

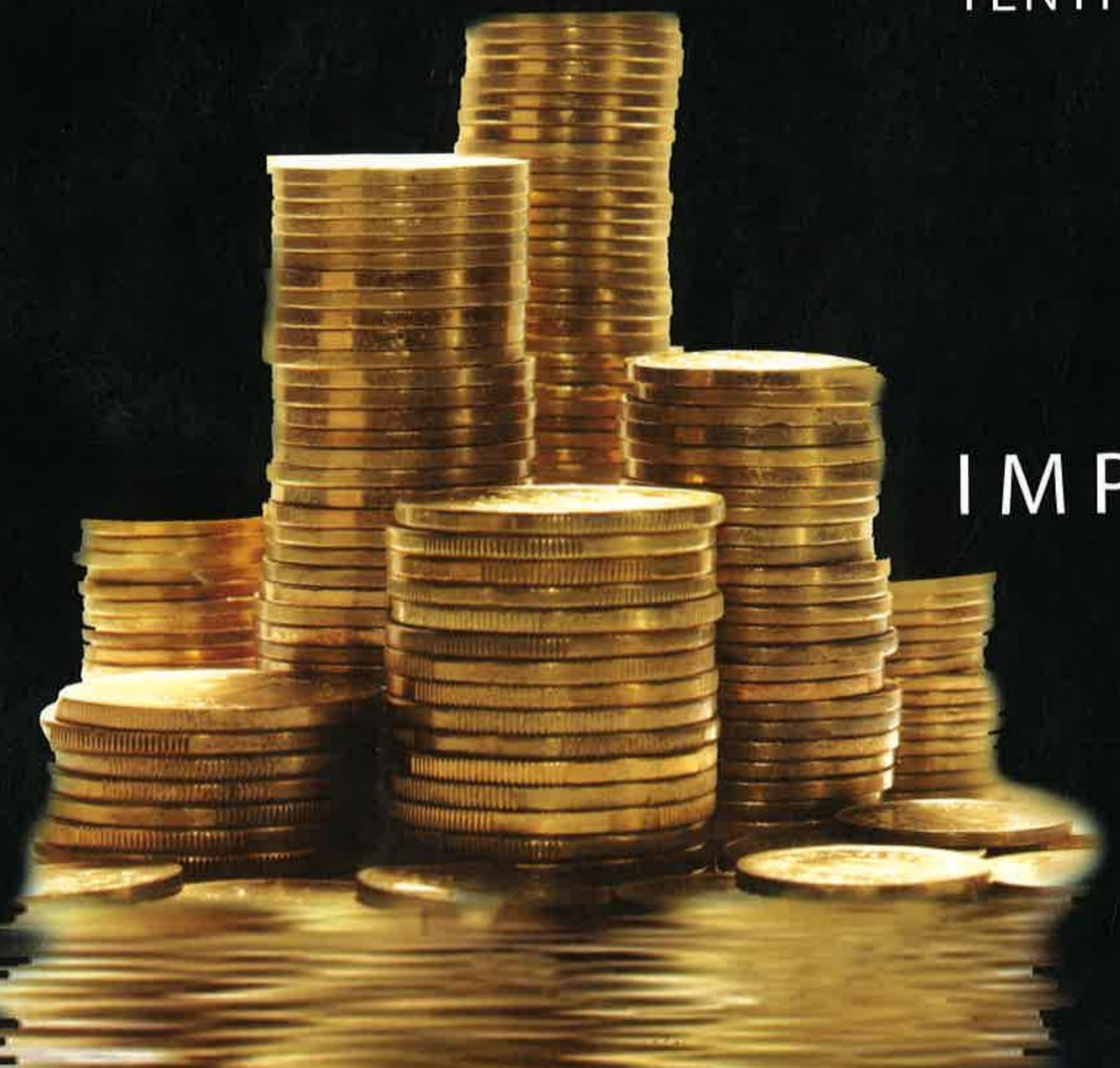


VIKAS®



Financial Management

TENTH EDITION



I M PANDEY

Contents



Preface vii

Acknowledgements xi

About the Author xiii

1. NATURE OF FINANCIAL MANAGEMENT

Learning Objectives	2
Introduction	2
Scope of Finance	2
Finance Function	3
Finance Manager's Role	5
Financial Goal: Profit Maximization vs Wealth Maximization	7
Agency Problems: Managers vs Shareholders Goals	11
Financial Goal and Firm's Mission and Objectives	11
Exhibit: BHEL's Mission and Objectives	12
Organization of the Finance Functions	12
Summary 14; Key Concepts 15; Student Activities* 15	

2. CONCEPTS OF VALUE AND RETURN

Learning Objectives	17
Introduction	17
Time Preference for Money	17
Future Value	19
■ Future Value of a Single Cash Flow	21
■ Future Value of an Annuity	22
■ Annuity of a Future Value (Sinking Fund)	23
Present Value	23
■ Present Value of a Single Cash Flow	25
■ Present Value of an Annuity	27
■ Capital Recovery	28
■ Present Value of an Uneven Cash Flow	29
■ Constantly Growing Annuity	30
Value of an Annuity Due	31
Multi-period Compounding	32
Net Present Value	33
Present Value and Rate of Return	34
■ Multi-period Compounding	35
■ Yield or IRR Calculation	36
Summary 36; Key Concepts 38; Student Activities* 38; Appendix 2A 4	

3. VALUATION OF BONDS AND SHARES

Learning Objectives	46
Introduction	46
Concepts of Value	46
Features of a Bond	47

*Student Activities = Illustrative Solved Problems; Review Questions; Quiz Exercises; Problems; Cases; Practical Project

Excel Applications

Bonds Values and Yields	48
☒ Yield to Maturity	49
☒ Present Value of a Bond	50
Bond Values and Interest Rates	51
The Term Structure of Interest Rates	53
Valuation of Preference Shares	56
Valuation of Ordinary Shares	57
☒ Two-stage Growth	62
Equity Capitalization Rate	65
Linkages Between Share Price, Earnings and Dividends	65
Price-Earnings (P/E) Ratio: Is it Significant?	67
Exhibit: Myths about EPS and P/E Ratio: A Manager's Views	68
Summary 69; Key Concepts 70; Student Activities 70	

4. RISK AND RETURN: AN OVERVIEW OF CAPITAL MARKET THEORY

Learning Objectives	77
Introduction	77
Return on a Single Asset	77
Risk of Rates of Return: Variance and Standard Deviation	79
☒ Calculation of Variance and Standard Deviation	80
Historical Capital Market Returns	81
Expected Return and Risk: Incorporating Probabilities in Estimates	82
Summary 85; Key Concepts 86; Student Activities 86	

5. RISK AND RETURN: PORTFOLIO THEORY AND ASSETS PRICING MODELS

Learning Objectives	90
Introduction	90
Portfolio Return: Two-asset Case	90
Portfolio Risk: Two-asset Case	92
Portfolio Risk–Return Analysis: Two-asset Case	96
☒ Calculation of Portfolio Return and Risk and Minimum Variance Portfolio	99
Efficient Portfolio and Mean-Variance Criterion	100
Portfolio Risk: The n -asset Case	101
Risk Diversification: Systematic and Unsystematic Risk	102
Combining a Risk-free Asset and a Risky Asset	103
Multiple Risky Assets and a Risk-free Asset	104
Capital Asset Pricing Model (CAPM)	106
Implications and Relevance of CAPM	108
The Arbitrage Pricing Theory (APT)	109
Summary 111; Key Concepts 113; Student Activities 113	

6. BETA ESTIMATION AND THE COST OF EQUITY

Learning Objectives	117
Introduction	117
Beta Estimation	117
Beta Estimation in Practice	119
☒ Beta Estimation	121
Determinants of Beta	123
CAPM and the Opportunity Cost of Equity Capital	124
Summary 125; Key Concepts 126; Student Activities 126	

7. OPTIONS AND THEIR VALUATION

Learning Objectives	130
Introduction	130
Options	130
Call Option	131
Put Option	133

PART 2



INVESTMENT DECISIONS

Combinations of Put, Call and Share	135
Factors Determining Option Value	143
Binomial Model for Option Valuation	145
Black–Scholes Model for Option Valuation	146
☒ Black–Scholes Model for Valuing Call and Put Options	148
Ordinary Share as an Option	148
Summary 149; Key Concepts 150; Student Activities 151	

8. CAPITAL BUDGETING DECISIONS

Learning Objectives	158
Introduction	158
Nature of Investment Decisions	158
Types of Investment Decisions	159
Investment Evaluation Criteria	160
Net Present Value	161
☒ Calculation of NPV	162
Internal Rate of Return	164
☒ Calculation of IRR	166
Profitability Index	167
Payback	167
Exhibit: Capital Budgeting Methods in Practice	169
Discounted Payback	170
Accounting Rate of Return	170
NPV vs IRR	171
Reinvestment Assumption and Modified Internal Rate of Return (MIRR)	177
Varying Opportunity Cost of Capital	178
NPV vs PI	178
Summary 179; Key Concepts 182; Student Activities 182	

