ED: Unit -4th

Strategic Management

Strategic decision-making is done through the process of strategic management, which has been defined by different authors --

'Strategic management is that set of decisions and actions which leads to the development of an effective strategy or strategies to help achieve corporate objectives.' – F.Glueck

Strategic management is defined as the set of decisions and actions in formulation and implementation of strategies designed to achieve the objectives of an organization.' – W.F. Glueck

'Strategic management is primarily concerned with relating the organization to its environment, formulating strategies to adapt to that environment, and, assuming that implementation of strategies takes place.' – Pearce & Robinson

"Strategic management is the dynamic process of formulation, implementation, evaluation and control of strategies to achieve the organization's strategic intent."

This definition emphasizes on four stages of the strategic management process namely formulation, implementation, evaluation and control. The four phases of strategic management process are depicted as –

Four Phases of Strategic Management Process:

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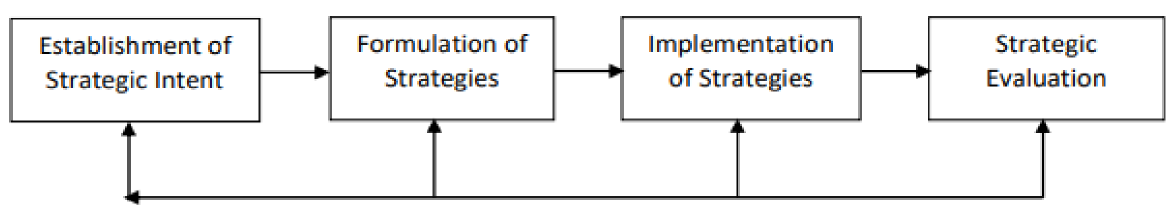
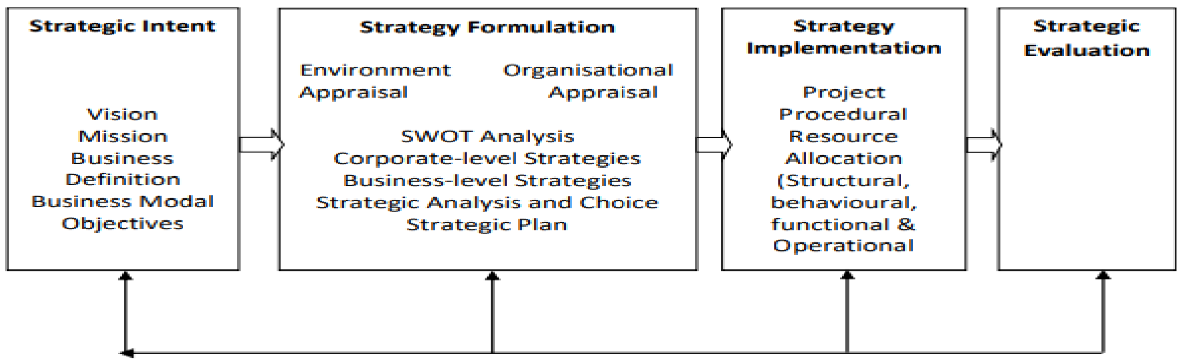


The first stage relates to establishment of strategic intent for the organization. Strategic intent is the list of objectives that an organization creates for itself. This includes defining its vision, mission, objectives and business. The aim of strategic management is effectively realizing the strategic intent.

In the second stage a single strategy or few strategies are formulated, the stage is also called strategic planning. Essentially, this is an analytical phase in which strategists think, analyze and plan strategies.

The third phase of implementation is the 'putting into action' phase. The strategies formulated in the previous stages are implemented through a number of executive and managerial actions.

Lastly, the fourth stage of evaluation and control involves assessing whether the formulated strategies were apt and whether the same were implemented effectively. The outcomes of assessment help in suggesting corrective actions ranging from making minor changes to severe reformulations of strategies.



The steps of the process are:

1st stage: Strategic intent lays foundations for the strategic management of an organization. The intent establishes the vision, mission, business definition, and objectives for the organization. It makes clear what an organization stands for, the vision highlights what the organization wants to achieve in long run. The mission relates the organization to the society at large. The business definition defines the businesses of the organization while the business model depicts how the organization creates revenue. The objectives of the organization explain what is to be achieved in a set time frame and serve as benchmarks for measuring performance.

2nd stage: Environmental and organizational appraisal identifies various opportunities and threats functional in the environment, as well as defines the strengths and weaknesses of an organization. In such a manner, enables organization to take advantage of existing opportunities by using its strengths and reduce the impact of threats and minimize the weaknesses.

3rd stage: Formulation of strategies at four levels viz. corporate, business, functional and operational takes place in an organization. The major strategies are formulated at corporate and business levels where corporate strategies relate to the strategic decisions regarding the business, business strategies focus of building competitive advantage for the business.

4th stage: Strategic alternatives and choices are necessary for defining various alternative strategies and selecting the most appropriate strategy keeping in view the environmental opportunities and threats as well as the organizational strengths and weaknesses. Strategies are defined and selected at corporate and business-level. The process of strategy selection includes strategic analysis and choice. As a result, a strategic plan ready for implementation.

5 Ps of Strategy

Henry Mintzberg developed his 5 Ps of Strategy as five different definitions of (or approaches to) developing strategy. He first wrote about the 5 Ps of Strategy in 1987. Each of the 5 Ps is a different approach to strategy. They are Plan, Ploy, Pattern, Position, and Perspective.

- **Plan** - the default, automatic approach that we adopt brainstorming options and planning how to deliver them.
- **Ploy** - Mintzberg says that getting the better of competitors, by plotting to disrupt, dissuade, discourage, or otherwise influence them, can be part of a strategy. This is where strategy can be a ploy, as well as a plan. Here, techniques and tools such as the Futures Wheel, Impact Analysis, and Scenario Analysis can help you explore the possible future scenarios in which competition will occur. Our article on Game Theory then gives you powerful tools for mapping out how the competitive "game" is likely to unfold, so that you can set yourself up to win it.
- **Pattern** - Strategic plans and ploys are both deliberate exercises. Sometimes, however, strategy emerges from past organizational behavior. Rather than being an intentional choice, a consistent and successful way of doing business can develop into a strategy.
- **Position** - "Position" is another way to define strategy that is, how you decide to position yourself in the marketplace. In this way, strategy helps you explore the fit

between your organization and your environment, and it helps you develop a sustainable competitive advantage.

