CLASS -12

BUSINESS STUDIES

PART-1

Chapter 9: Financial Management

Financial Management

Introduction to Financial Management:

Let's define financial management as the first part of the introduction to financial management. For any business, it is important that the finance it procures is invested in a manner that the returns from the investment are higher than the cost of finance. In a nutshell, financial management.

- Endeavors to reduce the cost of finance
- Ensures sufficient availability of funds
- Deals with the planning, organizing, and controlling of financial activities like the procurement and utilization of funds.

Some Definitions:

"Financial management is the activity concerned with planning, raising, controlling and administering of funds used in the business." – **Guthman and Dougal**

Objectives of Financial Management:

1. **Wealth Maximization:** The main objective of Financial management is to maximize shareholder's wealth, for which achievement of optimum capital structure and proper utilization of funds is a must.

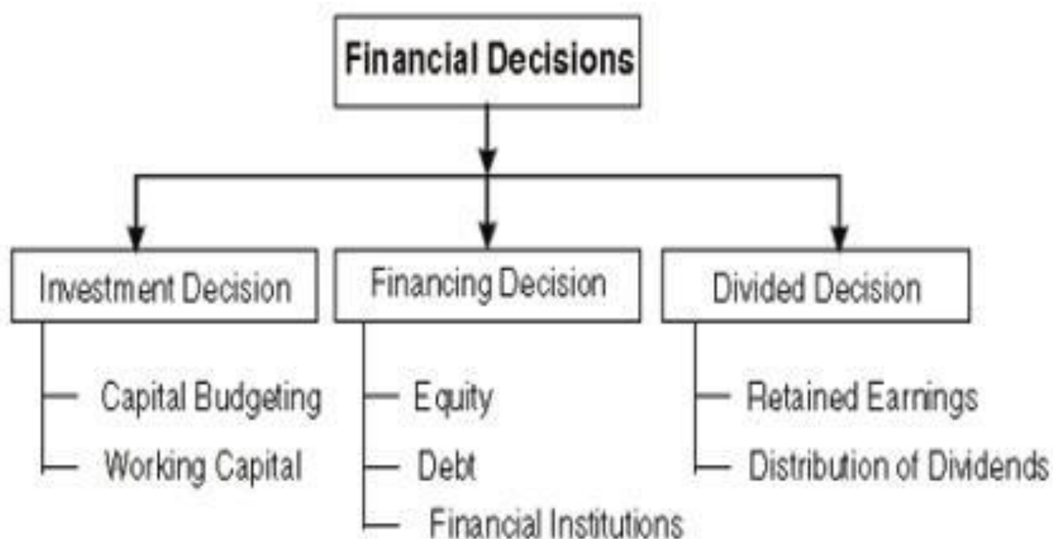
2. **To procure sufficient funds for the organization:** Adequate and regular supply of funds is to be maintained for smooth operations of the business.

3. To ensure effective utilization of funds.

4. **To ensure safety of funds:** The chances of risk in investments should be minimum possible.

5. **To attain optimum capital structure:** A sound and economical combination of shares and debentures must be attempted so as to maintain optimum capital structure.

Financial Decisions:



Every company is required to take three main financial decisions which are as follows:

1. **Investment Decision:** It relates to how the firm's funds are invested in different assets. Investment decision can be long-term or short-term. A long term investment decision is called capital budgeting decision as they involve huge amounts of funds and are irreversible except at a huge cost while short term investment decisions are called working capital decisions, which affect day to day working of a business.

   Factors affecting Investment Decisions/Capital Budgeting decisions:

   a) **Cash flows of the project:** The series of cash receipts and payments over the life of an investment proposal should be considered and analyzed for selecting the best proposal.

   b) **Rate of Return:** The expected returns from each proposal and risk involved in them should be taken into account to select the best proposal.

   c) **Investment Criteria Involved:** The various investment proposals are evaluated on the basis of capital budgeting techniques. These involve calculation regarding investment amount, interest rate, cash flows, rate of return etc.

2. **Financing Decision:** It relates to the amount of finance to be raised from various long term sources. The main sources of funds are owner's funds i.e. equity/shareholder's funds and the borrowed funds i.e. Debts. Borrowed funds have to be repaid at a fixed time and thus some amount of financial risk (i.e. risk of default on payment) is there in debt financing. Moreover, interest on borrowed funds has to be paid regardless of whether or not a firm has made a profit. On the other hand, shareholder's fund involves no commitment regarding payment of returns or repayment of capital. A firm mix both debt and equity in making financing decisions.

Factors Affecting Financing Decision:

a) **Cost:** The cost of raising funds from different sources are different. The cheapest source should be selected.

b) **Risk:** The risk associated with different sources is different. More risk is associated with borrowed funds as compared to owner's fund as interest is paid on it and it is repaid also, after a fixed period of time or on expiry of its; tenure.

c) **Flotation Cost:** The costs involved in issuing securities such as brokers commission, underwriters' fees, expenses on prospectus etc. are called flotation costs. Higher the flotation cost, less attractive is the source of finance.

d) **Cash flow position of the business:** In case the cash flow position of a company is good enough then it can easily use borrowed funds and pay interest on time.

e) **Control Considerations:** In case the existing shareholders want to retain the complete control of business then finance can be raised through borrowed funds but when they are ready for dilution of control over business, equity can be used for raising finance.

f) **State of Capital Markets:** During boom, finance can easily be raised by issuing shares but during depression period, raising finance by means of debt is easy.

g) **Period of Finance:** For permanent capital requirement, Equity shares must be issued as they are not to be paid back and for long and medium term requirement, preference shares or debentures can be issued.

Dividend refers to that part of the profit which is distributed to shareholders.
A company is required to decide how much of the profit earned by it should be distributed among shareholders and how much should be retained. The decision regarding dividend should be taken keeping in view the overall objective of maximizing shareholder's wealth.

3. **Factors affecting Dividend Decision:**

a) **Earnings:** Companies having high and stable earning could declare high rate of dividends as dividends are paid out of current and paste earnings.

b) **Stability of Dividends:** Companies generally follow the policy of stable dividend. The dividend per share is not altered and changed in case earnings change by small proportion or increase in earnings is temporary in nature.

c) **Growth Prospects:** In case there are growth prospects for the company in the near future them it will retain its earning and thus, no or less dividend will be declared.

d) **Cash Flow Positions:** Dividends involve an outflow of cash and thus, availability of adequate cash is for most requirement for declaration of dividends.

e) **Preference of Shareholders:** While deciding about dividend the preference of shareholders is also taken into account. In case shareholders desire for dividend then company may go for declaring the same.

f) **Taxation Policy:** A company is required to pay tax on dividend declared by it. If tax on dividend is higher, company will prefer to pay less by way of dividends whereas if tax rates are lower than more dividends can be declared by the company.

g) **Issue of bonus shares:** Companies with large reserves may also distribute bonus shares to increase their capital base as it signifies growth of the company and enhances its reputation also.

h) **Legal constraints:** Under provisions of Companies Act, all earnings can't be distributed and the company has to provide for various reserves. This limits the capacity of company to declare dividend.

Financial Planning:

The process of estimating the fund requirement of a business and specifying the sources of funds is called financial planning. It ensures that enough funds are available at right time so that a firm could honor its commitments and carry out its plans.

