unit 1 : Financial management

Meaning :

Financial management include the strategic planning, coordination, guidance, and regulation of an organization's financial assets. In order to meet the company's financial goals and optimize shareholder wealth, it entails supervising the effective use of cash. Financial planning, budgeting, investment choices, financing, risk management, and dividend policy are just a few of the many tasks that go into managing a company's or entity's finances. Optimizing the utilization of available funds is the main objective, along with lowering financial risks and increasing stakeholder returns.

Nature of financial management :

- Multidisciplinary: It incorporates elements of mathematics, accounting, economics, and other disciplines.
- Process is continuous and entails ongoing strategy monitoring, planning, and adjustment.
- Making decisions: It facilitates the process of making well-informed choices about dividends, finance, and investments.
- Goal-oriented: Concentrates on guaranteeing financial stability and optimizing shareholder wealth.

Scope of financial management:

- Financial planning includes goal-setting, budgeting, and forecasting.
- Capital Structure: Establishes the ideal ratio of debt to equity to fund business activities.
- Making profitable investment decisions requires assessing projects or assets.
- Risk management reduces possible losses by identifying and controlling financial risks.
- Dividend Policy: Determines how earnings are allocated to stockholders.

Approaches of financial management:

- Conventional Approach: Prioritizes increasing shareholder wealth and profits.
- The modern approach is centered on maximizing wealth while taking time value of money and risk into account.
- Value-based management is centered on using strategic decision-making to create value for stakeholders.
- Behavioral finance takes into account the psychological influences on financial choices.

Objectives of financial management :

1. **Profit maximisation** : The goal of financial management's profit maximization objective is to increase a company's net earnings or profits. It suggests that a company's main goal is to make as much money as it can in a specific amount of time.

Advantages of profit maximisation :

- Goal Clarity: It gives the business a precise, readily quantifiable goal.
- Increased dividends and greater stock prices are frequently the result of maximizing profitability, which satisfies shareholders.
- Resource Allocation: Facilitates the effective distribution of resources to the most profitable endeavors.
- Performance Indicator: Serves as a gauge for the effectiveness and prosperity of businesses.

Disadvantages of profit maximisation :

- Short-term Focus: May promote making decisions based on immediate needs rather than long-term sustainability or growth.
- Danger of Ignoring Other Goals: It could overlook other important aspects like as customer happiness or social responsibility.
- Quality vs. Quantity: Cutting expenses at the expense of quality could result in a product or service that is of worse quality.
- Conflict of Interest: Maximizing profits may occasionally conflict with moral or societal obligations.

2. Shareholders wealth maximisation :

A primary goal of financial management is to maximize shareholder wealth by raising a company's overall worth for its owners. Wealth maximization takes into account the long-term value creation for shareholders, in contrast to the exclusive focus on short-term earnings. This strategy is consistent with the view that a company's long-term goal should be to increase shareholder value.

Key elements of shareholders wealth maximisation:

- Long-term Perspective: Places more emphasis on choices that, over time, result in value development and steady growth than on maximizing profits right now.
- Total Returns: Takes into account increases in stock price as well as dividends as crucial elements of shareholder wealth.
- Strives to strike a balance between risk and reward by strategically choosing actions that will optimize profits while carefully monitoring potential hazards.
- Value creation is the process of increasing a company's worth through

Importance and benefits :

- Alignment with Stakeholders: Promotes investor loyalty and trust by balancing the interests of shareholders with the long-term profitability of the business.
- Long-Term Growth: Supports tactics that enhance competitiveness and sustained growth for the benefit of the business and its shareholders.
- Access to funds: As a company's value rises, it draws in more investors and makes funds available, enabling growth and development.
- Market perception and confidence in the firm's potential are improved by market confidence, which could raise the market value of the company.

Decisions of finance :

1**. Investment decision** : Capital budgeting is the process of selecting long-term investments or projects to work on after weighing the risks and possible returns. The process of allocating money among various asset classes, such as stocks, bonds, and real estate, in order to maximize returns while minimizing risk is known as asset allocation.

2. **Financing Decisions**:

Capital structure is the process of choosing how much debt and equity to use to finance operations while keeping cost of capital and risk in check.

Choosing the means and channels (stocks, bonds, loans) to raise money for expansion and investment is known as raising capital.

3. **Working Capital management decisions** : Managing cash flow to guarantee there is adequate liquidity for regular business operations and emergencies is known as cash management.Inventory management is the process of balancing costs and meeting demand while avoiding overstocking.

4. Dividend Policy: Selecting how much of profits to give shareholders in the form of dividends as opposed to holding onto earnings for future use.

Unit 2 : a. Time Value Of Money

A key idea in financial management is the temporal value of money (TVM), which acknowledges the idea that an amount of money invested now has greater value than the same amount later on because of the possibility for growth. Its foundational idea is that money has a temporal value that is determined by elements such as opportunity cost, inflation, and interest. This is a summary:

Time value of money principles:

- Future Worth (FV): When referring to the worth of money at a given future date, compound interest on the principal amount is taken into account.
- Present Value (PV): Taking into consideration the time value of money, PV is the current value of a sum of money that is discounted to reflect its value today.
- Interest rates: The cost of borrowing money or the pace at which money increases over time. It affects both the current and future worth of money.
- Applications in Financial Management: Investment Analysis: By comparing the current value of projected returns to the initial investment, TVM aids in the evaluation of investment prospects.
- Loan and Mortgage Decisions: By computing the present value of future payments, it helps determine loan amounts, repayment plans, and interest rates.
- Capital Budgeting: TVM takes future earnings and the time value of cash flows into account when evaluating the feasibility of long-term projects.
- Retirement planning: Assists people in estimating their current savings needs while taking inflation and investment returns into consideration in order to reach their future financial objectives.

Factors influencing time value of money :

- Interest Rates The current and future values of money are impacted by changes in interest rates. Higher rates usually result in lower present values and higher future values.
- Inflation: As prices rise, money's purchasing power decreases over time, lowering its potential worth.

- Compounding Frequency: Investing grows more quickly when compounding occurs more frequently, for as monthly as opposed to annually.

Making wise financial decisions requires an understanding of the temporal worth of money. By taking into consideration the earning potential of money across various time periods, it helps organizations and people to evaluate the value of money over time, compare investment possibilities, and manage their finances wisely.

