TOPIC

Unit 1

Financial Management — An Overview

Objective ⇒ Wealth MAX ⇒ Market value of Share

Procurement of Funds

⇓

min. cost

Utilisation of funds

⇓

MAX. Return

Difference Between Fixed Capital and Working Capital

Asset

Fixed Capital

Fixed capital is the capital that is used for buying fixed assets that are used for a longer period of time in the business.

Day to day Exp.

Working Capital

Working capital is the capital that is used to carry out day-to-day business activities.

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Forms Of Business Organisation

- Sole Proprietary ⇒ Self
- Partnership Firm ⇒ Friends (unlimited)
- Limited Liability Partnership (LLP ⇒ Friends (limited)
- Hindu Undivided Family ⇒ Family
- Association of Persons or Body of Individuals ⇒ Temprorary
- Company ⇒ large level
- Co-operative society ⇒ Mutual help

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Sole Proprietary

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⇒ Min. 2 - MAX. 50
⇒ objective - Profit sharing
⇒ unlimited Liability
⇒ Registration - Not Mandatory
⇒ No sep. legal identity

Partnership Firm

Partnership is the relation between persons who have agreed to share the profits of a business carried on by all or any of them acting for all.

- Governed by the Indian Partnership Act, 1932.
- As per Section 4 of the Indian Partnership Act

From this definition, the following points are clear:

- An association of two or more persons
- An agreement/contract between the persons
- The agreement is to carry on a business with the object of sharing profits
- The business is to be carried on by all or any of them acting for all.

- The partnership firm may be registered but it is not mandatory.
- A partnership has no separate legal status apart from its partners

Maximum member: 50 persons.

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⇒ Act = 2008
⇒ Liability = Limited
⇒ Reg. = mandatory
⇒ Sep. legal identity

Limited Liability Partnership (LLP)

- It is a newly established concept introduced in India by Limited Liability Partnership Act, 2008.
- A (LLP) is a partnership in which some or all partners have limited liabilities.
- **Registration:** Ministry of Corporate Affairs while registration of a partnership firm is done with Registrar of Firms.
- **Legal Entity:** An LLP is a legal entity unlike a partnership firm which has no separate legal status apart from its partners.

Co-operative society

⇒ min. 10 members ⇒ 1 Member = 1 Vote

- This can also be one form of a business organisation.
- It is a form of business where individuals join hands for the promotion of their common goals.
- **Main objective:** Mutual assistance and service.
- A registered co-operative society is recognized as a separate legal entity by law.

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⇒ Hindu law apply – only India.
⇒ Member = By Birth
⇒ Senior most member = Karta
⇒ Karta = unlimited liability
⇒ other member = Co-parceners ⇓ limited liability

Hindu Undivided Family (HUF)

- Exists only in India and is governed by the provisions of the Hindu Law.
- It is different from a partnership firm as it comes into existence not out of any contract but birth in a Hindu family.
- The firm is owned by the members of undivided Hindu family, **called coparceners.**
- Typically managed by the senior-most male member, **also known as Karta or Manager.**
- For the sake of income tax, the HUF is considered as a separate entity and is taxed separately

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Definition = Sec.2 (20)
Sep legal identity
ownership = Shares (equity)
Types = Pvt. Co. = 2-200
Public = 7- No limit
OPC = 1

Company

Company ⇒ Incorporate / Registered ⇒ Co. Act 2013

- A company is an association of persons who contribute money or money's worth to a common stock and use it for a common purpose.
- Created by law and effected by law.
- **A legal person just as much as an individual but with no physical existence.**
- **Section 2 (20) (Chapter I) of the Companies Act, 2013,** defines a company as - A company incorporated under this Act, or under any previous Company law.
- Companies Act 2013 also permits formation of **"One-Person Company"** which has only one person as its member.

