SMIT SIR COMMERCE

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ORGANISATION OF COMMERCE AND MANAGEMENT

STANDARD 12

CHAPTER 8

Financial Management

Complete Concept Notes | Simple Explanations | Examples | Exam Preparation

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Learn the Concept. Understand the Logic. Write Better Answers.

Chapter at a Glance

Finance is the lifeblood of business. Financial management is concerned with acquiring funds, using them properly, making investment and financing decisions, deciding dividend policy, and maintaining the right balance between fixed and working capital.

Stage	Topic	What You Learn
1	Financial Management	Concept, definition, characteristics, objectives and importance
2	Financial Decisions	Investment, financing and dividend decisions
3	Capital Structure	Concept, ideal capital structure, types and affecting factors
4	Working Capital	Meaning, gross/net working capital, characteristics and factors
5	Fixed Capital	Meaning, characteristics, need and affecting factors
6	Fixed vs Working Capital	Important board-style distinction

EXAM IMPORTANT

Very high-value areas: profit vs wealth maximisation, financial decisions, ideal capital structure, types of capital structures, factors affecting capital structure, working capital, fixed capital, and differences.

Learning Objectives

- define financial management in simple and academic language.
- explain the characteristics and objectives of financial management.
- distinguish profit maximisation and wealth maximisation.
- explain the importance of financial management.
- understand investment, financing and dividend decisions.
- explain capital structure, ideal capital structure and its types.
- explain internal and external factors affecting capital structure.
- define gross and net working capital and explain working-capital characteristics.
- explain factors affecting working capital and fixed capital.
- differentiate fixed capital and working capital.

SMIT SIR'S NOTE

The easiest chapter logic is: Get Money -> Invest Money -> Decide Debt/Equity Mix -> Manage Day-to-Day Funds -> Manage Long-Term Assets.

8.1 Concept and Definition of Financial Management

Meaning: Financial management means management of finance functions in the routine activities of business. It includes decisions relating to acquisition, allocation, use and review of funds.

In Simple Words: Financial management answers three questions: How much money is needed? From where should it come? How should it be used?

KEY TERM - FINANCIAL MANAGEMENT

Managerial activity concerned with acquiring funds, allocating and using them efficiently, and reviewing financial decisions.

Source framing: The chapter cites thinkers such as F. W. Paish, Raymond J. Chambers and Prof. M. Kimbal to emphasize acquisition of funds, implementation of financial decisions and optimum utilisation.

REMEMBER THIS

Finance is not only 'raising money'. It also includes proper use and allocation of money.

8.1.1 Characteristics of Financial Management

No.	Characteristic	Core Idea
1	Branch of Management	Financial management is a specialized management function.
2	Wide Scope	It covers acquisition, allocation, use, control and financial decisions.
3	Base of Management	Finance supports every business activity and managerial function.
4	Relation with Financial Decisions	Investment, financing and dividend decisions are central.
5	Objective of Maximisation of Wealth	Modern financial management emphasizes owners' wealth.
6	Key Position	Finance occupies a central position in business decision-making.
7	Relation with Other Areas	It is linked with production, marketing, HR and other functions.
8	Decisions are for Future	Financial decisions have long-term consequences.

1. Branch of Management

Explanation: Financial management is a specialized branch dealing with finance-related activities.

Teacher Example: A finance manager plans the firm's funding and investment decisions.

2. Wide Scope

Explanation: Its scope includes raising funds, allocating funds, controlling use and reviewing financial results.

Teacher Example: A company raises debt, invests in machinery and monitors cash flows.

3. Base of Management

Explanation: Without sufficient finance, other managerial and business activities cannot be performed effectively.

Teacher Example: Production cannot begin without funds for material, wages and machinery.

4. Relation with Financial Decisions

Explanation: Financial management is strongly connected with investment, financing and dividend decisions.

Teacher Example: Management must decide whether to invest in a new plant, issue shares, or retain profit.

5. Objective of Maximisation of Wealth

Explanation: Modern financial management gives importance to increasing the economic wealth of owners/shareholders.

Teacher Example: A decision is preferred when it increases long-term value rather than merely short-term profit.

6. Key Position

Explanation: Finance is required throughout business operations and therefore occupies a central position.

Teacher Example: Every department depends on approved financial resources.

