**Qn.1. The term financial management has received a lot of attention from the ancient times, citing various scholars critically evaluate the definitions they put forward of the term Financial Management**

Financial management, the meaning of 'finance' has to be explained. In fact, the providing, managing of all the money, capital or funds of any kind to be used in connection. As put forth by Hurband and Dockery in his book 'Modern Corporation .... Defined as the position of money at the time it is wanted.

Meaning Finance is the lifeblood of business. Before discussing the nature and scope of financial management, the meaning of ‘finance’ has to be explained. In fact, the term, finance has to be understood clearly, as it has different meaning and Interpretation in various contexts. The time and extent of the availability of finance in any organization indicates the health of a concern. Every organization, may it be a company, firm, college, school, bank or university requires finance for running day to day affairs. As every organization previews stiff competition, it requires finance not only for survival but also for strengthening themselves. Finance is said to be the circulatory system of the economy body, making possible the required cooperation between the innumerable units of activity.

**Finance:** According to F.W. Palish, Finance may be defined as the position of money at the time it is wanted.

In the words of John J. Hampton, the term finance can be defined as the management of the flows of money through an organization, whether it will be a corporation, school, bank or government agency. According to Howard and Upton, “finance may be defined as that administrative area or set of administrative functions in an organization which relates with the arrangement of each and credit so that the organization may have the means to carry out the objectives as satisfactorily as possible.

From the above explanations, we can now say financial management has undergone fundamental changes as regards its scope and coverage. Financial management is the application of planning and control to the finance function. It helps in profit planning, measuring costs, and controlling inventories, accounts receivables. It also helps in monitoring the effective deployment of funds in fixed assets and in working capital. It aims at ensuring that adequate cash is on hand to meet the required current and capital expenditure. It facilitates ensuring that significant capital is procured at the minimum cost to maintain adequate cash on hand to meet any exigencies that may arise in the course of business. Financial management helps in ascertaining and managing not only current requirements but also future needs of an organization.

According to Weston and Brigham, financial management is an area of financial decision-making, harmonizing individual motives and enterprise goals. In the words of Phillip patus, financial management is concerned with the managerial decisions that result in the acquisition and financing of long-term and short-term credits for the firm. As such it deals with the situations that require selection of specific assets / combination of assets, the selection of specific liability / combination of liabilities as well as the problem of size and growth of an enterprise. The analysis of these decisions is based on the expected inflows and outflows of funds and their effects upon managerial objectives.

We need to have a brief outlook on the evolution of Financial Management. Finance, as capital, was part of the economics discipline for a long time. So, financial management until the beginning of the 20th century was not considered as a separate entity and was very much a part of economics.

In the 1920s, liquidity management and raising of capital assumed importance. The book, `FINANCIAL POLICY OF CORPORATIONS' written by Arthur Stone Dewing in 1920 was a scholarly text on financing and liquidity management, i.e., cash management and raising of capital in 1920s.

In the 1930s, there was the Great Depression, i.e., all round price declines, business failures and declining business. This forced the business to be extremely concerned with solvency, survival, and reorganisation and so on.

**Qn .2. With relevant examples, discuss the functions of financial management to organizations**

To begin with, we need to know what the term financial management is all about before we can move to discuss the functions of financial management to an organization. Financial management therefore refers to the strategic planning; organizing; directing ad controlling of financial undertakings in an organization or an entity. It also includes applying management principles to the financial assets of an organization, while also playing an important part in fiscal management.

In brief, Financial Management means planning, organizing, directing and controlling the financial activities such as procurement and utilization of funds of the enterprise. It means applying general management principles to financial resources of the enterprise.

Financial management is also made up of certain elements. These include financial planning: This is the process of calculating the amount of capital that is required by an organisation and then determining its allocation. A financial plan includes certain key objectives, which are:

* Determining the amount of capital required;
* Determining the capital organisation and structure;
* Framing of the organisation’s financial policies and regulations.
* Financial control: This is one of the key activities in financial management. Its main role is to assess whether an organisation is meeting its objectives or not. Financial control answers questions such as are the organisation’s assets being used competently? Are the organisation’s assets secured? Is the management acting in the best financial interests of the organisation and the key stakeholders?
* Financial decision-making: This involves investment and financing with regards to the organisation. This department takes decisions about how the organisation should raise finance, whether they should sell new shares, or how the profit should be distributed.