9. THE COST OF CAPITAL

Learning Objectives	189
Introduction	189
Significance of the Cost of Capital	189
The Concept of the Opportunity Cost of Capital	190
Determining Component Costs of Capital	193
Cost of Debt	193
Cost of Preference Capital	195
Cost of Equity Capital	196
Cost of Equity and the Capital Asset Pricing Model (CAPM)	199
Cost of Equity: CAPM vs Dividend-Growth Model	200
The Weighted Average Cost of Capital	200
Flotation Costs, Cost of Capital and Investment Analysis	201
Calculation of the Cost of Capital in Practice: Case of Larsen & Toubro Ltd	202
Divisional and Project Cost of Capital	207
Summary 211; Key Concepts 212; Student Activities 212	

10. DETERMINING CASH FLOWS FOR INVESTMENT ANALYSIS

Learning Objectives	220
Introduction	220
Cash Flows vs Profit	220
Incremental Cash Flows	221
Components of Cash Flows	222
Calculation of Depreciation for Tax Purposes	226
Additional Aspects of Incremental Cash Flow Analysis	231
Investment Decisions under Inflation	233

■ Investment Analysis under Inflation	236
Financing Effects in Investment Evaluation	237
<i>Summary 238; Key Concepts 239; Student Activities 239; Appendix 10.A 252</i>	

11. COMPLEX INVESTMENT DECISIONS

Learning Objectives	255
Introduction	255
Investment Decisions: Projects with Different Lives	255
Investment Timing and Duration	257
Replacement of an Existing Asset	260
Investment Decisions under Capital Rationing	260
<i>Exhibit:</i> Do Companies Face Capital Rationing Problem in Practice?	264
■ Capital Rationing: Using the Excel Solver	264
<i>Summary 266; Key Concepts 266; Student Activities 266</i>	

12. RISK ANALYSIS IN CAPITAL BUDGETING

Learning Objectives	272
Introduction	272
Nature of Risk	272
Statistical Techniques for Risk Analysis	273
Conventional Techniques of Risk Analysis	276
<i>Exhibit:</i> Risk Analysis in Practice	277
Sensitivity Analysis	280
Scenario Analysis	282
■ Scenario Analysis	283
Simulation Analysis	284
Decision Trees for Sequential Investment Decisions	285
Utility Theory and Capital Budgeting	289
<i>Summary 290; Key Concepts 291; Student Activities 291</i>	

13. REAL OPTIONS, INVESTMENT STRATEGY AND PROCESS

Learning Objectives	297
Introduction	297
Capital Investments	297
Capital Investment Planning and Control	298
Qualitative Factors and Judgment in Capital Budgeting	301
Investment Decisions and Corporate Strategy	302
Managerial Flexibility and Commitment	303
Strategic Real Options	303
Capital Budgeting Decision-making Levels	309
<i>Summary 310; Key Concepts 310; Student Activities 310</i>	

14. FINANCIAL AND OPERATING LEVERAGE

Learning Objectives	316
Introduction	316
Capital Structure Defined	316
Meaning of Financial Leverage	317
Measures of Financial Leverage	318
Financial Leverage and the Shareholders' Return	319
Combining Financial and Operating Leverages	327
Financial Leverage and the Shareholders' Risk	329
<i>Summary 332; Key Concepts 333; Student Activities 333</i>	

15. CAPITAL STRUCTURE: THEORY AND POLICY

Introduction	342
Relevance of Capital Structure: The Net Income and the Traditional Views	342
Irrelevance of Capital Structure:	
NOI Approach and the MM Hypothesis Without Taxes	347
Relevance of Capital Structure: The MM Hypothesis under Corporate Taxes	352
Financial Leverage and Corporate and Personal Taxes	355
The Trade-off Theory: Costs of Financial Distress and Agency Costs	361
Pecking Order Theory	363
Capital Structure Planning and Policy	363
Approaches to Establish Target Capital Structure	366
<i>Exhibit:</i> Debt Trap: Case of Hindustan Shipyard	367
<i>Exhibit:</i> Debt Burden under Cash Crunch Situation: Case of NALCO	369
Practical Considerations in Determining Capital Structure	370
Manager's Attitude towards Debt	374
<i>Exhibit:</i> Do Managers Prefer Borrowing?	374
Capital Structure Analysis of L&T Ltd	374
<i>Summary 377; Key Concepts 378; Student Activities 378</i>	

16. VALUATION AND FINANCING

Learning Objectives	386
Introduction	386
Beta, Cost of Capital and Capital Structure	386
Free Cash Flow and WACC	391
Equity Cash Flows or Flow-to-equity Approach	395
Capital Cash Flows and the Opportunity Cost of Capital	395
Adjusted Present Value (APV)	397
Adjusted Cost of Capital: Case of Perpetual Cash Flows	401
WACC and Miles-Ezzell's Formula for Adjusted Cost of Capital	403
Choice of the Appropriate Valuation Approach	403
Valuation of a Firm	404
<i>Summary 410; Key Concepts 411; Student Activities 412</i>	

17. DIVIDEND THEORY

Learning Objectives	420
Introduction	420
Issues in Dividend Policy	420
Dividend Relevance: Walter's Model	422
Dividend Relevance: Gordon's Model	425
Dividend and Uncertainty: The Bird-in-the-hand Argument	427
Dividend Irrelevance: The Miller-Modigliani (MM) Hypothesis	428
Relevance of Dividend Policy under Market Imperfections	430
<i>Exhibit:</i> Taxes and Dividends	433
Informational Content of Dividends	433
<i>Summary 435; Key Concepts 435; Student Activities 436</i>	

18. DIVIDEND POLICY

Learning Objectives	441
Introduction	441
Objectives of Dividend Policy	441
Practical Considerations in Dividend Policy	442
Stability of Dividends	446
Target Payout and Dividend Smoothing:	
Lintner's Model of Corporate Dividend Behaviour	448
Forms of Dividends	448
Buyback of Shares	453
Dividend Policy Analysis: Case of L&T Ltd	456

19. CAPITAL MARKET EFFICIENCY AND CAPITAL MARKETS IN INDIA	
Learning Objectives	464
Introduction	464
Capital Market Efficiency	464
Capital Markets in India	468
Primary Capital Market in India	468
Secondary Markets in India	472
Merchant Banking: Role in Capital Markets	475
Mutual Funds and Capital Markets	476
Summary 479; Key Concepts 480; Student Activities 481	
20. LONG-TERM FINANCE: SHARES, DEBENTURES AND TERM LOANS	
Learning Objectives	482
Introduction	482
Ordinary Shares or Equity	482
Rights Issue of Equity Shares	485
Preference Shares	488
Debentures	489
<i>Exhibit:</i> Credit Rating of Debentures in India	491
Term Loans	492
Summary 494; Key Concepts 495; Student Activities 495	
21. CONVERTIBLE DEBENTURES AND WARRANTS	
Learning Objectives	498
Introduction	498
Convertible Debentures	498
Warrants	501
Convertible Zero-Interest Debentures	505
Secured Premium Notes (SPN) with Warrants	505
Summary 507; Key Concepts 507; Student Activities 507	
22. ASSET-BASED: LEASE, HIRE PURCHASE AND PROJECT FINANCING	
Learning Objectives	510
Introduction	510
Lease Financing	510
<i>Exhibit:</i> Commonly Used Lease Terminology	512
Evaluating a Financial Lease	514
Can a Lease Benefit Both Lessor and Lessee?	517
Depreciation Tax Shield and Salvage Value under Indian Tax Laws	519
Leveraged Lease	520
Hire Purchase Financing	521
Infrastructure Project Financing	524
Summary 531; Key Concepts 532; Student Activities 532	
23. VENTURE CAPITAL FINANCING	
Learning Objectives	536
Introduction	536
Notion of Venture Capital	536
The Business Plan	538
The Process of Venture Capital Financing	540
Methods of Venture Financing	542
Disinvestment Mechanisms	543
Development of Venture Capital in India	544
Fiscal Incentives	545
Future Prospects of Venture Financing	545
Summary 546; Key Concepts 547; Student Activities 547	

PART 5**FINANCIAL
AND PROFIT
ANALYSIS****24. FINANCIAL STATEMENTS AND CASH FLOW ANALYSIS**

Learning Objectives	550
Introduction	550
Balance Sheet	550
Profit and Loss Account	552
Definition of Profit: Economic vs Accounting	554
Changes in Financial Position	554
Funds Flow Statement	556
Cash Flow Statement	562
Uses of the Statement of Changes in Financial Position	564
Summary 566; Key Concepts 566; Student Activities 567	

25. FINANCIAL STATEMENT ANALYSIS

Learning Objectives	581
Introduction	581
Users of Financial Analysis	581
Nature of Ratio Analysis	582
Liquidity Ratios	584
Leverage Ratios	586
Activity Ratios	589
Profitability Ratios	593
Evaluation of a Firm's Earning Power: DuPont Analysis	600
Comparative Statements Analysis	601
Trend Analysis	603
Inter-Firm Analysis	603
Utility and Limitations of Ratio Analysis	605
Cautions in Using Ratio Analysis	607
Financial Ratios as Predictors of Failure	608
Summary 610; Key Concepts 611; Student Activities 612	

