



FINANCIAL MANAGEMENT

MBA (5 Years Integrated – MAM Dual Degree)

Osmania University, Hyderabad

Year I - Semester II

FINANCIAL MANAGEMENT

Subject Name

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Faculty:

S.No.	Links to contents of unit		Details of textbook/journal/casestudies/ PDFs, PPTs, etc.,	Chapter #/ Page #
	Unit	TOPIC/CONTENT DESCRIPTION		
1	I	Nature of Financial Management – Introduction, Scope of Finance, Finance Functions – Finance Manager's Role, Goal of Financial Management Profit Maximization Vs. Wealth Maximization, Organization of Finance Function, Agency problems, Managers Vs. Shareholders goals.	I.M. Pandey, “ Financial Management ”, Vikas Publications, 9th Edition.	Chapter 1 Page 3 to 14
2	I	Emerging Role of Finance Managers in India.	M Y Khan & P K Jain, “ Financial Management ”, TMH, 7/E	Chapter 1 Page 1.22
3	II	Time Preference for Money – Introduction – Future Value of a single cash flow, annuity, perpetuity, continuous compounding, Present Value – Present Value of a single cash flow, annuity, perpetuity, continuous discounting, Practical Applications of Compounding and present Value Techniques.	I.M. Pandey, “ Financial Management ”, Vikas Publications, 9th Edition	Chapter 2 Page 17 to 35
4	III	Sources of Finance – Long term Finance: Shares, Debentures and Term Loans – ordinary shares, Rights issue and equity share issue.	I.M. Pandey, “ Financial Management ”, Vikas Publications, 9th Edition	Chapter 20 Page 432 to 442
5	III	Convertible Debenture	I.M. Pandey, “ Financial Management ”, Vikas Publications, 9th Edition	Chapter 21 Page 445 to 451

6	III	Venture Capital	I.M. Pandey, " Financial Management ", Vikas Publications, 9th Edition	Chapter 23 Page 477 to 485
7	III	Mutual funds	I.M. Pandey, " Financial Management ", Vikas Publications, 9th Edition	Chapter 23 Page 427 to 430
8	III	Short Term Finance – Money market instruments – commercial paper, Certificates of Deposit, Bills, Intercompany deposits.	I.M. Pandey, " Financial Management ", Vikas Publications, 9th Edition	Chapter 30 Page 731 to 732
9	IV	Determining cash flows for investment analysis – Cash Flow Vs Profit, Flows, Calculation of Depreciation for tax purposes, cash flows, Components of Cash Flows, Calculation of Depreciation for tax purpose, cash flow Replacement decision,	I.M. Pandey, " Financial Management ", Vikas Publications, 9th Edition	Chapter 10 Page 199 to 210
10	IV	Break even analysis	M Y Khan & P K Jain, " Financial Management ", TMH, 7/E	Chapter 7 Page 7.1 to 7.16
11	V	Valuation of Bonds & Shares – Introduction to Risk & Return	I.M. Pandey, " Financial Management ", Vikas Publications, 9th Edition.	Chapter 4 Page 70 to 79
12	V	Valuation of Bonds & Shares – Concept of Value, Features of a Bond, Bond Values & Yields, Features and valuation of Ordinary Shares and Preference Shares, Significance of P/E Ratio.	I.M. Pandey, " Financial Management ", Vikas Publications, 9th Edition.	Chapter 3 Page 43 to 61

 REPRESENTS UNITS WITH NUMERICAL PROBLEM

FINANCIAL MANAGEMENT

1. Nature of Financial Management

- ☐ Introduction
- ☐ Scope of Finance
- ☐ Finance Functions

2. Finance Manager's Role

3. Goal of Financial Management

- ☐ Profit Maximization Vs. Wealth Maximization,

4. Organization of Finance Function

5. Agency problems

- ☐ Managers Vs. Shareholders goals

6. Emerging Role of Finance Managers in India.

I. Nature of Financial Management

I.I. Introduction

- ❑ Financial management is that managerial activity which is concerned with planning and controlling of the firm's financial resources.
- ❑ ***“Financial management deals with the maintenance and creation of economic value or wealth by focusing on decision making with an eye toward creating wealth.”¹***
- ❑ Financial management deals with financial decisions such as
 - When to introduce a new product,
 - When to invest in new assets,
 - When to replace existing assets,
 - When to borrow from banks,
 - When to sell stocks or bonds,
 - When to extend credit to a customer, and
 - How much cash and inventory to maintain

I. Nature of Financial Management ²

I.2. Scope of Finance




- The field of finance is broad and dynamic. It directly affects the lives of every person and every organization.

I.2.1. What is Finance?




- Finance can be defined as the art and science of managing money.
- Virtually all individuals and organizations earn or raise money and spend or invest money.
- Finance is concerned with the process, institutions, markets, and instruments involved in the transfer of money among individuals, businesses, and governments.


1.2.2. Real and Financial Assets

Real Assets

-  A firm requires real assets to carry on business
-  **Tangible Real Assets** are physical assets such as Plant, Machinery, Office Factory, Furniture and Building
-  **Intangible Real Assets** are technical know-how, technological collaborations, patents & copyrights.

Financial Assets

-  Is also known as securities
-  They are financial papers or instruments such as bonds or debenture.
-  Firms issue securities to investors in the **Primary Capital Markets** to raise necessary funds.

- 
- ❑ The securities issued by firms are traded (bought & sold) by investors in the **Secondary Capital Markets**, referred to as stock exchanges.
 - ❑ Financial assets also include lease obligations and borrowings from banks, financial institutions and other sources.
 - ❑ In a **lease**, the lessee obtains a right to use the lessor's asset for an agreed amount of rental over the period of lease.
 - ❑ Funds applied to assets by the firm are called **Capital Expenditure (CAPEX)** or investments.
 - ❑ The firm expects to receive return on investment and might distribute return (or profit) as dividend to investors.

1.2.3. Equity and Borrowed Funds

1.2.3.1 Equity Funds – called Equity

- ❑ A firm sells shares to acquire equity funds
- ❑ **Shares** represent ownership rights of their holders
- ❑ Buyers of shares are called shareholders or stockholders, and they are legal owners of the firm whose shares they hold.
- ❑ ***Shareholders invest their money in the shares of a company in the expectation of a return on their invested capital.***
- ❑ Shareholders make capital gains (or loss) by selling their shares.

