Chapter- 1: Scope & Objective of Financial Management

1. FINANCIAL MANAGEMENT DEALS WITH (BASIC FUNCTIONS):

a. **Procurement of Fund:** Funds can be obtained from different sources having different characteristics in terms of risk, cost and control. There are thus risk, cost and control considerations which a finance manager must consider while procuring funds.
Example:

Short Term Sources: BOD, CC, Commercial Paper

Long Term Sources: ESC, PSC, Debenture/Bond, Bank Loan, Venture Capital, Angel Financing

b. **Application/Effective Utilization:**
   i. Fixed Assets (Long term solvency) – Long Term Sources.
   ii. Working Capital (Short Term Solvency) – Short Term Sources.

The Finance Manager has to ensure that funds are not kept idle or there is no improper use of funds.

2. FINANCING DECISION:

a. **Long Term Decision:**

   i. **Investing:** Investment decisions relate to the selection of assets in which funds will be invested by a firm. It shall be taken on the basis of capital budget techniques. A firm shall identify, evaluate and invest in positive NPV project in order to maximize shareholders' wealth.

   ii. **Financing:** Financing decisions relate to acquiring the optimum finance to meet financial objectives and seeing that fixed and working capitals are effectively managed.

   iii. **Dividend:** Dividend decisions relate to the determination as to how much and how frequently cash can be paid out of the profits of an organization as income for its owners/shareholders.

b. **Short Term Decision:**

   i. **Working Capital Management:** Investment in working capital provides liquidity however, it adversely effects profitability as there is low return in investment in working capital. On the other hand, lower investment in working capital may increase profitability however, it adversely effects the liquidity of the firm. Therefore, a Financial Manager shall maintain trade-off between liquidity and profitability while investing in working capital

3. PROFIT MAXIMIZATION V/S WEALTH MAXIMIZATION (OBJECTIVE OF FINANCIAL MANAGEMENT)

Profit Maximization	Wealth Maximization
Profit increase	Market price of share increase
Easy to calculate and easy to determine link between financial decision and profit	No clear relation between financial decision and share price
Short Term Gain	Long Term Gain
Ignore risk and uncertainty	Recognize risk and uncertainty
Ignore timing and return eg. Proposal 'A' may be appropriate in Short term, however 'B' may be preferred in Long term due to timing of return.	Recognize timing and return eg. Proposal 'A' may be appropriate in Short term, however 'B' may be preferred in Long term due to timing of return.

4. FUNCTION OF CFO (RESPONSIBILITY)

a. Investment Decision
b. Dividend Decision
c. Financing Decision
d. Working Capital Management Decision
e. Cash Management Decision
f. Decision regarding Capital Structure
g. Estimating requirement of fund
h. Risk Management

5. ROLE OF FINANCIAL MANAGER IN CHANGING SCENARIO.

Traditional Role	Role in Modern scenario
Raising fund from various sources.	Shaping organization & involved in various decisions such as merger, acquisition, etc.
It deals with fund management.	Financial Manager works in changing environment & has to take decision accordingly.
	He has occupied Key Position

6. EMERGING ISSUE AFFECTING FUTURE ROLE OF CFO.

i. Regulation increase
ii. Globalization
iii. Technology
iv. Risk
v. Stakeholder Management
vi. Strategy
vii. Talent & Capability

7. FINANCIAL DISTRESS

Use of Debt Fund

↓

Unable to meet Obligations

↓

Financial Distress

Revive
*Reconstruction
*Incurs additional cost

Insolvent

Insolvency Cost
(Company have to sell assets at lower price to meet obligation).

8. AGENCY PROBLEM

Company

Owner

Focus to increase interest of Shareholder i.e. wealth max.

Management

focus to increase their own interest rather than shareholders' i.e. salary, perquisites.

Agency Problem (Problem – Agent Relation)

Involves agency cost

Types:

1. Monitoring
2. Bonding
3. Opportunity
4. Structuring

9. FINANCE MANAGEMENT AND ACCOUNTING

Particulars	Accountancy	Finance
Relationship	It provides input to Financial Management for decision making Example: Balance Sheet, Profit & Loss, Change in Equity	It uses data from accounting for decision making
Difference	**Treatment of Fund**	
	Accrual	Cash Flow
	Decision Making	
	It collects and present financial data	It focuses on Financial Planning, Controlling and Decision Making

Chapter- 2: Type of Financing

1. MEANING:

Business enterprises need funds to meet their different types of requirements. These funds can be arrange from various short term & long term sources.

2. CLASSIFICATION OF SOURCE OF FINANCE:

a. Period:

Particulars	Long Term	Medium Term	Short Term
Period	>5 years	>1 Years but <5 years	<1 year
Example	ESC, PSC, Retained Earning, Debenture, Long Term Loan	PSC, Loan, etc	Advances, Trade Credit, Commercial Paper, etc
Need	Investment in Fixed Assets, Long Term Investments	Medium Term Needs, Deferred Revenue Expenses	Current Assets.

b. On the Basis on Ownership:

Shareholders Fund → ESC, RE, PSC

External Borrowing → Debenture, Loan, Bond, etc

c. On the Basis of Source:

Internal	External
Example: Retained Earning, Depreciation Fund, etc	Example: ESC, PSC, Loan, Bond, etc

3. LONG TERM SOURCE OF FINANCE:

a. Equity Share Capital:

Advantages	Disadvantages
It is a permanent source of finance.	Inflexible in nature.
Equity capital increases the company's	No tax deductible on dividend distribution.

financial base	
The company is not obliged legally to pay dividends	Higher risk (due to uncertain dividend payment).
The company can make further issue of share capital by making a right issue.	Ownership dilution.

b. Preference Share Capital:

Advantages	Disadvantages
Flexible in nature.	No tax deductible on dividend distribution.
Cumulative in nature.	Cumulative in nature i.e. dividend to be paid later on.
No risk of take-over.	
It provides financial leverage.	
Fixed rate of dividend.	