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Importance of Financial Planning:

1. To ensure availability of adequate funds at right time.
2. To see that the firm does not raise funds unnecessarily.
3. It provides policies and procedures for the sound administration of finance function.
4. It results in preparation of plans for future. Thus new projects can he under taken smoothly.
5. It attempts to achieve a balance between inflow and outflow of funds. Adequate liquidity is ensured throughout the year.
6. It serves as the basis of financial control. The management attempts to ensure utilization of funds in tune with the financial plans.

Capital Structure:

Capital structure refers to the mix between owner's funds and borrowed funds. It will be said to be optimal when the proportion of debt and equity is such that it results in an increase in

the value of the equity share. The proportion of debt in the overall capital of a firm is called Financial Leverage or Capital Gearing. When the proportion of debt in the total capital is high then the firm will be called highly levered firm but when the proportion of debts in the total capital is less, then the firm will be called low levered firm.

Factors Affecting Capital Structure:

1. **Trading on Equity:** t refers to the increase in profit earned by the equity shareholders due to the presence of' fixed financial charges like interest. Trading on equity happens when the rate of earning of an organization is higher than the cost at which funds have been borrowed and as a result equity shareholders get higher rate of dividend per share.

   The use of more debt along with the equity increases EPS as the debt carries fixed amount of interest which is tax deductible. Let us understand with an example:

	Company X	Company Y
Share capital (or Rs.10 each)	10,00,000	5,00,000
Debentures @10%		5,00,000
Total capital	10,00,000	10,00,000
	Company X	Company Y
Earning before int. and taxes(EBIT)@25% p.a.	2,50,000	2,50,000
Less tax (40%)	(1,00,000)	(1,00,000)
Profit after tax (available for equity shareholders)	1,50,000	1,50,000
No. of equity shares	1,00,000	1,00,000
Earnings per share	Rs. 1.50	Rs. 2.40

   Thus the EPS of company Y is higher than company X because of application of 'Trading on equity'.

2. **Cash Flow Position:** In case a company has strong cash flow position then it may raise finance by issuing debts, as they are to be paid back after some time.

3. **Interest Coverage Ratio:** It refers to the number of times earnings before interest and taxes of a company covers the interest obligation. High Interest coverage ratio indicates that company can have more of borrowed funds. Formula for calculating ICR = EBIT/interest.

4. **Return on Investment:** If return on investment is higher than the rate of interest on debt then it will be beneficial for a firm to raise finance through borrowed funds.

5. **Floatation Cost:** The cost involved in issuing securities such as brokers' commission, under -writers' fees, cost of prospectus etc. is called flotation cost. While selecting the

source of finance, flotation cost should be taken into account.

6. **Control:** When existing shareholders are ready to dilute their control over the firm then new equity shares can be issued for raising finance but in reverse situation debts should be used.

7. **Tax Rate:** Interest on debt is allowed as a deduction; thus in case of high tax rate, debts are preferred over equity but in case of low tax rate more preference is given to equity. Company X Company Y.

8. **Flexibility:** A good financial structure should be flexible enough to have scope for expansion or contraction of capitalization whenever the need arises. Issue of debenture and preference shares brings flexibility.

9. **Capital Market Conditions:** Conditions prevailing in capital market influences the determination of securities to be issued. Like during depression, people do not like to take risk and so are not interested in equity shares but during boom, investors are ready to take risk and invest inequity shares.

Fixed Capital:

Fixed capital refers to investment in long-term assets. Investment in fixed assets is for longer duration and they must be financed through long-term sources of capital. Decisions relating to fixed capital involve huge capital funds and are not reversible without incurring heavy losses.

Factors Affecting Requirement of Fixed Capital:

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1. **Nature of Business:** Manufacturing concerns require huge investment in fixed assets & thus huge fixed capital is required for them but trading concerns need less fixed capital as they are not required to purchase plant and machinery etc.

2. **Scale of Operations:** An organization operating on large scale requires more fixed capital as compared to an organization operating on small scale. For Example - A large scale steel enterprise like TISCO requires large investment as compared to a mini steel plant.

3. **Choice of Technique:** An organization using capital intensive techniques requires more investment in plant & machinery as compared to an organization using labour intensive techniques.

4. **Technology upgradation:** Organizations using assets which become obsolete faster require more fixed capital as compared to other organizations.

5. **Growth Prospects:** Companies having more growth plans require more fixed capital. In order to expand production capacity more plant & machinery are required.

6. **Diversification:** In case a company goes for diversification then it will require more

fixed capital to invest in fixed assets like plant and machinery.

7. **Distribution Channels:** The firm which sells its product through wholesalers and retailers requires less fixed capital.

8. **Collaboration:** If companies are under collaboration, Joint venture, then they need less fixed capital as they share plant & machinery with their collaborators.

Working Capital:

Working Capital refers to the capital required for day to day working of an organization. Apart from the investment in fixed assets every business organization needs to invest in current assets, which can be converted into cash or cash equivalents within a period of one year. They provide liquidity to the business. Working capital is of two types - Gross working capital and Net working capital. Investment in all the current assets is called Gross Working Capital whereas the excess of current assets over current liabilities is called Net Working Capital.

Following are the factors which affect working capital requirements of an organization:

1. **Nature of Business:** A trading organization needs a lower amount of working capital as compared to a manufacturing organization, as trading organization undertakes no processing work.

2. **Scale of Operations:** An organization operating on large scale will require more inventory and thus, its working capital requirement will be more as compared to small organization.

3. **Business Cycle:** In the time of boom more production will be undertaken and so more working capital will be required during that time as compared to depression.

4. **Seasonal Factors:** During peak season demand of a product will be high and thus high working capital will be required as compared to lean season.

5. **Credit Allowed:** If credit is allowed by a concern to its customers than it will require more working capital but if goods are sold on cash basis than less working capital is required.

6. **Credit Availed:** If a firm is able to purchase raw materials on credit from its suppliers than less working capital will be required.

7. **Inflation:** Working capital requirement is also determined by price level changes. For example, during inflation prices of raw material, wages also rise resulting in increase in working capital requirements.

8. **Operating Cycle/Turnover of Working Capital:** Turnover means speed with which the working capital is converted into cash by sale of goods. If it is speedier, the amount of working capital required will be less.