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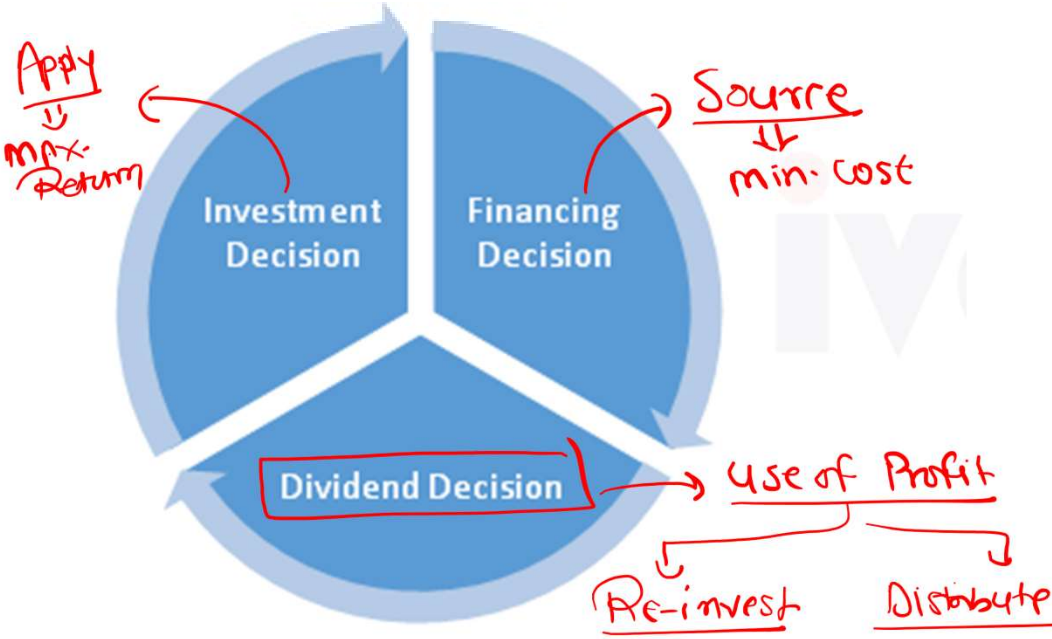
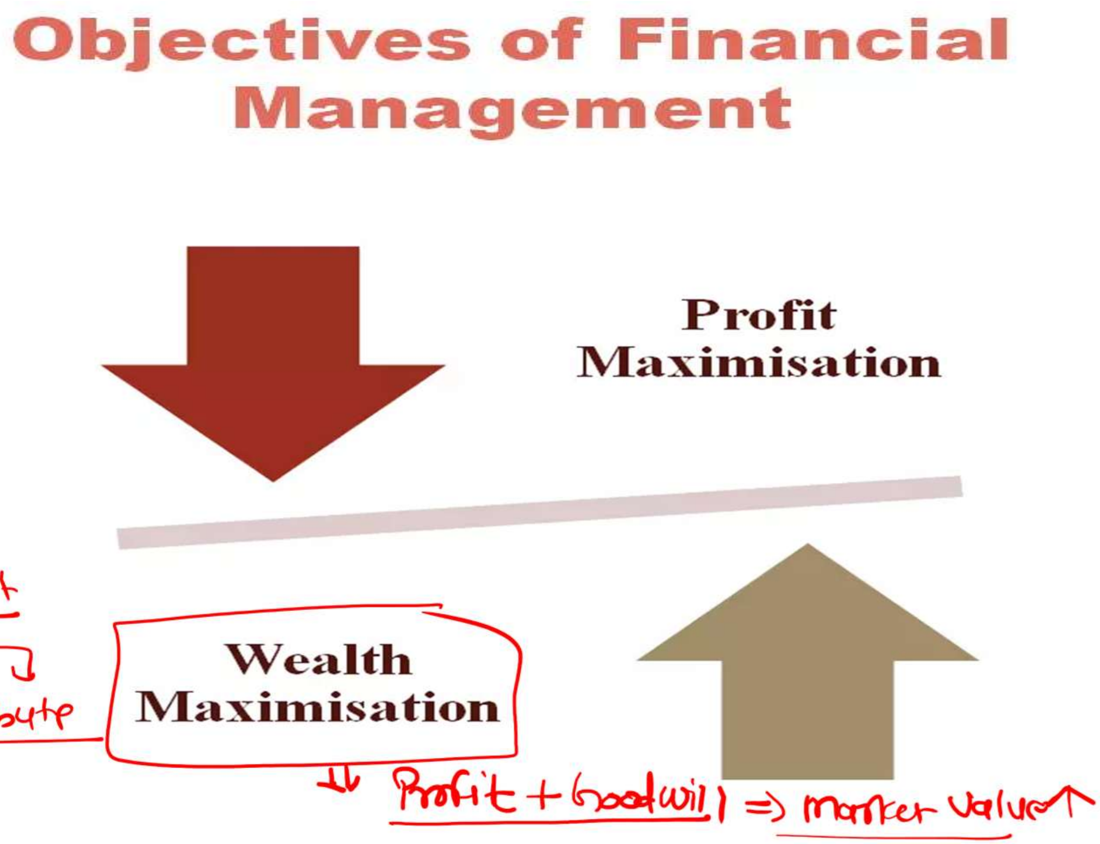
Financial Decisions In A Firm





