Time value of money

The value of a unit of money is different in different time periods. The value of a sum of money received today is more than its
value received after some time. In other words the sum of value of money can also be referred to as time preference for money. Time preference of money is found in reinvestment opportunity for the founds which are received earlier. It is the rate of return. This will vary from individual to individual.

EXAMPLE : - If one has option to receive 10000 now or one year after than one would like to receive 10000 now only. If some one receive it after one year than he would like to receive 10500 which may be rate of return for that person. In this cases the time value of money will be 500Rs. or 5%

TECHNIQUES : -

(1) Compounding

(2) Non compounding

Short notes on the sources of fund and financial management

Under the stock invest Scheme prepared by various banks, the investor can open an account for a deposit with the concerned bank and request the bank in writing to issue the instrument called **BUSINESS RISK AND FINANCIAL RISK**: business risk (sometimes also referred to as operating risk) refers to the variability of earning before interest and taxes (FBTT) as a result of environment in which a company operates. The environment consists of company internal factors, industry speeific factors and economy specific factors, internal and external. The earning before interest and taxes of a firm are thus subject to many influences. These Influences may be peculiar to the firm, some are common to all the firms in the industry and some are related to the general economic conditions that affect all the firms in an uncertain world, EBIT in any period can out to be higher or lower than expected. Thus uncertainly with respect to EBIT often is referred to as business risk. Every business is subject to this risk. One major source of business risk is business cycle-the periods of business boom and recession. Other sources of business risk are technological changes obsolescence, government policies, actions of compertitor, shift in consumer preferences, changes in prices. Other unknown events and happenings,etc. The incidence of business risk is, therefore, unavoidable and not within the control of the firm. The degree of operating leverage measured by the formula.

Contribution____ is an index of business risk
Operting profit(EBIT)

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Operating profit_(EBIT) is used as an index of financial risk.
Earning before tax(EBIT)

Dow jones' theory: Dow jones' theory deals with the behaviour of share prices in the market. According to dow jones theory , the movements in the share prices on the share market can be classified into the following three major categories:-

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(a) The company would like that the issue is fully subscribed by its existing shareholders. For this purpose, it will have to keep the price at a level lower than the existing price being quoted on the stock exchange. For example, if the share is quoted at Rs. 16 at the stock exchange against its face value of Rs. 10, it is obvious that the right share cannot be issued at a premium of more than Rs. 6 Actually, it has to be issuedat a lower premium so that the existing shareholders are motivated to subscribe to it. The spread between the market price and the subscription price is of great importance. When the right shares are issued the upper limit of the premium is provided by the market price of that issue. The premium has to be fixed keeping in viewthe normal fall in the market price of a share when a right issue is announced. If the difference between the market price and the issue price of right share is low, a situatian may arise when due to fluctuations in the market, the price of the share may fall below the price at which the right shares are offered. In such a situation the rights issue will not be successful since the existing shareholder will prefer to buy the shares from the market. Many companies have come to great due to issuing right share in a falling market.

(b) The state of capital market and the trends there in are of main importance in determining the premium. The price of right share must be kept at a level that it absorbs the drop in the market price of the shares arising out of the declaration of the right issue. the normal fluctuations and the drop in the price due to the fact that the number of shares would now be larger than earlier. It must be realised that issue of rights share must take into account the expectationsof investors regarding the future outlook of the companv.

In conclusion the pricing of rights share should be such as the shareholders get an advantage even after the ditution of market price of the shares. If the price of the rights share becomes negative due to dilution in the market price of share, it is obvious that the shareholders will not subscribe to such shares.

Swaps is one of the new instruments in international capital market. It is the cost of exchanging one currency into another for a specified of time. The swap will represent an increase in the value of the forward exchange rato (a premium) of a decrease (discount). Swap has mainly two main categories, viz, interest rate swaps and currency swaps or combination of both.

In the interest swaps category, a fixed rate ot interest is swapped for a floating rate of interest or vice-versa. Here two parties agree to exchange the interestpayment on a national principal over a specified period without exchange of principal amount. Currency swaps allows an equity to redenominate a ioan from one currency into another currency. Here, both principal and interest in one currency are swapped for principal and interest in another currency.

Hedging on the other hand, is a transaction that limits the risk associated with market price fluctuation of securities The hedge means to take opposite positions in the cash market and the futures market. Hedges are undertaken to reduce the risk of adverse price movement.
Short hedges are used to protect against unexpected increasos in interest rates. A short hedge is formed when a long position in the cash is hedged by going short in the futures market. Long market hedges are used to protect against falling interest rates. A long hedge is formed when a short position in the cash market is hedged by going long in the future market.

Diversification vs. Divestment strategies

Diversification strategy is defined as a strategy in which growth objectives of a corporate unit are sought to be achieved by adding new product or service to the existing proruct line. According to steiner, diversification is producing new product for market involving quite different skilld, processes and knowlodge from those associated with current products and services or markets. Thus in diversification novel products are acquired and previously unexplored market are entered. During past two decades, business organisations have been pursuing diversification strategy for accomplishing greater growth and stability.

On the other hand, divestment strategy involves selling off or liquidating unprofitable business units or product divisions or sequence of business operations with negative cash flows. In divestment strategy, the organisation decides to get out of certain business and sell units or divisions. The basic objective underlying a divestment strategy is to prevent any particular unit or segment of business being a drag on the total profitability of the enterprise, particularly when opportunities of alternative investment exist.

Technical appraisal of projects

Viability test of project is to be carried out by examining the project from different aspects, one of them being technical espect of project appraisal. Technical examination of a project involves consideration of the following factors:

1. Feasibility of the selected technical process and its suitability under Indian conditions.
2. Scale of operations.
3. Location.
4. Plant and equipment and their specifications.
5. Plant layout.
6. Facilities for the supply of water, power and fuel.
7. Facilities for disposal of waste and also of the by-product, if any.
8. Availability for economies of the means of transport in the region be examined and ensured.
9. Arrangement for Raw materials and lobour.
10. Constrution schedule.
11. Cost estimates, including provision of operative expenses machinery spare-parts, working capital etc.

Financial feasibility study of new projects : when a new project is ventured upen, feasibility of it from different angles such as technical commercial and financial is studied both by the promoters and by lending financial mstitutions of these angles, financial feasibility is the most important as there can be no compromise as to this aspect of viability.

The important issues examined as part of financial feasibility study are:

1) Eastimates of the cost of the project.

2) Pattern of financing.

3) Profitability and cash flows.

4) Internal rate of return.

5) Debt service capacity.

Financial institutions, when they evaluate feasibility, are likely ti strees on debt service capability besides an assessment of managerial capability. From the angle of promoters, the emphasis is likely to be on the internal rate of return vis-a-vis the cost of capital.