❑ **Shareholders are of two types**

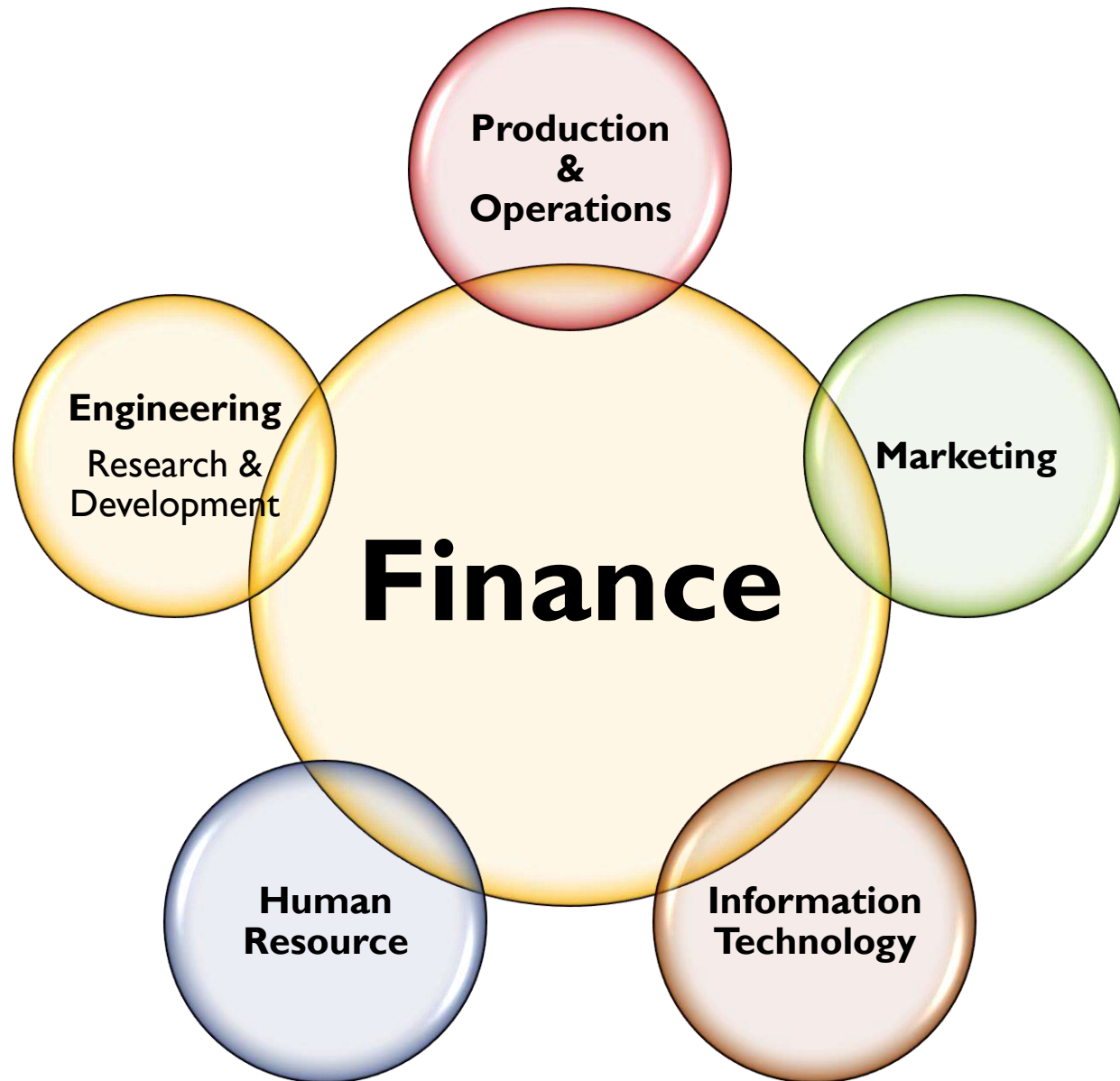
1. **Preference Shareholders** - *They receive dividend at a fixed rate, and have a priority over ordinary shareholders.*
2. **Ordinary or Equity Shareholders** - *The dividend for Ordinary shareholders is not fixed, it can vary from year to year depending on the decision of the board of directors.*

- ❑ A company can obtain equity funds by retaining earnings available for shareholders.
- ❑ **Retained earnings**, which is referred as internal equity, are undistributed profits of equity capital.
- ❑ If a company distributes all earnings to shareholders, then, it can reacquire new capital from the same sources (existing shareholders) by issuing new shares called **Rights Shares**
- ❑ A **Public Issue** of shares may be made to attract new (as well as existing) shareholders to contribute equity capital.

1.2.3.2. Borrowed funds – called Debts

- ☐ Another important source of securing capital is **Creditors** or **Lender**
- ☐ Lenders are not the owners of the company.
- ☐ They make money available to the firm as loan or debt
- ☐ Loans are generally furnished for a specified period at a fixed rate of interest
- ☐ For lenders, the return on loans or debt is **Interest** paid by the firm
- ☐ The firm may borrow funds from a large number of sources, such as Banks, Financial Institutions, Public – by issuing bonds or debentures.
- ☐ A **Bond** or **Debenture** is a certificate acknowledging the amount of money lent by the bondholder to the company, It states the amount, the rate of interest, and the maturity of the bond or debenture.
- ☐ Bond/Debenture is a financial instrument that can be traded in the secondary capital market

I.2.4. Finance and Management Function



1.3. Finance Functions

FINANCE FUNCTIONS

Financing Decision

- When, Where from & how to acquire funds to meet the firm's investment needs
- Determine the appropriate proportion of equity and debt
- The mix of debt & equity is known as firm's Capital Structure
- Obtain best financing mix
- The firm's Capital Structure is considered optimum when market value of shares is maximized

Investment Decision

- Capital Budgeting or Capital Expenditure (CAPEX) Decision
- Allocation of funds to long term assets expecting yield in future.
- Evaluating prospective profitability of new investments
- Risk, Expected Return , & Cost of capital considered

Working Capital Decision

- Current assets investment affects the firm's profitability
- Lack of liquidity in extreme situations can lead to firm's insolvency
- Cash Mgt.,
- Debtor's Mgt.,
- Credit Mgt.,
- Inventory Mgt.