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The main principles of finance are as under: PV

- Time Value of Money ⇒ ⇒ Compounding ⇒ / ⇒ Discounting =
- Opportunity Cost of Money ⇒ Cost of Capital
- Risk and Return ⇒ Trade off ⇒ Risk ↑ Return ↑ ⇒ Discounting Rate $\boxed{Ke}$
- Liquidity and Return ⇒ "only Req. liquidity is Suggested"

5Y FV

PV 10000 — 20000

FV 20000 — PV

Cost of equity

Expectation of Investor

20% Rm = Market Return

7% Rf = Risk-free Rate

β = Risk index (Syst Risk)

CAPM = Capital Asset Pricing Model = Rf + $\boxed{(Rm - Rf)\,\beta}$

Required Rate of Return = Risk-free Return + Risk Premium

⇒ ① Ke = 7% + (20% − 7%) 1.5 = 26.50%

② Ke = 7% + (20% − 7%) 1 = 20%

③ Ke = 7% + (20% − 7%) 0.5 = 13.5%

1.5 ⇒ β > 1 = More

1 ⇒ β = 1 = Equal

0.5 ⇒ β < 1 = low

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Conflicts of interest and the agency problem in financial management

The agency problem is a fundamental concept in finance that arises when there's a conflict of interest between a principal and their agent. In the context of financial management, this often refers to the potential misalignment of interests between a company's shareholders (principals) and its management (agents)

100% Dividend ← → "We need Money for Re-investment"

Dividend decision

Business Ethics

VS

Social Responsibiity

The social obligations of a business, but also the obligations to employees, customers, suppliers, and competitors.

Under the umbrella of business ethics but focuses more narrowly on a company's social obligations.

eFinance Management

FINANCE, ACCOUNTING, and ECONOMICS

Hw

Basis	Finance	Accounting	Economics
Meaning	We use it for acquisition of money from different source, its investment its management	An activity of recording the transaction of finance for personal and business use	Looks into the production or acquisition, distribution, and consumption of goods & services
Scope 3	Maximize wealth	To report wealth maximization	Optimize wealth maximization
Approach	Practical	Practical	Theoretical
Flow of money	Create a flow of money for its beneficiaries	Essential activity to keep track of such flow	Studies broader forces that create flow of money
Standards	No standards	GAAP	No standards

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Provisions of Section 135 of the Indian Companies Act 2013 as regards to Corporate Social Responsibility.