Bridge finance: Bridge finance refers, normally, to loans taken by a business, usually from commercial banks for a short period, pending dusbursement of term loans by financial institutions. Normally ,it takes time for the financial institution to finalise procedures of creation of socurity, tie-up participation with other institution etc, even though a positive appraisal of the project has been made. However, once the loans are approved in priciple, firms in order not to lose further time in starting their projects, arrange for bridge finance. Such temporary loan is normally repaid out of the proceeds of the principal term loans. Generallythe rate of interest on bridge finance is 1% or 2% higher than on normal term loans.

Traditional theory of cost of capital : There are broadly, two approaches to determine the capital structure in relation to cost of capital. The older approach is referred to as the traditional theory and the later, called after the names of its propounders, the Miller-Modigliani Thepry.

Traditional theorists argue:

(a) that debt is cheaper than equity becouse of the tax shield on interest;
(b) that. therrfore, if debt is increased and equity part decreased, average cost of capital will be reduced.
(c) that, however, if debt is increased beyond certain leveles, investors will start perceiving greater degree of risk which in turn , will increase expectations and cost of capital ; and
(d) that, in the light of the above ,a solution to the capital structure problem will be in optimising debt vis-a-vis least rate for average cost of capital.
Thus, a firm should strive to reachthe optimal capital structure and increase its total valuation

through a judicious use of loan capital.

Common Size statements : One useful way of analysing financial statements is to convert them into common size statements by expressing absolute rupee amounts into percentage. In case of the income statements, all items of expense are exhibited in percentage of sales. Sales are taken at 100%. Similarly in balance sheet individual asset and liability is shown as a percentage of total Assets/Liabilities.

Common size statements preppared for a firm/company over the years would highlight the relative changes in each group of expenses, assets and liabilities. These statements are very useful in inter-firm comparisons.

An illustration of common size statement regarding the profit and loss statement of X Ltd. is given below:

Profit and loss statement

Net sales 100%
Cost of goods sold 50% / 50%
Gross profit
Selling, administration
and general expenses 25% / 25%
PBIT
Interest 10% / 15%
PBT
Tax PAT
concentration Banking is one of the methods for speeding up the process of collecting recievables. This helps in reducing the size of the float. Inthis metnod, a number of strategic collection centres in different regions are established instead of a single collection point. The system reduces the time period between the time a customer mails his remittances and the time when the funds became available for spending with the company.Payment recieved by the different collection centres are concentration bank of the head office. The bank with which the company has its major abnk account its normally located at the head office.

Factoring refer to the buying of trade receivables. One who buys trade receivables is called

'factor'. The following are the benefits of factoring:
i). Factoring eliminate the need for cash discounts.
ii). Suppliers of goods and services can concentrate on their making activies without worry for collection of receievables.
iii). Due to specialization , a factor can effect prompt and timely payment's.
iv). The dealer is saved of the cost of carrying debtors and maintaining collection department . It increase his return.
v). Factoring improves the liquidity of a firm.

One of the method of comparing two alternative proposals of capital expenditure is desirability factor or usually known as ' profitability index'. It is more relevant when we have to compare number of proposals each involving different amount of cash flows. Desirability factor is calculated as follows:

Sum of discounted net cash inflows
Initial cash outlay

Suppose we have three projects X,Y,Z, each involving an outlay of Rs 50,000 Rs 75,000 and 100,000 respectively. Further, the sum of the discounted cash inflows from projects are Rs 60,000 ,Rs 95,000 and 1,25,000 resectively.The desirability factors of these projects come to 1,2,1.267 and 1.25 respectively.In terms of absolute NPV, project Z has the highest NPV of Rs 25,000 whereas in terms of desirability factor, project Y which shows the highest profitability index, should be preferred. Thus desirability factor helps in ranking various projects, particularly when a situation of capital rationing prevails.

It is a short term unsecured promissory note sold by large business firm to arrange cash. These are sold either directly or through dealers companies with high credit rating can sell commercial papers was recommended by a working group on the money market, appointed by the Reserve Bank of India in 1986.

The main conditions for issues of commercial paper are :
i). The working capital (fund based) limit of a company should not be less than Rs 10 crores.
ii). The denomination could be in multiples of Rs 5 lakhs subject to a minimum investment by a

single investor of Rs 25lakhs (par value).
iii). Aggregate amount to be raised by issue of commercial paper should not exceed 30% of the company's working capital limit.
iv). The currency of the instrument is 3-6 months.
v). Credit rating of the company issuing commercial paper should not be below 3% by CRISIL.

Financial forecasting techniques: Forecating is the starting point in a planing process. The success of forecasting lies in the degree of accurany as well as the simplicity of the forecasting techniques. Now a day with the use of computers, highly sophisticated techniques can also be employed in financial forecasting. A new forecating techniqhes are briefly considered below.

(a) Precent of sales method : The simplest forecasting can be made by estimating the financial needs on a sides forecast . Any change in sales is likely to have an impact on various items of assets and liabilities. Hence , these items are expressed for changes in levels of activity . A sound knowledge of the relation between sales and assets is a prerequisite to the use of the method. This method is more suitable for short term forecasting.

(b) Simple regression method : With sales forecast as the starting point and based on the past relationship between sales and assets items, it is possible to construct a line of best fit or the regression line. It is possible to link sales with one it em of asset as a time. This method is more suitable for long term forecasting.

Zero coupon Bouns: These are bonds issued at a deep discount to their face value. their redemption will be at par on \\\\\\\\\\ and no interest coupon in between is admissible. The initial discount is so calculated to give a yield to maturity consistent with prevalling market alternatives. Zero coupon bonds are genarally issued to arbitrage tax barrier. In addition investors in zero coupon bonds have a view that interest rates are on a declining trend hence by buying zero coupon they buy instrument which not only lock in current market yields but also take into account the reinvestment of interest ////////// back at the current yield . These bonds are also known as pure discount bonds.

SEBI : The securities and Exchange Board of India (SEBI) is the nodel agency formed under an Act of Parliament i.e. (SEBI Act), 1992.The Act, is extended to whole of India and has come into force on 30th January, 1992. SEBI is entrusted with the task of regulating capital market and related issues in India. This has been established after the repeal of the Capital Issues Control Act, 1947.

SEBI has formulated a basic set of guidelines for disclosure and Investor Protection in 1992. These guildlines form the core of SEBI's regulation and cover various aspects such as pricing , promoter's contribution' look-in period ,credit rating etc.

SEBI had also taken steps for registration of all intermediaries in the captial market, prescring their code of conduct and enforcing market discipline etc.

Euro Issues : The Government of India, as a part of liberalistion and de-regulation of industry and to augment the financial resource of companies, has allowed companiesto directly tap foreign resouces for thier reguirements. The liberalised measures have boosted the confidence of foreign investors and provided an opporrunity to india-conpaniws to explose the possibility of tapping the International Captical Market for their financial requirements, where the resources are raised through the mechanism of Global Depository Receipts(GDRs0, A deposity receipt is basically a negotiable certificate, denominated in USdollars, that represents a non-US company's pubicly traded local currency(Indian rupee) equity shares. The depository receipt can also represent a debt instrument During the first half of the fiscal year 1994-95. Indian companies moblilsed more than $ 1 billion through GDR and Euro-convertible bond issues.

