it is a circular movement.
3. **AN ELEMENT OF FLUCTUATION**: - Working capital will be a fixed some time but it keep on changes according to requirements and needs the portion of working capital that changes with production, sales, price, etc.
4. **SHORT TERM NEEDS**: - Working capital nature itself it is used for short term needs it used to acquire current assets to convert into cash.
5. **LIQUIDITY:** - Working capital is more liquidity in nature. Means, the working capital can easily converted into cash.
6. **LESS RISKY**:- If we invested amount into fixed assets was recover after a long term but funds invested in working capital can easily convert into cash and other forms so investment is working capital is less risky.

The above are the characteristics of working capital.

3. FACTORS DETERMING THE WORKING CAPITAL:-

1. **NATURE OPF THE BUSINESS**: - The working capital requirement of a firm basically depends upon the nature of its business. Example in the public sector like electricity, railways the need of cash is very less comparatively. So the nature of the business determine the working capital how much needed for the business operations.

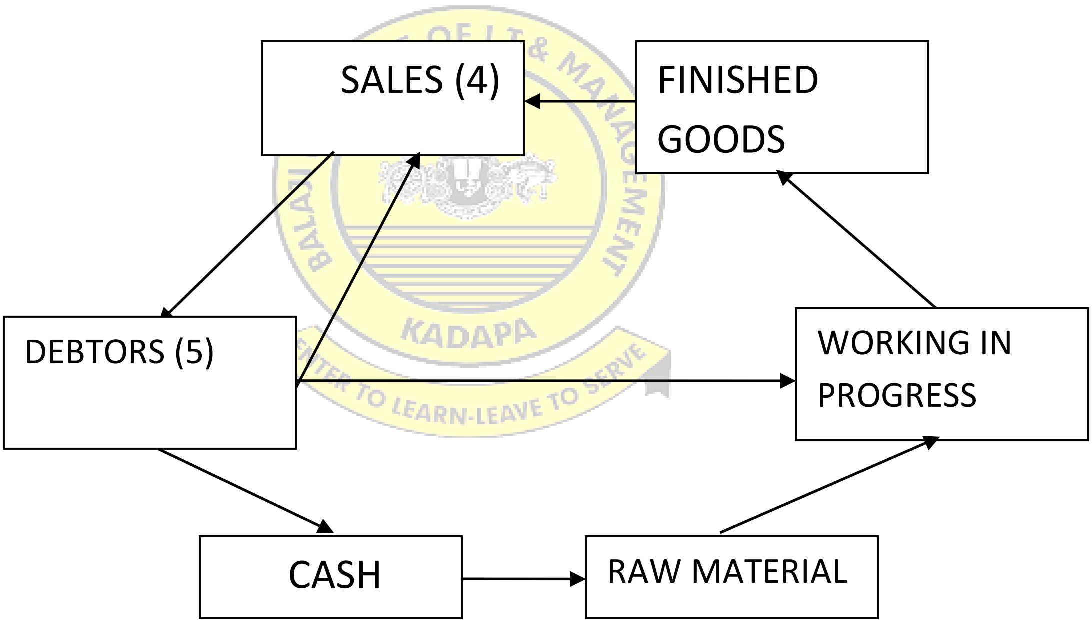
2. **<u>SCALE OF BUSINESS/SIZE OF BUSINESS</u>**: - Size of business decided how much working capital required the business size is large the working capital are also required more the business size is small less working capital is required.
3. **<u>PRODUCTION POLICY</u>**: - Based on the production policy working capital is needed. Because if the company is producing products four times in a year the working capital requirement. Is more if the company produce product twice in a year less working capital required comparatively four times in a year.
4. **<u>SEASONAL VARIATIONS</u>**: - In certain industries raw material is not available so they have to buy raw materials in build, during the season to ensure an uninterrupted flow for the production.
5. **<u>WORKING CAPITAL CYCLE</u>**: - In manufacturing concern the working cycle starts with the purchase of raw material and with bills receivable from the sales. The company working capital cycle determines the requirement of working capital longer the period of the cycle large working capital required.
6. **<u>CREDIT POLICY</u>**: - The credit polity means the dealings with debtors and creditors influence the working capital requirement if the creditors given more time for repayment to creditors comparatively our debtors. Than less working capital required.
7. **<u>BUSINESS CYCLE</u>**: - Business cycle refers to alternatives expansion and contraction in general business activity. In a period of boom i.e. when the products are highly demanded and rise of raw material cost then large amount of working capital required.
8. **<u>GROWTH RATE OF BUSINESS</u>**: - If the business is growing and business operations are expedite the working capital requirement is more.
9. **<u>EARNING CAPACITY AND DIVIDEND POLICES</u>**: - Some firms have more earning capacity then others due to quality of their products, highly earning capacity may generate. Cash profits from operation the dividend polices may also influence the working capitals requirements.