Dividend Decision

Decide whether the firm should distribute all profits, or retain them, or distribute a portion and retain balance

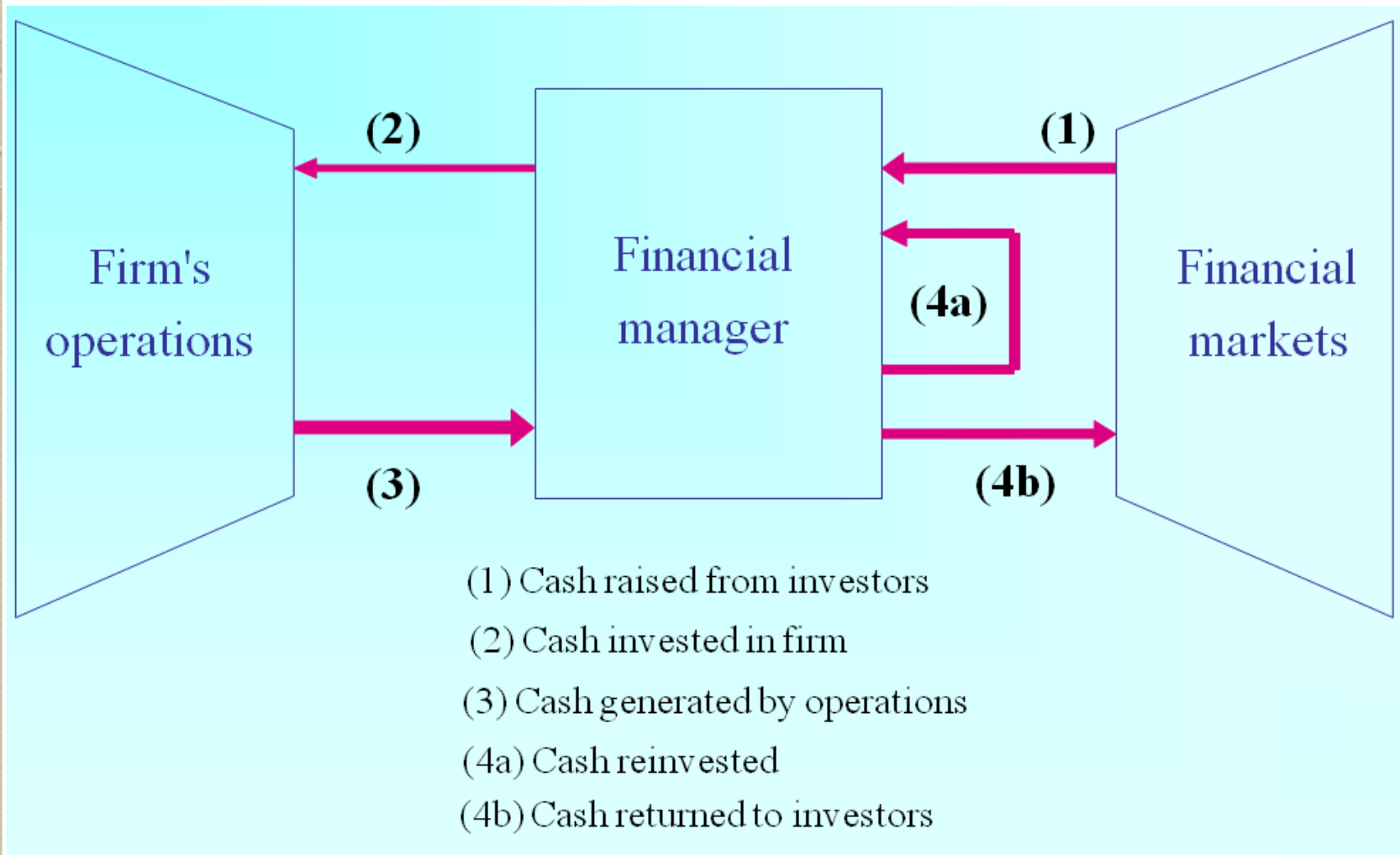
The proportion of profits distributed as dividends is called **Dividend Payout Ratio (DPR)**

The retained portion of profit is known as the **Retention Ratio**

2. Finance Manager's Role

- ❑ The financial manager is a person who is responsible, in a significant way to carry out the finance functions.
- ❑ Today financial manager occupies a key position and he/she is one of the members of top management team
- ❑ The financial manager's function is not confined to maintaining records, preparing reports, etc,. Rather his/her role became more intensive and significance in solving complex fund management problems.
- ❑ The financial manager stands between the firm and outside investors.
- ❑ The financial manager helps manage the firm's operations, particularly by helping to make good investment decisions.
- ❑ The financial manager deals with investors—not just with shareholders but also with financial institutions such as banks and with financial markets

2. Finance Manager's Role



3. Goal of Financial Management

- ❑ A successful business enterprise uses a goal oriented financial structure. The financial manager performs certain tasks or functions that help to achieve the goals of the finance department.
- ❑ The goals in turn help the firm achieve its overall operational objectives.
- ❑ The firm should ensure that the actions of all operating units, including finance are helping it to achieve its stated objectives.
- ❑ The starting point for developing a goal oriented financial structure is the defining of workable goals for the firm as a whole.
- ❑ Since business firms are profit seeking organizations, their objectives are frequently expressed in terms of money.
- ❑ Two primary objectives are commonly encountered

Profit Maximization

Wealth Maximization

3. Goal of Financial Management

❑ Maximization of Profit

- ❑ First frequently stated goal of the firm is profit
- ❑ As long as business is earning more revenue while holding down costs, this goal is achieved
- ❑ Profit maximization has the benefit of being simple and straightforward statement of purpose
- ❑ It is easily understood as a rational goal for a business and focuses on the firm's efforts towards making money.

3. Goal of Financial Management

- ❑ **Profit maximization** is widely professed, but in fact the concept has several weaknesses.
- ❑ **Profit maximization is vague**
 - ❑ Is it short term or long term?
 - ❑ Is it Profit before tax or Profit after tax?
 - ❑ Is it total profits or profit per share?
- ❑ **Profit maximization ignores timing**
 - ❑ It does not distinguishes between returns received in different time periods
 - ❑ It gives no consideration to time value of money
 - ❑ It values benefits received in different periods of time as the same
- ❑ **Profit maximization overlooks quality aspects of future activities**
 - ❑ It gives preference to profit than growth of sales
 - ❑ It will not accept lower profit to gain the stability provided by a large volume sales
 - ❑ It will not prefer diversifying of business activities as it results in short term decline in profit

3. Goal of Financial Management

□ Wealth Maximization

- In making financial decisions, the financial manager should aim at increasing the value of the shareholders' stake in the firm. This is referred to as the principles of shareholder's wealth maximization
- Wealth maximization is superior to profit maximization since wealth is precisely defined as net present value and it accounts for time value of money and risk.
- Wealth maximization means *“to maximize the value of the firm over the long run”*
- Wealth is defined as ***the net present value of the firm.***
- Rather than focusing directly on profits, this goal emphasizes the impact of profits on the current market value of the firm's securities – **Common Stock** also called as **Shares**.