26. FINANCIAL PLANNING AND STRATEGY

Learning Objectives	627
Introduction	627
Strategic Decision-Making and Planning	627
Strategic Financial Planning	629
Financial Planning	630
<input checked="" type="checkbox"/> Constructing Financial Model	633
Planning for Sustainable Growth	637
<i>Exhibit:</i> Sustainable Growth Equation	639
Summary 641; Key Concepts 642; Student Activities 642	

27. PRINCIPLES OF WORKING CAPITAL MANAGEMENT

Learning Objectives	648
Introduction	648
Concepts of Working Capital	648
Operating and Cash Conversion Cycle	649
Permanent and Variable Working Capital	653
Balanced Working Capital Position	653
Determinants of Working Capital	654
Issues in Working Capital Management	656
<i>Exhibit:</i> Levels of Current Assets: Some Examples of Indian Companies	657
Estimating Working Capital Needs	659
Policies for Financing Current Assets	660
Summary 663; Key Concepts 664; Student Activities 664	

28. RECEIVABLES MANAGEMENT AND FACTORING

Learning Objectives	673
Introduction	673
Credit Policy: Nature and Goals	673
<i>Exhibit:</i> Why do Companies in India Grant Credit	674
Optimum Credit Policy: A Marginal Cost-benefit Analysis	675
Credit Policy Variables	677
Credit Evaluation of Individual Accounts	685
<i>Exhibit:</i> Credit Policy and Practices at Siemens India	685
Monitoring Receivables	687
Factoring	689

Summary 693; Key Concepts 694; Student Activities 694

29. INVENTORY MANAGEMENT

Learning Objectives	700
Introduction	700
Nature of Inventories	700
Need to Hold Inventories	701
Objective of Inventory Management	701
Inventory Management Techniques	702
Analysis of Investment in Inventory	707
Inventory Control Systems	710
The Inventory Management Process	712
<i>Exhibit:</i> The Inventory Management Process: Case of BHEL	712
<i>Exhibit:</i> Levels of Inventory: Some Examples	713

Summary 713; Key Concepts 714; Student Activities 714

30. CASH MANAGEMENT

Learning Objectives	719
Introduction	719
Facets of Cash Management	719
Motives for Holding Cash	720
Cash Planning	721
Managing Cash Collections and Disbursements	726
Investing Surplus Cash in Marketable Securities	731

Summary 733; Key Concepts 733; Student Activities 733

31. WORKING CAPITAL FINANCE

Learning Objectives	740
Introduction	740
Trade Credit	740
Accrued Expenses and Deferred Income	742
Bank Finance for Working Capital	743
<i>Exhibit:</i> Working Capital Finance by SBI	744
Regulation of Bank Finance	744
Commercial Paper	749

Summary 750; Key Concepts 751; Student Activities 751

PART 7**MANAGING
VALUE AND
RISK****32. CORPORATE RESTRUCTURING, MERGERS AND ACQUISITIONS**

Learning Objectives	756
Introduction	756
Corporate Restructuring and Business Combination	757
Types of Business Combinations	757
Mergers and Acquisition in India	759
Motives and Benefits of Mergers and Acquisitions	759
Value Creation Through Mergers and Acquisitions	763
<i>Exhibit:</i> The Tomco-Lever Mega Merger	763
Valuation under Mergers and Acquisitions: DCF Approach	764
Financing a Merger	767
Merger Negotiations: Significance of P/E Ratio and EPS Analysis	771
Tender Offer and Hostile Takeover	774
Corporate Strategy and Acquisitions	775
Accounting for Mergers and Acquisitions	778
Leveraged Buyouts	779
SEBI Guidelines for Takeovers	782

Summary 784; Key Concepts 784; Student Activities 785

33. DERIVATIVES FOR MANAGING FINANCIAL RISK

Learning Objectives	793
Introduction	793
Derivatives and Risk Hedging	793
Risk Hedging with Options	794
Forward Contracts	795
Futures Contracts	796
Swaps	799
Risk Management Strategy: Case of BHP Limited	801
Uses of Derivatives	802

Summary 802; Key Concepts 803; Student Activities 803

34. INTERNATIONAL FINANCIAL MANAGEMENT

Learning Objectives	806
Introduction	806
The Foreign Exchange Market	806
International Parity Relationships	809
Foreign Exchange Risk and Hedging	812
International Capital Investment Analysis	816
Political Risk of Foreign Investments	819
Financing International Operations	819

Summary 821; Key Concepts 822; Student Activities 823

35. SHAREHOLDER VALUE AND CORPORATE GOVERNANCE

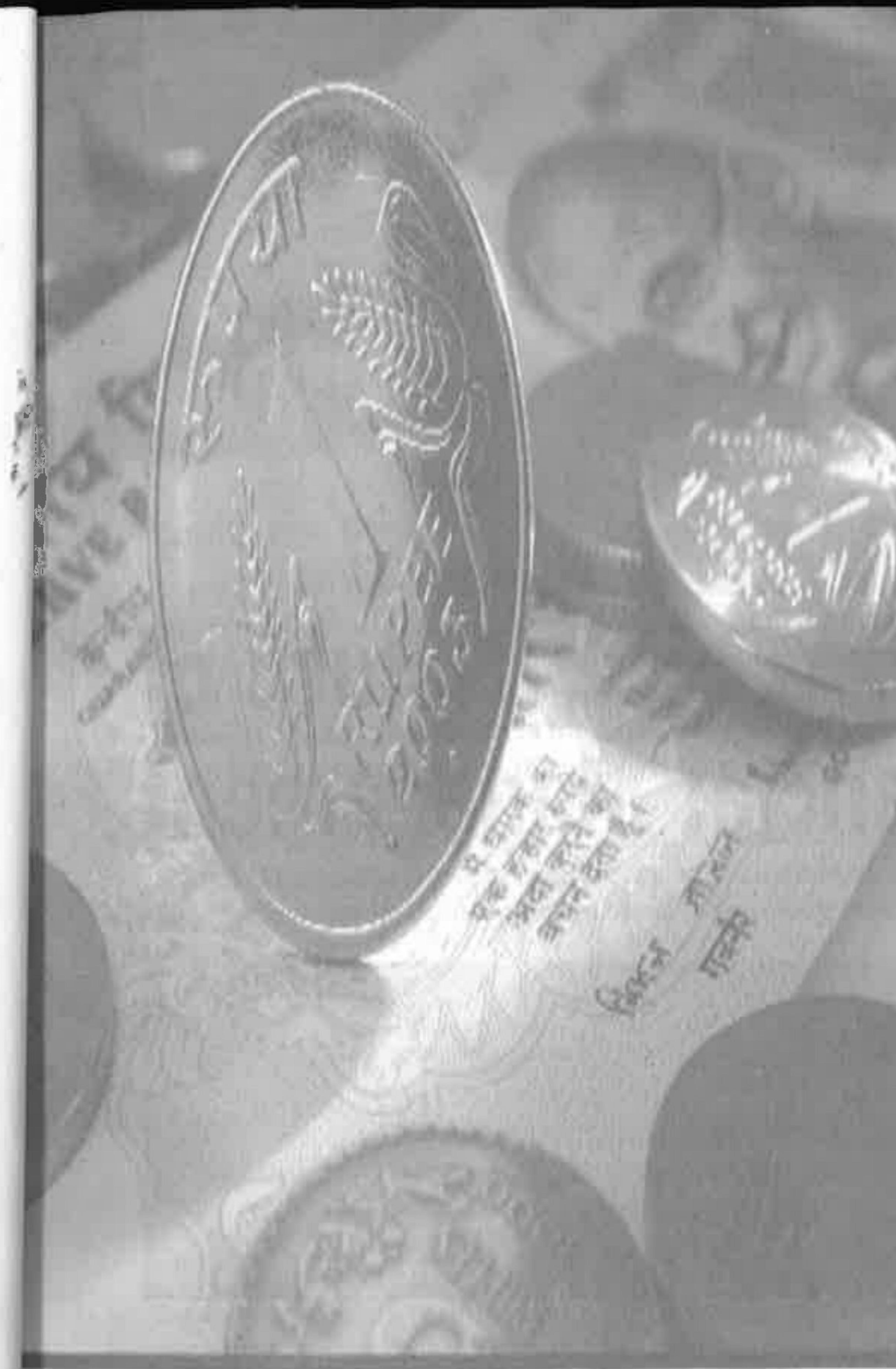
Learning Objectives	827
Introduction	827
Financial Goals and Strategy	827
Shareholder Value Creation	828
<i>Exhibit:</i> Financial Goals of Indian Companies	828

Shareholder Value Analysis: Case of Cadila Healthcare Limited	836
Managerial Implications of Shareholder Value	837
Balanced Scorecard	838
Corporate Governance	842
<i>Summary 845; Key Concepts 845; Student Activities 845</i>	