10. **PRICE LEVEL CHANGES**:- Based on the price level changes the working capital is needed.

4. WORKING CAPITAL CYCLE:-

The working capital requirement of the firm depends on working capital cycle.

The duration of time required to complete the products from purchase of raw material to realization of cash is called working capital cycle



STEP-1:-

Raw materials are to be purchased for cash.

STEP-2:-

Production process converts raw materials into work in process.

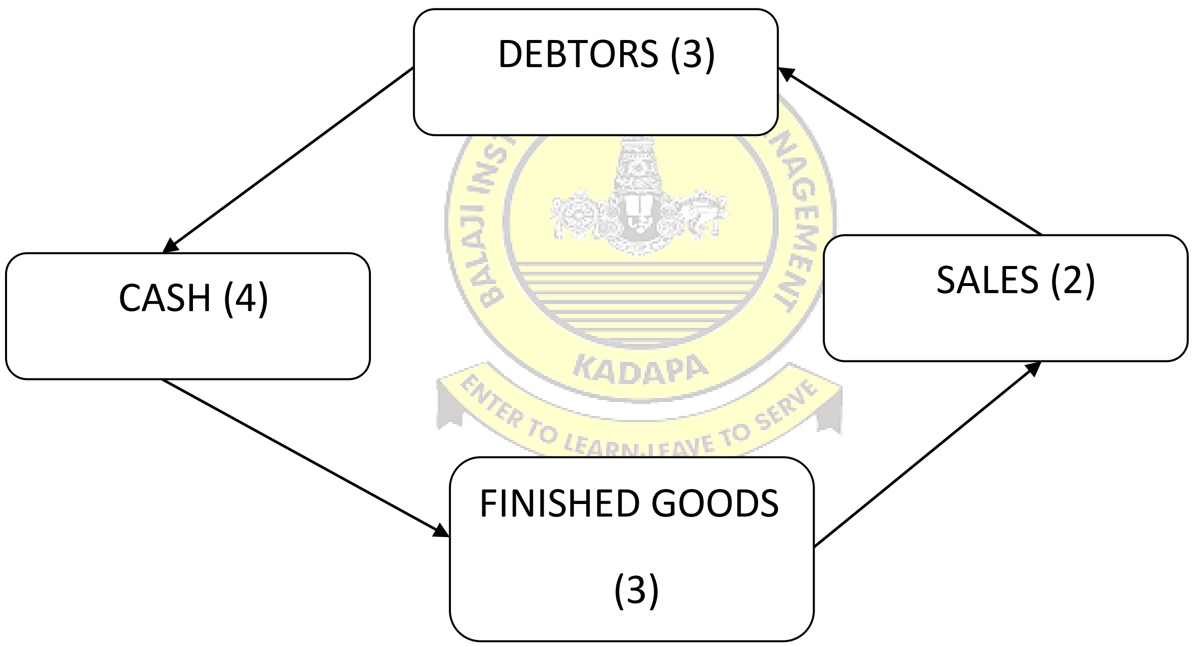
STEP-3:-

Work-in process is converted into finished goods. During course of time through productions process.

STEP-5:-

Accounting receivables are realized in to cash in the above the process manufacturing firm working capital cycle.