The financial management department of any firm is handled by a financial manager. This department has numerous functions such as:

* **Calculating the capital required:** The financial manager has to calculate the amount of funds an organisation requires. This depends upon the policies of the firm with regards to expected expenses and profits. The amount required has to be estimated in such a way that the earning capability of the organisation increases.
* **Formation of capital structure:** Once the amount of capital the firm requires has been estimated, a capital structure needs to be formed. This involves debt equity analysis in the short-term and the long-term. This depends upon the amount of the capital the firm owns, and the amount that needs to be raised via external sources.
* **Investing the capital:** Every organisation or firm needs to invest money in order to raise more capital and gain regular returns. Hence, the financial manager needs to invest the organisation’s funds in safe and profitable ventures.
* **Allocation of profits:** Once the organisation has earned a good amount of net profit, it is the financial manager’s duty to efficiently allocate it. This could involve keeping a part of the net profit for contingency, innovation, or expansion purposes, while another part of the profit can be used to provide dividends to the shareholders.
* **Effective management of money:** This department is also responsible for effectively managing the firm’s money. Money is required for various purposes in the firm such as payment of salaries and bills, maintaining stock, meeting liabilities, and the purchase of any materials or equipment.
* **Financial control:** Not only does the financial manager have to plan, organise, and obtain funds, but he also has to control and analyse the firm’s finances in the short-term and the long-term. This can be done using financial tools such as financial forecasting, ratio analysis, risk management, and profit and cost control.

The functions of financial management to an organization are discussed as below with relevant examples for illustration purposes:

1. **Estimation of capital requirements:** A finance manager has to make estimation with regards to capital requirements of the organization/company. This will depend upon expected costs and profits and future programmes 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 has been made, the capital structures 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-

* Issue of shares and debentures
* Loans to be taken from banks and financial institutions
* 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 decisions have to be made by the finance manager. This can be done in two ways:

1. Dividend declaration - It includes identifying the rate of dividends and other benefits like bonus.
2. Retained profits - The volume has to be decided which will depend upon expansion, innovation, 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.

**Qn.3. Discuss the five fields of finance**

If one is thinking what field one have for a career in finance. There are lots of fields to start one’s career in finance industry. In finance industry offer lots of opportunity for job as well as for business. There are lots of job role in finance which pay high payoff to you.

Multiple fields to starting career in finance industry: -

**1. Accounting:** The accounting is one of the option to start your career in finance industry. Accounting is a type of service where the accountant provide service to individual or company to track their financial transaction. Accountant record all the business transaction that do not manipulate the accounting rules.

**2. Corporate Finance:** Corporate Finance is one of the options to start your career in finance industry. Corporate finance offer working for corporate company to analyse the financial transaction. Give the information about the finance need to run business. Its all about to analysing business financial condition and give the solution for sustain business.

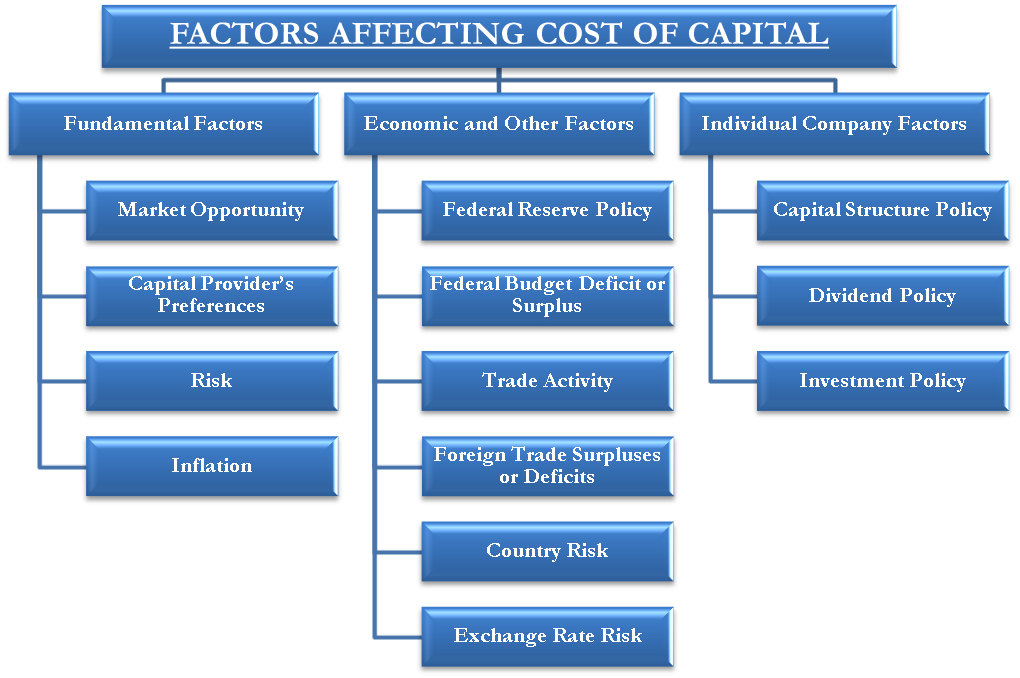
**3. Investment Banking:** Investment banking providing services to corporate company and make them available to the public to invest in company. Investment bank provides information to both company and individual.

