

# CONTENTS

	PAGE
<i>About the Authors</i>	I-5
<i>Preface</i>	I-7
<i>Acknowledgements</i>	I-11
<i>Chapter-heads</i>	I-13

## **PART ONE** **ESSENTIALS OF FINANCIAL MANAGEMENT**

### **CHAPTER 1** **FINANCIAL MANAGEMENT: AN OVERVIEW**

<b>1.1</b>	Approaches to Financial Management	<b>6</b>
<b>1.1.1</b>	Traditional Approach	<b>6</b>
<b>1.1.2</b>	Modern Approach	<b>7</b>
<b>1.2</b>	Objectives of Financial Management	<b>7</b>
<b>1.2.1</b>	Profit Maximization	<b>8</b>
<b>1.2.2</b>	Wealth Maximization	<b>8</b>
<b>1.2.3</b>	Value Maximization	<b>9</b>
<b>1.2.4</b>	Other Objectives	<b>10</b>
<b>1.3</b>	Financial Decisions	<b>11</b>
<b>1.3.1</b>	Investment Decisions	<b>11</b>
<b>1.3.2</b>	Financing Decisions	<b>12</b>
<b>1.3.3</b>	Dividend Decisions	<b>13</b>
<b>1.4</b>	Finance Function	<b>14</b>
<b>1.4.1</b>	Functions of a Finance Manager	<b>14</b>
<b>1.4.2</b>	Finance Manager as a Facilitator	<b>15</b>
<b>1.4.3</b>	Need to Centralize Finance Function	<b>16</b>
<b>1.4.4</b>	Organization Chart of Finance Function	<b>17</b>

	PAGE
1.5	Separation of Management and Ownership and Agency Problem
1.5.1	Agency Theory Models
1.5.2	Agency Costs
1.5.3	Constituents of Agency Theory
1.5.4	Criticism of Agency Theory
1.6	Impact of Taxation, Inflation and Depreciation
1.6.1	Corporate Taxation
1.6.2	Impact of Inflation on Business Firm
1.6.3	Impact of Depreciation on Business Firm
1.7	Significance of Financial Management

## **CHAPTER 2**

### **BASIC VALUATION CONCEPTS: TIME VALUE OF MONEY, INTEREST RATES, VALUATION OF BONDS AND RISK-RETURN ANALYSIS**

2.1	Time Value of Money in Investment Decisions
2.1.1	Effects of Inflation on Decision-making
2.1.2	Present Value
2.1.3	Discount Factors
2.1.4	Compounding Rate and Capitalising Rate
2.1.5	Annuity
2.1.6	Future Value of Ordinary Annuity
2.1.7	Present Value of Ordinary Annuity
2.1.8	Present Value of Deferred Annuity
2.1.9	Present Value of Perpetuity
2.2	Interest Rate
2.2.1	Factors affecting Interest Rates
2.2.2	Theorems on Term Structure of Interest Rates
2.2.3	Yield to Maturity (YTM)
2.2.4	Factors Determining Yield on Stocks
2.2.5	Computation of Yield of Stocks
2.2.6	Simple Interest
2.2.7	Compound Interest
2.2.8	Amortization
2.2.9	Sinking Fund

	PAGE
<b>2.3</b>	<b>Valuation of Bonds</b>
	55
<b>2.3.1</b>	<b>Related Terms in Bond Valuation</b>
	55
<b>2.3.2</b>	<b>Bond Value</b>
	57
<b>2.3.3</b>	<b>Theorems in Bond Valuation</b>
	58
<b>2.4</b>	<b>Risk Analysis</b>
	59
<b>2.4.1</b>	<b>Business Risk and Financial Risk</b>
	60
<b>2.4.2</b>	<b>Risk Analysis in Project Selection</b>
	60
<b>2.4.3</b>	<b>Risk Minimization through Portfolio Selection</b>
	61
<b>2.4.4</b>	<b>Utility Function, Indifference Curves and Risk Taking</b>
	62
<b>2.4.5</b>	<b>Risk and Required Return</b>
	64
<b>2.4.6</b>	<b>Risk-Return Relationship</b>
	65
<b>2.4.7</b>	<b>Costing and Risk</b>
	67
<b>2.4.8</b>	<b>Risk-Return Trade Off</b>
	67