7. Relation with Other Areas

Explanation: Finance is connected with production, marketing, personnel and other departments.

Teacher Example: Marketing campaigns need budgets; production needs capital; HR needs salary funds.

8. Decisions are for Future

Explanation: Many financial decisions affect the business for several years.

Teacher Example: A plant investment today influences cost and earnings for years.

8.1.2 Objectives of Financial Management

The chapter presents two major approaches:

Objective	Meaning
Profit Maximisation	Maximise accounting profit / earnings of the business.
Wealth Maximisation	Maximise the economic wealth/value of owners or shareholders.

A. Objective of Profit Maximisation

Meaning: Profit maximisation aims at increasing the profit of the business.

Why attractive: Profit is important for survival, growth and reward to owners.

Limitations of this approach:

- Ambiguity: 'Profit' can be defined in different ways.
- Ignores time value: It may not distinguish profit received now from profit received much later.
- Ignores risk: Two alternatives with equal profit may carry very different risk.
- May encourage short-term decisions: Immediate profit may be preferred even when long-term value suffers.

SMIT SIR'S NOTE

The source chapter treats profit maximisation as an older approach and contrasts it with wealth maximisation.

B. Objective of Wealth Maximisation

Meaning: Wealth maximisation aims to maximise the present value / economic wealth of owners by considering future cash flows, time and risk.

Why considered superior in modern finance:

- considers the time value of money.
- considers risk and uncertainty.
- focuses on long-term value rather than only short-term accounting profit.
- provides a clearer decision criterion for owners' economic welfare.

Teacher Example: Project A gives slightly lower immediate profit but much stronger and safer long-term cash flows. Wealth maximisation may prefer A even if short-term profit is lower.

EXAM IMPORTANT

Easy difference: Profit Maximisation = accounting profit focus. Wealth Maximisation = value + time + risk focus.

Profit Maximisation vs Wealth Maximisation

Basis	Profit Maximisation	Wealth Maximisation
Main Focus	Accounting profit	Owners' economic value / wealth
Time Value	Generally ignored	Considered
Risk	May be ignored	Considered
Time Horizon	Can encourage short-term focus	Long-term focus
Decision Quality	Less comprehensive	More comprehensive in modern finance

8.1.3 Importance of Financial Management

- Financial planning: Helps estimate financial needs and arrange funds.
- Optimum utilisation: Ensures funds are used productively.
- Capital structure decisions: Helps choose an appropriate debt-equity mix.
- Investment decisions: Supports selection of profitable investment opportunities.
- Dividend decisions: Helps balance distribution and retention of profit.
- Liquidity and solvency: Helps maintain the ability to meet obligations.
- Co-ordination: Supports other departments through proper allocation of finance.
- Growth and survival: Sound financial decisions support expansion and stability.

EXAM IMPORTANT

For 'importance', connect every point with one of three themes: raise funds, use funds, protect business value.

8.2 Financial Decisions

Decision	Main Question
Investment Decision	Where should funds be invested?
Financing Decision	From which sources should funds be raised?
Dividend Decision	How much profit should be distributed and how much retained?

REMEMBER THIS

Three finance decisions: Invest - Finance - Dividend.

8.2.1 Decisions Related to Investment

Meaning: Investment decision is concerned with selecting assets or projects in which business funds should be invested.

Long-term investment: Investment in fixed assets such as land, building, machinery or expansion projects is often called capital budgeting.

Short-term investment: Investment in current assets such as inventory, receivables and cash is connected with working capital management.

Factors mentioned in the chapter: expected return, risk and safety, liquidity, and other relevant investment considerations.

KEY TERM - CAPITAL BUDGETING

Decision-making relating to investment of funds in long-term assets or projects.

8.2.2 Decisions Related to Financing

Meaning: Financing decision determines how the business will obtain the funds required for investment and operations.

Important source choices include owners' funds and borrowed funds. The finance manager must decide the proper mix.

Teacher Example: A company requiring Rs. 10 crore for expansion may raise part through equity shares and part through debt.

KEY TERM - FINANCING DECISION

Decision about the sources and mix of funds used to finance business assets and activities.

8.2.3 Decisions Related to Dividend

Meaning: Dividend decision determines how much of the profit should be distributed to shareholders and how much should be retained in the business.

