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SYLLABUS

FINANCE SPECIALIZATION : CORE SUBJECT

CORPORATE FINANCE



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SYLLABUS

Number of Sessions

1. Goals and Governance of the Firm: (7 + 2)

Corporate Investment and Financial Decisions (Investment Decisions and Financing Decisions), Goals of the Corporations.

2. Business Valuation (7 + 2)

Concept of Valuation, Different Concept of Value - Book-Value, Market Value, Intrinsic Value, Liquidation Value, Replacement Value, Salvage Value and Fair Value. Major approaches to Valuation of Business - Asset Based, Earning Based, Market Value Based Fair Value Based. EVA and MVA.

3. Corporate Value Based Management System (7 + 2)

Shareholders Value, Concept and Features of Value Based Management, Need for Value Based Management, Need, Benefits and Approaches of Value Based Management System
Corporate Governance: Concept of Corporate Governance, Criteria for Good Corporate Governance, Corporate Governance in India, Corporate Governance (Clause 49 Listing Agreement), Models of Corporate Governance.

4. Dividend Decisions (7 + 2)

Meaning, Types of Dividend, Important Considerations in Dividend Policy, Theories on Dividend Policies (Walter's Approach, Gordon's Approach and Modigliani-Miller Approach)

5. Corporate Restructuring (7 + 2)

Concept of Restructuring, Reasons for Restructuring, Broad Areas of Restructuring, Techniques of Corporate Restructuring – Expansion Technique, Divestment Technique, Other Techniques, Strategies for Restructuring.

- Numerical Problems will be asked on the following topics only - Business Valuation and Dividend Decisions. The weightage of theory questions will be 60% and numerical problems 40%.

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© **Publisher** **14512**

Published by :

PRAGATI BOOKS PVT. LTD.

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Off J.M. Road, Pune – 411005,
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Printed By :

RACHANA OFFSETS

Sr. No. 15, Arihant Marg,
Sukhsagar Nagar, Katraj
PUNE - 411 046
Tel - (020) 26863220

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1

GOALS AND GOVERNANCE OF THE FIRM

SYNOPSIS

- 1.1 *Corporate Investments and Financial Decisions (Investment Decisions and Finance Decisions)*
- 1.2 *Goals of the Corporation*

1.1 Corporate Investments and Financial Decisions (Investment Decisions and Finance Decisions)

Q. 1 : Define and Explain the term 'Finance'.

OR

Explain the Concept of Finance.

Ans. : Finance (Meaning) :

- The finance function is one of the most important function of any business organisation.
- Finance function is concerned with obtaining and utilising funds in an efficient manner.
- Finance function is an integral part of the overall management rather than merely fund raising operation.
- Finance function is comprehensive and covers different aspects such as financial planning, forecasting of cash receipts and disbursements, raising and using funds and financial control.
- Finance refers to the issuance of, the distribution of, and the purchase of liability and equity claims issued for the purpose of generating revenue producing assets.

Definitions of the Term 'Finance' :

- (a) "Finance is the process of organising the flow of funds so that a business can carry out its objectives in the most efficient manner and meet its obligations".
– **K. Midgley and R. Burns**
- (b) "Finance is the management of monetary affairs of a company. It includes determining what has to be paid for and when, raising the money on the best terms available and devoting the available funds to the best uses".
– **P. G. Husings**
- (c) "Finance is a specialised functional field found under the general classifications of business administration."
– **John Hampton**

FINANCE :

F = Funds.
I = Investments.
N = Negotiation.
A = Accounting.
N = Numerical Information.
C = Costing.
E = Estimating.

Q. 2 : Explain the Nature and Scope of Finance.**Ans. : Nature of Finance :**

- (a) Finance is concerned with estimating, planning, raising, utilising, controlling and administering the funds used in the business.
- (b) Finance function is a process of acquiring and utilising funds of a business.
- (c) Finance function is a technique of managing money, capital or funds of a business.
- (d) Finance function is an integral part of overall management.
- (e) Finance function is concerned with financial forecasting.
- (f) Finance function is concerned with budgeting, reporting and accounting.