- **Perspective** - The choices an organization makes about its strategy rely heavily on its culture just as patterns of behavior can emerge as strategy, patterns of thinking will shape an organization's perspective and the things that it is able to do well. To get an insight into your organization's perspective, use cultural analysis tools like the Cultural Web, Deal and Kennedy's Cultural Model, and the Congruence Model.

Difference between Policy and Strategy:

	Policy	**Strategy**
Definition	Policy is a set of guidelines which help people to take appropriate decisions or act in a specific situation.	Strategy is a comprehensive plan of action formulated or designed in order to achieve a particular goal.
Framed by	Usually middle management	Usually top management
Deals with	Thoughts and Actions	Primarily actions
Importance	• It decides the long term health of an enterprise • It is all about taking crucial decisions • It is an official line adopted by an organization	• It helps managers to take appropriate decisions • A good strategy can bring extraordinary results for an average company • It helps in dealing with threats in response to environmental forces and developments
Concerned activities	Routine/daily activities	Taking strategic decisions

HUMAN RESOURCE MANAGEMENT :

Human Resource (HR) refers to all the people who work in an organization called personnel. Human Resource Management refers to the organizational function which includes practices that help the organization to deal effectively with its people during the various phases of the employment cycle. HRM is management function concerned with hiring, motivating, and maintaining people in an organization. It focuses on people in the organization.

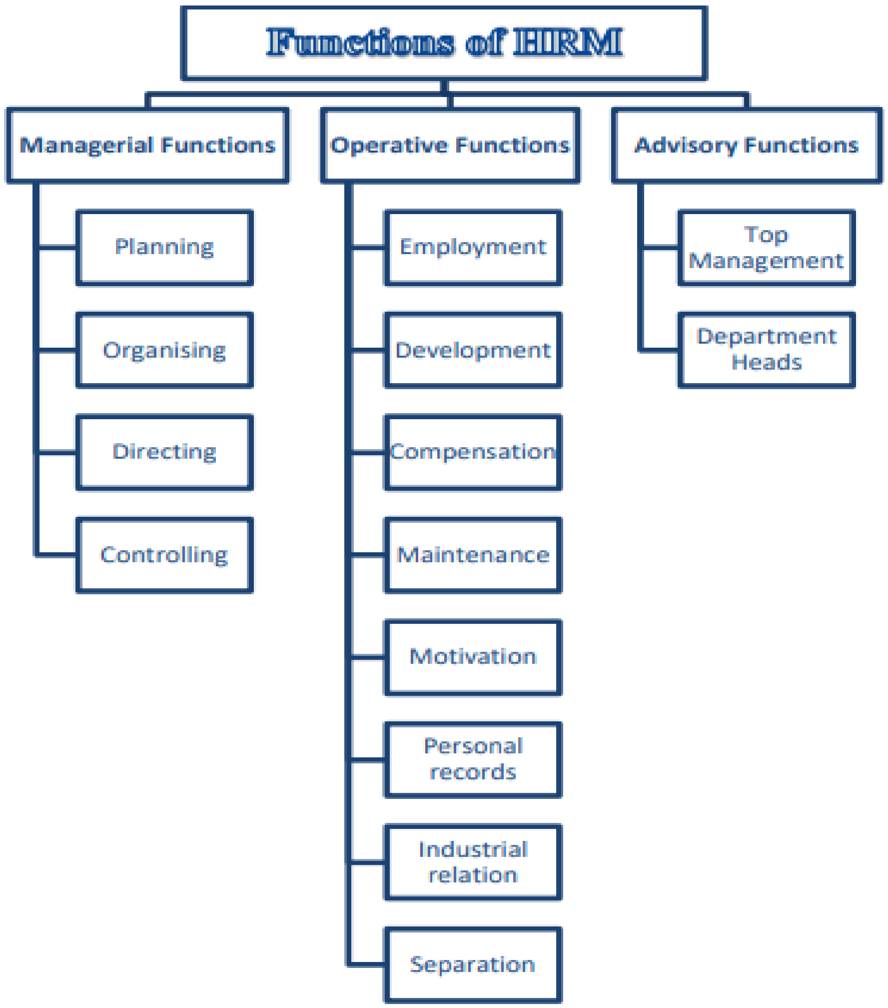
Human Resource Management (HRM) is a management function that deals with recruiting, selecting, training and developing human resource in an organization. It is concerned with the "people" dimension in management. It includes activities focusing on the effective use of human resources in an organization. It is concerned with the development of a highly motivated and smooth functioning workforce. It also includes planning, acquiring, developing, utilizing and maintaining 'human resources' in the achievement of organizational goals.

Human Resource management means getting right people for the right job through right mode at right cost and at the right time.

According to Edwin B. Flippo, "Human resource management is the planning, organizing, directing, and controlling of the procurement, development, compensation, integration, maintenance and separation of human resources to the end that individual, organizational and societial objectives are accomplished."

Functions of HRM

Human Resources management has an important role to play in equipping organizations to meet the challenges of an expanding and increasingly competitive sector. Increase in staff numbers, contractual diversification and changes in demographic profile which compel the HR managers to reconfigure the role and significance of human resources management.



Managerial Functions:

The Human Resource Manager is a part of the organizational management. So he must perform the basic managerial functions of planning, organizing, directing and controlling in relation to his department. These functions are ---

Planning: To get things done through the subordinates, a manager must plan ahead. Planning is necessary to determine the goals of the organization and lay down policies and procedures to reach the goals. For a human resource manager, planning means the determination of personnel programs that will contribute to the goals of the enterprise, i.e., anticipating vacancies, planning job requirements, job descriptions and determination of the sources of recruitment.

Organizing: Once the human resource manager has established objectives and developed plans and programs to reach them, he must design and develop organization structure to carry out the various operations.

Directing: The plans are to be pure into effect by people. But how smoothly the plans are implemented depends on the motivation of people. The direction function of the personnel manager involves encouraging people to work willingly and effectively for the goals of the enterprise.

Controlling: Controlling is concerned with the regulation of activities in accordance with the plans, which in turn have been formulated on the basis of the objectives of the organisation. Thus, controlling completes the cycle and leads back to planning. It involves the observation and comparison of results with the standards and correction of deviations that may occur.

Operative Functions:

The operative functions are those tasks or duties which are specifically entrusted to the human resource or personnel department. These are concerned with employment, development, compensation, integration and maintenance of personnel of the organization. The operative functions of human resource or personnel department are discussed below:

Employment: The first operative function of the human resource of personnel department is the employment of proper kind and number of persons necessary to achieve the objectives of the organization. This involves recruitment, selection, placement, etc. of the personnel.