TABLES

<i>Table A: Compound Value Factor of a Lump Sum (CVF) of Re 1</i>	852
<i>Table B: Compound Value Factor of an Annuity (CVFA) of Re 1</i>	854
<i>Table C: Present Value Factor of a Lump Sum (PVF) of Re 1</i>	856
<i>Table D: Present Value Factor of an Annuity (PVFA) of Re 1</i>	858
<i>Table E: Continuous Compounding of Re 1 e^x and Continuous Discounting of Re 1</i>	860
<i>Table F: Value of the Standard Normal Distribution Function</i>	861
<i>Table G: Cumulative Distribution Function for the Standard Normal Random Variable</i>	862

<i>Author Index</i>	865
<i>Subject Index</i>	867



**PART
1**

Valuation

Chapter 1:

Nature of Financial Management

Chapter 2:

Concepts of Value and Return

Chapter 3:

Valuation of Bonds and Shares

Chapter 4:

Risk and Return: An Overview of Capital Market Theory

Chapter 5:

Risk and Return: Portfolio Theory and Assets Pricing Models

Chapter 6:

Beta Estimation and the Cost of Equity

Chapter 7:

Options and Their Valuation



Author Index

A

- Ackerman, R.W., 309
Alexander, G. I., 46
Altman, E.I., 610, 680
Andrews, V.L., 707
Ansoff, H.L., 759
Anthony, R.N., 561, 582, 607
Anthony, Robert B., 8
Archer, S.H., 6, 102
Arthur, R., 756

B

- Barker, C.A., 450, 453
Barges, Alexander, 192, 345, 346, 588
Baumol, W.J., 729
Basu, Sankarshan, 801
Beaver, W.H., 608
Bhat, Ramesh, 339, 448
Bhattacharya, S.K., 190
Bhattacharyya, H.K., 756, 782
Bierman, Harold Jr., 255, 272, 318, 319, 324
Bierman, H., 17, 162, 163, 172, 174, 222, 261, 274
Bicksler, J. L., 52
Bird, M.M., 302
Biscoe, P.N., 689
Black, F., 130, 146
Bond, G., 527
Bower, J.F., 302, 515, 516, 518
Brandt, L.K., 443, 446
Brealey, R., 18, 58, 59, 60, 65, 68, 101, 164, 172, 176, 255, 260, 281, 282, 355, 360, 361, 399, 466, 500, 503, 504, 512, 524, 600, 760, 779, 798
Brigham, Eugene F., 51, 52, 63, 64, 168, 174, 178, 331, 346, 443, 498, 503, 504, 656, 657, 658, 661, 662, 762
Brouilette, A.B., 453
Bruner, Robert F., 364, 366
Bruno, A.A., 540
Bussard, R.N., 720
Butters, J.K., 78, 90, 606, 676
Buzzel, R.D., 629, 560

C

- Carter, L., 527
Chen, L., 110
Chung, K.S., 774
Cohen, J.B., 13
Copeland, T.E., 101, 166, 174, 221, 234, 235, 237, 255, 258, 259, 289, 360, 442, 678, 721, 722, 779
Cox, J., 130, 145
Crum, R.L., 302
Culp, C., 802

D

- D'Ambrosio, 6
Dodd, David L., 427
Dean, Joel, 164
Dobrovolsky, Sergie P., 426
Donaldson, G., 11, 302, 368, 369, 370, 640, 827
Derkindern, F.G.J., 302
Drucker, P.F., 12, 593, 777
Durand, David, 342
Dyle, E.A., 676

E

- Eismann, P.C., 450
Eitman, D.K., 806
Evans, J. L., 102
Ezzell, John R., 202

F

- Fama, E.F., 109, 110, 466
Faucett, R.B., 720
Findlay, M.C., 234, 235
Fisher, D.E., 106
Fisher, I., 18, 175, 629
Foster, G., 581, 583
Fruhan, W.E., 831, 835
Francis, Jack Clark, 46, 422, 423, 424, 425, 428, 429
Frankle, A.W., 234, 235
French, R.R., 109, 110

G

- Goel, Rajeev, 645
Gordon, Myron J., 58, 60, 63, 169, 197, 425, 442, 629, 637
Gordon, L.A., 309
Graham, Benjamin, 427
Grayson, C. J., 273, 276, 277, 278, 288, 290
Gupta, G.P., 690, 691
Gupta, L.C., 102, 177, 450, 472, 484, 487, 489, 607, 609, 680, 745

H

- Haldeman, R.G., 610
Hall, W.K., 302
Hamada, R.S., 390
Hastie, K. L., 282, 298, 300
Hastings, P.G., 443, 444, 449
Hausman, W.H., 453,
Hax, A.C., 835
Haynes, W.W., 298
Heavy, D. F., 629
Hertz, David B., 284
Higgins, R.C., 638
Hoag, S.E., 774
Hofer, C.W., 627, 629
Howton, Shwan D., 802
Hull, J., 130, 143, 145

J

- James, C., 370, 657
Jarrow, R., 130, 145
Jensen, M.C., 431
Johnson, D.A., 638
Johnson, R.E., 346
Johnson, R.W., 688
Jordan, R.J., 106

K

- Kaplan, R.S., 838
Keene, Simon E., 202
Kennedy, R.D., 594
Keown, A.J., 487, 488, 489, 498, 501, 502, 503, 504

P
 Pandey, Ajay, 801
 Pandey, I.M., 297, 300, 302, 339, 352
 448, 510, 536, 541, 544

Perfect, Steven B., 802
 Petty, J.W., 298, 300, 302
 Phelps, C.W., 690, 691
 Pike, R.H., 299

Piper, Thomas R., 364
 Pogue, G.A., 720

Porter, R. Pourr, 202
 Porterfield, J.T.S., 160, 168, 192, 450,
 451

Porterfield, James C.T., 9
 Porwal, L.S., 301

Pratt, S.E., 536, 537
 Pringle, John J., 7, 329, 367, 372, 675,

677, 707, 709, 727

Q
 Que, A.V., 498, 499, 500
 Quirin, G.D., 159, 168, 171, 190, 194

R
 Ramamoorthy, V.E., 653, 654, 673,
 686, 703, 726
 Rangarajan, C., 177
 Rappaport, A., 764, 775

Reece, J.S., 561, 582, 607
 Reinhardt, U.E., 281
 Richard D. Irwin, 442, 707

Richards, V.D., 650
 Richmond, Herbert J., 711
 Robbins, S.M., 13
 Roberts, H.V., 466

Robicheck, A, 4, 273, 279, 350
 Rockley, L.E., 298, 300
 Roll, R., 110

Ross, S.A., 109, 110, 434
 Rozeff, M., Growth, 431, 442
 Ruback, R.S., 389, 390

Rubinstein, M., 130, 145

S
 Savage, L.J., 173
 Schall, L.D., 299, 300, 514

Schendel, D., 627, 629
 Schneiderman, A. M., 840
 Schoeffler, S., 629

Scholes, M., 130, 146
 Schroders, 528, 529
 Scott, D.F., 298, 300, 302

Sharpe, W. F., 46, 100, 102, 105, 106,
 107, 118

Shapiro, A.C., 806, 814
 Shelton, J.P., 498, 502, 503, 504

Sinha, S., 438, 510, 524, 801
 Sirpal, Sanjeev, 727
 Smidt, S. 162, 163, 172, 174, 222, 255,
 261, 272, 274

Smith, Adam 8
 Smith, P.L., 525
 Solomon, Erza, 64, 199, , 329, 345, 346,
 352, 367, 372, 424, 434, 675, 677, 707,
 709, 727

Solomon, M.B., 298
 Srinath, N., 777
 Staple, G., 525
 Starr, Martin, K., 701, 702
 Stonehill, A.F., 806
 Sundem, G.L., 299
 Sykes, Allen, 277
 Synder, Arthur, 705

T
 Tobin, J., 104
 Treynor, J., 100
 Tyebjee, T.T., 540

U
 Upton, C.W., 511

V
 Vaish, Manoj, 759
 Van Horne, James C, 64, 202, 234,
 237, 289, 370, 443, 451, 657, 657, 658,
 685, 687, 704, 705, 713, 721, 722, 726,
 732, 760, 761, 772
 Vardarajan, P., 639
 Verma, J.C., 476
 Vijay, P.N., 505

W
 Walker, E.W., 657
 Walter, Dolde, 802
 Walter, James E., 422-23, 498, 499, 500

Waterman, Merwin H., 318
 Waya, H., 756
 Weide, J.V., 678
 Weinhol, Wolf A., 364

West, R.R., 453
 Westlake, M., 689
 Weston, J. Fred, 44, 51, 52, 101, 166,
 168, 174, 178, 221, 234, 235, 237, 255,

258, 259, 289, 331, 360, 442, 443, 656,
 657, 658, 661, 662, 678, 721, 722, 762,
 774, 779