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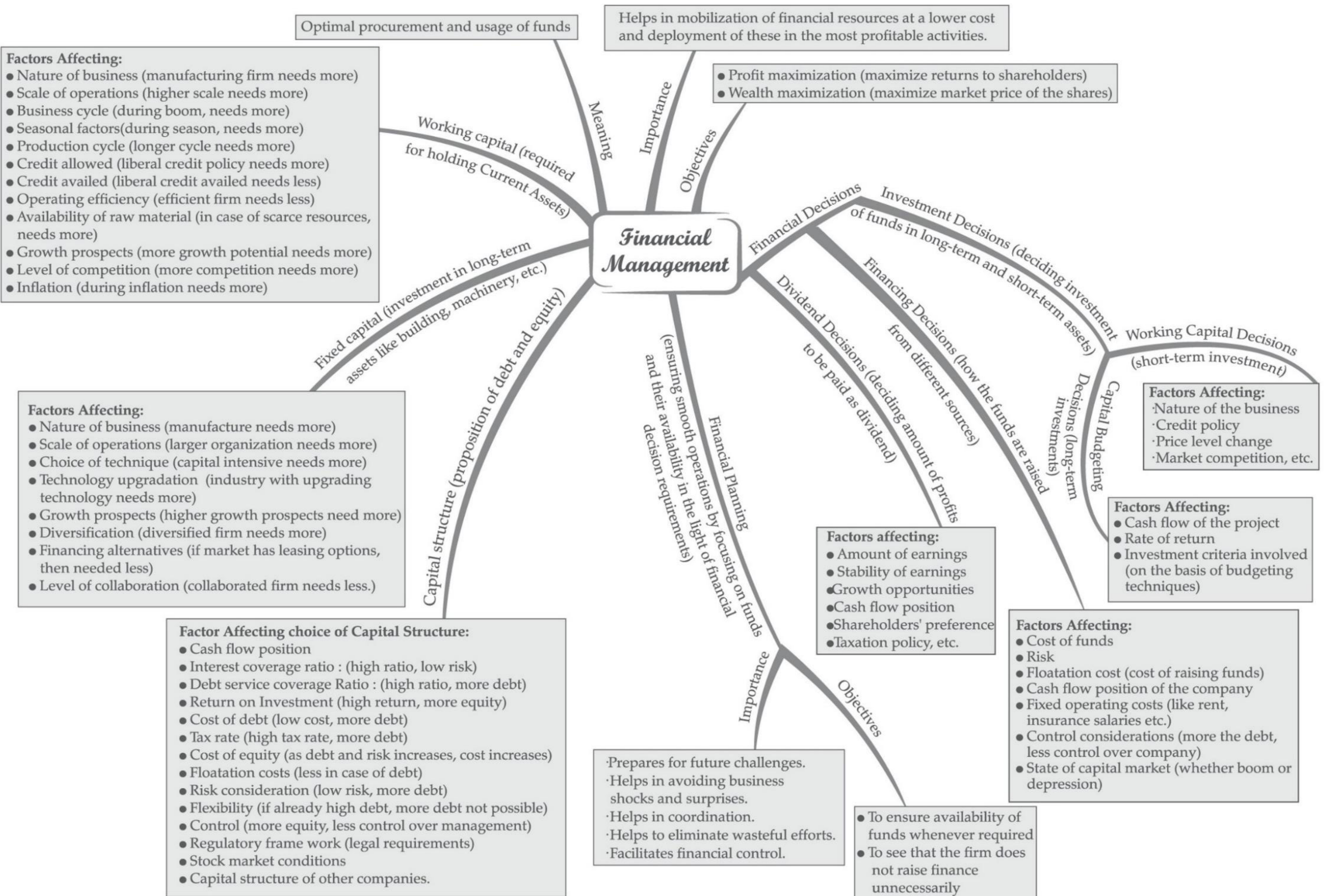
CHAPTER - 9 FINANCIAL MANAGEMENT
Financial Management
Meaning
Optimal procurement and usage of funds
Importance
Helps in mobilization of financial resources at a lower cost and deployment of these in the most profitable activities.
Objectives
● Profit maximization (maximize returns to shareholders)
● Wealth maximization (maximize market price of the shares)
Working capital (required for holding Current Assets)
Factors Affecting:
● Nature of business (manufacturing firm needs more)
● Scale of operations (higher scale needs more)
● Business cycle (during boom, needs more)
● Seasonal factors(during season, needs more)
● Production cycle (longer cycle needs more)
● Credit allowed (liberal credit policy needs more)
● Credit availed (liberal credit availed needs less)
● Operating efficiency (efficient firm needs less)
● Availability of raw material (in case of scarce resources, needs more)
● Growth prospects (more growth potential needs more)
● Level of competition (more competition needs more)
● Inflation (during inflation needs more)
Fixed capital (investment in long-term assets like building, machinery, etc.)
Factors Affecting:
● Nature of business (manufacture needs more)
● Scale of operations (larger organization needs more)
● Choice of technique (capital intensive needs more)
● Technology upgradation (industry with upgrading technology needs more)
● Growth prospects (higher growth prospects need more)
● Diversification (diversified firm needs more)
● Financing alternatives (if market has leasing options, then needed less)
● Level of collaboration (collaborated firm needs less.)
Capital structure (proposition of debt and equity)
Factor Affecting choice of Capital Structure:
● Cash flow position
● Interest coverage ratio : (high ratio, low risk)
● Debt service coverage Ratio : (high ratio, more debt)
● Return on Investment (high return, more equity)
● Cost of debt (low cost, more debt)
● Tax rate (high tax rate, more debt)
● Cost of equity (as debt and risk increases, cost increases)
● Floatation costs (less in case of debt)
● Risk consideration (low risk, more debt)
● Flexibility (if already high debt, more debt not possible)
● Control (more equity, less control over management)
● Regulatory frame work (legal requirements)
● Stock market conditions
● Capital structure of other companies.
Financial Planning (ensuring smooth operations by focusing on funds and their availability in the light of financial decision requirements)
Importance
·Prepares for future challenges.
·Helps in avoiding business shocks and surprises.
·Helps in coordination.
·Helps to eliminate wasteful efforts.
·Facilitates financial control.
Objectives
● To ensure availability of funds whenever required
● To see that the firm does not raise finance unnecessarily
Financial Decisions
Investment Decisions (deciding investment of funds in long-term and short-term assets)
Working Capital Decisions (short-term investment)
Factors Affecting:
·Nature of the business
·Credit policy
·Price level change
·Market competition, etc.
Capital Budgeting Decisions (long-term investments)
Factors Affecting:
● Cash flow of the project
● Rate of return
● Investment criteria involved (on the basis of budgeting techniques)
Financing Decisions (how the funds are raised from different sources)
Factors Affecting:
● Cost of funds
● Risk
● Floatation cost (cost of raising funds)
● Cash flow position of the company
● Fixed operating costs (like rent, insurance salaries etc.)
● Control considerations (more the debt, less control over company)
● State of capital market (whether boom or depression)
Dividend Decisions (deciding amount of profits to be paid as dividend)
Factors affecting:
● Amount of earnings
● Stability of earnings
●Growth opportunities
●Cash flow position
●Shareholders' preference
●Taxation policy, etc.

Important Questions

Multiple Choice questions-

Question 1. Higher debt-equity ratio results in:

(a) a Higher degree of financial risk

(b) a Higher degree of operating risk

(c) Higher EPS

(d) Lower financial risk

Question 2. Cost of advertising and printing prospectus is called_________

(a) Floatation cost

(b) Debt cost

(c) Equity cost

(d) Dividend cost

Question 3. The primary goal of the financial management is ___________

(a) To maximize the return

(b) To minimize the risk

(c) To maximize the wealth of owners

(d) To maximize profit

Question 4. Which of the following affects the Dividend Decision of a company?

(a) Taxation Policy

(b) Cash Flow Position

(c) Earnings

(d) All of the above

Question 5. Which of the following affects capital budgeting decision?

