

RIZVI COLLEGE OF ARTS, SCIENCE & COMMERCE



STD: 12th COMMERCE
Subject: Secretarial Practice
(SP)

CHAPTER 1: **INTRODUCTION TO** **CORPORATE** **FINANCE**

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CORPORATE FINANCE: MEANING & DEFINITION

- Deals with the **raising** and **using** of **finance** by a corporation.
- Also deals with **financing** the **activities of the corporation**, **capital structuring** and making **investment decisions**.
- Includes **financial planning**, **study of capital market**, **money market**, and **share capital**.
- Covers **capital formation** and **foreign capital**.

DEFINITION:

HENRY HOAGLAND – “Corporate Finance deals primarily with the acquisition and use of capital by business corporation.”



CORPORATE FINANCE: MEANING & DEFINITION

The finance manager of any corporation has to ensure that -

1. the firm has adequate finance.
2. they are using the right source of funds that have minimum cost.
3. the firm utilises raised funds effectively.
4. they are generating maximum returns for it's owners.



Corporate Finance Essentials: Investment & Financing Decisions

❖ FINANCING DECISION:

- Firm has to access **capital market** for **financial needs**.
- Firm has **multiple choices** of **sources of financing** and the firm can **choose** from whether it wants to **raise equity capital** or **debt capital**.
- Firms can even **opt** for **bank loan, public deposit, debentures**, etc.
- Finance manager ensures that the firm is **well capitalized** i.e they have the **right amount** of **capital** and **right combination** of **debt** and **equity**.

Market for long term debt instruments and equity shares.

the funds generated by a company through issuing equity shares.

company raises by borrowing from external sources.

Corporate Finance Essentials: Investment & Financing Decisions

❖ INVESTMENT DECISION

- After the firm has received capital, the finance manager has to take **decision** regarding the **use of funds** in a **systematic manner** to bring **maximum returns**.
- And hence, the firm needs to know the **cost of capital**.
- After which, it can **deploy or use** the funds in a way where returns are more than cost of capital.
- **Finding investments** and **deploying them** successfully in the business is known as **investing decision**.
- Also called as “**Capital Budgeting**”.

minimum return
expected by it's
investors

IMPORTANCE OF CORPORATE FINANCE

1. Helps in decision making

- ▶ Important decisions of business cannot be taken without funds.
- ▶ Every decision needs to be taken keeping in view its impact on profitability.
- ▶ Any project can get green signal only if it is financially possible.
- ▶ Thus, Corporate Finance is significantly important in decision making process.



2. Helps in raising capital for a project.

- ▶ When a business firm wants to start a new project, it needs capital which can be fulfilled through issuing shares, debentures, bonds, and taking loans.

3. Helps in Research & Development (R&D)

- ▶ R & D is a lengthy process and funds are required throughout the research work.
- ▶ When a company wants to upgrade its old product or develop new product, company has to conduct survey, market analysis, etc which requires finance.

IMPORTANCE OF CORPORATE FINANCE

4. Helps in smooth running of business firm

- Smooth flow of finance is required for salaries of employees, loans, purchase of raw materials, sales promotion, and even launching of new products.

5. Brings co-ordination between various activities

- Corporate finance is important for control and co ordination of activities of business.
- Eg: production will suffer if there is less finance for purchase of raw materials.

6. Promotes Expansion and diversification

- Corporate finance is compulsory to purchase modern machines and technologies.



IMPORTANCE OF CORPORATE FINANCE

7. Managing risk

- Manage risk such as fall in sales, loss due to natural calamity, strikes, etc.
- Company needs financial aid to manage such risks.



8. Replace old assets

- Finance is required to replace old outdated assets by new modern assets.

9. Payment of Dividend & Interest

- Finance is needed to pay dividend to shareholders and interest to creditors, banks, etc.

10. Payment of Taxes/Fees

- Finance is required to pay Income Tax, GST, and fees to ROC.



CAPITAL REQUIREMENTS

Fixed Assets

A. FIXED CAPITAL

- Capital which is used for **buying fixed assets**.
- These assets are **not for resale**.
- Mostly required during starting a **new company**.
- Even **existing company** needs fixed capital for **expansion, development, replacement of equipment, etc.**
- **Initial planning** of fixed capital is made by **company's promoters**.
- An **entrepreneur gets funds** for the purchase of fixed assets from **capital market**.
- Funding can come from **issue of shares, debentures, bonds, etc.**