Development: Training and development of personnel is a follow up of the employment function. It is a duty of management to train each employee property to develop technical skills for the job for which he has been employed and also to develop him for the higher jobs in the organization. Proper development of personnel is necessary to increase their skills in doing their jobs and in satisfying their growth need.

Compensation: This function is concerned with the determination of adequate and equitable remuneration of the employees in the organization of their contribution to the organizational goals. The personnel can be compensated both in terms of monetary as well as non-monetary rewards.

Maintenance (Working Conditions and Welfare): Merely appointment and training of people is not sufficient; they must be provided with good working, conditions so that they may like their work and workplace and maintain their efficiency. Working conditions certainly influence the motivation and morale of the employees.

Motivation: Employees work in the organization for the satisfaction of their needs. In many of the cases, it is found that they do not contribute towards the organizational goals as much as they can. This happens because employees are not adequately motivated. The human resource manager helps the various departmental managers to design a system of financial and non-financial rewards to motivate the employees.

Personnel Records: The human resource or personnel department maintains the records of the employees working in the enterprise. It keeps full records of their training, achievements, transfer, promotion, etc. It also preserves many other records relating to the behaviour of personnel like absenteeism and labour turnover and the personnel programs and policies of the organisation.

Industrial Relations: These days, the responsibility of maintaining good industrial relations is mainly discharged by the human resource manager. The human resource manager can help in collective bargaining, joint consultation and settlement of disputes, if the need arises. This is because of the fact that he is in possession of full information relating to personnel and has the working knowledge of various labour enactments.

Separation: Since the first function of human resource management is to procure the employees, it is logical that the last should be the separation and return of that person to society. Most people do not die on the job. The organization is responsible for meeting certain requirements of due process in separation, as well as assuring that the returned person is in as good shape as possible. The personnel manager has to ensure the release of retirement benefits to the retiring personnel in time.

Advisory Functions:

Human resource manager has specialized education and training in managing human resources. He is an expert in his area and so can give advice on matters relating to human resources of the organisation. He offers his advice to:

1- Advised to Top Management: Personnel manager advises the top management in formulation and evaluation of personnel programs, policies and procedures. He also gives advice for achieving and maintaining good human relations and high employee morale.

2. Advised to Departmental Heads: Personnel manager offers advice to the heads of various departments on matters such as manpower planning, job analysis and design, recruitment and selection, placement, training, performance appraisal, etc.

Marketing Management :

Introduction: The marketing concept come out in the mid- 1950s and challenged the proceeding concepts. For understanding the meaning of marketing, firstly understand the meaning of market .The **word Market is derived from the Latin word MARCATUS which means merchandise or trade or a place where business is conducted.** Marketing is not only a place of exchange but an arrangement that provides an opportunity of exchanging goods and services for money.

Peter Drucker, a leading management theorist, puts it this way –

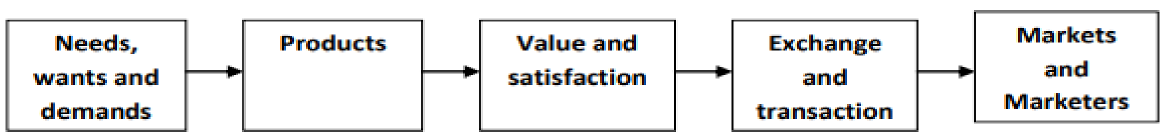
“There will always one can assume, be need for some selling. But the aim of marketing is to make selling super fulvous. The aim of marketing is to know and understand the customer so well that the product or services fits him and sells it. Ideally, marketing should result in a customer who is ready to buy. All that should be needed then is to make the product or services available.”

Marketing is a broader concept which includes all human activities in relation to the market .it includes product planning and development, buying and assembling, pricing distribution and selling, branding and packaging, standardization and grading , transportation and warehousing, promotion and advertising, financing, risk bearing, analysis of market in terms of its present and potential customers.

The American Marketing Association defines “Marketing as the process of planning and executing the conception, pricing, promotion and distribution of ideas, goods and services to create exchanges that satisfy individual and organizational objectives.”

Marketing is a broader and comprehensive term and it includes set of activities and important resources necessary to direct and facilitate the flow of goods and services from the producer to the consumer. Marketing also availing the right goods and services to the right people, at the right place and at the right time.

Philip Kotler explained the core concept of marketing in his book – “Marketing Management” as,



Core Concept of Marketing

Definitions of Marketing : To understand the concept of marketing different authors define marketing in their own way . Some definitions of Marketing are as follows:

According to Pyle,(Principles of Marketing) – “ Marketing comprises both buying and selling activities.”

According to Tousley ,Clark and Clark (Principles of Marketing) – “Marketing consists of those efforts which affect transfers in the ownership of goods and services and which provide for their physical distribution.”

According to Paul Mazur – “ Marketing is the delivery of standard of living.”

According to William J. Stanton – “ Marketing is a total system of interacting business activities designed to plan, price, promote and distribute want satisfying products and services to present and potential customers.”

Difference between selling & marketing :

SELLING	MARKETING
Selling refers to a process where goods or services are exchanged for money	Marketing refers to activities and plans that are used by companies to promote the buying or selling of a product or service
Involves creating products or services and selling them to customers	Involves finding the wants of customers and fulfilling them
Basically focuses on the wants of the seller	Focuses on the wants of the customer
Emphasizes more on the product or service	Emphasizes more on the needs and wants of the consumer
Identifies the significance of the product or the service first	Identifies the market first
Sees the business as a process of goods and service production	Sees the business as a consumer satisfying process

Meaning of marketing mix:

The term 'marketing mix' was coined by Neil H. Bordan. It means the combination of firm's inputs which form the core of its marketing system i.e. the product, the price structure, the distribution system and the promotional activities.

Marketing mix comprises of important elements which constitute the marketing programme of an organization and forces that influence its marketing activities and programmes. The marketer adjusts his marketing programs as per the external forces so as to develop a mix or programme that can achieve marketing objective.

