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PRESENTING

CA RAHUL GARG's

The SPARKLE

FINANCIAL MANAGEMENT

CA Rahul Garg

Gold Medalist | AIR IN CA, CS, CMA

PREFACE

Dear Students,

It gives me immense pleasure and heartfelt satisfaction to present to you **'THE SPARKLE'** - a book specially designed for you, the CA Intermediate students, for the subject Financial Management.

This book is not just a compilation of theoretical aspects of **FINANCIAL MANAGEMENT**; it's a thoughtfully crafted learning companion. It brings together the **most relevant and frequently asked concepts** from each chapter, organized systematically to ensure conceptual clarity and practical understanding. Each topic is presented in a simple, lucid manner, making even the most complex concepts easier to grasp.

What makes 'THE SPARKLE' truly stand out is its **student-centric approach.** To help you learn efficiently and revise effectively, we've put in smart features like Color Coding Scheme, Tabular Presentation, Most Imp. Points specially highlighted. These elements are carefully interlinked to give you a **seamless and structured learning experience**—an approach that aims to boost your confidence and performance.

While every effort has been made to ensure the content is accurate and error-free, any inadvertent mistakes are sincerely regretted. As we believe that the path to excellence is always under construction, your suggestions, feedback, and constructive criticism are warmly welcomed.

Wishing you all great success and bright future.

Let 'THE SPARKLE' be the light that guides your preparation journey!

With Best Wishes
RAHUL GARG
Gold Medalist
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FINANCIAL MANAGEMENT

1 BASIC CONCEPTS

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Financial Management

✓ Financial Management is the management (i.e. planning, organizing, directing, co-ordinating and controlling) of all activities relating to acquisition and application of the financial resources of an entity, to achieve specified financial objectives.

Aspects of Financial Management

There are two basic aspects of financial management viz., procurement of funds and an effective use of these funds to achieve business objectives.

Procurement of Funds		
Basic	✓ Procurement of funds means to arrange the amount of finance for various business activities. Since funds can be obtained from different sources therefore their procurement is always considered as a complex problem by business concerns.	
Major considerations	✓ Deciding the proportion of equity and debt in capital structure. ✓ Analysing each source of finance w.r.t. cost. ✓ Analysing each source of finance w.r.t. financial risk involved.	
Major sources	Equity Share Capital	✓ The funds raised by the issue of equity shares are the best from the risk point of view for the firm, since there is no question of repayment of equity capital except when the firm is under liquidation. From the cost point of view, however, equity capital is usually the most expensive source of funds.
	Debentures	✓ Debentures are comparatively cheaper than the shares because of their tax advantage. However, debentures entail a high degree of risk since they have to be repaid as per the terms of agreement.
	Funding from banks	✓ Commercial Banks play an important role in meeting the long term and short-term needs of a business enterprise.
	International Funding	✓ With liberalization and globalization, a business enterprise has options to raise capital from International market also.
	Angel Financing	✓ An angel investor is a wealthy individual who provides capital for start-up or expansion, in exchange for an ownership in the company.

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Effective Utilisation of Funds		
Basic	✓ Utilisation of funds means to invest the amount of finance arranged for various business activities.	
Major considerations	✓ If these funds are not utilised in the manner so that they generate an income higher than the cost of procuring them, there is no point in running the business. Hence, it is crucial to employ the funds properly and profitably.	
2 Main Aspects	Fixed Assets	✓ The funds are to be invested in the manner so that the company can produce at its optimum level and maximise its return on investment.
	Working Capital	✓ It should be ensured that the firm does not keep too much funds blocked in inventories, book debts, cash etc.

Evolution Of Financial Management

Stage I	Traditional Phase	✓ During this phase, financial management was considered necessary only during special and significant events such as takeovers, mergers, expansion, liquidation, etc.
Stage 2	Transitional Phase	✓ During this phase, the day-to-day problems faced by financial managers were given importance.
Stage 3	Modern Phase	✓ The scope of financial management has greatly increased. It is viewed as a supportive and facilitative function, not only for Top Management, but for all levels of Managers.

Finance Functions/ Finance Decisions

The finance function relates to three major decisions which the finance manager has to take:
(I) Investment decision, (2) Financing decision; and (3) Dividend decision.

Investment decisions (I)	
Meaning	✓ Investment decision relates to the careful selection of assets in which funds will be invested by the firm. The firm may need funds for setting up new business or for expansion or modernisation of existing business.
Objective	✓ While investing the funds, the objective is to maximize return on investment.

Financing decisions (F)

1 BASIC CONCEPTS

Meaning	✓ Financing decision relates to the composition of relative proportion of various sources of finance. The financial manager needs to ensure that the company has a sound capital structure, i.e. a proper balance between equity capital and debt.
Objective	✓ While procuring funds, the objective is to minimize the cost of funds obtained.
Dividend decisions (D)	
Meaning	✓ Dividend decision involves deciding whether to distribute the profits as dividend to shareholders or to retain profits and reinvest in the business.
Objective	✓ It is to divide net earnings in an optimum manner with the objective of maximising the wealth of shareholders.

Importance Of Financial Management

✓ Ensures timely optimal procurement of adequate funds at reasonable cost
✓ Ensures effective utilisation of funds
✓ Maximizes profit
✓ Maximizes Earning Per Share
✓ Minimizes Costs
✓ Ensures that there is a sufficient level of short-term working capital

Objectives Of Financial Management

The two important objectives of financial management to be discussed are :	
Profit Maximization	
Meaning	✓ The basic business motive is Profitability. So, the Finance Manager has to take his decisions in order to maximise the profits of the business.
Nature	✓ Profit maximisation cannot be the sole objective of a company. It is at best a limited objective.
Advantages	✓ Resources are efficiently utilized. ✓ It serves interest of society through factor payments. ✓ It is easy to calculate profits. ✓ It is essential for growth and development of business.
Dis-advantages/ Problems	✓ The term profit is vague as it conveys a different meaning to different people.
	✓ It ignores time pattern of returns.
	✓ It is considered immoral since it ignores social responsibility.
	✓ The risk factor is altogether ignored ie. finance manager will accept highly risky proposals also, if they give high profits.

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Wealth / Value Maximisation	
Meaning	✓ The wealth of owners of a company is reflected by the market value of company's shares in the long run.
Nature	✓ It is a better objective for a business since it represents both return and risk.
Advantages	✓ Benefits are measured in terms of cash flows. ✓ Shareholders prefer an increase in the Firm's wealth (long term objective) as against mere increase in flow of profits (short term objective). ✓ Wealth maximization objective takes into account the time value of money and discounts the future cash flows to reach at the net present value. ✓ The risk factor is also considered before reaching the conclusion.
Dis-advantages/ Problems	✓ There is no clear relationship between cause & effect. As there are lot of financial decisions taken, it becomes difficult to identify, by which decision price of the share has gone up and which decision has affected it badly. ✓ Share Prices are affected by external factors also. Hence, sole dependence on Financial Decisions for maximizing Wealth can lead to management anxiety and frustration.

Conflicts In Profit Versus Value Maximisation Principle

S. No.	Basis	Profit Maximisation	Wealth Maximisation
1.	Timing pattern	It ignores time pattern of returns.	It recognises the time pattern of returns.
2.	Effect of risk	It does not consider the effect of uncertainty / risk.	It recognises the risk-return relationships.
3.	Impact of dividends, EPS etc.	It does not consider the effect of future cash flows, dividend decisions, EPS, etc.	It recognises the effect of all future cash flows, dividends, EPS, etc.
4.	Relation between decision & it's impact	It is comparatively easy to determine the relationship between financial decisions and profits.	It offers no clear or specific relationship between financial decisions and share market prices.
5.	Focus w.r.t. time period	It focuses on entity's short term gains and profits.	It focuses on long-term wealth of entity, shareholders and society as a whole.