The guidelines for Euro-issues-1994-95 were announced by the government on May 11, 1994 However, the Finance Ministry has reviewed recently the guidelines
applicable to Euro -issues. The major features of Euro-issues are.

(1) The issue is in foreign currency.
(2) The issue is to investors outside India.
(3) It is under////////////////////////// and traded in by international syndicate of bank/financial institions.
The reasons for sudden spurt in such issues are:
(1) European market are flushed with funds.
(2) Euro investors are looking for higher yield than that available locally.
(3) Opening up of the Indian economy.

Venture capital

Venture capital may be for financing which is specially designed for high risk and high reward projects. It is direct investment in securities of new and new enterprises by way of private placement. It plays an important role not only in financing high technology projects but also helps to turn research and development into commercial production. Venture capital is also involved in fostering growth and development.

In India, venture capital scheme is of recent origin. In recent years, the moves to deregulate both industries and financial market, coupled with the country's defective infrastructure and strong domestic market have made this country ideal for formation of venture capital industry as a provider of development and risk capital prior of listing. Presently, in India, there are about 15 venture capital funds operating and have been promoted by both the private and public sector.

Systematic and Unsystematic Risk

Systematic risk is that part of total risk that results from the tendency of stock prices to move together with the general market. Some of the examples of systematic risk include market risk interest rate risk and purchasing power risk, etc. On the other hand, unsystematic risk is that portion of a security risk which emerges as a result of known and controllable factor. Some of the major, examples of unsystematic risk, include business risk, financial risk, default and insolvency risk and other risks. The basic distinction between two is that unsystematic risk is diversifiable and can be eliminated by increasing the number systematic risk is non-diversifiable and cannot be eliminated.

Indicators of social desirability of a project : In the context of project evaluation. It is not sufficientthat a project should only be commercially viable but it should also be socially desirable. The following are the indicators of social desirability of a project:

(1) Employment potential criterion : Projects which have higher employment potential are naturally preferred, particularly in developing countries.

(2) capital output ratio : This ratio shows the value of expected output in relation to the capital employed. Under this criterion, a project which gives a high output
per unit of capital is ranked high.

(3) value added per unit of capital of capital : In this, instead of taking the value of output, value added by the project is cansidered. It shows the net contribution of
a project to the national economy, hence a good indicator for ranking projects according to their economic importance.

(4) Foreign exchange benefit criterion : This seeks to evaluate the likely of a project on the overall balance of payments of the country. Project which promise to
earn more of foreign exchange are given preference.

(5) Cost benefit ratio criterion : This criterion attempts to measure the total effect of all the social benefits and costs of a project.

Marginal cost of capital : It is the cost of raising an additional rupee of capital. It is derived when the average cost of capital is computed with marginal weights. The weights represent the proportion of funds the firm intends to employ. The marginal cost of capitalis calculated with the intended financing proportion as weights. When the funds are raised in the same proportion and if the component costs remain unchanged, there will be no difference between average cost of capital and marginal cost of capital. The component costs may remain constant upto a certain level and then start increasing. In that case both the average cost and marginal cost will increase but the marginal cost of capital will rise at a faster rate.

Use of ratios for predicting sickness: A good deal of research has been done in using ratios for predicting sickness of an enterprise. Two types of studies viz, univariate and multi variate help in predicting. The former uses individual ratios whereas the latter encompasses several ratios. Studies have been conducted in India and abroad and the following ratios are used in prediction by the formulation of a model.

Cash flow to total debt, net income to total assets, total debt to total assets, working capital to total assets and current assets to current liabilities . These ratios were selected by Beaver.

Altman developed an empirical model using multiple discriminate analysis. His model was
Z = Overall index of the multiple discriminant function.
X1 = Working capital/Total Assets
X2 = Retained Earning/ Total Assets
X3 = EBIT/Total Assets
X4 = Market Value of Equity/ Book Value of Total liabilities
X5 = Sales/Total Assets

Depending on the value of Z, it was possible to predict the sickness. If Z score comes to more than 2.99 there is no danger of bankrupty, Z score below 1.81 indicates imminent insolvency and Z score between 1.81 and 2.99 shows the grey area. Similar models have been developed by other also.

Under capitalisation : It is a state where in a company does not have sufficient funds at its disposal to carry on its activities. The company may not have adequate arrangement for meeting its working capital requirement . This may also happen when some fixed assets acquired on lease are depleted. In an under- capitalised company, the current ratio will be low, hence liquidity is in danger. Profitability will be eroded and essential expenditure like repairs, maintenance, advertising, research and development also cannot be incurred. Under this situation, purchases cannot be made at a proper time and adequate inventories cannot be built up. The entire operating cycle is affected. Hence the company should take immediate steps for arrangement of funds to get rid of a situation of under capitalisation.

Bills discounting as a means of finance : Bill discounting is a short term source of finance. It can be either supplier bill (erchase) or for sale of goods. These can be discouted with Financial Institutions, Bank and non-banking finance companies.The Reserve Bank of India and the Central government have been placing emphasis on developing bill discounting culture . Bill discounting fee is generally taken up-front. To the extent cost should be adjusted to compare with other means of financing. Additional cost like stamp duty ,bank charges should also be taken into account . However, there is scope for misuse in forms of accommodation bill. Through billl ,it is easierto colllect interest for delayed payments.

Posted by anurag agnihotri at 11:27 AM 0 comments

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cash gets converted into cash again. This cycle is also known as " operating cycle " and can be depicted as follows.

Pricing of rights share: Provisions of section 81 (1) of the compenies Act, 1956 are applicable in cash of issue of Rights Share. The letter of offer of Right issue has to be vatted by SEBI. The determination of price of Right Share means the price at which the right share are to be issued. In other words, it requires the determination of the amount of premium at which right share are to be issued. This premium is determined taking into account the intrinsic worth of the share, the future profit earning capacity of the company and the existing market quotation of the share, if it listed on the stock exchange. The price of rights share has to be determined keeping in view the following two objectives.

(a) The company would like that the issue is fully subscribed by its existing shareholders. For this purpose, it will have to keep the price at a level lower than the existing price being quoted on the stock exchange. For example, if the share is quoted at Rs. 16 at the stock exchange against its face value of Rs. 10, it is obvious that the right share cannot be issued at a premium of more than Rs. 6 Actually, it has to be issuedat a lower premium so that the existing shareholders are motivated to subscribe to it. The spread between the market price and the subscription price is of great importance. When the right shares are issued the upper limit of the premium is provided by the market price of that issue. The premium has to be fixed keeping in viewthe normal fall in the market price of a share when a right issue is announced. If the difference between the market price and the issue price of right share is low, a situatian may arise when due to fluctuations in the market, the price of the share may fall below the price at which the right shares are offered. In such a situation the rights issue will not be successful since the existing shareholder will prefer to buy the shares from the market. Many companies have come to great due to issuing right share in a falling market.

