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**Q.1: Discuss in details the three important decisions a finance manger is required to take.**

**Financing Decision**

Running an organization must involve taking thousands of decisions a day as you can imagine. The decisions that have to be taken with respect to the capital structure are known as Financing Decision. Let us learn a bit more about the types of financing decisions.

Ans : The three major areas are:

* 1 Investment decision
* 2 financing decision
* 3 assets management decision (dividend decision)

**A: investment decision** : (capital budgeting decision )

The investment decision is very sensitive area in which they take the decisions where to he funds will be invested in firms.

A firm has many options to invest their funds but they have to select the most appropriate investment which will bring the maximum benefits for the firm. Deciding or selecting most appropriate proposal in investment decision. The firm invests its funds in acquiring fixed assets as well as current assets.

With every investment proposal, there is some risk is also involved; the company must try to calculate the risk involved in every proposal. The firm invests its funds in acquiring fixed assets as well as current assets. When decision regarding fixed assets is taken it is also called capital budgeting decision.

**1. Cash Flow of the Project:**

Where a company is investing huge funds in an investments proposal it expects some regular amount of cash flow to meet day-to-day requirement. The amount of cash flow an investments proposal will be able to generate must be assessed properly before investing in the proposal.

1. ***Profits*:**

The basic criteria for starting any venture is to generate income but moreover profits. The most critical criteria in choosing the venture are the rate of return it will bring for an organization n the nature of profit for,

e.g., if venture A is getting 10% return and venture В is getting 15% return then one must prefer project B.

**B Financing decision :**

The second important decision which finance manager has to take is deciding source of finance a company can raise finance by some sources such as by issue of shares, debentures or by taking loan etc . the main concern of finance manager is to decide how much raise from owners fund and how much raise to from borrowed. . while taking this decision the finance manager compares the advantages and dis advantages of different sources of finance. the borrowed funds have to be paid back and involve some degree of risk

sources of finance can be divided into two categories :

**1: owners funds:**

owners funds mean the funds which are procured by the owners of a business, which may be a sole entrepreneur or partner or shareholders of a business. It also includes profit which are reinvested in the business.

**2: borrowed funds**

borrowed funds refer to the borrowings of a business firms. In a company, borrowed funds consists of the finance raised from debenture holders, public deposit etc .

F**actors affecting financing decisions:**

while taking financing decision the finance manager keeps in mind the following factors :

**1: cost**

the cost of raising finance from various sources is different and finance managers always prefer the source with minimum cost.

**2:risk**

Finance manager compares the risk with the cost involved and prefers securities with moderate risk factor.

**3: cash flow position**

The cash flow position of the company also helps in selecting the securities.

**C Dividend decision:**

This decision is concerned with distribution of profit earns . The profit of the firm is distributed among various parties such as creditors, employees, debenture holders, shareholders, etc. To take this decision finance manager keeps in mind the growth plans and investment opportunities.

If more investment opportunities are available and company has growth plans then more is kept aside as retained earnings and less is given in the form of dividend, but if company wants to satisfy its shareholders and has less growth plans, then more is given in the form of dividend and less is kept aside as retained earnings

To take this decision finance manager keeps in mind the growth plans and investment opportunities.

**Factors Affecting Dividend Decision:**

The finance manager analyses following factors before dividing the net earnings between dividend and retained earnings:

**1.Earning**

#### Dividends are paid out of current and previous year’s earnings. If there are more earnings then company declares high rate of dividend whereas during low earning period the rate of dividend is also low.

#### 2. Stability of Earnings:

Companies having stable or smooth earnings prefer to give high rate of dividend whereas companies with unstable earnings prefer to give low rate of earnings.

**Q3 (a): Differentiate between:**

**Financial markets:**

“All institutions and procedures for bringing buyers and sellers of financial instruments together is called financial market”.

Financial markets can be broken into two classes:

**money market and capital market**

1. **Money Market:**

* Def : the money market is an organized exchange market where participants can lead. The market concerned with buying and selling of short term (less than one year original maturity) The market enables govt banks and other other large institutions to sell short term securities. Government and corporate debt securities is called money market.
* Maturity: upto one year.
* Liquidity: high liquidity
* Risk factor: lower risk
* Return on investment: lower than that of capital markets
* Credit instruments: govt securities, shares, bonds, debentures, currencies, derivatives.

**2. Capital Markets:**

* def : The market concerned with relatively long term (greater than one year original maturity) debt and equity instruments (e.g bonds and stocks) is called capital market. Market where long term are issued and traded.
* Maturity: one year or more may even be indefinite.
* Liquidity: comparatively lower
* Risk factor: comparatively higher
* Return on investment: comparatively higher
* Credit instruments: treasury bills, commercial papers, municipal notes, money funds etc.

**Primary and Secondary Markets**

**1.Primary market:**

* Def : A market where new securities are bought and sold for the first time is called primary market.
* Issue of securities: Issue of new shares by the company is done at the primary market.
* Mode of investment: Direct investment as the securities is required directly from the company.
* Parties in action: The parties to dealing in this market are company and investors.
* Intermediary: The intermediaries in between are the underwriters.
* Salability: The securities once sold here, cannot be resold here.

**2.Secondary Market:**

* Def: A market where existing (used) securities are bought and sold rather than new issues are called secondary market.
* Issue of securities: issued earlier are traded in the secondary market.
* Mode of investment: Indirect investment as the securities as acquired from other stakeholders.
* Parties in action: the parties in dealing are only investors.
* Intermediary: the intermediaries are security brokers.
* Salability: the securities can be sold unlimited time.

**Q3 B**: The real owners of a company are considered to be the one common shareholder because one reason is preferred shareholder has no voting right while appointing board of director all voting rights are with stock holders

Second reason is there dividends are not sure they will be cleared or not its up to shareholder we there want to declare them clear or not

Dividend income risk preferred stock dividends are not guaranteed. An issuer that experiences financial difficulties might reduce or suspends preferred dividends. Preferred shareholders would be stuck with shares that had neither appreciation potential nor dividends

**Q2: (a) shortcomings of earnings as organizations objectives.**

Ans : Profit maximization leads to exploitation of workers and consumers. Profit maximization creates immoral activities. Profit maximization leads to inequalities among stockholders. There are many intervals as swell as external risks involve which is not taken into consideration in profit maximization objectives. To earn more profit an enterprise tries to change more prices and to take more work from workers with less pays.

When company earns more profit the entry of new shareholders is not required which leads to full control of the company with existing shareholders.

Example : Reducing fixed cost business leader can maximize profit by moving to smaller facilities, reducing insurance coverage or minimizing utilities usage. In particular, moving to facilities with lower rent expenses may have negative effect on productive capacity and a company’s ability to grow in the future.

**Alternative objectives**

Wealth maximization it is superior to profit maximization as its main aim is to maximize shareholders wealth. It is precise and unambiguous it is based on the concept of cash flow rather than profit. Considers time value of money wealth maximization objectives take into account that time of cash low. Considers future risk associated with occurrence of cash flow this is done with the help of discounting rate higher the discount rate, higher there the risk and vice versa. It considered the impact of risk factor while calculating the net profit at a particular discount rate, adjustments is being made to cover the risk that is associated with the investments.

* Q2 (B): In my opinion the wealth maximization is most viable because the wealth maximization is a clear term. Here the present value of cash flow it taken into consideration. The net effect of investment and benefits can be measure clearly. It is universally accepted, because it take care of interests of financial institutions, owners, employees and the society at large. It guides the management in farming a consistent strong dividend policy to reach maximum return of equity holders.