FACTORS AFFECTING FIXED CAPITAL REQUIREMENTS

1. Nature of business

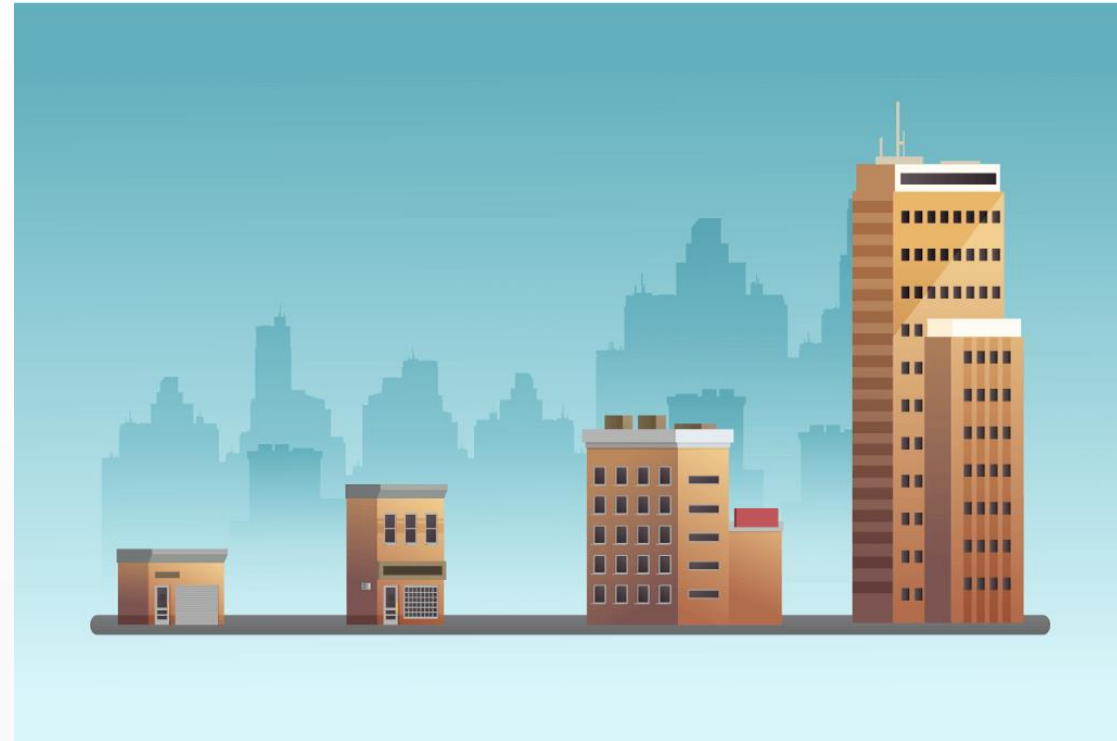
- Manufacturing industries and public utilities invest huge amount of funds in fixed assets.
- Other business firms many not need huge investments.

2. Size of business

- Business firms with large scale operations have more requirement of fixed capital than others.

3. Scope of business

- Business firms which carry on production or distribution on large scale require more amount of fixed capital.



FACTORS AFFECTING FIXED CAPITAL REQUIREMENTS

4. Extent of lease or rent

- If business acquires assets on lease or rental basis, then less amount of funds will be required.

5. Arrangement of sub – contract

- If business sub-contracts some process of production to others, it will minimize fixed capital requirements.

6. Acquisition of old assets

- If old equipment's and assets are taken at low prices, it will reduce fixed capital requirement.



FACTORS AFFECTING FIXED CAPITAL REQUIREMENTS

7. Acquisition of assets on concessional rate

- To grow industries at regional level, government provides assets at concessional rates and even on installment basis.
- This will reduce fixed capital requirement.

8. International Conditions

- Large organizations carrying business on international level require large funds for fixed assets.

9. Trend in economy

- If future of the company is predicted to be bright, it will enhance business owners for expansion, which allows investments of large amount of funds.



FACTORS AFFECTING FIXED CAPITAL REQUIREMENTS

10. Population Trend

- When population is increasing at high rate, certain business expand their activities, which increases capital requirement.

11. Consumer Preference

- Business providing goods & services at high demand, they will require high capital requirement.

12. Competitive Factor

- If one competition shifts to automation, others will also follow.
- This will increase capital requirement.



CAPITAL REQUIREMENTS

A. WORKING CAPITAL

- Capital which is used to carry out **day-to-day business activities**.
- Refers to a firm's investment in current assets such as cash, account receivable and inventories.
- **Sum of current assets** of a company is **gross working capital**.
- Excess of current assets over current liabilities refers to net working capital.
- Also called as '**circulating capital**'.
- A business firm will have to arrange capital for the following:
 - For building up inventories
 - For financing receivables and payables.
 - For covering day-to-day operating expenses.
- Capital invested in these assets is referred to as working capital .

