WELCOME

CTFs

WEBINAR SERIES

On

BUSINESS STUDIES

Ensuring Success : Because CTF cares..!!

BUSINESS STUDIES

Ensuring Success.. Because CTF Cares..!!

WEBINAR SERIES

FINANCIAL MANAGEMENT

Initiative by COMMERCE TEACHERS' FOUNDATION

CTF

तत् त्वं पूषन् अपावृणु

www.ctf.org.in/webinar.html

For any queries/suggestion at 9810447742

WEBINAR SERIES

BUSINESS STUDIES

FINANCIAL MANAGEMENT

Team CTF Members

Ms. Kavita Sachdeva

D A V Centenary Public School
Paschim Enclave, New Delhi

&

Ms. Nameet Chadha

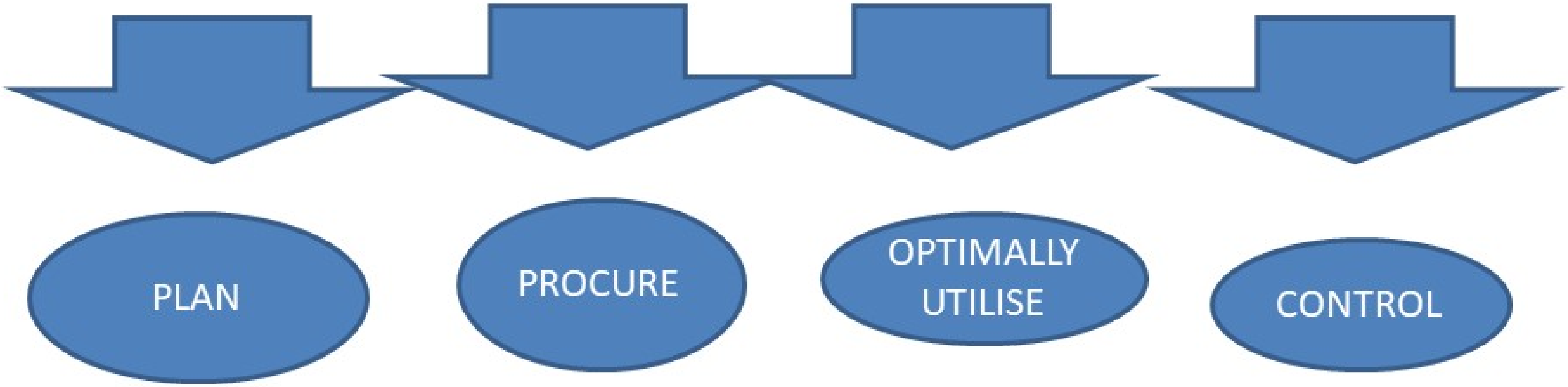
G D Goenka Public School,
Sector 22, Rohini , New Delhi

FINANCIAL MANAGEMENT

CTF
तत् त्वं पूषन् अपावृणु

FINANCIAL MANAGEMENT

(MANAGEMENT OF FINANCE)



Financial Management is concerned with optimal Procurement and Usage of Finance.

Efforts By:-
Ms. Kavita Sachdeva, D A V Centenary Public School, Paschim Enclave, New Delhi
Ms. Nameet Chadha, G D Goenka Public School, Sector 22, Rohini , New Delhi

FINANCIAL MANAGEMENT

IMPORTANT Topics

- Role and Objectives
- Financial Decisions – Investment, Financing & Dividend
- ❑ Factors affecting Investment Decision
- ❑ Factors affecting Financing Decision
- ❑ Factors affecting Dividend Decision
- Financial Planning - Importance
- Financial Leverage/ Trading on Equity
- Factors affecting choice of Capital Structure
- Factors affecting requirements of Fixed Capital
- Factors affecting requirements of Working Capital

CTF
तत् त्वं पूषन् अपावृणु

ROLE OF FINANCIAL MANAGEMENT

1. Size and quantum of Fixed Assets
2. Quantum of Current Assets and break up into Cash, Inventories and Receivables
3. Amount of short-term and long-term funds to be used
4. Break-up of long-term financing into debt-equity etc
5. All items in P & L Account, interest, expense, depreciation etc

Balance Sheet	
Liabilities	Assets
Debt Equity Current Liabilities (3&4)	Fixed assets(1) Current assets(2)

Profit & Loss A/c (5)

OBJECTIVES OF FINANCIAL MANAGEMENT

Primary Objective:

Maximisation of Wealth of Shareholders

Computed as:

Number of Shares X Market Price per share

FINANCIAL DECISIONS

FINANCIAL DECISIONS

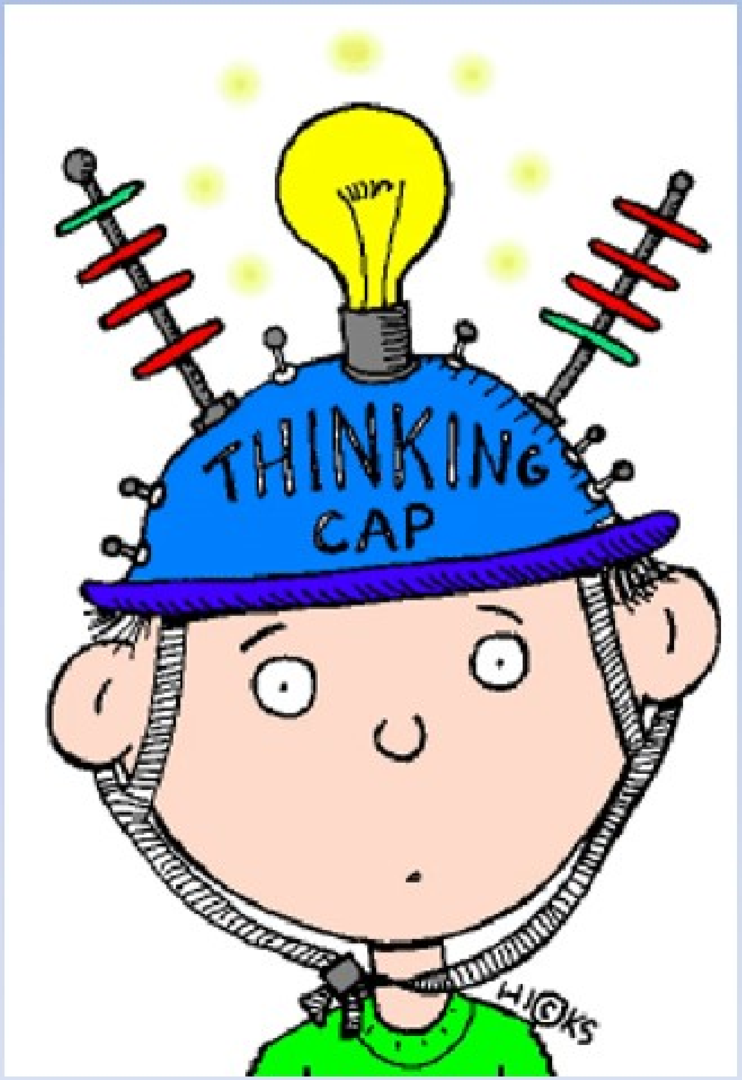
- INVESTMENT DECISION
  - CAPITAL BUDGETING/FIXED CAPITAL DECISION
  - WORKING CAPITAL DECISION
- FINANCING DECISION
  - CAPITAL STRUCTURE
- DIVIDEND DECISION

CAPITAL BUDGETING DECISION

long-term investment decision

FACTORS:

- CASH FLOWS OF THE PROJECT
- RATE OF RETURN
- INVESTMENT CRITERIA



Efforts By:-
Ms. Kavita Sachdeva, D A V Centenary Public School, Paschim Enclave, New Delhi
Ms. Nameet Chadha, G D Goenka Public School, Sector 22, Rohini , New Delhi

FINANCIAL PLANNING OR FINANCIAL MANAGEMENT – WHICH ONE HAS A WIDER SCOPE?

ANSWER:

FINANCIAL MANAGEMENT

CBSE 2019

'G Motors' is the manufacturer of sophisticated cranes. The production manager of the company, reported to the Chief Executive Officer, Ashish Jain that one of the machines used in manufacturing of sophisticated cranes had to be replaced to compete in the market, as other competitors were using automatic machines for manufacturing cranes. After a detailed analysis, it was decided to purchase a new automatic machine having the latest technology. It was decided to finance this machine through long term sources of finance. Ashish Jain compared various machines and decided to invest in the machine which would yield the maximum returns to its investors.

Identify the financial decision taken by Ashish Jain.

Explain the three factors affecting the decision identified in a) above.

4 MARKS

Efforts By:-
Ms. Kavita Sachdeva, D A V Centenary Public School, Paschim Enclave, New Delhi
Ms. Nameet Chadha, G D Goenka Public School, Sector 22, Rohini , New Delhi

CBSE 2019

ANSWER:

Investment decision / Capital Budgeting / Long Term Investment Decision

Factors affecting: Investment decision / Capital Budgeting / Long Term Investment Decision

- **Cash Flows of the project**
- **Rate of Return**
- **Investment Criteria**

4 MARKS

Efforts By:-
Ms. Kavita Sachdeva, D A V Centenary Public School, Paschim Enclave, New Delhi
Ms. Nameet Chadha, G D Goenka Public School, Sector 22, Rohini , New Delhi

CTF
तत् त्वं पूषन् अपावृणु

FINANCING DECISION

(from where to procure long-term finance? Equity or Debt?)