3. Goal of Financial Management

Example - If Profit After Tax (PAT) of the **Avenue Supermarts** in 2018 was Rs.784.66 Cr. and Rs.936.35 Cr. in 2019. Total shares outstanding are 64.78 Cr. Investors require 15 per cent return on their investment. What is total value of stock? The value on a per share basis?

Sol – CSM = NI/ER; CMPs = CSM/Outstanding Shares

CSM -Current Market Value of firm's share, **CMPs** – Current Market Price of Share

NI – Net Income, in this case PAT; **ER** – Expected rate of return

2018

$$\text{CSM} = 784.66 / 0.15 = \text{Rs. 4991 Cr.}$$

$$\text{CMPs} = \text{Rs. 4991} / 64.78 = \text{Rs. 77}$$

2019

$$\text{CSM} = 936.35 / 0.15 = \text{Rs. 6242 Cr.}$$

$$\text{CMPs} = \text{Rs. 6242} / 64.78 = \text{Rs. 96}$$

From the above calculation we can see that if the firm's profit increases Year-on-Year, the firm's present worth (*wealth*) would also increase.

The Year on Year change in CMPs is Rs.16. The share price increased by 20 per cent $[(96-77/77)*100]$ thereby creating wealth for the shareholders.

3. Goal of Financial Management

- ❑ Maximization of wealth implies other factors in addition to profits
- ❑ Long run value is affected by the firm's growth, the amount of risk acceptable to investors, the market price of the stock, and the cash dividends.
- ❑ A firm that is maximizing wealth must do the following:
 - ❑ Avoid High Levels of Risk
 - ❑ Pay Dividends
 - ❑ Seek Growth
 - ❑ Maintain Market Price of Stock
- ❑ Maximization of wealth is more useful than maximization of profit as a statement of the objective of most business firms.
- ❑ Profit factor should be considered from a long term point of view.

AVENUE SUPERMARTS (Dmart)

Standalone Profit & Loss account ----in Rs. Cr. ----

	Mar 20	% Change	19-Mar	%	18-Mar	%	17-Mar	%	16-Mar
	12 mths		12 mths		12 mths		12 mths		12 mths
INCOME									
Revenue From Operations [Gross]	24,675.01	13	21,827.98	33	16,446.54	29	12,717.71	39	9,150.53
Less: Excise/Service Tax/Other Levies	0	-100	1,946.43	32	1,471.89	71	859.3	45	593.22
Revenue From Operations [Net]	24,675.01	24	19,881.55	33	14,974.65	26	11,858.42	39	8,557.30
Other Operating Revenues	0	-100	34.7	1	34.24	51	22.7	27	17.87
Total Operating Revenues	24,675.01	24	19,916.25	33	15,008.89	26	11,881.12	39	8,575.18
Other Income	63.33	23	51.41	-29	72.65	132	31.29	56	20.05
Total Revenue	24,738.34	24	19,967.66	32	15,081.54	27	11,912.41	39	8,595.23
EXPENSES									
Purchase Of Stock-In Trade	21,349.14	23	17,409.12	35	12,862.76	24	10,368.95	39	7,444.17
Changes In Inventories	-333.21	-22	-429.18	101	-213.88	-22	-272.96	110	-130.28
Employee Benefit Expenses	424.74	27	335.03	21	276.56	46	189.47	30	146.22
Finance Costs	62.76	33	47.15	-21	59.42	-51	121.8	34	91.23
Depreciation & Amortization Expenses	339.81	71	198.8	29	154.65	23	126.02	30	97.1
Other Expenses	1,112.21	16	959.1	29	746.14	18	632	38	458.44
Total Expenses	22,955.45	24	18,520.02	33	13,885.65	24	11,165.29	38	8,106.87
Profit/Loss Before Tax	1,782.89	23	1,447.64	21	1,195.89	60	747.11	53	488.35
Tax Expenses-Continued Operations									
Current Tax	433	-14	501.21	20	417.17	66	251.24	56	160.82
Deferred Tax	0	-100	17.77	-426	-5.45	-147	11.65	23	9.49
Tax For Earlier Years	0	-100	-7.69	1469	-0.49	-131	1.58	1115	0.13
Total Tax Expenses	433	-15	511.29	24	411.23	55	264.47	55	170.44
Profit/Loss After Tax (PAT)	1,349.89	44	936.35	19	784.66	63	482.64	52	317.91

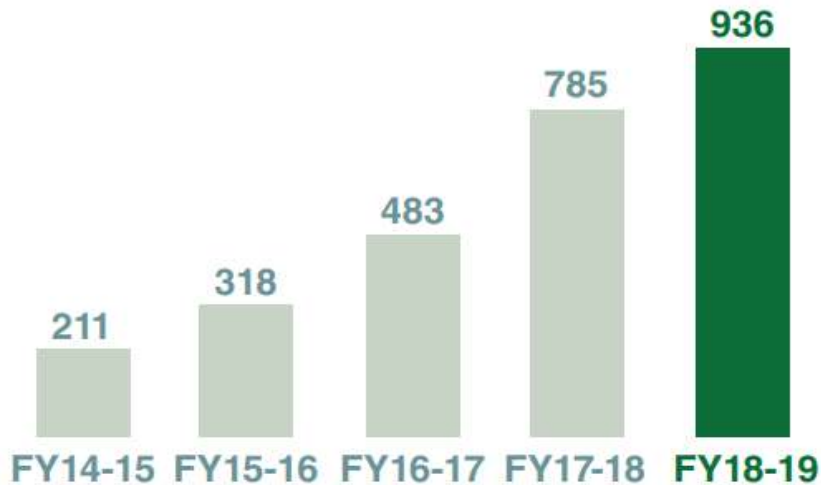
Source – www.moneycontrol.com

The Profit After Tax (PAT) of Avenue Supermarts witnessed stupendous 324% $(1349.89 - 317.91 / 317.91 \times 100)$ increase from 2016 to 2020. PAT of 2016 is 317.91 & PAT of 2020 is 1349.89

With a strategy of maintaining cost efficiencies while offering the best customer value, **DMart** has continued to witness stable performance across Financial and Operational parameters, Year-on-Year.