(b) The state of capital market and the trends there in are of main importance in determining the premium. The price of right share must be kept at a level that it absorbs the drop in the market price of the shares arising out of the declaration of the right issue. the normal fluctuations and the drop in the price due to the fact that the number of shares would now be larger than earlier. It must be realised that issue of rights share must take into account the expectationsof investors regarding the future outlook of the companv.

In conclusion the pricing of rights share should be such as the shareholders get an advantage even after the ditution of market price of the shares. If the price of the rights share becomes negative due to dilution in the market price of share, it is obvious that the shareholders will not subscribe to such shares.

Swaps is one of the new instruments in international capital market. It is the cost of exchanging one currency into another for a specified of time. The swap will represent an increase in the value of the forward exchange rato (a premium) of a decrease (discount). Swap has mainly two main categories, viz, interest rate swaps and currency swaps or combination of both.

In the interest swaps category, a fixed rate ot interest is swapped for a floating rate of interest or vice-versa. Here two parties agree to exchange the interestpayment on a national principal over a specified period without exchange of principal amount. Currency swaps allows an equity to redenominate a ioan from one currency into another currency. Here, both principal and interest in one currency are swapped for principal and interest in another currency.

Hedging on the other hand, is a transaction that limits the risk associated with market price fluctuation of securities The hedge means to take opposite positions in the cash market and the futures market. Hedges are undertaken to reduce the risk of adverse price movement.
Short hedges are used to protect against unexpected increasos in interest rates. A short hedge is formed when a long position in the cash is hedged by going short in the futures market. Long market hedges are used to protect against falling interest rates. A long hedge is formed when a short position in the cash market is hedged by going long in the future market.

Diversification vs. Divestment strategies

Diversification strategy is defined as a strategy in which growth objectives of a corporate unit are sought to be achieved by adding new product or service to the existing proruct line. According to steiner, diversification is producing new product for market involving quite different skilld, processes and knowlodge from those associated with current products and services or markets. Thus in diversification novel products are acquired and previously unexplored market are entered. During past two decades, business organisations have been pursuing diversification strategy for accomplishing greater growth and stability.

On the other hand, divestment strategy involves selling off or liquidating unprofitable business units or product divisions or sequence of business operations with negative cash flows. In divestment strategy, the organisation decides to get out of certain business and sell units or divisions. The basic objective underlying a divestment strategy is to prevent any particular unit or segment of business being a drag on the total profitability of the enterprise, particularly when opportunities of alternative investment exist.

Technical appraisal of projects

Viability test of project is to be carried out by examining the project from different aspects, one of them being technical espect of project appraisal. Technical examination of a project involves consideration of the following factors:

1. Feasibility of the selected technical process and its suitability under Indian conditions.
2. Scale of operations.
3. Location.
4. Plant and equipment and their specifications.
5. Plant layout.
6. Facilities for the supply of water, power and fuel.
7. Facilities for disposal of waste and also of the by-product, if any.
8. Availability for economies of the means of transport in the region be examined and ensured.
9. Arrangement for Raw materials and lobour.
10. Constrution schedule.
11. Cost estimates, including provision of operative expenses machinery spare-parts, working capital etc.

Financial feasibility study of new projects : when a new project is ventured upen, feasibility of it from different angles such as technical commercial and financial is studied both by the promoters and by lending financial mstitutions of these angles, financial feasibility is the most important as there can be no compromise as to this aspect of viability.

The important issues examined as part of financial feasibility study are:

1) Eastimates of the cost of the project.

2) Pattern of financing.

3) Profitability and cash flows.

4) Internal rate of return.

5) Debt service capacity.

Financial institutions, when they evaluate feasibility, are likely ti strees on debt service capability besides an assessment of managerial capability. From the angle of promoters, the emphasis is likely to be on the internal rate of return vis-a-vis the cost of capital.

Bridge finance: Bridge finance refers, normally, to loans taken by a business, usually from commercial banks for a short period, pending dusbursement of term loans by financial institutions. Normally ,it takes time for the financial institution to finalise procedures of creation of socurity, tie-up participation with other institution etc, even though a positive appraisal of the project has been made. However, once the loans are approved in priciple, firms in order not to lose further time in starting their projects, arrange for bridge finance. Such temporary loan is normally repaid out of the proceeds of the principal term loans. Generallythe rate of interest on bridge finance is 1% or 2% higher than on normal term loans.

Traditional theory of cost of capital : There are broadly, two approaches to determine the capital structure in relation to cost of capital. The older approach is referred to as the traditional theory and the later, called after the names of its propounders, the Miller-Modigliani Thepry.

Traditional theorists argue:

(a) that debt is cheaper than equity becouse of the tax shield on interest;
(b) that. therrfore, if debt is increased and equity part decreased, average cost of capital will be reduced.
(c) that, however, if debt is increased beyond certain leveles, investors will start perceiving greater degree of risk which in turn , will increase expectations and cost of capital ; and
(d) that, in the light of the above ,a solution to the capital structure problem will be in optimising debt vis-a-vis least rate for average cost of capital.
Thus, a firm should strive to reachthe optimal capital structure and increase its total valuation through a judicious use of loan capital.

Common Size statements : One useful way of analysing financial statements is to convert them into common size statements by expressing absolute rupee amounts into percentage. In case of the income statements, all items of expense are exhibited in percentage of sales. Sales are taken at 100%. Similarly in balance sheet individual asset and liability is shown as a percentage of total Assets/Liabilities.

Common size statements preppared for a firm/company over the years would highlight the relative changes in each group of expenses, assets and liabilities. These statements are very useful in inter-firm comparisons.

An illustration of common size statement regarding the profit and loss statement of X Ltd. is given below:

Profit and loss statement

Net sales 100%
Cost of goods sold 50% / 50%
Gross profit
Selling, administration
and general expenses 25% / 25%
PBIT
Interest 10% / 15%
PBT
Tax PAT

concentration Banking is one of the methods for speeding up the process of collecting recievables. This helps in reducing the size of the float. Inthis metnod, a number of strategic collection centres in different regions are established instead of a single collection point. The system reduces the time period between the time a customer mails his remittances and the time when the funds became available for spending with the company.Payment recieved by the different collection centres are concentration bank of the head office. The bank with which the company has its major abnk account its normally located at the head office.

