CS EXECUTIVE

FINANCIAL MANAGEMENT

Comprehensive Curriculum Coverage
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All chapters aligned topic-wise with the official Module Sequence

Theoretical + Practical Questions
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Module 1

CONTENTS

CHAPTER 1

INTRODUCTION TO FINANCIAL MANAGEMENT

A. INTRODUCTION TO FINANCIAL MANAGEMENT

Starting a business? Whether it's a tech startup, a retail shop, or a manufacturing unit, every aspiring entrepreneur must answer these **three crucial questions**:

What to invest in?

Think land, machines, R&D, IT systems — what capital assets are needed?

Where will the money come from?

Will it be **Equity**, **Debt**, or a mix of both? Your capital structure matters.

How to manage daily money matters?

Collecting payments, paying suppliers, and managing working capital - these daily operations keep the business running.

Understanding these helps build a **strong financial foundation**, and that's where **Financial Management** plays a hero's role

EVOLUTION OF FINANCIAL MANAGEMENT

Financial Management didn't emerge overnight. It evolved through **3 key phases**:

1. Traditional Phase (1900s–1940s)

(a) Focus: Rare events — mergers, expansions, bankruptcies.
(b) Approach: Legalistic and descriptive.
(c) Viewpoint: Mainly from outsiders like bankers and investors.
(d) Classic Work: The Financial Policy of Corporations by Arthur S. Dewing.

2. Transitional Phase (1940s–1950s)

(a) Shift in focus to **daily finance issues**: cash flows, planning, control.
(b) Highlight: **Working Capital Management**.
(c) Key Work: Essays on Business Finance by Wilford J. Eiteman et al.

3. Modern Phase (1950s–Present)

(a) **Goal:** Maximize shareholder wealth with smart fund allocation.
(b) **Tools:** Data, analysis, economic theory.
(c) **Modern concepts include:**
   (i) Capital Budgeting
   (ii) Asset Pricing & Valuation
   (iii) Capital Structure Theory
   (iv) Option & Agency Theory
   (v) Working Capital & Behavioural Finance

Finance today is **dynamic, data-driven, and decision-oriented** — a perfect blend of logic and numbers, offering endless challenges and opportunities!

B. MEANING OF FINANCE – THE LIFELINE OF BUSINESS

Finance is like the **heartbeat** of any business — without it, nothing moves!

What is Finance?

Finance is the **art & science** of managing **money**—from raising funds to using them efficiently. It enables businesses to define their **scope of operations**, shape their **strategy**, and drive **growth**.

Think of finance as

- **Oil** for machines (Production)
- **Blood** for the body (Business operations)

No **startup**, no **growth**, and no **development** is possible without **finance**.

a. ORIGIN & INTERPRETATION

1. Derived from Latin word **'finis'** = end/finish
2. Refers to **funds, capital, investments, money**
3. Covers both the **creation** and **management** of money in various forms – banking, credit, securities, and more.

b. WEBSTER'S DICTIONARY

"Finance is the science or study of the management of funds — including money circulation, credit granting, investments, and banking services."

c. KEY CONCEPT: TIME VALUE OF MONEY

Finance deeply connects with:

1. Time value of money
2. Interest rates
3. Future cash flows

It's about making **smart choices today** that pay off **tomorrow**!

C. TYPES OF FINANCE (3 BROAD CATEGORIES)

a. PUBLIC FINANCE

1. Managed by **Central, State & Local governments**
2. **Sources:** Taxes, fees, borrowings
3. **Purpose: Welfare**, not profit
4. **Focus:** Policies for **social & economic upliftment**

   Study of government revenues, expenditures & financial systems

b. CORPORATE FINANCE

1. Concerned with **companies**
2. **Focus:** Raising capital, investment decisions, financial planning
3. **Objectives:** Maximize shareholder value
4. **Activities include:**
   (a) Managing cash flows
   (b) Structuring capital
   (c) Preparing statements
   (d) Issuing stocks/bonds

c. PERSONAL FINANCE

1. Managing **individual or family finances**
2. Involves:
   (a) Budgeting
   (b) Savings & Investments
   (c) Insurance
   (d) Retirement & Tax planning
   (e) **Goal:** Achieve **financial freedom** & make **smart decisions**

Finance is **everywhere** — in your wallet, your business, and your government. The more you know about it, the better you can manage, grow, and secure your future.