B. WORKING CAPITAL CYCLE OF TRADING FIRM



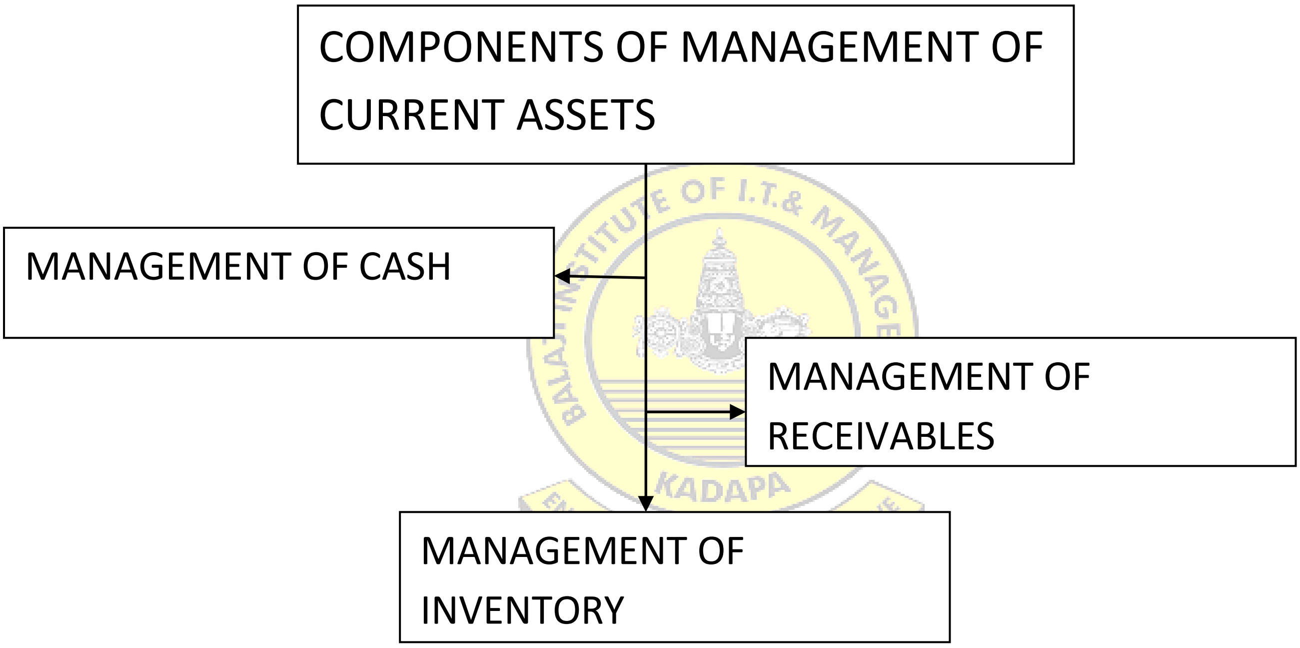
Trading firms are whole sales retailers, thy directly purchased the finished goods and they directly sell the goods.

In other words trading firms purchase finished goods and sell them either cash (or) credit. If they sell goods on credit the above process we need to adopt.

5. MANAGEMENT OF CURRENT ASSETS:

Management of current assets means effectively manage the current assets in all organization to get the expected profits.

Management of current assets consists of management of cash, management of receivables and management of inventory.



5.1 CASH MANGEMENT:-

Effective utilization of cash for the business to meet day to day expenses and reduce cash holding costs.

5.2 OBJECTIVES OF CASH MANAGEMENT:

1. **MEETING THE PAYMENTS**: - The main objective of the cash management is to meet the cash payments, on regular basis to suppliers.

2. **MINIMIZING FUNDS COMMITTED TO CASH BALANCE**:
   Another main objective is to minimize the cash balances. Not to keep more cash balances but only maintain the cash how much is required.
3. **CHANCE OF GETTING RAW MATERIAL WITH LESS COST**:

   Effective cash management gives the advantage of chance to available the raw material cost with less cost. If we maintain sufficient cash in the organization. We can raw material are less cost we can immediately purchase the available.

5.3 **RECEIVABLES MANAGEMENT**: - Identify the appropriate credit policy i.e. credit terms which attract customers to purchase more that leads to highest sales. Effective receivables management impress on cash conversion cycle hence the revenue increased.

5.4 **OBJECTIVE OF RECEIVABLES MANAGEMENT**:-

- Objective of receivables management
- Improve sales and eliminate bad debts
- Another objective is to reduce the transaction costs.
- Receivables management helps to get optimum level of investment in receivables
- Receivable management convert book debts in cash. So book debts used as a marketing tool for improving business.

<u>5.4 INVESTORS MANAGEMENT</u>: - Identify the level of inventory which allows for uninterrupted production but reduces the investment in raw materials and minimizes re-order costs hence increase cash flow.

<u>INVENTORY MANAGEMENT TECHNIQUES</u>

ECONOMIC ORDER QUANTITY

REORDER LEVES

ABC analysis

VEO Analysis

JUST IN TIME

INVENTORY TURNOVER

INVENTORY CONTROL OF SAPRES AND SLOW MOVING ITEMS

A. **<u>ECONOMIC ORDER QUANTITY (EOQ)</u>**:- It is reasonable be ordered economically at a time. It also knows as standard order quantity.