Techniques of time value of money :

1. **Compounding**: Compounding is the process by which an investment gains value over time by reinvested earnings or interest on both the initial principal amount and the cumulative interest.

Future Value (FV): Determines an investment's value at a given future date by taking compound interest into account. FV = PV * (1 + r)^n is the formula, in which r denotes the interest rate, n is the number of periods, and PV represents the present value.

Frequency of Compounding: Because interest is earned on interest, an investment will increase more quickly the more often it is compounded (e.g., annually, semi-annually, quarterly).

2. **Discounting:** Discounting is the practice of using a discount rate to represent the time value of money and determine the present value of future cash flows or sums.

The present value (PV) of a future cash flow or a future amount discounted to its present value is determined. PV = FV / (1 + r)^n is the formula, in which n is the number of periods, r is the discount rate, and FV is the future value.

Calculating Present Worth: Discounting makes it simpler to compare options and make investment decisions by estimating the present worth of future payments.

Table 2.2 Discounting or Present Value Method for Single and Multiple Cash Flows

S. No.	Single and Multiple Cash Flows	Formula	Notations Used
1.	Annually single Cash Flow	$PV = FV\left\{\frac{1}{(1+r)^n}\right\}$ or, $PV = FV(1+r)^{-n}$ or, $PV = FV(PVIF_{r,n})$	PV = Present Value FV = Future Value r = Discount rate n = Number of years $PVIF_{r,n}$ = Present Value Interest Factor
2.	Multiple times, say m number of times discounting is done	$PV = FV\left\{\frac{1}{\left(1+\frac{r}{m}\right)^{nm}}\right\}$	PV = Present Value FV = Future Value r = Discount rate n = Number of years m = Number of times discounting is done say quarterly then $m = 4$; half-yearly, $m = 6$ and so on.
3.	Cash Flows of different amounts over the years	$PV = \frac{FV_1}{(1+r)^1} + \frac{FV_2}{(1+r)^2} + \cdots + \frac{FV_n}{(1+r)^n}$, i.e. $\sum_{t=1}^{n} \frac{A^t}{A(1+r)^t}$	PV = Present Value FV = Future Value r = Discount rate n = Number of years

Table 2.6 Method for Calculating Future or Compounded Value of an Annuity

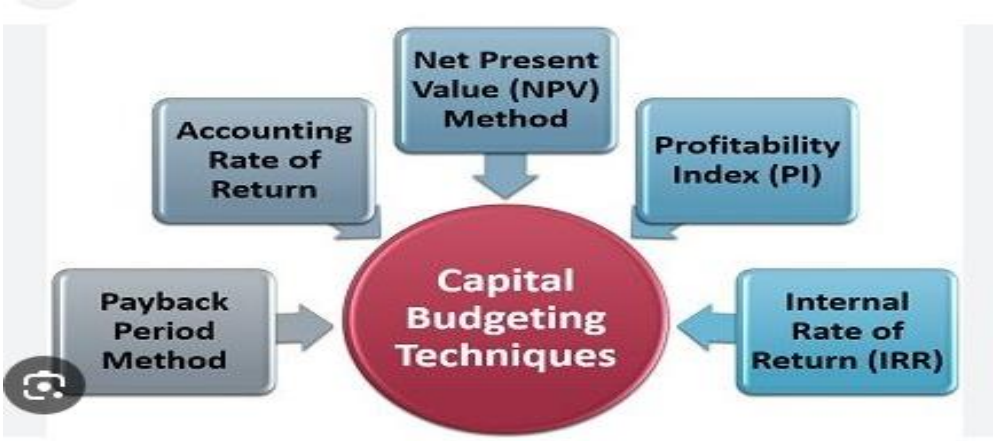
S. No.	Annuity	Formula	Notations Used
1.	Deferred Annuity (Cash Flow at the end of each period)	$FVA = A\left\{\frac{(1+r)^n - 1}{r}\right\}$	FVA = Compounded sum of Annuity/Future Value of Annuity A = Equal Cash Flows r = Interest rate n = Number of years Future Value Interest Factor of an Annuity $(FVIFA_{r,n}) = \left\{\frac{(1+r)^n - 1}{r}\right\}$ $FVIFA_{r,n}$ is the interest factor used to calculate the Future Value of an Annuity at a particular interest rate for a specified time period.
2.	Annuity Due (Cash Flow at the beginning of each period)	$FVA = A\left\{\frac{(1+r)^n - 1}{r}\right\}(1+r)$	FVA = Compounded sum of Annuity/Future Value of Annuity A = Equal Cash Flows r = Interest rate n = Number of years
The amount to be invested for certain number of years at a specified rate of interest to generate ₹1 at the end of the year is known as Sinking Fund.			
3.	Sinking Fund Factor	$A = \left\{\frac{S_n}{\frac{(1+r)^n - 1}{r}}\right\}$	A = annual fixed amount or Sinking Fund r = Rate of interest n = Number of years S_n = Compounded sum of Annuity or Future Value of an Annuity

B. Capital budgeting

Businesses use capital budgeting as a tool to assess and choose long-term investment projects or expenses that require sizable financial outflows. Usually, the company's operations are impacted by these actions for several years. Below is a summary that addresses its definition, approaches, and workflow:

Meaning and Definition: The process of strategically planning and deciding how to allocate funds for long-term expenditures in projects, machinery, equipment, or facilities is known as capital budgeting. It entails evaluating possible investments to ascertain their suitability financially and in relation to the goals of the business.