1 BASIC CONCEPTS

Role Of Finance Executive

Responsibilities of CFO	
✓ Financial analysis and planning	
✓ Investment decisions	
✓ Financing and capital structure decisions	
✓ Management of financial resources	
✓ Risk management	
Role of Finance executive	
Role in the Past	Role in the Present
✓ Budgeting ✓ Forecasting ✓ Accounting ✓ Treasury (cash management) ✓ Preparing internal financial reports for management ✓ Preparing quarterly, annual filings for investors ✓ Tax filing ✓ Tracking accounts payable and accounts receivable ✓ Travel and entertainment expense management	✓ Budgeting ✓ Strategic Planning ✓ Forecasting ✓ Managing M&As ✓ Profitability analysis ✓ Pricing analysis ✓ Outsourcing vs In-House Production Decisions ✓ Evaluating the IT function ✓ Overseeing the HR function ✓ Regulatory compliance ✓ Risk management

Financial Distress And Insolvency

Meaning	✓ Financial distress is a condition where a company cannot meet, or has difficulty paying off, its financial obligations to its creditors, typically due to high fixed costs or revenues sensitive to economic downturns.
After effects	✓ If the distress continues for a long period of time, firm may have to sell its asset, even at a lower price and may become insolvent.

Agency Problem And Agency Cost

Meaning	✓ Agency Problem is the chance that managers may place personal goals ahead of the goal of owners.
Cause of Agency Problem	✓ In corporates, there is a separation between owners or shareholders and managers. Consequently, management should act in such a manner so as to maximize wealth of their owners. However, this may not happen because owners and management have different interests. These behavioural problems on the part of management lead to agency problems.

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Meaning of Agency Cost	✓ Agency cost is the additional cost borne by the shareholders to monitor the manager and control their behaviour so as to maximise shareholders wealth. Example of the agency costs are salary, bonuses and perks paid to employees, monitoring costs such as audit fees paid to statutory auditors etc.

The earlier you start working on something,
the earlier you will see results.

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Financial Needs And Sources Of Finance Of A Business

Long-term financial needs	✓ Such needs are for a period exceeding 5-10 years. All investments in plant, machinery, land, buildings etc., are considered as long-term financial needs. Funds required to finance permanent working capital are procured from long term sources.
Medium-term financial needs	✓ Such needs are for a period exceeding one year but not exceeding 5 years. This might be needed for stores and spares, critical spares, tools, dies, moulds etc.
Short-term financial needs	✓ Such needs arise for a short period of time not exceeding one year and known as working capital requirements of the concern. Need for these funds arise to finance current assets such as stock, debtors, cash etc.

Owners Capital Or Equity Capital

Meaning	✓ An equity share is a share, which is not a preference share. Equity shareholders are considered owners of the company.
Advantages	✓ It is a permanent source of finance. Since such shares are not redeemable, the company has no liability for cash outflows associated with its redemption. ✓ The company is not obliged legally to pay dividends.
Dis-advantages	✓ The cost of ordinary shares is higher because dividends are not tax deductible and also the floatation costs of such issues are higher. ✓ Investors find ordinary shares riskier. ✓ The issue of new equity shares reduces the EPS of the existing shareholders. ✓ The issue of new equity shares can also dilute the ownership and control.

Preference Share Capital

Meaning	✓ A preference share is one, which carries the following two rights: ❖ A right to receive dividend before equity shares; and ❖ A right to receive repayment of capital on winding up, before the equity shares.	
Types	**Type of Preference Shares**	**Salient Features**
	Cumulative	✓ Arrear of Dividend accumulate.

	Non-cumulative	✓ Arrear of Dividend don't accumulate.
	Redeemable	✓ Redemption is done after certain time period.
	Non-redeemable	✓ Redemption is not done during life time.
	Participating	✓ Participate in the surplus of firm.
	Non-participating	✓ Don't participate in the surplus of firm.
	Convertible	✓ Option to Convert into equity Shares.
	Non-convertible	✓ No option to Convert into equity Shares
Advantages	✓ There is no dilution in EPS on enlarged capital base. ✓ There is leveraging advantage as it bears a fixed charge. ✓ The cost of preference share is lower than the cost of equity shares. ✓ The preference dividends are fixed and pre-decided.	
Dis-advantages	✓ Preference dividend is not tax deductible and so does not provide a tax shield to the company. Hence a preference share is costlier to the company than debt. ✓ If preference dividends are cumulative in nature, the arrears of dividend need to be paid later.	

Retained Earnings

Meaning	✓ The portion of profits which is not distributed but is retained and reinvested in the business is known as retained profits.
Advantages	✓ It does not involve any explicit cost. ✓ Accumulation of reserves increases financial strength to the company.
Dis-advantages	✓ There is an implicit cost. ✓ Large accumulation can lead to situation of over capitalization.

Debentures

Meaning	✓ A debenture is a written instrument acknowledging a debt. The persons who contribute money through debentures are called debentureholders.	
Division on the basis of convertibility	Non-convertible debentures	✓ These types of debentures do not have any feature of conversion and are repayable on maturity.
	Fully convertible debentures	✓ Such debentures are converted into equity shares as per the terms of issue in relation to price and the time of conversion.

	Partly convertible debentures	✓ Those debentures which carry features of both convertible and non-convertible debentures belong to this category.
Other types	Bearer	✓ Transferable like negotiable instruments.
	Registered	✓ Interest payable to registered person.
	Mortgage	✓ Secured by a charge on Asset(s).
	Simple or naked	✓ Not secured by any charge.
	Redeemable	✓ To be repaid after a certain period.
	Non-redeemable	✓ Not to be repaid.
Advantages	✓ The cost of debentures is much lower than the cost of preference or equity capital as the interest is tax-deductible. ✓ Debenture financing does not result in dilution of control.	
Dis-advantages	✓ Debenture interest and capital repayment are obligatory payments. ✓ Debenture financing enhances the financial risk of the organisation. ✓ Debenture increases the risk of shareholders.	

Bond

Meaning	✓ Bond is fixed income security created to raise fund.
Types of Bond (on the basis of call)	
Callable bonds	✓ It has a call option which gives the issuer the right to redeem the bond before maturity at a predetermined price known as the call price.
Puttable bonds	✓ It gives the investor a put option (i.e. the right to sell the bond) back to the company before maturity.
Foreign Bonds	
Foreign Currency Convertible Bond (FCCB)	✓ This bond comes at a very low rate of interest. ✓ The advantage is that the issuer can get foreign currency at a very low cost. ✓ The risk is that in case the bond has to be re-deemed on the date of maturity.
Plain Vanilla Bond	✓ The issuer would pay the principal amount along with the interest rate. ✓ This type of bond would not have any options. ✓ This bond can be issued in the form of discounted bond or can be issued in the form of coupon bearing bond.

Convertible Floating Rate Notes (FRN)	✓ It's a convertible FRN with an option for the holder to convert it into longer term debt security with a specified coupon. ✓ It protects an investor against falling interest rate. ✓ Capital gain is not applicable to FRN.
Drop Lock Bond	✓ It's a Floating Rate Note with a normal floating rate. ✓ The floating rate bond would be automatically converted into fixed rate bond if interest rate falls below a predetermined level. ✓ It is the short option structure whereas the convertible floating rate note is long option holder structure.
Yield Curve Note (YCN)	✓ It's a structured debt security. ✓ Yield increases when prevailing interest rate declines. ✓ Yield decreases when prevailing interest rate increases.
Euro Bond	✓ These bonds are issued or traded in a country using a currency other than the one in which the bond is denominated. This means that the bond uses a certain currency, but operates outside the jurisdiction of the central bank that issues that currency. ✓ Eurobonds are issued by multinational corporations, for example, a British company may issue a Eurobond in Germany, denominating it in U.S. dollars.
Emerging Market Bond	✓ It's a debt instrument issued by the developing countries. ✓ It provides higher yields in comparison to U.S. corporate and Treasury bonds. ✓ It tends to carry higher risks than domestic debt instruments.
Indian Bonds	
Masala Bond	✓ Masala (means spice) bond is an Indian name used for Rupee denominated bond that Indian corporate borrowers can sell to investors in overseas markets. ✓ These bonds are issued outside India but de-nominated in Indian Rupees.
Municipal Bonds	✓ Municipal bonds are used to finance urban infrastructure and are increasingly evident in India.
Government or Treasury Bonds	✓ Government or Treasury bonds are bonds issued by Government of India, RBI, any state Government or any other Government department.