Factoring refer to the buying of trade receivables. One who buys trade receivables is called 'factor'. The following are the benefits of factoring:
i). Factoring eliminate the need for cash discounts.
ii). Suppliers of goods and services can concentrate on their making activies without worry for collection of receievables.
iii). Due to specialization , a factor can effect prompt and timely payment's.
iv). The dealer is saved of the cost of carrying debtors and maintaining collection department . It increase his return.
v). Factoring improves the liquidity of a firm.

One of the method of comparing two alternative proposals of capital expenditure is desirability factor or usually known as ' profitability index'. It is more relevant when we have to compare number of proposals each involving different amount of cash flows. Desirability factor is calculated as follows:

Sum of discounted net cash inflows
Initial cash outlay

Suppose we have three projects X,Y,Z, each involving an outlay of Rs 50,000 Rs 75,000 and 100,000 respectively. Further, the sum of the discounted cash inflows from projects are Rs 60,000 ,Rs 95,000 and 1,25,000 resectively.The desirability factors of these projects come to 1,2,1.267 and 1.25 respectively.In terms of absolute NPV, project Z has the highest NPV of Rs 25,000 whereas in terms of desirability factor, project Y which shows the highest profitability index, should be preferred. Thus desirability factor helps in ranking various projects, particularly when a situation of capital rationing prevails.

It is a short term unsecured promissory note sold by large business firm to arrange cash. These are sold either directly or through dealers companies with high credit rating can sell commercial papers was recommended by a working group on the money market, appointed by the Reserve Bank of India in 1986.

The main conditions for issues of commercial paper are :
i). The working capital (fund based) limit of a company should not be less than Rs 10 crores.
ii). The denomination could be in multiples of Rs 5 lakhs subject to a minimum investment by a single investor of Rs 25lakhs (par value).
iii). Aggregate amount to be raised by issue of commercial paper should not exceed 30% of the company's working capital limit.
iv). The currency of the instrument is 3-6 months.
v). Credit rating of the company issuing commercial paper should not be below 3% by CRISIL.

Financial forecasting techniques: Forecating is the starting point in a planing process. The success of forecasting lies in the degree of accurany as well as the simplicity of the forecasting techniques. Now a day with the use of computers, highly sophisticated techniques can also be employed in financial forecasting. A new forecating techniqhes are briefly considered below.

(a) Precent of sales method : The simplest forecasting can be made by estimating the financial needs on a sides forecast . Any change in sales is likely to have an impact on various items of assets and liabilities. Hence , these items are expressed for changes in levels of activity . A sound knowledge of the relation between sales and assets is a prerequisite to the use of the method. This method is more suitable for short term forecasting.

(b) Simple regression method : With sales forecast as the starting point and based on the past relationship between sales and assets items, it is possible to construct a line of best fit or the regression line. It is possible to link sales with one it em of asset as a time. This method is more suitable for long term forecasting.

Zero coupon Bouns: These are bonds issued at a deep discount to their face value. their redemption will be at par on \\\\\\\\\\ and no interest coupon in between is admissible. The initial discount is so calculated to give a yield to maturity consistent with prevalling market alternatives. Zero coupon bonds are genarally issued to arbitrage tax barrier. In addition investors in zero coupon bonds have a view that interest rates are on a declining trend hence by buying zero coupon they buy instrument which not only lock in current market yields but also take into account the reinvestment of interest ////////// back at the current yield . These bonds are also known as pure discount bonds.

SEBI : The securities and Exchange Board of India (SEBI) is the nodel agency formed under an Act of Parliament i.e. (SEBI Act), 1992.The Act, is extended to whole of India and has come into force on 30th January, 1992. SEBI is entrusted with the task of regulating capital market and related issues in India. This has been established after the repeal of the Capital Issues Control Act, 1947.

SEBI has formulated a basic set of guidelines for disclosure and Investor Protection in 1992. These guildlines form the core of SEBI's regulation and cover various aspects such as pricing , promoter's contribution' look-in period ,credit rating etc.

SEBI had also taken steps for registration of all intermediaries in the captial market, prescring their code of conduct and enforcing market discipline etc.

Euro Issues : The Government of India, as a part of liberalistion and de-regulation of industry and to augment the financial resource of companies, has allowed companiesto directly tap foreign resouces for thier reguirements. The liberalised measures have boosted the confidence of foreign investors and provided an opporrunity to india-conpaniws to explose the possibility of tapping the International Captical Market for their financial requirements, where the resources are raised through the mechanism of Global Depository Receipts(GDRs0, A deposity receipt is basically a negotiable certificate, denominated in USdollars, that represents a non-US company's pubicly traded local currency(Indian rupee) equity shares. The depository receipt can also represent a debt instrument During the first half of the fiscal year 1994-95. Indian companies moblilsed more than $ 1 billion through GDR and Euro-convertible bond issues.

The guidelines for Euro-issues-1994-95 were announced by the government on May 11, 1994 However, the Finance Ministry has reviewed recently the guidelines
applicable to Euro -issues. The major features of Euro-issues are.

(1) The issue is in foreign currency.
(2) The issue is to investors outside India.
(3) It is under///////////////////////// and traded in by international syndicate of bank/financial institions.

The reasons for sudden spurt in such issues are:
(1) European market are flushed with funds.
(2) Euro investors are looking for higher yield than that available locally.
(3) Opening up of the Indian economy.

Venture capital

Venture capital may be for financing which is specially designed for high risk and high reward projects. It is direct investment in securities of new and new enterprises by way of private placement. It plays an important role not only in financing high technology projects but also helps to turn research and development into commercial production. Venture capital is also involved in fostering growth and development.

In India, venture capital scheme is of recent origin. In recent years, the moves to deregulate both industries and financial market, coupled with the country's defective infrastructure and strong domestic market have made this country ideal for formation of venture capital industry as a provider of development and risk capital prior of listing. Presently, in India, there are about 15 venture capital funds operating and have been promoted by both the private and public sector.

Systematic and Unsystematic Risk

Systematic risk is that part of total risk that results from the tendency of stock prices to move together with the general market. Some of the examples of systematic risk include market risk interest rate risk and purchasing power risk, etc. On the other hand, unsystematic risk is that portion of a security risk which emerges as a result of known and controllable factor. Some of the major, examples of unsystematic risk, include business risk, financial risk, default and insolvency risk and other risks. The basic distinction between two is that unsystematic risk is diversifiable and can be eliminated by increasing the number systematic risk is non-diversifiable and cannot be eliminated.

Indicators of social desirability of a project : In the context of project evaluation. It is not sufficientthat a project should only be commercially viable but it should also be socially desirable. The following are the indicators of social desirability of a project:

(1) Employment potential criterion : Projects which have higher employment potential are

naturally preferred, particularly in developing countries.

(2) capital output ratio : This ratio shows the value of expected output in relation to the capital employed. Under this criterion, a project which gives a high output per unit of capital is ranked high.