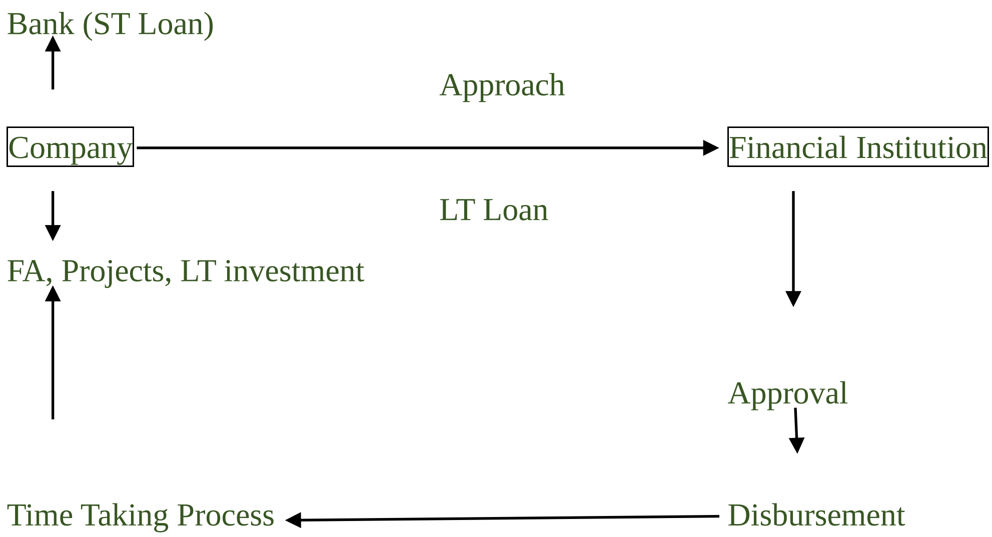
c. Difference between ESC & PSC:

Sl. No.	Basis of Distinction	Equity Share	Preference Share
1	Preference dividend	Equity Dividend is paid after preference dividend.	Payment of preference dividend is preferred over equity dividend
2	Rate of dividend	Fluctuating	Fixed
3	Convertibility	Not convertible	Convertible
4	Voting rights	Equity shareholders enjoy voting rights	They do not have voting rights

d. Debt Capital:

Advantages	Disadvantages
Flexible in nature.	Increases financial risk.
It provides financial leverage.	Fixed obligation.
No dilution of ownership.	
Tax deductible	
Low cost finance.	

e. Bridge Financing: Bridge finance refers to loans taken by a company normally from commercial banks for a short period because of pending disbursement of loans sanctioned by financial institutions. Though it is a of short term nature but since it is an important step in the facilitation of long term loan, therefore it is being discussed along with the long term sources of funds.



f. Venture Capital:

Meaning: The venture capital financing refers to financing of new high risky venture promoted by qualified entrepreneurs who lack experience and funds to give shape to their ideas. In broad sense, under venture capital financing venture capitalist make investment to purchase equity or debt securities from inexperienced entrepreneurs who undertake highly risky ventures with a potential of success.

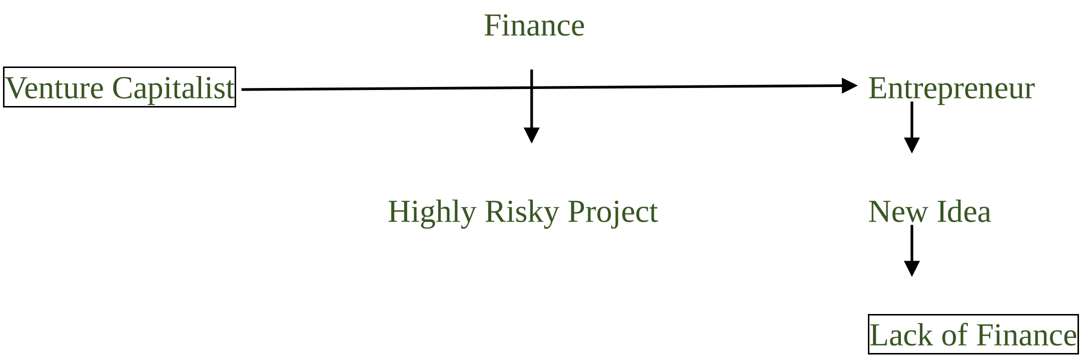
Methods of Venture Capital Financing:

i. Equity financing (not exceeding 49%)

ii. Conditional loan (charging royalty on income/sales)

iii. Income note (charging both – interest and royalty i.e. interest on conventional loan and royalty on conditional loan.)

iv. Participating debenture (venture capitalist participates in level of operation).



Factors to be considered by a Venture Capitalist before Financing any Risky Project:

i. Quality of the management team is a very important factor to be considered. They are required to show a high level of commitment to the project.

ii. The technical ability of the team is also vital. They should be able to develop and produce a new product / service.

iii. Technical feasibility of the new product / service should be considered.

iv. Since the risk involved in investing in the company is quite high, venture capitalists should ensure that the prospects for future profits compensate for the risk.

