



# Contents

---

	PAGE
<i>About the Author</i>	I-5
<i>Preface</i>	I-7
<i>Organization of the book</i>	I-9
<i>Detailed Outline of Financial Management Syllabus</i>	I-11
<i>Chapter-heads</i>	I-13
<i>Abbreviations and Notations</i>	I-23

## PART I : BACKGROUND

### 1

#### FINANCIAL MANAGEMENT : AN INTRODUCTION

◆ Evolution of Finance as a discipline	4
- Finance upto 1950 - The Traditional Phase	4
- After 1950 - An integrated view of Finance Function	4
◆ Finance as an Area of Study	5
◆ Scope of Finance Function	5
◆ Financial Decision Making	7
- Financial Decision Making and the Relevant Groups	7
- Goal or Objective of the Financial Decision Making	8
◆ Risk and return : Basic Dimensions of Financial Decisions	10
◆ Financial Management and other areas of Management	10
◆ Some Basic Propositions and Axioms of Financial Management	11
◆ Treasury Management	12
◆ Financial Management and Financial Accounting : Complementary Companions	12
◆ Financial System and Environment in India : An Overview	13
<i>Points to Remember</i>	14
<i>Objective Type Questions</i>	15
<i>Multiple Choice Questions</i>	15
<i>Assignments</i>	16

### 2

#### THE MATHEMATICS OF FINANCE

◆ Concept and Relevance	20
◆ Compounding Technique	21

	PAGE
◆ Discounting Technique	24
◆ Other Specific Cash Flows	25
◆ Applications of the Concept of TVM	27
<i>Points to Remember</i>	29
<i>Graded Illustrations</i>	30
<i>Objective Type Questions</i>	32
<i>Multiple Choice Questions</i>	32
<i>Assignments</i>	34
<i>Problems</i>	34

## PART II : LONG-TERM INVESTMENT DECISIONS : CAPITAL BUDGETING

### 3

#### **CAPITAL BUDGETING : AN INTRODUCTION**

◆ Features and Significance	40
◆ Problems and Difficulties in Capital Budgeting	40
◆ Types of Capital Budgeting Decisions	41
◆ Capital Budgeting Decisions and Funds availability	42
◆ Capital Budgeting Decisions : Assumptions and Procedure	42
◆ Estimation of Costs and Benefits of a Proposal	42
◆ Incremental Approach to Cash Flows	46
◆ Taxation and Cash Flows	47
◆ Depreciation, Non-cash items and Cash Flows	47
◆ Treatment of depreciation and Profit/Loss on Sale/Scrapping of an Asset	47
◆ Financial Cash Flows	49
<i>Points to Remember</i>	50
<i>Graded Illustrations</i>	51
<i>Objective Type Questions</i>	54
<i>Multiple Choice Questions</i>	55
<i>Assignments</i>	56
<i>Problems</i>	56

### 4

#### **CAPITAL BUDGETING : TECHNIQUES OF EVALUATION**

◆ Evaluation of Proposals : The Background	60
◆ Capital Budgeting : Techniques of Evaluation	60
◆ Traditional or Non-discounting Techniques	60
- Payback Period	61
- Accounting Rate of Return or Average Rate of Return (ARR)	62
◆ Discounted Cash Flows or Time-Adjusted Techniques	63
- Discounting Procedure : A common ingredient to Discounted Cash flow Techniques	64
- Net Present Value (NPV) Method	64
- Profitability Index (PI)	66
- Discounted Payback Period	67
- Internal Rate of Return (IRR)	67
- Modified Internal Rate of Return (MIRR)	70
◆ Capital Budgeting Decisions : Some cases	71
◆ Capital Budgeting with Unequal Lives of Proposals	76
◆ Risk Analysis in Capital Budgeting	77
◆ Conventional Techniques of Risk Analysis	78
◆ Selecting the Appropriate Technique	80

PAGE

<i>Points to Remember</i>	81
<i>Graded Illustrations</i>	81
<i>Capital Budgeting Problems based on Block of Assets Concept</i>	97
<i>Objective Type Questions</i>	99
<i>Multiple Choice Questions</i>	99
<i>Assignments</i>	101
<i>Problems</i>	101