Methods of capital budgeting :



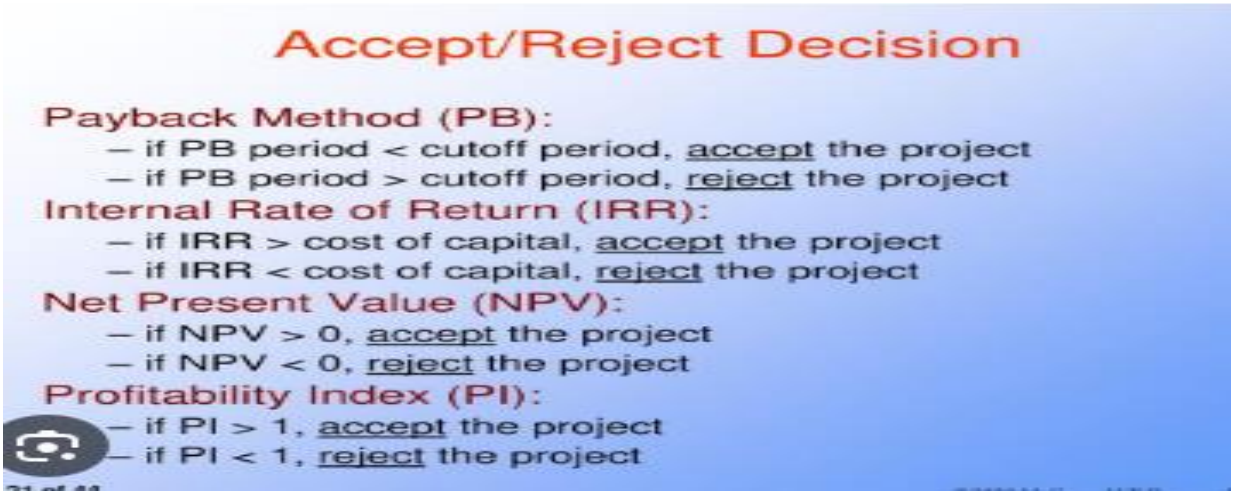
1. **Payback Period**: Measures the amount of time needed to recoup the initial outlay. Shorter payback periods for projects are typically favored.

2. **Net Present Value (NPV)**: Determines the present value of future cash flows by applying a predefined discount rate to reduce them to their present value. An investment with a positive net present value (NPV) may be profitable.

3. **The internal rate of return, or IRR**, is the percentage of the discount rate that an investment's net present value (NPV) equals. An investment is deemed more appealing when the IRR is higher.

4. **The profitability index (PI)** calculates the ratio of the initial investment to the present value of future cash flows. An investment with a probability of profit is indicated by a PI larger than 1.

5. The average yearly accounting profit is compared to the average investment to determine the Accounting Rate of Return (ARR). It is predicated on accounting metrics.



Unit 3 : A. Sources of long term finance

1. **Equity financing**: Issuing Shares: To raise money, ownership stakes in the company (common or preferred shares) are sold.Selling shares to a select group of investors or to institutional investors is known as a private placement.Offering shares to the general public in order to convert a private firm into a public one is known as an initial public offering, or IPO.

2. **Debt Financing**: Bank Loans: Getting bank loans, usually with interest rates that are fixed or variable.Corporate bonds are issued to investors with maturity repayment terms and fixed interest rates. Debentures: Unsecured financial instruments secured by the creditworthiness of the business.

3. **Retained Earnings**: Internal Accruals: Reinvesting earnings held within the business for expansion plans.Putting Profits Back Into the Company: Investing profits back into the company as opposed to paying out dividends.

A. Equity shares :

Ownership in a firm is represented by equity shares, sometimes referred to as common stock or ordinary shares. Equity share owners are regarded as partial owners and are entitled to vote in shareholder meetings and, in the event that dividends are declared, to receive them.

Features:

- Ownership Rights: Equity shareholders are able to influence corporate decisions through voting rights that are based on their shareholding.
- Dividends: The firm is required to pay them a portion of its profits in the form of dividends, but the amount of these payments is contingent upon the company's success and decision to distribute profits.
- Remaining Claim: Following the satisfaction of creditors' and preference shareholders' claims, equity shareholders are entitled to a portion of the company's assets in the event of liquidation.
- Risk and Reward: Because their rewards are contingent on the performance of the firm, they carry the most risk of all capital types, but they also have the opportunity to earn larger returns should the company perform well.

Advantages :

- Permanent Capital: Unlike debt, equity capital has no payback requirements and serves as a steady source of funding for the business.
- Enhanced Creditworthiness: By lowering the company's debt-to-equity ratio, equity shares can increase its appeal to lenders.
- No Dividend Obligations: Unlike debt financing, if a corporation isn't successful, dividend payments to equity stockholders are not required.
- Flexible Financing: Businesses can raise money without taking on debt or paying interest by issuing more stock shares.

Disadvantages :

- Dilution of Control: The ownership and control of the company by current shareholders may be weakened by the issuance of additional equity shares.
- Dividend Volatility: Since businesses are not required to pay dividends to equity shareholders, there could be some degree of uncertainty and fluctuation in profits.
- Cost of Issuance: Underwriting and administrative expenses can make the process of issuing new equity shares pricey.
- Market Volatility: The value of equity shares can change dramatically depending on the state of the market, which can affect shareholder wealth.

B. preference shares :

A particular kind of corporate equity asset called preference shares combines elements of debt and equity. Offering stockholders a fixed dividend payout and dividend precedence over common shareholders, they combine the qualities of bonds and common stock.

Features :

- Fixed dividend :Preference share holders are entitled to receive fixed dividends at a pre-established rate, frequently ahead of common shareholders.
- Distribution of Priority Shares: In the event of a liquidation, preference shareholders will receive assets before common shareholders, but after creditors.
- No Voting Rights: Unlike common shareholders, preference shareholders often do not have the ability to vote on decisions made by the corporation.
- Dividends: Cumulative preference shares grant their holders the right to receive unpaid dividends in arrears ahead of common shareholders. Unpaid dividends do not accrue on preference shares that are non-cumulative.

Advantages :

- Regular Income: Preference shareholders, like bondholders, receive set dividends that provide a steady stream of income.
- Dividend Priority: They receive dividends more quickly than common shareholders, giving them a more stable source of income.
- Priority in collapse: They will receive assets before common shareholders in the event of a company collapse.
- Less Risk than Equity: Because they provide a fixed dividend, they are less risky than equity shares, which appeals to investors who are risk averse.

  Disadvantages :

  - Limited Growth Potential: Unlike equity shareholders who gain from higher profits, they do not have the opportunity to receive higher dividends in the event that the firm does remarkably well.
  - No Voting Rights: Generally speaking, preference shareholders have no voting rights when it comes to business decisions, which limits their power.
  - Interest Rate Sensitivity: Preference shares may become less appealing than alternative investment options in response to changes in interest rates.
  - Non-cumulative Dividends: Missed dividend payments are irreversibly lost because non-cumulative preference shares do not accrue unpaid dividends.