Scope of Finance :

- (a) **Determining the Financial Needs of the Organization :** This deals with the amount of finance needed by the organisation for its short-term as well as long-term requirements. The firm may need finance for production purpose i.e. for buying raw materials, for wage payments, for working capital requirements etc. Also, it may need funds for increasing production, for capacity expansion, diversification etc.

- (b) **Raising of Funds at Minimum Cost** : It is concerned with procurement of the funds from various sources i.e. the market, various financial institutions, government agencies etc.
- (c) **Allocation of Funds to Various Assets** : It is concerned with the optimum utilization of funds for specific assets.
- (d) **Developing the Tools and Techniques of Control for Evaluating the Performance of the Organisation** : It concerns with various tools of control i.e. ratio analysis, funds flow analysis, budgetary control etc. for evaluating the performance of the organisation.
- (e) **Providing Financial Data for Decision-making** : It concerns with the maintenance of the data regarding the financial position of the firm so that in the light of the above data the top management can take important decisions regarding the organisation.

Q. 3 : Explain the Importance of Finance.

OR

State the Significance of Finance Function.

Ans. : Importance of Finance or Significance of Finance Function :

(a) **Financing Decision** : The decision is concerned with the mobilisation of finance for investment. The finance manager has to take good decisions regarding the acquisition of finance. Whether entire capital required should be raised in the form of equity capital or the amount should be borrowed totally or a balance should be struck between equity and borrowed capital has to be decided.

(b) **Investment Decision** : Investment decision is a long range financial decision. It is concerned with the allocation of capital. It has to show how the funds can be invested in assets which would yield benefit in future. This is a risky decision to be taken by the managers as they have to forecast the anticipated profit which is based on several uncertainties. Thus, this is a decision based on risk and uncertainty.

(c) **Dividend Decision** : This decision is concerned with the divisible profits of the company.

The dividend decision deals with the following issues:

- (i) How much cash dividend should be paid to the shareholders ?
- (ii) How much profit is to be flown back by capitalisation ?
- (iii) Maintenance of stable dividend rate over the period are some of the issues concerned with this decision.

Q. 4 : What is Business Finance ? State the Characteristics of Business Finance. OR

What is Corporate Finance. State its Features.

Ans. : Business Finance/Corporate Finance :

- Business Finance is an integral part of 'Business Organisation' and not a staff function. Business Finance is not only confined to fund raising operations but extends beyond it to cover utilization of funds and monitoring its uses.

Characteristics of "Business Finance" :

- (a) The term 'Business Finance' is a wider term** as compared to the term corporation finance. This is because finance covers the entire business activity which includes industry, trade, aids to trade and so on. Corporation finance, on the other hand, deals with the financial aspects of a company form of organisation. It is concerned with the corporate sector only.
- (b) Financial Management is one of the aspects of total business management** and financial planning is one component of total business planning.
- (c) Business Finance is concerned with the estimation, collection (acquisition) and utilisation of funds** for the conduct of business operations in an orderly and profitable manner.
- (d) Business Finance is concerned with the financial aspect of business** and is important as it touches all aspects of business management. Finance means capital or funds used for managing a business activity.
- (e) Business Finance deals with planning, raising, administrating and controlling the funds** used in business. It is a science as well as an art of managing financial aspect of business.
- (f) A business unit needs different types of finance** i.e. fixed, working, etc. and it is collected from different sources such as shares, debentures, loans, deposits and so on.
- (g) 'Business Finance'** deals with the mobilisation of finance for proper investments.
- (h) 'Business Finance'** has undergone several changes and it is now considered as a subject which deals in planning and control of financial operations of business. This deals with the procurement of funds and their effective utilisation.

Q. 5 : What are the Reasons for Managing Business Finances Efficiently ?

OR

State the Various Causes for Managing Business Financially.

Ans. : Reasons for Managing Business Finances Efficiently :

(a) Financial Forecasting :

- The first and foremost function of financial management is to forecast the financial needs of the concern. In the initial stage, it is done by promoters but, it is generally performed by the chief executive or by the office in charge of the finance department in a large scale enterprise.
- In estimating the financial requirements of the concern, help of various budgets i.e. sales budget, production budget etc. are prepared by the concerned departments of the firm is taken. Profit and Loss Account, Balance Sheet and other related data is sought.