PROFIT AFTER TAX

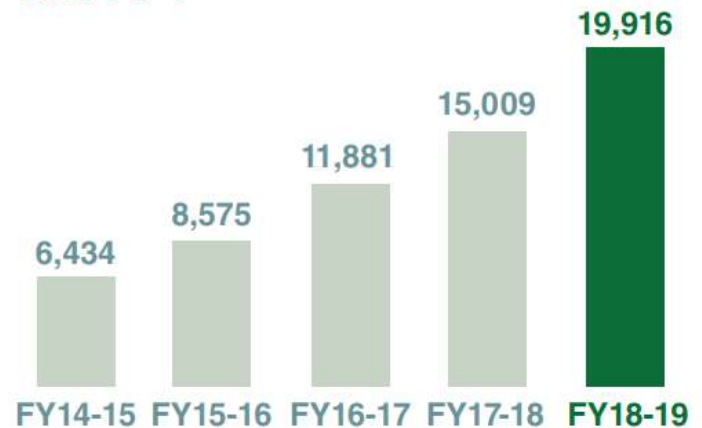
19% Y-o-Y



(₹ in crores)

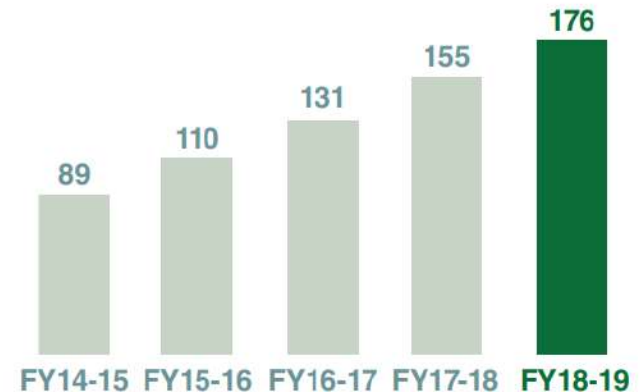
REVENUE FROM OPERATIONS

33% Y-o-Y



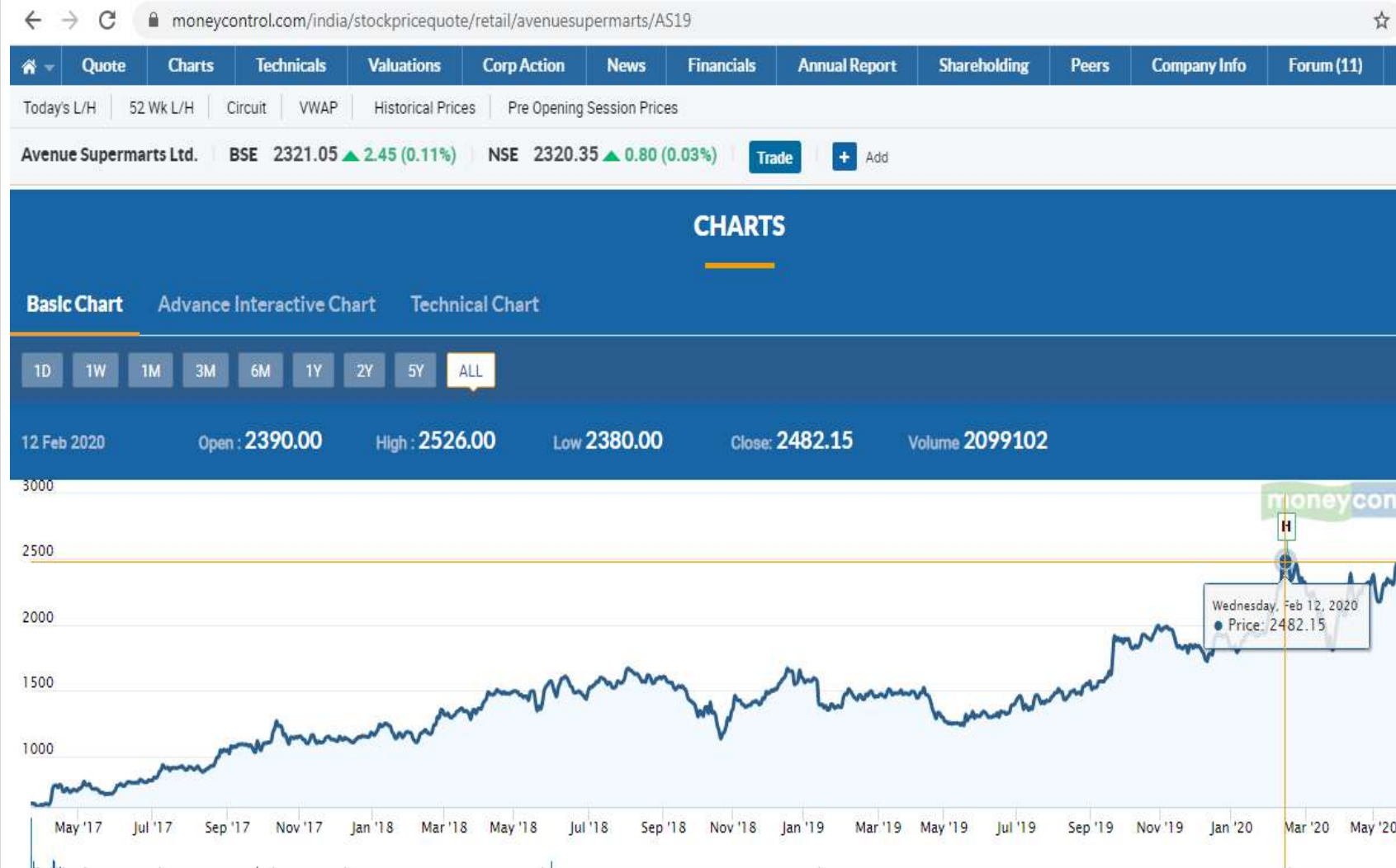
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CUMULATIVE NUMBER OF STORES



(in numbers)

Wealth Maximization at Avenue Supermarts



As on 30-Apr-2020, the return for shareholder of Avenue Supermarts, who invested on 02-May-2017 at the share price of Rs.752.30 was 217% (Ending price – Beginning Price/Beginning Price x 100). Share price as on 30-Apr-2020 was Rs.2383.65. Note – Dividends are ignored in above calculations