Loans From Commercial Banks

Permanent Working Capital Loan	✓ It is funding of that portion of working capital which is always required (the minimum level) and is not impacted by seasonal requirement of the company.

Bridge Finance	✓ 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. The bridge loans are repaid/ adjusted out of the term loans as and when disbursed by the concerned institutions. ✓ The rate of interest on bridge finance is higher as compared with that on term loans.

Venture Capital Financing

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.	
Methods	Equity financing	✓ As the venture capital undertakings may not be able to provide returns to the investors during the initial stages, so the finance is generally provided by way of equity share capital. The equity contribution of venture capital firm does not exceed 49% of the total equity capital.
	Conditional loan	✓ A conditional loan is repayable in the form of a royalty after the venture is able to generate sales. No interest is paid on such loans.
	Income note	✓ It is a hybrid security which combines the features of both conventional loan and conditional loan. The entrepreneur has to pay both interest and royalty on sales but at substantially low rates.
	Participating debenture	✓ Such security carries charges in three phases : ❖ in the start up phase, no interest is charged, ❖ in next stage, a low rate of interest is charged ❖ after that, a high rate of interest is required to be paid.

Debt Securitisation

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 are secured by a segregated income producing asset or pool of assets.	
Three Functions	The originating function	✓ A borrower seeks a loan from a finance company or bank. The creditworthiness of borrower is evaluated and a contract is entered into with

		repayment schedule structured over the life of the loan.
	The pooling function	✓ Similar loans or receivables are clubbed together to create an underlying pool of assets. The pool is transferred in favour of a SPV (Special Purpose Vehicle) which acts as a trustee for the investor.
	The securitisation function	✓ It is the SPV's job now to structure and issue the securities on the basis of asset pool. The securities carry a coupon and an expected maturity. These are generally sold to investors through merchant bankers.
Advantages to originator	✓ The assets are shifted off the balance sheet, thus giving the originator recourse to off balance sheet funding. ✓ It converts illiquid assets to liquid portfolio. ✓ It helps in enhancing credit rating of originator.	
Advantages to investor	✓ For the investor, securitisation opens up new investment avenues. ✓ Securities are rated by Credit Rating Agencies and it becomes easier for an investor to compare risk return profile and make an informed choice.	

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. It can be Operating or Finance Lease.

S.No.	Basis	Finance Lease	Operating Lease
1.	Risk and reward	The risk and reward incident to ownership are passed on the lessee.	Risk incident to ownership belongs only to the lessor.
2.	Risk of obsolescence	The lessee bears the risk of obsolescence.	The lessor bears the risk of obsolescence.
3.	Cost of repairs	The lessor does not bear the cost of repairs, maintenance or operations.	Usually, the lessor bears the cost of repairs, maintenance or operations.
4.	Life of contract	Life of contract approximates the economic life of the asset.	Life of contract is shorter than the economic life of the asset.
Other Types of Leases			

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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. The asset is not physically exchanged but it all happen in records only.
Leveraged Lease	✓ Lessor borrows a part of purchase cost (say 80%) of the asset from the third party i.e., lender and asset so purchased is held as security against the loan. The lender is paid off from the lease rentals directly by the lessee and the surplus after meeting the claims of the lender goes to the lessor.

Short Term Sources Of Finance

Trade Credit	✓ It represents credit granted by suppliers of goods, etc., as an incident of sale. It generates automatically in the course of business and is common to almost all business operations.	
Accrued Expenses and Deferred Income	Accrued Expenses	✓ These represent liabilities which a company has to pay for the services which it has already received like wages, taxes, interest and dividends.
	Deferred income	✓ It reflects the amount of funds received by a company in lieu of goods and services to be provided in the future. Since these receipts increase a company's liquidity, so considered an important source of spontaneous finance.
Advances from Customers	✓ Manufacturers and contractors engaged in producing or constructing costly goods involving considerable length of manufacturing or construction time usually demand advance money from their customers at the time of accepting their orders.	
Commercial Paper	✓ A Commercial Paper is an unsecured money market instrument issued in the form of a promissory note. ✓ Commercial papers are issued in denominations of ₹ 5 lakhs or multiples thereof and the interest rate is generally linked to the yield on the one-year government bond.	
Treasury Bills	✓ Treasury bills are a class of Central Government Securities. Commonly referred to as T-Bills, these are issued by Government of India to meet short term borrowing requirements with maturities ranging between 14 to 364 days.	
Bank Advances	✓ It can be in the form of ❖ Short Term Loans ❖ Overdraft ❖ Clean Overdrafts	

	❖ Cash Credits ❖ Advances against goods		
Financing of Export Trade by Banks	✓ The commercial banks provide short-term export finance mainly by way of pre and post-shipment credit. Export finance is granted in Rupees as well as in foreign currency.		
	Pre-shipment finance i.e., before shipment of goods	✓ 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. Following are its various types :	
		Clean packing credit	✓ This is an advance made available to an exporter only on production of a firm export order or a letter of credit without exercising any charge or control over raw material or finished goods.
		Packing credit against hypothecation of goods	✓ Export finance is made available on certain terms and conditions where the exporter has pledgeable interest and the goods are hypothecated to the bank as security.
		Packing credit against pledge of goods	✓ Export finance is made available on certain terms and conditions where the exportable finished goods are pledged to the banks. The possession of goods so pledged lies with the bank and is kept under its lock and key.
		E.C.G.C. guarantee	✓ Any loan given to an exporter against a firm order qualifies for the packing credit guarantee issued by Export Credit Guarantee Corporation.
	Post-shipment Finance i.e., after shipment of goods.	✓ It takes the following forms :	
		Purchase/ discounting of documentary export bills	✓ Finance is provided to exporters by purchasing export bills, covering confirmed sales and backed by documents including documents of the title of goods.

		Advance against export bills sent for collection	✓ Finance is provided by banks to exporters by way of advance against export bills forwarded through them for collection.
		Advance against duty draw backs, cash subsidy, etc.	✓ To finance export losses sustained by exporters, bank advance against duty draw- back, cash subsidy, etc., receivable by them against export performance.
Inter Corporate Deposits	✓ The companies can borrow funds for a short period say 6 months from other companies which have surplus liquidity. The rate of interest on inter corporate deposits varies depending upon the amount involved and time period.		
Certificate of Deposit (CD)	Meaning	✓ The certificate of deposit is a document of title similar to a time deposit receipt issued by a bank except that there is no prescribed interest rate on such funds.	
	Advantage	✓ The main advantage of CD is that banker is not required to encash the deposit before maturity period and the investor is assured of liquidity because he can sell the CD in secondary market.	

Other Sources Of Financing

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. The Seed Capital Assistance is interest free but carries a service charge of one per cent per annum for the first five years and at increasing rate thereafter. The project cost should not exceed ₹ 2 crores and the maximum assistance under the project will be restricted to 50 percent of the required promoter's contribution or ₹ 15 lacs, whichever is lower.
Deep Discount 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.
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.

Zero Interest Fully Convertible Debentures	✓ These are fully convertible debentures which do not carry any interest. These are compulsorily and automatically converted after a specified period of time and holders thereof are entitled to new equity shares of the company at predetermined price.
Zero Coupon Bonds	✓ A Zero-Coupon Bond 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.
Option Bonds	✓ These are cumulative and non-cumulative bonds where interest is payable on maturity or periodically. Redemption premium is also offered to attract investors.
Inflation Bonds	✓ Inflation Bonds are the bonds in which interest rate is adjusted for inflation. Thus, the investor gets interest which is free from the effects of inflation.
Floating Rate Bonds	✓ This is the 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.
High Yield Bonds (or Junk Bonds)	✓ Junk Bond is a bond that is rated below investment grade by credit rating agencies. It has a low credit rating and a high risk of default.

International Financing

External Commercial Borrowings (ECB)	Meaning	✓ ECBs refer to commercial loans availed from non-resident lenders with minimum average maturity of 3 years.
	Routes	✓ External Commercial Borrowings can be accessed under two routes viz ❖ Automatic route and ❖ Approval route. ✓ Under the Automatic route, there is no need to take the RBI or Government approval whereas such approval is necessary under the Approval route.
Foreign Bonds	✓ These are debt instruments issued by foreign corporations or foreign governments. These bonds are denominated in the currency of the country where they are issued.	