Definition of Marketing Mix

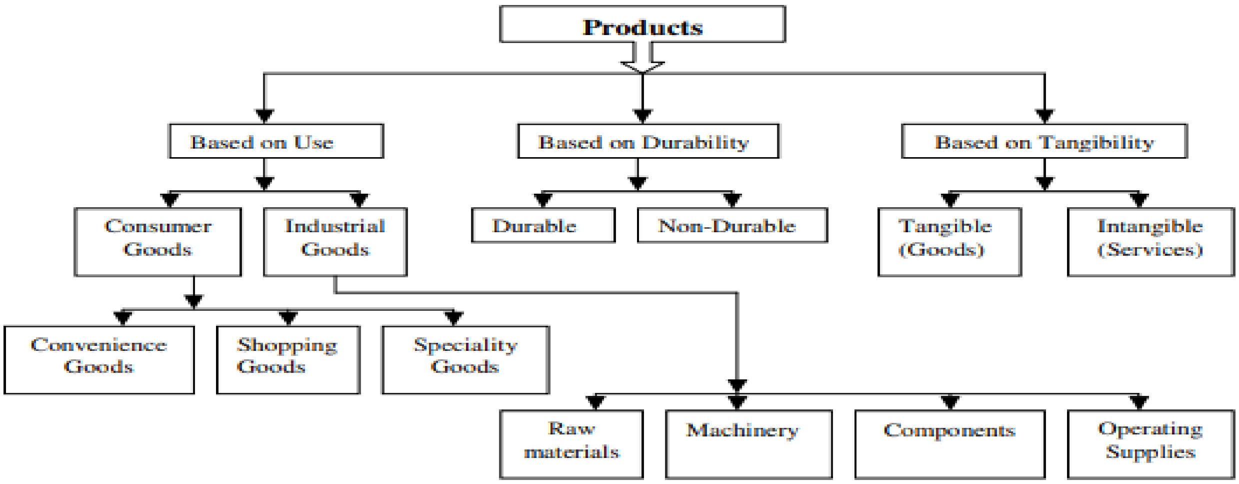
According to **Philip Kotler** - *"**Marketing Mix** is the combination of four elements, called the 4P's (product, Price, Promotion, and Place), that every company has the option of adding, subtracting, or modifying in order to create a desired marketing strategy"*

Elements of marketing mix

The term marketing mix has been popularized by the marketing experts in terms of four P's and accordingly the elements of marketing mix has been classified as follows:-

• Product • Price • Place (Distribution) • Promotion

Product - Products are offerings that a marketer offers to the target audience to satisfy their needs and wants. Product can be tangible good or intangible service. Tangible products are goods like - cellphone, television, or motor car, whereas intangible products are services like - financial service in a bank, health treatment by a doctor, legal advice of a lawyer.



Price - Price is the amount that is charged by marketer of his offerings or the amount that is paid by consumer for the use or consumption of the product. Price is crucial in determining the organization's profit and survival. Adjustments in price affect the demand and sales of the product. Marketers are required to be aware of the customer perceived value of the product to set the right price.

Methods of fixing the price can be broadly divided into the following categories.

1. Cost based pricing

2. Competition based pricing

3. Demand based pricing

1. Cost Based Pricing: Under this method, price of the product is fixed by adding the amount of desired profit margin to the cost of the product. If a particular soap costs the marketer Rs. 8 and he desires a profit of 25%, the price of the soap is fixed at Rs 8 + (8x25/100) =Rs. 10. While calculating the price in this way, all costs (variable as well as fixed) incurred in manufacturing the product are taken into consideration.

2. Competition Based Pricing: In case of products where market is highly competitive and there is negligible difference in quality of competing brands, price is usually fixed closer to the price of the competing brands. It is called 'young rate pricing' and is a very convenient method because the marketers do not have to worry much about demand and cost and effect the change as per the changes by the industry leaders.

3. Demand Based Pricing: At times, prices are determined by the demand for the product. Under this method, without paying much attention to cost and competitor's prices, the marketers try to ascertain the demand for the product. If the demand is high they decide to take advantage and fix a high price. If the demand is low, they fix low prices for their product. At times they resort to differential prices and charge different prices from different groups of customers depending upon their perceived values and capacity to pay. Take the case of cinema halls where the rates of tickets differ for the different sets of rows in the hall.

Promotion - Promotion represents the different methods of communication that are used by marketer to inform target audience about the product. Promotion includes - advertising, personal selling, public relation, and sales promotion.

The main objective of promotion is to seek buyers' attention towards the product with a view to: – arouse his interest in the product; – inform him about its availability; and – inform him as to how is it different from others. It is thus a persuasive communication and also serves as a reminder. A firm uses different tools for its promotional activities which are as follows:

- **Advertising**
- **Publicity**
- **Personal selling**
- **Sales promotion**

These are also termed as four elements of a promotion mix. Let us have a brief idea about these promotion tools.

1. Advertising: Advertising is the most commonly used tool for informing the present and prospective consumers about the product, its quality, features, availability, etc. It is a paid form of non-personal communication through different media about a product, idea, a service or an organization by an identified sponsor. It can be done through print media like newspaper, magazines, billboards, electronic media like radio, television, etc. It is a very flexible and comparatively low cost tool of promotion.

2. Publicity: This is a non-paid process of generating wide range of communication to contribute a favorable attitude towards the product and the organization. You may have seen articles in newspapers about an organization, its products and policies. The other tools of publicity are press conference, publication and news in the electronic media etc. It is published or broadcasted without charging any money from the firm. Marketers often spend a lot of time and effort in getting news items placed in the media for creation of a favorable image of the company and its products.

3. Personal selling: You must have come across representatives of different companies knocking at your door and persuading you to buy their product. It is a direct presentation of the product to the consumers or prospective buyers. It refers to the use of salespersons to persuade the buyers to act favorably and buy the product. It is most effective promotional tool in case of industrial goods.

4. Sales promotion: This refers to short-term and temporary incentives to purchase or induce trials of new goods. The tool includes contests, games, gifts, trade shows, discounts, etc. Sales promotional activities are often carried out at retail levels.

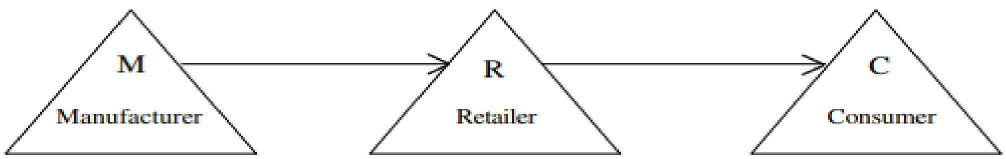
Place - Place or distribution refers to making the product available for customers at convenient and accessible places.