Source – www.moneycontrol.com

Investor Return for Avenue Supermarts

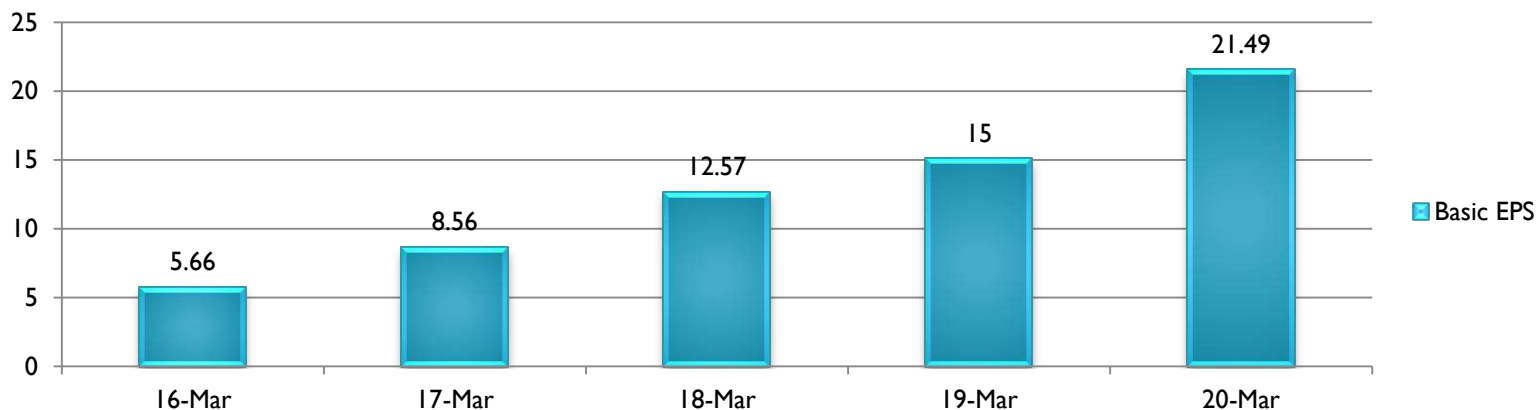
PERIOD	DATE	PRICES (RS.)	RETURN(%)
1 Week	22-May-2020	2398.30	-5.38
1 Month	29-Apr-2020	2344.35	-3.20
3 Month	02-Mar-2020	2228.95	1.81
6 Month	29-Nov-2019	1822.50	24.52
1 Year	29-May-2019	1307.05	73.62
2 Year	29-May-2018	1544.05	46.97
3 Year	29-May-2017	714.80	217.48
5 Year	21-Mar-2017	641.60	253.70

Source: <https://www.motilaloswal.com/get-quotes-equity/Avenue-Supermarts-Ltd/540376/40942>

EARNINGS PER SHARE	Mar 20	%	19-Mar	%	18-Mar	%	17-Mar	%	16-Mar
Basic EPS (Rs.)	21.49	43	15	19	12.57	47	8.56	51	5.66
Diluted EPS (Rs.)	21.33	44	14.79	19	12.41	45	8.55	51	5.66

Source – www.moneycontrol.com

Graph showing Basic EPS of Avenue Supermarts for the 5 years period (2016 -2020)

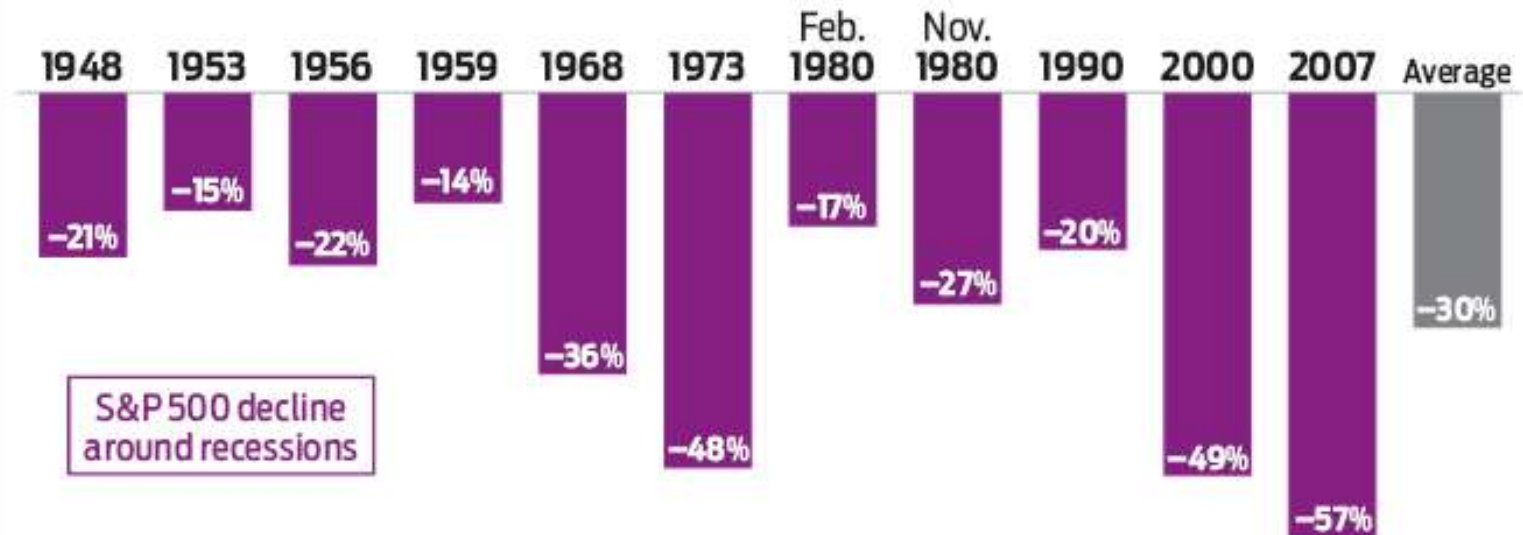


Market Performance impacts wealth maximization

Look Out Below

MARKET DROPS AROUND RECESSIONS

The stock market declines below occurred roughly around the time of the 11 recessions that have taken place since 1948. Six months after the low, stocks returned 26%, on average.