**4. Commercial banking:** Commercial banking is the banking which provides services like bank accounts, loans. Commercial bank offer lots of career options. The career options available in the commercial banking are cashier, Credit officer, marketing and sales, manager.

**Qn .4. What are the factors that determine the cost of capital?**

We first need to look at what cost of capital means in financial management. Cost of capital is the cost for a business but return for an investor. There are various factors that can affect the cost of capital. Broadly, factors can be classified as ‘fundamental factors’ and ‘economic and other factors’. Fundamental factors are market opportunities, capital provider’s preference, risk, and inflation. Other factors include Federal Reserve policy, federal surplus and deficit, trade activity, foreign trade surpluses and deficits, country risk and exchange rate risk.

More detailed explanations of these factors are illustrated in the chart below: -



## Fundamental Factors affecting Cost of Capital

### Market Opportunity: Unquestionably, most fundamental price deciding factor for anything in this world is the law of demand-supply. Cost of capital is also not away from this fundamental law. When the demand for capital increases, the cost of capital also increases and vice versa. The demand is influenced greatly by the available market opportunities. If there are a lot of production opportunities in the market, more and more entrepreneurs will explore those opportunities to create profitable ventures. Entrepreneurs, then, would require capital to implement their business ideas. So, cost of capital is directly related to the market opportunities available in the market.

### Capital Provider’s Preferences: An individual who has some additional funds has two straight choices – save money or consume it. It is completely a personal choice but to a great extent, it is impacted by the culture of a society. For example, Ugandan people are more bent towards saving compared to the South Sudanese. Another important factor that determines the utility of capital is the interest rate or returns available to their funds. Naturally higher returns would enforce higher savings.

### Risk: ‘High-risk high-return’ principle works here too. If the venture where investment is required has a high level of risk, the return required by the investor would also be very high to compensate the risk. On the other hand, the businessman taking up the venture may not opt for a too high cost of capital because it may put the viability of the overall project at stake. So, this is how risk plays a key role deciding the capital transactions in the market.

### Inflation: All capital providers try to invest in a manner that maximizes returns. The lower benchmark for investing has always been the inflation. At the minimum, an investment should beat the inflation and there should be some real income. Real income is nothing but the actual return less inflation. In simple words, you invested money which could buy you a particular basket of things a year ago. After a year when your investment is matured and you receive money, you would at least expect that money should be able to buy that same basket of things. If the matured money falls short of buying you the same basket, you have diminished the value of your money in last one year. If the money is more than just buying that basket, you have earned real income on your investment.

### Economic and Other Factors Affecting Cost of Capital

### Federal Reserve Policy: All federal banks have got the power to influence the economy. US Federal Reserve Board simple purchases the treasury securities, normally held by banks, to boost the economy. Let’s understand how it works. When the ‘Federal Reserve Board’ buys the Treasury securities from the banks, the banks accumulate a lot of loan-able funds with it. Now, the banks with a higher supply of funds would start offering loans at lower interest rates. This reduction in interest rates will encourage industrialists to start more and more ventures and that, in turn, will create job opportunities, overall demand in the market etc. Although, there is a flip side of this policy that it will increase the inflation in the longer run. This is how federal policies have a great impact on the cost of capital.