FACTORS AFFECTING WORKING CAPITAL

1. Nature of business

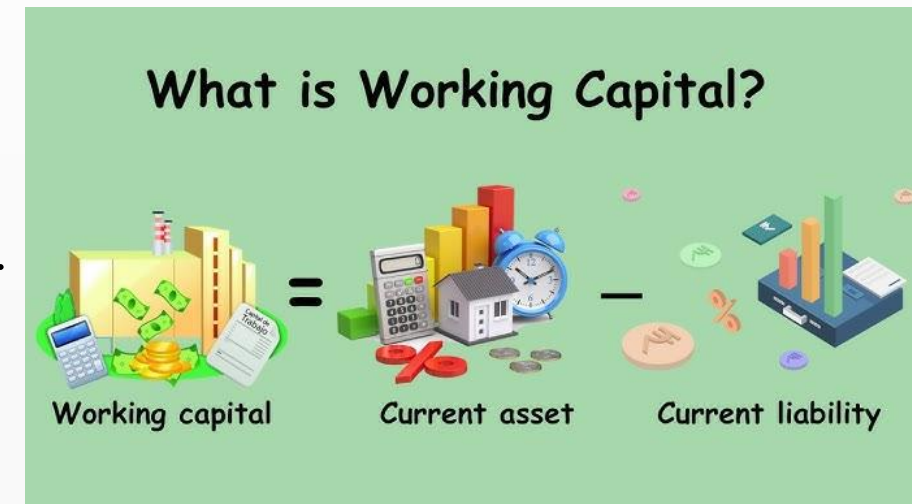
- Firms engaged in products of daily consumption and public utility concerns need less working capital as they have constant and sufficient cash inflow
- Business dealing in luxurious products, trading/merchandising firms, require large amount of working capital.

2. Size of business

- Firms with large scale operations require more working capital.
- Firms with small scale operations require less working capital.

3. Volume of sales

- If volume of sales increases, there will be an increase in working capital and vice – versa.



FACTORS AFFECTING WORKING CAPITAL

4. Production Cycle

- If production cycle is longer, then the firm needs more amount of working capital and if it is short, then less amount of working capital.

5. Business Cycle

- During boom in economy, more working capital.
- During recession in economy, less working capital.



6. Terms of purchase and sale

- If the business has favorable credit policy for purchases & has less liberal credit policy for sales, then the working capital requirement will be less.
- Working capital requirement will be more, if the firm has a good credit policy for sales, no credit facility for purchases.

FACTORS AFFECTING WORKING CAPITAL

7. Credit Control

- If credit control policy is sound, the firm will require less working capital.
- If credit control policy is liberal, then the firm will require more working capital.

8. Growth and Expansion

- When there is increase in growth of a firm, the working capital requirement will also increase.

9. Management Ability

- If there is proper co – ordination between production and distribution of goods, the working capital requirement will be less.



CAPITAL STRUCTURE

OWNED CAPITAL

- EQUITY SHARE CAPITAL
- PREFERENCE SHARE CAPITAL
- RESERVES & SURPLUS

BORROWED CAPITAL

- DEBENTURES
- LOANS

CAPITAL STRUCTURE: MEANING

- **Mix up** of various sources of funds in **desired proportion**.
- Means to decide upon the **ratio of different types of capital**.
- Composed of **owned funds** and **borrowed funds**.
- Also known as ‘**security mix**.’

❖ DEFINITION

According to R.H.Wessel:

“The long term sources of funds employed in a business enterprise.”

Capital Structure



COMPONENTS OF CAPITAL STRUCTURE

1. EQUITY SHARE CAPITAL
2. PREFERENCE SHARE CAPITAL
3. RETAINED EARNINGS
4. BORROWED CAPITAL



COMPONENTS OF CAPITAL STRUCTURE

1. EQUITY SHARE CAPITAL

- Basic source of financing activities.
- Own the company.
- Bear ultimate risk.
- Carry dividend at fluctuating rate depending upon profits.
- Repayment of capital is done after payment of preference shares.



2. PREFERENCE SHARE CAPITAL

- Carry preferential rights in payment of dividend and even during repayment of capital.
- Carry dividend at fixed rate.



COMPONENTS OF CAPITAL STRUCTURE

3. RETAINED EARNINGS

- Internal source of financing.
- Ploughing back of profit.



4. BORROWED CAPITAL

a. DEBENTURE

- Acknowledgement of loans
- Carry interest at an agreed rate.

b. TERM LOANS

- Carry fixed rate of interest.
- Provided by bank & financial institutions.



DISTINGUISH BETWEEN FIXED CAPITAL AND WORKING CAPITAL

Points	Fixed capital	Working capital
1) Meaning	Fixed capital refers to any kind of physical asset i.e. fixed assets.	Working capital refers to the sum of current assets.
2) Nature	It stays in the business almost permanently.	Working capital is circulating capital. It keeps changing.
3) Purpose	It is invested in fixed assets such as land, building, equipments, etc.	Working capital is invested in short term assets such as cash, account receivable, inventory, etc.
4) Sources	Fixed capital funding can come from selling shares, debentures, bonds, long term loans, etc.	Working capital can be funded with short term loans, deposits, trade credit, etc.
5) Objectives of Investors	Investors invest money in fixed capital hoping to make future profit.	Investors invest money in working capital for getting immediate returns.
6) Risk	Investment in fixed capital implies more risk.	Investment in working capital is less risky.

Thank you!

