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Q.1. Discuss in details the financing and asset management decisions a finance manager is required to take.

Answer: The Finance Manager of a company must have the proper ability and training to address key financial management decisions. The main aspects of the financial decision-making process relate to investments, financing dividends and asset management.

Financial management refers to the acquisition, financing and management of assets. This decision-making process is very sensitive and must be under the control of a Finance Manager to analyze external and internal variables that can affect the normal development of company activities.

The role of the Finance Manager in the decision-making process can be divided into four main areas:

1. **Investment Decision**
2. **Financing Decision**
3. **Asset Management Decision**
4. **Dividend Policy Decision**

Investment Decision: in the investments area, the Finance Manager is responsible for defining the optimal size of the company. In this regard, it is important to have a market study in place and be clear on the objectives that the company needs to meet. It is important to have properly studied the demand, technology and equipment, financing methods and human resources available. The financial manager needs to determine the dollar amount that appears above the double lines on the left-hand side of the balance sheet – that is, the size of the firm. Even when this number is known, the composition of the assets must still be decided. For example, how much of the firm's a total asset should be devoted to cash or to inventory? Also, the flip side of investment – disinvestment – must not be ignored. Assets that can no longer be economically justified may need to be reduced, eliminated, or replaced.

In second place, the director must analyze whether the resources adapt to the optimal size desired for the company. If they don't, it is necessary to define the types of assets that the company must acquire, or otherwise sell or get rid of, in order to achieve efficient management.

Financing Decision: defining a financing strategy is essential to the continuity of the business over the long term. Access to financing is closely related with maintaining a constant inflow of capital since the savings margin will not allow operations to continue for much longer without the support of additional liquidity. The Finance Manager must define several aspects of the financing strategy. For example, study the sources willing to offer credit to the organization, and define the best financing options for operations. The Finance Manager can also design a mixed financing strategy for efficient financial management: this is called the company's "financing mix". Sometimes the company can benefit from a combination of short and long term financing to meet investment and financial strategy objectives.

Asset Management Decision: 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 Finance 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.

Dividend Policy Decision: one of the most important financial decisions that a Finance 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.

Q.2. A. Elaborate the shortcomings of "earnings as organizations' objectives".

Answer: Shortcoming of the objective of maximizing earnings per share – a shortcoming shared by other traditional return measures, such as return on investment – is that risk is not considered. Some investment projects are far more risky than others. As a result, the prospective stream of earnings per share would be more risky if these projects were undertaken. In addition, a company will be more or less risky depending on the amount of debt in relation to equity in its capital structure. This financial risk also contributes to the overall risk to the investor. Two companies may have the same expected earnings per share, but if the earnings stream of one is subject to considerably more risk than the earnings stream of the other, the market price per share of its stock may well be less.

The objective does not allow for the effect of dividend policy on the market price of the stock. If the only objective were to maximize earnings per share, the firm would never pay a dividend. It could always improve earnings per share by retaining earnings and investing them at any positive rate of return, however small. To the extent that the payment of dividends can affect the value of the stock, the maximization of earnings per share will not be a satisfactory objective by itself.

Shortcomings of "Earnings as Organization' Objectives" are categorized in to type

Profit Maximization:

Profit maximization, in financial management, represents the process or the approach by which profits Earning Per Share (EPS) is increased and Maximizing a firm's earnings after taxes. In simple words, all the decisions whether investment or financing etc. are focused on maximizing the profits to optimum levels.

It is regarded as the most reasonable and productive business objective of an organization. Apart from this, profit maximization helps in determining the behavior of business organizations as well as the effect of various economic factors, such as price and output, in different market conditions.

Problems

- Could increase current profits while harming firm (e.g., defer maintenance, issue common stock to buy T-bills, etc.).
- Ignores changes in the risk level of the firm.
- While profit maximization in financial management has the potential to bring in extra money in the short-term, long-term earning could be drastically diminished.
- Lowering production quality for the sake of increased profits will hurt your brand, upset customers, and allow competitors to steal your business.

Earnings per Share Maximization:

Earnings per share (EPS) Maximization are the portion of the company's distributable profit which is allocated to each outstanding equity share (common share) which maximizing earnings after taxes divided by shares outstanding. EPS when calculated over a number of years indicates whether the earning power of the company has improved or deteriorated.

Problems

- Does not specify timing or duration of expected returns.
- Ignores changes in the risk level of the firm.
- Calls for a zero payout dividend policy.

Q.2. B. Discuss why the share market price is a preferred objective of a company.