(3) value added per unit of capital of capital : In this, instead of taking the value of output, value added by the project is cansidered. It shows the net contribution of a project to the national economy, hence a good indicator for ranking projects according to their economic importance.

(4) Foreign exchange benefit criterion : This seeks to evaluate the likely of a project on the overall balance of payments of the country. Project which promise to earn more of foreign exchange are given preference.

(5) Cost benefit ratio criterion : This criterion attempts to measure the total effect of all the social benefits and costs of a project.

Marginal cost of capital : It is the cost of raising an additional rupee of capital. It is derived when the average cost of capital is computed with marginal weights. The weights represent the proportion of funds the firm intends to employ. The marginal cost of capitalis calculated with the intended financing proportion as weights. When the funds are raised in the same proportion and if the component costs remain unchanged, there will be no difference between average cost of capital and marginal cost of capital. The component costs may remain constant upto a certain level and then start increasing. In that case both the average cost and marginal cost will increase but the marginal cost of capital will rise at a faster rate.

Use of ratios for predicting sickness: A good deal of research has been done in using ratios for predicting sickness of an enterprise. Two types of studies viz, univariate and multi variate help in predicting. The former uses individual ratios whereas the latter encompasses several ratios. Studies have been conducted in India and abroad and the following ratios are used in prediction by the formulation of a model.

Cash flow to total debt, net income to total assets, total debt to total assets, working capital to total assets and current assets to current liabilities . These ratios were selected by Beaver.

Altman developed an empirical model using multiple discriminate analysis. His model was

Z = Overall index of the multiple discriminant function.

X1 = Working capital/Total Assets

X2 = Retained Earning/ Total Assets

X3 = EBIT/Total Assets

X4 = Market Value of Equity/ Book Value of Total liabilities

X5 = Sales/Total Assets

Depending on the value of Z, it was possible to predict the sickness. If Z score comes to more than 2.99 there is no danger of bankrupty, Z score below 1.81 indicates imminent insolvency and Z score between 1.81 and 2.99 shows the grey area. Similar models have been developed by other also.

Under capitalisation : It is a state where in a company does not have sufficient funds at its disposal to carry on its activities. The company may not have adequate arrangement for meeting its working capital requirement . This may also happen when some fixed assets acquired on lease are depleted. In an under- capitalised company, the current ratio will be low, hence liquidity is in danger. Profitability will be eroded and essential expenditure like repairs, maintenance, advertising, research and development also cannot be incurred. Under this situation, purchases cannot be made at a proper time and adequate inventories cannot be built up. The entire operating cycle is affected. Hence the company should take immediate steps for arrangement of funds to get rid of a situation of under capitalisation.

Bills discounting as a means of finance : Bill discounting is a short term source of finance. It can be either supplier bill (erchase) or for sale of goods. These can be discouted with Financial Institutions, Bank and non-banking finance companies.The Reserve Bank of India and the Central government have been placing emphasis on developing bill discounting culture . Bill discounting fee is generally taken up-front. To the extent cost should be adjusted to compare with other means of financing. Additional cost like stamp duty ,bank charges should also be taken into account . However, there is scope for misuse in forms of accommodation bill. Through billl ,it is easierto colllect interest for delayed payments.

Posted by anurag agnihotri at 11:27 AM 0 comments

introduction to the financial management

Financial management is a specialized functional field dealing with the management of finance right from estimation and procurement till its effective utilization in the business. It is an area looked after by the finance manager who deals with the following issues:
i). Which new proposals for employing capital should be accepted by the firm ?
ii). How much working capital will be needed to support the firm's operations ?
iii). Where should the firm go to raise long term capital and how much will it cost ?
iv). Should the firm declare dividend on its equity capital and if so, how large a dividend should be declared ?
v). What steps can be taken to increase the value of firm's equity capital?

The above issues are solved by taking three major decisions (1) Investment decision (2) Financing decision (3) Dividend decision. As objective of the Financial Management is to maximize the value (i.e. wealth of shareholders). the firm should strive for an optimal combination of the there interrelated decisions solved jointly .The decisions to invest in a new capital project, for example, necessities financing the investment. The financing decisions in turn, influences and is influenced by the dividend decision. The retained earnings used in internal financing represents dividends foregone by the shareholders. With a proper conceptual frame work, joint decisions that tend to be optimal can be reached .

1) Financial management is a process to
Function of fib dividend
g Estimate the requirement of found k
g How to arrange the found k financial
g How to invest or utilised k
2) It is the efficient managment of the financial assets. Its objectives are the maximization of wealth and profit maximization.

FINANCIAL TOOLS

Financial tools are the techniques that can be employed by the finance manager to solve the problem properly effectively and efficiently. The following are the financial tools:
1) Ratio analysis
2) Fund flow and cash flow analysis

3) Cash budget
4) ABC analysis
5) EOQ model
6) Ageing schedule
7) Projected financial statements
8) Long - term investment appraisal tools - pay back period, net present value, profitability index internal rate of return. etc.
9) Cost of capital
10) Leverages
11) Hedging

APPROCHES / MEANING OF F.M.

The basic message behind the statement " Financial Management is concerned with the solutions of the three major decisions a firm must make the investment decision, the financing decision and the dividend decision " is self evident.
A firm wants to earn profit because the founders of the firm believe that there is an opportunity to make profitable investment. This profitable investment need to be financed and profit distributed amongst those who have contributed the capital. Hence, there is need for decisions such as how to finance investment ? How to distribute profit among shareholders ?

Modern approach of financial management basically provides a conceptual and analytical framework for financial decision making. It emphasises on an effective use of fund. According to this approach the financial management can be broken down into three different decisions:
1) Investment Decisions;
2) Financing Decisions; and
3) Dividend Decisions

1) Investment Decisions : These involve the allocation of resources among various type of assets. what portion of the firm's fund should be invested in various current assets such as cash. marketable securities and receivable and what portion in fixed assets, such as inventories and plant and equipment. The assets mix affects the amount of income the firm can earn.For example, a manufacturer is in business to earn income with fixed assets such as machinery and not with current assets. However, placing too high a percentage of its assets in new building or new machinerymay leave the firm short of cash to meet an unexpected need or exploit sudden opportunity. The firm's financial manager must invest in fixed assets. but not too much. Besides determining the assets mix financial manager must also decide what type of fixed and current

assets to acquire. All this covers area pertaining to capital budgeting and working capital management.

2) Financing Decision : It is the next step in financial management for executing the investment decisions once taken a look at the balance - sheet of a company indicates that it obtains finance from shareholders ordinary, preference, debentureholders, or long - term loans from the institutions, bank and other sources. There are variations in the provisions contained in preference shares, debentures, loans papers etc. Thus financing decisions i.e. the financing mix of capital structure. Efforts are made to obtain an otimal financing mix for a particular company. This necessitates study of capital structure as also the short and intermediate term financing plans of the company.