TYPES OF CHANNELS OF DISTRIBUTION:

Generally we do not buy goods directly from the producers. The producers/manufacturers usually use services of one or more middlemen to supply their goods to the consumers. But sometimes, they do have direct contact with the customers with no middlemen in between them. This is true more for industrial goods where the customers are highly knowledgeable and their individual purchases are large. The various channels used for distribution of consumer goods can be described as follows:

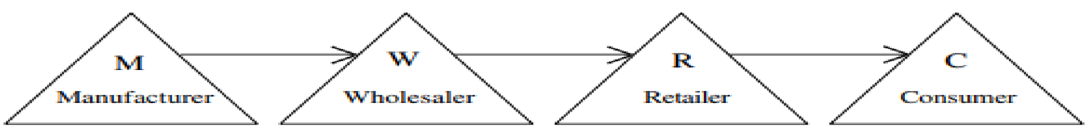
Zero stage channel of distribution :

(b) One stage channel of distribution



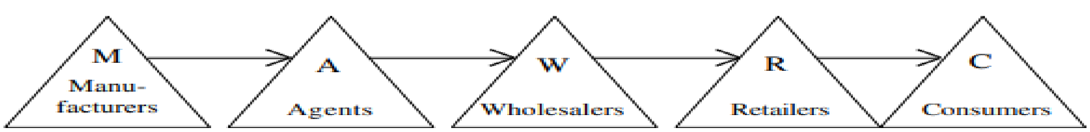
In this case, there is one middleman i.e., the retailer. The manufacturers sell their goods to retailers who in turn sell it to the consumers. This type of distribution channel is preferred by manufacturers of consumer durables like refrigerator, air conditioner, washing machine, etc. where individual purchase involves large amount. It is also used for distribution through large scale retailers such as departmental stores (Big Bazaar, Spensors) and super markets.

(c) Two stage channel of distribution



This is the most commonly used channel of distribution for the sale of consumer goods. In this case, there are two middlemen used, namely, wholesaler and retailer. This is applicable to products where markets are spread over a large area, value of individual purchase is small and the frequency of purchase is high.

(d) Three stage channel of distribution



When the number of wholesalers used is large and they are scattered throughout the country, the manufacturers often use the services of mercantile agents who act as a link between the producer and the wholesaler. They are also known as distributors.

FINANCIAL MANAGEMENT

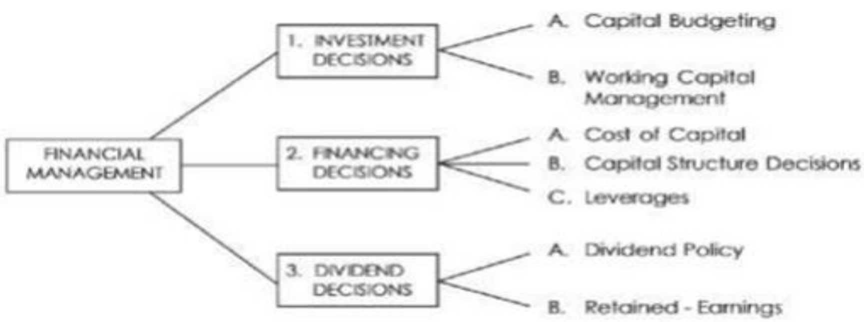
Introduction to Financial Management

Finance is the life-blood of business and there must be a continuous flow of funds in and out of a business enterprise. Money makes the wheels of business run smoothly. Sound plans, efficient production system and excellent marketing network are all hampered in the absence of an adequate and timely supply of funds.

Sound financial management is as important in business as production and marketing. A business firm requires finance to commence its operations, to continue operations and for expansion or growth. Finance is, therefore, an important operative function of business.

Financial management is both a science and an art. Its nature is nearer to applied sciences as it envisages use of classified and tested knowledge as a help in practical affairs and solving business.

Functions of Financial Management:



Meaning of Financial Management:

Financial management may be defined as planning, organising, directing and controlling the financial activities of an organisation. According to Guthman and Dougal, financial management means, "the activity concerned with the planning, raising, controlling and administering of funds used in the business." It is concerned with the procurement and utilization of funds in the proper manner.

Ezra Solomon has described the nature of financial management as follows: "Financial management is properly viewed as an integral part of overall management rather than as a staff specially concerned with funds raising operations.

Objectives of Financial Management:

Financial management is one of the functional areas of business. Therefore, its objectives must be consistent with the overall objectives of business. The overall objective of financial management is to provide maximum return to the owners on their investment in the long- term.

This is known as wealth maximization. Maximization of owners' wealth is possible when the capital invested initially increases over a period of time. Wealth maximization means maximizing the market value of investment in shares of the company.

Wealth of shareholders = Number of shares held ×Market price per share.

In order to maximise wealth, financial management must achieve the following specific objectives:

(a) To ensure availability of sufficient funds at reasonable cost (liquidity).

(b) To ensure effective utilisation of funds (financial control).

(c) To ensure safety of funds by creating reserves, re-investing profits, etc. (minimisation of risk).

(d) To ensure adequate return on investment (profitability).

(e) To generate and build-up surplus for expansion and growth (growth).

(f) To minimize cost of capital by developing a sound and economical combination of corporate securities (economy).

Profit Maximization:

Very often maximization of profits is considered to be the main objective of financial management. Profitability is an operational concept that signifies economic efficiency. Some writers on finance believe that it leads to efficient allocation of resources and optimum use of capital.

It is said that profit maximization is a simple and straightforward objective. It also ensures the survival and growth of a business firm. But modern authors on financial management have criticized the goal of profit maximization.

Ezra Solomon has raised the following objections against the profit maximisation objective:

Objections against the Profit Maximization Objectives:

(i) The concept is ambiguous or vague. It is amenable to different interpretations, e.g., long run profits, short run profits, volume of profits, rate of profit, etc.

(ii) It ignores the timing of returns. It is based on the assumption of bigger the better and does not take into account the time value of money. The value of benefits received today and those received a year later are not the same.

(iii) It ignores the quality of the expected benefits or the risk involved in prospective earnings stream. The streams of benefits may have varying degrees of uncertainty. Two projects may have same total expected earnings but if the earnings of one fluctuate less widely than those of the other it will be less risky and more preferable. More uncertain or fluctuating the expected earnings, lower is their quality.

