Part-B

chapter-9

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Financial Management

⇒ **Business Finance:-** Refers to the money required for carrying out business activities.

⇒ **Financial Management:-** is concerned with management of flow of funds and involves decisions relating to procurement of funds, investment of funds in long-term and short-term assets and distribution of earnings to the owners.

⇒ **Role of Financial Management:-** Financial Management influence the following:

(1) Size as well as composition of Fixed Assets.
(2) Quantum of current Assets.
(3) Amount of long-term and short term financing
(4) Break-up of long term financing into debt and equity.
(5) All items in the profit and loss Account.

⇒ **Objective of Financial Management:-** The primary and most important objective is to maximise wealth of equity share holders, which means maximising the market price of equity share.

⇒ **Financial Decisions:-** The financial decision can be broadly classified into three groups.

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(1) Investment Decision:- It is concerned with Investment of firm's funds in different Assets. Investment decisions is categorised as capital budgeting Decisions (relating to fixed Assets) and working capital Decisions.

(2) Financing Decision:- It deals with the determination of source of finance amount to be raised from each source and the cost of each source of fund.

(3) Dividend Decisions:- It deals with determination of amount of profit to be ~~distribt~~ distributed among share holders and amount of profit to be retained in the business for financing its long term growth.

⇒ Factor Affecting capital budgeting Decision:-

(1) cash Flow of Project.
(2) Rate of Return.
(3) Investment criteria.

⇒ Factor Affecting financing Decision:- The various Factor which Influence the financing Decisions are:

(1) cost
(2) Risk
(3) Flotation cost.
(4) cash Flow position
(5) Fixed operating cost
(6) control consideration.

(7) State of capital Markets.

⇒ **Factor Affecting Dividend Decision**: The decision of payment of dividend is influenced by following factors:

1. Amount of Earning
2. Stability of Dividends
3. Cash flow Position
4. Taxation policy
5. Access to capital Market
6. Contractual constraint
7. Stability of Earnings
8. Shareholder preference
9. Stock Market Reaction
10. Legal constraints

⇒ **Financial planning**: is the process of estimating the Fund Requirement, specifying the Source of Funds and utilising them in optimum manner.

⇒ **Objective of Financial planning**: It aims to achieve Two objectives:

(1) To ensure availability of Funds when Required.

(2) To ensure unnecessarily Finance is not Raised.

⇒ **Importance of Financial planning**: Financial planning is important because:

(1) It helps the company to prepare for Future

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(2) It helps in avoiding business shocks and surprises.

(3) It helps in achieving coordination between various functions.

(4) It prevents duplication of efforts and gaps in planning.

(5) It helps to link present with future

(6) It provide a link between investment and financing decisions.

(7) It makes the evaluation of actual performance easier.

⇒ **Capital structure:** Refers to proportion of debt and equity used for financing the operation of business.

⇒ **Factor affecting choice of capital structure:**

The choice of capital structure is affected by following factors:

1. cash Flow position.
2. Debt service coverage Ratio.
3. cost of Debt
4. cost of Equity.
5. Risk consideration.

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(6) control
(7) Stock Market conditions.
(8) Interest coverage Ratio.
(9) Return on Investment.
(10) Tax Rate
(11) Floatation costs.
(12) Flexibility
(13) Regulatory Framework.
(14) capital structure of other companies

⇒ Fixed capital: Refers to that part of money which is invested in fixed Assets, which is to be used over a long period of time.

⇒ Importance of capital Budgeting Decisions:

(1) Long term growth and effects.

(2) Large amount of funds Involved.

(3) Risk involved.

(4) irreversible decisions.

⇒ Working capital: Refers to that part of capital which is required for holding current Assets. It may also be defined as excess of current Assets over current liabilities.

Types of Working capital :

(1) Gross Working capital (GWC)

(2) Net Working capital (NWC)

Factor Affecting fixed capital Requirement :

The Requirement of fixed capital is influenced by following factors.

1. Nature of Business.
2. Scale of operations.
3. Choice of Technique.
4. Technology upgradation.
5. Growth prospects.
6. Diversification.
7. Financing Alternatives.
8. Level of collaborations.

Factors Affecting working capital Requirement

The Requirement of working capital is influenced by following factors.

(1) Nature of Business.

(2) Scale of operations.

(3) Business cycle.

(4) Seasonal factors.

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(5) production cycle.

(6) credit Allowed.

(7) credit Availed.

(8) Availability of Raw Material.

(9) operating Efficiency.

(10) Growth prospects

(11) level of Competition.

(12) Inflation.