## PART III : FINANCING DECISION

### 5

#### COST OF CAPITAL

◆ Concept of Cost of Capital	108
◆ Factors Affecting the Cost of Capital	108
◆ Types of Cost of Capital	109
◆ Measurement of Cost of Capital	110
◆ Cost of Long-term Debt and Bonds	110
◆ Cost of Preference Share Capital	112
◆ Cost of Equity Share Capital	113
◆ Cost of Retained Earnings	117
◆ Weighted Average Cost of Capital	117
◆ Marginal Cost of Capital	120
<i>Points to Remember</i>	123
<i>Graded Illustrations</i>	123
<i>Objective Type Questions</i>	132
<i>Multiple Choice Questions</i>	133
<i>Assignments</i>	134
<i>Problems</i>	135

### 6

#### FINANCING DECISION : LEVERAGE ANALYSIS

◆ Concept of Leverage	138
◆ Operating Leverage	139
◆ Financial Leverage	141
◆ Combined Leverage	144
<i>Points to Remember</i>	145
<i>Graded Illustrations</i>	145
<i>Objective Type Questions</i>	152
<i>Multiple Choice Questions</i>	152
<i>Assignments</i>	154
<i>Problems</i>	154

### 7

#### FINANCING DECISION : EBIT-EPS ANALYSIS

◆ Constant EBIT and Change in the Financing Patterns	158
◆ Varying EBIT with Different Patterns	159
◆ Financial Break-even Level	160
◆ Indifference Point/Level	160
◆ Short-falls of EBIT-EPS Analysis	164

<i>Points to Remember</i>	165
<i>Graded Illustrations</i>	166
<i>Objective Type Questions</i>	174
<i>Multiple Choice Questions</i>	174
<i>Assignments</i>	175
<i>Problems</i>	175

## 8

### **LEVERAGE, COST OF CAPITAL AND VALUE OF THE FIRM**

◆ Capital Structure Theories	180
◆ Net Income Approach : Capital Structure matters	181
◆ Net Operating Income Approach : Capital Structure does not matter	182
◆ Traditional Approach : A Practical Viewpoint	183
◆ Modigliani-Miller Model : Behavioural Justification of the NOI Approach	185
◆ The Arbitrage Process	186
◆ MM Model with Taxes	189
<i>Points to Remember</i>	189
<i>Graded Illustrations</i>	190
<i>Objective Type Questions</i>	196
<i>Multiple Choice Questions</i>	196
<i>Assignments</i>	198
<i>Problems</i>	198

## 9

### **CAPITAL STRUCTURE : PLANNING AND DESIGNING**

◆ Factors determining Capital Structure	202
◆ Profitability and Capital Structure : EBIT-EPS Analysis	203
◆ Liquidity and Capital Structure : Cash Flow Analysis	204
<i>Points to Remember</i>	206
<i>Graded Illustrations</i>	206
<i>Objective Type Questions</i>	208
<i>Multiple Choice Questions</i>	209
<i>Assignments</i>	209

## **PART IV : DIVIDEND DECISION**

## 10

### **DIVIDEND DECISION AND VALUATION OF THE FIRM**

◆ Concept and Significance	214
◆ Relevance of Dividend Policy	215
- Walter's Model	215
- Gordon's Model	216
◆ Irrelevance of Dividend Policy	217
- Residuals theory of Dividends	217
- MM Approach	218
<i>Points to Remember</i>	221
<i>Graded Illustrations</i>	221
<i>Objective Type Questions</i>	227
<i>Multiple Choice Questions</i>	227
<i>Assignments</i>	228
<i>Problems</i>	229

**11****DIVIDEND POLICY : DETERMINANTS AND CONSTRAINTS**

◆ Dividend Payout Ratio	232
◆ Stability of Dividends	233
◆ Constant DP Ratio	233
◆ Steady Dividend per Share	233
◆ Steady Dividends plus extra	234
◆ Legal and Procedural Considerations	234
◆ Scrip Dividend or Bonus Shares	235
◆ Informational Contents of Dividends	236
<i>Points to Remember</i>	237
<i>Graded Illustrations</i>	237
<i>Objective Type Questions</i>	239
<i>Multiple Choice Questions</i>	240
<i>Assignments</i>	241

**PART V : MANAGEMENT OF CURRENT ASSETS****12****WORKING CAPITAL : PLANNING AND MANAGEMENT**

◆ The Operating Cycle and Working Capital Needs	247
◆ Factors Determining Working Capital Requirement	249
◆ Working Capital : Policy and Management	250
◆ Financing of Current Assets	254
◆ Working Capital : Monitoring and Control	258
<i>Points to Remember</i>	259
<i>Graded Illustrations</i>	259
<i>Objective Type Questions</i>	263
<i>Multiple Choice Questions</i>	263
<i>Assignments</i>	265