SOURCE: Goldman Sachs Investment Research

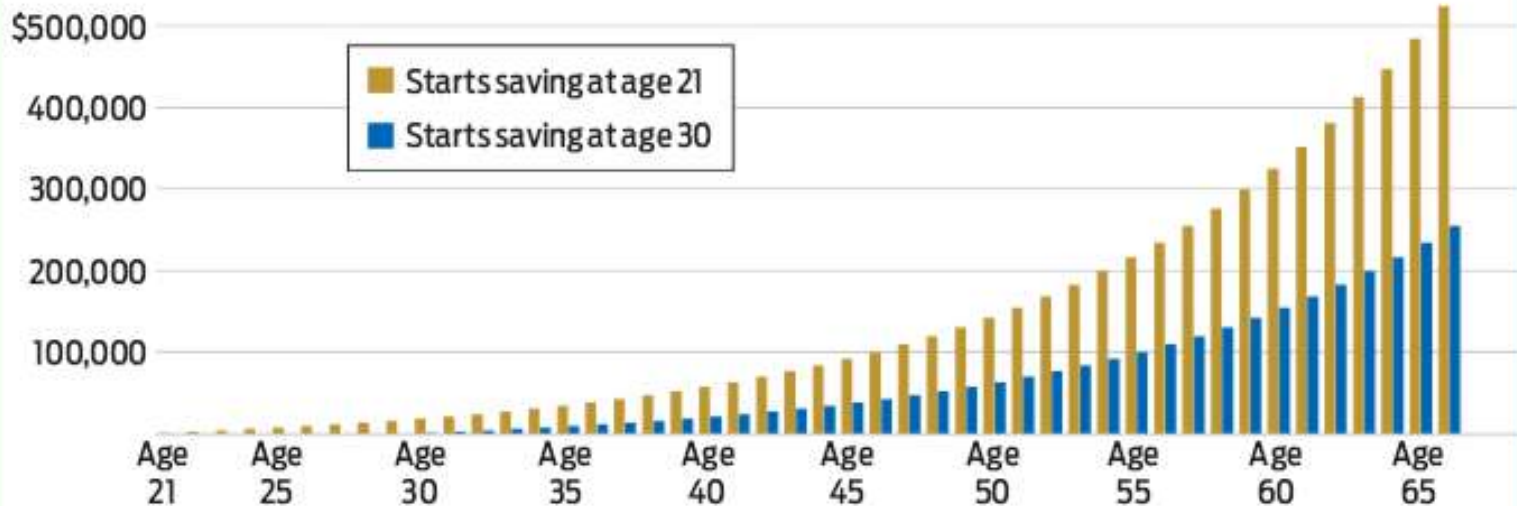
Source - Kiplinger's Personal Finance, Vol. 74, No. 5, May 2020, Pg - 10

Investing early maximizes investor's wealth in the long run

Time Value of Money

A BIG HEAD START

One investor starts saving for retirement at age 21 (shown in gold), while the other waits until 30 (shown in blue). Both put away \$100 a month and earn an annualized 8% until age 67.

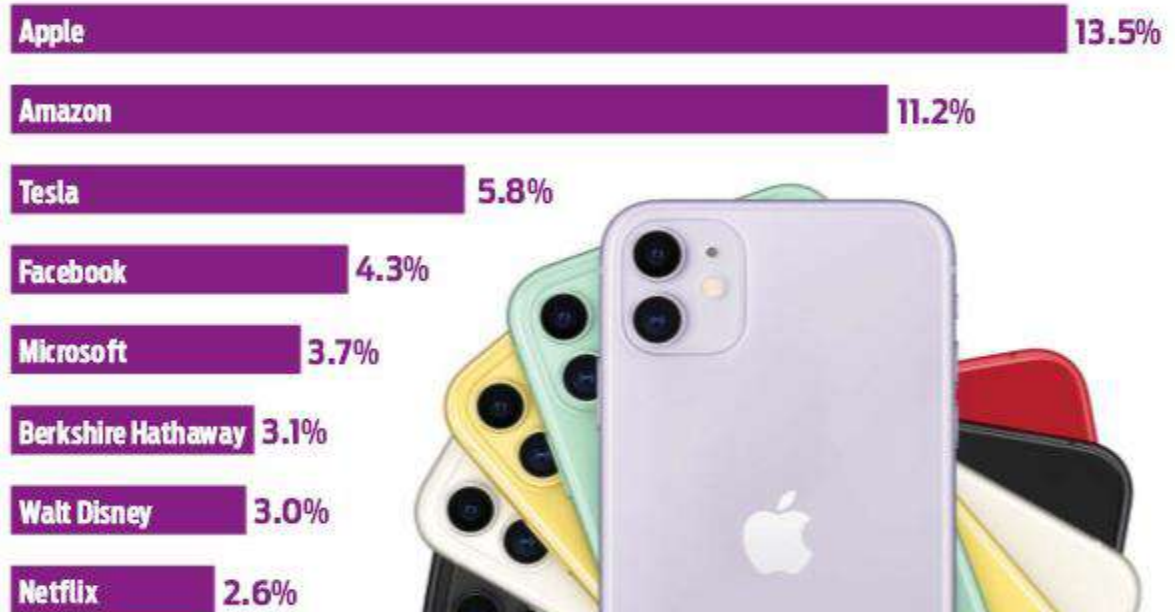


SOURCE: Bankrate.com

Selecting right stock is essential for investor's wealth maximization

WHAT STOCKS MILLENNIALS WANT

These are the top holdings of U.S. millennial investors, according to the Millennial 100 report by Apex Clearing, a specialist in digital wealth management. Apex Clearing analyzed more than 734,000 portfolios. The average age of investors in the study was just over 31, and the average account size was about \$2,300.



Baby Boomers – Born between 1946 and 1964 (ages 74 to 56 in 2020)