D. DEFINITION OF FINANCIAL MANAGEMENT – THE BRAIN BEHIND BUSINESS MONEY

What is Financial Management?

Financial Management is like the **GPS system** for any business's money matters — guiding it through **planning**, **raising**, **allocating**, and **utilizing** funds efficiently.

It's a **core part of overall management**, ensuring that **every rupee works hard** for the business!

EXPERT DEFINITIONS

Let's break down what top scholars have said:

1. Core Focus: Efficient Use of Capital

- **Solomon:**
  "Efficient use of capital funds – a vital economic resource."
- **Kuchal**:
  "Procurement and effective use of funds."

2. Decision-Making & Strategic Role

- **Howard & Upton:**
  "Applying general management to financial decisions."
- **Weston & Brigham:**
  "Balancing personal motives with enterprise goals."

3. Operations & Activities

- **Joseph & Massie:**
  "Operational activity of obtaining and using funds effectively."
- **Guthman & Dougal:**
  "Planning, raising, controlling, and administering funds."

4. Capital Selection & Goal Alignment

- **J.F. Brandley:**
  "Judicious use of capital to guide spending towards goals."

5. In Simple Terms

- **Khan & Jain:**
  "Finance is the **art and science** of managing money."
- **Wheeler:**
  "Acquiring & converting capital to meet financial needs."

6. Business Finance Angle

Let's understand what **Business Finance** scholars have to say:

- **E.W. Walker:**
  "Planning, coordinating, and implementing financial activities."
- **Henry Hoagland:**
  "Decisions about financing & investments to achieve corporate goals."
- **Gloss & Baker:**
  "Finding sources and ensuring proper use of money."
- **Parhter & Wert:**
  "Focuses on raising and using funds in non-financial businesses."

E. NATURE OF FINANCIAL MANAGEMENT

a. **Lifeblood of business** – Every activity needs funds.
b. **Continuous & strategic** – Involves planning, execution & control.
c. **Universal** – Applies to all organizations (business, NGO, schools, etc.).

F. SCOPE OF FINANCIAL MANAGEMENT

a. **Planning** – Estimating financial needs & setting goals.
b. **Procurement** – Raising funds via equity, debt, loans.
c. **Allocation** – Investing wisely for better returns.
d. **Utilization** – Ensuring efficient use of funds.
e. **Control** – Monitoring budgets, costs & profits.
f. **Decision Support** – Helps in financial strategies & investments.

G. OBJECTIVES OF FINANCIAL MANAGEMENT

a. Ensure regular & sufficient funds
b. Use funds efficiently
c. Maximize shareholder wealth
d. Maintain balanced capital structure
e. Maintain financial discipline
f. Plan for future needs

Financial Management = Smart use of money to ensure **growth**, **stability**, and **wealth creation**!

H. TYPES OF FINANCIAL DECISIONS

a. INVESTMENT DECISIONS

An **investment decision** involves allocating money to projects/assets expected to yield **future returns**. It's all about **value creation**, often linked to **capital budgeting**.

1. Why it matters?

(a) High risk
(b) Long-term impact
(c) Affects growth, survival, and profitability

But **persistent outflows without returns** or when funded by debt might raise red flags.

Inflows from Investing Activities	Outflows from Investing Activities
Proceeds from disposal of property, plant, and equipment	Payments for acquisition of property, plant, and equipment
Cash receipts from the disposal of debt instruments of other entities	Payments for purchase of debt instruments of other entities
Receipts from sale-of-equity instruments of other entities	Payments for purchase of equity instruments of other entities
	Sales/maturities of investments
	Purchasing and selling long-term assets and other investments

b. FINANCING DECISIONS

Financing decisions involve choosing the right mix of **equity and debt** to fund the company's activities after investment decisions are made. The main goal is to build an **optimal capital structure**—a combination that maximizes shareholder wealth while minimizing cost and risk. A company's **balance sheet** reflects this mix through equity share capital, preference capital, reserves, debentures, loans, etc.