FACTORS:

- COST
- RISK
- FLOATATION COST
- CASH FLOW POSITION OF THE COMPANY
- FIXED OPERATING COST
- CONTROL CONSIDERATIONS
- STATE OF CAPITAL MARKETS

FINANCING DECISION

(from where to procure long-term finance? Equity or Debt?)

FACTORS:

- COST –Minimum (Debt)
- RISK – Minimum (Equity)
- FLOATATION COST – Minimum (Debt)

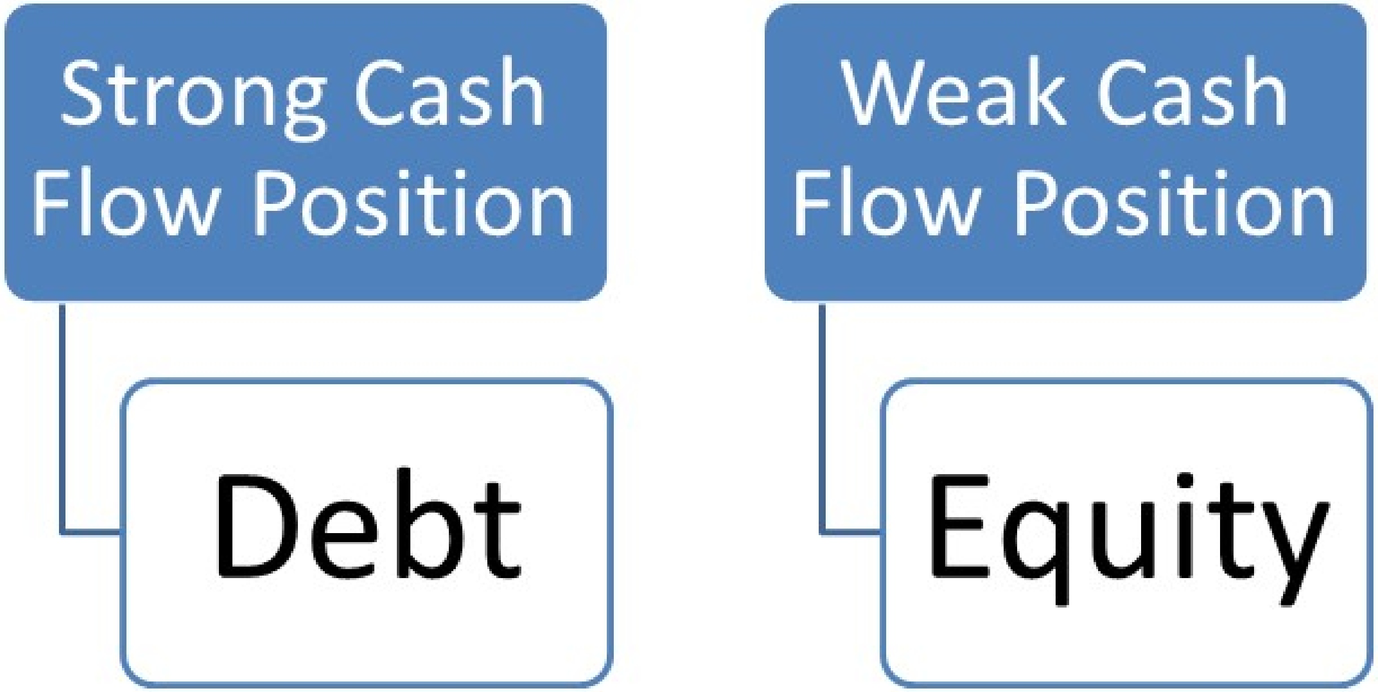
Efforts By:-
Ms. Kavita Sachdeva, D A V Centenary Public School, Paschim Enclave, New Delhi
Ms. Nameet Chadha, G D Goenka Public School, Sector 22, Rohini , New Delhi

FINANCING DECISION

(from where to procure long-term finance? Equity or Debt?)

FACTORS:

- CASH FLOW POSITION OF THE COMPANY

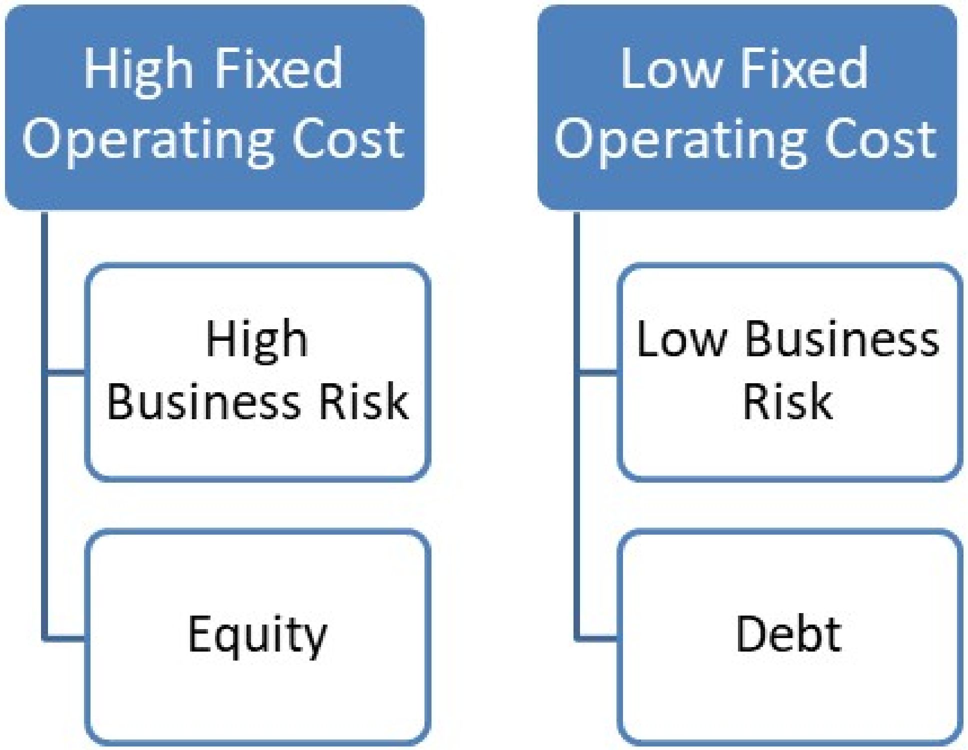


FINANCING DECISION

(from where to procure long-term finance? Equity or Debt?)

FACTORS:

- FIXED OPERATING COST



FINANCING DECISION

(from where to procure long-term finance? Equity or Debt?)

FACTORS:

- CONTROL CONSIDERATIONS

Dilution of Control desired

Equity

Strict control desired

(Dilution of control not desired)

Debt

FINANCING DECISION

(from where to procure long-term finance? Equity or Debt?)

FACTORS:

- STATE OF CAPITAL MARKETS

- BOOM
  - Investors are willing to take risk
  - Equity
- DEPRESSION
  - Investors are not willing to take risk
  - Debt

FINANCING DECISION

(from where to procure long-term finance? Equity or Debt?)

FACTORS:

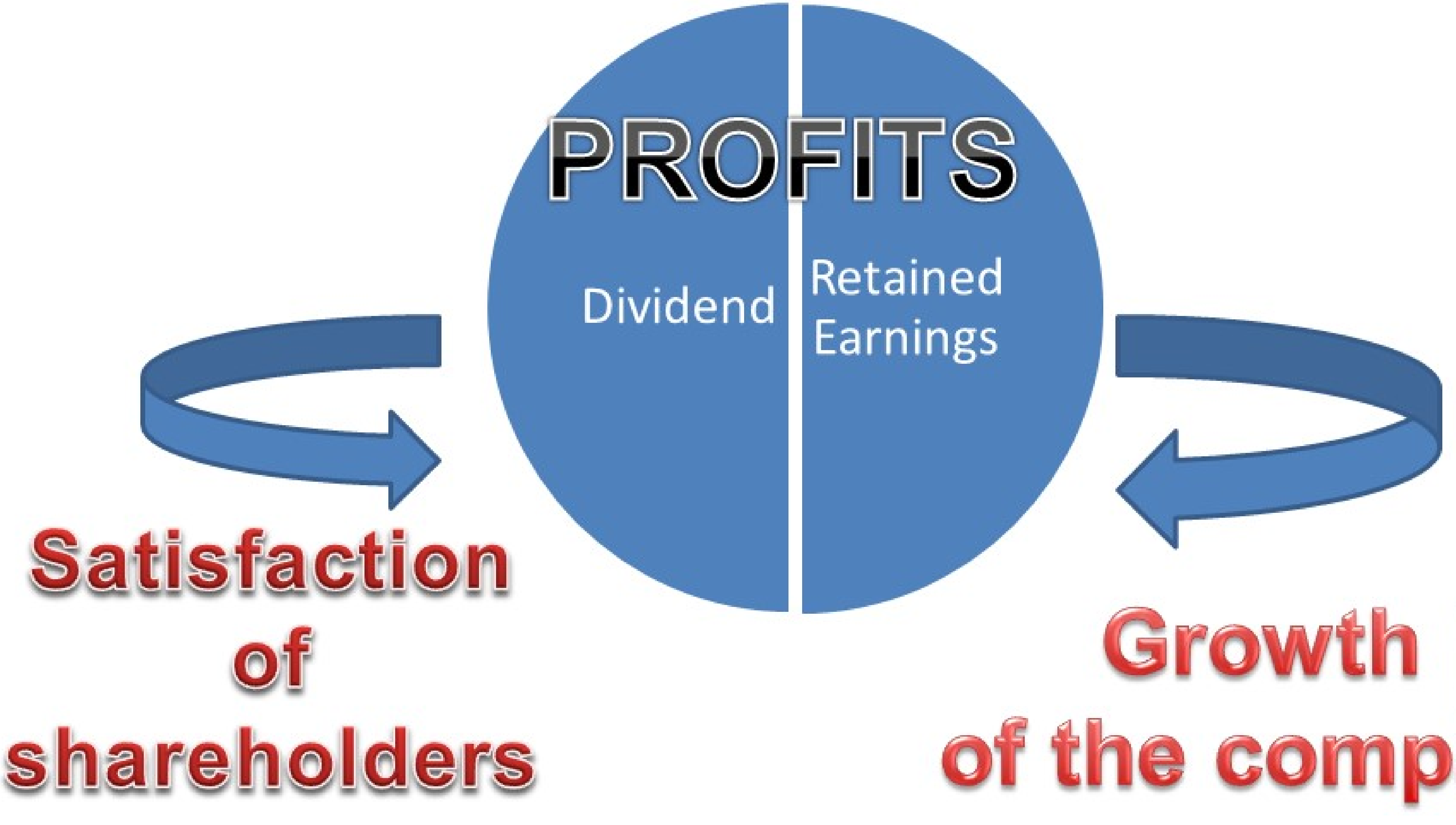
- **COST** (1 COST)
- **RISK**
- **FLOATATION COST** (2 COST)
- **CASH FLOW POSITION OF THE COMPANY** (1 C)
- **FIXED OPERATING COST** (3 COST)
- **CONTROL CONSIDERATIONS** (2 C)
- **STATE OF CAPITAL MARKETS** (3 C)