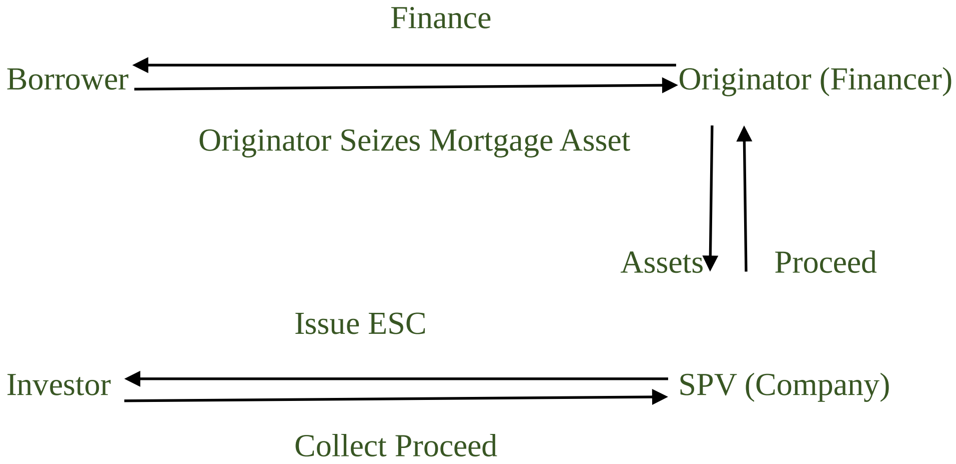
v. A research must be carried out to ensure that there is a market for the new product.

vi. The venture capitalist himself should have the capacity to bear risk or loss, if the project fails.

vii. The venture capitalist should try to establish a number of exist routes.

g. Debt Securitization:

The process of debt securitization is given below



Meaning:

Securitisation is a process in which illiquid assets are pooled into marketable securities that can be sold to investors. The process leads to the creation of financial instruments that represent ownership interest in, or are secured by a segregated income producing asset or pool of assets. These assets are generally secured by personal or real property such as automobiles, real estate, or equipment loans but in some cases are unsecured.

Benefits to the Originator of Debt Securitization:

i. The assets are shifted off the balance sheet, thus giving the originator recourse to off balance sheet funding.

ii. It converts illiquid assets to liquid portfolio.

iii. It facilitates better balance sheet management as assets are transferred off balance sheet facilitating satisfaction of capital adequacy norms.

iv. The originator's credit rating enhances.

h. Lease Financing: Leasing is a general contract between the owner and user of the asset over a specified period of time. The asset is purchased initially by the lessor (leasing company) and thereafter leased to the user (lessee company) which pays a specified rent at periodical intervals. Thus, leasing is an alternative to the purchase of an asset out of own or borrowed funds.

i. Types of Lease:

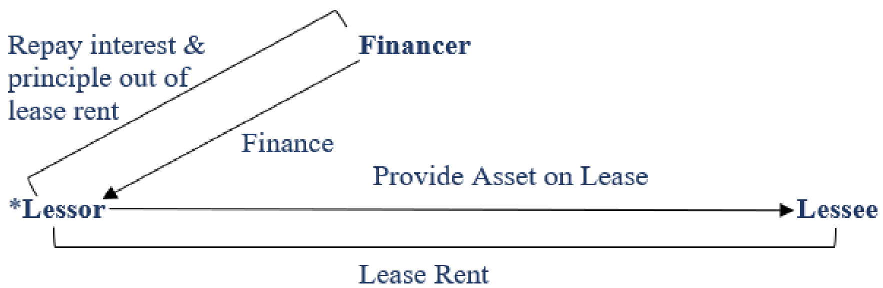
	Finance Lease	Operating Lease
1.	The risk and reward incident to ownership are passed on to the lessee. The lessor only remains the legal owner of the asset.	The lessee is only provided the use of the asset for a certain time. Risk incident to ownership belong wholly to the lessor.
2.	The lessee bears the risk of obsolescence.	The lessor bears the risk of obsolescence.
3.	The lessor is interested in his rentals and not in the asset. He must get his principal back along with interest. Therefore, the lease is non-cancellable by either party.	As the lessor does not have difficulty in leasing the same asset to other willing lessor, the lease is kept cancelable by the lessor.
4.	The lessor enters into the transaction only as financier. He does not bear the cost of repairs, maintenance or operations.	Usually, the lessor bears cost of repairs, maintenance or operations.
5.	The lease is usually full payout, that is, the single lease repays the cost of the asset together with the interest.	The lease is usually non-payout, since the lessor expects to lease the same asset over and over again to several users.

ii. Other types of Lease:

a. Sales and Lease Back : Under this type of lease, the owner of an asset sells the asset to a party (the buyer), who in turn leases back the same asset to the owner in consideration of a lease rentals.

b. Leveraged Lease

Leveraged lease involves lessor, lessee and financier. In leveraged lease, the lessor makes a substantial borrowing, even upto 80 per cent of the assets purchase price. He provides remaining amount – about 20 per cent or so – as equity to become the owner. The lessor claims all tax benefits related to the ownership of the assets. Lenders, generally large financial institutions, provide loans on a non-recourse basis to the lessor. Their debt is served exclusively out of the lease proceeds. To secure the loan provided by the lenders, the lessor also agrees to give them a mortgage on the asset. Leveraged lease are called so because the high non-recourse debt creates a high degree of leverage.



