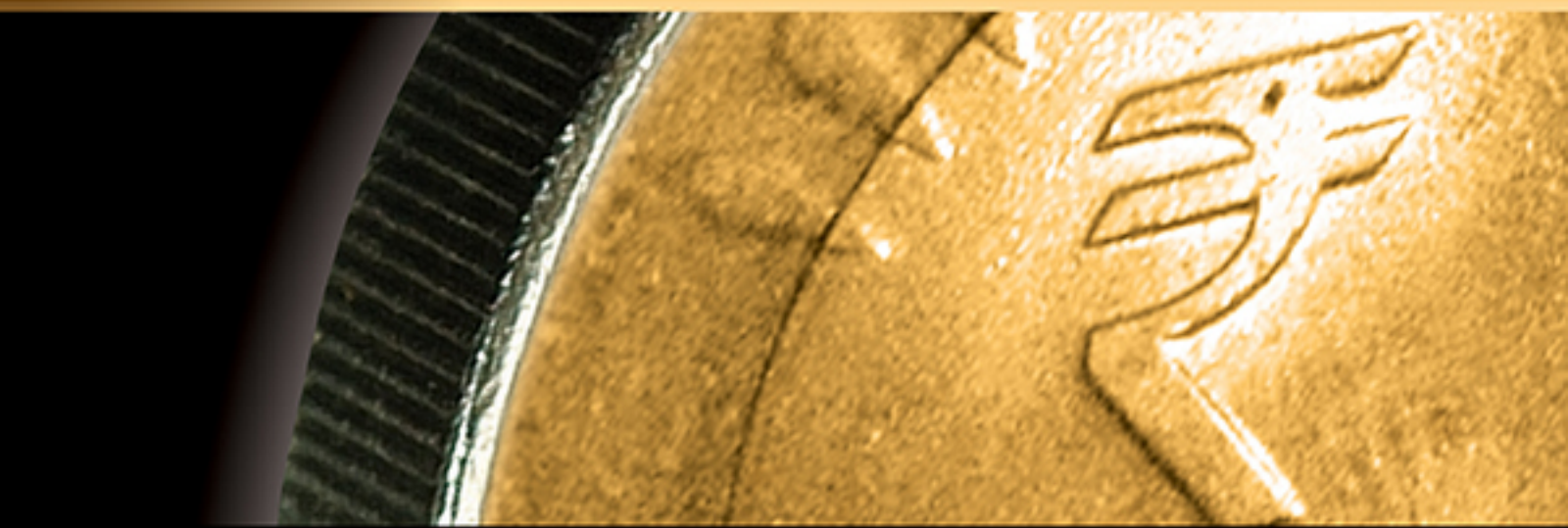




# FINANCIAL MANAGEMENT

ELEVENTH EDITION



I M PANDEY

# Financial Management

**11th  
Edition**

# Financial Management

**11th  
Edition**



**I M PANDEY**

**DIRECTOR GENERAL**

**DELHI SCHOOL OF BUSINESS**

**AND**

**VIVEKANAND INSTITUTE OF**

**PROFESSIONAL STUDIES**

**NEW DELHI**

**FORMER PROFESSOR & DEAN**

**IIM, AHMEDABAD**



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# Preface

About three decades ago, the scope of financial management was confined to raising of funds, and less significance was attached to analytical thinking in financial decision-making and problem solving. As a consequence, the earlier textbooks on finance were structured around this theme and contained descriptions of the instruments and institutions of raising funds and of the major events, like promotion, reorganization, readjustment, merger, consolidation, etc., when funds were raised. In the mid-fifties, the emphasis shifted to judicious utilization of funds. Modern thinking in financial management accords a far greater importance to management decision-making and policy. Today, financial managers do not perform the passive role of scorekeepers of financial data and information, and arranging funds, whenever directed to do so. Rather, they occupy key positions in top management areas and play a dynamic role in solving complex management problems. They are now responsible for shaping the fortunes of the enterprise and are involved in the most vital management decision of allocation of capital. It is their duty to ensure that the funds are raised most economically and used in the most efficient and effective manner. Because of this change in emphasis, the descriptive treatment of the subject of financial management is being replaced by growing analytical content and sound theoretical underpinnings. This is the approach adopted in this book.

## Focus of the Book

I wrote the first edition of *Financial Management* in 1978 with the following objectives, which remain unchanged in the eleventh edition of the book:

1. To demonstrate to readers that the subject of finance is simple to understand, relevant in practice and interesting to learn.
2. To help readers appreciate the logic for making better financial decisions.
3. To explain the concepts and theories of finance in a simple way so readers can grasp them very easily and are able to put them into practice.
4. To provide a book that has a comprehensive coverage for MBA and other postgraduate courses.
5. To create a book that differentiates itself from other textbooks in terms of coverage, presentation, and with an equal focus on theory and practice, with real-life examples.

*Financial Management* combines theory with practical applications. It begins with the discussion of fundamental concepts of value and return, risk and return relationship and valuation of shares and bonds. With this foundation, readers can easily understand the theories and methods, decision criteria, and financial policies and strategies necessary to manage funds and create and enhance the value of the firm.

*Financial Management* in its eleventh edition, like in its previous editions, highlights the 'modern', analytical approach to corporate finance decision-making. The text material has been structured to focus on finance theory and its implications in the financial decision-making process and policy. The book discusses the theories, concepts, assumptions, and the mechanics underlying financial decisions, *viz.*, 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 and the interface between financial and corporate policies. Importantly, the book helps students to relate theories and concepts to practice.