In more advanced companies financing decision today , has become fully - integrated with top - management policy formulation via capital budgeting, long - range planning , evalution of alternate uses of funds and establishment of measurable standards of performance in financial terms.

3) Dividend Decisions : The third major decision of financial management is the decision relating to the dividend policy. The dividend decision should be analysed in relation to the financing decision of a firm . Two alternatives are available in dealing with the profits of a firm; they can be retained in the business. Which courses should be followed - dividend or retention ? One: the dividend pay out ratio i.e. what proportion of net profits should be paid out to the shareholders. The decision will depend upon the preference of the shareholders and investment opportunities available within the firm. The second major aspect of the dividend decision is the factors determining dividend policy of a firm in practice

All the above decision of finance are inter - related with one another. Any decision undertaken by the firm in one area has its impact on other areas as well. For example acceptance of an investment proposal by a firm affects its capital structure and dividend decision as well. So these decision are inter - related and should be taken jointly so that financial decision is optimal. All the financial decision have ultimately to achieve the firm's goal of maximisation of shareholders wealth.

Modern Approach to corporate finance in an improvement on the Traditional Approach : company finance is identified with raising of funds in meeting financial needs and fulfilling the set objectives of a company. At the outset in the early
years corporate finance was confined to :

1) Arrangement of funds from financial institutions.
2) Mobilising funds through financial institutions.
3) looking after the legal and accounting relationship between corporate unit and its sources of funds.

The traditional approach to corporate finance laid emphasis on the external fund. But the subject or corporate finance spreads itself wider and wider. In the changed scenario the scope and importance of corporate finance has been greatly widened. onalNow it not only includes the traditional and conventional role of taking decision viz, investment, financing and dividend but also covers the area of reviewing and controlling decision to commit funds to new and on going uses.

The field underwent a number of significant changes - new financial instrument and transactions like options on future contracts, foreign currency swaps, and interest rate swaps, GDR (Global Depository Receipts), globalisation of capital market, liberalisation measures taken by various government - all these have emphasised the need for effective and efficient modern approach to corporate finance.

The modern approach to corporate finance lay emphasis that the corporate unit must make the best and most efficient use of finances available to it. Accordingly the central theme of financial policy is the wise use of funds and a rational matching of advantage of potential uses against the cost of alternative potential useu with a desire to reach the set financial goals. It facilitates the key - how large should an undertaking be, in what form assets should beheld with capital market.

Given the existing legal, poltical and economic environment the modern approach entails a conceptual framework and is concerned with issues like -
(a) - financial goals or corporate unit;
(b) - adequacy of capita - maintaining minimum levels of capital to support the perceived risks ;
(c) - controls of client's money.
(d) - measuring the performance of the company.
(e) - position of the firm within the group.

Thus it is quit obvious that the modern approach to corporate finance is an extension as well as an improvement on the traditional approach.

Profitability may not always assure liquidity :
Profitability is the ratio of profit per rupee of sales/ investment. It reflects the firm's ability to generate profits per unit sales. If sales lack sufficient margin of profit, it is difficult for the business enterprise to cover its fixed costs, including fixed charges on debt and to earn profit for shareholders. The net profit margin indicates the firm's ability to generate profits after paying all taxes and expenses. The ratio reflects the ability of the firm to utilise its assets effectively.

Profitabitity thus is a measure of efficiency and the search for provides an incentive to achieve efficiency. It also indiean public acceptance of the firm's product and shows that the firm can produce competitively. In addition it is profits which generate resources for repaying debt incurred to finance the project and internal financing of expansion.

Liquidity on the other hand may be defined as the firm's ability to meet its short term and current obligations on the becoming due for payment. It reflects the ability to convert its assets into cash to pay its dues on schedule and in perquisite for the very survival of a firm. Liquidity is assessed through the use of ratio analysis. These ratio help analy the present cash solvency of a firm and its ability to remain solvent in the event of umexpected occurrence.

While short term creditors of the firm as interested in the short term solvency or liquidity of a firm, liquidity implies the ability to meet the demands of creditors and business. The three motives which affect the management's attitude towards liquidity are (1) Transaction motive ; the firm must maintain adequate cash to meet its short term liabilities covering a period of upto one year (2) Precautionary motive . idle cash must be maintained to meet unexpected demands for funds due to occurrence of unforescen circumstances ; and (3) Speculative motive ; the management may like to maintain adequate funds to take advantage of an unexpected bargain / deal when may come its way in the near future.

While both liquidity and profitability are efficient financial management of a firm, these are basically contradictory financial decision. Decision taken by the finance manager to increase profitability generally strain the liquidity position of a firm. For example a firm may opt for debt financing vis -a - vis equity financing due to the inbuilt tax (leverage) advantage. The decision however is likely to strain the liquidity position of the firm, due to the periodic interest and re - payment obligations. Equity financing however places no such obligation on the firm, and the decision to pay dividend is discretionary. With increase in debt component in the capital structure of a firm, the expeuted profitability goes up . Although endangering liquidity in the process. The financial manager's jb therefore entails maintaining a balance between liquidity and profitability. While maximising returns he must ensure maintenance of sale liquidity position for the firm.

Principles of financial Decision Making :

All major business decisions have financial implications. For example , should the firm expand; what would be the best way to finance an expansion; which proposal would generate more revenue ; which would result in the greatest long - term benefit and how to produce it ? What price to charge for it ? Finance scholars and proffessional have developed a body of theory and a set of tools. These are the principles of financial decision making .

At the outset, there are two basic principles of financial decision making viz .

(1) Time value of money , i.e. value maximisation.

(2) risk / exected return trade off.

(A) Time value of money or value maximisation :

The time value of money refers to the fact that a rupee available for use immediately is more valueble than a rupee that will become available use only later.

This is the most basic principle in finance. Why a rupee today is worth more than a rupee a year from now ? For instance, the interest rate today on saving is 9% and the rupee deposited today will grow total value of Rs 1.09 in one year.

The saver is committing a present value of Re . 1 for a future value of Rs 1.09. The concept of the time value of money is extremely important for all financial decision.

(B) Risk / expected trade off :

Return is the percentage change in the value of an investment over a period of time. For a risky investment, the expected return is the planned or anticipated return from the invesment.

These consideration of risk and expected return lead to general principle of great importance. Investors make a risky investment only if the expected return from the risky investment justify the risk.

Imp note : All the above decision should be taken after considering risk and return relationship.