### **CHAPTER 3**

## **STRATEGIC FINANCIAL PLANNING**

<b>3.1</b>	<b>Strategic Financial Planning</b>	115
<b>3.1.1</b>	<b>Strategy</b>	116
<b>3.1.2</b>	<b>Steps in Strategic Planning</b>	117
<b>3.2</b>	<b>Economic Environment of Business</b>	118
<b>3.3</b>	<b>Strategic Financial Management</b>	119
<b>3.4</b>	<b>Financial Planning</b>	120
<b>3.4.1</b>	<b>Financial Planning Environment</b>	120
<b>3.4.2</b>	<b>Financial Planning Process</b>	121
<b>3.5</b>	<b>Limitations of Financial Planning</b>	122
<b>3.6</b>	<b>Forecasting</b>	123
<b>3.6.1</b>	<b>Financial Forecasting Techniques</b>	124
<b>3.6.2</b>	<b>Benefits of Financial Forecasting</b>	125
<b>3.7</b>	<b>External Fund Requirement (EFR)</b>	126
<b>3.8</b>	<b>Internal Growth Rate (IGR)</b>	126
<b>3.9</b>	<b>Sustainable Growth Rate (SGR)</b>	126
<b>3.10</b>	<b>Financial Engineering</b>	127
<b>3.10.1</b>	<b>Features of Financial Engineering</b>	128

## PART TWO

### **ANALYSIS OF FINANCIAL POSITION**

#### **CHAPTER 4**

#### **ANALYSIS OF FINANCIAL STATEMENTS**

<b>4.1</b>	Financial Statements	146
<b>4.1.1</b>	Financial Statements Analysis	147
<b>4.1.2</b>	Types of Financial Statement Analysis	147
<b>4.1.3</b>	Methods of Analyzing Financial Statements	148
<b>4.2</b>	Comparative Financial Statements	148
<b>4.3</b>	Common-Size Financial Statements	149

#### **CHAPTER 5**

#### **STATEMENT OF CHANGES IN FINANCIAL POSITION: FUNDS FLOW ANALYSIS**

<b>5.1</b>	Identification of Fund and Flow	165
<b>5.1.1</b>	Meaning of 'Fund' and 'Flow'	166
<b>5.1.2</b>	Identification of Flow of Funds	167
<b>5.2</b>	Statement of Sources and Application of Funds	167
<b>5.2.1</b>	Sources of Funds or Funds Generated from Operations	168
<b>5.2.2</b>	Funds Raised from Shares, Debentures and Long-term Loans	170
<b>5.2.3</b>	Sale of Fixed Assets and Long-term Investments	170
<b>5.3</b>	Applications of Funds	170
<b>5.4</b>	Statement of Changes in Working Capital	171
<b>5.4.1</b>	Statement of Changes in Working Capital	172
<b>5.5</b>	Comparison with Financial Statements	173
<b>5.5.1</b>	Funds Flow Statement and Balance Sheet: Distinction	173
<b>5.5.2</b>	Funds Flow Statement and Income Statement: Distinction	173
<b>5.6</b>	Benefits of Funds Flow Analysis	174
<b>5.7</b>	Drawbacks of Funds Flow Analysis	175

## **CHAPTER 6**

### **FINANCIAL STATEMENT ANALYSIS USING CASH FLOW ANALYSIS**

<b>6.1</b>	Meaning of Cash Flow Statements	193
<b>6.1.1</b>	Uses of Cash Flow Statement	194
<b>6.1.2</b>	Limitations of Cash Flow Statement	194
<b>6.2</b>	Comparison with Funds Flow Statement and Cash Budget	195
<b>6.2.1</b>	Funds Flow and Cash Flow: Distinction	195
<b>6.2.2</b>	Cash Flow and Cash Budget: Distinction	196
<b>6.3</b>	Classification of Cash Flows	197
<b>6.3.1</b>	Cash Flows from Operating Activities	197
<b>6.3.2</b>	Cash Flows from Investing Activities	197
<b>6.3.3</b>	Cash Flows from Financing Activities	198
<b>6.4</b>	Treatment of Special Items	198
<b>6.4.1</b>	Foreign Currency Cash Flows	198
<b>6.4.2</b>	Extraordinary Items	199
<b>6.4.3</b>	Interest and Dividends	199
<b>6.4.4</b>	Taxes on Income	199
<b>6.4.5</b>	Investments in Subsidiaries, Associates and Joint Ventures	199
<b>6.4.6</b>	Acquisition and Disposal of Subsidiaries and Other Business Units	200
<b>6.4.7</b>	Non-cash Transactions	200
<b>6.5</b>	Preparation of Cash Flow Statement	200
<b>6.5.1</b>	Data Required for Preparation of a Cash Flow Statement	200
<b>6.5.2</b>	Procedure for Preparation of Cash Flow Statement	200
<b>6.5.3</b>	Reporting of Cash Flows from Operating Activities	201