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Fully Hedged Bonds		✓ In foreign bonds, the risk of currency fluctuations exists. ✓ Fully hedged bonds eliminate the risk by selling in forward markets the entire stream of principal and interest payments.
Floating Rate Notes (FRN)		✓ These are issued up to seven years maturity. ✓ Interest rates are adjusted to reflect the prevailing exchange rates.
Euro Commercial Papers (ECP)		✓ ECPs are short term money market instruments. ✓ These are for maturities less than one year. ✓ These are usually designated in US Dollars.
Foreign Euro Bonds		✓ In domestic capital markets of various countries, the Bonds issues referred to above are known by different names such as Yankee Bonds in the US, Swiss Frances in Switzerland, Samurai Bonds in Tokyo and Bulldogs in UK.
Euro Convertible Bonds		✓ A convertible bond is a debt instrument which gives the holders of the bond an option to convert the bonds into a pre-determined number of equity shares of the company. ✓ These bonds carry a fixed rate of interest and if the issuer company so desires may also include a Call Option or a Put Option.
Euro Convertible Zero Bonds		✓ These bonds are structured as a convertible bond. No interest is payable on the bonds. But conversion of bonds takes place on maturity at a pre- determined price.
Euro Bonds with Equity Warrants		✓ These bonds carry a coupon rate determined by market rates. ✓ The warrants are detachable. Pure bonds are traded at a discount.
Environmental, Social and Governance-linked bonds (ESG)		✓ These bonds carry a responsibility of the issuer company to prioritize optimal environmental, social and governance (ESG) factors. Investing in ESG bonds is considered as socially responsible investing.
	Green bonds	✓ These are the most popular ESG bonds that are issued by an institution, where the bond proceeds are used to finance "green projects".
	Social bonds	✓ These bonds finance the socially impactful projects. The projects here are related to the social concerns such as Human rights, Equality, animal welfare etc.
	Sustainability-linked bonds (SLBs)	✓ These bonds are combination of green bonds and social bonds. Their proceeds are not meant for a specific project but for general

		corporate purpose to achieve Key Performance Indicator (KPIs).	
Euro Issues by Indian Companies	✓ Indian companies are permitted to raise foreign currency resources through issue of ordinary equity shares through GDRs, ADRs and/ or issue of Foreign Currency Convertible Bonds (FCCB) to foreign investors.		
	American Depository Receipts (ADRs)	Meaning	✓ These are securities offered by non-US companies who want to list on any of the US exchange.
		Features	✓ Each ADR represents a certain number of a company's regular shares. ✓ ADRs allow US investors to buy shares of these companies without the costs of investing directly in a foreign stock exchange.
	Global Depository Receipts (GDRs)	Meaning	✓ 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.
		Features	✓ These financial instruments are used by companies to raise capital in either dollars or Euros. ✓ These are mainly traded in European countries and particularly in London.
	Indian Depository Receipts (IDRs)	✓ IDRs are similar to ADRs/ GDRs in the sense that foreign companies can issue IDRs to raise funds from the Indian Capital Market in the same lines as an Indian company uses ADRs/ GDRs to raise foreign capital. ✓ The IDRs are listed and traded in India in the same way as other Indian securities are traded.	

Contemporary Sources Of Funding

Crowd funding	✓ Crowdfunding means raising money for an individual or organisation from a group of people to fund a project, typically via internet (social media and crowdfunding websites). It generally

2 SOURCES OF FINANCE

	involves collecting funds from family, friends, strangers, corporates and many more in exchange of equity (known as Equity funding), loans (known as P2P lending) or nothing at all (i.e. donation).
Peer-to-Peer P2P) lending	✓ It is that category of crowdfunding where lenders match with the borrowers in order to provide unsecured loans through online platform. ✓ It involves certain risk of defaults.
Start-up funding	✓ As a start-up, it is difficult to manage loans from bank, leaving crowdfunding as one of the sources of finance. Through crowdfunding, a start-up company can raise money from large group of people.
Donation-based Crowdfunding	✓ It is a source of finance where large group of people donate money as a charity for some cause with no expectation of any ownership or debt. Example : Ketto (used for donation against medical needs).

Nobody is going to protect you or save you.
Get up, work hard and be your own hero.

3 COST OF CAPITAL

Cost Of Capital

Meaning	✓ Cost of capital is the return expected by the providers of capital (i.e. shareholders, lenders and the debt-holders) to the business as a compensation for their contribution to the total capital. ✓ It is also known as 'cut-off' rate, 'hurdle rate', 'minimum rate of return' etc.
Significance	✓ Evaluation of investment options by discounting
	✓ Performance Appraisal of the projects
	✓ Designing of optimum credit policy

Its not over when you lose,
its over when you quit.

4 LEVERAGE

Business Risk Vs. Financial Risk

S. No.	Basis	Business Risk	Financial Risk
1.	Meaning	Business Risk refers to the risk associated with the firm's operations.	Financial Risk refers to the additional risk placed on the firm's shareholders as a result of use of debt.
2.	Type of cost	It occurs due to fixed operating cost.	It occurs due to fixed financing cost.
3.	Avoidable or Unavoidable	Business Risk is generally unavoidable.	Financial Risk can be avoided by not using the source of finance involving fixed payment.
4.	Higher Risk	Higher the fixed operating cost, higher the Business Risk.	Companies that issue more debt instruments would have higher financial risk.

Leverage

Meaning	✓ Leverage refers to the ability of a firm in employing long term funds having a fixed cost, to enhance returns to the owners. A firm with a lot of debt in its capital structure is said to be highly levered.
Relation between variables	✓ In financial analysis, it represents the influence of one financial variable over some other related financial variable. These financial variables may be costs, output, sales revenue, Earnings Before Interest and Tax (EBIT), Earning per share (EPS) etc.

Operating Leverage

✓ The operating leverage may also be defined as "the firm's ability to use fixed operating cost to magnify the effects of changes in sales on its earnings before interest and taxes."

Financial Leverage

Meaning	✓ Financial leverage (FL) may be defined as 'the use of funds with a fixed cost in order to increase earnings per share.'
Financial Leverage as 'Trading on Equity'	✓ A firm is known to have a positive leverage when its earnings are more than the cost of debt. If earnings are equal to or less than cost of debt, it will be an unfavourable leverage. ✓ When the quantity of fixed cost fund is relatively high in comparison to equity capital it is said that the firm is "trading on equity".

4 LEVERAGE

Financial Leverage as a 'Double edged Sword'	✓ On one hand, when cost of 'fixed cost fund' is less than the return on investment, financial leverage will help to increase return on equity and EPS. ✓ However, when cost of debt will be more than the return it will affect return of equity and EPS unfavourably and as a result firm can be under financial distress. This is why financial leverage is known as "double edged sword".

Combined Leverage

✓ Combined leverage maybe defined as the potential use of fixed costs, both operating and financial, which magnifies the effect of sales volume change on the earning per share of the firm.

Time = life; therefore, waste your time and it's waste of your life, or master your time and master your life."

5 CAPITAL STRUCTURE

CA Rahul Garg
Gold Medalist (AIR 1)

Capital Structure

Meaning	✓ Capital structure is the combination of capitals from different sources of finance.
Significance	✓ The capital structure decisions are very important in financial management as they influence debt - equity mix which ultimately affects shareholders return and risk. ✓ Therefore, such a pattern of capital structure must be chosen which ❖ minimises cost of capital and ❖ maximises the owners' return.

Fundametal Principles Governing Capital Structure

Cost Principle	✓ An ideal pattern or capital structure is one that minimises cost of capital structure and maximises earnings per share (EPS).
Risk Principle	✓ Reliance is placed more on common equity for financing capital requirements than excessive use of debt.
Control Principle	✓ 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.
Flexibility Principle	✓ 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. ✓ While debt could be interchanged (if the company is loaded with a debt of 18% and funds are available at 15%, it can return old debt with new debt, at a lesser interest rate), but the same option may not be available in case of equity investment.