TAGLINE: 3 COSTS bear karo,

RISK lo, 3 Cs check karo

DIVIDEND DECISION

(appropriation of profits earned; out of profits – how much dividend and how much retained earnings..)



DIVIDEND DECISION

FACTORS:

1. Amount of Earnings
2. Stability of Earnings
3. Stability of Dividends
4. Growth opportunities
5. Cash flow position
6. Shareholders' Preference
7. Taxation policy
8. Stock market reaction
9. Access to capital markets
10. Legal constraints
11. Contractual constraints

DIVIDEND DECISION

FACTORS:

1. Amount of Earnings - Dividend to be paid out of present or past earnings(reserves)

More Earnings

More Dividend

Less Earnings

Less Dividend

DIVIDEND DECISION

FACTORS:

2. Stability of Earnings

- Stable Earnings
  - More Dividend
- Fluctuating Earnings
  - Less Dividend

DIVIDEND DECISION

FACTORS:

3. Stability of Dividends: Stable dividend policy

Eg. Rs. 50 per share

DIVIDEND DECISION

FACTORS:

4. Growth Opportunities

- More Growth Opportunities
  - Less Dividend
- Less Growth Opportunities
  - More Dividend

DIVIDEND DECISION

FACTORS:

5. Cash Flow Position(CFP): Apart from Profits, cash is also required to pay dividends.

- Strong CFP
  - More Dividend
- Weak CFP
  - Less Dividend

DIVIDEND DECISION

FACTORS:

6. Shareholders' Preference

- Increase in current income
  - More Dividend
- Capital gains (Increase in market value of shares)
  - Less Dividend

DIVIDEND DECISION

FACTORS:

7. **Taxation Policy :** The company has to pay dividend distribution tax. The dividend income is tax-free in the hands of shareholders.

8. **Stock Market Reaction**: Distribution of dividends leads to increase in market prices of securities.

Efforts By:-
Ms. Kavita Sachdeva, D A V Centenary Public School, Paschim Enclave, New Delhi
Ms. Nameet Chadha, G D Goenka Public School, Sector 22, Rohini , New Delhi

DIVIDEND DECISION

FACTORS:

9. **Access to Capital Markets: For procuring funds**

Quick and easy access to capital market

More Dividend

Difficult access to capital market

Less Dividend

DIVIDEND DECISION

FACTORS:

10. Legal Constraints: Provisions of Companies Act, SEBI Guidelines. Example – Dividend cannot be paid out of capital.
11. Contractual Constraints : Restrictions on dividend payment due to loan agreements.

Efforts By:-
Ms. Kavita Sachdeva, D A V Centenary Public School, Paschim Enclave, New Delhi
Ms. Nameet Chadha, G D Goenka Public School, Sector 22, Rohini , New Delhi

DIVIDEND DECISION

TAGLINE:

FACTORS:

1. Amount of Earnings (A)
2. Stability of Earnings (S)
3. Stability of Dividends (S)
4. Growth opportunities (G)
5. Cash flow position (C)
6. Shareholders' Preference (S)
7. Taxation policy (T)
8. Stock market reaction (S)
9. Access to capital markets (A)
10. Legal constraints (L)
11. Contractual constraints (C)

4 Strawberries

2 Apples

2 Cakes

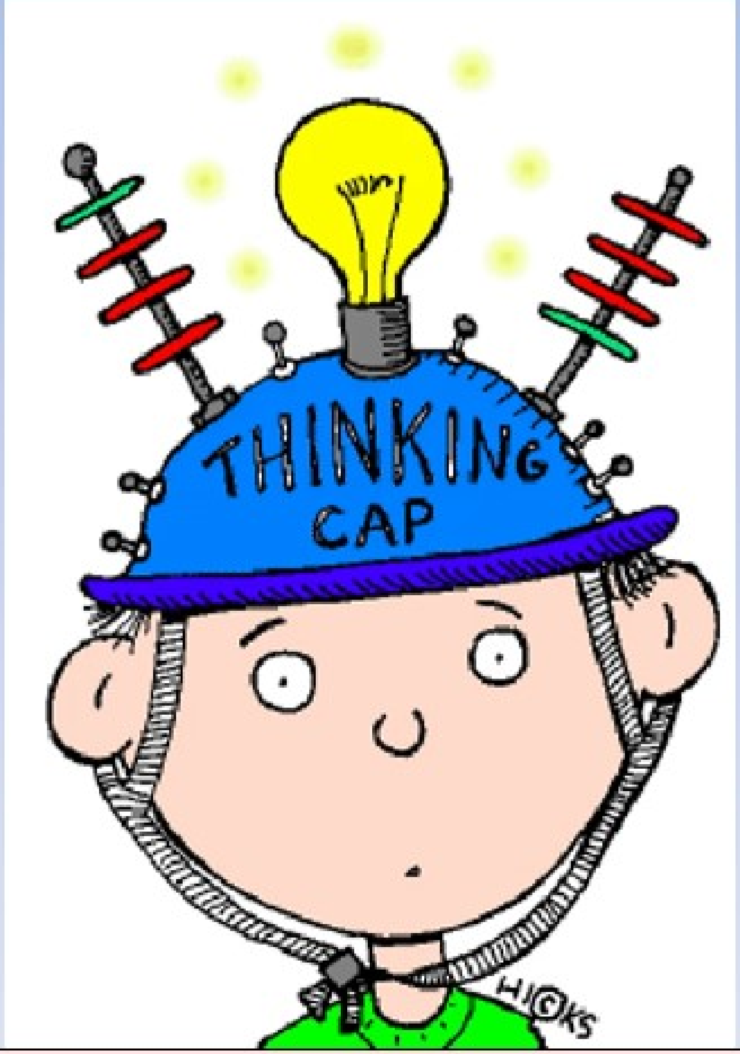
Lets Grow

Together (SSSS

AA CC LGT)

CTF

तत् त्वं पूषन् अपावृणु



Efforts By:-
Ms. Kavita Sachdeva, D A V Centenary Public School, Paschim Enclave, New Delhi
Ms. Nameet Chadha, G D Goenka Public School, Sector 22, Rohini , New Delhi

CBSE QUESTIONS

A growing company is likely to pay more dividends. TRUE/FALSE?

ANSWER: FALSE

Efforts By:-
Ms. Kavita Sachdeva, D A V Centenary Public School, Paschim Enclave, New Delhi
Ms. Nameet Chadha, G D Goenka Public School, Sector 22, Rohini , New Delhi

CBSE QUESTIONS

It is a decision made by directors and/or management as to how, when, where and how much capital will be spent on opportunities. The decision often follows research to determine costs and returns for each option' Identify the decision reflected above. State any two aspects of decision identified in part (a). 3 MARKS

ANSWER: INVESTMENT DECISION

CTF

तत् त्वं पूषन् अपावृणु

FINANCIAL PLANNING

The process of estimating the funds requirement of a business and determining the sources of funds is called financial planning.

(ensuring that right amount of funds are available at the right time)

FINANCIAL PLANNING: Types

Long-term

- More than one year
- Capital expenditures

Short-term

- One year or less
- Budget

FINANCIAL PLANNING: Objectives

No shortage of funds

- *To ensure availability of funds as & when required*

No surplus of funds

- *To ensure that firm does not raise resources unnecessary*

FINANCIAL PLANNING: Process

Sales Forecast → Determining long-term and short-term fund requirements → Determining fixed and working capital requirements → Determining sources of funds

FINANCIAL PLANNING: Importance

- *Forecasting the future*
- *Avoiding business shocks & surprises*
- *Coordination*
- *Optimum utilization of resources*
- *Link present with future*
- *Financial Decisions*
- *Financial Control*

CTF
तत् त्वं पूषन् अपावृणु

FINANCIAL PLANNING: Importance
(Tagline: FFF COLA – 3 friends to have COLA)

- *Forecasting the future (F)*
- *Avoiding business shocks & surprises (A)*
- *Coordination (C)*
- *Optimum utilization of resources (O)*
- *Link present with future (L)*
- *Financial Decisions (F)*
- *Financial Control (F)*

CTF
तत् त्वं पूषन् अपावृणु

CTF
तत् त्वं पूषन् अपावृणु

CBSE 2008

To tackle uncertainty in respect of availability and timings of funds, what is required? 1 MARK

ANSWER: FINANCIAL PLANNING

Efforts By:-
Ms. Kavita Sachdeva, D A V Centenary Public School, Paschim Enclave, New Delhi
Ms. Nameet Chadha, G D Goenka Public School, Sector 22, Rohini , New Delhi

CBSE 2019

'XY' Ltd is registered with an authorized capital of Rs. 10 crore. The paid-up capital of the company is Rs. 6 crore. The company was facing shortage of funds. The management of the company decided to raise funds by issue of 1,00,000 equity shares of Rs. 100 each. The issue was fully subscribed. After this it was realized that the funds raised were in excess of the actual requirement.