According to section **135 (1)** of the Indian Companies Act 2013, every company having -

- NET WORTH of INR 500 crore or more, or
- TURNOVER of INR 1000 crore or more, or
- NET PROFIT of INR 5 crore or more,

during any financial year are required to constitute a Corporate Social Responsibility Committee of the Board consisting of three or more directors, out of which at least one director shall be an independent director.

⇒ 2% of 3Y. Avg NP

2021 100cr.
22 150cr.
23 140.
390cr.
÷ 3
130cr.
× 2%.
2.6cr.
||
CSR
||
Sch. VII

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- The company spends, in every financial year, at least 2% of the average net profits of the company made during the three immediately preceding financial years.

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Unit 2

Ratio Analysis

4 TYPES OF RATIOS

PROFITABILITY RATIOS

How well does the company generate profits?

LEVERAGE RATIOS

How extensively is the company using debt?

LIQUIDITY RATIOS

Does the company have enough cash to pay the bills?

EFFICIENCY RATIOS

How efficiently does the company use its assets and capital?

Comparative Analysis

- Intra-company basis – comparisons within the company.
- Inter-company basis – comparisons with other companies.
- Industry averages – comparisons with other companies in the same industry.

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Return on Capital Employed Formula

$$ROCE = \frac{15,00,000}{100L - 10L} \times 100 = 16.67\%$$

(1) $$\text{Return on Capital Employed} = \frac{\text{EBIT}}{\text{Total Assets} - \text{Total Current Liabilities}}$$

$$\frac{15,00,000}{30L + 60L} \times 100 = 16.67\%$$

(2) $$\text{Return on Capital Employed} = \frac{\text{EBIT}}{\text{Shareholder's Equity} + \text{Long Term Liabilities}}$$

(3) $$ROCE = \frac{\text{EBIT}}{ESC + R/S + \text{loan} - \text{Non Buss.} - \text{Fict. Asset}} \times 100 = \frac{15,00,000}{30L + 20L + 60L - 10L - 10L} \times 100 = 16.67\%$$

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eg:- XYZ Ltd. Submitted following data!

⇒ loan @ 10% of ₹2000000
⇒ Tax Rate 20%
⇒ PSC 10% 14,00000
⇒ No of eashare 100000
⇒ Sales 5000000
⇒ VC @ 60%
⇒ FC 5,00000
⇒ Asset = 100L
⇒ CL = 10L
⇒ Eq.S.Capital = 30L
⇒ Bankloan = 60L
⇒ RIS = 20L
⇒ Non Bussi. = 10L
⇒ Ficti Asset = 10L
[Prelim-Exp]

* Find EPS
* Find PE Ratio if mps ₹90

Income statement

Sales	50,00,000
− VC @ 60%	(30,00,000)
Contribution	20,00,000
− Fixed cost	(5,00000)
EBIT	15,00000
− Interest	(2,00,000)
PBT	13,00000
− Tax @ 20%	(2,60,000)
PAT ← Net income	10,40000
− Pref-Div.	(1,40,000)
EAESH	9,00000
÷ No. of ES	÷ 1,00,000
EPS	₹9

EPS and P/E Ratio

$$\frac{10{,}40{,}000 - 1{,}40{,}000}{100000} = ₹\,9$$

$$EPS = \frac{\text{Net Income - Preferred Dividends}}{\text{Number of Shares Outstanding}}$$

$$P/E \text{ Ratio} = \boxed{\frac{MPS}{EPS}} = \frac{90}{9} = \boxed{10 \text{ times}}$$

$$\boxed{\frac{1}{Ke}} = \text{eg:- } Ke = 20\% \text{ find } P/E \text{ Ratio} = \frac{1}{Ke} = \frac{1}{0.20} = \boxed{5 \text{ times}}$$

$$P/E \text{ Ratio} = \frac{\text{Market Capitalization}}{\text{Earnings}} = \frac{\text{Price}}{EPS} = \frac{MPS}{EPS}$$