  Debentures :

  Long-term debt instruments known as debentures are issued by businesses to raise money. They stand for a lending arrangement in which the issuer (business) agrees to pay the investor interest on a regular basis and refund the principal amount at a predetermined maturity date.

Features :

- Fixed Interest Payments: Just like bondholders, holders of debentures get fixed interest payments at regular intervals until maturity.
- No Ownership Rights: Unlike shares, debentures do not grant holders the opportunity to vote or own stock in the business.
- Secured/Unsecured: Debentures may be unsecured, meaning they don't require any specific security, or they may be secured by firm assets (secured debentures).
- Maturity Date: They have a set date, either short-term or long-term, at which the principle must be returned.

Advantages :

- Fixed Income: By making fixed interest payments, fixed income offers investors a steady source of income.
- Less Risky Than Equity: Due to their regular revenue stream and priority claim over firm assets in the event of bankruptcy or liquidation, debentures are less risky than equity.
- Funding Flexibility: Unlike stock issues, companies can raise long-term capital without sacrificing ownership or control.
- Different Types: To accommodate a range of investor preferences, debentures are offered in a variety of types, including convertible, non-convertible, redeemable, and perpetual

Disadvantages :

- Interest Payment Obligations: Even in times of financial hardship, the business is still required to pay interest, which raises fixed expenses.
- No Profit Share: Unlike equity stockholders, holders of debentures do not gain from the company's growth or profits.
- Market Risk: If they are traded on the secondary market before to maturity, their value may change as a result of modifications in interest rates and general market circumstances.
- Possible Default Risk: Should the business be unable to pay its debts, debt.

B. Capital structure

A company's capital structure is the combination of funding sources it uses to support its overall operations and expansion. It symbolizes the mix of debt, stock, and other financial instruments that make up a company's capital.

Determinants of capital structure :

- **Risk to Business**: Higher levels of debt may be preferred by businesses with steady and predictable cash flows since they can more readily service it. During recessions, riskier companies could choose to take on less debt in order to protect their finances.

- **Capital Cost**: Businesses aim to reduce their total cost of capital. Because interest on debt is tax deductible, it is frequently less expensive than equity. A larger usage of debt in the capital structure may be influenced by a lower cost of debt.
- **Control and Flexibility**: During recessions, equity financing is more flexible because it has no set payments.Regular payment requirements are a requirement of debt financing, but ownership or control is not diminished.

- **Situation of the Market**: Positive market circumstances may incentivize businesses to issue more shares.
  Since borrowing becomes more affordable when interest rates are low, businesses may decide to take on additional debt.

- **Tax-related Considerations**: Debt financing is more tax-efficient than equity since debt interest payments are deductible from taxes.
  Companies may use debt more frequently in their capital structure due to tax benefits.

- **Industry Standards and Guidelines**:Certain sectors or industries may have rules or conventions that dictate their preferred capital structure.
  Certain industries may impose limitations on debt levels or mandate the preservation of a specific equity ratio.

Importance of capital structure :

- Ideal Balance: Risk, cost of capital, and financial flexibility of a corporation are all impacted by choosing the appropriate ratio of debt to equity.
- Tradeoff between Risk and Return: Capital structure choices have an impact on the possible returns for creditors and shareholders as well as the risk profile.
- Fiscal Health: An organization's capacity for growth and stability can be improved by a well-designed capital mix.

C. Cost of Capital

The cost of capital refers to the cost a company incurs in order to obtain financing for its operations. It represents the overall rate of return required by investors (both debt and equity holders) to compensate them for investing in the company.

Components of cost of capital :

1. cost of debt
2. cost of equity
3.cost of preference capital
4. cost of retained earnings

1. **cost of debt :**

The cost of debt refers to the effective rate a company pays on its borrowed funds. It's the return required by lenders or bondholders for providing loans or buying bonds issued by the company. This cost is incurred through interest payments and is a crucial component in calculating a company's overall cost of capital.

2. **cost of equity :**

The cost of equity represents the return expected by investors for investing in a company's stock. It's the rate of return required by equity investors as compensation for the risk they undertake by investing in the company's shares.

3. **cost of preference capital** :

The cost of preference capital refers to the cost associated with raising funds through preference shares. Preference capital represents a type of financing that combines characteristics of both debt and equity.

4. **cost of retained earnings** :

The cost of retained earnings, also known as the opportunity cost of equity, represents the return shareholders could have received if the earnings were distributed as dividends or invested elsewhere.

Weighted average cost of capital :

The Weighted Average Cost of Capital (WACC) is a financial metric used to assess a company's overall cost of financing, taking into account the proportionate mix of its various sources of capital, including debt and equity.

WACC's constituent parts include:

- Cost of Debt (Rd): The expense a business bears when it borrows money, typically from bonds or loans.
- Cost of Equity (Re): The anticipated rate of return on an investor's stock purchase in the company.
- Weight of Debt (WD): The percentage of total capital that is allocated to debt in the company's capital structure.
- Weight of Equity (WE): The percentage of total capital that is allocated to equity in a company's capital structure.

D. Dividend policy decision

Dividends are distributions of a company's earnings to its shareholders, typically paid in cash or additional shares. They're a way for companies to share profits with their investors

Types of dividend :

- Cash Dividend: The most common type, where shareholders receive cash payments from the company's profits.
- Stock Dividend: Instead of cash, shareholders receive additional shares of the company. It's essentially a proportional increase in the number of shares held by existing shareholders.
- Property Dividend: Sometimes companies distribute assets, such as inventory or equipment, as dividends.
- Special Dividend: Occasional, non-recurring payments made in addition to regular dividends, often resulting from extraordinary profits or asset sales.
- Scrip Dividend: Companies issue promissory notes to shareholders, promising to pay cash at a future date instead of immediate cash payment.
- Liquidating Dividend: Paid when a company is winding up its operations, distributing its remaining assets to shareholders.

Factors influencing dividend decisions :

- Company Profits: Dividend payments are typically made from profits available after covering expenses and investment needs.
- Company Growth: Rapidly growing companies might reinvest profits into growth rather than paying dividends.
- Cash Flow: Companies require sufficient cash flow to pay dividends without compromising operations or future investments.
- Legal and Contractual Obligations: Some companies have legal or contractual obligations regarding dividend payments.