## **CHAPTER 7**

### **FINANCIAL STATEMENT ANALYSIS USING RATIO ANALYSIS**

<b>7.1</b>	Liquidity Ratios	228
<b>7.1.1</b>	Current Ratio	228
<b>7.1.2</b>	Quick/Liquid/Acid Test Ratio	229
<b>7.2</b>	Leverage Ratios	229
<b>7.2.1</b>	Debt-Equity Ratio	229
<b>7.2.2</b>	Shareholders Equity Ratio	230

	PAGE
7.2.3	Long-term Debt to Shareholders Net Worth Ratio 230
7.2.4	Capital Gearing Ratio 230
7.2.5	Fixed Assets to Long-Term Funds Ratio 231
7.2.6	Proprietary Ratio 231
7.2.7	Interest Cover 231
7.2.8	Debt Service Coverage Ratio (DSCR) 231
7.2.9	Dividend Cover 232
7.3	Asset Management Ratios 232
7.3.1	Inventory Turnover Ratio 232
7.3.2	Inventory Ratio 233
7.3.3	Debtors Turnover Ratio 233
7.3.4	Debtors Collection Period 233
7.3.5	Creditors Turnover Ratio 233
7.3.6	Creditors Payment Period 233
7.3.7	Fixed Assets Turnover Ratio 234
7.3.8	Total Assets Turnover Ratio 234
7.3.9	Working Capital Turnover Ratio 234
7.3.10	Sales to Capital Employed Ratio 234
7.3.11	Bad Debts to Sales Ratio 235
7.4	Profitability Ratios 235
7.4.1	Gross Profit Margin 235
7.4.2	Net Profit Margin 236
7.4.3	Cash Profit Ratio 236
7.4.4	Return on Total Assets 237
7.4.5	Return on Shareholders' Funds or Return on Net worth 237
7.4.6	Return on Equity (ROE) 237
7.4.7	Return on Capital Employed (ROCE) 237
7.5	Operating Ratios 239
7.5.1	Absolute Liquid/Super Quick Ratio 239
7.5.2	Defensive-Interval Ratio 240
7.6	Market Based Ratios 240
7.6.1	Earnings Per Share (EPS) 240
7.6.2	Cash Earnings Per Share 241
7.6.3	Dividend Payout Ratio 241
7.6.4	Dividend Yield 241

	PAGE
7.6.5 Book Value	241
7.6.6 Price Earnings Ratio (P/E Ratio)	242
7.6.7 Price to Book Value Ratio (P/BV Ratio)	242
7.7 Du Pont Analysis	242
7.8 Importance of Ratio Analysis	244
7.9 Factors Affecting Efficacy of Ratios	245
7.10 Non-Financial Performance Measures	246

## **CHAPTER 8**

### **FINANCIAL STATEMENT ANALYSIS USING ECONOMIC VALUE ADDED**

8.1 Economic Value Added (EVA)	274
8.1.1 How to Calculate EVA?	275
8.1.2 Means of Enhancing EVA	276
8.1.3 Steps in Implementing EVA	276
8.1.4 Superiority of EVA	276
8.1.5 Drawbacks of EVA	277
8.2 Market Value Added (MVA)	278
8.3 Shareholder Value Analysis (SVA)	278
8.4 Value Based Management (VBM)	279
8.4.1 Methods of VBM	280

## **CHAPTER 9**

### **FINANCIAL STATEMENT ANALYSIS USING FINANCIAL AND OPERATING RATIOS**

9.1 Operating Leverage	290
9.1.1 Degree of Operating Leverage (DOL)	291
9.2 Financial Leverage	291
9.2.1 Degree of Financial Leverage (DFL)	292
9.2.2 Impact of Financial Leverage on EPS	292
9.2.3 Impact of Financial Leverage on WACC	293
9.2.4 Impact of Financial Leverage on ROE and ROA	293
9.3 Total Leverage	293
9.3.1 Degree of Total Leverage (DTL)	294