Trade-off: Higher dividend gives current return to shareholders, while retained earnings provide an internal source of finance for future growth.

Factors indicated in the chapter: dividend policy may be influenced by profit position, need for funds, stability, shareholder expectations and related financial considerations.

EXAM IMPORTANT

Dividend decision = Distribute profit vs Retain profit.

8.3 Capital Structure - Concept and Definition

Meaning: Capital structure means the composition or proportion of different long-term sources of finance used by a company.

In Simple Words: Capital structure tells us how much long-term money comes from owners and how much comes from borrowed sources.

KEY TERM - CAPITAL STRUCTURE

The proportionate mix of different long-term securities or sources used to finance a company.

Examples of components: equity share capital, preference share capital, debentures and long-term debt.

8.3.2 Characteristics of Ideal Capital Structure

No.	Characteristic	Core Idea
1	Simplicity	Structure should be easy to understand and manage.
2	Profitability	It should support higher return / profitability.
3	Safety	The level of fixed financial obligation should remain safe.
4	Flexibility	The company should be able to change the mix when required.
5	Minimum Cost	Cost of raising and servicing capital should be economical.
6	Balanced / Proper Proportion	Owners' capital and borrowed capital should remain in a suitable balance.
7	Liquidity / Solvency Support	Capital structure should not create excessive repayment pressure.
8	Control Consideration	Financing choices should consider effect on ownership/control.

REMEMBER THIS

Ideal capital structure = Low cost + manageable risk + flexibility + adequate return.

8.3.3 Types of Capital Structures

Type	Composition
A	Only equity shares
B	Equity shares + preference shares
C	Equity shares + debentures
D	Equity shares + preference shares + debentures

SMIT SIR'S NOTE

The textbook diagram shows four simple combinations. Learn these exactly as combinations of long-term securities.

8.3.4 Factors Affecting Capital Structure

The chapter divides factors into Internal Factors and External Factors.

Internal Factors	External Factors
Type of business	Condition of boom/depression in capital market
Size of business	Present rate of interest in capital market
Estimation of business income	Cost of raising expenses of issuing securities
Nature and requirement of assets	Legal restrictions
Attitude of directors	Taxation policy
Financial requirements	Institutional investors / market conditions
Duration of capital requirement	Foreign institutional investors

Internal Factors Affecting Capital Structure

1. Type of Business

Explanation: Different businesses have different stability, asset needs and financing capacity.

Teacher Example: A public utility with stable income may safely use more debt than a highly uncertain new venture.

2. Size of Business

Explanation: Large businesses generally have wider access to capital markets and multiple finance sources.

Teacher Example: A large listed company can issue securities more easily than a very small firm.

3. Estimation of Business Income

Explanation: Stable and sufficient expected income makes fixed-interest debt easier to service.

Teacher Example: A company with predictable cash flows can consider more borrowed capital.

4. Nature and Requirement of Assets

Explanation: Businesses requiring large fixed assets may need long-term finance.

Teacher Example: A manufacturing firm needs more long-term capital than a small service firm.

5. Attitude of Directors

Explanation: Directors' preference toward risk, control and borrowing affects the financing mix.

Teacher Example: Directors may avoid new equity if they fear dilution of control.

6. Financial Requirements

Explanation: Amount and period for which funds are required influence the source chosen.

Teacher Example: Short-term needs should not normally be financed entirely by permanent long-term capital.

7. Duration of Capital Requirement

Explanation: Permanent needs generally require permanent sources, while temporary needs may use shorter sources.

Teacher Example: Long-term expansion calls for long-term finance.

External Factors Affecting Capital Structure

1. Capital Market Condition

Explanation: Boom or depression affects investor demand and ease of raising different securities.

Teacher Example: Equity issues may be easier in a strong market.

2. Rate of Interest

Explanation: High interest rates make debt more expensive; lower rates may make borrowing more attractive.

Teacher Example: A company delays a bond issue when interest rates are unusually high.

3. Cost of Raising Securities

Explanation: Issue expenses and flotation costs influence source choice.

Teacher Example: A costly public issue may make another source relatively attractive.

4. Legal Restrictions

Explanation: Company law and regulatory rules may limit the use or issue of certain securities.

Teacher Example: The company must comply with legal conditions before raising funds.

5. Taxation Policy

Explanation: Tax treatment can affect the relative attractiveness of debt and equity.