Determinants of dividend policy :

- Earnings and Profitability: Companies tend to pay dividends when they have stable and consistent earnings. Higher profits often lead to increased dividend payments.
- Cash Flows: Availability of sufficient cash flow is essential for paying dividends without affecting the company's operations or growth prospects.
- Company's Growth Stage: Growing companies might reinvest profits into growth opportunities rather than paying substantial dividends. Mature or stable companies with fewer growth opportunities often pay regular dividends.
- Investment Opportunities: Companies with lucrative investment opportunities may opt for retaining earnings to fund these opportunities instead of paying dividends.
- Capital Needs: Capital-intensive industries may retain more earnings to fund their ongoing operations or expansion plans.
- Shareholder Expectations: The company's history of dividend payments and shareholders' expectations influence dividend decisions.
- Some investors prefer regular income through dividends, while others might prefer capital appreciation.

- Tax Considerations: Tax policies and rates impact dividend policy. In some cases, investors might prefer share buybacks due to favorable tax treatment.
- Legal and Regulatory Requirements: Companies might have legal or contractual obligations dictating dividend payments or restrictions on dividend distributions.
- Corporate Governance and Management's Preference: The board of directors and management play a vital role in setting and implementing the dividend policy.
- Management's vision, preference for reinvesting profits, or rewarding shareholders can influence dividend decisions.

Unit 4 : a. Working capital management

Working capital refers to the financial metric that represents the operational liquidity available to a company to manage its day-to-day operations. It's the difference between a company's current assets and its current liabilities.

Components of working capital :

- **Current Assets**:These are assets that are expected to be converted into cash or consumed within a year.

Examples include cash, accounts receivable, inventory, and short-term investments.

- **Current Liabilities**: These are obligations or debts that the company needs to settle within a year.

Examples include accounts payable, short-term loans, and accrued expenses.

Working Capital=Current Assets−Current Liabilities

Importance of working capital :

- Operations management makes sure the business has adequate resources to satisfy its daily requirements.
- Liquidity: Offers information on a company's capacity to pay short-term debt.
- Efficiency: The effective administration of working capital lowers excess debt and idle cash while guaranteeing the best possible use of resources.
- Makes strategic decisions pertaining to accounts receivable, payables, and inventory management.
- Financial Health: Indicates a company's short-term solvency and overall financial health.

Determinants of working capital :

- Nature of Business: Different industries require varying levels of working capital. For instance, manufacturing businesses generally need higher inventory levels compared to service-oriented companies.

- Business Cycle: Stage of the business cycle impacts working capital needs. During growth phases, companies may need more working capital to support increased sales and production.
- Sales Volume and Seasonality: Higher sales usually require higher levels of inventory and accounts receivable, affecting working capital requirements. Seasonal businesses might need more working capital during peak seasons to meet increased demand.
- Credit Policy: The terms provided to customers affect accounts receivable. Looser credit policies result in higher accounts receivable, increasing working capital needs.
- Supplier Terms: Payment terms negotiated with suppliers influence accounts payable. Longer payment terms can reduce immediate cash outflows, impacting working capital positively.
- Operating Efficiency: Efficient inventory management and receivables collection can minimize the need for excessive working capital.
- Technological Changes: Innovations or technological advancements might impact production cycles, inventory turnover, and credit terms, affecting working capital needs.
- Regulatory and Economic Factors: Changes in government policies or economic conditions can affect interest rates, inflation, and overall business environment, impacting working capital requirements.

Dangers of excessive and inadequate working capital:

- Overworking Capital: Devoting surplus funds to working capital can result in inefficient use of resources and lower returns on investment.
- Insufficient Working Capital: Lack of working capital can cause business disruptions, strained relationships with suppliers, and missed opportunities.

b. Cash management

Cash is one of the components of current assets. It is the medium of exchange for the pre of goods and services and for discharging liabilities. It is the most liquid asset and the basic input required to keep the business running on a continuous basis. To quote Gitman, liquid assets provide a pool of funds to cover unexpected outlays, thereby reducing the risk of a liquidity crisis .Adequate availability of cash is essential to meet the business needs. Since it is necessary in daily business operations and in productive, the cash owned by an enterprises at any time should be carefully regulated.

MOTIVES FOR HOLDING CASH

Cash is the most crucial component of the working capital of a firm, as every transaction results either in an inflow or outflow of cash. Idle cash has no earning power, then why does a firm need cash? John Maynard Keynes put forth that there are three possible motives for holding cash.

1. **The Transaction Motive**: This motive arises due to the necessity of having cash for various disbursements like purchase of raw materials, payment of business expenses, payment of tax, payment of dividend and so on. The need to hold cash would not arise if there is perfect synchronization between the cash receipts and the cash payments. Hence, the firm must have an adequate cash balance particularly when payments are in excess of receipts to meet its obligations. The requirement of cash to meet routine cash needs is known as the transaction motive and such motive refers to the holding of cash to meet anticipated obligations whose timing is not perfectly synchronized with each receipts. The transaction motive, thus, refers to the holding of cash to meet anticipated obligations whose timing is not perfectly synchronized with cash receipts.

2. **The Precautionary Motive**: Apart from the non-synchronization of anticipated cash flows in the ordinary course of business, a firm may require cash for the payment of unexpected disbursements. The unexpected cash needs at short-notice may be the result of floods, strikes and failure of important customers, bills may be presented for settlement earlier than expected, slow down in collection of accounts receivables, sharp increase in cost of raw materials. It provides cushion or buffer to withstand some unexpected emergency. The precautionary balance may be held in near-money assets like marketable securities. The amount set aside for precautionary motive is not expected to earn anything. As a matter of abundant caution, many companies had learnt the art of 'cultivating the rich uncle', by establishing and maintaining good lasting link with progressive banking institutions. Ready borrowing power is the best antidote to emergency cash drains and facilitates release of available cash resources for remunerative applications.

3.**The Speculative Motive**: It refers to the desire of a firm to take advantage of opportunities which present themselves at unexpected moments and which are typically outside the normal course of business. To put it simply, it is a motive of holding cash for investing in profitable opportunities a and when they arise. In other words, this motive comes from a desire of holding cash to gain is speculative transactions such as, purchase of raw materials at reduced price on payment of immediate cash, dealing in commodities in bulk purchasing and selling when rates are considered favorable Hence firms, which have such speculative dealings, may carry additional liquidity.