	PAGE
<b>9.4</b> Structural Leverage	294
<b>9.4.1</b> Debt-Equity Ratio	295
<b>9.4.2</b> Total Debt to Equity Ratio	295
<b>9.4.3</b> Debt to Net Worth Ratio	295
<b>9.5</b> Interest Cover and Income Gearing	295
<b>9.5.1</b> Interest Cover	295
<b>9.5.2</b> Income Gearing	296
<b>9.6</b> Trading on Equity and Gearing	296
<b>9.6.1</b> Debt and Equity: Distinction	296
<b>9.6.2</b> Trading on Equity	297
<b>9.6.3</b> Gearing	297

## PART THREE **INVESTMENT DECISION**

### CHAPTER 10 **CAPITAL BUDGETING**

<b>10.1</b>	Meaning of Capital Budgeting	319
<b>10.2</b>	Methods of Capital Budgeting	320
<b>10.2.1</b>	Payback Period Method	320
<b>10.2.2</b>	Accounting Rate of Return Method	322
<b>10.2.3</b>	Net Present Value Method	323
<b>10.2.4</b>	Internal Rate of Return Method	325
<b>10.2.5</b>	Profitability Index Method	326
<b>10.2.6</b>	Discounted Payback Period Method	327
<b>10.2.7</b>	Adjusted Present Value Method	327
<b>10.3</b>	Capital Rationing	328
<b>10.3.1</b>	Meaning	328
<b>10.3.2</b>	Factors Leading to Capital Rationing	329
<b>10.3.3</b>	Situations of Capital Rationing	330
<b>10.4</b>	Impact of Inflation on Capital Budgeting	330
<b>10.5</b>	Impact of Corporate Taxation on Capital Budgeting	331
<b>10.6</b>	Impact of Investment Incentives on Capital Budgeting	332
<b>10.7</b>	Impact of Non-Financial Factors in Capital Investment Decisions	333

**CHAPTER 11****RISK EVALUATION IN CAPITAL BUDGETING**

<b>11.1</b>	Risk and Uncertainty	364
<b>11.1.1</b>	Objectives of Risk Management	365
<b>11.1.2</b>	Steps in Risk Management Process	366
<b>11.2</b>	Probability and Expected Value	366
<b>11.2.1</b>	Basic Tenets of Probability Theory	366
<b>11.2.2</b>	Advantages of Expected Value	367
<b>11.2.3</b>	Disadvantages of Expected Value	367
<b>11.3</b>	Optimistic, Most Likely and Pessimistic Estimates	368
<b>11.4</b>	Value of Information	368
<b>11.4.1</b>	Value of Perfect Information	368
<b>11.4.2</b>	Value of Imperfect Information	369
<b>11.5</b>	Standard Deviation of Cash Flows	369
<b>11.5.1</b>	Hillier's Model for Risk Analysis	369
<b>11.6</b>	Sensitivity Analysis	370
<b>11.6.1</b>	Advantages of Sensitivity Analysis	371
<b>11.6.2</b>	Disadvantages of Sensitivity Analysis	371
<b>11.7</b>	Certainty Equivalent (CE)	371
<b>11.8</b>	Risk Adjusted Discount Rate (RADR)	371
<b>11.8.1</b>	RADR and CE : Distinction	372
<b>11.9</b>	Decision Tree	373
<b>11.9.1</b>	Rules and Conventions of Drawing Decision Tree	373
<b>11.9.2</b>	Steps in Drawing Decision Tree	374
<b>11.10</b>	Simulation	375
<b>11.10.1</b>	Steps in Monte Carlo Simulation	376
<b>11.10.2</b>	Application of Simulation	377
<b>11.10.3</b>	Advantages of Simulation	377
<b>11.10.4</b>	Disadvantages of Simulation	378
<b>11.10.5</b>	Hertz Simulation Model	379
<b>11.11</b>	Project Beta	379
<b>11.11.1</b>	Capital Structure and Beta Values	380