Optimal Capital Structure

✓ Objective of financial management is to maximize wealth. For this purpose, following analysis should be done:	
EBIT - EPS-MPS Analysis	✓ We have to choose a capital structure which maximizes market price per share. For this, we start with same EBIT for all capital structures and calculate EPS and then MPS.
EBIT-EPS Indifference Point Analysis	✓ The objective of this analysis is to find the EBIT level that will equate EPS regardless of the financing plan chosen.

5 CAPITAL STRUCTURE

Financial Break Even Point Analysis	✓ Financial break-even point is the minimum level of EBIT needed to satisfy all the fixed financial charges i.e. interest and preference dividend.

Over-Capitalisation

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.
Causes	✓ Raising more money through issue of shares than company can employ profitably. ✓ Borrowing huge amount at higher rate than rate at which company can earn. ✓ Excessive payment for the acquisition of fictitious assets such as goodwill etc. ✓ Wrong estimation of earnings and capitalisation.
Consequences	✓ Considerable reduction in the rate of dividend and interest payments. ✓ Reduction in the market price of shares. ✓ Resorting to "window dressing". ✓ Some companies may opt for reorganization.

Under-Capitalisation

Meaning	✓ It is a state, when its actual capitalisation is lower than its proper capitalisation as warranted by its earning capacity.
Consequences	✓ The dividend rate will be higher in comparison to similarly situated companies. ✓ Market value of shares will be higher than other similar companies because their earning rate being considerably more than the prevailing rate on such securities.
Effects	✓ It encourages acute competition. ✓ High rate of dividend encourages the workers' union to demand high wages. ✓ Invite more government control and regulation on the company.

"The bad news is time flies.
The good news is you're
the pilot"

6 THEORIES OF CAPITAL STRUCTURE

Capital Structure Theories

Theories	✓ Net Income (NI) approach ✓ Traditional approach ✓ Net Operating Income (NOI) approach ✓ Modigliani-Miller (MM) approach
Assumptions	✓ There are only two kinds of funds used by a firm i.e. debt and equity. ✓ The total assets of the firm are given. ✓ The degree of leverage can be changed by selling debt to purchase shares or selling shares to retire debt. ✓ Taxes are not considered. ✓ The payout ratio is 100%. ✓ The firm's total financing remains constant. ✓ Business risk is constant over time.

Trade-Off Theory

Concept	✓ An important purpose of the trade-off theory of capital structure is to explain the fact that corporations usually are financed partly with debt and partly with equity. ✓ This theory basically entails offsetting the costs of debt against the benefits of debt. It primarily deals with the two concepts; cost of financial distress and agency costs.
Working	✓ It states that there is an advantage to financing with debt i.e. the tax benefits of debt and there is a cost of financing with debt i.e. the costs of financial distress.
Financial Distress Cost	✓ The direct cost of financial distress refers to the cost of insolvency of a company. Once the proceedings of insolvency start, the assets of the firm may be needed to be sold at distress price, which is generally much lower than the current values of the assets.
Agency Costs	✓ The firms may often experience a dispute of interests among the management of the firm, debt holders and shareholders. These disputes generally give birth to agency problems that in turn give rise to the agency costs.

Pecking Order Theory

Meaning	✓ This theory states that firms prefer to issue debt when they are positive about future earnings. Equity is issued when they are doubtful and internal finance is insufficient.

6 THEORIES OF CAPITAL STRUCTURE

Cost of Debt Vs. Cost of Equity	✓ Debt is cheaper than both internal and external equity because of interest. ✓ Further internal equity is less costly than external equity particularly because of no transaction/ issue cost, no tax etc.
Sources for raising the funds	✓ Managers may use various sources for raising of fund in the following order : ❖ Managers first choice is to use internal finance. ❖ In absence of internal finance, they can issue debt. ❖ They may issue new equity shares as a last option.

"Never lose hope. Storms make people stronger and never last forever."

7 CAPITAL BUDGETING

Capital Budgeting

Meaning	✓ Investment decision is concerned with optimum utilization of funds to maximize the wealth of the organization and in turn the wealth of its shareholders.	
Purpose	The capital budgeting decisions are important, crucial and critical business decisions due to the following reasons: ✓ To invest in a project or projects, a substantial capital investment is required. It is therefore necessary for an entity to make such decisions after a thorough study and planning. ✓ The capital budgeting decision has its effect over a long period of time. ✓ Most of the investment decisions are irreversible. Once the decision is implemented, it is not possible to reverse the decision. ✓ It is quite difficult to estimate all the benefits or costs relating to a particular investment decision.	
Types of Decisions on the basis of Firm's Existence	Replacement & Modernisation decisions	✓ These decisions aim to improve operating efficiency and to reduce cost.
	Expansion decisions	✓ Existing successful firms may experience growth in demand of their product line and accordingly expansion.
	Diversifi-cation decisions	✓ These decisions require evaluation of proposals to diversify into new product lines, new markets etc. for reducing the risk of failure by dealing in different products or markets.
Types of Decisions On the basis of decision situation	Mutually exclusive decisions	✓ The decisions are said to be mutually exclusive when the acceptance of one proposal will exclude the acceptance of other alternative proposals.
	Accept-reject decisions	✓ The accept-reject decisions occur when proposals are independent and do not compete with each other.
	Contingent decisions	✓ The contingent decisions are dependable proposals. The investment in one proposal requires investment in one or more other proposals.

7 CAPITAL BUDGETING

Capital Budgeting Techniques

Payback Period	
Meaning	✓ It is the time required to recover the initial cash outflow.
Advantages	✓ It is easy to compute. ✓ It is easy to understand. ✓ The length of the payback period can also serve as an estimate of a project's risk.
Limitations	✓ It ignores the time value of money. ✓ It ignores cash flows after the payback period. ✓ It may cause organizations to place too much emphasis on short payback periods.
Accounting or Average (Book) Rate of Return (ARR)	
Meaning	✓ It measures the average annual net income of the project as a percentage of the investment.
Advantages	✓ It uses readily available data routinely generated for financial reports. ✓ This method is commonly used to evaluate performance. ✓ The calculation under this method considers all net incomes over the entire life of the project and provides a measure of the investment's profitability.
Limitations	✓ It ignores the time value of money. ✓ The technique uses accounting numbers that are dependent on the organization's choice of accounting procedures, and different accounting procedures. ✓ The method uses net income rather than cash flows.
Net Present Value Technique (NPV)	
Meaning	✓ The net present value method uses a specified discount rate to bring all subsequent net cash inflows after the initial investment to their present values.
Advantages	✓ NPV method takes into account the time value of money. ✓ The whole stream of cash flows is considered.
Limitations	✓ It involves difficult calculations. ✓ Accuracy of NPV depends on accurate estimation of certain factors which may be quite difficult to estimate accurately in practice.
Profitability Index/ Desirability Factor/ Present Value Index Method (PI)	
Meaning	✓ In this method, the present value of cash inflows is divided by the present value of cash outflows.
Advantages	✓ This method uses the concept of time value of money.

	✓ Since the present value of cash inflows is divided by the present value of cash outflow, it is a relative measure of a project's profitability.
Limitations	✓ It fails as a guide in resolving capital rationing where projects are indivisible. ✓ Once a single large project with high NPV is selected, possibility of accepting several small projects which together may have higher NPV than the single project is excluded.
Internal Rate of Return Method (IRR)	
Meaning	✓ It is the discount rate that equates the present value of expected net cash flows with the initial cash outflow.
Advantages	✓ This method makes use of the concept of time value of money. ✓ All the cash flows in the project are considered. ✓ IRR is easier to use as instantaneous understanding of desirability can be determined by comparing it with the cost of capital.
Limitations	✓ The calculation process is tedious. ✓ It creates a peculiar situation if we compare two projects with different inflow/ outflow patterns. ✓ It is assumed that under this method all the future cash inflows of a proposal are reinvested at a rate equal to the IRR, which is not correct.
Modified Internal Rate of Return (MIRR)/ Terminal Value method	
✓ The MIRR addresses some of the deficiencies of IRR e.g., it eliminates multiple IRR rates; it addresses the reinvestment rate issue and produces results which are consistent with the Net Present Value method.	
Discounted Payback Period Method	
✓ Discounted Payback Period is the time required for cumulative present value of cash inflows to recover the present value of cash outflows of the project.	