(1) Cost element - While taking financial decision, cost element should be taken into consideration. It is the most vital concept and represents a standard for allocating the firm's investible funds in the most optimum manner.
(2) Risk element - This is another important factor to be considered before arriving at an investment involves risk, its return is uncertain. Financial decision should be made only when the expected returns from the risky investment justify the risk.
(3) Liquidity and profitability - Financial managers should made decision which would capable of generating both liquidity and profitability. Liquidity is very important to meet short - term requirement. Further it is necessary for ensuring solvency. Profitability is required to meet objectives of share holders. But there is a tangle between profitability and liquidity. Therefore financial decision should be made in such a way which have a balanced mixture of liquidity and profitability.
(4) Leverage effects - The financing decision is a significant one as it influences the shareholder's return and risk. The new financing decision may affect a company's debt - equity mix. The effect of leverage may be favourable or unfavourable. EPS is the vital concept of company and therefore financial decisions should be made after analysing leverage affect .
(5) Prevailing environment in the company as well as in the industry - Financial decision should be made in accordance with the conditions prevailing both in the company as well as in the industry. This is necessary to meet the challenges of competitiors. In order to derive optimum advantage of the industry, competitors strategy on various decision like production, pricing should be carefully followed before making financial decisions.
Besides these factors, suitability and diversification factors also have to be kept in mind.
(6) Diversification
(7) Suilability
Financial management as a science or as an art :
Financial management is science or an art is a debatable issue. In true sense. neither it is pure science like physics, not it is an art like painting. It lies somewhere between two extremes. It is science because it is based on theoretical prepositions and procedures adopted in the business enterprises. The subject matter of the financial management in addition to theoretical propositions includes the body of rules and regulations. It also takes the help of statistical techniques, econometric models, operational research and computer technology for

solving corporate financial problems.
These problems may be budgeting decisions, choice of investment acquisition or allocation of funds, locating sources of capital and various other areas In this way the nature of financial management is nearer to the applied science as it envisages the sue of classified and tested knowledge in solving business problems.

Despite the use of scientific method in the area of financial management there remains a wide application of value judgement in financial decision - making. Application of mathematical or computer based packages provide in many cases no solutions unless human thinking and skills are appiled or making choice. thus the application of human judgement sills skills become neceesary in many cases, such judgement is based on experience of a particular financial manager making the decisions. The application of human judgement in the decision making makes financial management an art along with its features of science. Thus in this way knowledge of facts, principal and concepts as well as personal involvement of finance manager along with application of skills in the analysis and decision-making process the financial management both science as well art.

Globalisation & Liberalisation & Financial Management :

Globalisation means integration of nationanl economy to the world economy. In economic sense globalisation refers borderless world where there is free flow of money and currencies. ideas and exertise , postering patnership and allian to serve the customers best financial decision making deals with financial matter of a corporate enterprise i.e. kind of assests to be acquired , patten captain structure and distribution of assets and investment

(1) Complicates the task of investment decision : Presently the invetment decision making has become a complicated and tendious exercise. Corporate units now alongwith national conditions also takes into account global view i.e. foreign exchange risk exposure, economic, political, legal and tax parameters while making investment decisions. It demands higher level of expertise from finance executives to understand the situation and to arrive at optimal investment decision.

(2) Widens the scope raising the funds : Corporate units now have access to foreign market to raise the resources at competitive rates. Foreign intitutional investors and NRI may also participate in this process and this help in attaining the least cost capital structure.

(3) Dividend decision have to be taken in the light of global scenario and available portfolio opportunities, and internal needs of the corporate units.

Liberalisation is a process which is aimed at to create an atmosphere of free competition among different agent of production and distribution of goods and services, finance and trade both public and private, demestic and foreign, small and large alike. The major components of liberalisation process includes changes in industrial policy which amounted to redical transformation of the entire industrial environment. The major impact of liberalisation on the Indian industry include the following:

1. Optimum utilisation of financial, material and human resources;
2. Effective role of market mechanism in determination of allocation of resources;
3. Boost in trade and commerce;
4. Encouragament of foreign investment and integration of country's economy with global economy;
5. Increase in number of foreign collaborations and transfer of technologies;
6. Capital inflows and improvement in foreign reserve position;
7. Development of infrastructure.

8.Financial Markets :

It is a market where buyer's and sellers meet to exchange things for money. Financial markets can be divided into :

(a) Money Market
(b) Capital Market

Money Market refers to open - market operations in highly marketable instrument like bills of exchange etc.

Capital market is again can be divided into :

(a) PRIMARY MARKET
(b) SECONDARY MARKET

New issues of shares and debt securities are made in the primary market and existing securities are traded in the secondary market

Primary market can have following three segment :

(a) PUBLIC ISSUE
(b) RIGHT ISSUE
(c) PRIVATE PLACEMENT

Secondary market again can be divided into three segment :
(a) STOCK EXCHANGE [23 stock exchange in India]
(b) National stock Exchange
(c) Over the counter Exchange of India.

9.GLOBALISSTION OF FINANCIAL MARKET :
With the economic reforms, in the financial sector in India, the financial markets of India have been integrate with the financial markets in other parts
of would. The financial liberalisation in India has enabled the India companies to source funds from the inter- national market through EVRO-ISSUES.

International market [Euro Marker] can again be dividend into :
a) INTERNATIONAL MONEY MARKET
b) INTERNATIONAL CAPITAL MARKET

Financial sector reforms and financial management :
Financial sector reform is one of the important component of economic reforms initiated by the government of india to boost its economy and also to intenrate ot to the world economy. “The reform objective in our out country in largely to promot adiversified efficient and a competitive financial system. It aims at raising the following the allocative efficiency of available saving increasing the return on investments and promoting the accelerated growth and development of the real sector, Specifi goals of the programme include:

i). to correct and improve the macro-economic policy setting within which banks operate. This involve monetary control reforms including rationalization of interest rates, redesigning direct credit programmes, and bringing down the level of resource pre-emptions:
ii). To improve the financial health and condition of banks by recapitalizing banks, restructurning the weak ones and improving the incetive under which banks function:
iii). To build financial institution and infrastructure relating to supervision . audit technology and leg framework.
iv). To improve the level of managerial competence and the quality of human resource by reviewing policies recruitiment , training , placement etc.
v). To improve access to financial saving.
vi). To reduce intermediating costs and distortions in the banking system.

vii). To promote competition through a level playing field and freer entry and exit in the financial sector.
viii). To develop transparent and efficient capital and money markets.

In India, financial sector reforms are confined to banking and financial institutions.

In recent years, the government of India along with other regulatory bodies have undertaken various steps to make financial sector more competitive , efficient, transparent and flexible. Some of these step in this reguard include following:

Reducing in statutory Liquidity ratio, cash reserve ratio and interest rate , SCP,CRR & interest .
Permission to set up banks under private sector .
Floating interest rate on financial assistance by some all India development banks.
Strengthening the supervisory process.
Instilling a greater element of competition.
Introduction of various financial institutions and instruments.
o
However, the financial sector reforms addressed on the issue like rate of interest and prudential norms.

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i am a lecturer in management, finanace and laws in the Delhi college of advanced studies Affiliated to GGSIP university. My qulifications: M.Com, LLM,AICWAI, MBA(Fin), MBA(HR), PGDIPR