Capital structure is essentially about how a firm divides its cash flow between fixed returns to debt holders and residual income for equity shareholders. Debt is cheaper but riskier, while equity is costlier but less risky. Hence, choosing the right proportion is key. These decisions are strategic and influence profitability, risk level, and overall firm value.

Modern financing decisions are deeply integrated with capital budgeting, long-term planning, and performance measurement. They now rely heavily on financial analysis and technology tools for better decision-making.

1. Factors Affecting Financing Decisions

Several factors influence financing decisions.

(a) **Cost** – Choose the cheapest source of funds.

(b) **Risk** – Debt increases financial risk; equity offers more safety.

(c) **Cash Flow Position** – Firms with strong, steady cash flow can afford more debt.

(d) **Control** – To retain control, promoters may prefer debt over issuing new equity.

(e) **Floatation Cost** – Lower costs of raising funds are preferred (e.g., fewer fees, commissions).

2. Cash Flow from Financing Activities (CFFA)

Cash flow from financing activities in the cash flow statement shows how a company raises and repays capital. It tracks cash movements between the firm and its investors or creditors. **Positive cash flow** indicates raising money (through loans or equity), while **negative cash flow** shows repayments (like loan repayments, dividend payouts, or share buybacks).

Common examples include cash received from issuing shares or debt, repayment of loans, dividend payments, and proceeds from stock options or hybrid securities like convertible debt.

In essence, financing decisions determine how much, from where, and at what cost capital is raised. Cash flow from financing activities reflects these decisions in action—whether the firm is growing by raising capital or returning profits to investors.

c. DIVIDEND DECISIONS – DISTRIBUTE OR RETAIN?

A **dividend decision** involves choosing how much of the firm's profit should be:

- **Distributed to shareholders** as dividends, or
- **Retained** for reinvestment in business.

Objective: Maximize shareholder wealth while maintaining sufficient funds for future growth.

1. Linked with Other Financial Decisions

(a) **Investment Decision** – Profitable use of funds

(b) **Financing Decision** – How to raise the required funds

(c) **Dividend Decision** – Whether to pay or retain profits

All three are interconnected and affect firm's long-term value.

2. Factors Affecting Dividend Policy

(a) **Legal Requirements**

Must follow rules: Net profit rule, Capital impairment rule, Insolvency rule.

(b) **Liquidity Position**

Even with profits, no cash = no dividends.

(c) **Repayment Needs**

Firm may retain earnings to repay debts.

(d) **Expected Return on Investment**

Higher return projects = more retention, less dividend.

(e) **Stability of Earnings**

Stable income = stable/larger dividends; fluctuating income = cautious payout.

3. Dividend Decision Matrix

Factors	FCFE> Dividends	FCFE<Dividends
ROE> Cost of Equity	(a) Good Projects (b) Cash flow surplus (c) No Change	(a) Good Projects Decrease (b) Dividends Invest in Projects
ROE< Cost of Equity	(a) Poor Projects (b) Cash flow surplus (c) Increase Dividends (d) Reduce Investment	(a) Poor Projects (b) Cash flow Deficit (c) Decrease Dividends (d) Reduce Investment

I. STABLE DIVIDEND POLICY – SMOOTHING OVER TIME

A **Stable Dividend Policy** means companies aim to keep **dividend payouts consistent** over time, even if earnings (EPS) fluctuate.

a. KEY INSIGHT – LINTNER'S OBSERVATION (1956)

Companies **prefer gradual increases** in dividends and **avoid cutting them**, leading to:

1. Less Volatile Dividends (DPS)
2. More Volatile Earnings (EPS)

b. WHY DO COMPANIES DO THIS?