### Federal Budget Deficit or Surplus: Federal budget deficit and surplus also have a role to play in deciding the cost of capital in the market. In a surplus situation, Fed would buy Treasury securities from the market and that will reduce the interest rates. On the contrary, in a deficit situation, Fed would sell Treasury securities or mint money. Minting money would increase the money supply in the market along with an expectation of higher inflation and that leads to increasing the cost of money. Similarly, selling Treasury securities to banks will reduce the loan-able funds with banks and they increase the cost of funds.

### Trade Activity: Economic boom and recession also play a very important role in determining the cost of capital by impacting the interest rates in the market.

### Foreign Trade Surpluses or Deficits: A foreign trade deficit creates a need for borrowing from other countries. Borrower countries will have their own opportunity cost of capital based on the interest rates available with other countries. Higher the borrowings and higher will be the interest rates. That will impact the capital market.

### Country Risk: Country risk is the risk associated with political, social, economic environment of a country. To understand with an example, assume a country has trends of suddenly changing the tax rates, regulations relating to trade and commerce etc. An international investor would resist investing in that country because their policy can put any business at stake suddenly. This will reduce the flow of international capital in the country and thereby increase the cost of capital.

* **Exchange Rate Risk:** Investment in countries other than the home country has a bearing of exchange rate risk on them. The real return of an investor depends on two factors.
* The performance of the investment in the foreign country and
* The performance of the currency of that country in comparison to home currency.

At the time of maturity of the investment, if the home currency weakens, the net realization in home currency would also be reduced. That can affect an investor’s decision of investing in other countries, especially whose currency rates fluctuate a lot.

1. **Individual Company Factors Affecting Cost of Capital**

### Capital Structure Policy: All companies try to optimize their capital structure with a policy that suits their individual situations. New acquisition of capital will depend a lot on the capital structure policy and therefore the capital structure policy of the said company will have a bearing on its cost of capital.

### Dividend Policy: A dividend policy of a corporation decides how much percentage of profits it will retain and how much will be distributed as dividends. If a company retains higher percentage of profits in the business, it is effectively adding a capital at the cost of equity. Accordingly, the overall cost of capital will be impacted.

### Investment Policy: A company is nothing but a set of different projects it takes up. It is very important to note that different projects would have different risk profile. If a company is adding a project with higher risk compared to overall risk level of the organization, it is effectively increasing the risk of the organization. With this increase in risk, the required rate of return will also increase. This is how, investment policy impacts the cost of capital

**References:**

Book: Financial Management by Brigham and Ehrhardt

**Qn.5. Citing an example, how is the present value of annuity calculated**

An annuity is a binding agreement between you and an insurance company that aids in meeting your monetary goals at retirement. They usually require that you make an initial lump sum payment or a series of scheduled payments, in exchange for the insurer paying to your periodic payments at a future date.

Annuities usually defer taxes on investment gains but then tax withdrawals from the annuity at ordinary income rates. They also often contain a death benefit in the event one die and are unable to withdraw the money as income at retirement.

**Present Value of Annuity**. The present value of annuity formula determines the **value** of a series of future periodic payments at a given time. The present value of annuity formula relies on the concept of time value of money, in that one-dollar present day is worth more than that same dollar at a future date.

The present value formula is the core formula for the time value of money; each of the other formulae is derived from this formula. For example, the annuity formula is the sum of a series of present value calculations.

The present value (PV) formula has four variables, each of which can be solved for:

PV= FV

  PV \ = \ \frac{FV}{(1+i)^n}   
PV is the value at time=0

1. FV is the value at time=n
2. i is the rate at which the amount will be compounded each period
3. n is the number of periods (not necessarily an integer)

**Example 1: What return is needed to double money?**

1. Similarly, the present value formula can be rearranged to determine what rate of return is needed to accumulate a given amount from an investment. For example, $100 is invested today and $200 return is expected in five years; what rate of return (interest rate) does this represent?
2. The present value formula restated in terms of the interest rate is:

**Qn. 6. How much financial leverage is enough? Discuss**

Leverage in finance actually has multiple definitions, based on a single concept - using borrowed money - usually from fixed-income securities like debt and preferred equity or preferred shares of stocks - to increase a company's return on investment.