Identify and define the concept which was not considered by the company before deciding the amount of funds to be raised. 1 MARK

ANSWER: FINANCIAL PLANNING

CTF

तत् त्वं पूषन् अपावृणु

CAPITAL STRUCTURE

- Related to Financing Decision
- Ownership funds / Equity Vs Borrowed funds / Debt

CAPITAL STRUCTURE

- Owners' funds (Equity) - It includes equity shares, preference shares and reserves and surplus.
- Borrowed funds (Debt) - It includes debentures, loans, public deposits etc.
- The appropriate mix of owners' funds (equity) and borrowed funds (debt) is called capital structure.

Efforts By:-
Ms. Kavita Sachdeva, D A V Centenary Public School, Paschim Enclave, New Delhi
Ms. Nameet Chadha, G D Goenka Public School, Sector 22, Rohini , New Delhi

CTF
तत् त्वं पूषन् अपावृणु

CAPITAL STRUCTURE

- **Computation**

  Debt - Equity ratio (D/E)

  or

  Proportion of Debt over Total Capital

  [D/ (D+E)].

- **Optimum Capital Structure**
- The capital structure is said to be optimum when it leads to maximization of shareholders' wealth by increasing Earning per share.

FINANCIAL LEVERAGE

- Also called as Trading on Equity
- Toffees pack 100 toffees ….100 persons, including 10 teachers …1 toffee each
- 500 toffees….100 persons..5 each
- 500 toffees… ten teachers…1 toffee each..490 toffees left.. 90 children…more than 5 toffees to each (5.44)
- 1000 toffees…ten teachers…1 toffee each…990 toffees left…90 children…11 toffees each
- 10,000 toffees…ten teachers…1 toffee each…9,990 toffees left…90 children…111 toffees each

TOFFEE PACK(NO. OF TOFFEES)	TOTAL PERSONS	TEACHERS	STUDENTS	FIXED NUMBER OF TOFFEES FOR TEACHERS	TOFFEES PER CHILD
100	100	10	90	-	1
500	100	10	90	1	5.44
1000	100	10	90	1	11
10000	100	10	90	1	111

Efforts By:-
Ms. Kavita Sachdeva, D A V Centenary Public School, Paschim Enclave, New Delhi
Ms. Nameet Chadha, G D Goenka Public School, Sector 22, Rohini , New Delhi

FINANCIAL LEVERAGE

LESSON FROM TOFFEE STORY

Increase in number of toffees
for children by giving fixed number
Of toffees to teachers
(with increase in size of toffee packet)

FINANCIAL LEVERAGE

LESSON FROM TOFFEE STORY

Toffee Packet – **EBIT**

Fixed number of toffees for teachers – **Fixed Charge; Interest on Debt**

Increase in number of toffees received by children – **Increasing EPS**

FINANCIAL LEVERAGE

LEARNING FROM TOFFEE STORY

Increase in profits earned by shareholders, due to use of fixed charge securities in the capital structure is called as Favourable Financial Leverage.

In other words, we can say that the company is getting the benefit of Trading on Equity.

FINANCIAL LEVERAGE

The proportion of Debt in the overall capital is called Financial Leverage.

- Equity involves
  No FINANCIAL RISK

- Debt involves
  FINANCIAL RISK*

•*__Financial risk__** is the chance that a firm may fail to meet its payment obligation including interest payment, preference dividend and repayment obligations.

FINANCIAL LEVERAGE

CASE I: FAVOURABLE FINANCIAL LEVERAGE

Total funds used	Rs. 30 Lakh
Interest rate	10% per annum
Tax rate	30%
EBIT	Rs.4 Lakh
Debt Situation I Situation II Situation III	 Nil Rs. 10 Lakh Rs. 20 Lakh

EBIT- EPS ANALYSIS

Particulars	SITUATION IAMOUNT (Rs.)	SITUATION II AMOUNT (Rs.)	SITUATION III AMOUNT (Rs.)
EBIT	4,00,000	4,00,000	4,00,000
Less Interest on Debt	NIL	1,00,000	2,00,000
EBT	4,00,000	3,00,000	2,00,000
Less Tax @ 30%	1,20,000	90,000	60,000
EAT	2,80,000	2,10,000	1,40,000
No. of Shares	3,00,000	2,00,000	1,00,000
EPS (EAT/No. of Shares)	0.93	1.05	1.40

FINANCIAL LEVERAGE

CASE II: UNFAVOURABLE FINANCIAL LEVERAGE

Total funds used	Rs. 30 Lakh
Interest rate	10% per annum
Tax rate	30%
EBIT	Rs.2 Lakh
Debt Situation I Situation II Situation III	 Nil Rs. 10 Lakh Rs. 20 Lakh

CTF
तत् त्वं पूषन् अपावृणु

EBIT- EPS ANALYSIS

Particulars	SITUATION IAMOUNT (Rs.)	SITUATION II AMOUNT (Rs.)	SITUATION III AMOUNT (Rs.)
EBIT	2,00,000	2,00,000	2,00,000
Less Interest on Debt	NIL	1,00,000	2,00,000
EBT	2,00,000	1,00,000	NIL
Less Tax @ 30%	60,000	30,000	NIL
EAT	1,40,000	70,000	NIL
No. of Shares	3,00,000	2,00,000	1,00,000
EPS (EAT/No. of Shares)	0.47	0.35	0

In CASE I, by increasing the use of debt, EPS is increasing. But in CASE II, by increasing the use of debt, EPS is decreasing.

WHY??

CASE	ROI (EBIT / Total funds used) X 100]	COST OF DEBT (INTEREST RATE)	CHANGE IN EPS	CONCLUSION
I	(4,00,000/ 30,00,000)X 100 = 13.33%	10%	INCREASES	FAVOURABLE FINANCIAL LEVERAGE
II	(2,00,000/ 30,00,000)X 100 = 6.67%	10%	DECREASES	UNFAVOURABLE FINANCIAL LEVERAGE

CONCLUSION

- Increased use of debt in the capital structure increases EPS (or shareholders wealth) only when cost of debt (interest rate) is less than ROI.
- Increased use of debt also increases the FINANCIAL RISK.
- So, the company should go for such a capital structure which minimizes the financial risk on one hand and maximizes the RETURN for shareholders on the other.

THE COMPANY HAS TO STRIKE A BALANCE BETWEEN RISK AND RETURN.

CTF

तत् त्वं पूषन् अपावृणु


THINKING
CAP
HICKS

CBSE 2010

Cost of debt is lower than cost of equity. Give reason why a company cannot work with debt only. 1 MARK

ANSWER: This is so because a company cannot be formed without equity.

CTF

तत् त्वं पूषन् अपावृणु

CBSE 2018

The Return on Investment (ROI) of a company ranges between 10% to 12% for the past three years. To finance its future fixed capital needs, it has the following options for borrowing debt : Option 'A' : Rate of interest 9% Option 'B' : Rate of interest 13% Which source of debt, 'Option A' or 'Option B', is better ? Give reason in support of your answer. Also state the concept being used in taking the decision.

3 MARKS

CBSE 2018

ANSWER: OPTION A IS BETTER AS ROI must be greater than Cost of Debt in order to get the benefit of Trading on Equity.

Efforts By:-
Ms. Kavita Sachdeva, D A V Centenary Public School, Paschim Enclave, New Delhi
Ms. Nameet Chadha, G D Goenka Public School, Sector 22, Rohini , New Delhi

FACTORS AFFECTING CHOICE OF CAPITAL STRUCTURE

1. *Cash flow position*
2. *Interest coverage Ratio*
3. *Debt service coverage Ratio*
4. *Return on investment*
5. *Cost of Debt*
6. *Tax rate*
7. *Cost of equity*
8. *Floatation cost*
9. *Risk Consideration*
10. *Flexibility*
11. *Control*
12. *Regulatory framework*
13. *Stock market condition*
14. *Capital Structure of other companies*

FACTORS AFFECTING CHOICE OF CAPITAL STRUCTURE

1. *Cash flow position*

To prepare Projected Cash Flow Statement

Strong CFP

- Debt

Weak CFP

- Equity

Efforts By:-
Ms. Kavita Sachdeva, D A V Centenary Public School, Paschim Enclave, New Delhi
Ms. Nameet Chadha, G D Goenka Public School, Sector 22, Rohini , New Delhi

FACTORS AFFECTING CHOICE OF CAPITAL STRUCTURE

2. Interest Coverage Ratio

EBIT/ Interest

High ICR → Debt

Low ICR → Equity

Efforts By:-
Ms. Kavita Sachdeva, D A V Centenary Public School, Paschim Enclave, New Delhi
Ms. Nameet Chadha, G D Goenka Public School, Sector 22, Rohini , New Delhi

FACTORS AFFECTING CHOICE OF CAPITAL STRUCTURE

3. Debt Service Coverage Ratio

$$\frac{\text{Profit after tax} + \text{Depreciation} + \text{Interest} + \text{Non Cash exp.}}{\text{Pref. Div} + \text{Interest} + \text{Repayment obligation}}$$

- High DSCR
  - Debt
- Low DSCR
  - Equity

FACTORS AFFECTING CHOICE OF CAPITAL STRUCTURE

4. Return on Investment

- If ROI > Cost of Debt
  - The company can get benefit of Trading on Equity
  - Debt
- If ROI < Cost of Debt
  - The company cannot get benefit of Trading on Equity
  - Equity

FACTORS AFFECTING CHOICE OF CAPITAL STRUCTURE

5. Cost of Debt

High Cost of Debt
- Equity

Low Cost of Debt
- Debt

FACTORS AFFECTING CHOICE OF CAPITAL STRUCTURE

6. Tax Rate

Interest on debt is tax deductible. So, if tax rate is high and business wishes to reduce tax liability, debt should be issued.