## PART FOUR

### FINANCING DECISIONS

#### CHAPTER 12

#### COST OF CAPITAL AND IMPACT ON FIRM'S EARNING PER SHARE (EPS)

<b>12.1</b>	Meaning of Cost of Capital	417
<b>12.1.1</b>	Different Categories of Long-term Funds	418
<b>12.1.2</b>	Importance of Cost of Capital in Decision-making	418
<b>12.2</b>	Cost of Equity Share Capital ( $K_e$ )	419
<b>12.2.1</b>	Dividend Yield Method	420
<b>12.2.2</b>	Dividend Growth Method	420
<b>12.2.3</b>	Price Earning Method	421
<b>12.2.4</b>	Capital Asset Pricing Model	421
<b>12.3</b>	Cost of Retained Earnings ( $K_r$ )	421
<b>12.3.1</b>	Opportunity Cost Approach	422
<b>12.3.2</b>	Rights Offer Approach	422
<b>12.4</b>	Cost of Preference Share Capital ( $K_p$ )	423
<b>12.4.1</b>	Cost of Irredeemable Preference Shares	423
<b>12.4.2</b>	Cost of Redeemable Preference Shares	423
<b>12.5</b>	Cost of Debentures and Term-Loans ( $K_d$ )	424
<b>12.5.1</b>	Nominal and Real Cost of Debt	424
<b>12.5.2</b>	Cost of Perpetual Debt	425
<b>12.5.3</b>	Cost of Redeemable Debt	425
<b>12.5.4</b>	Cost of Zero Coupon Bonds	425
<b>12.5.5</b>	Cost of Convertible Debentures	426
<b>12.5.6</b>	Cost of Floating Rate Debt	426
<b>12.6</b>	Weighted Average Cost of Capital (WACC)	426
<b>12.6.1</b>	Simple WACC	427
<b>12.6.2</b>	WACC Based on Book Values and Market Values	427
<b>12.6.3</b>	WACC Considering Tax Shield	427
<b>12.6.4</b>	Use of WACC in Investment Appraisal	428
<b>12.7</b>	Opportunity Cost of Capital	428
<b>12.7.1</b>	Opportunity Cost of Equity Funds	429
<b>12.7.2</b>	Opportunity Cost of Debt Funds	429

	PAGE
<b>12.8</b> Marginal Cost of Capital	429
<b>12.8.1</b> Marginal Cost of Capital and WACC	429

### **CHAPTER 13**

## **CAPITAL STRUCTURE THEORIES AND VALUE OF FIRM**

<b>13.1</b> Equity and Debt in Capital Structure	451
<b>13.1.1</b> Equity Funds	452
<b>13.1.2</b> Debt Funds	453
<b>13.2</b> Factors Determining Capital Structure	453
<b>13.3</b> Optimum Capital Structure	455
<b>13.4</b> Capital Structure Theories	456
<b>13.4.1</b> Net income Approach	456
<b>13.4.2</b> Net Operating Income Approach	458
<b>13.4.3</b> WACC Approach (Traditional View)	459
<b>13.4.4</b> Modigliani and Miller Approach (Modern View)	461
<b>13.5</b> Static Trade-Off Theory	467
<b>13.5.1</b> Financial Distress and Agency Costs	467
<b>13.5.2</b> Financial Distress and Bankruptcy Costs	468
<b>13.5.3</b> Agency Costs	469
<b>13.6</b> Pecking Order Theory	469
<b>13.6.1</b> Assumptions	470
<b>13.7</b> Modified Pecking Order Theory	470
<b>13.8</b> Debt-Equity Ratio Approach	471
<b>13.9</b> EBIT-EPS Approach	471
<b>13.9.1</b> Financial Break-even	472
<b>13.9.2</b> Financial Indifference Point	472
<b>13.10</b> Financial and NEDC Risks Trade-Off Approach	473
<b>13.10.1</b> Assumptions	473
<b>13.10.2</b> Financial Risks	473
<b>13.10.3</b> NEDC Risks	474