MANAGEMENT OF CASH FLOWS

After estimation of cash flows, the finance manager's job is to ensure that there is no more deviation between the projected cash flows and the actual cash flows, which is a must for efficient cash management. Financial management should have the control on cash receipts and cash disbursements. As the objectives of cash management is to accelerate cash receipts as much as possible and/or delay cash payments as much as possible. In other words, the various collection and disbursement methods can be employed to improve cash management efficiently constitutes two sides of the same coin. Both collections and disbursements exercise a joint impact on the overall efficiency of cash management. The idea is speed collection of accounts receivables, so that the firm can use money sooner, otherwise, it has to borrow money, wherein costs are involved. Conversely. firm wants to pay accounts payables

late as possible without affecting credit standing, so that the firm can make use of the money it already has. Hence, for efficient cash management the firm has (A) to collect accounts receivables as early as possible, and (B) it has to delay the accounts payables without affecting credit standing.

(A) **Accelerating Cash Collections**

Accelerating (speedy) cash collections can conserve cash and reduce its requirements for cash balances of a firm. Cash inflow process can be accelerated through systematic planning. The following are the methods of accelerating cash collections.

1. **Prompt Billing and Cash Discount**: In speed collection the first hurdle could be the firm itself. It may take a long time to process the invoice. Prompt payment by customers will be possible by prompt billing. The seller has to inform customers about the amount of payment and period of payment in advance. Automation of billing and enclosure of self-addressed envelope, will be helpful for speed payment of cash. The other way of prompting customers to pay earlier is to offer cash discounts. Cash discounts help customers save money and it would be easier to avail the discount.

2. **Minimizing Deposit Float**: After using cheques by the customers in favour of the firm collections can be quickened. Conversion of cheques into cash is the second hurdle. There is a time lag between the time a cheque is being prepared by the customer and the time the funds are credited to firm's account. There are three steps involved here, viz., (i) Mailing time - The time taken by the post offices in transferring the cheques from the customer to the firm. The time lag is referred to as "postal float". (ii) Lethargy-time taken in processing the cheques within the company and sending them to the bank for deposit and (iii) Bank Float - The time taken by the bank in collecting the payment from the customer's bank. The postal float, lethargy and bank float-collectively known as "deposit float". To quote Rama Moorthy, deposit float as the sum of cheques written by the customer that are not yet useable by the firm. In India deposit float can assume sizeable opportunities as cheques normally take a longer time to get realised than in most countries, Accelerated collection of cash is possible when a firm reduces the transit, lethargy and bank float.

How can the deposit float be reduced?

It is possible through the options of a decentralized collection policy. There are two important methods available to use in a decentralized collection network, they are (i) concentration banking and (ii) Lock-Box system, and (iii) payment by wire.

3. **Concentration Banking or Decentralized Collections**: A firm operating its business spread over a vast area and its branches located at different places would do well to decentralize its collections. The decentralized collection procedure in the US is called as "Concentration Banking." Concentration banking is a system of operating through a number of collection centres, instead of a single collection centre centralized at the company's head office premises. Under this system, a firm will have a large number of bank accounts in the operated areas, but all the areas may not have collection centres. Opening of a separate

collection centre depends on the volume of business. In this system, the customers are instructed to send their payments to the collection centre covering the area under which they come and these are deposited in the local account of the concerned collection centre. On realization of the proceeds of the cheques, these may be remitted for credit to the Head Office Account, by way of telegraphic transfer, daily or weekly, as per the quantum of collections and the local requirements of funds for expenses. Hence, concentration banking reduces float, which saves time and reduces the operating cash needs. This system should be adopted only when the savings are higher than the cost.

4. **Lock-Box System**: This is another technique of accelerating collection of cash. It is more popular in the USA and European countries. Under this arrangement, a firm rents post office boxes and authorizes its bank to pick up remittances in the box. The boxes will be placed at different centres on the basis of number of consumers. Customers are billed with instructions to mail remittances to the box. The local authorized bank of the firm, at the respective places picks up the mail several times a day and deposits the same into the firm's account. After the collection of cheques the bank sends a deposit slip along with the list of payments and other required enclosures. But now a days banks provide daily record of receipts collected usually via an electronic data transmission system.

Unit 5 : a. Receivables Management

Receivable management is a process of managing the account receivables within a business organization. Account receivables simply mean credit extended by the company to its customers and are treated as liquid assets. It involves taking decisions regarding the investment to be made in trade debtors by organization.

Objectives of Receivables Management:

The main aim of credit management is not to maximize the sales, nor to minimize risk of bad debts, but it is to manage its credit in such a way that sales are expanded to such an extent to which risk remains within an acceptable limit. In order to attain the maximize the value of the firm, it should manage its trade credit to:

- obtain the optimum volumes of sales for which the efficient and effective credit management helps the firm to retain the old customers and attract new customer.
- Control the cost of credit and keep it at minimum, which are associated with trade credit in the form of administrative expenses, bad debts losses and opportunity cost of funds tied up in receivables.
- Maintain investment in debtors at an optimum level, by extending liberal credit, sales and profits increase but increased investment in debtors also result in increased cost and therefore, make a trade off between costs and benefits.

Costs of receivables management

1. **Collection Costs**:

These costs are those which are to be incurred by a firm in order to collect the amount on account of credit sales, i.e., these expenses would not be incurred if the firm does not sell goods on credit, e.g., additional expenses incurred for the maintenance of credit and collection department, expenses incurred for obtaining information about credit-worthiness of potential customers.

2. **Capital Costs/Cost of Financing**:

The amounts which are locked up in debtors on account of credit sales may be financed from one of the following three sources:

(i) Share capital;

(ii) Debt capital (long and short-term); and

(iii) Retained earnings.

3. **Delinquency Costs**:

When the period of payment becomes due (i.e., after the expiry of the credit period) but is not received from the customers, the same is known as delinquency cost.