Teacher Example: Interest-related tax effects can influence borrowing decisions.

6. Institutional Investors

Explanation: Policies and participation of institutions influence availability of finance.

Teacher Example: Large institutions may prefer certain risk/return profiles.

7. Foreign Institutional Investors

Explanation: Foreign-investor participation can influence capital-market financing opportunities.

Teacher Example: Greater foreign demand may improve access to securities markets.

8.4 Working Capital

Meaning: Working capital is the capital required for day-to-day operations of a business.

In Simple Words: Fixed assets help the business exist; working capital helps the business keep moving every day.

KEY TERM - WORKING CAPITAL

Funds invested in current assets and used for day-to-day business activities.

Examples of current assets: cash, bank balance, inventory, bills receivable and debtors.

REMEMBER THIS

Working capital is also called circulating / revolving capital because it keeps moving through the operating cycle.

8.4.2 Concept of Working Capital - Gross and Net

Gross Working Capital: Total investment in current assets.

Formula: Gross Working Capital = Total Current Assets

Net Working Capital: Excess of current assets over current liabilities.

Formula: Net Working Capital = Current Assets - Current Liabilities

KEY TERM - CURRENT ASSETS

Assets expected to be converted into cash or used within the normal operating cycle / short period.

Teacher Example: Current assets Rs. 5 lakh, current liabilities Rs. 3 lakh -> Net working capital = Rs. 2 lakh.

EXAM IMPORTANT

Do not confuse formulas: Gross = CA; Net = CA - CL.

Gross Working Capital vs Net Working Capital

Basis	Gross Working Capital	Net Working Capital
Meaning	Total current assets	Excess of current assets over current liabilities
Formula	Current Assets	Current Assets - Current Liabilities
Focus	Investment in current assets	Short-term liquidity position
Can be Negative?	No, as it is the amount of current assets	Yes, if current liabilities exceed current assets

8.4.4 Characteristics of Working Capital

No.	Characteristic	Core Idea
1	Short-Term Capital	Used for short-term operating needs.
2	Investment in Current Assets	Cash, debtors, stock, bills receivable, etc.
3	Liquidity	Current assets are comparatively liquid.
4	Less Risk	Risk is generally lower than long-term fixed investment.
5	Changing Form	Working capital continuously changes from cash to stock to debtors and back to cash.
6	Day-to-Day Expenses	Required for routine business expenses.
7	No Depreciation	Depreciation is generally not charged on working capital itself.
8	Requirement Varies	Amount changes according to business type and operating needs.

8.4.5 Factors Affecting Working Capital

Factor	How It Affects Working Capital
Type and Nature of Business	Trading/manufacturing and service businesses have different needs.
Size of Business	Larger activity generally requires more current assets.
Production Cycle	Longer cycle keeps funds blocked for longer.
Production Policy	Seasonal or steady production affects inventory needs.
Credit Policy	More credit to customers increases receivables and working-capital need.
Availability of Raw Material	Uncertain supply may require larger inventory.
Growth Prospect	Growing business normally needs more working capital.
Operating Efficiency	Higher efficiency may reduce funds blocked in operations.
Price Level Changes	Inflation can increase the amount of working capital required.
Seasonal Nature	Seasonal businesses need different amounts at different times.

8.5 Fixed Capital

Meaning: Fixed capital means funds invested for a long period in fixed assets required for the business.

Examples: land, building, plant, machinery, furniture and other long-term assets.

KEY TERM - FIXED CAPITAL

Long-term capital invested in fixed assets that support the business over several years.

REMEMBER THIS

Fixed capital = long-term assets. Working capital = day-to-day operations.

8.5.1 Characteristics of Fixed Capital

- Long period: Investment remains blocked for more than one year and often many years.
- Different nature in different businesses: Requirement depends on the type of business.
- Less liquidity: Fixed assets cannot be converted into cash as easily as current assets.
- High investment: Land, machinery and buildings often require large amounts.
- Depreciation: Many fixed assets lose value over time and depreciation is charged.
- Long-term planning: Fixed-capital decisions affect business capacity and cost for years.