## PART FIVE

### **DIVIDEND DECISIONS**

#### **CHAPTER 14**

#### **DIVIDEND THEORIES AND VALUE OF FIRM**

<b>14.1</b>	Meaning and Kinds of Dividend	497
<b>14.1.1</b>	Meaning of Dividend	497
<b>14.1.2</b>	Dividend Terminology	498
<b>14.1.3</b>	Kinds of Dividend	498
<b>14.2</b>	Determinants of Dividend Policy	499
<b>14.3</b>	Dividend Payout Policies	502
<b>14.3.1</b>	Constant Dividend Payout Policy	502
<b>14.3.2</b>	Constant Dividend Rate Policy	503
<b>14.3.3</b>	Optimum Dividend Policy	504
<b>14.4</b>	Dividend Growth Model	505
<b>14.4.1</b>	Assumptions	505
<b>14.4.2</b>	Criticism	506
<b>14.5</b>	Walter's Valuation Model	506
<b>14.5.1</b>	Assumptions	507
<b>14.5.2</b>	Implications of Walter's Model	507
<b>14.6</b>	Modigliani and Miller's Dividend Irrelevancy Model	508
<b>14.6.1</b>	Basic Tenets	508
<b>14.6.2</b>	Assumptions	509
<b>14.6.3</b>	Computation of Market Price of Share	509
<b>14.6.4</b>	Assumptions	510
<b>14.7</b>	Capital Asset Pricing Model	510
<b>14.8</b>	Gordon and Linter's Theory	511
<b>14.9</b>	Other Theories on Dividend Policy	511
<b>14.9.1</b>	Tax Differential Theory	511
<b>14.9.2</b>	Residual Theory	511
<b>14.9.3</b>	100% Payout Theory	512
<b>14.9.4</b>	100% Retention Theory	512
<b>14.9.5</b>	Investor Rationality Theory	512
<b>14.9.6</b>	Span of Control Theory	512

## PART SIX

### **WORKING CAPITAL MANAGEMENT**

#### **CHAPTER 15**

#### **BASICS OF WORKING CAPITAL**

<b>15.1</b>	Working Capital	<b>539</b>
<b>15.1.1</b>	Meaning of Working Capital	<b>539</b>
<b>15.1.2</b>	Objectives of Working Capital Management	<b>540</b>
<b>15.1.3</b>	Current Assets and Current Liabilities	<b>540</b>
<b>15.1.4</b>	Classification of Working Capital Gross and Net Working Capital	<b>541</b>
<b>15.2</b>	Working Capital Management	<b>544</b>
<b>15.2.1</b>	Overtrading	<b>544</b>
<b>15.2.2</b>	Under Capitalization	<b>545</b>
<b>15.2.3</b>	Over Capitalization	<b>546</b>
<b>15.2.4</b>	Symptoms of Poor Working Capital Management	<b>546</b>
<b>15.2.5</b>	Measures to Overcome Working Capital Crunch	<b>546</b>
<b>15.3</b>	Operating Cycle	<b>547</b>
<b>15.3.1</b>	Computation of Operating Cycle Period	<b>548</b>
<b>15.3.2</b>	Reasons for Prolonged Operating Cycle	<b>548</b>
<b>15.3.3</b>	Measures to Reduce Operating Cycle	<b>549</b>
<b>15.4</b>	Working Capital Policies	<b>550</b>
<b>15.4.1</b>	Restricted Policy	<b>551</b>
<b>15.4.2</b>	Relaxed Policy	<b>551</b>
<b>15.4.3</b>	Moderate Policy	<b>551</b>
<b>15.5</b>	Strategies in Financing Working Capital	<b>551</b>
<b>15.5.1</b>	Conservative Strategy	<b>551</b>
<b>15.5.2</b>	Aggressive Strategy	<b>552</b>
<b>15.5.3</b>	Hedging Strategy	<b>553</b>
<b>15.5.4</b>	Zero Working Capital Strategy	<b>554</b>

#### **CHAPTER 16**

#### **ESTIMATING WORKING CAPITAL**

<b>16.1</b>	Determinants of Working Capital Need	<b>571</b>
<b>16.2</b>	Working Capital Estimation Methods	<b>573</b>

	PAGE
16.2.1	Percentage of Sales Method 573
16.2.2	Regression Analysis Method 573
16.2.3	Operating Cycle Method 574
16.2.4	Individual Components Method 574
16.3	Approaches to Working Capital Estimation 577
16.3.1	Estimation of Working Capital Need in Seasonal Industries 578
16.3.2	Inflationary Tendency 578
16.3.3	Estimation of Working Capital Need in Shift Operations 579
16.4	Working Capital Leverage 580