It includes:

(i) Blocking up of funds/cost of financing for an extended period; and

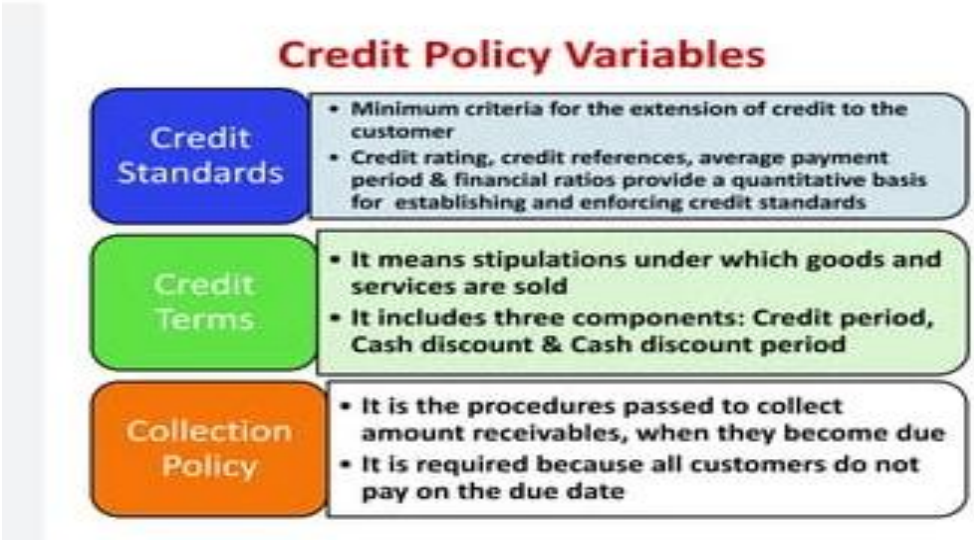
(ii) Cost of extra steps to be taken to collect the over-dues, e.g., reminders, legal charges etc.

4. **Default Costs**:

Sometimes the firms may not collect the over-dues from the customers since they are unable to pay. These debts are treated as bad debts and are to be written-off accordingly since the amounts will not be realized in future. Such costs are termed as 'Default Costs'. Although the firms make proper provision against bad debts, the cost will increase if the amount of credit sales is increased in proportion to cash sales.

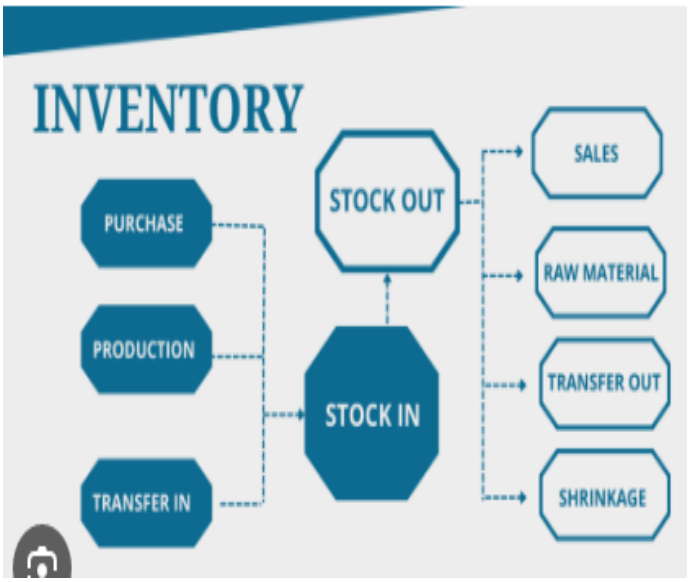
Factors influencing the size of Receivables.

- Size of credit sales.
- Credit policies.
- Terms of trade.
- Expansion plans.
- Relation with profits.
- Credit collection efforts.
- Habits of customers.



B. Inventory Management

Inventory management refers to the process of ordering, storing, using, and selling a company's inventory. This includes the management of raw materials, components, and finished products, as well as warehousing and processing of such items. There are different types of inventory management, each with its pros and cons, depending on a company's needs.



OBJECTIVES OF INVENTORY MANAGEMENT

- TO ENSURE CONTINUOUS SUPPLY OF RAW MATERIAL, SPARES AND FINISHED GOODS.
- TO AVOID BOTH OVERSTOCKING AND UNDERSTOCKING OF INVENTRY.
- TO MAINTAIN INVESTMENTS IN INVENTORIES AT OPTIMUM LEVEL.
- TO ELIMINATE DUPLICATIONS IN ORDERS
- TO KEEP MATERIAL COST UNDER CONTROL.
- TO MINIMIZE LOSSES THROUGH WASTAGE AND DAMAGES .

Need for Balanced Investment in Inventory…

Consequences of Excessive Investment in Inventory

- Block of funds
- Loss of liquidity
- Mishandling of inventory
- Increases carrying cost
- Physical deterioration

Consequences of inadequate investment in Innovation

- Disturbs production
- Unable to deliver goods on delivery date
- Loss of customers

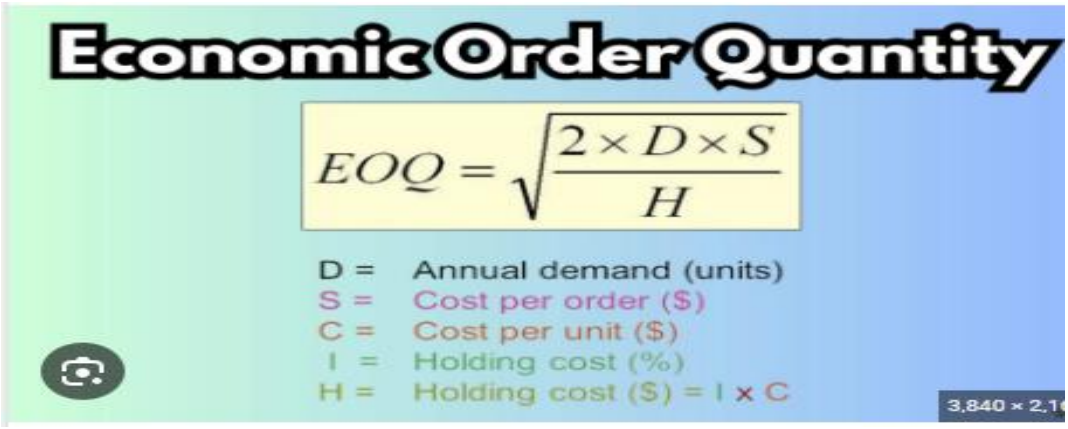
Tools of Inventory Control…

- ABC analysis
- EOQ
- Order point problem
- Two-bin technique
- VED classification
- HML classification
- SDE classification
- FSN classification
- JIT technique

Economic Order Quantity (EOQ)

This model is used in inventory management by calculating the number of units a company should add to its inventory with each batch order to reduce the total costs of its inventory while assuming constant consumer demand. The costs of inventory in the model include holding and setup costs.