FACTORS AFFECTING CHOICE OF CAPITAL STRUCTURE

7. Cost of Equity

Cost of equity is measured in terms of expectations of shareholders. If company issues debt, financial risk increases, so shareholders expect more return and cost of equity also increases.

FACTORS AFFECTING CHOICE OF CAPITAL STRUCTURE

8. Floatation Cost

Cost of issuing shares and debentures also need to be considered.

Generally, floatation cost of issuing debt is less.

Efforts By:-
Ms. Kavita Sachdeva, D A V Centenary Public School, Paschim Enclave, New Delhi
Ms. Nameet Chadha, G D Goenka Public School, Sector 22, Rohini , New Delhi

FACTORS AFFECTING CHOICE OF CAPITAL STRUCTURE

9. Risk Considerations

Total Risk = Operating Risk + Financial Risk

- High Operating Risk
  - **Low financial risk should be assumed**
  - Equity
- Low Operating Risk
  - **High financial risk can be assumed**
  - Debt

FACTORS AFFECTING CHOICE OF CAPITAL STRUCTURE

10. Flexibility

Flexibility here refers to ease with which additional funds can be raised.

To maintain flexibility, excessive debt should not be issued.

FACTORS AFFECTING CHOICE OF CAPITAL STRUCTURE

11. Control

Dilution of Control desired

Equity

Strict control desired

(Dilution of control not desired)

Debt

Efforts By:-
Ms. Kavita Sachdeva, D A V Centenary Public School, Paschim Enclave, New Delhi
Ms. Nameet Chadha, G D Goenka Public School, Sector 22, Rohini , New Delhi

FACTORS AFFECTING CHOICE OF CAPITAL STRUCTURE

12. Regulatory Framework

The provisions of Companies Act and SEBI guidelines must be followed.

FACTORS AFFECTING CHOICE OF CAPITAL STRUCTURE

13. Stock Market Conditions

BOOM
- Investors are willing to take risk
- Equity

DEPRESSION
- Investors are not willing to take risk
- Debt

FACTORS AFFECTING CHOICE OF CAPITAL STRUCTURE

14. Capital Structure of other companies

To check and comply with industry norms, if any.

FACTORS AFFECTING CHOICE OF CAPITAL STRUCTURE

1. *Cash flow position (C)*
2. *Interest coverage Ratio (I)*
3. *Debt service coverage Ratio (D)*
4. *Return on investment (R)*
5. *Cost of Debt (C)*
6. *Tax rate (T)*
7. *Cost of equity (C)*
8. *Floatation cost (F)*
9. *Risk Consideration (R)*
10. *Flexibility (F)*
11. *Control (C)*
12. *Regulatory framework (R)*
13. *Stock market condition (S)*
14. *Capital Structure of other companies (C)*

Tagline: 4 Criminals in 3 Rooms, CID To Search Fast Fast

(CCCC RRR CID TS FF)

CTF

तत् त्वं पूषन् अपावृणु

FIXED AND WORKING CAPITAL

Fixed Capital/Block Capital refers to investment in long term assets. It includes capital invested in fixed assets like plant & machinery, land & building, furniture & fixtures etc.

MANAGEMENT OF FIXED CAPITAL

Management of Fixed Capital is called **CAPITAL BUDGETING.** It refers to deciding about the investment in long term projects or fixed assets.

FACTORS AFFECTING REQUIREMENTS OF FIXED CAPITAL

1. *Nature of Business*
2. *Scale of Operations*
3. *Choice of Technique*
4. *Technology Upgradation*
5. *Growth Prospects*
6. *Diversification*
7. *Financing alternatives*
8. *Level of collaboration*

FACTORS AFFECTING REQUIREMENTS OF FIXED CAPITAL

MANUFACTURING OF GOODS

TRADING OF GOODS

FACTORS AFFECTING REQUIREMENTS OF FIXED CAPITAL

1. Nature of Business

MANUFACTURING BUSINESS

- More FC required

TRADING BUSINESS

- Less FC required

Efforts By:-
Ms. Kavita Sachdeva, D A V Centenary Public School, Paschim Enclave, New Delhi
Ms. Nameet Chadha, G D Goenka Public School, Sector 22, Rohini , New Delhi

CTF
तत् त्वं पूषन् अपावृणु

FACTORS AFFECTING REQUIREMENTS OF FIXED CAPITAL

BUSINESS BY
LALA RAMLAL

BUSINESS BY
LALA SHAMLAL

FACTORS AFFECTING REQUIREMENTS OF FIXED CAPITAL

2. Scale of Operations

LARGE SCALE
- More FC required

SMALL SCALE
- Less FC required

Efforts By:-
Ms. Kavita Sachdeva, D A V Centenary Public School, Paschim Enclave, New Delhi
Ms. Nameet Chadha, G D Goenka Public School, Sector 22, Rohini , New Delhi

FACTORS AFFECTING REQUIREMENTS OF FIXED CAPITAL

FARMING BY BHOLA RAM

FARMING BY GOLA RAM

FACTORS AFFECTING REQUIREMENTS OF FIXED CAPITAL

3. Choice of Technique

Labour - Intensive Technique

Less FC required

Capital- Intensive Technique

More FC required

Efforts By:-
Ms. Kavita Sachdeva, D A V Centenary Public School, Paschim Enclave, New Delhi
Ms. Nameet Chadha, G D Goenka Public School, Sector 22, Rohini , New Delhi

CTF
तत् त्वं पूषन् अपावृणु

FACTORS AFFECTING REQUIREMENTS OF FIXED CAPITAL

4. Technological Upgradation

Rapid Technological Advancement
- More FC required

Slow Technological Advancement
- Less FC required

FACTORS AFFECTING REQUIREMENTS OF FIXED CAPITAL

5. Growth Prospects

- **High Growth Prospects**
  - More FC required
- **Low Growth Prospects**
  - Less FC required

FACTORS AFFECTING REQUIREMENTS OF FIXED CAPITAL

6. Diversification

Single Product Line (Lack of Diversification)

- Less FC required

Multiple Product Lines (Diversified Operations)

- More FC required

Efforts By:-
Ms. Kavita Sachdeva, D A V Centenary Public School, Paschim Enclave, New Delhi
Ms. Nameet Chadha, G D Goenka Public School, Sector 22, Rohini , New Delhi

FACTORS AFFECTING REQUIREMENTS OF FIXED CAPITAL

7. Financing Alternatives

Financing Alternatives Available (Such as Lease Financing)	Financing Alternatives Not Available
Less FC required	More FC required

Efforts By:-
Ms. Kavita Sachdeva, D A V Centenary Public School, Paschim Enclave, New Delhi
Ms. Nameet Chadha, G D Goenka Public School, Sector 22, Rohini , New Delhi

CTF
तत् त्वं पूषन् अपावृणु

FACTORS AFFECTING REQUIREMENTS OF FIXED CAPITAL

8. Level of Collaboration

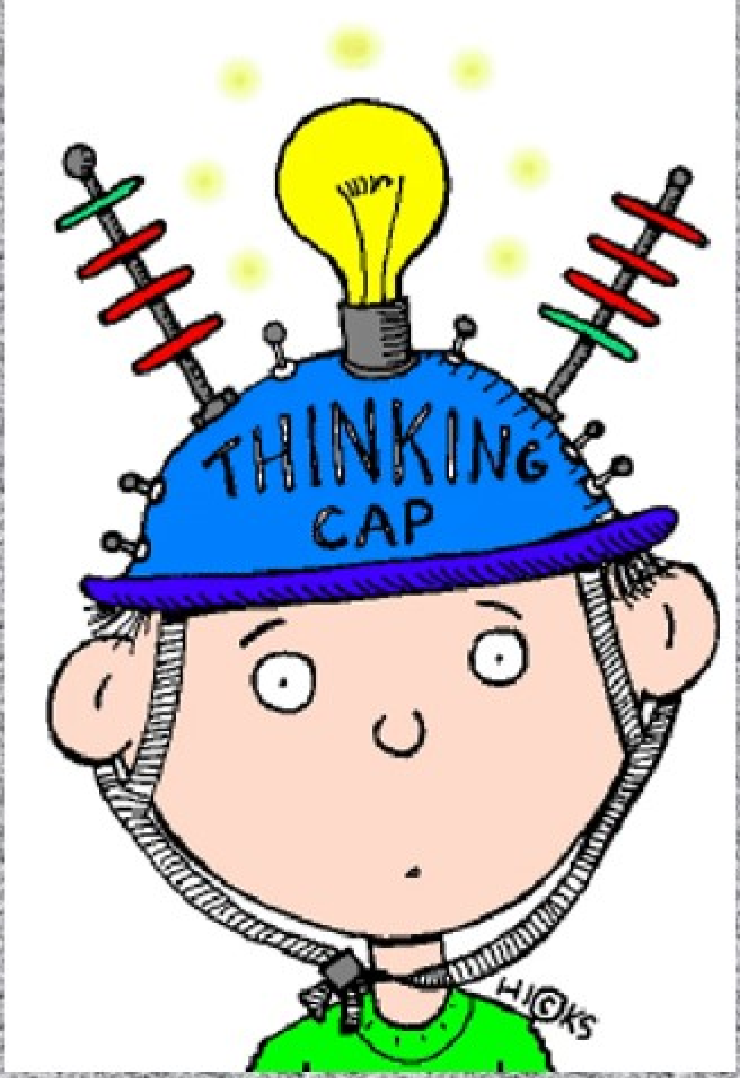
- **Collaborative Ventures**
  - Less FC required
- **Independent Ventures**
  - More FC required

FACTORS AFFECTING REQUIREMENTS OF FIXED CAPITAL

1. ***Nature of Business (N)***
2. ***Scale of Operations (S)***
3. ***Choice of Technique (C)***
4. ***Technology Upgradation (T)***
5. ***Growth Prospects (G)***
6. ***Diversification (D)***
7. ***Financing alternatives (F)***
8. ***Level of collaboration (L)***

Tagline: (NSC FT DGL) Nice Sweet Cake, Fill Tummy, Don't Get Late !!