"When I was young, I observed that nine out of ten things I did were failures. So I did ten times more work."

8 ESTIMATION OF WORKING CAPITAL

Meaning And Concept Of Working Capital

Meaning	✓ Working capital is the difference between the current assets and current liabilities.	
Working Capital Management	✓ Working Capital Management is process which is designed to ensure that an organization operates efficiently by monitoring & utilizing its current assets and current liabilities to the best effect.	
Concept of Working Capital	Value	✓ Gross working capital refers to the firm's investment in current assets. ✓ Net working capital refers to the difference between current assets and current liabilities.
	Time	✓ Permanent working capital refers to the base working capital, which is the minimum level of investment in the current assets that is carried by the entity at all times to carry its day-to-day activities. ✓ Temporary working capital refers to that part of total working capital, which is required by an entity in addition to the permanent working capital.

Scope Of Working Capital Management

Liquidity and Profitability	✓ For uninterrupted and smooth functioning of the day to day business of an entity, it is important to maintain liquidity of funds evenly. ✓ But, while maintaining liquidity the cost aspect needs to be borne in mind. As organization may loose the opportunity to earn better return. ✓ Hence, a trade-off is required between the liquidity and profitability which increases the profitability without disturbing the day to day functioning.	
Investment and Financing	Concept	✓ Investment in working capital is concerned with the level of investment in the current assets. It gives the answer of 'How much' fund to be tied in to achieve the organisation objectives (i.e. Effectiveness of fund). ✓ Financing decision is concerned with the arrangement of funds to finance the working capital. It gives the answer 'Where from fund to be sourced' at lowest cost possible (i.e. Economy).

	Approaches of working capital investment	Aggressive	✓ Investment is kept at minimal in current assets ie. entity holds lower level of inventory, follows strict credit policy, keeps less cash balance.
		Conservative	✓ Investment is kept at highest in current assets ie. entity keeps higher inventory level, follows liberal credit policies and keeps high cash balance.
		Moderate	✓ This approach is in between the above two approaches where moderate investment is made in current assets.

"Never let small minds convince you that your dreams are too big."

9 DEBTOR'S MANAGEMENT

CA Rahul Garg Gold Medalist (AIR 1)

Management Of Receivables

Meaning	✓ Management of receivables refers to planning and controlling of 'debt' owed to the firm from customer on account of credit sales.
Objective	✓ It's basic objective is to optimise the return on investment on these assets.

Financing Receivables

Pledging	Meaning	✓ This refers to the use of a firm's receivable to secure a short term loan. ✓ The lender scrutinizes the quality of the accounts receivables, selects acceptable accounts, creates a lien on the collateral and fixes the percentage of financing receivables.
Factoring	Meaning	✓ This refers to outright sale of accounts receivables to a factor or a financial agency. A factor is a firm that acquires the receivables of other firms.
	Advantages	✓ The biggest advantages of factoring are the immediate conversion of receivables into cash and predicted pattern of cash flows. ✓ It can help a company needing liquidity without creating a net liability on its financial condition. ✓ It is a flexible financial tool providing efficient record keepings & effective management of the collection process.
Forfaiting	Meaning	✓ In this, a financial institution or bank buys the trade bills (invoices) or trade receivables from exporters of goods or services, where the exporter relinquish his right to receive payment from importer.
	Functioning	✓ Exporter sells goods or services to an overseas buyer. ✓ The overseas buyers i.e. the importer on the basis trade bills and import documents draws a letter of credit through its bank (known as importer's bank). ✓ The exporter on receiving the letter of credit approaches to its bank (known as exporter's bank). ✓ The exporter's bank buys the letter of credit 'without recourse basis' and provides the exporter the payment for the bill.

9 DEBTOR'S MANAGEMENT

Factoring Vs. Bill Discounting

S. No.	Basis	Factoring	Bill Discounting
1.	Other name	Factoring is called as "Invoice Factoring".	Bills discounting is known as 'Invoice discounting."
2.	Parties	In Factoring, the parties are known as the client, factor and debtor.	In Bills discounting, they are known as drawer, drawee and payee.
3.	Purpose	Factoring is a sort of management of book debts.	Bills discounting is a sort of borrowing from commercial banks.
4.	Relevant statute	For factoring, there is no specific act.	In the case of bills discounting, the Negotiable Instruments Act is applicable.

Some Other Aspects Of Receivable Management

Alternative Payment Strategies	✓ The following alternative modes of payment may also be used along with traditional methods like Cheque Book etc. :	
	Direct debit	✓ Authorization for the transfer of funds from the purchaser's bank account.
	IVR	✓ Integrated Voice Response system uses human operators and a computer-based system to allow customers to make payment over phone.
	Collection by a third party	✓ The payment can be collected by an authorized external firm. Banks may also act as collecting agents of their customers and directly deposit the collections in customers' bank accounts.
	Lock Box Processing	✓ Under this system, an outsourced partner captures cheques and invoice data and transmits the file to the client firm for processing in that firm's systems.
	Payments via Internet	✓ Payment can be made via internet using fund transfer methods like RTGS, NEFT, IPMS, UPIs, App based payment like Paytm, Phone Pe, etc.
Ageing Schedule	Meaning	✓ When receivables are analysed according to their age, the process is known as preparing the ageing schedules of receivables.
	Purpose	✓ The purpose of classifying receivables by age groups is to have a closer control over the quality of individual accounts.

		✓ To ascertain the condition of receivables for control purposes, it may be considered desirable to compare the current ageing schedule with an earlier ageing schedule in the same firm and also to compare this information with the experience of other firms.

Surround yourself with those who are hungry for success.

10 TREASURY AND CASH MANAGEMENT

Treasury And Cash Management

✓ Treasury management is defined as 'the corporate handling of all financial matters, the generation of external and internal funds for business, the management of currencies and cash flows and the complex, strategies, policies and procedures of corporate finance.'

Functions Of Treasury Department

Cash Management	✓ It involves efficient cash collection process and managing payment of cash both inside the organisation and to third parties.
Currency Management	✓ Treasury department manages the foreign currency risk exposure of the company. The use of matching receipts and payments in the same currency will save transaction costs. If risks are to be minimized then forward contracts can be used either to buy or sell currency forward.
Fund Management	✓ Treasury department is responsible for planning and sourcing the company's short, medium and long-term cash needs. They also facilitate temporary investment of surplus funds by mapping the time gap between funds inflow and outflow.
Banking	✓ It is important that a company maintains a good relationship with its bankers. Treasury department carries out negotiations with bankers and act as the initial point of contact with them.
Corporate Finance	✓ Treasury department is involved with both acquisition and divestment activities within the group.

Management Of Cash

Insights	✓ Management of cash is an important function of the finance manager. It is concerned with the managing of : ❖ Cash flows into and out of the firm; ❖ Cash flows within the firm; and ❖ Cash balances held by the firm	
Need for Cash	✓ The following are three basic considerations in determining the amount of cash or liquidity as have been outlined by Lord Keynes :	
	Transaction need	✓ Cash facilitates the meeting of the day-to-day expenses and other debt payments.
	Speculative need	✓ Cash may be held in order to take advantage of profitable opportunities that may present themselves and which may be lost for want of ready cash/ settlement.

	Precautionary need	✓ Cash may be held to act as cushion for providing safety against unexpected events.
Cash Budget	✓ Cash Budget is the most significant device to plan for and control cash receipts and payments. This represents cash requirements of business during the budget period.	

Accelerating Cash Collections

Different Kinds of Float	
The term float is used to refer to the periods that affect cash as it moves through the different stages of the collection process. Four kinds of float with reference to management of cash are:	
Billing Float	✓ The time between the sale and the mailing of the invoice is the billing float.
Mail Float	✓ This is the time when a cheque is being processed by post office, messenger service or other means of delivery.
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.
Bank processing float	✓ This is the time from the deposit of the cheque to the crediting of funds in the seller's account.