8.5.2 Factors Affecting the Need of Fixed Capital

Factor	Effect
Type and Nature of Business	Capital-intensive industries need more fixed capital.
Size of Business	Large-scale operations generally require more fixed assets.
Use of Ownership / Lease	Leasing assets can reduce immediate fixed-capital requirement.
Stage / Position of Business	Expansion and modernization may increase requirement.
Technology / Production Method	Capital-intensive technology needs more machinery investment.
Growth Plans	Expansion creates additional fixed-asset needs.
Government Assistance / Policy	Grants, incentives or infrastructure can influence requirement.
Availability of Outsourcing / External Capacity	Using external capacity may reduce owned fixed assets.

8.5.3 Difference between Fixed Capital and Working Capital

Basis	Fixed Capital	Working Capital
Meaning	Capital invested in fixed assets	Capital invested in current assets / day-to-day operations
Period	Blocked for long period	Required for short period and revolving operations
Liquidity	Relatively low	Relatively high
Risk	Comparatively higher because funds are blocked long-term	Comparatively lower and more liquid
Requirement	For purchase of land, building, plant, machinery, etc.	For wages, materials, stock, debtors and routine expenses
Sources	Mainly long-term sources	Short-term and circulating sources
Depreciation	Depreciation charged on many fixed assets	Depreciation not charged on working capital itself

EXAM IMPORTANT

This is a highly probable distinction. Use 7 clear bases and a neat table.

Chapter Glossary

Term	Simple Meaning
Financial Management	Management of acquisition, allocation and use of business funds.
Profit Maximisation	Objective of increasing accounting profit.
Wealth Maximisation	Objective of increasing economic value/wealth of owners.
Investment Decision	Decision about where funds should be invested.
Financing Decision	Decision about sources and mix of funds.
Dividend Decision	Decision about distribution vs retention of profit.
Capital Structure	Mix of long-term sources of finance.
Equity Capital	Owners' share capital carrying ownership risk and return.
Debt Capital	Borrowed capital carrying repayment and interest obligations.
Working Capital	Capital required for day-to-day operations.
Gross Working Capital	Total current assets.
Net Working Capital	Current assets minus current liabilities.
Fixed Capital	Long-term capital invested in fixed assets.
Current Assets	Short-term assets such as cash, inventory and receivables.
Current Liabilities	Short-term obligations payable within the operating period.

Common Mistakes Students Make

COMMON MISTAKE

Wrong idea: Financial management means only arranging finance.
Correct idea: It also includes allocation, investment, financing, dividend and control decisions.

COMMON MISTAKE

Wrong idea: Profit maximisation and wealth maximisation are identical.
Correct idea: Wealth maximisation explicitly considers time, risk and long-term owner value.

COMMON MISTAKE

Wrong idea: Capital structure includes only equity.
Correct idea: It is the mix of long-term securities such as equity, preference capital and debt/debentures.

COMMON MISTAKE

Wrong idea: Working capital means only cash.
Correct idea: It covers investment in current assets such as cash, inventory and receivables.

COMMON MISTAKE

Wrong idea: Gross and net working capital are the same.
Correct idea: Gross = current assets; Net = current assets minus current liabilities.

COMMON MISTAKE

Wrong idea: Working capital cannot be negative.
Correct idea: Net working capital can be negative when current liabilities exceed current assets.

COMMON MISTAKE

Wrong idea: Fixed capital and fixed assets are identical terms.
Correct idea: Fixed capital is the funds invested in fixed assets.

COMMON MISTAKE

Wrong idea: Dividend decision means all profit must be distributed.
Correct idea: Management decides the balance between distribution and retention.

How to Write Major Answers in the Exam

Q1. Explain Financial Management and its Characteristics

Best structure: Meaning/definition -> 8 characteristics -> 1-2 lines each.

Q2. Explain Objectives of Financial Management

Best structure: Profit maximisation -> limitations -> wealth maximisation -> why it is broader.

Q3. Explain Financial Decisions

Best structure: Investment -> Financing -> Dividend, with one example each.

Q4. Explain Ideal Capital Structure and Factors

Best structure: Meaning -> characteristics -> internal factors -> external factors.

Q5. Explain Working Capital

Best structure: Meaning -> gross/net concept -> characteristics -> affecting factors.

Q6. Differentiate Fixed and Working Capital

Best structure: Use a 7-basis table.