CTF
तत् त्वं पूषन् अपावृणु


THINKING
CAP
HICKS

MANAGEMENT OF FIXED CAPITAL IS CALLED AS..............

ANSWER: **CAPITAL BUDGETING**

Efforts By:-
Ms. Kavita Sachdeva, D A V Centenary Public School, Paschim Enclave, New Delhi
Ms. Nameet Chadha, G D Goenka Public School, Sector 22, Rohini , New Delhi

CTF
तत् त्वं पूषन् अपावृणु

GIVE ONE WORD FOR 'CURRENT INCOME FOR SHAREHOLDERS'

ANSWER: DIVIDEND

RISK-LESS SOURCE OF FINANCE

ANSWER: EQUITY

CHEAPEST SOURCE OF FINANCE

ANSWER: **DEBT**

CBSE 2019

Sunflag Iron Ltd. is manufacturing steel at its plant in India. It is enjoying increased demand for its steel as economic growth of the country is about 8%. Its is planning to set up a new plant to avail the benefits of increased demand. It is estimated that it will require about Rs. 4,000 crore for setting up the plant and about Rs. 600 crore for other expenses to start the new plant.

To collect the above mentioned funds, the sources to be used and the quantity to be collected from different sources had to be considered.

Identify the above discussed concept and give its meaning. Explain any two factors that affect the concept identified in (a) above. 3 MARKS

ANSWER : CAPITAL STRUCTURE

WORKING CAPITAL

- **Gross Working Capital** –

- **Net Working Capital** -

FACTORS AFFECTING REQUIREMENTS OF WORKING CAPITAL

1. *Nature of Business*
2. *Scale of operations*
3. *Business Cycle*
4. *Seasonal factors*
5. *Production cycle*
6. *Credit allowed*
7. *Credit Availed*
8. *Operating efficiency*
9. *Availability of raw material*
10. *Growth prospects*
11. *Level of competition*
12. *Inflation*

FACTORS AFFECTING REQUIREMENTS OF WORKING CAPITAL

MANUFACTURING OF GOODS

TRADING OF GOODS

SERVICES

FACTORS AFFECTING REQUIREMENTS OF NET WORKING CAPITAL

1. Nature of Business

- **Manufacturing Business Firm**
  - Stock of Raw Material, WIP & Finished Goods
  - More NWC
- **Trading Business Firm**
  - Stock of Finished Goods Only
  - Comparatively Less NWC
- **Service Providing Firm**
  - No Stock
  - Very less NWC

Efforts By:-
Ms. Kavita Sachdeva, D A V Centenary Public School, Paschim Enclave, New Delhi
Ms. Nameet Chadha, G D Goenka Public School, Sector 22, Rohini , New Delhi

FACTORS AFFECTING REQUIREMENTS OF NET WORKING CAPITAL

BUSINESS BY LALA RAMLAL

BUSINESS BY LALA SHAMLAL

FACTORS AFFECTING REQUIREMENTS OF NET WORKING CAPITAL

2. Scale of Operations

LARGE SCALE

- More NWC

SMALL SCALE

- Less NWC

FACTORS AFFECTING REQUIREMENTS OF NET WORKING CAPITAL

3. Business Cycle

BOOM	DEPRESSION
More NWC	Less NWC

Efforts By:-
Ms. Kavita Sachdeva, D A V Centenary Public School, Paschim Enclave, New Delhi
Ms. Nameet Chadha, G D Goenka Public School, Sector 22, Rohini , New Delhi

FACTORS AFFECTING REQUIREMENTS OF NET WORKING CAPITAL

4. Seasonal Factors

PEAK SEASON
- More NWC

LEAN SEASON
- Less NWC

Efforts By:-
Ms. Kavita Sachdeva, D A V Centenary Public School, Paschim Enclave, New Delhi
Ms. Nameet Chadha, G D Goenka Public School, Sector 22, Rohini , New Delhi

FACTORS AFFECTING REQUIREMENTS OF NET WORKING CAPITAL

BUSINESS BY MS. PREETO (COOKIES)

BUSINESS BY MS. JEETO (MEDICINES)

FACTORS AFFECTING REQUIREMENTS OF NET WORKING CAPITAL

5. PRODUCTION CYCLE

LONG PRODUCTION CYCLE	SHORT PRODUCTION CYCLE
More NWC	Less NWC

FACTORS AFFECTING REQUIREMENTS OF NET WORKING CAPITAL

6. CREDIT ALLOWED

LIBERAL CREDIT POLICY

- Long credit period allowed to customers
- **More NWC**

STRICT CREDIT POLICY

- Short credit period allowed to customers
- **Less NWC**

FACTORS AFFECTING REQUIREMENTS OF NET WORKING CAPITAL

7. CREDIT AVAILED

LONG CREDIT AVAILED

- Long credit period allowed by suppliers
- **Less NWC**

SHORT CREDIT AVAILED

- Short credit period allowed by suppliers
- **More NWC**

FACTORS AFFECTING REQUIREMENTS OF NET WORKING CAPITAL

8. OPERATING EFFICIENCY

HIGH OPERATING EFFICIENCY

- Less NWC

LOW OPERATING EFFICIENCY

- More NWC

FACTORS AFFECTING REQUIREMENTS OF NET WORKING CAPITAL

9. AVAILABILITY OF RAW MATERIAL

CONTINUOUS & FREE SUPPLY OF RAW MATERIAL AND/OR SHORT LEAD TIME

- **Less NWC**

INTERRUPTED SUPPLY OF RAW MATERIAL AND/OR LONG LEAD TIME

- **More NWC**

FACTORS AFFECTING REQUIREMENTS OF NET WORKING CAPITAL

10. GROWTH PROSPECTS

HIGH GROWTH PROSPECTS

- More NWC

LOW GROWTH PROSPECTS

- Less NWC

Efforts By:-
Ms. Kavita Sachdeva, D A V Centenary Public School, Paschim Enclave, New Delhi
Ms. Nameet Chadha, G D Goenka Public School, Sector 22, Rohini , New Delhi

FACTORS AFFECTING REQUIREMENTS OF NET WORKING CAPITAL

11. LEVEL OF COMPETITION

HIGH COMPETITION
- More NWC

LOW COMPETITION
- Less NWC

FACTORS AFFECTING REQUIREMENTS OF NET WORKING CAPITAL

12. INFLATION –

If the prices of raw materials, labour etc., increase, the working capital requirements will increase. If such increase in prices is passed on to consumers in the form of increased prices of goods and services, then the working capital requirements will not change much.

FACTORS AFFECTING REQUIREMENTS OF WORKING CAPITAL

1. *Nature of Business (N)*
2. *Scale of operations (S)*
3. *Business Cycle (B)*
4. *Seasonal factors (S)*
5. *Production cycle (P)*
6. *Credit allowed (C)*
7. *Credit Availed (C)*
8. *Operating efficiency (O)*
9. *Availability of raw material (A)*
10. *Growth prospects (G)*
11. *Level of competition (L)*
12. *Inflation (I)*

TAGLINE:

Non Stop

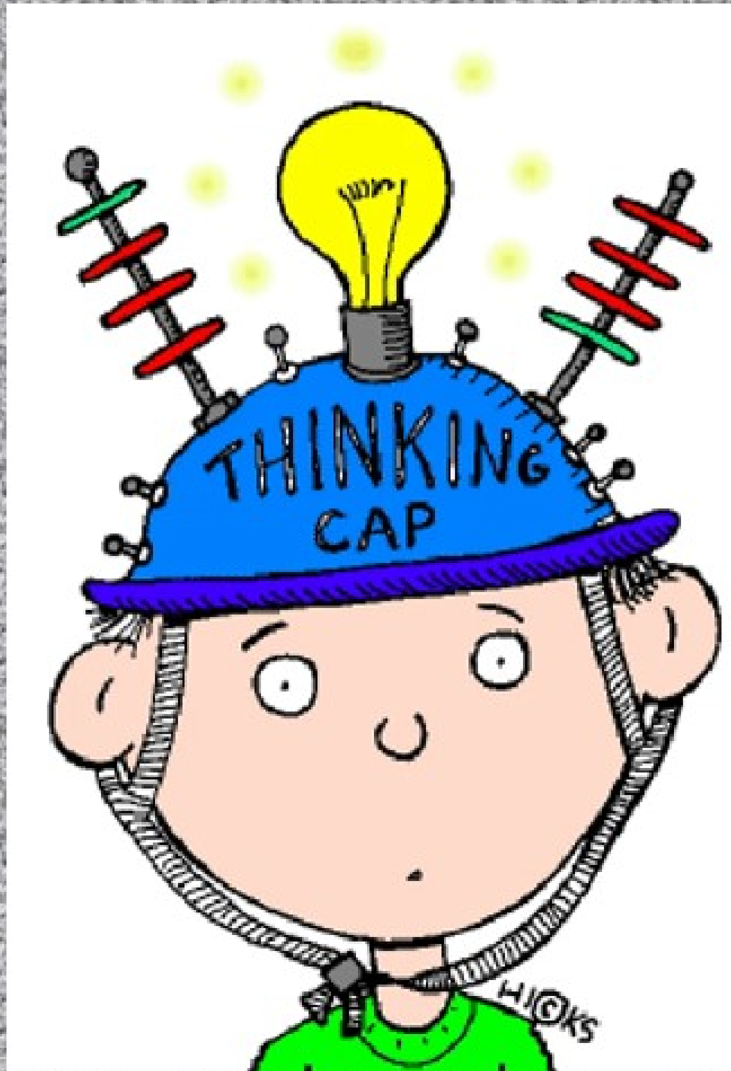
Business

Studies In PC,

Get COLA

NS BS IPC G

COLA



CTF
तत् त्वं पूषन् अपावृणु

Warehousing Business MORE/LESS WORKING CAPITAL?

ANSWER: **LESS WORKING CAPITAL**

Transportation Business MORE/LESS WORKING CAPITAL?

ANSWER: **LESS WORKING CAPITAL**

Decision affecting Liquidity and Profitability of Business…..

ANSWER: WORKING CAPITAL DECISION

Financial Decision affecting long-term growth, profitability and earning capacity of business

.....

ANSWER: LONG-TERM INVESTMENT / FIXED CAPITAL DECISION/ CAPITAL BUDGETING DECISION

Identify the type of capital that will be required to meet the day to day expenses of business, such as:

ANSWER: WORKING CAPITAL

CBSE QUESTION

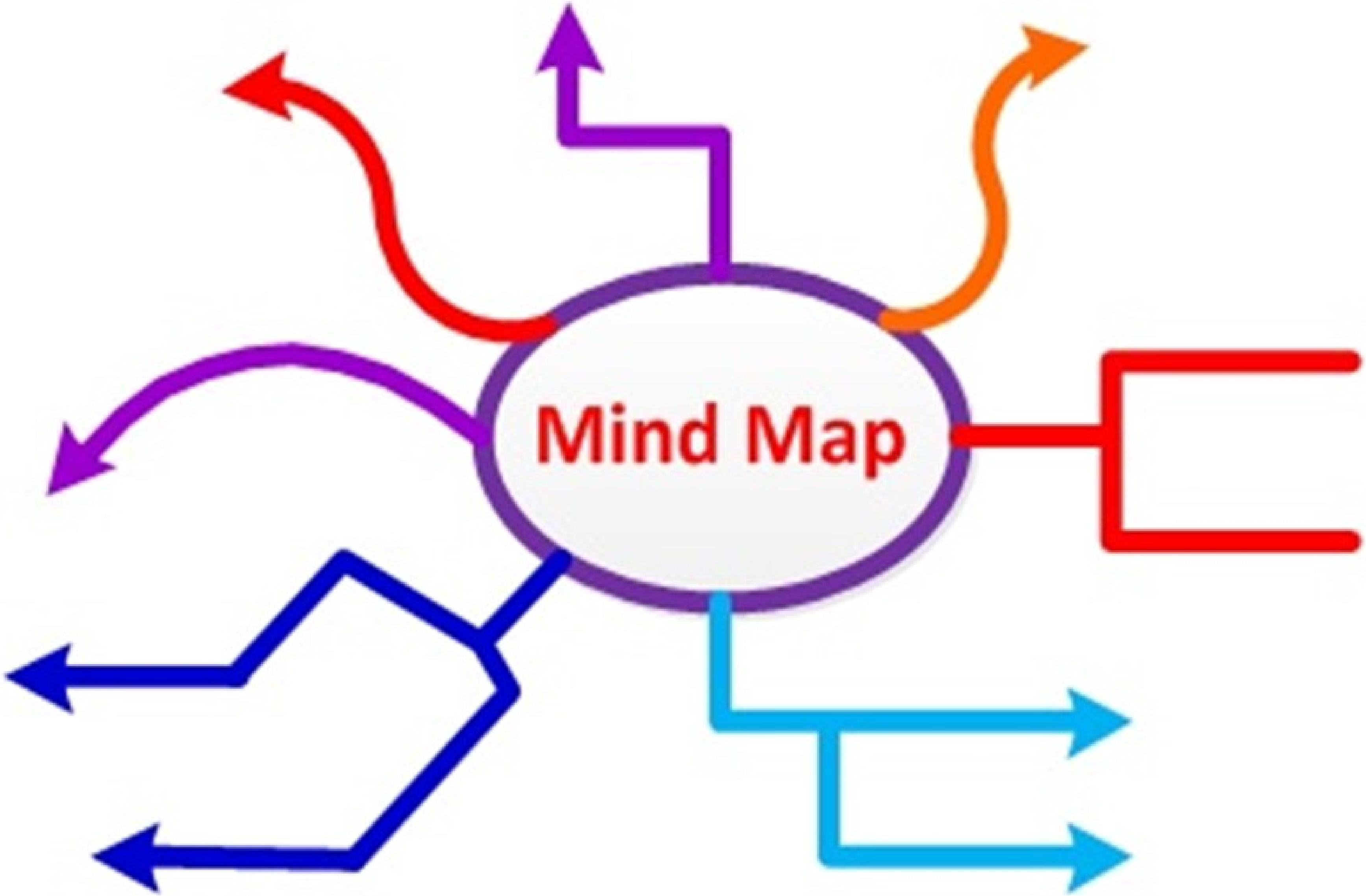
In the paint industry, various raw materials are mixed in different proportions with petroleum for manufacturing different kinds of paints. One specific raw material is not readily and regularly available to the paint manufacturing companies. Bonler Paints Company is also facing this problem and because of this there is a time lag between placing the order and the actual receipt of the material. But, once it receives the raw materials, it takes less time in converting it into finished goods. Identify the factor affecting the working capital requirements of this industry.