1. **Build investor confidence**
2. **Predictability** for income-focused shareholders
3. **Avoid negative market signals** from dividend cuts
4. **Maintain reserves** for future stability

c. EPS VS. DPS TREND

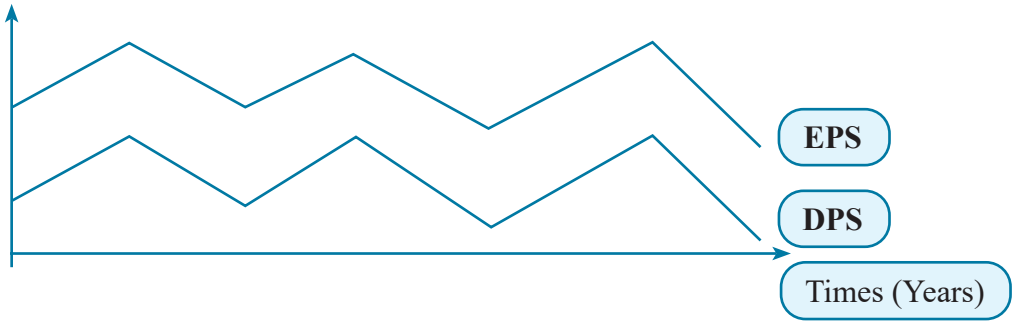
1. If **EPS falls** → DPS may **slightly fall** or stay the same
2. If **EPS rises** → DPS increases **slowly** (lagging behind)

This gradual adjustment is called **dividend smoothing**

d. FIRM MAY ADAPT ANY OF THE FOLLOWING STABLE DIVIDEND POLICIES:

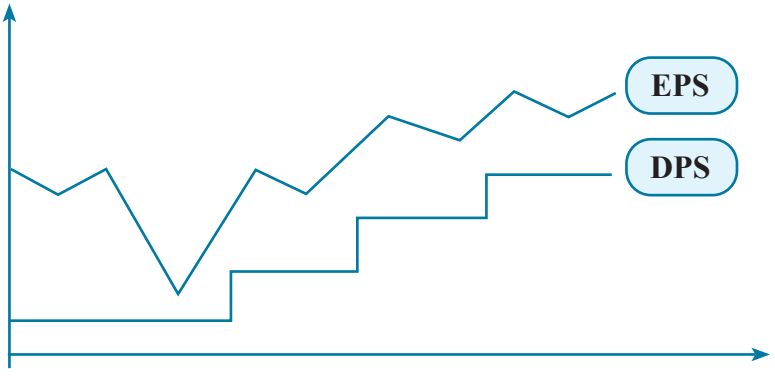
1. Stable dividend payout ratio
2. Stable dividends per share
3. A regular plus extra dividend policy

1. **Stable Dividend Payout Ratio:** As per this policy the percentage of dividends paid out of earnings remains constant.



Example: if a company adopts a 30% payout ratio and if EPS is Rs 100, then shareholder having 10 shares will receive Rs.300 as dividend under this policy.

2. **Stable Dividends Per Share:** According to this policy, the firm pays a certain fixed amount of dividend per share every year. Annual dividend per share is increased only when the company reaches a new level of earnings and expects to maintain it.



3. **A Regular Plus Extra Dividend Policy:** According to this policy a certain fixed percentage or a minimum amount of dividend is paid every year, which is referred to as regular dividend. The firm pays 'additional' or 'extra' dividend if earnings are higher than normal in any year.

e. RATIONALE FOR STABLE DIVIDEND POLICY

Companies prefer a stable dividend policy because it builds investor trust and ensures a steady income for shareholders, especially retirees. It reduces uncertainty, which can lead to lower capital costs and higher stock prices. Institutional investors also favor firms with consistent dividend records. Such stability boosts investor confidence and helps in raising external funds more easily. However, once adopted, this policy reduces corporate flexibility—cutting dividends later may hurt the company's image and shake investor confidence.

J. DECISION CRITERIA IN FINANCIAL MANAGEMENT

Decision-making in finance revolves around selecting the best project or financial option to **maximize returns** and **minimize costs**. A sound decision criterion helps distinguish between acceptable and non-viable proposals. Two guiding principles are: **"Bigger and Better"** (choose higher benefits) and **"Bird in Hand"** (prefer earlier returns).