(iv) It does not consider the effect of dividend policy on the market price of the share. The goal of profit maximisation implies maximising earnings per share which is not necessarily the same as maximising market-price share. According to Solomon, "to the extent payment of dividends can affect the market price of "the stock (or share), the maximisation of earnings per share will not be a satisfactory objective by itself."

(v) Profit maximisation objective does not take into consideration the social responsibilities of business. It ignores the interests of workers, consumers, government and the public in general. The exclusive attention on profit maximisation may misguide managers to the point where they may endanger the survival of the firm by ignoring research, executive development and other intangible investments.

Wealth Maximisation:

Prof. Ezra Solomon has advocated wealth maximisation as the goal of financial decision-making. Wealth maximisation or net present worth maximisation is defined as follows: "The gross present worth of a course of action is equal to the capitalised value of the flow of future expected benefits, discounted (or as capitalised) at a rate which reflects their certainty or uncertainty.

Wealth or net present worth is the difference between gross present worth and the amount of capital investment required to achieve the benefits being discussed. Any financial action which creates wealth or which has a net present worth above zero is a desirable one and should be undertaken.

Any financial action which does not meet this test should be rejected. If two or more desirable courses of action are mutually exclusive (i.e., if only one can be undertaken), then the decision should be to do that which creates most wealth or shows the greatest amount of net present worth. In short, the operating objective for financial management is to maximise wealth or net present worth."

Wealth maximisation is more operationally viable and valid criterion because of the following reasons:

(a) It is a precise and unambiguous concept. The wealth maximisation means maximising the market value of shares.

(b) **It takes into account both the quantity** and quality of the expected steam of future benefits. Adjustments are made for risk (uncertainty of expected returns) and timing (time value of money) by discounting the cash flows,

(c) As a decision criterion, wealth maximisation involves a comparison of value of cost. It is a long-term strategy emphasising the use of resources to yield economic values higher than joint values of inputs.

(d) **Wealth maximisation is not in conflict** with the other motives like maximisation of sales or market share. It rather helps in the achievement of these other objectives. In fact, achievement of wealth maximisation also maximises the achievement of the other objectives. Therefore, maximisation of wealth is the operating objective by which financial decisions should be guided.

There are **three compelling arguments in support of the goal of shareholder wealth maximisation, viz., legal, economic, and decisional.**

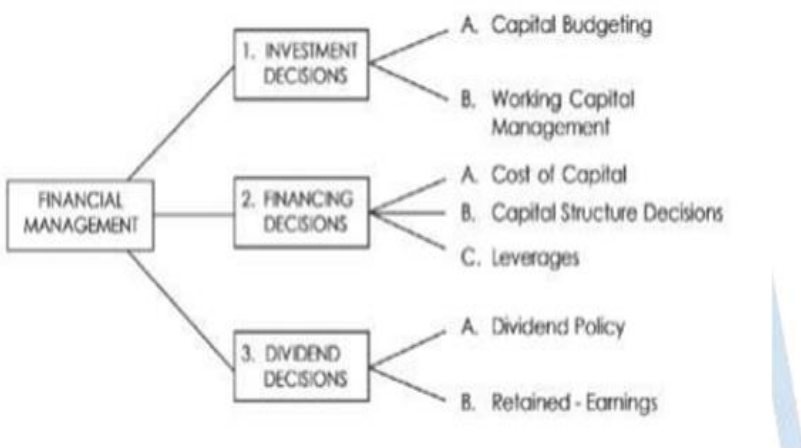
Functions of Financial Management

1. **Estimation of capital requirements:** A finance manager has to make estimation with regards to capital requirements of the company. This will depend upon expected costs and profits and future programs and policies of a concern. Estimations have to be made in an adequate manner which increases earning capacity of enterprise.
2. **Determination of capital composition:** Once the estimation have been made, the capital structure have to be decided. This involves short- term and long- term debt equity analysis. This will depend upon the proportion of equity capital a company is possessing and additional funds which have to be raised from outside parties.
3. **Choice of sources of funds:** For additional funds to be procured, a company has many choices like-
    a. Issue of shares and debentures
    b. Loans to be taken from banks and financial institutions
    c. Public deposits to be drawn like in form of bonds.

    Choice of factor will depend on relative merits and demerits of each source and period of financing.

4. **Investment of funds:** The finance manager has to decide to allocate funds into profitable ventures so that there is safety on investment and regular returns is possible.
5. **Disposal of surplus:** The net profits decision have to be made by the finance manager. This can be done in two ways:
    a. Dividend declaration **-** It includes identifying the rate of dividends and other benefits like bonus.
    b. Retained profits **-** The volume has to be decided which will depend upon expansional, innovational, diversification plans of the company.
6. **Management of cash:** Finance manager has to make decisions with regards to cash management. Cash is required for many purposes like payment of wages and salaries, payment of electricity and water bills, payment to creditors, meeting current liabilities, maintenance of enough stock, purchase of raw materials, etc.
7. **Financial controls:** The finance manager has not only to plan, procure and utilize the funds but he also has to exercise control over finances. This can be done through many techniques like ratio analysis, financial forecasting, cost and profit control, etc.

Functions of Financial Management:



1-Investment Decisions: Managers need to decide on the amount of investment available out of the existing finance, on a long-term and short-term basis. They are of two types:

- Long-term investment decisions or Capital Budgeting mean committing funds for a long period of time like fixed assets. These decisions are irreversible and usually include the ones pertaining to investing in a building and/or land, acquiring new plants/machinery or replacing the old ones, etc. These decisions determine the financial pursuits and performance of a business.
- Short-term investment decisions or Working Capital Management means committing funds for a short period of time like current assets. These involve decisions pertaining to the investment of funds in the inventory, cash, bank deposits, and other short-term investments. They directly affect the liquidity and performance of the business.

