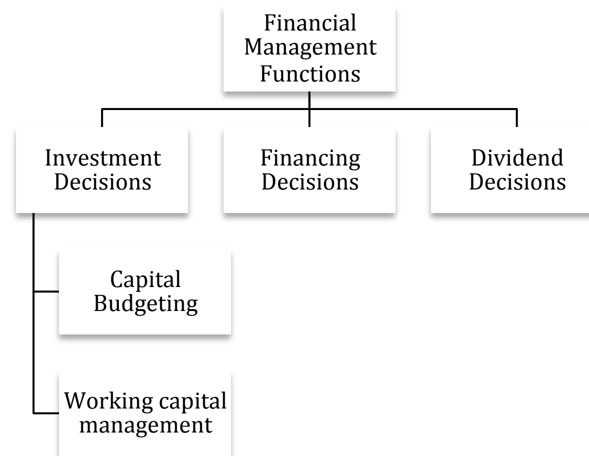
UNIT 1 – FINANCIAL MANAGEMENT
CHAPTER 1 – INTRODUCTION & BASIC CONCEPTS



Objectives of the Firm:

- **Profit maximisation** – Financial management has to endeavour for maximising the rupee income of the firm. The firm must maximise output out of scarce resources and minimise cost of production in order to achieve this objective.
- **Value maximisation** – Emphasizes on time value of money. It means maximisation of the net present value.

W = V – C

Where, W = net present value

V = gross present value of benefit

C = total value of investment required to acquire the asset or to purchase the course of action

Role of Chief Financial Officer:

- Development of new financial system
- Emergence of financial service sector
- Recent innovations and development of financial tools, techniques, instruments, & products

Financial environment:

Financial environment refers to that environment, which consists of those factors of economic environment that influence the financial activities of industry, trade, and commerce.

Time value of money:

It refers to the concept that money available at the present time is worth more than the same sum of money in the future due to its potential earning capacity.

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Reasons for time value of money:

- Inflation
- Most individuals in general have subjective preference for present consumption over future either because of the urgency of their consumption or because of the uncertainty of the future
- Where the money is receivable after a long time-gap, the receivable may lose the opportunities of investing it in a more profitable manner

Compounding techniques:

- Graphical view of future value growth
- Rule of 69 or 72
- Shorter compounding year
- Nominal rate and effective rate

Discounting technique:

- Present value of a single cash flow
- Perpetual annuity

Risk return relationship:

Frequently non-financial decisions involve choice among different alternative courses of action such as –

- Selection of plant capacity
- Fixation of a debt equity mix
- Adoption of a restrictive or liberal credit policy
- Fixation of a dividend policy

Different alternative courses of action have a different combination of risk and return associated to it. Proper balance between risk and return is necessary for the satisfaction of shareholders wealth maximization objective. Such a balance is called risk return tradeoff.