(a) Investment Criteria and interest rate

(b) Rate of Return

(c) Cash Flow of the Project

(d) All of the above

Question 6. Higher working capital usually results in:

(a) Higher equity, lower risk, and lower profits

(b) Lower current ratio, higher risk, and profits

(c) Lower equity, lower risk, and higher profits

(d) Higher current ratio, higher risk, and higher profits

Question 7. Which of the following is not concerned with the Long term investment

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decision

(a) Management of fixed capital

(b) Inventory management

(c) Research and Development Programme

(d) Opening a new branch

Question 8. Favourable financial leverage is a situation where ____

(a) ROI is higher than the rate of interest on debt

(b) ROI is Equal to the Rate of interest on debt

(c) ROI is lower than the rate of interest on debt

(d) None of the above

Question 9. Other things remaining the same, an increase in the tax rate on corporate profits will:

(a) Make the debt relatively cheaper

(b) Make the debt relatively the dearer

(c) Have no impact on the cost of debt

(d) None of the above

Question 10. Higher dividend per share is associated with:

(a) High earnings, high cash flows, stable earnings, and high growth opportunities

(b) High earnings, high cash flows, stable earnings, and lower growth opportunities

(c) High earnings, low cash flows, stable earnings, and lower growth opportunities

(d) High earning, high cash flows, unstable earnings, and higher growth opportunities

Question 11. The main objective of financial planning is to ensure that________

(a) Enough funds are available at the right time

(b) Dividend is paid to shareholders at the right time

(c) Purchase of raw material

(d) Purchase of fixed assets

Question 12. Financial planning arrives at:

(a) Doing only what is possible with the funds that the firms have at its disposal

(b) Entering that the firm always have significantly more funds than required so that there is no paucity of funds

(c) Minimising the external borrowing by resorting to equity issues

(d) Ensuring that the firm faces neither a shortage nor a glut of unusable funds

Question 13. Which of the following is not a financial Decision?

(a) Financing Decision

(b) Investment Decision

(c) Staffing Decision

(d) Dividend Decision

Question 14. The cheapest source of finance is:

(a) Preference share

(b) Retained earning

(c) Equity share capital

(d) Debenture

Question 15. Financial leverage is called favourable if:

(a) Return on Investment is lower than the cost of debt

(b) If the degree of existing financial leverage is low

(c) Debt is easily available

(d) ROI is higher than the cost of debt

Very Short-

Q1) When is financial leverage considered favorable?

Q2) why does financial risk arise?

Q3) How does production cycle effect working capital?

Q4) Enumerate two objectives of financial management?

Q5) What is the primary objectives of financial management?

Q6) What do you mean by floatation cost?

Q7) Name any 2 sources of long term fund?

Q8) What is Business Finance?

Q9) " A decision to acquire a new and modern plant to upgrade an old one". Identify the aspect of financial decision.

Q10) Are the share holders of a company likely to gain with a debt component in the capital employed ? Explain with the help of an example?

Short Questions-

Question 1. What are the various factors affecting Financial Planning?

Question 2. Explain in brief the various steps in financial planning.

Question 3. Explain the major characteristics or Principles of a sound financial plan.

Question 4. Define the term 'Cost of Capital'. Also, explain the Significance of the cost of capital.

Question 5. The board of Directors has asked you to design the capital structure of the company. Explain any sin factors that you would consider while doing so. 6

Question 6. Every manager has to take three major decisions while performing the

finance function. Explain them.

Question 7. What do you call the capital needed for day to day operations? Explain any 5 factors affecting such capital needs.

Question 8. The directors of a company have decided to expand their business activities by increasing the stock of raw materials and finished goods at an estimated cost of Rs. 50 lakhs, Describe the various ways open to the company to raise necessary finance for the purpose.

Question 9. A capital budgeting decisions is capable of changing the financial fortune of a business. Do you agree? Why or why not?

Long Questions-

Question 1. Explain the various determinants of the financial needs of a business?

Question 2. Define the term 'Over-Capitalisation' and 'Under Capitalisation' and their causes?

Case Study Based Question-

1. Somnath Ltd. is engaged in the business of export of garments. In the past, the performance of the company had been upto the expectations. In line with the latest technology, the company decided to upgrade its machinery. For this, the Finance Manager, Dalmia estimated the amount of funds required and the timings. This will help the company in linking the investment and the financing decisions on a continuous basis. Dalmia therefore, began with the preparation of a sales forecast for the next four years. Fie also collected the relevant data about the profit estimates in the coming years. By doing this, he wanted to be sure about the availability of funds from the internal sources of the business. For the remaining funds he is trying to find out alternative sources from outside. (CBSE, Delhi 2017)

   Identify the financial concept discussed in the above para. Also state the objectives to be achieved by the use of financial concept, so identified.

2. Ramnath Ltd. is dealing in import of organic food items in bulk. The company sells the items in smaller quantities in attractive packages. Performance of the company has been up to the expectations in the past. Keeping up with the latest packaging technology, the company decided to upgrade its machinery. For this, the Finance Manager of the company, Mr. Vikrant Dhull, estimated the amount of funds required and the timings. This will help the company in linking the investment and the financing decisions on a continuous basis.

   Therefore, Mr. Vikrant Dhull began with the preparation of a sales forecast for the next four years. He also collected the relevant data about the profit estimates in the coming years. By doing this, he wanted to be sure about the availability of funds from the internal sources. For the remaining funds he is trying to find out alternative sources.

   Identify the financial concept discussed in the above paragraph. Also, state any two points of importance of the financial concept, so identified. (CBSE, OD 2017)

Assertion Reason Question-

1. In these questions, a statement of assertion followed by a statement of reason is given. Choose the correct answer out of the following choices.
   a. Assertion and reason both are correct statements and reason is correct explanation for assertion.
   b. Assertion and reason both are correct statements but reason is not correct explanation for assertion.
   c. Assertion is correct statement but reason is wrong statement.
   d. Assertion is wrong statement but reason is correct statement.

   Assertion (A): Capital budgeting decisions are very crucial and must be taken with utmost care.

   Reason (R): Investment decisions affect the earning capacity of the firm over the long run and are irreversible except at a huge cost.
2. In these questions, a statement of assertion followed by a statement of reason is given. Choose the correct answer out of the following choices.
   a. Assertion and reason both are correct statements and reason is correct explanation for assertion.
   b. Assertion and reason both are correct statements but reason is not correct explanation for assertion.
   c. Assertion is correct statement but reason is wrong statement.
   d. Assertion is wrong statement but reason is correct statement.

   Assertion (A): A company having easy access to the capital market follows a strict dividend policy.

   Reason (R): Such a company can raise capital by approaching the capital market.

MCQ Answers-

1. Answer: (a) a Higher degree of financial risk
2. Answer: (a) Floatation cost
3. Answer: (c) To maximize the wealth of owners
4. Answer: (d) All of the above
5. Answer: (d) All of the above
6. Answer: (d) Higher current ratio, higher risk, and higher profits
7. Answer: (b) Inventory management
8. Answer: (a) ROI is higher than the rate of interest on debt
9. Answer: (a) Make the debt relatively cheaper
10. Answer: (b) High earnings, high cash flows, stable earnings, and lower growth opportunities

11. Answer: (a) Enough funds are available at the right time
12. Answer: (d) Ensuring that the firm faces neither a shortage nor a glut of unusable funds
13. Answer: (c) Staffing Decision
14. Answer: (b) Retained earning
15. Answer: (d) ROI is higher than the cost of debt

Very Short Answers-

Ans 1) Financial leverage is considered favourable when return on investment is higher than the cost of debt.