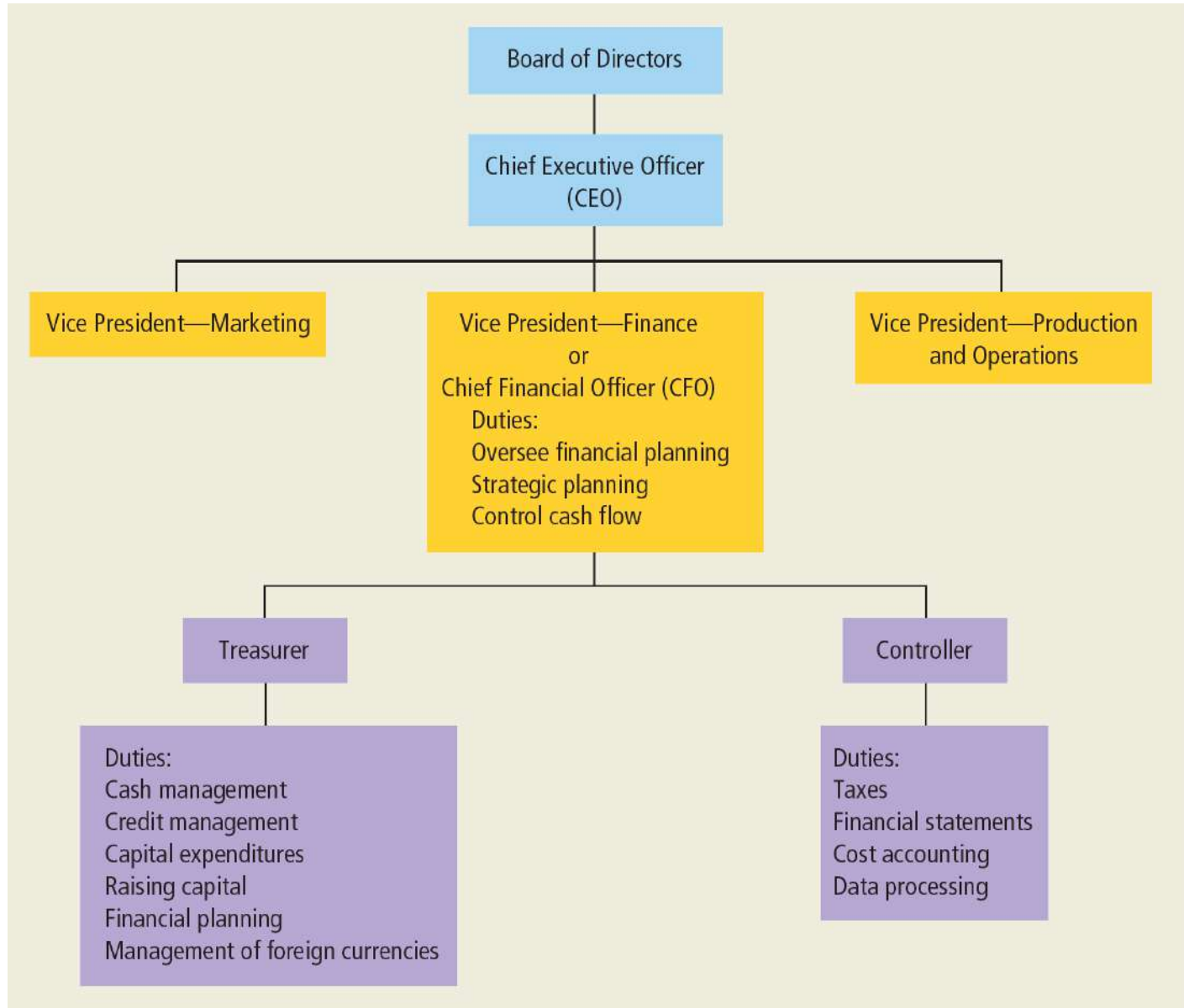
Generation X – Born between 1965 and 1980 (ages 55 to 40 in 2020)

Generation Y – **(Millennial)** - Born between 1981 and 1996 (ages 39 to 24 in 2020)

Generation Z – Born between 1997 and 2012 (ages 23 to 8 in 2020)

Source - Kiplinger's Personal Finance, Vol. 74, No. 4, April 2020, Pg - 19

4. Organization of Finance Function



5. AGENCY PROBLEMS

□ Managers Vs. Shareholders goals

- Shareholders and managers have principal and agent relationship
- Conflict that arise between the interests of shareholders and managers is known as **Agency Problem**.
- The cost associated to deal with Agency problem is termed as **Agency Cost**.
- These are the costs of monitoring management behavior, ensuring against dishonest acts of management, and giving managers the financial incentive to maximize share price.
- **Agency costs are** incurred when
 - (1) managers do not attempt to maximize firm value and
 - (2) shareholders incur costs to monitor the managers and constrain their actions.

5. AGENCY PROBLEMS

- ❑ Managers are not endowed with a special value-maximizing gene. They will consider their own personal interests, which creates a potential conflict of interest with outside shareholders.
- ❑ This conflict is called a principal–agent problem. Any loss of value that results is called an agency cost.
- ❑ **Corporate governance** helps to align managers' and shareholders' interests, so that managers pay close attention to the value of the firm. For example, managers are appointed by, and sometimes fired by, the board of directors, who are supposed to represent shareholders.
- ❑ The managers are spurred on by incentive schemes, such as grants of stock options, which pay off big only if the stock price increases. If the company performs poorly, it is more likely to be taken over. The takeover typically brings in a fresh management team.

5. AGENCY PROBLEMS

- ❑ When the managers have little or no ownership in the firm, they are less likely to work energetically for the company's shareholders.
- ❑ Instead, the managers will have an incentive to enrich themselves with perks and other financial benefits—say, luxury corporate jets, expensive corporate apartments, or resort vacations.
- ❑ They will also have an incentive to turn down projects that have an element of risk in order to avoid jeopardizing their jobs—even though their shareholders would like the company to pursue these projects.
- ❑ The end result of this behavior is that the value of the firm's stock is not maximized and the goal of the firm is not achieved.

5. AGENCY PROBLEMS

- The most popular, powerful, and expensive approach is to *structure management compensation to correspond with share price maximization.*
- *The objective* is to give managers incentives to act in the best interests of the owners. In addition, the resulting compensation packages allow firms to compete for and hire the best managers available.
- The two key types of compensation plans are incentive plans and performance plans.

5. AGENCY PROBLEMS

- ❑ **Incentive Plans** - Management compensation plans that tend to tie management compensation to share price; most popular incentive plan involves the grant of *stock options*.
- ❑ **Stock Options** - An incentive allowing managers to purchase stock at the market price set at the time of the grant.
- ❑ **Performance Plans** - Plans that tie management compensation to measures such as EPS, growth in EPS, and other ratios of return. *Performance shares and/or cash bonuses* are used as compensation under these plans.
 - ❑ **Performance Shares** - Shares of stock given to management for meeting stated performance goals.
 - ❑ **Cash Bonuses** - Cash paid to management for achieving certain performance goals.

6. Emerging Role of Finance Managers in India.

Corporate Finance

Capital Structure

CAPEX

Dividend Policy

Working Capital

Mergers & Acquisition

Investor Relations

Investment Banking

Stock Market

Commodity Market

Mutual Fund

FOREX

Money Market

Bonds

Financial Services

Credit Rating

Leasing

Hire Purchase

Factoring

Venture Capital

Merchant Banking

Insurance

Post 1990s the economic & financial environment has undergone drastic change making the job of the financial manager more complex & challenging. Few of the challenges are:

Global Competition

Volatile Financial Prices

Technological Advancements

Financial Disruption

Tax Law Changes

Ethical Concern

Artificial Intelligence

Blockchain Technology

Economic Uncertainty



Question?

Thank You