*obtains all tax benefit associated with ownership.

c. **Sales-aid lease:** Under this lease contract, the lessor enters into a tie up with a manufacturer for marketing the latter's product through his own leasing operations, it is called a sales-aid lease. In this lease, leaser earns lease rental and commission from manufacturer.

d. **Close-ended and Open-ended Leases:**

Close ended	Open ended
Asset is transferred to leaser at the end.	Lessee has option to buy lease asset at the end of lease period.

i. **Ploughing back of Profits:**

Long-term funds may also be provided by accumulating the profits of the company and ploughing them back into business. Such funds belong to the ordinary shareholders and increase the net worth of the company. A public limited company must plough back a reasonable amount of its profits each year keeping in view the legal requirements in this regard and its own expansion plans. Such funds also entail almost no risk. Further, control of present owners is also not diluted by retaining profits.

4. SHORT TERM SOURCE OF FINANCE:

a. Trade Credit
b. Accrued Expenses and Deferred Income
c. Advances from Customers
d. Treasury Bills
e. Certificates of Deposit (CD)
f. **Commercial Paper:**

A commercial paper is an unsecured money market instrument issued in the form of a promissory note.

The following are the features of commercial paper:

i. It can be issued for maturities between 7 days and a maximum upto one year from the date of issue.
ii. These can be issued in denominations of ₹ 5 lakh or multiples therefore.
iii. All eligible issuers are required to get the credit rating from credit rating agencies.

Eligibility criteria for issuer of commercial paper:

The companies satisfying the following conditions are eligible to issue commercial paper.

✓ The tangible net worth of the company is ₹ 5 crores or more as per audited balance sheet of the company.

✓ The fund base working capital limit is not less than ₹ 5 crores.

- ✓ The company is required to obtain the necessary credit rating from the rating agencies such as CRISIL, ICRA etc.
- ✓ The issuers should ensure that the credit rating at the time of applying to RBI should not be more than two months old.
- ✓ The minimum current ratio should be 1.33:1 based on classification of current assets and liabilities.
- ✓ For public sector companies there are no listing requirement but for companies other than public sector, the same should be listed on one or more stock exchanges.
- ✓ All issue expenses shall be borne by the company issuing commercial paper.

g. Bank Advances:

i. Short Term Loans
ii. Overdraft:
iii. Clean Overdrafts
iv. Cash Credits
v. Advances against goods
vi. Bills Purchased/Discounted

h. Financing of Export Trade by Banks:

1. **Pre-Shipment Finance:** This generally takes the form of packing credit facility; packing credit is an advance extended by banks to an exporter for the purpose of buying, manufacturing, processing, packing, shipping goods to overseas buyers.

Types of Packing Credit:

- ➢ Clean packing credit
- ➢ Packing credit against hypothecation of goods
- ➢ Packing credit against pledge of goods
- ➢ E.C.G.C. guarantee
- ➢ Forward exchange contract

2. **Post-shipment Finance:** it means credit facility provided after shipment of goods.

Types of Post-shipment Credit:

- ➢ Purchase/discounting of documentary export bills
- ➢ E.C.G.C. Guarantee
- ➢ Advance against export bills sent for collection
- ➢ Advance against duty draw backs, cash subsidy, etc.

i. Factoring:

☞ **Concept of factoring:**

Factoring involves provision of specialized services relating to credit investigation, sales ledger management purchase and collection of debts, credit protection as well as provision of finance against receivables and risk bearing. In factoring, accounts receivables are generally sold to a financial institution (a subsidiary of commercial bank – called “factor”), who charges commission and bears the credit risks associated with the accounts receivables purchased by it.

☞ **Advantages:**

i. The firm can convert accounts receivables into cash without bothering about repayment.

ii. Factoring ensures a definite pattern of cash inflows.
iii. Continuous factoring virtually eliminates the need for the credit department because receivables are managed by financial institution.
iv. Unlike an unsecured loan, compensating balances are not required in this case.
v. Another advantage consists of relieving the borrowing firm of substantially credit and collection costs and from a considerable part of cash management.

☞ **Factoring v/s Bill Discounting:**
The differences between Factoring and Bills discounting are:

(a) Factoring is called as "Invoice Factoring' whereas Bills discounting is known as 'Invoice discounting."
(b) In Factoring, the parties are known as the client, factor and debtor whereas in Bills discounting, they are known as drawer, drawee and payee.
(c) Factoring is a sort of management of book debts whereas bills discounting is a sort of borrowing from commercial banks.
(d) For factoring there is no specific Act, whereas in the case of bills discounting, the Negotiable Instruments Act is applicable.

j. Inter Corporate Deposits
k. Certificate of Deposit (CD)
l. Public Deposits

5. OTHER SOURCES OF FINANCE:

a. **Seed Capital Assistance:** The Seed capital assistance scheme is designed by IDBI for professionally or technically qualified entrepreneurs and/or persons possessing relevant experience, skills and entrepreneurial traits but lack adequate financial resources. All the projects eligible for financial assistance from IDBI, directly or indirectly through refinance are eligible under the scheme.

b. **Deep Discount Bonds:** Deep Discount Bonds is a form of zero-interest bonds. These bonds are sold at a discounted value and on maturity face value is paid to the investors. In such bonds, there is no interest payout during lock in period.

c. **Secured Premium Notes:** Secured Premium Notes is issued along with a detachable warrant and is redeemable after a notified period of say 4 to 7 years. The conversion of detachable warrant into equity shares will have to be done within time period notified by the company.

d. **Zero Coupon Bonds:** A Zero Coupon Bonds does not carry any interest but it is sold by the issuing company at a discount. The difference between the discounted value and maturing or face value represents the interest to be earned by the investor on such bonds.

e. **Floating Rate Bonds:** This as the name suggests is bond where the interest rate is not fixed and is allowed to float depending upon the market conditions. This is an ideal instrument which can be resorted to by the issuer to hedge themselves against the volatility in the interest rates.

f. **ADR, GDR, IDR:**
American Depository Receipts (ADRs): These are securities offered by non-US companies who want to list on any of the US exchange.