Ans 2) Interest on borrowed fund have to be paid regardless of whether or not you firm has made a profit. Moreover, borrowed fund have to be repaid after a fixed time and it carries a charge on assets. This gives rise to financial risk.

Ans 3) working capital requirement is higher with longer production cycle.

Ans 4) (a)To ensure availability of required funds.

(b) to see that the firm does not raise resources unnecessarily.

Ans 5) Wealth Maximisation.

Ans 6) Cost uncured for raising funds.

Ans 7) (a) Debt.

(b) Equity

Ans 8) Money required for carrying out business activities is called business finance.

Ans 9) Investment decision (Capital Budgeting).

Ans 10) The shareholders of a company are very likely to gain with debt component in the capital employed by way of trading. On equity as it increases the earning per share(EPS) of the share holders.

Short Answers-

Answer 1: A financial plan should be prepared very carefully because it has a long-term impact on the working of an enterprise. A financial plan is affected by a number of factors. All these factors should be’ taken into consideration while preparing a financial plan.

1. Nature of Business: The nature of business plays a decisive role in formulating a financial plan. A manufacturing business requires more amount of long-term funds than a trading business. In addition to it, the factors such as stability and regularity of income, future prospects of growth, seasonal fluctuations, assets structure, etc. affect the financial requirements as well as sources of finance.

2. Degree of Risk: The risk involved in the business also plays an important role while planning the sources of finance. A firm whose sales and earnings are subject to wide fluctuations runs the risk of not being able to meet the required payments in respect of interest and repayment of loans. Clearly, such firms should use more amount of

their own funds and rely less on debt. On the other hand, the enterprises with stable sales and earnings can employ more amount of debts and hence can take the advantage of trading on equity.

3. Standing of the concern: Credit standing of concern among investors affects financial planning to a great extent. The credit standing of concern is determined by a number of factors such as the age of the firm, its past performance, size, market area, the reputation of management, etc.

4. Plans for future Growth: The plans for growth and expansion of the firm in near future are considered while formulating a financial plan. The financial plan should be developed in such a way as to facilitate required funds without much difficultly.

5. Alternative Sources of Finance: Since finance can be procured from a number of sources, the pros and cons of all the sources should be properly considered while choosing the proper sources of finance. The sources should be able to provide adequate funds to meet the requirements of the business.

6. Attitude of Management: The attitude of management towards risk and control of the business affects financial planning to a great extent. If the management is of risk-taking nature, it would employ more amount of borrowed funds. On the contrary, if it is of conservative nature it will employ more amount of equity capital. From the control point of view, if the management desires to keep full control of the enterprise, it will not issue fresh equity shares so that the new shareholders may not control the enterprises.

7. Government Policies and Control: The financial plan of a company is affected by the rules and regulations framed by the Government stock exchanges and financial institutions from time to time. The terms of issue of shares and debentures, interest rates, dividend payments, etc. are governed by the rules framed by the government periodically. Permission of the Securities and Stock Exchange Board of India (SEBI) is also required for the issue of shares and debentures.

8. Changes in Technology, Consumer Tastes, and Competitive Factors: Rapid innovations are taking place in every field nowadays. A financial plan is adequately affected by changes in technology, consumer preferences, degree of competition, and general economic conditions.

Answer 2: Following steps should be taken for preparing a financial plan:

1. Determination of Financial Objectives: For the purpose of preparing an effective financial plan first of all the financial objectives of a firm should be clearly determined. The financial objectives should be divided into short-term objectives as well as long-term objectives. The short-term objectives may include maintaining the liquidity of funds, maintaining the market standing of the firm and proper maintenance of sales, etc.

On the other hand, the long-term objectives may include the achievement of maximum efficiency of factors of production at minimum cost and the maximization of shareholder's wealth. The objectives should be clearly defined so that they can be used as guidelines for determining the 1 policies and procedures.

2. Formulation of Financial Policies: The second step in financial planning is the formulation of financial policies. Financial policies act as guidelines for the f procurement, allocation, and effective utilization of funds of the organization. Financial policies are framed by the top management with the advice of the financial manager. The policies may be regarding capitalization, capital structure, trading on equity, fixed assets management, working capital management, dividend distribution, etc.

3. Formulation of Procedures: The policies laid down must be clarified in the form of detailed procedures. Each subordinate must know what he is required to do. Procedures are essential to ensure the consistency of actions. In financial procedures, financial executives decide about the control system, establish the standards of performance and compare the actual performance with the standards to ascertain the deviations and their causes. Thereafter, necessary steps are taken to control the deviations.

4. Provision of Flexibility: The objectives, policies, and procedures laid down as above constitute the financial plan of a business. Financial planning is a continuous process and hence there should be proper flexibility in the financial objectives, policies, and procedures so that these may be revised or thoroughly overhauled according to the changing circumstances.

Answer 3: An ideal financial plan must be based on the principles or qualities mentioned below:

1. Simplicity: Financial plan should be so simple that it may be easily understood by everyone. It should have a simple capital structure capable of being managed easily. The type of securities issued should be kept at a minimum because various types of securities will create unnecessary suspicion in the minds of investors.

2. Foresight: The financial plan should be prepared to keep in view the future needs of the business. It should take into consideration the future demand of the company's products, the future scale of operations, technological innovations, and various other changes. A financial plan should be able to meet the future requirements of fixed as well as working capital.

3. Optimum use of Funds: An ideal financial plan should always aim at the best possible and intensive use of all available resources of finance. The business should neither be starved of funds nor it should have a surplus or idle funds. Unnecessary idle funds are as bad as inadequate funds. A proper balance should also be kept between the short-term and long-term funds of the business.

4. Flexibility: A financial plan should be sufficiently flexible. It should be possible for a company to change its financial plan with minimum cost and delay if warranted by changed circumstances. The company should be able to substitute one form of financing for another to economize the use of funds. The financial plan should allow a scope for adjustments as and when a new situation arises like recession, boom, etc. A rigid financial plan can easily become a burden rather than a 1 technique of financial management.

5. Liquidity: Liquidity is the ability of the enterprise to pay off its day-to-day expenses

and other short-term liabilities on time. The financial plan should provide sufficient liquidity of funds as it will ensure the creditworthiness and goodwill of the enterprise. Adequate liquidity in the \ financial plan increases its flexibility also.

6. Economical: Financial plan must be prepared in such a way that the cost of capital is minimum. The average cost of capital will be minimum when a fair 1 balance is maintained between debt funds and owned capital. Also, the financial plan should involve minimum expenses on the issue of capital such as underwriting Commission, brokerage, etc.

7. Contingencies: A financial plan should keep-in view the requirement of funds for contingencies. Contingencies mean the requirement of funds for unseen: events.

8. Adequate system of Control: A financial plan should establish and maintain a proper system of financial control.

9. Suitable to the Organisation structure: A financial plan should be in accordance with the size and organizational structure of the firm.