a. KEY INVESTMENT DECISION CRITERIA

1. **Urgency** – Non-quantifiable but useful when immediate action is needed for critical projects or goal alignment.
2. **Payback Period** – Measures how quickly the investment is recovered. Shorter payback = better. However, it **ignores cash flows after recovery**, violating both decision principles.
3. **Rate of Return (ROR)** – Shows percentage return over time. It helps compare profitability but may vary depending on income or asset treatment.
4. **Benefit-Cost Ratio (Undiscounted)** – Compares total benefits with costs. Useful but gives equal weight to future and present benefits, ignoring the time value of money.
5. **Discounted Benefit-Cost Ratio** – More reliable as it applies present value calculations. It follows both financial principles and adjusts for timing of cash flows.
6. **Net Present Value (NPV)** – Evaluates total present value of future cash inflows against the investment cost. Positive NPV = project is viable. It reflects the **time value of money** and helps in selecting between mutually exclusive projects.
7. **Internal Rate of Return (IRR)** – The discount rate at which NPV becomes zero. It considers both timing and size of cash flows. IRR is widely used and aligns with both "bigger" and "earlier" return preferences.

K. CAPITAL STRUCTURE – THE FINANCIAL FRAMEWORK

Capital structure is the **mix of equity (owner's funds)** and **debt (borrowed funds)** used by a company to finance its operations and assets.

a. KEY COMPONENTS

1. **Equity** = Shareholders' capital
2. **Debt** = Loans, debentures, bonds

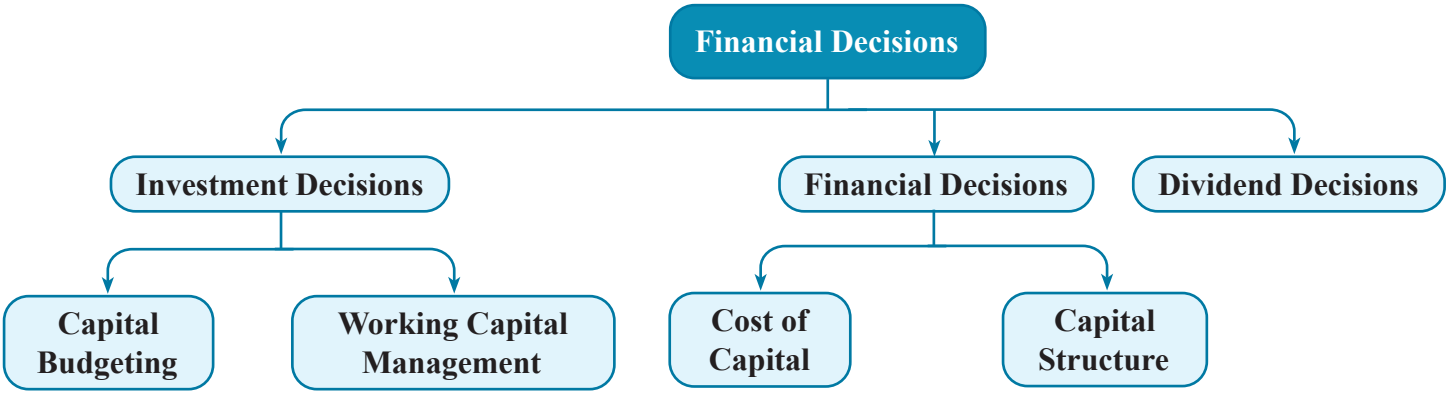
b. WHY INCLUDE DEBT?

1. **Tax savings** (interest is tax-deductible)
2. **Lower cost** vs. equity
3. **Reduces floatation cost**
4. **Leverage advantage** (boosts returns)
5. **No equity dilution** (ownership/control retained)
6. **Refinancing tool** for short-term liabilities
7. **Improves financial ratios** in inflationary times

c. ROLE OF EQUITY

1. Acts as a **cushion** for debt
2. Strong equity base = easier to raise debt

Please refer the following exhibit on forms of financial decisions.



