

Financial Management.

Meaning: ⇒ Finance,
⇒ fund,
⇒ financial Management.

Financial Management- refers to the management of flow of funds in the firm. It deals with the financial decision making of the firm. It is mainly concerned with the timely procurement of adequate finance from various sources and its utmost effective utilization of organizational goal.

Definition:

Solomon — "Financial Management is concerned with the efficient use of an important economic resource, namely capital funds".

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2. Scope of Financial Management:

1. Traditional approach.

(i) procuring funds to the corporates to meet their financial needs.

(ii) then it's fallen into, the merger, acquisition, consolidation and reorganization of the firms.

(iii) ~~(iii)~~ In the initial stage the FM is dominated by the traditional approach.

(iv) This approach is failed to consider the routine managerial problems relating to finance of a firm.

(v) This approach is ignored cost of capital and optimum capital structure.

~~one to two~~

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Modern approach: After 1950's the approach of financial mgt ~~is~~ got revolution.

- (i) It focuses on 'wise use of fund'
- (ii) determining the size of the business, shaping the profitability, amount of risk taking, selecting the asset mix, determination of optimum capital structure, etc.
- (iii) the decisions ~~are~~ have taken on the basis of optimum use of funds.

Objectives.

1. Profit maximization:—

It ~~stands~~ highlights the fact that all decisions - financing, dividend and investment, should result in profit maximization.

favours

- (i) yard stick
- (ii) efficient utilization of resources.
- (iii) rate of return is the measurement of profit.
- (iv) It maximizes the social & economic welfare.

Criticizem

- (i) Ambiguity \Rightarrow different means of terms & narrations. so confusion.
- (ii) Time value of money: \Rightarrow value of income in the different periods.
- (iii) Risk factor.

② Wealth Maximization.

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⇒ Shareholder's wealth.

⇒ net present value of the firm.

- (i) financing decision.
 - (ii) investment decision.
 - (iii) dividend decision.
- } will affect the present value of the firm.

inc. ⇒ net present value ↑ means value of the firm ↑.

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inc ⇒ market price of the shares ↑.

③ ^{To} Return maximization. ⇒ Shareholders, Creditors & employees.

④ To provide support for decision making.

⑤ To manage risks.

⑥ ~~to~~ To use resources efficiently & effectively.

⑦ provide a supportive control environment.

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Functions of Financial Managers.

① Forecasting Financial Requirements.

⇒ funds required for long term purpose ⇒ investment in fixed assets.

⇒ fund requirements for working capital.

⇒ the fund requirements are forecasting by the use of

Wednesday 14

Budgetary Control techniques.

② Financing Decision:

⇒ determine the sources of funds,

⇒ they have to worked out various mix of sources.

⇒ has to maintain proper balance of long-term funds and short-term funds.

⇒ maintain the cost of capital.

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③ Investment Decision:

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⇒ Selection of assets to be invested,

⇒ Rationing the resources and allocate among the competing investment alternatives.

⇒ long-term investment decision.
⇒ fixed assets.

⇒ Short term investment decision
⇒ working capital management.

④ Dividend Decision:

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⇒ Declaration of dividend

⇒ Dividend payment ratio.

⇒ preference of the equity shareholders

⑤ Deciding overall objectives:

⇒ determine the overall goal

of finance department,

⇒ It helps in effective financial planning.

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⑥ Supply of funds to all parts of the organization.

⇒ cash management

⇒ cash disbursement policies.

⑦ Evaluating financial performance.

⇒ he should constantly review the financial performances

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⇒ ROI Chart is useful in this regard.

ROI ⇒ Return on Investment.

⇒ Analysis of financial performance of the firm.

⑧ Financial negotiations

He may spend his time with the financial institutions & banks for financial negotiations.

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Financial Planning

Meaning: -

Financial planning refers to the planning function related to financial requirements of a firm. \Rightarrow Shortage and excess of funds.

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purpose - arrange the require funds in all forms.

Scope of financial planning:

① Determining financial objectives.

⇒ identify, define and determine the financial objectives.

② Determining the capital requirements:

⇒ proper estimate of capital. Monday 3

⇒ capital requirements is based on the type of business & ~~and~~ size of the business.

⇒ assets required

⇒ need for purchase of fixed & current assets.

⇒ Budget is part of planning. Large range plans for fixed assets.

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- ⇒ estimatory working capital
- ⇒ plan for contingencies,
- ⇒ expansion & restructuring programmes also to be considered.

③ Deciding upon capital mix!

- ⇒ right proportion of ~~capital~~ debt & equity.

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- ⇒ amount of risk involved in it.
- ⇒ there should be sufficient earnings to pay interest.
- ⇒ fixed rate of dd to be given to pref. shares.
- ⇒ DD ~~to~~ has to be paid from profits to equities.



④ Formulating policies and procedures:

⇒ Policies formulating regarding financial activities & working capital requirements.

⇒ Credit policy.

⇒ Cash management policies.

⇒ retained earning policy.

Objectives of financial planning Friday 7

1. To ensure supply of sufficient fund
2. To minimize cost of fund
3. To protect owners against the loss of business.
4. To provide flexibility in the plan.
5. To keep F.P as simple.

Time value of Money

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A rupee available today is worth more than a rupee available at a future date.

Methods of analysis

1. Compounding (or)
2. Discounting

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Compounding techniques.

a) Compounding of interest over n years \rightarrow the interest ~~are~~ on investment are generally ~~at~~ spread ~~Future Value (FV) is $B(1+r)^n$~~ over a number of years. These interest are to be compounded annually to ascertain the future Value.



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$$\text{Future Value (FV)} = P(1+R)^n$$

P = Principal.

R = Rate of interest.