Answer 4: The cost of capital of a firm is the minimum rate of return expected by its investors. The capital used by a firm may be in the form of equity shares, preference shares, debts, and retained earnings. The cost of capital is the weighted average cost of these sources of finance used by the firm. The concept of cost of capital occupies a very important role in financial management because investment decisions are based on it. If a firm is not able to achieve its cost of capital the market value of its shares will fall.

Definition:

Cost of capital for a firm may be defined as the cost of obtaining the funds, i.e., the average rate of return that the investors in a firm expect, for investing funds in the firm.

It is also referred to as cut-off rate,-target rate, hurdle rate, the minimum required rate of return, etc.

Some of the important definitions of cost of capital are stated below:

- "The cost of capital is the minimum required rate of earnings or the cut-off rate of capital expenditures." – Ezra Salomon
- "The cost of capital is the minimum rate of return which a firm requires as a condition for undertaking as an investment." – Milton H. Spencer
- "Cost of Capital represents a cut-off rate for the allocation of capital to investments of projects. It is the rate of return on a project that will leave unchanged the market price of its securities." – James C. Van. Horne
- "The Cost of Capital is the rate of return a company must earn on an investment to maintain the value of the company." – M. J. Fordon
- "A firm's so-called cost of capital – commonly expressed as an annual percentage figure – is simply that rate of return which its assets must produce in order to justify raising the funds to acquire them." – W. G. Lawpllen

Thus, on the basis of the above definitions, we can say that cost of capital is the

minimum rate of return that a firm, must and, is expected to earn on its investments so as to maintain the market value of its shares.

Significance of the Cost of Capital: The concept of cost of capital is very important in making all the financial decisions of the firm. No financial decision is possible without the use of the cost of capital. Some important uses of cost of ' capital are:

1. Helpful in Designing the Capital Structure: The concept of cost of capital plays a vital role in designing the capital structure of a company. The capital structure of a company consists of different sources of capital such as equity capital, retained earnings. Preference capital and debt capital. These sources differ from each other in terms of their respective costs. As such a company will have k to design such a capital structure that minimizes the cost of capital. Hence, the calculation of the cost of capital of different sources of capital is very essential to design an optimum capital structure.

2. Helpful in taking Capital Budgeting Decisions Capital budgeting is the process of decision making regarding the investment of funds in long-term projects of the company. The concept of cost of capital is very useful in making capital budgeting decisions $ because the cost of capital is the minimum required rate of return on an investment project. Also, a Finn must not invest in those projects which generate a return less than the cost of capital incurred for its financing.

Net Present Value (NPV) and Internal Rate of Return (IRR) are two important methods used in capital budgeting. Both of these methods are dependent upon the use of the cost of capital. In the NPV method, a project is accepted if its NPV is positive. The project's NPV is calculated by discounting its cash flows at the cost of capital rate. Under the IRR method, the cost of capital is used as a minimum required rate of return. Hence, the cost of capital serves as a decision criterion for taking capital budgeting decisions.

3. Helpful in Evaluation of Financial Efficiency of Top Management: The concept of cost of capital can be used to evaluate the financial efficiency of top management. Such an evaluation will involve a comparison of the projected overall cost of capital with the actual cost of capital incurred by the management. Lower the actual cost of capital better is the financial performance of the management of the firm.

4. Helpful in Comparative Analysis of Various Sources of Finance: Cost of capital to be raised from various sources goes on changing from time to time. Calculation of cost of capital is helpful in the analysis of the usefulness of various sources of finance. A particular source of finance may be encouraged or discouraged on the basis of its changed cost.

5. Helpful in taking other Financial Decisions: The cost of a capital concept is also useful in making other financial decisions such as dividend policy, rights issue, working capital decisions, and capitalization of profits.

Answer 5: For design the capital structure of the company six factors are as following:-

1) Cash Flow Position.

2) Interest coverage ration(ICR)

3) Debt Service coverage ratio(DSCR)

4) Return on investment (ROI)

5) Cost of debt

6) Tax rat

Answer 6: A manager take three following major decisions:-

1) financing Decision.

2) Investment Decision.

3) Dividend Decision.

Answer 7: Capital needed for day to day operations is called working capital. explain any 5 factors affecting such capital needs.

1) Nature of business

2) Scale of operations

3) Seasonal Factors

4) Production cycle

5) Credit allowed

Answer 8: the company can raise necessary finance for the purpose of expansion through the following function.

(a) Issue of shares

(b) Issue of debentures

(c) Loans from banks and financial institutions.

(d) Retained earnings.

Answer 9: hint Yes, I agree to this statement because of the following importance of capitals budgeting decisions.

(a) long term growth and effects.

(b) Large amt of funds involved

(c) Risk involved

(d) Irreversible decisions.

Long Answers-

Answer 1: Determination of Financial Needs of a Business

or

Assessing Funds Requirements

Estimating or determining the financial requirements of the business is one of the main objectives of financial planning. Before raising funds, it is essential that the requirement of funds be correctly estimated. In the absence of correct estimates, the

firm may suffer either from inadequate or surplus funds. If the funds are short of its requirements, the firm will not be able to meet its day-to-day expenses and pay the short-term and long-term liabilities on time.

On the other hand, if the funds are in excess of the requirements of the business, they will remain idle and will reduce the profitability of the business. Hence, the estimates should be made in a way that all financial requirements are properly satisfied.

Funds requirements of a business can broadly be classified into two main categories. They are:

1. Fixed Capital Requirements, and
2. Working Capital Requirements.

Assessment of Fixed Capital Requirements: Fixed capital is the capital that is meant for fulfilling the permanent or long-term needs of the business. In the words of Shubin, "Fixed capital is the funds required for the acquisition of those assets that are to be used over and over for a long period."

Fixed capital is required for acquiring fixed assets. Fixed assets may include the following:

1. Tangible assets such as land, buildings, plant and machinery, furniture, etc.
2. Intangible assets such as goodwill, patents, copyrights, etc.

A certain amount of fixed capital is also required for meeting certain expenditures not leading to the creation of an asset like research expenses, promotional expenditure incurred for the establishment of business, share issue expenses, underwriting commission, etc. The requirement of funds for these expenditures is long-term and hence the funds required in respect thereof are also included under fixed capital.

Every business needs a fair amount of fixed capital to be invested in fixed assets so as to create production or business facilities. For a new business, the fixed capital is needed in the beginning because fixed assets are needed at the time of promoting or establishing the business. For an existing business fixed capital is required for the development and expansion of the business. Hence, it is essential to have an adequate amount of fixed capital in the business.

The assessment of fixed capital requirements for a new business can be made by preparing a list of fixed assets needed by the business.

The list is prepared by the promoters by studying similar units and by taking advice from technical experts. The estimation of cost of land can be made from property dealers, estimation regarding the cost of building can be made with the help of building contractors and the cost of machinery can be ascertained from the suppliers of the machinery. Similarly, the amount to be paid for goodwill, patents, trade-marks, etc. can also be estimated.

Factors Affecting the Estimation of Fixed Capital/Fixed Assets Requirements: Factors that affect the estimation of Fixed Capital or Fixed assets requirements can be studied under two heads

(a) Internal Factors and

(b) External Factors.

(a) Internal Factors:

1. Nature of Business: Certain types of businesses require heavy investment in fixed assets, while others do not. Usually, the manufacturing concerns require more fixed assets than trading concerns. Similarly, public utility undertakings like railway, electricity, water supply, etc. require huge funds to be invested in fixed assets.