Practice Set A - MCQs

1. Financial management mainly deals with:

- A. financial decisions
- B. only production
- C. only staffing
- D. only sales

2. Modern financial management gives major importance to:

- A. wealth maximisation
- B. only sales maximisation
- C. only employee count
- D. only production

3. Which decision determines where funds should be invested?

- A. Investment decision
- B. Dividend decision
- C. Staffing decision
- D. Pricing decision

4. Which decision determines sources of funds?

- A. Financing decision
- B. Recruitment decision
- C. Promotion decision
- D. Production decision

5. Which decision determines profit distribution?

- A. Dividend decision
- B. Investment decision
- C. Staffing
- D. Marketing

6. Capital structure is a mixture of:

- A. long-term sources of finance
- B. only current liabilities
- C. only cash
- D. only inventory

7. Which is a characteristic of ideal capital structure?

- A. Flexibility
- B. Maximum confusion
- C. Maximum cost
- D. No balance

8. Gross working capital means:

- A. total current assets
- B. current assets minus liabilities
- C. fixed assets
- D. equity only

9. Net working capital means:

- A. current assets - current liabilities
- B. fixed assets - debt
- C. sales - profit
- D. equity - debt

10. If current liabilities exceed current assets, net working capital is:

- A. negative
- B. always positive
- C. zero always
- D. fixed

11. Working capital is mainly required for:

- A. day-to-day operations
- B. purchase of land only
- C. long-term building only
- D. ownership only

12. Fixed capital is mainly invested in:

- A. fixed assets
- B. only cash
- C. only receivables
- D. only inventory

13. Which is generally more liquid?

- A. Working capital assets
- B. Fixed assets
- C. Land only

- D. Machinery only

14. Depreciation is generally charged on:

- A. many fixed assets
- B. working capital itself
- C. current liabilities
- D. dividend

15. A longer production cycle generally:

- A. increases working capital need
- B. eliminates working capital
- C. reduces all finance
- D. has no effect

Practice Set B - Conceptual MCQs

16. A company chooses between buying a new plant and expanding the old one. Which decision?

- A. Investment decision
- B. Dividend decision
- C. Staffing
- D. Recruitment

17. A company chooses debt and equity in a 40:60 ratio. Which concept?

- A. Capital structure
- B. Working capital
- C. Dividend policy only
- D. Training

18. A company retains more profit to finance growth. Which financial decision?

- A. Dividend decision
- B. Recruitment
- C. Production only
- D. Staffing

19. Interest rates rise sharply. Which capital-structure factor?

- A. External factor
- B. Internal factor only
- C. Staffing factor
- D. Production factor

20. Directors fear loss of control from issuing more equity. Which factor?

- A. Internal factor - attitude/control
- B. External inflation only
- C. Working capital characteristic
- D. Dividend payment

21. A firm has Rs. 8 lakh current assets and Rs. 5 lakh current liabilities. Net working capital is:

- A. Rs. 3 lakh
- B. Rs. 13 lakh
- C. Rs. 5 lakh
- D. Rs. 8 lakh

22. A seasonal business needs extra stock before peak season. Which need rises?

- A. Working capital
- B. Fixed capital only
- C. Equity control
- D. Dividend

23. A company leases machinery rather than buying it. What may happen to fixed-capital need?

- A. It may decrease
- B. It must increase
- C. It becomes working capital
- D. No concept applies

24. Inflation increases raw-material prices. Which requirement may rise?

- A. Working capital
- B. Only dividend
- C. Only ownership
- D. Only control

25. A capital-intensive manufacturing firm usually needs:

- A. more fixed capital
- B. no fixed capital
- C. only working capital
- D. only dividend

MCQ Answer Key

Q	Ans
1	A
2	A
3	A
4	A
5	A
6	A
7	A
8	A
9	A
10	A
11	A
12	A
13	A
14	A
15	A
16	A
17	A
18	A
19	A
20	A
21	A
22	A
23	A
24	A
25	A

SMIT SIR'S NOTE

For numericals, remember only one formula here: Net Working Capital = Current Assets - Current Liabilities.

Exam Question Bank - One Sentence

- Financial management is related to which type of financial decision-making?
- Which objective of financial management follows the modern approach?
- State any two objectives of financial management.
- What does capital structure consist of?
- What is working capital?
- What is fixed capital?
- What is gross working capital?
- What is net working capital?
- Why is depreciation not charged on working capital?
- State any one source of fixed capital.

