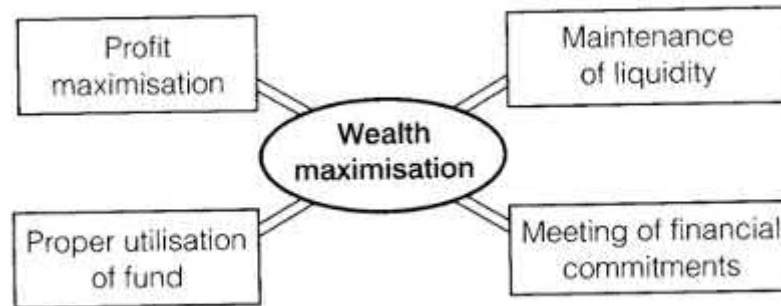


CHAPTER - 9

FINANCIAL MANAGEMENT

Points to Remember

1. Business Finance Money required for carrying out business activities is called Business Finance.
2. **Financial Management** It refers to efficient acquisition of finance, efficient utilisation of finance and efficient distributing and disposal of surplus for smooth working of company. According to Howard and Upton, "Financial management involves the application of general management principles to a particular financial operation."
3. **Role of Financial Management**
 - (i) Size and composition of fixed assets
 - (ii) Amount and composition of current assets
 - (iii) The amount of long term and short financing
 - (iv) Fixing debt equity ratio in capital
 - (v) All items in Profit and Loss account
5. **Objectives of Financial Management**



6. Financial Decisions

The financial functions relate to three major decisions which every finance manager has to take

- (i) Investment decision
- (ii) Financing decision
- (iii) Dividend decision

7. Investment Decision (Capital Budgeting Decision)

This decision relates to careful selection of assets in which funds will be invested by the firms.

Factors affecting investment/capital budgeting decisions are

- (i) Cash flow of the project (ii) Return on investment
- (iii) Risk involved (iv) Investment criteria

8. Financing Decision This relates to composition of various securities in the capital structure of the company. Mainly sources of finance can be divided into two categories

- (i) Owners fund
- (ii) Borrowed fund

Factors affecting financing decisions are

- (i) Cost (ii) Risk
- (iii) Cash flow position (iv) Control consideration (v) Floatation cost (vi) Fixed operating cost
- (vii) State of capital market

9. Dividend Decision This relates to distribution of profit earned. The major alternatives are to retain the earnings or to distribute to the shareholders.

Factors affecting dividend decisions are

- (i) Earning
- (ii) Stability of earning
- (iii) Cash flow position
- (iv) Growth opportunities
- (v) Stability of dividend
- (vi) Preference of shareholders
- (vii) Taxation policy
- (viii) Access to capital market consideration
- (ix) Legal restrictions
- (x) Contractual constraints
- (xi) Stock market reaction

10. Financial Planning It means deciding in advance how much to spend, on what to spend according to the funds at your disposal.

11. Objectives of Financial Planning

- (i) To ensure availability of funds whenever these are required,
- (ii) To see that firm does not raise resources unnecessarily.

12. Importance of Financial Planning

- (i) It facilitates collection of optimum funds.
- (ii) It helps in fixing the most appropriate capital structure.
- (iii) Helps in investing finance in right projects.
- (iv) Helps in operational activities.
- (v) Base for financial control.
- (vi) Helps in proper utilisation of finance.
- (vii) Helps in avoiding business shocks and surprises.
- (viii) Link between investment and financing decisions.
- (ix) Helps in co-ordination.
- (x) It links present with future.

13. Capital Structure Capital structure means the proportion of debt and equity used for financing the operations of business.

$$\text{Capital Structure} = \frac{\text{Debt}}{\text{Equity}}$$

14. Financial Leverage It refers to proportion of debt in the overall capital

$$\text{Financial Leverage} = \frac{D}{E}$$

Where, D = Debt, E = Equity

15. Factors Determining the Capital Structure

(i) Cash flow position

$$(ii) \text{ Interest Coverage Ratio (ICR)} = \frac{\text{EBIT}}{\text{Interest}}$$

(iii) Debt Service Coverage Ratio (DSCR)

(iv) Return on investment

(v) Cost of debt

(vi) Tax rate

(vii) Cost of equity (viii) Floatation cost

(ix) Risk consideration

(x) Flexibility

(xi) Control

(xii) Regulatory framework (xiii) Stock market condition (xiv) Capital structure of other companies

16. **Fixed Capital** Fixed Capital involves allocation of firm's capital to long term assets or projects.

17. Importance or Scope of Capital Budgeting Decision

(i) Long term growth (ii) Large amount of funds involved

(iii) Risk involved (iv) Irreversible decision

18. Factors Affecting Requirement of Fixed Capital

(i) Nature of business (ii) Scale of operation

(iii) Technique of production (iv) Technology upgradation (v) Growth prospects (vi) Diversification

(vii) Availability of finance and leasing facility

(viii) Level of collaboration/joint ventures

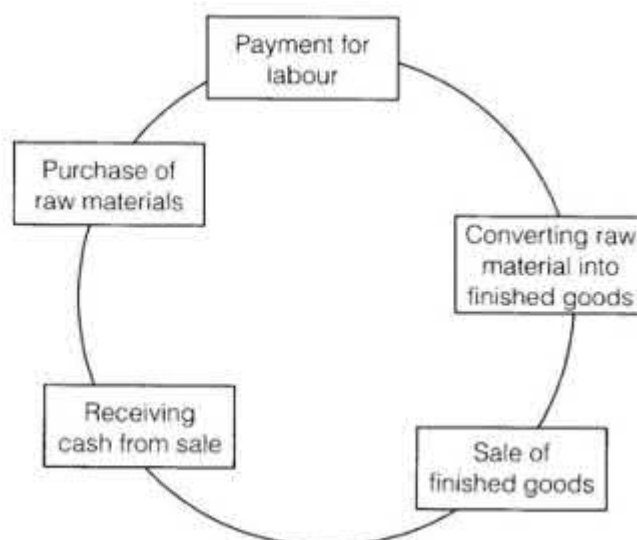
19. Working Capital

Working Capital refers to excess of Current assets over Current liabilities.

There are two types of working capital

(i) Gross working capital (ii) Net working capital

20. Operating Cycle



21. Factors Affecting the Working Capital

- (i) Length of operating cycle
- (ii) Nature of business
- (iii) Scale of operation
- (iv) Business cycle fluctuation
- (v) Seasonal factors
- (vi) Technology and production cycle
- (vii) Credit allowed
- (viii) Credit avail
- (ix) Operating efficiency
- (x) Availability of raw materials
- (xi) Level of competition
- (xii) Inflation
- (xiii) Growth prospects