B. **<u>RE-ORDER LEVEL</u>**: - It is used to derive number of units of inventory to order that represents the lowest possible total cost to the ordering entity.

C. **ABC ANALYSIS**: - ABC Analysis is the analysis of the store items cost criteria. The cost of each item is multiplied by the number used in a given period and then these items are in descending numerical order.

D. **VED ANALYSIS**: - Vital essential and desirable (VED) analysis is classifies material according to their criticality for the business into their categories.

E. **JUST IN TIME**: - just in time production is defined on eliminated waste by purchasing (or) manufacturing just enough of the right items just in time.

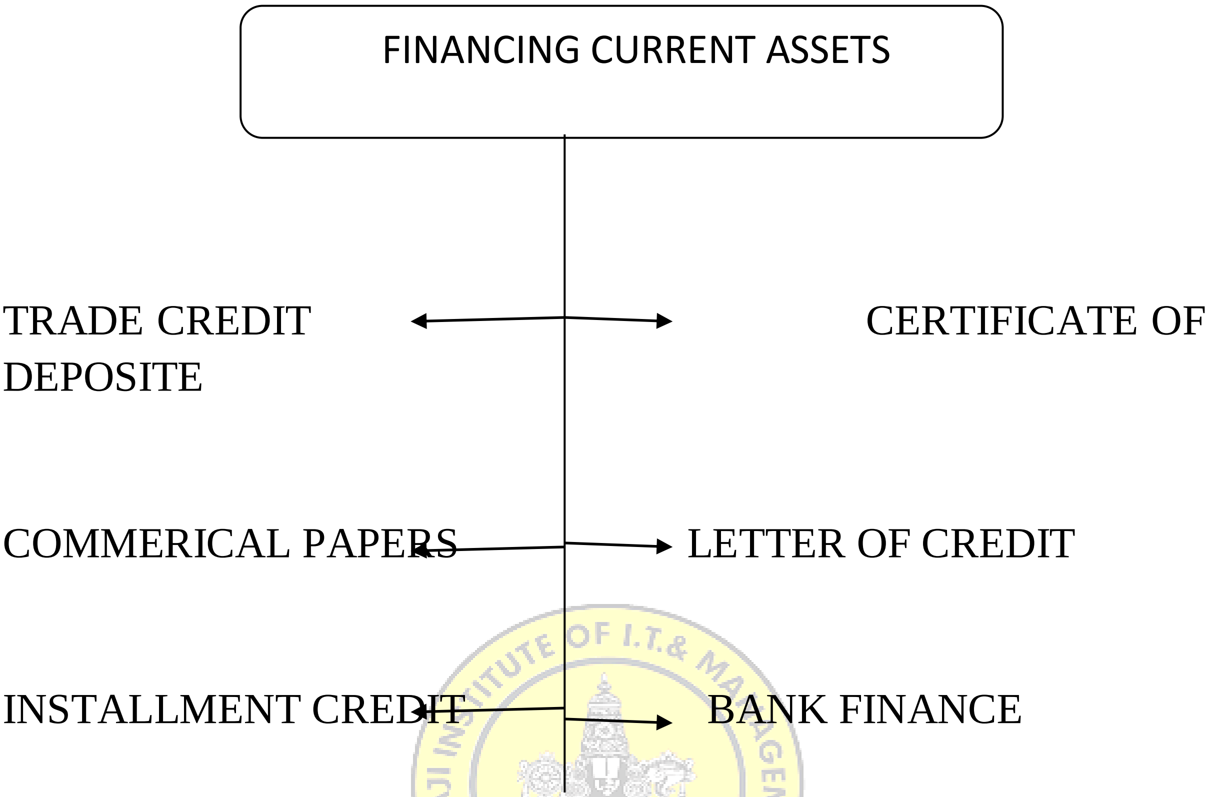
F. **INVENTORY TURNOVER: -** Inventory turnover helps the top management to know the average time taken for clearing the stocks.

$$\text{Stock turnover ratio} = \frac{\text{Cost of goods sold}}{\text{Average inventory}}$$

Inventory contract of spares and slow moving items commonly covers all kinds of supplies necessary to keep production equipment. Operating to turn but production to the desired quantity and quality at the desired time.