1 MARK

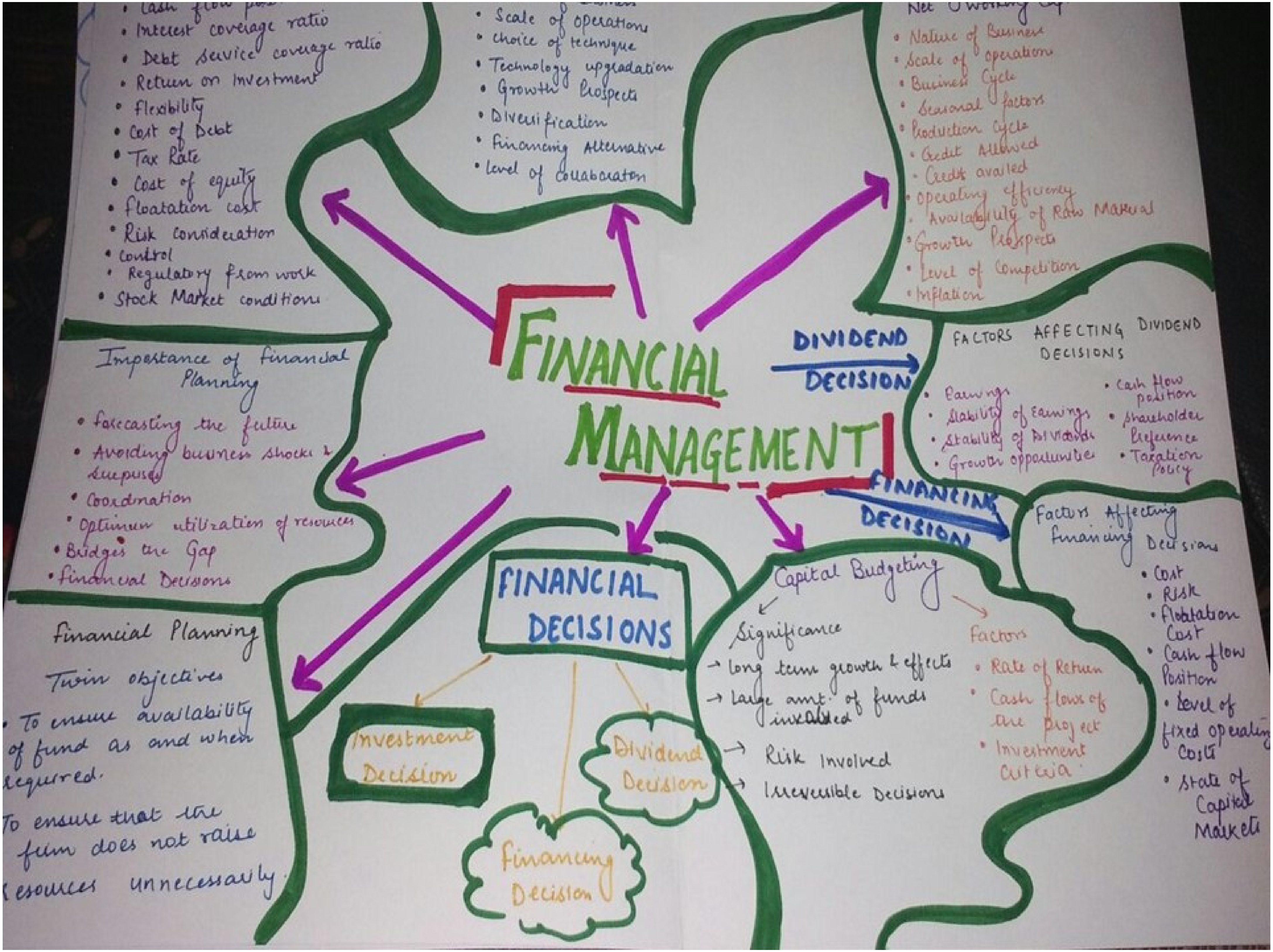
ANSWER: **AVAILABILITYOF RAW MATERIAL**

CTF

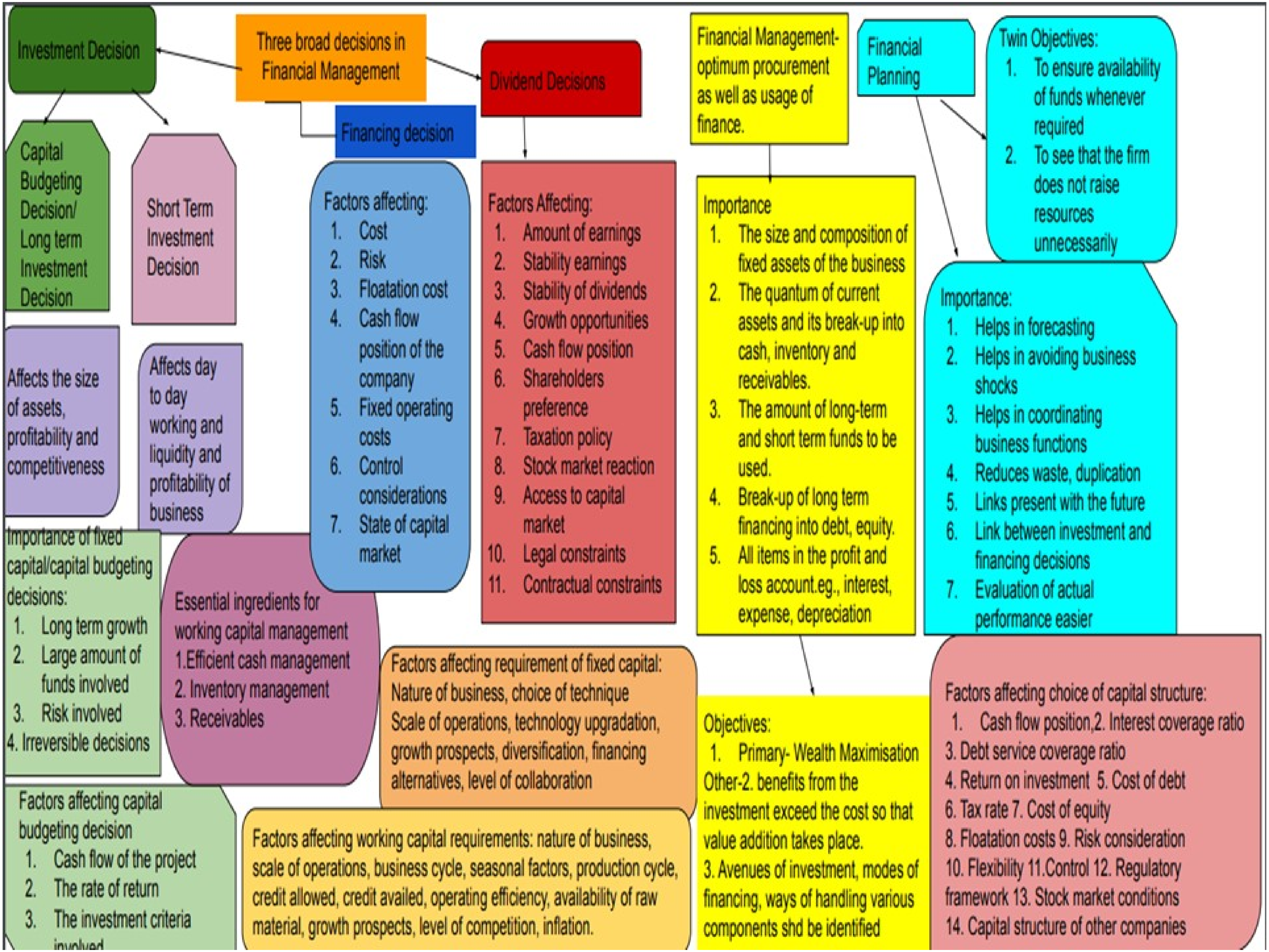
तत् त्वं पूषन् अपावृणु



Efforts By:-
Ms. Kavita Sachdeva, D A V Centenary Public School, Paschim Enclave, New Delhi
Ms. Nameet Chadha, G D Goenka Public School, Sector 22, Rohini , New Delhi



FINANCIAL MANAGEMENT
• Cash flow pos...
• Interest coverage ratio
• Debt service coverage ratio
• Return on Investment
• Flexibility
• Cost of Debt
• Tax Rate
• Cost of equity
• Floatation cost
• Risk consideration
• control
• Regulatory framework
• Stock Market conditions
• Scale of operations
• choice of technique
• Technology upgradation
• Growth Prospects
• Diversification
• Financing Alternative
• level of collaboration
Net Working Cap...
• Nature of Business
• Scale of operations
• Business Cycle
• Seasonal factors
• Production Cycle
• Credit Allowed
• Credit availed
• operating efficiency
• Availability of Raw Material
• Growth Prospects
• Level of Competition
• Inflation
DIVIDEND DECISION
FACTORS AFFECTING DIVIDEND DECISIONS
• Earnings
• Stability of Earnings
• Stability of Dividends
• Growth opportunities
• Cash flow position
• Shareholder Preference
• Taxation Policy
FINANCING DECISION
Factors Affecting financing Decisions
• Cost
• Risk
• Floatation Cost
• Cash flow Position
• Level of fixed operating costs
• State of Capital Markets
Importance of financial Planning
• forecasting the future
• Avoiding business shocks & surprises
• Coordination
• Optimum utilization of resources
• Bridges the Gap
• financial Decisions
financial Planning
Twin objectives
• To ensure availability of fund as and when required.
To ensure that the firm does not raise resources unnecessarily.
FINANCIAL DECISIONS
Investment Decision
Dividend Decision
Financing Decision
Capital Budgeting
Significance
→ long term growth & effects
→ Large amt. of funds involved
→ Risk Involved
→ Irreversible Decisions
Factors
• Rate of Return
• Cash flows of the project
• Investment criteria



Three broad decisions in Financial Management
Investment Decision
Dividend Decisions
Financing decision
Capital Budgeting Decision/ Long term Investment Decision
Short Term Investment Decision
Affects the size of assets, profitability and competitiveness
Affects day to day working and liquidity and profitability of business
Importance of fixed capital/capital budgeting decisions:
1. Long term growth
2. Large amount of funds involved
3. Risk involved
4. Irreversible decisions
Factors affecting capital budgeting decision
1. Cash flow of the project
2. The rate of return
3. The investment criteria involved
Essential ingredients for working capital management
1.Efficient cash management
2. Inventory management
3. Receivables
Factors affecting:
1. Cost
2. Risk
3. Floatation cost
4. Cash flow position of the company
5. Fixed operating costs
6. Control considerations
7. State of capital market
Factors Affecting:
1. Amount of earnings
2. Stability earnings
3. Stability of dividends
4. Growth opportunities
5. Cash flow position
6. Shareholders preference
7. Taxation policy
8. Stock market reaction
9. Access to capital market
10. Legal constraints
11. Contractual constraints
Factors affecting requirement of fixed capital:
Nature of business, choice of technique
Scale of operations, technology upgradation, growth prospects, diversification, financing alternatives, level of collaboration
Factors affecting working capital requirements: nature of business, scale of operations, business cycle, seasonal factors, production cycle, credit allowed, credit availed, operating efficiency, availability of raw material, growth prospects, level of competition, inflation.
Financial Management- optimum procurement as well as usage of finance.
Importance
1. The size and composition of fixed assets of the business
2. The quantum of current assets and its break-up into cash, inventory and receivables.
3. The amount of long-term and short term funds to be used.
4. Break-up of long term financing into debt, equity.
5. All items in the profit and loss account.eg., interest, expense, depreciation
Objectives:
1. Primary- Wealth Maximisation
Other-2. benefits from the investment exceed the cost so that value addition takes place.
3. Avenues of investment, modes of financing, ways of handling various components shd be identified
Financial Planning
Twin Objectives:
1. To ensure availability of funds whenever required
2. To see that the firm does not raise resources unnecessarily
Importance:
1. Helps in forecasting
2. Helps in avoiding business shocks
3. Helps in coordinating business functions
4. Reduces waste, duplication
5. Links present with the future
6. Link between investment and financing decisions
7. Evaluation of actual performance easier
Factors affecting choice of capital structure:
1. Cash flow position,2. Interest coverage ratio
3. Debt service coverage ratio
4. Return on investment 5. Cost of debt
6. Tax rate 7. Cost of equity
8. Floatation costs 9. Risk consideration
10. Flexibility 11.Control 12. Regulatory framework 13. Stock market conditions
14. Capital structure of other companies

Efforts By:-
Ms. Kavita Sachdeva, D A V Centenary Public School, Paschim Enclave, New Delhi
Ms. Nameet Chadha, G D Goenka Public School, Sector 22, Rohini , New Delhi