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**SUBJECT : BUSINESS FINANCE**

# **QUESTION NO.1**

# **Discuss in details the three important decisions a finance managers required to take.**

Answer:

FINANCIAL MANAGEMENT:

Financial Management is a vital activity in any organization. It is the process of planning, organizing, controlling and monitoring financial resources with a view to achieve organizational goals and objectives.

FINANCIAL MANAGERS:

 Financial managers are the people who will do research and based on the research, decide what sort of capital to obtain in order to fund the company's assets as well as maximizing the value of the firm for all the stockholders.

FINANCIAL MANAGEMENT DECISIONS:

In organizations, managers in an effort to minimize the costs of acquiring finance and using it in the most profitable manner, take the following decisions:

1. Investment decision
2. Financing decision
3. Asset management decision
4. Dividend decision

**Investment Decision:**

A financial decision which is concerned with how the firm’s funds are invested in different assets is known as investment decision. Investment decision can be long-term or short-term.

A long term investment decision is called capital budgeting decisions which involve huge amounts of long term investments and are irreversible except at a huge cost. Short-term investment decisions are called working capital decisions, which affect day to day working of a business. It includes the decisions about the levels of cash, inventory and receivables.

A bad capital budgeting decision normally has the capacity to severely damage the financial fortune of a business.

A bad working capital decision affects the liquidity and profitability of a business.

**Factors Affecting Investment Decisions / Capital Budgeting Decisions:**

1. *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.

2. *Rate of return*- The expected returns from each proposal and risk involved in them should be taken into account to select the best proposal.

3. *Investment criteria involved-* The various investment proposals are evaluated on the basis of capital budgeting techniques. Which involve calculation regarding investment amount, interest rate, cash flows, rate of return etc. It is to be considered which technique to use for evaluation of projects.

**Financing Decision**

Financial decision is important to make wise decisions about when, where and how should a business acquire fund. Because a firm tends to profit most when the [market](https://www.toppr.com/guides/business-economics/meaning-and-types-of-markets/market-meaning-and-classification/) estimation of an organization’s share expands and this is not only a sign of development for the firm but also it boosts investor’s wealth. Consequently, this relates to the composition of various securities in the capital structure of the company.

Factors affecting Financing Decisions

* Cost: Financing decisions are all about allocation of funds and cost-cutting. The cost of raising funds from various sources differ a lot. The most cost-efficient source should be selected.
* *Risk*: The dangers of starting a venture with the funds from various sources differ. Larger risk is linked with the funds which are borrowed, than the equity funds. This risk assessment is one of the main aspects of financing decisions.
* *Cash flow position*: Cash flow is the regular day-to-day earnings of the [company](https://www.toppr.com/guides/business-laws/companies-act-2013/meaning-and-features-of-a-company/). Good or bad cash flow position gives confidence or discourages the investors to invest funds in the company.

**DIVIDEND DECISION:**

One of the most important financial decisions that a Financial Manager must make is related to the company’s dividend policy. It concerns how much of the company’s earnings will be paid out to shareholders. Specifically, it is necessary to determine if generated earnings will be reinvested in the company to improve operations or if they will be distributed among shareholders. It is also possible to choose a mixed policy in this regard, distributing a part among shareholders and investing the rest in the company. However, if the dividends distributed are too high, the company may encounter limitations to expand or improve the management of its operations. It is important to consider that in order to have growth perspectives over the long term, short term reinvestments are necessary.

**Factors affecting Dividend Decision:**

*Growth prospects*- In case there are growth prospects for the company in the near future then, it will retain its earnings and thus, no or less dividend will be declared.

*Cash flow positions*- Dividends involve an outflow of cash and thus, availability of adequate cash is foremost requirement for declaration of dividends.

*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, then more dividends can be declared by the company.

**Asset management:**

Asset management is one of the main aspects for a company to adequately meet its obligations and in turn to position itself to meet the objectives or growth targets that have been laid out. In other words, the Financial Manager must stipulate and assure that the existing assets are managed in the most efficient way possible. Generally, this manager must prioritize current asset management before fixed asset management. Current assets are those that will become effective in the near future, such as accounts receivable or inventories. By contrast, fixed assets lack liquidity since they are needed for permanent operations. This includes offices, warehouses, machinery, vehicles, etc.

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# **QUESTION NO.2**

1. **Elaborate the shortcomings of earnings as organization’s objectives? If not earnings than what alternative objective is being proposed?**

**Profit Maximization**

Profit maximization is the main aim of any business and therefore it is also an objective of [financial management](https://efinancemanagement.com/financial-management). Profit maximization, in financial management, represents the process or the approach by which profits Earning Per Share (EPS) is increased. In simple words, all the decisions whether investment or financing etc. are focused on maximizing the profits to optimum levels.

Profit maximization is the traditional approach and the primary objective of financial management. It implies that every decision relating to business is evaluated in the light of profits. All the decisions with respect to new projects, [acquisition](https://efinancemanagement.com/mergers-and-acquisitions/acquisition) of assets, raising capital etc are studied for their impact on profits and profitability. If the result of a decision is perceived to have a positive effect on the profits, the decision is taken further for implementation.

**The alternative objective that is being proposed is Wealth maximization.**

**WEALTH MAXIMIZATION:**

Wealth maximization is the ability of a company to increase the market value of its common stock over time. The market value of the firm is based on many factors like their goodwill, sales, services, quality of products, etc.