2-Financing Decisions: Managers also make decisions pertaining to raising finance from long-term sources (called Capital Structure) and short-term sources (called Working Capital). They are of two types:

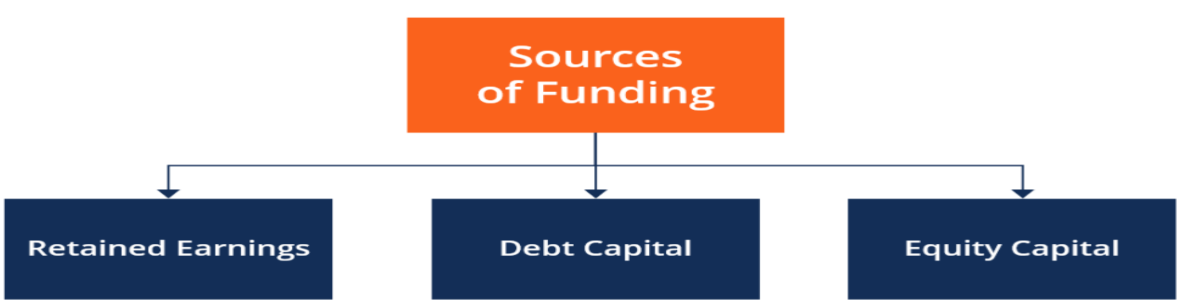
- **Financial Planning decisions** which relate to estimating the sources and application of funds. It means pre-estimating financial needs of an organization to ensure the availability of adequate finance. The primary objective of financial planning is to plan and ensure that the funds are available as and when required.
- **Capital Structure decisions** which involve identifying sources of funds. They also involve decisions with respect to choosing external sources like issuing shares, bonds, borrowing from banks or internal sources like retained earnings for raising funds.

3-Dividend Decisions: These involve decisions related to the portion of profits that will be distributed as dividend. Shareholders always demand a higher dividend, while the management would want to retain profits for business needs. Hence, this is a complex managerial decision.

SOURCES OF FUNDING:

Companies always seek sources of funding to grow their business. Funding, also called financing, represents an act of contributing resources to finance a program, project, or need. Funding can be initiated for either short-term or long-term purposes. The different sources of funding include:

- Retained earnings
- Debt capital
- Equity capital



Retained Earnings

Businesses aim to maximize profits by selling a product or rendering service for a price higher than what it costs them to produce the goods. It is the most primitive source of funding for any company.

After generating profits, a company decides what to do with the earned capital and how to allocate it efficiently. The retained earnings can be distributed to shareholders as dividends, or the company can reduce the number of shares outstanding by initiating a stock repurchase campaign.

Alternatively, the company can invest the money into a new project, say, building a new factory, or partnering with other companies to create a joint venture.

Debt Capital

Companies obtain debt financing privately through bank loans. They can also source new funds by issuing debt to the public.

In debt financing, the issuer (borrower) issues debt securities, such as corporate bonds or promissory notes. Debt issues also include debentures, leases, and mortgages.

Companies that initiate debt issues are borrowers because they exchange securities for cash needed to perform certain activities. The companies will be then repaying the debt (principal and interest) according to the specified debt repayment schedule and contracts underlying the issued debt securities.

The drawback of borrowing money through debt is that borrowers need to make interest payments, as well as principal repayments, on time. Failure to do so may lead the borrower to default or bankruptcy.

Equity Capital

Companies can raise funds from the public in exchange for a proportionate ownership stake in the company in the form of shares issued to investors who become shareholders after purchasing the shares.

Alternatively, private equity financing can be an option, provided there are entities or individuals in the company's or directors' network ready to invest in a project or wherever the money is needed for.

Compared to debt capital funding, equity funding does not require making interest payments to a borrower.

However, one disadvantage of equity capital funding is sharing profits among all shareholders in the long term. More importantly, shareholders dilute a company's ownership control as long as it sells more shares.

Other Funding Sources

Funding sources also include private equity, venture capital, donations, grants, and subsidies that do not have a direct requirement for return on investment (ROI), except for private equity and venture capital.

<u>Share</u>: A company's capital is divided into small equal units of a finite number. Each unit is known as a share.

In simple terms, a share is a percentage of ownership in a company or a financial asset. Investors who hold shares of any company are known as shareholders.

Share capital is the money a company raises by issuing common or preferred stock.

TYPES OF SHARE:

1- Equity Shares:

An equity interest in a company may be said to represent a share of the company's assets and a share of any profits earned on those assets after other claims have been met. The equity shareholders are the owners of the business; they purchase shares, the money is used by the company to buy assets, the assets are used to earn profits, which belong to the ordinary shareholders.

After satisfying the rights of preference shares, the equity shares shall be entitled to share in the remaining amount of distributable net profits of the company. The dividend on equity shares is not fixed and may vary from year to year depending upon the amount of profits available.

2-Preference Shares:

A preference share is a hybrid security because it has features of both ordinary shares and bonds. Preference shareholders have preferential rights in respect of assets and dividends. In the event of winding up the preference shareholders have a claim on available assets before the ordinary shareholders. In addition, preference shareholders get their stated dividend before equity shareholders can receive any dividends.

The dividends on preference shares are fixed and they must be declared as per legal obligation exists to pay them. The fixed nature of dividend is similar to that of interest on debentures and bonds.

Debentures are one of the most simple instruments by which companies can raise debts. They act as simple loans which a company borrows to meet its financial needs.

Features of debenture:

1. Debentures are nothing but **documents**. In other words, they possess documentary value.

2. These documents are **evidence of debt**. This shows that the company owes a debt to the debenture-holder.

3. The **interest** on debentures is always payable at a fixed rate. Further, the company has to pay interest regardless of whether it makes **profits or not**.

4. The company may either **repay** the debt or even **convert** the debenture into shares or other debentures.

5. Debentures may or may not carry a **charge** on the company's assets.

6. Finally, debentures are generally **transferable**. Debenture-holders can sell them on stock exchanges at any price.

BOND: A bond is a fixed-income instrument that represents a loan made by an investor to a borrower. Bonds are used by companies, municipalities, states, and sovereign governments to finance projects and operations. Owners of bonds are debt holders, or creditors, of the issuer.

BONDS	**DEBENTURES**
1-Bonds are secure in nature.	Debentures can be secure as well as unsecured.
2-One can have bonds of a corporation, government agencies or it can be of any financial institution.	On the other hand debentures are issued by private companies.
3-Bonds are less risky comparatively.	Whereas debentures are at high risk.
4-Talking about liquidity bonds are at the first priority.	Whereas in the case of debentures liquidity can only be done after the bondholders are paid.
5-Bonds give you low interest, but it depends on the issuing body totally.	Whereas debentures give you high interest.

COST OF CAPITAL

Introduction to Cost of Capital

The various sources from which the long term requirement of the capital can be met. Each of these sources involves some cost. The cost of capital can be defined as ‘”the rate of which an organization must pay to the suppliers of capital for the use of their funds”.

The cost of raising funds to finance a project. This cost may be in the form of the interest which the company may be required to pay to the suppliers of funds. This may be the explicit cost attached with the various sources of capital.