Global Depository Receipts (GDRs): These are negotiable certificate held in the bank of one country representing a specific number of shares of a stock traded on the exchange of another country.

Indian Depository Receipts (IDRs): The concept of the depository receipt mechanism which is used to raise funds in foreign currency has been applied in the Indian Capital Market through the issue of Indian Depository Receipts (IDRs).

g. Financial Instruments in the International Market:

Some of the various financial instruments dealt with in the international market are:

i. Euro Bonds
ii. Foreign Bonds
iii. Fully Hedged Bonds
iv. Medium Term Notes
v. Floating Rate Notes
vi. External Commercial Borrowings
vii. Foreign Currency Futures
viii. Foreign Currency Option
ix. Euro Commercial Papers.

h. External Commercial Borrowings (ECBs):

External Commercial Borrowings are loans taken from non-resident lenders in accordance with exchange control regulations. These loans can be taken from:

- International banks
- Capital markets
- Multilateral financial institutions like IFC, ADB, IBRD etc.
- Export Credit Agencies
- Foreign collaborators
- Foreign Equity Holders.

ECBs can be accessed under automatic and approval routes depending upon the purpose and volume.

In automatic there is no need for any approval from RBI / Government while approval is required for areas such as textiles and steel sectors restructuring packages.

Chapter- 3: Capital Structure

COVERAGE:

1. Capital structure theories
2. Over capitalisation v/s under capitalization
3. Factors affecting capital structure

a. **Trade-off Theory**:

It deals with balancing cost and benefit associated with fixed cost capital.

Fixed cost capital.

Fixed cost capital (Debt Fund)

Benefit
*Interest tax shield

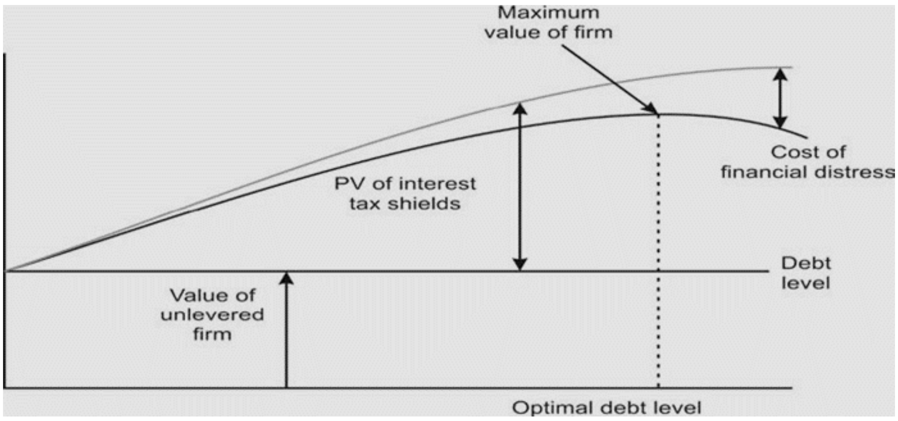
Cost

Cost of financial distress

Revive
*Reconstruction
*Incurs additional cost

Insolvent

Insolvency Cost
(Company have to sell assets at lower price to meet obligation).



Capital structure as per trade-off theory:

i. Equity Capital
ii. Debt Capital

b. Packing Theory:

It is based on asymmetric information i.e. situation where different parties have different information. However, a financial manager has better information than other.

Manager choice of capital:

i. **Internal financing (Retained earning)**
ii. **Debt capital (Secured, Unsecured & Hybrid):** If there is positive future earning i.e. ROCE > Cost of Debt.
iii. **External equity:** It is a high cost capital due to higher risk.

2. OVER CAPITALIZATION V/S UNDER CAPITALIZATION:

a. Over-capitalization:

Meaning:

- It is a situation where a firm has more capital than it needs or in other words assets are worth less than its issued share capital, and earnings are insufficient to pay dividend and interest.
- This situation mainly arises when the existing capital is not effectively utilized on account of fall in earning capacity of the company while company has raised funds more than its requirements.

Causes	Consequences	Remedies
Raising more money through issue of shares or debentures than company can employ profitably.	Considerable reduction in the rate of dividend and interest payments.	Company should go for thorough reorganization.
Borrowing huge amount at higher rate than rate at which company can earn.	Reduction in the market price of shares.	Buyback of shares.
Excessive payment for the acquisition of fictitious assets such as goodwill etc.	Resorting to "window dressing".	Reduction in claims of debenture-holders and creditors.
Improper provision for depreciation, replacement of assets and distribution of dividends at a higher rate.	Some companies may opt for reorganization. However, it may result into liquidation.	Value of shares may also be reduced.
Wrong estimation of earnings and capitalisation.		

b. Under-capitalization:

Meaning:

- It is just reverse of over-capitalisation. It is a state, when its actual capitalisation is lower than its proper capitalisation as warranted by its earning capacity.
- This situation normally happens with companies which have insufficient capital but large secret reserves in the form of considerable appreciation in the values of the fixed assets not brought into the books.