N = No. of years.

② Multiple compounding periods.

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The above method is compounded annually. So the value is compounded annual basis only. The compounding period 'n' may be other than a year also. Suppose the compounding is done in every 6 months "n" may be 2 times in a single year. In this case the frequency of compounding also will be



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calculated. So the formula is 18

$$\text{Future Value} = P \left(1 + \frac{R}{m} \right)^{nm}$$

P = Principal

R = Rate of interest

n = No. of years.

m = Frequency of compounding.

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③ Effective rate of interest:

The effective rate of interest may be calculated when an annual interest rate is compounded more than once per year. ^{when} the effective rate and nominal rate are equal the FIV is same

$$ERI = \left(1 + \frac{R}{m} \right)^m - 1$$

m = frequency of compounding.

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It is very useful in investment decisions in Financial Management.

4) Doubling period:

Sometimes the investors and financial decision makers are interested in knowing the doubling period of their investments.

Friday 21 Such period is called doubling period.

Rule of thumb methods:

rule of 72 and rule of 69 are used to find out the doubling period.

Rule of 72 Doubling period = $\frac{72}{\text{Rate of Int.}}$



$$\text{Rate of int} = \frac{72}{\text{Doubling period}}$$

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Rule of 69

It provides more accurate results.

$$\text{Doubling period} = 0.35 \times \frac{69}{\text{Rate of Int.}}$$

⑤ Compound value of an annuity

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Annuity means the same amount of cash flows for number of years. for. eg. 10000 for every year end for three years.

$$\text{Formula} = FV = A \times \left[\frac{(1+R)^n - 1}{R} \right]$$

A = annuity amt.

R = Rate of int. www.sbillife.co.in n = no. of years.

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If the annual instalment may be accumulated at the beginning of each year. ~~into~~ at that time the FV. of instalments may be calculated by

$$FV = \text{S.F. instalment} \times$$

$$\frac{(1+R)^n - 1}{R}$$

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$$\text{S.F. Instalment} \times \frac{(1+R)^n - 1}{R} \times (1+R)$$

Time value of money

Ex: 1

$$\left. \begin{array}{l} \text{Amt. of Maturity} \\ \text{or} \\ \text{Future value} \end{array} \right\} = P(1+R)^n$$

$$P = 50000$$

$$R = 6\%$$

$$n = 3 \text{ year}$$

$$\left. \begin{array}{l} P = 50000 \\ R = 6\% \\ n = 3 \text{ year} \end{array} \right\} = 50000 (1 + 0.06)^3$$

$$= 50000 \times (1.06)^3$$

$$= 50000 \times 1.19$$

$$FV = \boxed{\text{Rs. } 59550}$$

Ex: 2:

$$\left. \begin{array}{l} \text{Compound value or} \\ FV \end{array} \right\} = P(1+R)^n$$

$$= 20000 (1 + 0.08)^5$$

$$= 20000 \times (1.08)^5$$

$$= 20000 \times 1.47$$

$$FV = \boxed{\text{Rs. } 29387}$$

Ex: 3

$$\begin{aligned}FV &= P(1+R)^n \\&= 40000 \times (1+0.10)^4 \\&= 40000 \times (1.1)^4 \\&= 40000 \times 1.46\end{aligned}$$

$$FV = \text{Rs. } 58564.$$

Ex: 4

(i) annually

$$\begin{aligned}FV &= P(1+R)^n \\&= 300000 (1+0.12)^6 \\&= 300000 \times (1.12)^6 \\&= ~~300000 \times 1.97~~\end{aligned}$$

$$FV = \text{Rs } 592147$$

(ii) Semi annually or half yearly

$$FV = P(1+R)^{nm}$$

$$P = 300000, R = \frac{12\%}{2} = 6\%$$

$$m = \frac{12 \text{ months}}{6} = 2 \text{ times}; n = 6 \text{ yrs.}$$

$$\begin{aligned}FV &= 300000 (1+0.06)^{6 \times 2} \\&= 300000 (1.06)^{12} \\&= 300000 \times (1.06)^{12}\end{aligned}$$

$$FV = \text{Rs. } 603659$$

EX: 5

(i) Annually:

$$\begin{aligned} & P(1+R)^{nm} \\ &= 100000 (1+0.10)^{5 \times 1} \\ &= 100000 \times (1.10)^5 \end{aligned}$$

$$\boxed{FV = \text{Rs. } 1,61,051}$$

(ii) half yearly

$$P = 100000, R = \frac{10}{2} = 5\%$$

$$n = 5 \text{ yrs. } m = \frac{12}{6} = 2$$

$$\begin{aligned} \therefore & 100000 (1+0.05)^{5 \times 2} \\ &= 100000 \times (1.05)^{10} \end{aligned}$$

$$\boxed{FV = \text{Rs. } 1,62,889}$$

\therefore Yes. Manoj will get more if interest is compounded half yearly.

iii) Quarterly:

$$P = 300000 \quad n = 6 \text{ yrs.}$$

$$R = \frac{12\%}{4} = 3\% \quad m = \frac{12}{3} = 4 \text{ times.}$$

$$P(1+R)^{nm} = 300000 (1+0.03)^{6 \times 4}$$
$$= 300000 \times (1.03)^{24}$$

$$\boxed{FV = \text{Rs. } 6,09,838.}$$

iv) monthly:

$$P = 300000, \quad R = \frac{12\%}{12} = 1\%.$$

$$n = 6 \text{ yrs, } m = 12 \text{ times.}$$

$$300000 (1+0.01)^{6 \times 12}$$

$$300000 \times (1.01)^{72}$$

$$\boxed{FV = \text{Rs. } 6,14,130.}$$

∴ monthly compounding is better.