The cost of capital may be in the form of opportunity cost of the funds of the company i.e., rate of return which the company would have earned if the funds are not invested. E.g. suppose that a company has an amount of Rs. 100,000 which may either be utilised for purchasing a machine or may be invested with a bank as fixed deposit carrying the interest 10% p.a.

Meaning of Cost of Capital

It is a rate of returns expected by the investors i.e., K = ro + b + f. i.e., the cost of capital includes the rate of return at zero risk + premium for business risk + premium for financial risk.

It is the minimum rate of return the firm earns as its investment in order to satisfy the expectations of investors, who provide funds to the firm.

Cost of capital is the required rate of return to justify the use of capital so that expected rate of return can be maintained on equity shares and the market value of share remains unchanged or should not be reduced at cost.

When a company collects funds by issuing debentures, bonds and preference shares it has to earn at least a rate of return on investment which is equal to the cost of raising them. So that market value of equity shares remains unchanged.

The cost of capital is a minimum rate of return required to be earned on investment to keep the market value of the shares unchanged.

Definitions of Cost of Capital

The concept of the cost of capital plays an important role in corporate finance – theory and practice.

The term cost of capital is defined by various authors in different ways, some of which are stated below:

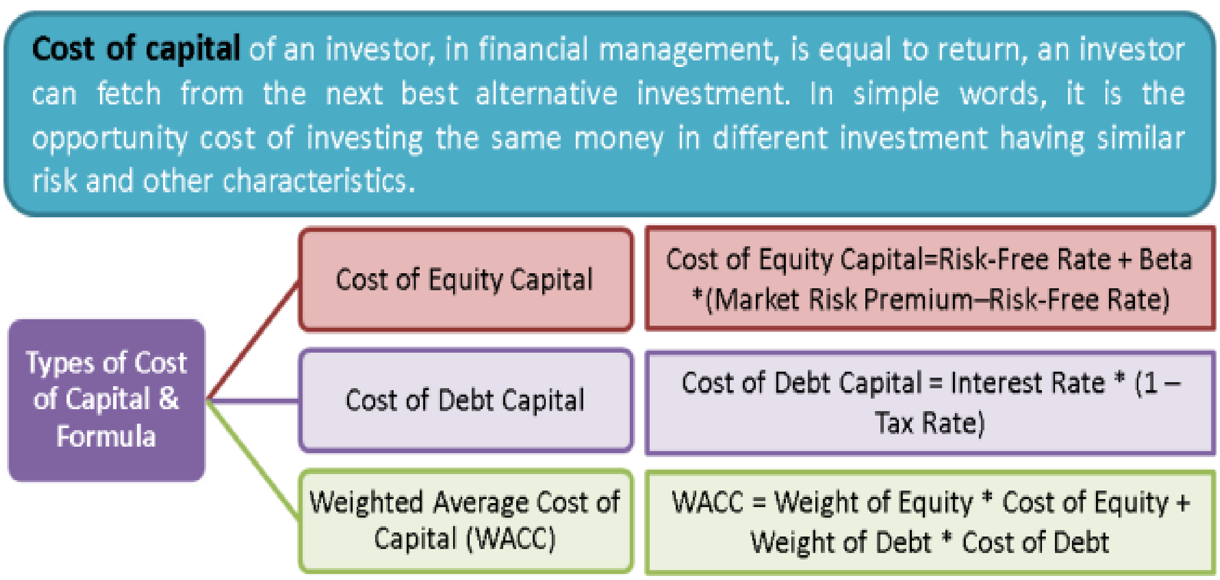
Milton H. Spencer says “cost of capital is the minimum required rate of return which a firm requires as a condition for undertaking an investment.”

According to Ezra Solomon, “the cost of capital is the minimum required rate of earnings or the cut-off rate of capital expenditure.”

L. J. Gitman defines the cost of capital as “the rate of return a firm must earn on its investment so the market value of the firm remains unchanged.”

The definition given by Keown refers to the cost of capital as “the minimum rate of return necessary to attract an investor to purchase or hold a security.”

In other words, the cost of capital is the average rate of return required by the investors who provide long-term funds. It is the price that is paid for time and risk involved in obtaining the capital.



Computation of Cost of Capital

Different sources of capital:

To calculate the weighted average cost of capital (WACC), you must first calculate the cost of debt and the cost of equity, which are represented by these formulas:

1. Cost of debt

The cost of debt refers to interest rates paid on any debt, such as mortgages and bonds. Interest expense is the interest paid on current debt.

$$\text{Cost of debt} = \frac{\text{total debt}}{\text{interest expense}} \times (1 - \text{marginal tax rate})$$

2. Cost of equity

Cost of equity refers to the return a company requires to determine if capital requirements are met in an investment. Cost of equity also represents the amount the market demands in exchange for owning the asset and therefore holding the risk of ownership.

Cost of equity is approximated by the capital asset pricing model (CAPM):

$$CAPM\ (cost\ of\ equity) = R_f + \beta\left(R_m - R_f\right)$$

In this formula:

- Rf= risk-free rate of return
- Rm= market rate of return
- Beta = risk estimate

3. Weighted average cost of capital

Cost of capital is based on the weighted average of the cost of debt and the cost of equity.

$$WACC = \left(\frac{E}{V} \times R_e\right) + \left(\frac{D}{V} \times R_d\right) \times (1 - T_c)$$

In this formula:

- E = the market value of the firm's equity
- D = the market value of the firm's debt
- V = the sum of E and D
- Re = the cost of equity
- Rd = the cost of debt
- Tc = the income tax rate

BREAK-EVEN ANALYSIS

The **break-even** point for a product is the point where total revenue received equals the total costs associated with the sale of the product (TR=TC).

A **break-even** point is typically calculated in order for business to determine if it would be profitable to sell a proposed product, as opposed to attempting to modify an existing product instead so it can be made lucrative. **Break-Even** Analysis can also be used to analyze the potential profitability of expenditure in a sales-based business.

Break-even point (for output) = fixed cost/ contribution per unit

Contribution (p.u) = Selling price (p.u) – Variable cost (p.u)

Break-even point (for sales) = fixed cost/ contribution (pu) *sp (pu)

A **break-even** chart is one in which sales revenue, variable costs, and fixed costs are plotted on the vertical axis while volume is plotted on the horizontal axis .The **Break-Even** Point is the Point at which the total sales revenue line intersects the total cost line.

Graphical method of Break-even analysis