2. Size of Business: Larger the size of a concern, the greater will be the requirement of fixed capital. Also, in larger concerns, most of the activities are performed with the help of automatic machines. As such, they require a huge investment in fixed assets.

3. Types of Products: A concern that manufactures simple consumer products such as soap, oil, etc. will need a lesser amount of fixed capital in comparison to a concern that manufactures complicated products such as motorcycles, cars, etc.

4. Activities Undertaken by the Enterprise: A concern that is engaged in the manufacturing of all parts of a product by itself will require a greater amount of fixed capital as compared to a concern that gets most of the parts manufactured from outside and merely assembles them. Similarly, if a concern itself manufactures and markets its products, it will require more amount of fixed capital as compared to a concern that is engaged only in the manufacturing or only in marketing activities.

5. Mode of Acquisition of Fixed Assets: If some of the fixed assets are available on the lease or on hire, a lesser amount of fixed capital will be required. On the contrary, if all the fixed assets are to be purchased on immediate cash payment, a larger amount of fixed capital will be needed.

6. Acquisition of Old Assets: In certain industries, old plant and machinery may be available at sufficiently reduced prices and which can be used 'satisfactorily. It would reduce the requirement of fixed capital to a great capital to a great extent. But the old plant and machinery should be used in the industries where the technological changes are moderate or slow.

7. Availability of Fixed Assets of Concessional Rate: In some areas, the Government provides land and other equipment at concessional rates to promote balanced industrial growth. In such a case, the requirement of fixed capital is reduced.

(b) External Factors:

1. General Economic Outlook: If the economy is recovering from depression and the level of business activity is expected to rise, the requirement for fixed assets will also rise and hence the need for fixed capital will also rise.

2. Technological Changes: If rapid technological innovations are taking place in an industry, the need for fixed capital will be larger because the old and out-dated machinery will have to be replaced by new ones.

3. Degree of Competition: The degree of Competition also affects the Fixed Capital-requirements. If there is a lot of competition in some industries, the need for fixed capital will be more because if some firms go on adopting the new technology, the others have to follow them.

4. Shift in Consumer Preferences: If the consumer preferences go on changing in some

industries, the need for fixed capital will be more because the firm will have to produce new varieties accordingly, which require more investment in fixed assets.

Assessment of Working Capital Requirements: After the assessment of fixed Capital, funds required for working capital are assessed. The term 'Working Capital' is used in two ways.

In one sense it denotes the 'total current assets' whereas in another sense it is regarded as the excess of current assets over current liabilities. Current assets include cash, receivables (i.e., debtors and bills receivables), stock, etc. The amount required to be invested in current assets differs from one business to another. The amount depends on various factors such as nature and size of the business, duration of the production cycle, rapidity of turnover, credit policy, the quantity of stock, seasonal fluctuations, rate of growth, etc.

Working capital may be fixed or fluctuating. Fixed working capital refers to the minimum amount which would always be invested in raw materials, work-in-progress, finished goods, receivables, and cash balance. This amount is absolutely essential throughout the year on a continuous basis to maintain a desirable level of business activity. The amount required for fixed working capital mainly depends on the duration of the production cycle.

The cycle starts from the purchase of raw material; then the raw material is converted into finished goods by incurring labor and other costs. On sale, these finished goods are converted into debtors and lastly, the firm will again have cash when the debtors pay. The length of the production cycle (i.e., the length of time between the purchase of raw material and receiving cash from debtors) will determine the quantum or requirements of fixed working capital. The longer the cycle, the higher will be the requirements of fixed working capital.

The requirement of working capital over and above the fixed working capital is known as fluctuating working capital. It keeps on fluctuating from time to time according to the change in the level of business activities. For instance, during peak season, due to intensive sales, more funds are blocked in stocks and debtors and thus more amount will be required for fluctuating working capital.

The total amount of working capital can be estimated by estimating the needs of working capital for the following:

1. For maintaining adequate stock
2. For receivables.
3. For paying day-to-day expenses
4. For contingencies

1. For maintaining adequate stock: Every industrial undertaking is required to maintain a minimum stock of raw materials, work in progress, and finished goods. The requirement of the stock is determined by various factors like volume of production, the length of the production cycle, and the period for which the finished goods have to remain in a warehouse before they are sold.

2. For receivables: Finished goods may be sold for cash or on credit. Credit sales take

the form of receivables (i.e., debtors and bills receivables). The amount is tied up in receivables until cash is realized from them. The amount tied up in receivables depends upon a number of factors such as quantum of credit sales, credit period allowed, the efficiency of the debt collection system, etc. For example, if a firm changes its credit period from 30 days to 60 days, the amount tied up in debtors will go up, and consequently, the need for working capital will also increase by a similar amount.

3. For paying day-to-day expenses: A firm has to carry some minimum cash balance to make payment for wages, salaries, and other expenses throughout the year. A proper cash balance is also maintained to avail of the cash discounts facilities offered by proper cash balance is also maintained to avail of the cash discounts facilities offered by the suppliers.

4. For contingencies: A minimum cash balance is also maintained for meeting unseen contingencies so that the business successfully sails through the period of crisis.

Thus, the overall financial needs of a business can be determined, by assessing the needs for fixed capital and working capital separately and then by adding the two.

Answer 2: Over Capitalisation: Quiet often, the term 'Over-Capitalisation' is misunderstood to mean the excess of capital. But in actual practice, over-capitalized concerns have been found short of funds.

In fact, over-capitalization refers to that state of affairs where a company earns less than what should have earned at a fair rate of return on the capital invested in it. In other words, if a company is continuously unable to earn a fair rate of return on its capital, it is termed an over-capitalized company.

In the words of Bonneville Dewey, " When a business is unable to earn a fair rate of return on its outstanding securities, it is over¬capitalised."

According to Gerstenberg, "A corporation is over-capitalized when its earnings are not large enough to yield a fair return on the number of stocks and bonds that have been issued or when the amount of securities outstanding exceeds the current value of assets."

The same view has been expressed by Harold Gilbert in these words, "When a company has consistently been unable to earn the prevailing rate of return o.n its outstanding securities (considering the earning of similar companies in the same industry and the degree of risk involved) it is said to be over-capitalized."

It is clear from the above definitions that the situation of over¬capitalisation arises due to a fall in the earning capacity of the business. On account of this, the earnings will not be sufficient to give a reasonable return on capital employed in it. For example, a company is earning a profit of Rs. 8,00,000 on a total capital investment of Rs. 80,0, 000. In case the normal, rate of return prevailing in the market is 10%, this company will be said to be fairly capitalized. However, if it earns only Rs. 2,20,000 while the normal rate is 10%, the company will be said to be over-capitalized because it will be able to give a return of only 6% on the total capital employed.

In order to ascertain whether a company is earning a fair return or not, the rate of return earned by the company should be compared with similar firms in that

industry. If the company's rate of return is t .substantially less than the average rate earned by other firms, will indicate that the company is unable to earn a fair return on the capital 1 employed in it. It may also be noteworthy that a company will be said to be over-capitalized only when it is continuously unable to earn fair income over a long period of time. If its earning is reduced temporarily, owing to the occurrence of abnormal events like strikes, lockouts, etc. the company will not be called over-capitalized.