6. FINANCING CURRENT ASSETS:

Financing current assets a part of the current assets are finance through trade credit, letter credit and bank finance etc.



1. TRADE CREDIT: - Trade credit is an agreement between two parties. Buyer need to pay amount in due to the seller.

2. COMMERCIAL PAPER: - Commercial paper is a money market financial instrument issued by large size corporate bodies to rise short term founds to meet their temporary.

3. CERTIFICATE OF DEPOSITES: - It is also a financial instrument by using certificate of deposit companies get finance when ever needed short term finance.

4. LETTER OF CREDIT: - The repeated companies get finance from the bands by giving writing letter to the bank requesting sum of money for short term repayment.

5. INSTALLMENT CREDIT: - In this the company may payment large amount in smaller amount regularly. Up to clear of total payment.

6. BANK FINANCE: - Most of the companies for less amounts they approaches bank finance.

Course Code	**FINANCIAL MANAGEMENT**	**L**	**T**	**P**	**C**
21E00201	**4**	**0**		**0**	**4**
Semester			**II**		

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The Finance function: Nature and Scope. Importance of Finance function – The role in the contemporary scenario – Goals of Finance function; Profit Vs Wealth maximization (Only theory).
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Reference Books:

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UNIT-5

CORPORATE RESTRUCTURES

Corporate restructure refers to the changes in ownership, business mix, assets mix with the view to enhance the share holder's value.

Hence corporate restructuring may in valve owner ship restructuring, business restructure and assets restructure. A company moves affect owner ship restructuring through mergers and accusations.

The purpose of restructuring is to enhance the share holders' value.

(1) **Corporate managers accusations and take over a merger**:-

A merger is said to occur when two (or) more companies combine into one company .one (or) more companies may merge with in company (or) they merge to form a new company. In manger there are complete assets and liabilities as merge and roll as one company.

A merger occurs when two separate entities combine forces to create a new joins organisation.

(2) Acquisitions:-

An acquisition refer to the lake oven of one equity by another Acquisition may be designed act of occurring effective control over assets (or) management of a company by another company without any combination of companies.

Acquisition involves one company beings the assets of another company.

(3) **Take over**:-

Take over occurs when the acquires firm takes over the control of the target firm. A company can have effective control oven another companies by holding Minority ownership ends the monopolises.

Take over's means purchasing majority of the shares in the target company. Takeover is the purchase of one company by another company. Any company jets control of another company by buying enough of targeted company shares is called take over.

(2)**Types of mergers**:-

(a)**HORIZONTAL MERGER**:-

Horizontal mergers means combining of two same productions of proud of firms into are firm called horizontal merger.

Ex:-merge of two book publications into one publican.

(B) **VERTICAL MERGER:-**

Combination of two (or) more firms involved is different productionans distribution.

Ex:-joining of a TV manufacturing company into one firm.

Vertical merger means firms production and distribution is different.

(C)**CONGLOMERATE MERGER:**

In conglomerate merger the combination of firms engaged UN related lines of business activity.

Ex:-merging of manufacturing of Cement Company into is firm.

(3) **Motives for mergers**:-

- Limited competition.
- Utilize under-utilized market power.
- Overcome the problem of slow growth.
- Achieve diversification.
- Gain economies of scale.
- Establish relation between local market and forging market.
- Replace existing management.
- Create an image of aggressiveness.

(a) **Limited competitors**:- The first motive for merger is competition is limited because of merger less completions chance of getting more profits

(b) **Utilized market power**:- Merger facilitates to take advantage of market power to capture the market and grow in a market place.

(c) **Overcome the problems of slow grow:-** Mergers are also improving the growth rate business operation because of reduce of competition and expenses.

(d) **Achieve diversification**:- Another motive for merger is we can achieve diversification I.E we can add new produces and expand the business operations.

(e) **Gain economic of scale**:- Merger facilitates to increase the and reduce the expenditure this leads to we can gain economic of scale.