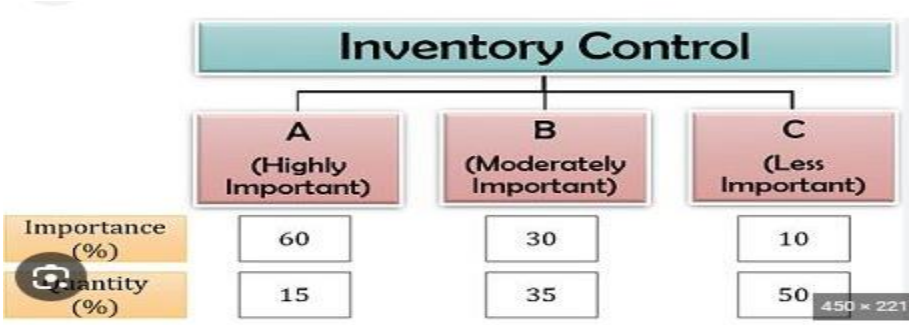
The EOQ model seeks to ensure that the right amount of inventory is ordered per batch so a company does not have to make orders too frequently and there is not an excess of inventory sitting on hand. It assumes that there is a trade-off between inventory holding costs and inventory setup costs, and total inventory costs are minimized when both setup costs and holding costs are minimized.

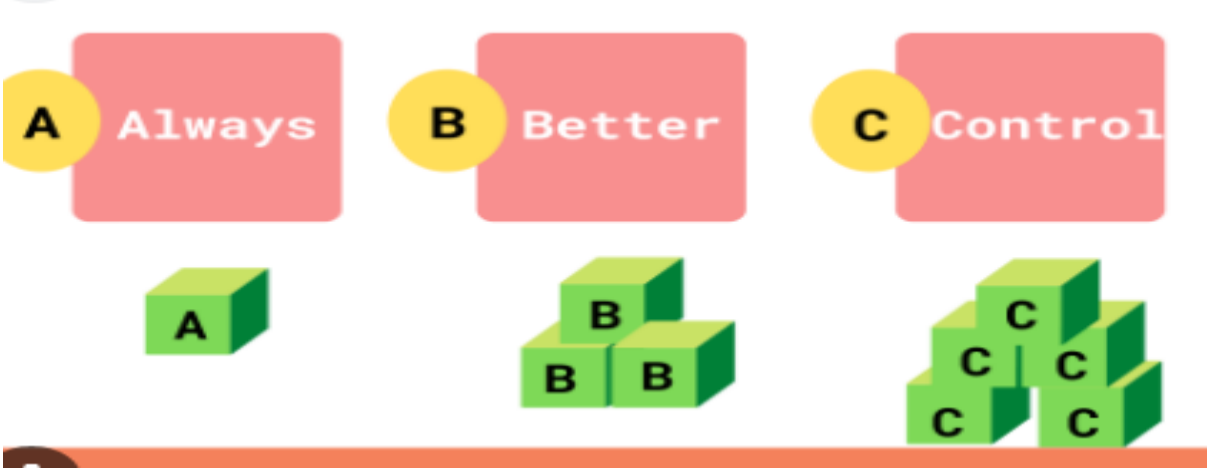


ABC analysis :

ABC analysis is an inventory management technique that determines the value of inventory items based on their importance to the business. ABC ranks items on demand, cost and risk data, and inventory mangers group items into classes based on those criteria. This helps business leaders understand which products or services are most critical to the financial success of their organization.

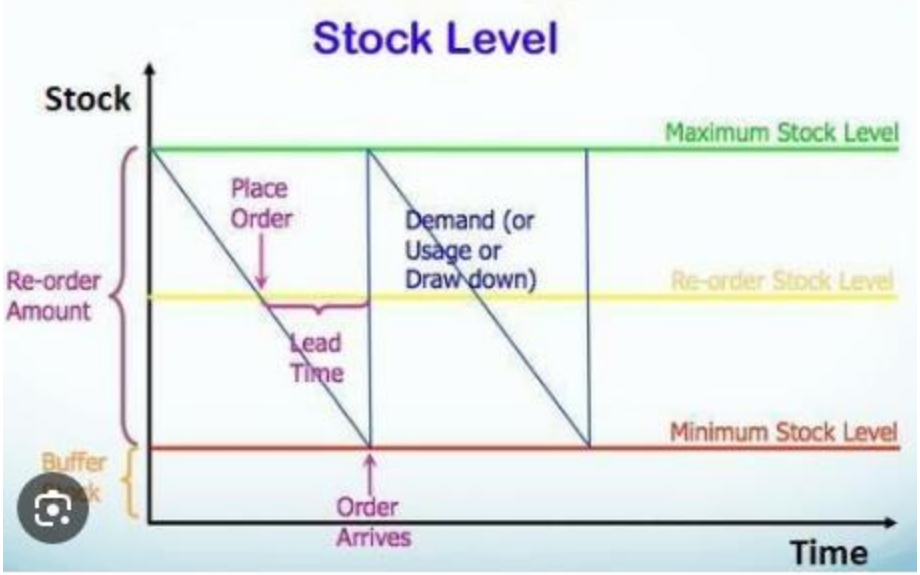
The most important stock keeping units (SKUs), based on either sales volume or profitability, are "Class A" items, the next-most important are Class B and the least important are Class C. Some companies may choose a classification system that breaks products into more than just those three groups (A-F, for example)





Inventory levels :

"Inventory levels" refers to the amount of stock available throughout your distribution network. By tracking your inventory levels, you can consistently meet demand without accruing unnecessary holding costs that diminish gross profits.



KEY TAKEAWAYS

- Inventory management is the entire process of managing inventories from raw materials to finished products.
- Inventory management tries to efficiently streamline inventories to avoid both gluts and shortages.