Weston, J.I., 774
 Williams, J.B 46, 58
 Woelfel, C.J., 554, 564

Y
 Yound, S.D., 834



Subject Index

A

Abandonment value, 306
 ABC analysis, 711
 Absorption, 757, 762, 778
 Accounting
 definition of, 554
 Accounting beta, 123-24
 Accounting rate of return (ARR), 160, 170-71, 178, 299
 acceptance rule, 163, 165-67
 evaluation, 166-71, 188
 investment decisions, 157
 reinvestment assumption, 177
 varying cost of capital and, 158
 Accounts payable, 224
 Accounts receivable, 571, 590-91, 630, 648, 667
 Accrual concept, 220
 Accrued expenses, 741-42, 750
 Acquisition, 758-60, 763-64, 769-70, 776-85
 Activity ratio, 583, 589, 593, 611
 Adjusted cost of capital, 401-03, 411
 Adjusted net income method, 722, 725, 733
 Adjusted net loss, 558
 Adjusted present value (APV), 395, 397-98, 411, 414
 Administrative capital budgeting, 309
 Advance factoring, 691
 Agency costs, 11, 14, 360, 362, 368, 431, 779
 Agency factoring, 691
 Aging schedule, 592, 685, 694
 American depository receipts (ADRs), 820
 Annual equivalent value (AEV), 256, 260, 266
 Annuity, 20-22, 25-32, 34-36, 39
 compound value of, 20, 30
 present value of annuity, 22-25, 28
 Annuity due, 30-31, 36, 39
 Arbitrage, 90, 109, 113, 347, 349, 378, 478, 797
 Asset beta, 123-24, 396
 Assets 1, 3-7, 9, 11-15, 570, 574, 576, 585
 current, 5, 581
 financial, 3
 fixed or long-term, 5, 14
 real, 3
 replacement cost of, 406

B

Assets cost of capital, 411
 Average return, 82, 86, 88, 93

Back-ended lease, 510, 514
 Backward induction, 286
 Backward integration, 761
 Bad-debt losses, 675-79, 683-84
 Balance sheet, 409, 550-55, 559, 562-64, 567
 functions of, 7
 liabilities, 551
 profit and loss account and, 556
 Balance sheet financing, 524
 Bank finance forms of, 743
 Chore committee, 745
 Dehejia committee, 745
 Tandon committee, 746
 Bank finance for working capital
 forms of cash credit, 743
 hypothecation, 744
 lien, 744
 mortgage, 744
 overdraft, 743
 pledge, 744
 purchase or discounting of bills, 743
 security required in, 744
 Bank references, 686
 Base-NPV, 411
 Bearish spread, 142
 Benefit-cost ratio, 167, 182
 Beta, 107-112
 determinants of, 117
 estimation of, 118, 120, 764
 in practice, 118
 levering, 411
 levered market or index model, 117
 unlevering, 411
 Bid-ask price, 822
 Bid-ask spread, 822
 Bills discounting, 684, 690
 Binomial approach, 145

- cial Management
5, 228, 238
55, 65, 68
t rate risk, 50
- payment, 48
459
459
ue of, 461
- 65
200
01
- s, 172
31
327
02
- . 721
LT), 525-26
O), 525, 531
- ancy factoring
- 754-55
6
545
- 63
- C**
- 141
236
- odel (CAPM), 106, 109, 111, 189,
4
9
model, 200
- , 103
312
ion, 4
ess, 297, 301, 308
- Capital employed to net worth ratio, 587
Capital expenditure, 3, 4, 15, 16, 213, 216, 225, 392
Capital investment
authorisation, 300
control and monitoring, 301
cut-off rate, 299
evaluation, 299
methods of, 299
planning phases, 298
recognition of risk, 300
- Capital gains, 57, 59, 63, 65
Capital gearing, 319
Capital market, 2, 3, 7, 14, 558
primary, 3
secondary, 4
Capital market efficiency, 106, 465-66
Capital market line, 104-05
Capital rationing, 174, 176, 179, 255, 260, 262, 300
Capital recovery, 26-27
Capital structure, 4, 123, 316, 317, 321, 323, 342, 388, 392
approach, 347
cost of capital and, 386
cost of capital and valuation, 386
EBIT-EPS analysis, 366
- Capital subsidy, 394
Capitalization rate (also see opportunity cost of capital), 379
Carrying cost, 701, 703-06, 708
Cash discount, 722
Cash dividend, 442
Cash ratio, 585
Cash budgeting, 721
Cash collection
accelerating, 726
decentralized, 726
instruments in India, 727
lock-box system, 726
Cash conversion cycle, 649, 652, 655
Cash credit system, 743-44, 746-47
Cash flow
consequences of a financial Lease, 511
debt-equity ratio, 587
depreciation and, 223
free, 225
incremental approach, 176
initial investment, 222
investment and financing decisions, 7, 9
nominal, 401
net, 220
nominal, 401
non-operating, 369
operating, 369
perpetual, 401, 403
profit and, 221
sources and uses, 562
terminal, 222, 225
Cash flow at risk (CFaR), 802
- Cash flow statement, 550, 554, 562
Cash flow, 9
Cash forecasting, 719, 722, 725
Cash inadequacy, 369
Cash management, 719-20
optimum cash balance, 729-30
planning
cash forecasting and budgeting, 721
sensitivity analysis, 725
short-term forecasting methods, 721
- Cash management cycle, 719
Cash planning, 719-20
Cash transaction, 796
Certainty equivalent, 276, 279-80
Chance events, 285-86
Characteristics line, 106, 118-19
Chargeable current assets, 747
Chief finance officer (CFO), 12
Circuit breaker, 475
Closely held company, 261, 373
Coefficient of determination, 119
Coefficient of variation, 273, 276, 330-32
Collar, 142
Collection efforts, 674, 684, 687
Collection experience matrix, 687-88
Collection period, 591
Collection procedures, 655, 684-85
Combination, 756-57, 760, 763, 767
Combined leverage, 328
Commercial paper (CP), 748
cost, 748
market in India, 748
merits and demerits, 749
short-term, 740, 742
use and maturity, 748
Commodity futures, 798
Companies Act, 1956, 782, 784
Component costs of capital, 193
cost of debt, 193
cost of equity capital, 196
Compound rate of return, 79
Compound value of
annuity, 20-21, 31
annuity due, 31
lump sum, 19
Compounding, 19, 23, 32-33, 50
Compressed APV, 400, 403
Concentration banking, 726
Conditional loan, 542-43
Conglomerate merger, 758, 761
Conservative forecasts, 300
Consolidation, 757, 782
Constant debt-to-value ratio, 399
Contingent claim, 130
Contingent costs, 232
Contingent investments, 160
- Controller, 13-14
functions of, 14
Conventional independent projects, 172
Conversion premium, 500
Conversion price, 501
Conversion ratio, 499, 500
Conversion value, 500
Convertible debenture, 469, 491
characteristics, 499
market value of, 500
valuation of, 499
why issue, 500
Convertible loan, 543
Convertible loan stock, 543
Convertible zero-interest debentures, 505
Corporate governance, 843-45
audit committee, 845
auditors' certificate on, 846
Board of directors, 844
remuneration committee, 845
Shareholders'/investors' grievance committee, 845
Corporate leverage, 348-49, 352
Corporate strategy, 297, 302
Correlation coefficient, 93, 96, 117, 119,
Cost of capital, 386
formula for opportunity, 192
overall vs. specific, 192
significance of
investment evaluation, 189
performance appraisal, 190
Cost of debt, 193-97, 199, 201, 205-06, 209, 343, 346, 351,
353
Cost of equity, 117, 124-25, 191-92, 196-97, 200, 202-03,
205, 207, 209, 343-46, 351, 368
Cost of external equity, 196
Cost of preference capital, 195
Cost trade-off, 658
Cost-reduction investments, 159
Coupon rate, 47, 52
Covariance, 92-94, 101-03, 106-08, 117-19, 122-23
Coverage ratio, 319, 364, 368, 589
Covered call, 138-39
Credit administration, 675
Credit bureau reports, 686
Credit collection and protection, 690
Credit information, 691
Credit investigation and analysis, 686
Credit limit, 687, 693, 738, 743, 746
Credit period, 670, 672, 684, 687
Credit policy, 592
factoring receivables, 692
goals of, 674
Credit procedure, for individual accounts, 673
Credit rating, 490
Credit standards, 674, 677-79, 681
Credit terms, 674, 678-79, 681

s, 582
return (CAR), 466
e preference shares (CCPS), 469
555, 558, 562

555-58, 563, 582, 585

D

ings (DIH), 590
sis, 281
55, 57, 193, 482, 488
490
, 490

87-88, 490

2, 762

99, 402, 406, 762, 768, 779

68

8

98

res, 469, 491

5

Delivery, 799
Deposit float, 726
Depository receipts, 820, 821
Depreciation, 221-30, 232, 235
Depreciation tax shield, 224, 228-30, 233, 235, 511
Derivatives, 365, 468, 474, 794, 802
use of, 803
Derivatives market, 474-75
Determinants of working capital
availability of credit, 656
credit policy, 655
demand conditions, 657, 741
manufacturing policy, 655
operating efficiency, 656
price level changes, 656
production policy, 658
Discount rate, 23, 25, 29-30, 32-34
Discounted cash flow (DCF), 160, 303, 404
Discounted payback, 158, 160, 170
Discounting, 18, 23, 32
Discretionary obligations, 370
Discriminant analysis, 609-10
Diversifiable risk, 107
Diversification, 159
Divestiture, 774
Dividend, 420-24, 426-27
decision, 5
earning yields, 599
policy, 5
Dividend capitalization, 57, 63
Dividend decision, 4
Dividend equalization reserve, 446
Dividend payments, 431
Dividend per share, 446
Dividend policy
constraints on paying dividends, 442
financial needs of the company, 451
shareholders expectations, 444
Dividend smoothing, 448
Dividend yield, 65, 78, 120, 421
Dividend-payout ratio, 599
Dividends per share (DPS), 598
Divisional cost of capital, 189, 835
Documentary bills, 727
Double taxation, 433
Dry lease, 512
Dual variable, 263
Due diligence, 539