**13****WORKING CAPITAL : ESTIMATION AND CALCULATION**

◆ Working Capital as a Percentage of Net Sales	268
◆ Working Capital as a Percentage of Total Assets or Fixed Assets	268
◆ Working Capital Based on Operating Cycle	269
<i>Points to Remember</i>	271
<i>Graded Illustrations</i>	271
<i>Assignments</i>	278
<i>Problems</i>	278

**14****MANAGEMENT OF CASH AND MARKETABLE SECURITIES**

◆ Motives for Holding Cash	282
◆ Cash Management : Theoretical Framework	283

	PAGE
◆ Cash Management : Planning Aspects	284
- Cash Budget	286
◆ Cash Management : Control Aspects	288
◆ Managing the Float	289
◆ Electronic Fund Transfer	290
◆ Optimum Cash Balance : A few Models	291
- Baumol's Model	291
- Miller-Orr Model	292
◆ Management of Marketable Securities	293
<i>Points to Remember</i>	294
<i>Graded Illustrations</i>	295
<i>Objective Type Questions</i>	301
<i>Multiple Choice Questions</i>	302
<i>Assignments</i>	303
<i>Problems</i>	303

## 15

### RECEIVABLES MANAGEMENT

◆ Costs of Receivables	308
◆ Benefits of Receivables	308
◆ Credit Policy	309
◆ Credit Evaluation	310
◆ Control of Receivables	311
◆ Evaluation of Credit Policies	312
<i>Points to Remember</i>	313
<i>Graded Illustrations</i>	313
<i>Objective Type Questions</i>	320
<i>Multiple Choice Questions</i>	321
<i>Assignments</i>	322
<i>Problems</i>	322

## 16

### INVENTORY MANAGEMENT

◆ Types of Inventories	326
◆ Inventory Management	326
◆ Reasons and Benefits of Inventories	327
◆ Costs of Inventory	328
◆ Cost of Stock-outs (A hidden cost)	328
◆ Techniques of Inventory Management	328
◆ ABC Analysis	329
◆ Economic Order Quantity Model	330
◆ Re-order Level	332
◆ Safety Stock or Minimum Inventory level	332
◆ Quantity Discounts and Order Quantity	333
<i>Points to Remember</i>	333
<i>Graded Illustrations</i>	334
<i>Objective Type Questions</i>	338
<i>Multiple Choice Questions</i>	338

<i>Assignments</i>	PAGE 339
<i>Problems</i>	340

## PART VI : VALUATION

**17**

### VALUATION OF SECURITIES

◆ Concept of Valuation	344
◆ Required Rate of Return	344
◆ Basic Valuation Model	345
◆ Bond Valuation	345
- Bond Value in case of Semi-Annual Interest	347
◆ Yield to Maturity (YTM)	347
◆ Valuation of Convertible Debentures	348
◆ Valuation of Deep Discount Bonds (DDB)	348
◆ Valuation of Preference Shares	349
◆ Valuation of Equity Shares	349
- Valuation of Equity Shares based on Accounting Information	350
- Valuation of Equity Shares based on Dividends	350
- Valuation of the Share Currently not paying Dividends	353
- Valuation of Equity Shares based on Earnings	354
<i>Points to Remember</i>	355
<i>Graded Illustrations</i>	355
<i>Objective Type Questions</i>	358
<i>Multiple Choice Questions</i>	358
<i>Assignments</i>	360
<i>Problems</i>	360

### APPENDICES

<b>APPENDIX I :</b>	FINANCIAL DECISION MAKING WITH EXCEL	365
<b>APPENDIX II :</b>	PAST YEAR QUESTION PAPERS WITH SUGGESTED ANSWERS TO PRACTICAL QUESTIONS IN QUESTION PAPERS OF FINANCIAL MANAGEMENT, B.COM. (H.), UNIVERSITY OF DELHI	379
	● NOVEMBER 2018 (SEMESTER V)	379
	● DECEMBER 2019 (SEMESTER V)	384
	● DECEMBER 2020 (SEMESTER V) (OBE)	390
	● DECEMBER 2021 (SEMESTER V) (OBE)	393
	● NOVEMBER 2022 (SEMESTER V)	396
<b>APPENDIX III :</b>	MATHEMATICAL TABLES	400