A highly common business and finance strategy, leverage can be used by a business to leverage debt to build financial assets. Financial leverage is largely defined as the leveraging of various debt instruments to boost a business's return on investment.

There is no guarantee that financial leverage will produce a positive outcome. Basically, the higher the amount of debt a company uses as leverage, the higher - and the riskier - is its financial leverage position.

Also, the more leveraged debt a company absorbs, the higher the interest rate burden, which represents a financial risk to companies and their shareholders.

**Financial Leverage Formula**

The formula for calculating financial leverage is as follows:

**Leverage = total company debt/shareholder's equity**.

**Pros and Cons of Financial Leverage**

There are upsides and downsides to financial leverage.

**Benefits of Leverage**

* **A solid way to access capital**. Financial leverage, deployed correctly, can turbo-boost the amount of financial capital a company deploys. Used adeptly, financial leverage enables companies to produce a higher rate of investment return than it likely could without using leverage.
* **Good for business expansion ventures**. Leverage financing is a solid way to successfully address a specific, short-term business growth objective, like engaging in an acquisition or buyout of another company, or by paying out a one-time dividend to shareholders.

**Negatives of Leverage**

* **Risk can be high**. With financial leverage, companies can use debt as a tool to enable their business - and their revenues - to grow faster. But if a company takes on too much debt, the risk of financial loss grows as well.
* **It can be cost-prohibitive**. By using leveraged loans and debt financing tools like high-yield bonds to grow their business, a company must pay interest to investors and lenders, a scenario that could lead to higher costs the more financial risk a company takes on. That's especially problematic in lean economic times, when a company can't generate enough sales revenue to cover high-interest rate costs.

**Understanding Financial Leverage:** “Leverage” is one of the more interesting and difficult concepts to fully grasp in all of finance, but it’s important for anyone that borrows or plans to borrow money to understand. Much of the confusion stems from the contrasting meanings embedded in the same word. Merriam-Webster’s dictionary includes two very different definitions. The first suggests strength: “power, effectiveness.” The other, on face value, has little to do with control: “the use of credit to enhance one’s speculative capacity.” Combining the two suggests that the party which borrows has the leverage — they have the power and advantage over others. Does that mean that the borrower is dominant over the lender? Somehow, that flies in the face of what many of us learned at an early age. The gambler who can’t pay his bookie ends up with a right hook to the gut. Yet many people jump into risky financial situations without considering the potential consequences.

**Qn. 7. What are the impacts of financial leverage?**

Before we look at the impacts of financial leverage, we need to understand the word ‘’Leverage’’ means to get more with little force as in physics. But in accounting it tells us how we can know from our sales that how much EBIT (earnings before interest and taxes) will be. In accounting it is called degree of leverage and is calculated as DOL= contribution margin/EBIT.

Financial leverage offers many advantages for a firm to move forward. But like most things, there are some limitations that come with financial leverage as well. For example, when a company uses financial leverage they are technically borrowing funds. Borrowing money is always going to develop a cloud whether it's one that just creates a little shade or one that causes a thunderstorm. When a company borrows constantly, they are creating an image that they might be of high risk. As a result, there might be an increase in interest rates and some restrictions could be given to the borrowing organization. Another area that could be affected by the use of financial leverage is the value of the stock. It could drop substantially if the stockholders become concerned. It seems that financial leverage is a good idea for a company when interest rates are low. But it is important to use financial leverage in moderation to avoid some of these limitations. The more debt in the capital structure of the firm, the greater the financial risk to the lender. This results in higher average interest rates to be paid and restrictions on the corporation. Common stockholders may become concerned and drive down the price of the stock.

Financial leverage is defined by the text as the amount of debt used in the capital structure of the firm. It is what determines how the company plans to finance their operations. The automobile industries rely heavily on the consumers' demands to purchase more and more every… (MORE)

Conclusively, Leverage as it relates to financial markets is the ability to profit on a financial instrument by putting up a portion of the full amount. This portion is generally known as "Margin." Some investment instruments allow for a deposit of "Good Faith" or Earnest Money to "control" the investment.

In principle, we can say the more debt in the capital structure of the firm, the greater the financial risk to the lender. This results in higher average interest rates to be paid and restrictions on the corporation. Common stockholders may become concerned and drive down the price of the stock.