(b) Investment Policy Decisions or Establishing Asset - Management Policies :

- In order to estimate and arrange for cash requirements of an enterprise, it is very necessary to decide how much cash will be invested in fixed (non-cash) assets and how much in short-term or current assets which are normally convertible into cash within a year. It also decides upon the kind and coverage of insurance that a company may carry. The financial decision in regard to the current assets is known as working capital management.
- The investment policy of fixed and current assets is popularly known as asset - management policy.
- Establishing a sound asset management policy is a pre-requisite to successful financial management.

(c) Dividend Policy Decision or Allocation of Net Profit :

- How to allocate the net profits of the concern is another problem before the financial managers.
- After paying all taxes the available net profits of the concern can be allocated for three purposes.
 - (i) For paying dividends to the shareholders of the company as a return on their investment.
 - (ii) For distributing bonus to the employees and company's contribution to other profit sharing plans.
 - (iii) Retention of profits for the expansion of business.

(d) Cash Flows and Requirements :

- It is the prime responsibility of the finance manager to see that an adequate supply of cash is available at proper time for the smooth running of the business. A good financial executive should ensure that cash inflows and outflows must be continuous and uninterrupted.
- Inflow of cash originates in sales and cash outflows or cash requirements are closely related to volume of sales. Here, the financial manager is to decide how much cash he must retain to meet the current obligations so that there would be no idle cash balance earning nothing for the company.
- The financial manager must maintain a balance between inflow and outflow of cash to pay his bills on time. The more he keeps cash in reserve to protect the company against risks associated with inability to pay bills on time, the more he loses returns on idle cash. It is certainly a dilemma of liquidity Vs. profitability.

(e) Deciding upon Borrowing Policy :

- Every organisation plans for the expansion of business for which it requires additional resources. Personal resources being limited the cash must be arranged by borrowing money either from commercial banks and other financial institutions or by floating new debentures or by issuing new shares.
- Financial manager will have to decide the financing mix or capital structure or leverage. It means he should take a decision that may carry an ideal proportion of debt and equity capital. The financial manager must choose the proportion he would like to maintain, keeping various relevant points into mind such as cost of different types of cost, returns expected, the financial risks involved etc.

(f) Negotiations for New Outside Financing :

- Finance function does not stop with the decision to undertake outside financing, it includes carrying on negotiations from the outside financing agencies to arrange for it.
- Finance is needed by an establishment to meet its short-term and long-term requirements. The financial manager must assess short-term and long-term financial requirements of the organisation and start negotiations for raising these funds.

(g) Checking upon Financial Performance :

- The finance manager is under an obligation to check the financial performance of the funds invested in the business.

Q. 6 : Explain the Concept : Strategic Financial Management. OR

What do you mean by Strategic Financial Management ?

Ans. : Strategic Financial Management (Meaning) :

- Strategic Financial Management (SFM) refers 'to the financial implications or aspects of various business strategies and the strategic management of finance'.
- Strategic Financial Management is the application of skills in the manipulation, use and control of funds strategically. It deals with the use of funds management in a broad strategic way.
- The concept of Strategic Financial Management should be in the tune with the overall objectives of the firm. The broad objectives of the firm i.e. wealth and profit maximization should be effectively met with the use of strategic financial management.
- Strategic Financial Management should concentrate on building up a most flexible core competence alongwith Strategic Cost Management.

Q. 7 : Explain the Need of Strategic Management of Business Finances in Present Economic Conditions.

Ans. : Need of Strategic Management of Business Finance in Present Economic Conditions :

- (a) To assure a steady financial growth rate for the business enterprise in the short-run and long-run.
- (b) To maintain an equal balance between the varying interests of various stakeholders.
- (c) To try to achieve accelerated financial growth rate.
- (d) To ensure the best application of the Enterprise Resource Planning (ERP) for the optimal usage of resources.
- (e) To capture and exploit the short-term and long-term business opportunities.
- (f) To provide funds to finance new ventures, new technologies, new markets and new benchmarks to boost productivity and profitability.
- (g) To use the innovative financial engineering techniques to accelerate the profitability.

- (h) To implement the action plan to meet the depressionary pressures, competitor's unexpected tactics, and other global and domestic adversities.
- (i) To maintain the solvency and liquidity position of the firm effectively to cope up with unexpected events.