E

Early-stage financing, 536
Earning
capitalization, 70
dividends and, 599
Earning per share (EPS), 9, 46, 598

Earning price ratio, 67, 198
Earnings before interest and taxes (EBIT), 123, 320, 392,
409, 583, 589, 594, 631, 680

Earnings capitalization, 63
Earnings cyclical, 123
Earnings variability, 123
Earnings-price (E/P) ratio, 67, 198

EBIT-EPS analysis, 322
EBIT-EPS chart, 324

Economic exposure, 813-14
Economic order quantity (EOQ), 702

carrying costs, 703
graphic approach, 705
optimum production run, 705
order-formula approach, 704
trial and error approach, 703

Economic profit, 832, 834-36
Economic return, 831
Economic value, 832
Economic value added (EVA), 832, 834, 841

Effect on shareholders' wealth, 487

Effective interest rate, 32, 35
Efficient capital markets, 46
Efficient forex markets, 810
Efficient frontier, 101, 106
Efficient portfolio, 101, 104, 106, 108

Enterprise value, 831

Episodic financing, 6

Equity, 386-87
capital, cost of, 196
cash flows, 395
funds, 3
public issue, 485
return on, 597

Equity beta, 124, 386-88

Equity cash flow (ECF), 395, 406

Equity shares, 56-57

Equivalent loan, 514, 516

Equivalent risk shares, 64

Beta estimation, 117, 818

Eurobonds, 820-22

Eurocurrency, 811, 820-21

Eurocurrency loans, 820-21

Eurocurrency markets, 820

European option, 131

EVA adjustments, 835

Evaluation, 4, 44, 160, 163, 166, 167-68, 171, 190, 455,
540, 600

Event studies, 466

Exchange rate, 807-20, 822

Exercise price, 130-40, 143, 502-05

Exercise ratio, 502-03

Expansion, 159

Expectation theory, 812

Expected net present value, 274-76, 286, 288

Expected rate of inflation, 812

Expense variability, 330
Experience curve, 628
Explicit cost of capital, 198
External capital rationing, 261

F

Factoring, 660
advance, 691
agency, 691
bills discounting and, 690
bulk, 691
costs and benefits of, 692
full service recourse, 691
maturity, 691
nature of, 689
non-notification, 691
services, 690
short-term financing and, 690
types of, 691

Free cash flow FCF, 391

Finance decisions , 4, 5

Finance functions, 12-13

Financing decision, 5

Financial asset, 2, 46

Financial assistance, 690

Financial distress, 342, 355, 361, 530

Financial flexibility, 371

Financial forecasting, 630, 634, 636

Financial futures, 799

Financial goals, 828

Financial lease, 511-14

evaluating, 514

Financial plans, 320, 322-26

constant EBIT, 320

varying EBIT, 322

Financial risk, 330

Financial leverage, 317-21, 327-29, 345, 350, 355, 402,
492, 521

degree of, 327

effect of, 321

effect on shareholder's

risk-return trade-off, 332

financial risk, 330

Financial management, 2, 5-7, 14

dividend decision, 3-5

liquidity decision, 3-5

profitability-liquidity trade-off, 5

nature of, 2

procedures, 5

systems, 5

traditional approach, 6

funds allocation, 6

profit planning, 7

Financial manager, 5

ial Management

30, 632, 636, 637

, 554, 556, 558, 561

tal, 558

re, 608

, 556, 561-64
207-08, 316, 319, 329-31

, 332

s

661

h, 661

661

7, 9, 14

operations, 819

61, 663, 664

89-192, 207, 211

2, 822

5, 177

26, 529

54, 555, 557, 560, 564-66

393, 607

396, 400

99

o, 389

202, 373

ns, 262

, 814-15

ent (FDI), 819

et, 806-07

, 807

806, 812, 814, 816, 821-22

19

814, 816

09

, 807, 809-12, 815-17, 821

4

51

iscount, 808-09

311

f, 811

25

ctoring, 691

Funds flow, 554, 556, 558-59, 561-62
Funds flow statement, 554, 556, 558, 559-62
Funds from operation, 555, 557-59
Futures contracts, 796-99
Futures price, 796-98, 802

G

Gearing, 317, 319
Geometric mean, 79
Global depository receipts (GDRs), 820-21
Goals, 6, 11-12
 financial goal, 11
 and firm's mission, 11
 managers vs. shareholders, 11
Going concern value, 47
Golden parachutes, 774-75
Greenmail, 774-75
Gross domestic product (GDP), 819
Gross profit margin, 594
Gross working capital, 648, 849, 663
Growth, 57-68
 Growth firm , 423, 426
 Growth opportunities, 370-71
 Growth option, 304
 Growth shares, 65

H

Hedge funds, 479
Hedge ratio, 147
Hedged position, 149
Hedging, 793-97, 801, 802, 812, 814, 816, 821
High-payout clientele, 431-33
Hire purchase, 31, 510, 511, 521-23
Holding company, 758
Holding period return, 79, 82
Homemade leverage, 348-49
Homogeneous risk class, 350
Horizon period, 390
Horizon value, 407-08, 411
Horizontal merger, 758, 761, 776, 784
Horizontal spread, 141
Hurdle rate, 165
Hybrid security, 488, 494, 495
Hypothecation, 744

I

Implied volatility, 147-48
Imputation taxation, 433
Incremental Approach, 176
Income gearing, 319
Income notes, 542-43

Incremental analysis, 707

 aspects of
 allocated overhead, 231
 incidental effects, 231
 opportunity costs, 231
 sunk costs, 232
 tax incentives, 233

Incremental approach, 176

Incremental cash flow, 220-22, 230-32, 238, 246, 248-49

Independent investments, 160

Index funds, 478-79

Index option, 135, 148

Indifference point, 325-26

Indirect quote, 807-08, 815

Industry analysis, 582

Inflation, 220, 230, 233-38, 401, 405

Information asymmetry, 341, 431, 434

Instalment sale, 521, 524

Intangible real assets, 2

Integrated international financial markets, 817

Integrated risk management, 801

Interbank market, 806

Interest coverage ratio, 589

Interest rate, 143, 806

 nominal, 811

 real, 811

Interest rate parity (IRP), 809-10, 812, 816, 821

Interest rate structure, 52

Interest rate swaps, 799

Interest tax shield, 3, 190, 195, 321, 342, 352, 353-60, 362,

371, 374, 389-401, 403-04, 406, 595

Internal capital rationing, 261

Internal rate of return (IRR), 35, 37, 158, 160, 164-65,

169, 171-180, 299, 519, 529

 acceptance rule, 163

 by trial and error method, 164, 182

 evaluation of, 158

 investment decisions, 158

 level cash flows, 165

 NPV profile and, 165

 uneven cash flows, 164

International capital investment, 816

International Finance Corporation, 527-28

International financial management, 806

 cost of, 757

 objectives of, 806

 risk of, 807, 811, 816

International financing, 821

International parity relationships, 809

Interval measure, 584-85

Inventory, 589

 components of, 590

 turnover, 589-93

Inventory management

 analysis of investment in
 choice of policy, 709
 incremental analysis, 707
 incremental investment, 708
 return on investment, 708-09
techniques

 EOQ, 702-06
 re-order point, 706

Investment allowance, 233

Investment decision, 3-5, 9-10, 18-19

 contingent, 160

 evaluation criteria

 accounting rate of return (ARR), 160, 170-71

 discounted cash flow (DCF) criteria, 160

 internal rate of return (IRR), 158, 164-65, 169

 net present value (NPV), 158, 160-61, 180

 non-discounted cash flow, 160, 181

 non-discounted cash flow criteria, 181

 payback, 158, 160, 167

 payback period (PB), 167-68

 profitability index (PI), 159, 167, 179-80

 importance of, 159

 independent, 160

 mutually exclusive, 160

 replacement of an existing asset, 260

 under inflation

 nominal vs. real rates, 233

 types off, 159

Investment evaluation, 819

Investment ideas, 298

Investments, 158-174, 176

Inward clearing, 728

Irredeemable, 195-96

Irredeemable preference share, 56-57, 69

Issue costs, 394, 398, 399

L

Law of one price, 809-10, 812

Lead time, 706, 713-14

Lease, 31, 38, 43, 510-526

Lease financing, 510

 advantages of, 513

 cash flow consequences of, 511-12, 515

 evaluation

 equivalent loan method, 514, 516

 net advantage of, 514-16

 net advantage of lease, 514, 516-17, 519

 net present value, 514, 516-17, 533-34

myths about, 512

types of

 financial lease, 512-14

73
43
57, 779, 782
12, 520, 524
89, 407
86, 389, 407
63

tion of India (LIC), 485
ent assets)