Consequences	Effect/Causes	Remedies
The dividend rate will be higher.	It encourages acute competition.	The shares of the company should be split up. It reduces dividend per share.
Market value of shares will be higher than similar companies.	High rate of dividend encourages the workers' union to demand high wages.	Issue of Bonus Shares.
Real value of shares will be higher than their book value.	Normally common people (consumers) start feeling that they are being exploited.	By revising upward the par value of shares.
	Management may resort to manipulation of share values.	
	Invite more government control and regulation on the company and higher taxation also.	

c. Over-Capitalisation vis-à-vis Under-Capitalisation:

- Both over capitalisation and under capitalisation are not good. However, over capitalisation is more dangerous to the company, shareholders and the society than under capitalisation.
- The situation of under capitalisation can be handled more easily than the situation of over-capitalisation.
- Moreover, under capitalisation is not an economic problem but a problem of adjusting capital structure.
- Thus, under capitalisation should be considered less dangerous but both situations are bad and every company should strive to have a proper capitalisation.

3. FACTOR AFFECTING CAPITAL STRUCTURE:

a. Financial leverage of Trading on Equity:

- The use of long-term fixed interest bearing debt and preference share capital along with equity share capital is called financial leverage or trading on equity.
- The use of long-term debt increases the earnings per share if the firm yields a return higher than the cost of debt.
- The earnings per share also increase with the use of preference share capital.
- However, leverage can operate adversely also if the rate of interest on long-term loan is more than the expected rate of earnings of the firm.

b. Growth and stability of sales:

The capital structure of a firm is highly influenced by the growth and stability of its sale. If the sales of a firm are expected to remain fairly stable, it can raise a higher level of debt and vice-versa.

c. **Cost Principle:**
According to this principle, an ideal pattern or capital structure is one that minimises cost of capital structure and maximises earnings per share (EPS). For e.g. Debt capital is cheaper than equity capital.

d. **Risk Principle:**
According to this principle, equity capital should be used more than excess use of debt because fixed cost capital are more risky due to interest commitment.

e. **Control Principle:**
While designing a capital structure, the finance manager may also keep in mind that existing management control and ownership remains undisturbed. Issue of new equity will dilute existing control pattern and also it involves higher cost. Issue of more debt causes no dilution in control, but causes a higher degree of financial risk.

f. **Flexibility Principle:**
By flexibility it means that the management chooses such a combination of sources of financing which it finds easier to adjust according to changes in need of funds in future too. Debt capital are flexible as compare to equity capital as it can be redeemed when firm has no necessity of fund.

g. **Other Considerations:**
Such as nature of industry, timing of issue and competition in the industry should also be considered.

Chapter- 4: Working Capital Management

Unit-I Working Capital Management (Estimation)

1. MEANING:

It refers to the difference between current assets and current liabilities.

That is, Working Capital = Current Assets – Current Liabilities

2. CLASSIFICATION:

Value	Time
Gross Working Capital: It refers to the firm's investment in current assets.	**Permanent Working Capital:** It is that minimum level of investment in the current assets that is carried by the business at all times to carry out minimum level of its activities.
Net Working Capital: It refers to the difference between current assets and current liabilities.	**Temporary Working Capital:** It refers to that part of total working capital, which is required by a business over and above permanent working capital.

3. WORKING CAPITAL MANAGEMENT DECISION:

Investment in working capital provides liquidity however, it adversely effects profitability as there is low return in investment in working capital. On the other hand, lower investment in working capital may increase profitability however, it adversely effects the liquidity of the firm. Therefore, a Financial Manager shall maintain trade-off between liquidity and profitability while investing in working capital.

4. WORKING CAPITAL MANAGEMENT DECISION:

Investment in Working Capital

It deals with how much amount to

be invested in working capital.

Financing of Working Capital

It deals with various short term

sources of financing of working capital.

5. INVESTMENT IN WORKING CAPITAL:

a. **Determinants/Factors of Working Capital:**
   i. Nature of Industry
   ii. Type of Product
   iii. Manufacturing v/s Trading v/s Service Industry
   iv. Volume of Sale
   v. Credit Policy
   vi. Level of Current Assets
   vii. Demand Conditions.

b. **Approach:**
   i. **Aggressive:** Lower investment in working capital.
   ii. **Conservative:** Higher investment in working capital.
   iii. **Moderate:** This approach involves trade-off between Liquidity and Profitability.

Unit-II Treasury and Cash Management

1. TREASURY MANAGEMENT:

- ✓ **Meaning:** It is management of liquidity and financial risk.
- ✓ **Functions of Treasury Department:**

a. **Cash Management:** It deals with:
   i. Payment of obligations on timely basis.
   ii. Optimum return from surplus cash.

b. **Currency Management:** It deals with:
   i. Management of Foreign Currency risk exposure.
   ii. It is usually in MNCs.

c. **Fund Management:** It provides short term & long term fund at minimum cost.

d. **Banking:** It involves:
   i. Maintaining relationship with bank.
   ii. Negotiation with banker.

e. **Corporate Finance:** Advising on corporate finance including merger, capital structure, etc.

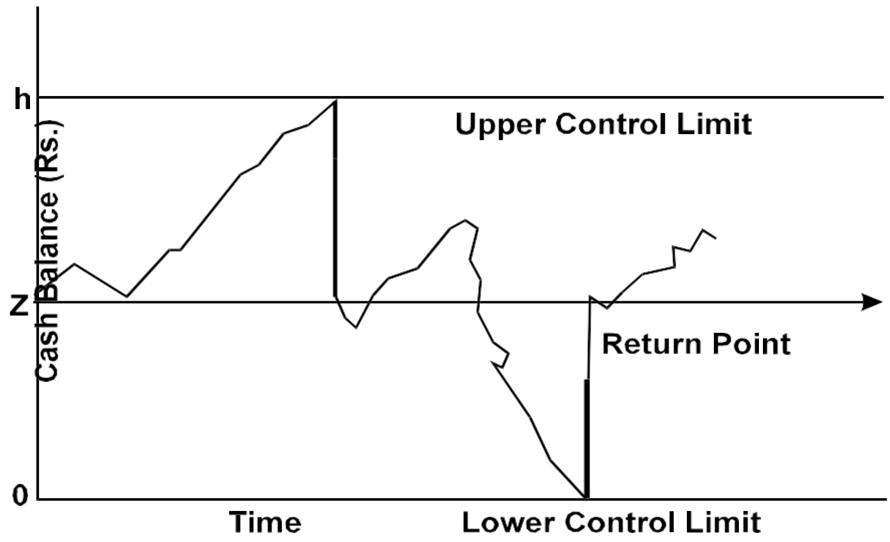
2. CASH MANAGEMENT:

- ✓ **Meaning:** It means management of cash in such a way that there is sufficient liquidity and no surplus ideal fund available with firm.
- ✓ **Techniques:**

1. Cash Budget
2. William J. Baumol’s Economic Order Quantity Model
3. Miller-Orr Cash Management Model
4. Management of Float
5. Accelerating Cash Collection
6. Management of Marketable Securities

1. Miller-Orr Cash Management Model

It is based on Stochastic Cash Flow Assumption (i.e. no uniform cash flow during year)



MILLER-ORR CASH MANAGEMENT

Lower Limit – management perception

$$\text{Spread} = 3\left(\frac{3/4 \times \text{Transaction Cost} \times \text{Variance of Cash flows}}{\text{Interest Rate}}\right)^{1/3}$$

U = Lower + Spread

R = Lower + 1/3 x Spread

2. Management of Float (Delays)

Dispatch of Goods to Customer

Billing Float

Preparation of Bill/Invoiced

Mail Float

Receipt of Invoice by Customer

Credit Period

Payment Due

Mail Float

Cheque Receipt

Cheque Processing Float

Cheque Deposit Bank

Bank Processing Float

Credit by Bank

Types:

1. **Billing Float:** An invoice is the formal document that a seller prepares and sends to the purchaser as the payment request for goods sold or services provided. The time between the sale and the mailing of the invoice is the billing float.
2. **Mail Float:** This is the time when a cheque is being processed by post office, messenger service or other means of delivery.
3. **Cheque Processing Float:** This is the time required for the seller to sort, record and deposit the cheque after it has been received by the company.
4. **Bank Processing Float:** This is the time from the deposit of the cheque to the crediting of funds in the sellers account.

3. Accelerating Cash Collection:

1. Concentrated Banking:

- ✓ Establish different collection centre instead single at HO.
- ✓ Cheque deposit in local bank & fund are transferred concentrated bank of HO.
- ✓ It reduces mail float.

2. Lock Box System:

- ✓ Reduces float by eliminating time between receipt of remittance & deposit in bank.
- ✓ Usually, arranged on regional basis (customer centre)

4. Management of Marketable Securities:

Cash Management

Surplus → Buy → Earn Return

Deficiency → Sell-out → Provides Liquidity

Factors affecting Selection of Marketable Securities

1. **Safety:**
   - Risk Increase, Return Increase
   - Objective: Liquidity with minimum risk (Low Return)
2. **Maturity:** based on forecasted cash need.
3. **Marketability (Convertibility into cash):**
   - Select high liquid marketable securities.

5. Recent Development:

a. Electricity Fund Transfer

b. Zero Balance Account

c. Petty Cash System

d. Electronic Cash Management System

e. **Virtual Banking:** provision of banking & related services with use of IT without direct recourse to banking customer.

Advantages:

1. Lower cost of handling transaction
2. High Speed
3. Improve high range of service.

UNIT-III RECEIVABLE MANAGEMENT

COVERAGE:

1. Meaning
2. Aspects of Receivable Management
3. Monitoring Of Receivables
4. Accounts Receivable System

1. MEANING:

Receivable management is an important aspect of working capital management because higher investment in receivable will lead higher investment in working capital and vice versa. As we know while investing in working capital trade-off is necessary i.e. maintain working capital at optimum level to maintain liquidity and profitability.

2. RECEIVABLE MANAGEMENT HAS THREE ASPECTS:

a. Credit Policy:

While determining credit policy:

Trade-off

Profit on additional sale

Cost involve:

- Administrative Cost
- Collection Cost
- Bad Debts

Factors (Focus):

- Credit Period
- Cash Discount
- Other related matters

b. Credit Analysis: Analyzing risk involved in providing credit.

c. Control of Receivable include:

i. Follow up
ii. Collection Policy
iii. Collection before Due Date

3. MONITORING OF RECEIVABLES

3 Steps:

1. Calculate average age of receivable:

- ✓ **Holding Period:** It involves calculation of holding period of receivable.

2. **Ageing Schedule:**
   - ✓ Analyse receivable according to age.
   - ✓ It helps to identify highly liquid & less liquid receivable.

3. **Collection Programmes:**
   - ✓ Monitoring the state of receivable.
   - ✓ Intimation to customer.
   - ✓ E-mail & telephonic advice.
   - ✓ Legal action.

4. ACCOUNTS RECEIVABLE SYSTEM

Manual	Automated
Recording & Managing Receivable ↓ *Costly *Time Consuming.	Recording & Managing Receivable ↓ *Low Cost. *Update Automatically. *Tracking Receivable. *Smooth Collecting of Receivable etc.