Concentration Banking

- ✓ In concentration banking, the company establishes a number of strategic collection centres in different regions instead of a single collection centre at the head office.
- ✓ This system reduces the period between the time a customer mails in his remittances and the time when they become spendable funds with the company.
- ✓ Payments received by the different collection centers are deposited with their respective local banks which in turn transfer all surplus funds to the concentration bank of head office.

Lock Box System

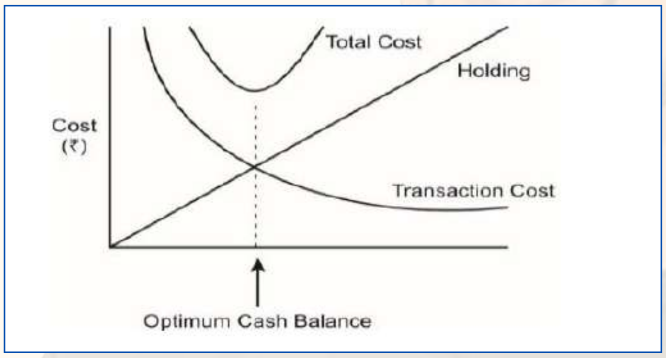
- ✓ Under this arrangement, the company rents the local post-office box and authorizes its bank at each of the locations to pick up remittances in boxes.
- ✓ Customers are billed with instructions to mail their remittances to the lock boxes. The bank picks up the mail several times a day and deposits the cheques in the company's account.

Determining The Optimum Cash Balance

✓ A firm should maintain optimum cash balance to cater to the day-to-day operations i.e. neither too much (to avoid any opportunity cost) nor too little cash balance (to settle day to day payments).

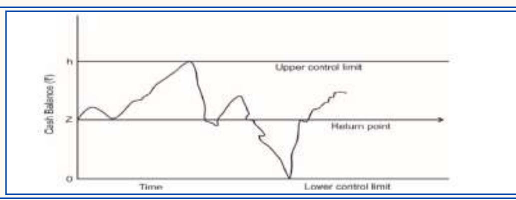
William J. Baumol's Economic Order Quantity Model (1952)

✓ According to this model, optimum cash level is that level of cash where the carrying costs and transactions costs are the minimum.

Assumptions	✓ Cash needs of the firm are known with certainty. ✓ Cash is used uniformly over a period of time and it is known with certainty. ✓ The holding cost is known and it is constant. ✓ The transaction cost also remains constant.
Diagram	

Miller-Orr Cash Management Model (1966)

✓ According to this model, the net cash flow is completely stochastic. When changes in cash balance occur randomly, the application of this control theory serves a useful purpose.

Process	✓ This model is designed to determine the time and size of transfers between an investment account and cash account. In this model, control limits are set for cash balances. These limits may consist of h as upper limit, z as the return point; and zero as the lower limit. ✓ When the cash balance reaches the upper limit, the transfer of cash equal to h - z is invested in marketable securities account. ✓ When it touches the lower limit, a transfer from marketable securities account to cash account is made. ✓ When cash balance stays between (h, z) and (z, 0) i.e. high and low limits, no transactions between cash and marketable securities account is made.
Diagram	

10 TREASURY AND CASH MANAGEMENT

Recent Developments In Cash Management

Electronic Cash Management System
✓ Most of the cash management systems now-a-days are electronically based, since 'speed' is the essence of any cash management system. ✓ Electronic-scientific cash management results in: ❖ Significant saving in time. ❖ Increase in interest earned & decrease in interest expense. ❖ Reduces paper-work & hence manpower. ❖ Greater accounting accuracy as it allows easy detection of book-keeping errors. ❖ Speedy conversion of various instruments into cash. ❖ Making available funds wherever required. ❖ Produces faster electronic reconciliation.
Virtual Banking
✓ Virtual banking denotes the provision of banking and related services through extensive use of information technology without direct recourse to the bank by the customer. ✓ Electronic Clearing Service Scheme (ECSS), UPI, Real Time Gross Settlement System (RTGS), are some of the significant developments.

Management Of Marketable Securities

✓ As the working capital needs are fluctuating, it is possible to park excess funds in some short-term securities, which can be liquidated when need for cash is felt. The selection of securities should be guided by three principles.	
Safety	✓ Return and risks go hand in hand. As the objective in this investment is ensuring liquidity, minimum risk is the criterion of selection.
Maturity	✓ Matching of maturity and forecasted cash needs is essential. Since this is for temporary excess funds, short term securities are preferred.
Marketability	✓ It refers to the convenience, speed and cost at which a security can be converted into cash. If the security can be sold quickly without loss of time and price, it is highly liquid or marketable.

You have three choices: give up,
give in or give it everything you have got.

Financing Of Working Capital

Spontaneous Sources	✓ Spontaneous sources of finance are those which naturally arise in the course of business operations like Trade credit, bills payable, accrued expenses etc.
Negotiated Sources	✓ These are specifically negotiated with lenders, commercial banks, financial institutions etc. The finance manager has to be very careful while selecting a particular source, or a combination thereof for financing of working capital.

Forms Of Bank Credit

Cash Credit	✓ This facility will be given by the banker to the customers by giving certain amount of credit facility on continuous basis. The borrower will not be allowed to exceed the limits sanctioned by the bank.
Bank Overdraft	✓ It is a short-term borrowing facility made available to the companies in case of urgent need of funds. The banks will impose limits on the amount they can lend. When the borrowed funds are no longer required, they can quickly and easily be repaid.
Bills Discounting	✓ The Company which sells goods on credit will normally draw a bill on the buyer who will accept it and sends it to the seller of goods. The seller, in turn discounts the bill with his banker.
Bills Acceptance	✓ To obtain finance under this type of arrangement, a company draws a bill of exchange on bank. The bank accepts the bill thereby promising to pay out the amount of the bill at some specified future date.
Line of Credit	✓ Line of Credit is a commitment by a bank to lend a certain amount of funds on demand specifying the maximum amount.
Letter of Credit	✓ It is an arrangement by which the issuing bank on the instructions of a customer or on its own behalf undertakes to pay or accept or negotiate or authorizes another bank to do so against stipulated documents.
Bank Guarantees	✓ Bank guarantee is one of the facilities that the commercial banks extend on behalf of their clients in favour of third parties who will be the beneficiaries of the guarantees.

The difference between ordinary and extraordinary is that little extra.

12
RATIO ANALYSIS

Users And Objective Of Financial Analysis

User	Objective	Ratios Usesd
Shareholders	✓ Being owners of the organization, they are interested to know about profitability and growth of the organization.	✓ Mainly Profitability Ratio [In particular Earning per share (EPS), Dividend per share (DPS), Price Earnings (P/E), Dividend Payout ratio (DP)]
Investors	✓ They are interested to know overall financial health of the organisation particularly future perspective of the organisations.	✓ Profitability Ratios ✓ Capital structure Ratios ✓ Solvency Ratios ✓ Turnover Ratios
Lenders	✓ They will keep an eye on the safety perspective of their money lended to the organization.	✓ Coverage Ratios ✓ Solvency Ratios ✓ Turnover Ratios ✓ Profitability Ratios
Creditors	✓ They are interested to know liability position of the organisation particularly in short term.	✓ Liquidity Ratios ✓ Short term solvency Ratios/ Liquidity Ratios
Employees	✓ They will be interested to know the overall financial wealth of the organisation and compare it with competitor company.	✓ Liquidity Ratios ✓ Long term solvency Ratios ✓ Profitability Ratios ✓ Return of investment
Regulator / Government	✓ They will analyse the financial statements to determine taxations and other details payable to the government.	✓ Profitability Ratios

Limitations Of Financial Ratios

Diversified product lines	✓ Many businesses operate a large number of divisions in quite different industries. In such cases, ratios calculated on the basis of aggregate data cannot be used for inter-firm comparisons.
Financial data are badly distorted	✓ Historical cost values may be substantially different from true values (due to inflation etc). Such distortions of financial data are also carried in the financial ratios.