Q. 8 : Define and Explain the term 'Financial Management'.

Ans. : Financial Management (Meaning) :

- Financial management involves obtaining funds required by an organisation in the most economic and prudent manner and employment of these funds in the most optimum manner to maximise the returns of the owners.
- Financial management, thus, includes any decision made by a business that affect its finances.

Definitions of Financial Management : These are as follows :

- (a) Hoagland :** "Financial management is the procedure of financing a needy concern."
- (b) Mock :** "The term financial management involved all functions starting basically from applying to the concerned authority for financial assistance and was presumed to continue till the stage of manipulation of the accumulated funds."
- (c) S. A. Sherlekar :** "The term financial management could be presumed to the custodian of corporate funds since it enables the said enterprise to finance in event of emergencies."

Q. 9 : Explain the Importance of Financial Management.

OR

Describe the Significance of Financial Management.

Ans. : Importance or Significance of Financial Management :

- (a) Life Blood for Organisation :** The financial management plays a very important role in any business organization. It is considered to be the life blood of an organisation. In the period of liberalisation and globalisation, financial management plays a vital role for the success of any organization.
- (b) Check on Inflow and Outflow of Funds :** The efficient system of financial management enables the organisation to keep a check on the inflow and outflow of funds from time to time. The organisation which keeps a check on the inflow and outflow of funds is in a better position to manage its affairs effectively.

- (c) **Elimination of Waste Resources** : Financial management enables the organisation to eliminate all the waste of resources arising due to improper check on the flow of funds from the said organisation to the outside world and even due to improper management procedures.
- (d) **Forecasting the Market Trends** : Financial management also enables the organisation to forecast ups and downs in the market trends with regard to sales if it is manufacturing company and hence indirectly acts as a cushion in times of emergency.
- (e) **Check** : Financial management cautions the enterprise to act with vigour and be tactful in order to acquire a greater market share in order to gain a upper-hand in the changing business environment.
- (f) **Facilitates Expansion** : The financial management also enables the organisation to concentrate on schemes of improvement and expansion of the business organisation.

Q. 10 : Explain the Scope of Financial Management.

Ans. : Scope of Financial Management :

- (A) Forecasting** : It includes,
 - (a) Analysis of economic trends.
 - (b) Anticipating industrial trends.
 - (c) Estimating financial requirements.
 - (d) Profit planning.
 - (e) Estimating rate of return on investment.
- (B) Financing** : It includes,
 - (a) Ensuring the availability of funds.
 - (b) Allocation of funds.
 - (c) Investing funds.
 - (d) Raising of funds.
- (C) Co-ordination and Control** : It includes,
 - (a) Financial adjustments.
 - (b) Accounting.
 - (c) Budgeting.
 - (d) Reporting.

(D) Costing : It includes,

- (a) Measuring the capital cost.
- (b) Measuring the company cost.
- (c) Controlling the cost of capital.
- (d) Controlling the company cost.

(E) Decision-making : It includes,

- (a) Financial decisions.
- (b) Investment decisions.
- (c) Management of income and dividend function.
- (d) Working capital decisions.

1.2 Goals of the Corporation

Q. 11 : Explain the Various Goals of Business Corporation.

Ans. : Goals of Business Corporation :

(a) Profit Maximisation :

- Profit maximisation is the primary objective of any business. It means that the firm should try to increase its profits by large amount as possible. It should invest only in those projects that are profitable and reject those which are not profitable or less profitable.
- As a firm makes maximum profits, it will be reflected in its share prices. Also it is more quantifiable and concrete than that of maximisation of shareholders wealth. But this profit maximisation suffers some drawbacks. It does not take into account the risk factor that is involved in the maximisation of profit.
- Profitability objective may be stated in terms of return on investment, or profit-to-sales ratio.
- According to this goal, all such actions as increased income and cut down costs should be undertaken, and those that are likely to have adverse impact on the profitability of business corporation should be avoided.

(b) Wealth Maximisation :

- According to the wealth maximisation concept, the objective of the firm is to maximise the value of its equity shares i.e. to maximise the earning of the shareholders.

Corporate Finance



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