Unit IV – Payable Management

Payable Management

Credit facility

2/10 net 45

Cost of availing ← → Not availing

A. COST OF AVAILING:

1. **Price:** If we avail credit facility it is not possible to avail discount. Thus, it increases purchase price.
2. **Loss of Goodwill:** If credit is over stepped, it may effect on goodwill of firm.
3. **Cost of management (Payable):** Management of payable involves administrative cost and accounting cost.
4. **Condition:** Supplier may insist for various conditions while availing credit facility such as minimum size, order on regular basis etc.

B. NOT AVAILING:

1. **Interest =** For early payment it is necessary to arrange fund.

2. **Inconvenience to suppliers:** Due to deferred payment.

Decision:

$\boxed{\textbf{Compare}}$

(a) Cost of not taking credit

$$\frac{d}{1-d} \times \frac{365}{t}$$

= (2/98 x 365/35)

(b) Opportunity cost of Investment

Given

If a>b, accept discount

If a<b, ignore discount

Particulars	Refuse	Accept
Payment	10,000	9,800
Interest earning (98,000 x 25% x 35/365)	(235)	-
	9,765	**9,800**

Chapter- 5: Dividend Decisions

1. FACTOR DETERMINING DIVIDEND POLICY:

Strategic determinants of dividend policy are:

i. **Firm Liquidity Position:** If a firm has good liquidity position, it adopts liberal dividend policy and vice-versa.
ii. **Investment opportunities:** If a firm has large no. of positive NPV investment opportunity, it adopts tight dividend policy.
iii. **Floating cost of new issue:** If floating cost of new issue is high, a firm adopts tight dividend policy.
iv. **Availability of finance from various sources:** If finance from various sources easily available, liberal dividend policy should be adopted.
v. **Restrictive Covenants:** If loan covenants are very restrictive, tight dividend policy should be adopted.
vi. **Investor's Preference:** In economy with poor corporate governance, a 100% payout ratio as advocated by traditional position is used.
vii. **Tax impact/ Treatment:** Since there is differential tax treatment of dividend v/s capital gain, it should be considered while designing dividend policy.

2. FIRMS IN REAL LIFE ADOPTS THE FOLLOWING TYPES OF DIVIDEND POLICY:

i. **Constant Payout Ratio:** It is the worst dividend policy as it would result in uncertain & unstable dividend.
ii. **Constant DPS:** It is good dividend policy but lacks growth feature.
iii. **Constant Dividend plus Growth:** Here the firm announces a minimum DPS which would be increased when there is permanent increase in the firm EPS. This is the best dividend policy as it reflects certainty, stability and growth.
iv. **Residual Policy:** In this policy, dividend becomes a residue which is left after financing equity portion of firm investment.

i.e., Dividend = PAT – Equity Portion of Investment.

This policy will result in unstable dividend and is therefore, not a good policy.

Chapter- 6: Investment Decisions

PURPOSE OF CAPITAL BUDGETING

The capital budgeting decisions are important, crucial and critical business decisions due to the following reasons:

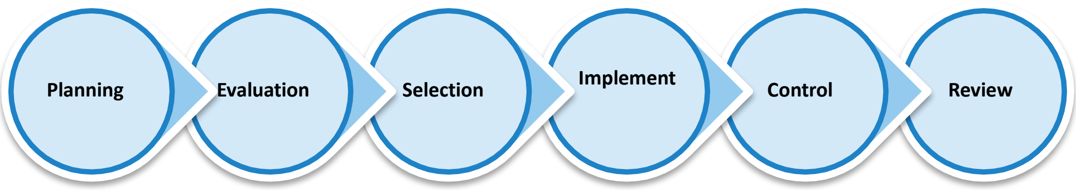
(i) **Substantial Investment :** Investment decisions are related with fulfillment of long-term objectives and existence of an organization. To invest in a project(s), a substantial capital investment is required. Based on size of capital and timing of cash flows, sources of finance are selected. Due to huge capital investments and associated costs, it is therefore necessary for an entity to make such decisions after a thorough study and planning.

(ii) **Long time period:** The capital budgeting decision has its effect over a long period of time. These decisions not only affect the future benefits and costs of the firm but also influence the rate and direction of growth of the firm.

(iii) **Irreversibility:** Most of the investment decisions are irreversible. Once the decision is implemented, it is very difficult and reasonably and economically not possible to reverse the decision. The reason may be upfront payment of amount, contractual obligations, technological impossibilities etc.

(iv) **Complex decisions:** The capital investment decision involves an assessment of future events, which in fact is difficult to predict. Further, it is quite difficult to estimate in quantitative terms, all the benefits or the costs relating to a particular investment decision.

CAPITAL BUDGETING PROCESS



- ✓ **Planning:** The capital budgeting process begins with the **identification of potential investment opportunities.** The opportunity then enters the planningphase when the potential effect on the firm's fortunes is assessed and the abilityof the management of the firm to exploit the opportunity is determined.
- ✓ **Evaluation:** This phase involves the **determination of proposal** and its investments, inflows and outflows. Investment appraisal techniques, ranging from the simple payback

method and accounting rate of return to the more sophisticated discounted cash flow techniques, are used to appraise the proposals.

- ✓ **Selection:** Considering the returns and risks associated with the individual projects as well as the cost of capital to the organisation, the organisation will **choose among the projects** which maximises the shareholders' wealth.
- ✓ **Implementation:** When the final selection is made, the firm must acquire the necessary funds, purchase the assets, and begin the **implementation of the project.**
- ✓ **Control:** The **progress of the project is monitored** with the aid of feedback reports. These reports will include capital expenditure progress reports, performance reports comparing actual performance against plans set and post completion audits.
- ✓ **Review:** When a project terminates, or even before, the organisation should **review the entire project** to explain its success or failure.