It is the versatile goal of the company and highly recommended criterion for evaluating the performance of a business organization. This will help the firm to increase their share in the market, attain leadership, maintain consumer satisfaction and many other benefits are also there.

It has been universally accepted that the fundamental goal of the business enterprise is to increase the wealth of its shareholders, as they are the owners of the undertaking, and they buy the shares of the company with the expectation that it will give some return after a period. This states that the financial decisions of the firm should be taken in such a manner that will increase the Net Present Worth of the company’s profit. The value is based on two factors:

1. Rate of Earning per share
2. Capitalization Rate.

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***B) In my opinion the most viable one is wealth maximization because:***

Profit maximization ruled the traditional business mindset which has gone through drastic changes. In the modern approach of business and financial management, much higher importance is assigned to [wealth maximization](https://efinancemanagement.com/financial-management/wealth-maximization) in comparison of [Profit Maximization vs. Wealth Maximization.](https://efinancemanagement.com/financial-management/profit-vs-wealth-maximization) The losing importance of profit maximization is not baseless and it is not only because it ignores certain important areas such as risk, quality, and the time value of money but also because of the superiority of wealth maximization as an objective of the business or financial management.

Whereas Wealth Maximization takes into account the interest concerning shareholders, creditors or lenders, employees, and other stakeholders. Hence, it ensures building up reserves for future growth and expansion maintaining the market price of the company’s share and recognizes the value of regular dividends. So, a company can take any number of decisions for maximizing profit but when it comes to decisions concerning shareholders then Wealth Maximization is the way to go.

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# **QUESTION NO. 3**

1. **Differentiate between:**

**1: The Money and capital markets**

**2: the primary and secondary markets.**

1. **The real owners of a company are considered to be the common shareholders. Give at least two reasons as why the preferred shareholders are not the real owners?**
2. **1: THE MONEY AND THE CAPITAL MARKETS:**

**THE MONEY MARKET: (Definition)**

Money market is the center of dealing in short term monetary assets like bill of exchange, short term government securities and other short term loans. The main dealers of money markets are the banks and financial institutions. They get and give loan or purchase and sell short term bill in this market. This is not fix place but this is system in which they deal with each other.

**THE CAPITAL MARKET: (Definition**)

The capital market is the market for securities, where companies and the government can raise long term funds. The capital market includes the stock market and the bond market.

**DIFFERENCES:**

Following are the differences between money market vs capital market:

BORROWING TERM

Lending and borrowing in the money market is for the short-term. In the capital market, investors lend and borrow securities for medium term to long-term.

PARTICIPAnts: Usual participants in the money market are central banks, commercial banks, mutual funds, financial institutions and chit funds. Capital market, involves stock brokers, retail investors, mutual funds, underwriters, insurance companies and stock exchanges.

INSTRUMENTS

Popular instruments in the money market are commercial papers, T-bills, call money, promissory notes and so on. Capital markets typically deal in bonds, debentures, [preference shares](https://efinancemanagement.com/sources-of-finance/preference-shares-and-its-features) and so on.

LIQUIDITY

Since money market deals with short-term instruments, it is more liquid. Capital market deals in medium to long-term time frame, thus liquidity is less.

RISK FACTOR

Money market usually involves less risk as the market is liquid and funds are for the short-term. Due to long-term maturity and comparatively less liquidity, the risk in the capital market is more.

RETURNS

Since the time duration is short and the risk is less, returns in the money market are also less. Return in the capital market is more as the investment is for more duration.

MATURITY PERIOD

Money market instruments have a max maturity period of one year. In the capital market, there is no specified maturity period for the instruments, but it is always more than a year.

**2: THE PRIMARY AND SECONDARY MARKETS:**

**THE PRIMARY MARKETS:**

Primary markets are where new [assets](https://capital.com/asset-definition) are offered to investors for the first time. The price you'll see is set by the seller – usually a company or government.

**THE SECONDARY MARKETS:**

The secondary market is the market in which existing securities are resold or traded. It is also known as stock market.

**DIFFERENCES:**

some of the major Difference Between Primary Market v/s Secondary Market:

* The securities are initially issued in a market known as Primary Market, which is then listed on a recognized stock exchange for trading, which is known as a Secondary Market.
* The prices in the primary market are fixed whereas the prices vary in the secondary market depending upon the demand and supply of the traded securities.
* In the primary market, the investor can purchase shares directly from the company. In Secondary Market, investors buy and sell the stocks and bonds among themselves.
* In the primary market, security can be sold only once, whereas in the secondary market it can be done an infinite number of times.
* In the Primary Market the amount received from the securities are the income of the company, but in the Secondary Market, it is the income of investors.
* The primary market is rooted in a specific place and has no geographical presence as it has no organizational setup. Conversely, the Secondary market is present physically, as a stock exchange, which is situated in a particular geographical area.
* Investment bankers do securities trading in case of Primary Market. Conversely, brokers act as intermediaries while trading in the secondary market.

1. **PREFERRED STOCKHOLDERS:**

**REASONS:**

Preferred stockholders are not the real owners because:

1: They are not the part of the profit or loss. If the company makes profits, common stockholders receive dividends. If a company incurs losses, they don’t receive any dividend. But in the case of preferred stockholders, they always receive fixed rate of dividends whether the company makes profits or incurs losses.

2: Common stockholders have voting rights and they can vote on the important issues of the company. Preferred stockholders don’t have any voting rights.