Seasonal factors may also influence financial data.	✓ The ratios in such case produce biased picture. Year-end picture may not be the average picture of the business.
Window Dressing	✓ The business may make some year-end adjustments in financial ratios like current ratio, debt-equity ratio etc. Such window dressing can change the character of financial ratios.
Differences in accounting policies and period	✓ It can make the accounting data of two firms non-comparable as also the accounting ratios.
No standard set of ratios for comparison	✓ If a firm desires to be above the average, then industry average becomes a low standard. On the other hand, for a below average firm, industry averages become too high a standard to achieve.

Financial Analysis

Horizontal Analysis	✓ When financial statements of one year are analysed and interpreted after comparing with another year or years, it is known as horizontal analysis.
Vertical Analysis	✓ When financial statement of single year is analyzed, then it is called vertical analysis. ✓ This analysis is useful in inter firm comparison. Every item of Profit and loss account is expressed as a percentage of gross sales, while every item on a balance sheet is expressed as a percentage of total assets held by the firm.

> I gave myself permission to make mistakes.
> I wouldn't ever give myself permission not to try.

13 DIVIDEND DECISIONS

Dividend

Meaning	✓ Dividend is that part of profit after tax which is distributed to the shareholders of the company.	
Significance of dividend policy	Long Term Financing Decision	✓ Under this purview, the decision is based on the following: ❖ Whether the organization has opportunities in hand to invest the amount of profits, if retained? ❖ Whether the return on such investment (ROI) will be higher than the expectations of shareholders i.e. Ke?
	Wealth Maximization Decision	✓ Management should develop a dividend policy which divides net earnings into dividends and retained earnings in an optimum way so as to achieve the objective of wealth maximization for shareholders.

Forms Of Dividend

Cash dividend	✓ It is the most common form of dividend. Cash here means cash, cheque, warrant, demand draft, or directly through Electronic Clearing Service (ECS) but not in kind.		
Share Repurchase	✓ A share repurchase is transaction in which company buys back its own shares using corporate cash.		
Stock Dividend (Bonus Shares)	Meaning	✓ It is distribution of shares in lieu of cash dividend to existing shareholders. ✓ Such shares are distributed proportionately thereby retaining proportionate ownership of the company.	
	Advantages	To Share Holders	✓ Policy of paying fixed dividend per share will increase total cash dividend of the shareholders in future. ✓ Bonus shares improve liquidity in the hands of shareholders as bonus shares leads to breaking down of higher priced shares into lower priced shares.
		To Company	✓ Conservation of cash for meeting profitable investment opportunities. ✓ Suitable in case of cash deficiency.

13 DIVIDEND DECISIONS

	Limitations	To Share Holders	✓ Stock dividend does not affect the wealth of shareholders and therefore it has no value for them. ✓ It merely divides the company's ownership into a large number of share certificates.
		To Company	✓ Stock dividends are more costly to administer than cash dividend.

Determinants Of Dividend Decisions

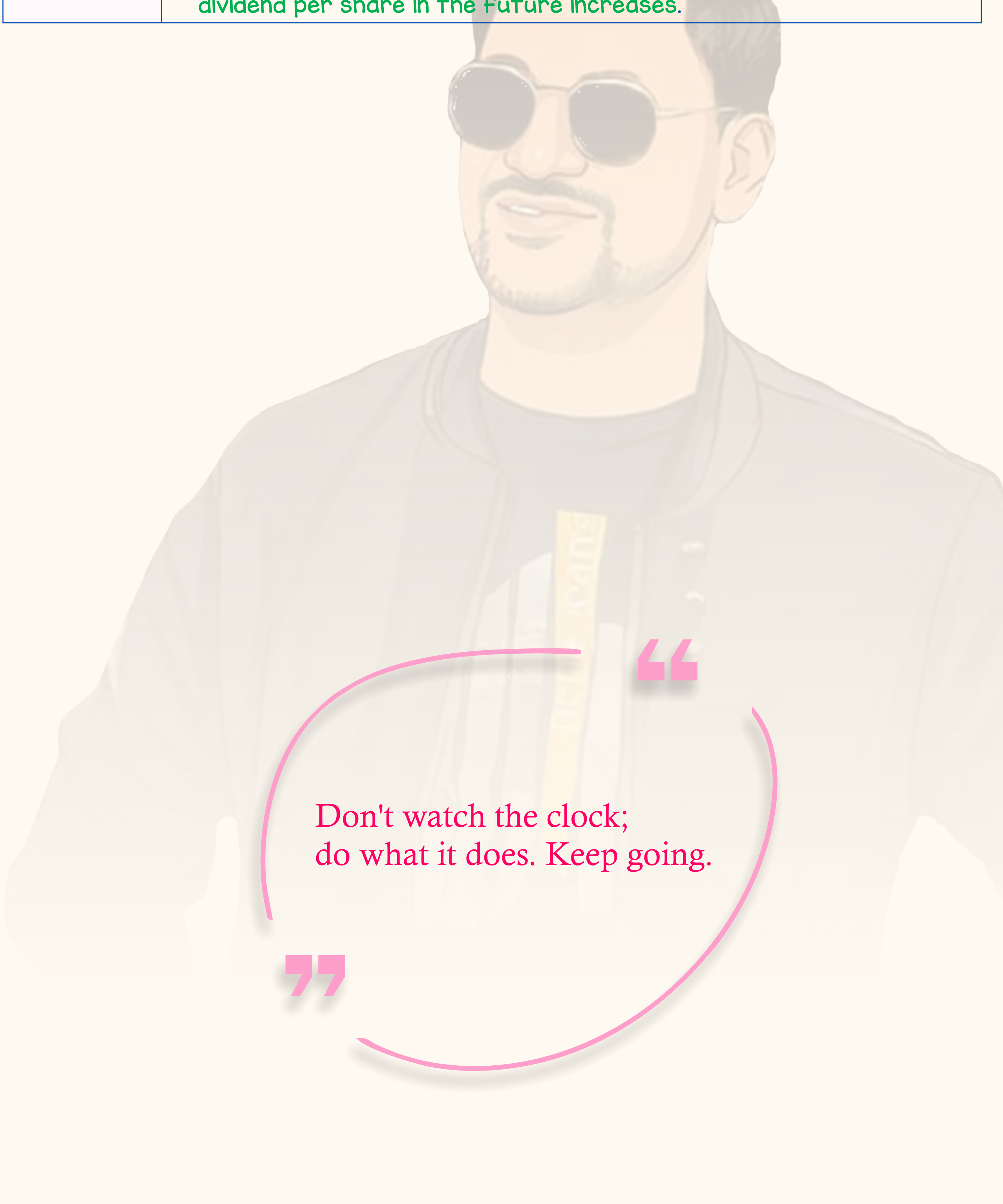
Availability of funds	✓ If the business is in requirement of funds, then retained earnings could be a good source. Since it saves the floatation cost and further the control will not be diluted as in case of fresh issue of share capital.
Cost of capital	✓ If the financing requirements can be financed through debt, then it should be preferred to distribute more dividend but if the financing is to be done through fresh issue of equity shares, it is better to use retained earnings as much as possible.
Capital structure	✓ An optimum Debt equity ratio should also be under consideration for the dividend decision.
Stock price	✓ Generally, higher dividends increase value of shares and low dividends decrease it.
Investment opportunities in hand	✓ The dividend decision is also affected, if there are investment opportunities in hand. In such case, the company may prefer to retain more from the earnings.
Expectation of shareholders	✓ Generally, the investor prefers current dividend more than the future growth.
Legal constraints	✓ Provisions of the Companies Act, 2013 regarding the declaration of dividend, are also to be complied with.

Stock Splits

Meaning	✓ Stock split means splitting one share into many, say, one share of ₹ 500 in to 5 shares of ₹ 100. It makes the share affordable to small investors.
Reason	✓ Stock splits is a tool used by the companies to regulate the prices of shares i.e. if a share price increases beyond a limit, it may become less tradable.

Share Buyback

Meaning	✓ Share buyback, means buying or repurchasing own shares by the company resulting into decrease in share capital of the company.
Insights	✓ Share buyback is also a form of shareholders' dividend. As the number of circulating shares in the market fall, amount of dividend per share in the future increases.



Don't watch the clock;
do what it does. Keep going.

CA NOTE HUB

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