Causes of Over-Capitalisation:

Following are some of the important causes of over-capitalization:-

1. Over-Issue of Capital: If a company raises more capital than it can profitably use, there will be a large number of idle funds will the company. Because of idle funds, the earning capacity of the company will be reduced. This leads – to the situation of over-capitalization because the company will have to pay dividends on idle capital too. Hence, the rate of dividend will fall which in turn leads to a fall in the market price of its shares.

2. Promotion of the Company with Inflated Assets: A company will fall prey to over-capitalization if it is promoted with assets purchased at excessive prices, the reason is that such prices of the assets do not fear any relation to their earning capacity. Such a situation arises particularly when a partnership firm or private company is converted into a public company and in that process, their assets may be transferred to the public company at price higher than their real values. Sometimes, the promoters also transfer their property to the new company at inflated prices.

3. Promotion or Expansion of the Company during Boom Period: If a company is formed or expanded during the boom period, it; may becomes a victim of over-capitalization. The reason is that the price paid for assets will be quite high. When the boom disappears the real value of such assets will decline to a great extent whereas they will be shown in the books at their original values. Such a company is over-capitalized because its earning will fall due to depression but the assets and capital will be shown in the books in previous figures.

4. High Promotion Expenses: A certain degree of over-capitalization may be caused due to the. fact that the promoters have incurred heavy expenses on the promotion. of the company, a huge amount may have been spent on issue and underwriting of shares and the promoters may have taken a fabulous. remuneration for the services rendered by them. A major part of the earnings of the company will be utilized to write off these expenses and consequently, the company will not be able to pay fair dividends on its shares.

5. Over-estimation of Earnings at the Time of promotion: In case of a new concern,-the amount of capitalization is determined on the basis of estimates of future earnings. However, if it is found that the actual earning is less than the estimated earning, it will lead to a situation of over-capitalization. For example, if a company's annual earnings were estimated at Rs, 50,000 and its current rate of return (or N capitalization rate) is 10% its, capitalization will be fixed at Rs. 5,00,000. Subsequently, it was found that the company actually earned (Rs. 40,000. On this basis, the company's capitalization should have been: fixed at Rs. 4,00,000. Thus, the company will be over-capitalized by

4 Rs. 1,00,000.

6. Under-estimation of Rate of Return at the Time of Promotion: A concern may have correctly estimated the number of its earnings, but it may have under-estimated its rate of return (i.e., capitalization, rate). For example, a company's annual earnings were estimated at ' Rs. 50,000 and the rate of return were fixed at 10%. By applying this rate the company's capitalization was worked out at Rs. 5,00,000. Subsequently, it was found that the actual rate of return was 12.5%, and hence the amount of capitalization should have been fixed at Rs. i.e., Rs. 50,000 × 100. 12.5 Obviously, there is over-capitalization to the extent of Rs.1,00,000.

7. Shortage of Capital: Sometimes, the shortage of capital may also lead to over-capitalization. It may happen when the promoters underestimate the requirements of capital and raise less capital in relation to the needs of the business. In such a case the company will be forced to borrow a large sum of money at an unreasonably high rate of interest. A major part of the earnings will be absorbed by the amount of interest, leaving little for the shareholders. This will bring down the value of shares leading to over-capitalization.

8. Inadequate Depreciation: If a company does not make sufficient provisions for depreciation and replacement of assets, it will find after some time that the earning capacity of the assets is diminished leading to a fall in its earnings. This is yet another case of over-capitalization.

Under-capitalization: The term 'under-capitalization' does not mean a shortage or inadequacy of capital. The term is just reverse to over-capitalization. In the words of Greenberg:

"A corporation may be under-capitalized when the rate of profits, it is making on total Capital, is exceptionally high in relation to the return enjoyed by similarly situated companies in the same industry, or when it has too little capital with which to conduct its business."

In simple words, under-capitalization is a state of affairs when the capital or resources of the company are being utilized more efficiently. As a result, the company succeeds in continuously earning an abnormally high rate of return on the capital employed in it. Such a company declares a high rate of dividend in comparison to the prevailing rate and the market value of its shares exceeds their book value. Thus under-capitalization refers to the sound financial position and good management of the company.

Causes of Under-Capitalisation:

The following are the important causes of under-capitalization:

1. Under-Estimation of Capital Requirements: At the time of promotion, the promoters may under-estimate the capital requirements of the company. This results in a situation of under-capitalization at later stages when more capital is required.

2. Under-Estimation of Earnings: Sometimes at the time of promotion, the future earnings of the company are under-estimated and the company is capitalized accordingly. If afterward it is found that the actual earnings are far in excess of the estimates, the company may find itself in a situation of under-capitalization.

3. Over-Estimation of Rate of Return at the Time of Promotion: Sometimes a concern estimates its income correctly but it over-estimates its rate of return (i.e,, capitalization rate). For example if a company's earnings were estimated at Rs. 60,000 and the rate of earnings were fixed at 15%. By applying this rate the capitalization was fixed at'Rs. 4,00,000 (i.e., Rs. 60,000 ×). Subsequently, it was ascertained that the actual rate was 10% and hence the amount of capitalization should have been Rs, 6,00,000 (i.e., Rs. 60,000 ×). Thus, the company is under-capitalized by Rs. 2,00,000.

4. Promotion of Company During Deflation: Companies that are floated under recessionary conditions often experience under-capitalization after the recession is over. This is because of two reasons. Firstly, during recession assets are purchased at a price that is must lower in comparison to their earning capacity. Secondly, companies established during a recession are capitalized at a low figure anticipating low earnings but when the recession is over earnings increase and the company becomes under-capitalized.

5. Conservative Dividend Policy: Certain companies follow a policy of declaring low dividends and plowing back a major part of their earnings. They build up large funds for replacement, renovation, and expansion. The result of such a policy is reflected in high earnings which is a situation of under-capitalization.

6. High Level of Efficiency: In a company where the management is very efficient, the company may operate on a high efficiency even with a meager amount of capital. Over a period, earning the position of the company will improve and it will become under-capitalized.

Case study Answer-

1. Answer:

   Financial planning is the financial concept discussed in the above paragraph. The process of estimating the fund requirements of a business and specifying the sources of funds is called financial planning. It relates to the preparation of a financial blueprint of an organisation's future operations. The objectives to be achieved by the use of financial concept are stated below:

   - To ensure availability of funds whenever required which involves estimation of the funds required, the time at which these funds are to be made available and the sources of these funds.
   - To see that the firm does not raise resources unnecessarily as excess funding is almost as bad as inadequate funding. Financial planning ensures that enough funds are available at right time.

2. Answer:

   a. Financial planning is the financial concept discussed in the above paragraph. The process of estimating the fund requirements of a business and specifying the sources of funds is called financial planning. It relates to the preparation of a financial blueprint of an organization's future operations.

   b. The two points highlighting the importance of planning are described below:

      - It ensures smooth running of a business enterprise by ensuring availability

of funds at the right time.

- It helps in anticipating future requirements of a funds and evading business shocks and surprises

Assertion Reason Answer-

1. a. Assertion and reason both are correct statements and reason is correct explanation for assertion.
2. d. Assertion is wrong statement but reason is correct statement.

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