L. VALUE OF FIRM – RISK & RETURN

Every **financial decision** (investment, financing, or dividend) involves a **degree of risk** and aims to generate **returns**. These two always go **hand in hand:**

- **Higher Risk = Higher Expected Return**
- **Lower Risk = Lower Expected Return**

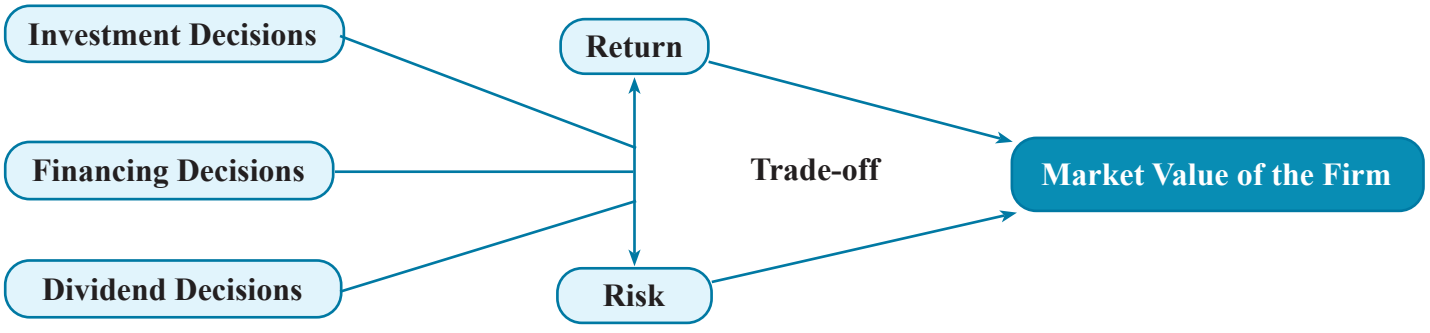
Investor Example

- **Govt Bonds** = Low risk, fixed returns
- **Shares** = High risk, uncertain but potentially higher returns

M. FINANCE MANAGER'S ROLE

The **goal** is to **maximize firm value** (market price of shares) by finding the **right balance between risk and return**—known as the **Risk-Return Trade-Off**.

A finance manager cannot avoid risk but must **optimize** it. Decisions should not chase return alone, but also evaluate the **associated risks** to protect shareholder value.



N. LIQUIDITY – THE BUSINESS LIFELINE

Liquidity refers to a company's **ability to meet short-term obligations** using its **current or near-cash assets**. It shows how quickly a firm can convert its assets into cash to pay off its bills.

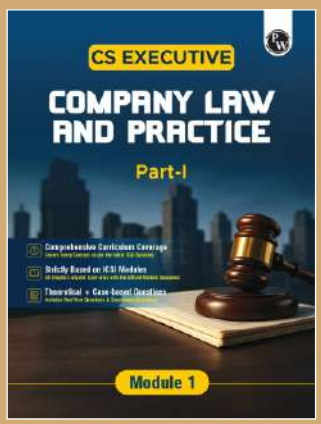
a. WHY IT MATTERS?

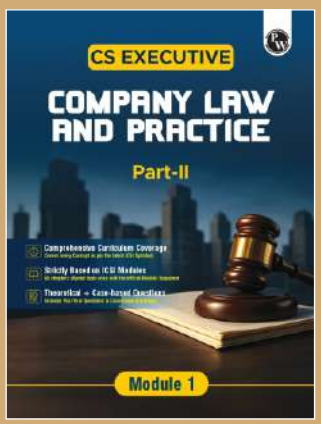
According to Ezra Solomon, liquidity ensures a company can handle:

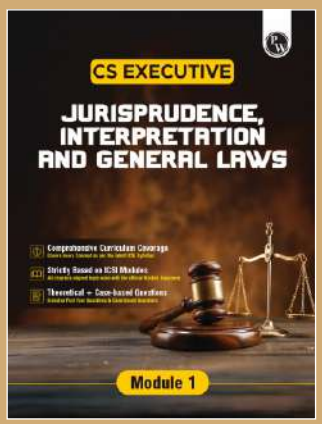
1. Operating losses
2. Asset expansion
3. Liability reduction

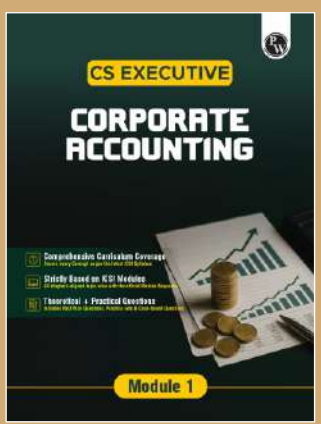
It improves **cash availability** and enhances **creditworthiness** in the market.

Other Books in This Series









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