, 657

ecory, 662
494

7, 729
ing rate (LIBOR), 820

142, 145
302
ecision, 442
32-33

M

79
303, 310
55

l, 200, 211, 213, 216
capital, 164

ney, 289-90
472-73

Merger and acquisitions

analysis
illustration, 763-64, 770-72, 778, 780
defensive tactics, 774
financing, 762, 767
forms of, 757-58
leveraged buy-outs, 779
motives and benefits of
accelerated growth, 760
diversification of risk, 761
enhanced profitability, 760
financial benefits, 762
increased market power, 762
reduction in tax liability, 762
negotiations
earnings growth, 772
exchange ratio, 770-73
regulation of
legal measures against takeovers, 782
legal procedures, 784
protection of minority shareholders interests, 783
transfer of shares, 783

Miles-Ezzell formula, 403

Modernisation, 158-59

Money, 8

Money market, 814-16

Money market operations, 814-15, 822

Monitoring, 301

Monopolies and Restrictive Trade Practice

(MRTP) Act, 758

Monte Carlo simulation, 284

Moral hazard, 526

Mortgage, 34, 744

Multi-period capital constraint, 262

Multi-period compounding, 32-33, 35, 37, 40, 45

Multiple discriminant analysis, 609

Multiple rates of return, 174, 176-77, 179

Mutual funds, 464, 476-79

Mutually exclusive investments, 160

Mutually exclusive projects, 9, 160, 163, 166, 174, 176, 255-57

N

Natural hedge, 801

Net advantage of a lease (NAL), 518, 531

Net assets turnover, 592

Net cash flows, 222, 223-29

Net income approach, 343-44

Net operating income approach, 348, 352

Net present value (NPV), 9, 17, 33, 117, 158, 160-61, 179-81, 220, 228, 240, 241, 243, 247, 398, 410

return-risk trade-off, 117

Net present value (NPV) method

acceptance rule, 165, 167-68, 171, 180

ARR method, 170, 171

evaluation of, 171

PI method, 167

Net profit margin, 595

Net working capital (NWC), 392, 405
ratio, 581-86

New issues

financial instrument, 469

pricing of, 471

New issues market, 468-69

Nominal cash flows, 234-35

Nominal discount rate, 234-36

Nominal interest rate, 811, 821-22

Non-conventional investments, 172-73, 182

Non-convertible debentures (NCDs), 491, 505-06

Non-diversifiable risk, 117

Non-notification factoring, 691, 693

Non-operating cash flows, 369

Non-peak level credit, 743

Non-systematic risk, 761

Normal distribution, 77, 84-86

Numerical credit scoring, 679

O

Objective probability, 83, 274

Objectives, 2, 6, 8-9, 11-12

Operating capital budgeting, 309

Operating cycle, 648-53, 659

Operating expense ratio, 596

Operating exposure, 813

Operating inventory, 710

Operating lease, 511, 514, 531

Operating leverage, 7, 123, 124, 126, 316, 327-30, 335

Operating options, 308

Operating risk, 316, 329-30

Opportunity cost, 222, 228-30, 232, 237

creditors claims, 191

of capital formula, 191

overall vs. specific cost of capital, 192

risk differences, 191

shareholders opportunities and values, 190

Opportunity cost of capital (OCC), 4, 9, 18-19, 33-34, 159-61, 163, 165-66, 170, 173, 177-78, 189-93, 386-88, 395-403, 405, 411

Optimum capital structure, 4, 345-47, 355, 361, 364, 366

Optimum cash balance, 729-30

Optimum credit policy, 673, 675, 677-78

Optimum production run, 705

Option, 130-150, 794-97

American, 131, 147, 149

binomial model for, 145

Black and Scholes (B-S) model, 146

buyer, 131-34, 139-49

call 130

call premium, 132

delta, 145-47

delta or hedge ratio, 147

determination of, 142

expiration, 131-32, 134-48

holder, 130-33, 143-45, 149

index, 134-36

naked, 138

premium, 131-35, 139-42

put, 130-31, 133-44, 146-50

seller, 132-34, 139, 141, 143

trading in India, 134

writer, 132-33, 138, 143

Ordering costs, 702-06, 713

Ordinary shares, 482-86, 488-89

OTC market, 468, 479

Out-of-the-money option, 130

Outward clearing, 728

Overall cost of capital, 190, 193, 200-07

Overdraft, 742-43

Owners of residue, 3

P

Payback, 276-77, 280, 290

acceptance rule, 163, 165

evaluation, 158, 160, 163, 166-68, 171

reciprocal and the rate of return, 169

Payment float, 728-29

Payout ratio, 420, 422, 427, 431, 434

Peak level credit, 743-44, 748

Perfect capital market, 342, 347, 350, 352, 464, 467-68

Permanent working capital, 653, 664

Perpetual bonds, 48, 51

Perpetuity, 27, 30-31, 34, 37

Personal leverage, 352

PIMS, 629

Pledge, 744

Poison pills, 775

Policies, 3, 5, 12-15

Policy obligations, 369

Pooling of interest, 778-79, 784

Portfolio, 90-92, 94-109

Portfolio opportunity set, 100, 103-04, 112

Portfolio return, 90-92, 94, 96-97, 99, 103

Portfolio risk, 90, 92, 95, 96-98, 101, 103, 105, 108, 111-12

Portfolio theory, 90, 100-101

Portfolio return: two-asset case, 90-92, 94, 96, 97, 99, 100

Portfolio risk

and correlation, 93-100

measuring, 92

N-security case, 101

two-asset case, 90, 92, 96, 100

Pre-emptive rights, 484

Precautionary motive, 701, 713

Preference share, 46, 55-57, 69, 191-92, 195-96, 201, 482-83, 488-89, 494

66

44

25

27

io, 46, 67, 409, 438, 451, 599

521

9, 472

ship, 14

costs, 675

33, 235, 237

ee dividend decision,

53

nt or account, 553-54, 563, 630-32,

8

, 160, 167, 179, 180, 262, 266

260-62

207

396, 411, 492, 510, 524-26

262, 266

alysis (PVA), 711

7, 142, 143, 149

-79, 784

ng of bills, 743

ity, 809-10, 812-13, 821

142

, 143, 147

QRate of return, 4, 9
accounting, 160, 170

average, 78

expected return and risk, 82

payback reciprocal and, 169

variability of, 79

Ratio analysis

standards of comparison, 582

Ratios

activity, 583, 589

assets turnover, 592

cash, 581

competitors, 582

coverage, 589

current, 584

debt, 581, 583

debt-equity ratio, 587

debtors turnover, 591-92

diagnostic role of, 606

dividend-payout, 599

industry, 582

leverage, 583, 586

liquidity, 584

market value-to-book value (MV/BV), 599

operating expense, 596

past, 581-83

price-earnings, 599

profitability, 583, 593

projected, 582-83

quick, 584-85

types of, 583

Real assets, 2, 46

Real cash flows, 234-35, 237

Real discount rate, 234-35

Real interest rate, 811

Real options, 297, 303-04, 310

Redeemable preference share, 56-57, 69, 196, 558,

562

Regression, 118-121

Reinvestment assumption, 177-78

Reinvestment rate, 177-78

Reorder point, 702, 706-07, 712-13

Replacement chains, 256, 260

Replacement cost of, 406

Replacement decisions, 159

Replacement value, 47

Required rate of return, 4, 15, 18, 28, 38

Residual income, 833

Retained earnings, 551, 555, 561, 566

Retention ratio, 420, 422, 425-28

Return, 90-100, 102-112

uncertainty of, 8

Return on equity (ROE), 597, 599, 605, 607, 611

Return on investment (ROI), 3-4, 170, 178, 322, 588,

596

Revenue expenditure, 221, 238

Risk, 4, 10, 17, 52, 54, 77-79, 82, 84-86, 90, 92, 94-96, 98, 101-04, 272-280, 282, 285, 289-290, 793-802