Answer: Most shareholders are attracted to preferred stocks because they offer more consistent dividends than common shares and higher payments than bonds. However, these dividend payments can be deferred by the company if it falls into a period of tight cash flow or other financial hardship. This feature of preferred stock offers maximum flexibility to the company without the fear of missing a debt payment. With bond issues, a missed payment puts the company at risk of defaulting. That would cause a credit downgrade and could even force a bankruptcy.

Some preferred shareholders also have the right to convert their preferred stock into common stock at a predetermined exchange price. In the event of bankruptcy, preferred shareholders receive company assets before common shareholders.

Within the vast spectrum of financial instruments, preferred stocks (or "preferreds") occupy a unique place. Because of their characteristics, they straddle the line between stocks and bonds. Technically, they are equity securities, but they share many characteristics with debt instruments.

Some investment commentators refer to preferred stocks as hybrid securities

Why preferred objective of a company

A company may choose to issue preferreds for a couple of reasons:

1. **Flexibility of payments** - Preferred dividends may be suspended in case of corporate cash problems.
2. **Easier to market** - The majority of preferred stock is bought and held by institutional investors, which may make it easier to market at the initial public offering.

Q.3. A. What is the purpose of financial markets?

The Purpose of Financial Markets

The purpose of financial markets in an economy is to allocate savings efficiently to ultimate users. If those economic units that saved were the same as those that engaged in capital formation, an economy could prosper without financial markets. In modern economies, however, most nonfinancial corporations use more than their total savings for investing in real assets. Most households, on the other hand, have total savings in excess of total investment.

Efficiency entails bringing the ultimate investor in real assets and the ultimate saver together at the least possible cost and inconvenience.

For investors (whether individual savers, institutions, banks, etc.), financial markets offer the opportunity to invest capital in exchange for a return called a "dividend", and the prospect of added value if their assets appreciate.

Financial Markets

Financial Market refers to a marketplace, where creation and trading of financial assets, such as shares, debentures, bonds, derivatives, currencies, etc. take place. It plays a crucial role in allocating limited resources, in the country’s economy. It acts as an intermediary between the savers and investors by mobilizing funds between them.

The financial market provides a platform to the buyers and sellers, to meet, for trading assets at a price determined by the demand and supply forces.

Classification of Financial Market

1. By Nature of Claim

- **Debt Market:** The market where fixed claims or debt instruments, such as debentures or bonds are bought and sold between investors.
- **Equity Market:** Equity market is a market wherein the investors deal in equity instruments. It is the market for residual claims.

2. By Maturity of Claim

- **Money Market:** The market where monetary assets such as commercial paper, certificate of deposits, treasury bills, etc. which mature within a year, are traded is called money market. It is the market for short-term funds. No such market exists physically; the transactions are performed over a virtual network, i.e. fax, internet or phone.
- **Capital Market:** The market where medium and long term financial assets are traded in the capital market. It is divided into two types:
  - **Primary Market:** A financial market, wherein the company listed on an exchange, for the first time, issues new security or already listed company brings the fresh issue.
  - **Secondary Market:** Alternately known as the Stock market, a secondary market is an organized marketplace, wherein already issued securities are traded between investors, such as individuals, merchant bankers, stockbrokers and mutual funds.

3. By Timing of Delivery

- **Cash Market:** The market where the transaction between buyers and sellers are settled in real-time.
- **Futures Market:** Futures market is one where the delivery or settlement of commodities takes place at a future specified date.

4. By Organizational Structure

- **Exchange-Traded Market:** A financial market, which has a centralized organization with the standardized procedure.

- **Over-the-Counter Market:** An OTC is characterized by a decentralized organization, having customized procedures.

Since last few years, the role of the financial market has taken a drastic change, due to a number of factors such as low cost of transactions, high liquidity, investor protection, transparency in pricing information, adequate legal procedures for settling disputes, etc.

Q.3. B. Which category of the shareholders is the real owners of a company and gives at least two reasons as why they are the real owners?

A shareholder, also referred to as a stockholder, is a person, company, or institution that owns at least one share of a company's stock, which is known as equity. Because shareholders are essentially owners in a company, they reap the benefits of a business' success. These rewards come in the form of increased stock valuations, or as financial profits distributed as dividends. Conversely, when a company loses money, the share price invariably drops, which can cause shareholders to lose money, or suffer declines in their portfolios' values.

Equity shareholders are the real owners of the company. Equity shares represent the ownership of a company and capital raised by the issue of such shares is known as ownership capital or owner's funds. They are the foundation for the creation of a company.

Reasons of Real Owner

1. Equity shareholders are the joint owners of the company. They have ownership rights in the company. They have the right to participate in the management of the company.

2. Since, equity shareholders accept the business risks in real sense, they are the real owners of the company. The control of the company is vested in equity shareholders. This is because they have exclusive voting rights.