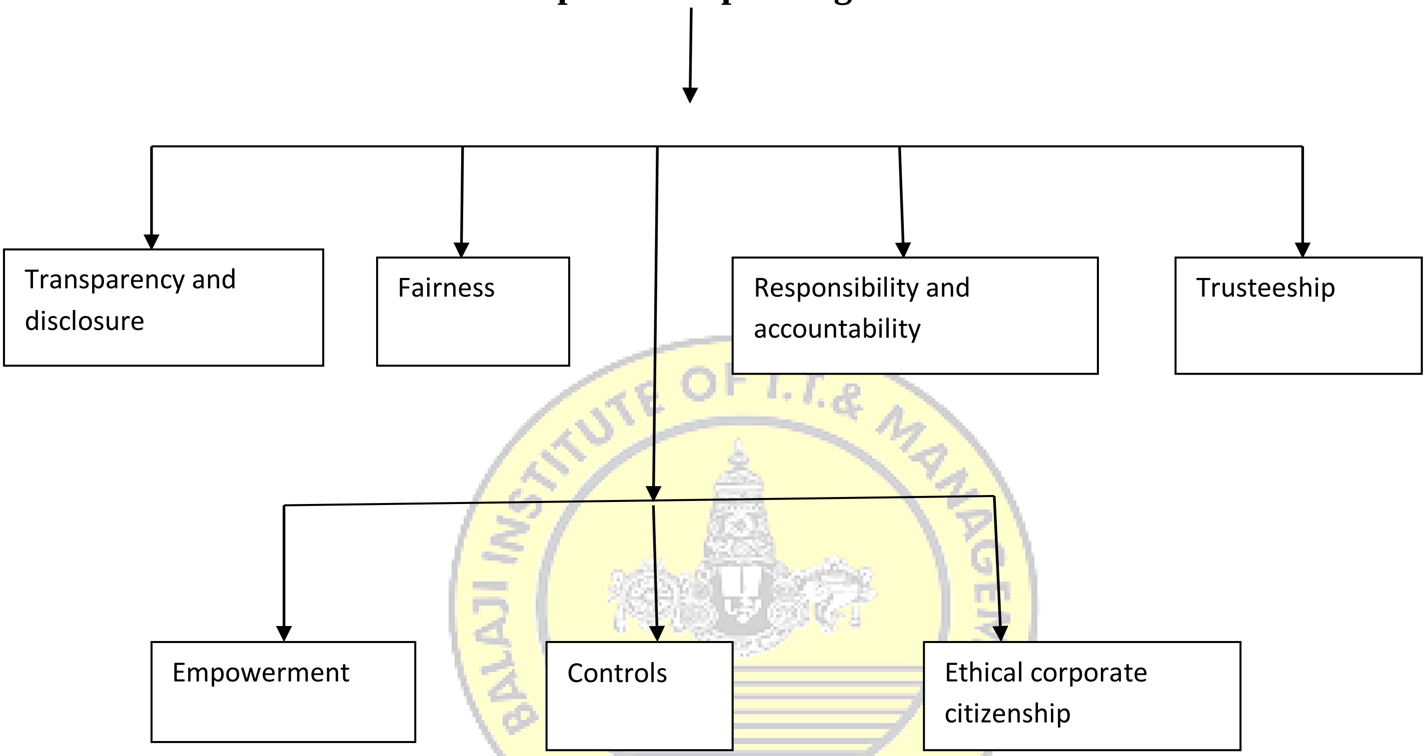
(f) **Replace of existing management**:- Merger replaces the old management with lot of new ideas and more scope for development.

(g) **Establish relationship between Beal market and foreign market**:- In two companies one is domestic company Anther Company is foreign company that leads to high profit.

(h) **Create on image of aggressiveness**:- Merging gives an age of creating an image in the in the market

(4)PRINCIPLES OF CORPORATE GOVERNANCE:-

Principles of corporate governance



(a) **Transparencies and disclosure**:- Transparencies and disclosure is the first principle of corporate governance. It means corporate governance is Cristal clear to all stake holders company relationship with employees is in openers.

(b) **Fairness**:- Corporate governance is fairness organisation should respect the share holders .the company rules must be unblessed to all employees.

(c) **Responsibilities and accountability:** - Company is more responsibilities and accountability towards the employees. Companies are required to take more active role in changing the practice and value.

(d) **Trusteeship:**-Multinational companies have bots social and economic objective, corporate governance creates the trusteeship between s employees and employee.

(e) **Empowerment**:- Empowerment is a process of means giving equal oppernitues to all employees in the company decision making and also giving right to express employees opinion in different decisions.

(f) **Control:-** Corporate governance controls the employees and employees to use their rights and duties. This control helps employees and employees to use their right in right directions.

(g) **Ethical corporate citizenship:-** Employees and employee follow the corporate governance that leads to ethical corporate citizens .the company should develop social accounting and social audit fir the well being if the ethical corporate citizenship.