Exam Question Bank - Short Answers

- What does maximum economic welfare of the owner mean?
- Explain objective of profit maximisation.
- Explain objective of wealth maximisation.
- What is meant by optimum capital structure?
- What is working capital in circulation?
- Explain any four characteristics of working capital.
- Explain any four characteristics of fixed capital.
- Explain any four factors affecting capital structure.

Exam Question Bank - Brief / Detailed Answers

Brief-answer questions:

- Explain the concept of financial management through definitions.
- Explain the objectives of financial management.
- Write notes on decisions related to investment and dividend.
- State the factors affecting working capital.

Detailed-answer questions:

- Explain the importance of financial management.
- Discuss the factors affecting capital structure.
- Explain in detail the concept of working capital.
- Distinguish gross working capital and net working capital.
- Distinguish fixed capital and working capital.

Application / Case-Based Practice

Case 1

A company chooses to invest Rs. 20 crore in a new plant. Which financial decision?

Answer: Investment Decision.

Case 2

The same company decides to finance the plant through 60% equity and 40% debt. Which concept?

Answer: Financing Decision / Capital Structure.

Case 3

Management decides to distribute 30% of profit and retain 70%. Which decision?

Answer: Dividend Decision.

Case 4

Current assets are Rs. 10 lakh and current liabilities are Rs. 7 lakh. Find net working capital.

Answer: Rs. 3 lakh.

Case 5

A company increases credit sales and debtors rise. What happens to working-capital need?

Answer: It generally increases.

Case 6

A business buys heavy machinery for long-term use. Which capital is required?

Answer: Fixed Capital.

Case 7

Interest rates in the capital market increase. Internal or external capital-structure factor?

Answer: External Factor.

Case 8

Directors avoid issuing more equity because they fear loss of control. Which factor?

Answer: Internal Factor - attitude/control consideration.

5-Minute Chapter Revision

Financial Management: Acquire, allocate, use and control finance.

Objectives: Profit maximisation and Wealth maximisation.

Modern focus: Wealth maximisation because it considers time and risk.

Financial Decisions: Investment, Financing, Dividend.

Capital Structure: Mix of equity/preference/debt long-term sources.

Ideal Capital Structure: Simple, safe, flexible, profitable, low-cost and balanced.

Working Capital: Day-to-day funds; Gross = CA; Net = CA - CL.

Working Capital Factors: Nature, size, production cycle, credit policy, inventory, growth, efficiency, prices, seasonality.

Fixed Capital: Long-term funds invested in fixed assets.

Fixed Capital Factors: Type, size, ownership/lease, expansion, technology, policy and growth.

EXAM IMPORTANT

Ultra-short memory: Finance = Invest + Fund + Dividend; Capital = Fixed + Working.

One-Page Master Revision Sheet

Topic	Must Remember
Financial Management	Acquisition + allocation + use + review of funds
Objectives	Profit maximisation / Wealth maximisation
Modern Objective	Wealth maximisation
Investment Decision	Where to invest funds
Financing Decision	From where to raise funds
Dividend Decision	Distribute vs retain profit
Capital Structure	Mix of long-term securities
Types	Equity only; Equity+Pref; Equity+Debt; Equity+Pref+Debt
Gross Working Capital	Current Assets
Net Working Capital	Current Assets - Current Liabilities
Working Capital	Short-term / circulating / day-to-day
Fixed Capital	Long-term investment in fixed assets
Fixed vs Working	Long-term/low liquidity vs short-term/high liquidity

Have You Mastered This Chapter?

- ☐ I can define financial management.
- ☐ I can explain profit vs wealth maximisation.
- ☐ I can explain all 3 financial decisions.
- ☐ I can explain ideal capital structure and its factors.
- ☐ I can identify all 4 textbook capital-structure types.
- ☐ I can calculate gross and net working capital.
- ☐ I can explain working-capital factors.
- ☐ I can explain fixed-capital factors.
- ☐ I can write the fixed vs working capital difference table.

CHAPTER 8 COMPLETE

Financial Management

SMIT SIR'S FINAL MESSAGE

Financial management is not simply about having money. It is about choosing the right amount, the right source, the right investment and the right balance between long-term and day-to-day financial needs.

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