## **CHAPTER 17**

### **INVENTORY MANAGEMENT**

17.1	Inventory Policy and Stock Control 602
17.1.1	Classification of Inventory 603
17.1.2	Features of Ideal Inventory Policy 603
17.1.3	Requirements of Stock Control 603
17.1.4	Impact of Inflation on Inventory Holding 604
17.2	Input-Output and Stock Turnover Ratio 604
17.2.1	Input-Output Ratio 604
17.2.2	Stock Turnover Ratio 605
17.3	Economic Order Quantity 605
17.3.1	Assumptions of EOQ 606
17.3.2	Ordering Costs 606
17.3.3	Carrying Costs 606
17.3.4	Stock-out Costs 607
17.3.5	EOQ with Discounts 608
17.4	Inventory Levels 608
17.4.1	Reorder Level 608
17.4.2	Minimum Stock Level 608
17.4.3	Maximum Stock Level 609
17.4.4	Danger Level 609
17.4.5	Average Stock Level 609
17.5	Techniques of Inventory Analysis 609
17.5.1	ABC Analysis 609

	PAGE
17.5.2 VED Analysis	612
17.5.3 FNSD Analysis	612
17.6 Pull System and JIT in Inventory Management	613

## **CHAPTER 18**

### **RECEIVABLES MANAGEMENT**

18.1	Meaning and Importance of Receivables Management	630
18.2	Trade Credit	631
18.2.1	Types of Credit	631
18.2.2	Costs of Granting Credit	631
18.2.3	Administration Costs of Receivables	632
18.2.4	Costs of Denying Credit	632
18.3	Steps in Evaluation of Increase in Credit Term	633
18.4	Cash Discount	633
18.4.1	Debtors Payment Terms	633
18.4.2	Economics of Offering Cash Discount	634
18.4.3	Steps in Evaluation of Increase in Cash Discount	635
18.5	Analysis of Receivables	635
18.5.1	Measuring Day's Sales in Terms of Debtors	635
18.6	Credit Control	638
18.6.1	Credit Control Department	638
18.6.2	Establish Credit Policy	638
18.6.3	Establish Credit Standards	639
18.6.4	Assess Credit Risk	639
18.6.5	Establish Effective Administration of Debtors	640
18.6.6	Establish Credit Status	640
18.6.7	Check Credit Limit	640
18.6.8	Authorization	640
18.6.9	Referral	641
18.6.10	Issuing the Delivery Note, Invoicing	641
18.6.11	Settlement	641
18.6.12	Assess Customer Creditworthiness	642
18.6.13	Establish Policy on Bad Debts	643

## ***CHAPTER 19***

### **CASH MANAGEMENT**

<b>19.1</b>	Motives for Holding Cash	661
<b>19.2</b>	Meaning of Cash Assets Management	662
<b>19.3</b>	Cash Surplus and Cash Deficit	663
<b>19.3.1</b>	Reasons for Cash Surplus	663
<b>19.3.2</b>	Reasons for Cash Deficit	664
<b>19.3.3</b>	Effects of Cash Deficit	664
<b>19.3.4</b>	Methods of Improving Liquidity	665
<b>19.4</b>	Baumol's EOQ Cash Management Model	666
<b>19.4.1</b>	Assumptions	668
<b>19.4.2</b>	Limitations	668
<b>19.5</b>	Miller-Orr's Stochastic Cash Management Model	668
<b>19.5.1</b>	Assumptions	670
<b>19.5.2</b>	Limitations	670
<b>19.6</b>	Marketable Securities	671
<b>19.6.1</b>	Objectives of Investment in Marketable Securities	671
<b>19.6.2</b>	Principles in Selecting Marketable Securities	671
<b>19.7</b>	Management of Float	672
<b>19.7.1</b>	Sources of Float	672
<b>19.7.2</b>	Types of Float	673
<b>19.8</b>	Modes of Cash Management	676
<b>19.8.1</b>	Electronic Cash Management System	676
<b>19.8.2</b>	Virtual Banking	678
<b>19.8.3</b>	Setting Cash Balance	679
<b>19.8.4</b>	Cash Cycle	679
<b>19.8.5</b>	Zero Balance Account	679
<b>19.8.6</b>	Money Market Banking	679
<b>19.8.7</b>	Petty Cash Imprest System	680
<b>19.9</b>	Treasury Management	680
<b>19.9.1</b>	Evolving Role of Treasury as a Profit Center	681
<b>19.9.2</b>	Role and Functions of Treasurer	682
<b>19.9.3</b>	Centralized or Decentralized Treasury Management	684
<b>19.9.4</b>	Cash Management and Treasury Management: Distinction	685