conventional techniques to handle

certainty equivalent, 278-80

payback, 276-77

risk-adjusted discount rate, 277

decision tree approach

steps in, 285

usefulness, 288

hedging, 793-95

probability distribution approaches

normal probability distribution, 85

recognition of, 300

relative measure of, 276

sensitivity analysis

DCF break-even analysis, 281

pros and cons of, 282

scenario analysis, 282

statistical techniques to handle

probability defined, 273

statistical techniques to handle

coefficient of variation, 273, 276

expected net present value, 274-76

standard deviation, 273, 275

Risk and return, 77

expected, 79, 82-83

free security, 103-05, 107-08

N-security, 101

Risk averters, 289

Risk management strategy, 801

Risk neutrality, 146

Risk of default, 10

Risk of expropriation, 819

Risk premium, 10, 18, 36, 38, 65, 75, 82, 125

Risk-adjusted discount rate, 210, 276-80, 290

certainty equivalent and, 276, 278

Risk-adjusted discount ratio, 277

Risk-averse, 84-85

Risk-free portfolio, 138

Risk-free rate, 10, 18, 36, 38

Risk-neutral, 84-85

Risk-return relationship, 10

Risk-return trade-off, 10, 332

Rolling settlement, 475, 480

S

Safety stock, 706-708, 713-14

Sale-and-lease-back, 511, 512

Sales

variability of, 324, 329-333

Salvage value, 222, 225-31, 235, 236, 238

Scenario analysis, 282-85, 290

Secondary lease, 511

Secondary markets, 472

Securities, 2, 5, 7, 14

Semi-strong form of efficiency, 466

Sensitivity analysis, 277, 280-82, 290, 300, 636

Separation theorem, 104-05, 112, 629

Set-up cost, 705

Shadow prices, 263

Share, 2-4, 7, 13

bonus, 441-445, 449

buyback of, 442, 449, 453-456

concepts of value, 46

constant dividend, 446-47

earning-price (E/P) ratio, 67

earnings capitalization, 62-64

equity

dividend capitalization, 57

effect on shareholders wealth, 487

pros and cons of, 485, 487, 489, 492

subscription price, 484, 486, 487

terms and procedures, 485

value of a right, 485

growth in dividends, 59

ordinary, 148

features of, 483, 488

private placement, 485

pros and cons of, 484, 487, 489, 492

public issue of equity, 485

reporting of, 482

preference, 191, 193, 195

preference shares

features of, 56

pros and cons, 56

price, earnings and dividends, 65

price-earnings (P/E) Ratio, 67

split

bonus share, 449

reasons for, 453

reverse split, 453

Share exchange ratio, 669-673

Share price index, 119, 466

Shareholders, 3, 7, 386

expectation of, 443

opportunities and values, 190

Shareholders value, 760, 772, 785

analysis, 830, 836-37

managerial implication of, 837

Shareholders value creation (SVC), 830, 837

Shareholders wealth maximization (SWM), 2, 7, 9, 11-12, 14-15

Short hedge, 796, 799

Short position, 138, 142, 145

Signalling, 363

Simulation analysis, 284, 285, 290

Single taxation, 433

Sinking fund, 22, 23, 26, 28, 36-38, 194, 488, 490

Small scale enterprises (SSEs), 536

Security market line (SML), 107-08

Special tax benefits, 394, 398, 411

01, 720-21
factor, 457
3
g, 660
99, 805
8
50
42
77, 79-86, 90, 92-100, 102, 106, 108,
5-76, 285, 289, 290, 330-333
s in financial position, 554, 556, 561,
449, 450, 457
4, 374
e Board of India (SEBI), 364
798
43, 150
491

lgetting, 309
28-29, 641, 837, 840-41
29, 637, 827, 837-39, 841-42, 845
payable, 742, 750
135, 141, 142, 144

iciency, 480
ty, 83
g, 397, 400
heet, 780
40
33, 238
h, 62-63, 197
, 627, 637-41, 828, 831
0, 802
9

5-76, 781
e loan, 800
ket risk, 102
7-18, 122, 761

T

761-62, 774-76, 782-84
95
e, 745-48
s, 2
cture, 192, 200-01, 206, 208-09, 364,
389, 391-92, 404
3, 448, 449, 457

Term structure of interest rates, 662
Terminal cash flow, 222, 225, 230, 238
Terminal value, 226, 229, 238, 392, 405
Time preference for money, 17-18, 36, 38
Time series analysis, 582-83
Time value of money, 8, 17-19, 23, 36, 38
Total assets turnover, 593
Trade bills, 727
Trade credit, 673, 693, 740-43, 750
Trade references, 686
Trade-off theory, 360
Trading on equity, 317-18
Transaction costs, 346, 350, 352, 363, 374
Transaction exposure, 812, 813, 816, 822
Transaction motive, 720
Translation exposure, 812, 814, 816, 822
Treasurer, 13-15
Treasurer's functions
 controller of, 13-14
Treasury bills, 732
Tree harvesting problem, 258
Turnaround financing, 537

U

Uncertainty, 8, 9, 272-74, 276-78, 284, 447, 724
Uncertainty of returns, 8
Under-investment, 371
Underlying asset, 130-34, 143-46
Underwriting, 485, 488, 492
Unlevered beta, 386, 389, 407
Unsystematic risk, 110, 117
Up-fronted lease, 510
Utility theory, 289-90
 benefits and limitations of, 289

V

Vaghul working group, 749
Valuation, 10, 145-48, 386, 391, 392, 394, 403, 404, 408,
409
 and financing, 386
 option, 130
Valuation model, 10, 11
Value
 book value, 47, 599
 compound value, 19-23, 31
 going concern, 47
 liquidation value, 47
 of an annuity due, 31
 present value, 17, 20-23, 31, 33-35
 replacement value, 47
Value additivity, 9, 222
 principle, 163, 166-67, 176-77
Value drivers, 835

Variable costs, 7, 327, 330
Variable working capital, 653
Variance, 79-81, 83-84, 90, 92-104, 106-09, 111, 275-76
Varying cost of capital, 179
Venture capital, 536-546
 in developed countries, 536, 540, 542-43, 545-46
Vertical merger, 758, 761
Vertical spread, 141

W

Walter's model, of dividend relevance,
 criticism of, 424
declining firms, 423
growth firms, 423
normal firms, 423
Warrants, 469, 498, 501-06
 characteristics, 499, 501
 characteristics of, 499, 501
 issue, 498-501, 504
 valuation of, 498-99, 502-03
Wealth maximization, 2, 7, 9-12, 14
 valuation approach, 10
Weak form of efficiency, 466
Weighted average cost of capital (WACC), 189, 192-93,
200-02, 206-07, 210-11, 300, 387, 391, 403-04, 406,
410
 investment evaluation, 190, 202
 limitations of, 394
Wet lease, 512
White knight, 774-75
Widely-held companies, 373

Y

Yield, 490-91
Yield curve, 662
Yield to maturity, 48-49, 51-52, 56, 69

Z

Zero coupon bonds, 38
Zero-interest bond, 34, 38
Zero-interest debentures (ZID), 469, 498, 505, 507

Financial Management

TENTH EDITION

The importance of financial management can hardly be overemphasized; it is a critical aspect of management. The tenth edition of the much acclaimed *Financial Management* has been thoroughly revised.

Highlighting the 'modern' analytical approach to corporate finance decision-making, the text has been restructured to focus on finance theory and its implications in the financial decision-making process involving investment, financing, dividend and working capital management. It also discusses sources and instruments of short-term and long-term finances, mergers and acquisitions, international financial management, shareholders' value creation, EVA, balanced scorecard, corporate governance and the interface between financial and corporate policies. Most importantly, the book helps students to relate theories and concepts to practice. The book is different from others in terms of coverage and presentation and provides comprehensive coverage for MBA, MCom, CA, CFA, ICWA and other postgraduate and professional courses.

**The book demonstrates that the subject of finance is simple, interesting and relevant in practice.
The book is application-oriented and focuses on the analytical approach to financial decisions, making it a one-point reference for all its readers.**

Latest topical material has been added in several chapters. The new features include:

- Check Your Concepts
- Quiz Exercises
- Practical Projects

Free Students' CD containing

- Answers to Review Questions and Problems
- Additional problems with solutions for practice from CA and other professional examinations
- Comprehensive Cases for analysing financial decisions in complex, real-life situations
- Additional problems with answers, along with questions from latest papers
- PowerPoint presentations for all chapters
- Excel-based Financial Problems to practice the use of spreadsheets in finance
- Web Links for an exhaustive list of finance-related sites
- Key Definitions and Formulae as a useful ready reckoner



A respected name in academic circles, **Dr I M Pandey** is currently Professor of Finance, Department of Commerce, Delhi School of Economics, University of Delhi. A PhD from Delhi School of Economics, he was earlier Professor, Indian Institute of Management, Ahmedabad (IIM-A) where he also served as Officiating Director, Dean and Chairman of Fellow Programme. Dr Pandey also served as Dean, School of Management, Asian Institute of Technology, Thailand, from 2005-07. He has taught at many international Universities/Institutes in USA, France, UK, Malaysia, Sri Lanka, Thailand and Vietnam.

Dr Pandey's research interests are focused on strategic financial management, financial decision-making processes, comparative financial systems, capital markets and financial services, with a special focus on emerging markets.

A prolific writer and a name to reckon with in his field, Dr Pandey has authored/co-authored ten books, five monographs and has written more than 100 articles and management cases. He was the Editor of IIMA's journal *Vikalpa: The Journal for Decision Makers* and is on the editorial board of several international journals. Currently on the board of Indorama Polymer Limited, Thailand, he has in the past served on the Boards of IFCI and HPCL, among others.