## Features of the Book

*Financial Management* aims to assist the reader to develop a thorough understanding of the concepts and theories underlying financial management in a systematic way. To accomplish this purpose, the recent thinking in the field of finance has been presented in a most lucid, simple, unambiguous and precise manner.

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The book contains a comprehensive treatment of topics on valuation, risk and return, options, capital budgeting, capital structure, dividend decisions, working capital management, mergers and acquisitions, shareholder value, corporate governance and international financial management with a view that readers understand these financial decisions thoroughly and are able to evaluate their implications for the shareholders and the company. The financial analysis, planning and modelling techniques are also discussed in detail for the benefit of those readers who have not been exposed to these topics earlier.

The book stresses the analytical approach for solving financial problems. Concepts are made clear in simple language before introducing complicated and sophisticated techniques and theories. For a better and easy comprehension of the concepts and theories, the book contains a number of real-life financial problems and cases in the Indian context in addition to examples and illustrative problems. Each chapter contains a summary of the key points as well as a list of key concepts. At the end of each chapter, review questions, quizzes and problems have been added, a number of which are based on professional courses and examinations. Review questions can be used for discussions in the class by teachers. Problems have been included to help readers apply the concepts discussed in the chapter. These have been designed to illustrate the key points in the text. Some questions and problems require readers to evaluate a situation or critically examine and analyse it. A special feature of *Financial Management* is the real-life cases of Indian companies at the end of most chapters. It is hoped that this will facilitate a better understanding of the subject matter and its practical application.

Many chapters of *Financial Management, Eleventh Edition*, have been revised. New concepts, like consumption beta, simulation in capital budgeting, three factor model, etc., have been added. A number of new real-life examples of companies have been included. Readers may notice that some real-life cases and other materials have been provided in Exhibits (boxes) to draw their attention. These have also been identified in the Contents. Particular care has been taken to ensure the correctness of equations, formulae, solved problems, and illustrations.

The main features of the book are as follows:

1. **Excel applications** Proficiency with spreadsheets and Excel is a great advantage to financial analysts and managers and a necessity for all the postgraduate students of management, commerce and accounting courses. With this in mind, at appropriate places, Excel Applications have been created showing how spreadsheets with the help of Excel could be used to solve finance problems and take decisions. These have also been identified in the Contents.
2. **Web links for financial data** Students must know how to access financial data and information on the Internet. With this in mind, a list of useful web links has been created to help readers retrieve useful financial information.
3. **Illustrative problems** Finance decisions involve solving problems using theoretical concepts. The book contains solved illustrations showing readers how concepts could be used to solve problems and take decisions.
4. **Real-life examples** The book contains a large number of real-life cases and examples to illustrate the practical applications of finance theories and concepts.
5. **Cases** Most chapters include mini cases that reflect the applications of the conceptual material in the chapters.
6. **Key concepts** For the benefit of readers, the key concepts of each chapter have been listed at the end of the chapter.
7. **Practical project** Most chapters have a 'Practical Project' each where students are helped to apply their knowledge to real company situations.

**Beta calculation in practice** Over the past few years, the use of beta in decision-making has increased in India. The National Stock Exchange ([www.nse-india.com](http://www.nse-india.com)) gives beta based on daily share prices for a one-year period for a number of companies. This information may not be useful when we require beta based on a longer time period or for different time periods. Chapter 6 shows how beta can be calculated for a real company in practice. Thus, use of 'Regression function' of Excel has been demonstrated to calculate beta.

**Valuation and governance** Managers are required to maximize the shareholder value. This needs a clear understanding of cash flows and discount rate and the financing impact. In practice, a number of managers are not able to understand the inter-relationships. Chapter 16 integrates cash flows, discount rate, financing and valuation. This material is further extended to shareholder value and corporate governance in Chapter 35.

**Cost of capital** The cost of capital is a contentious topic in finance. Its calculation could be quite tedious in practice. With the help of a real world company, its calculation has been demonstrated in Chapter 9. In Chapter 16, the effect of changes in capital structure on beta and the cost of capital has been analysed.

## Instructional Material for Teachers and Students

The following material is available for students and teachers:

1. **Students' CD** As earlier, the eleventh edition of *Financial Management* also has a students' CD. The CD includes:
  - (a) Answers to Review Questions and Problems
  - (b) PowerPoint presentation of each chapter

- (c) Data of companies for analysing their financial performance
  - (d) Excel problems to practice the use of spreadsheets and Excel functions in finance
  - (e) Web links for an exhaustive list of finance-related sites
2. **Teachers' Manual** To help teachers teaching from the book and design their finance courses, a Teachers' Manual is available, request for which can be placed on [helpline@vikaspublishing.com](mailto:helpline@vikaspublishing.com).

### **Audience of the Book**

*Financial Management* is designed for use in MBA, MCom, Chartered Accountancy, Cost Accountancy, and Company Secretary courses. It will also be useful for financial executives who want to update their knowledge about the recent thinking in financial management and who wish to improve their ability in making financial decisions. To cater to the needs of both students and financial executives, the subject matter has been discussed in a conceptual-cum-analytical manner. It is the aim of the book to help readers develop skill to understand, analyse and interpret financial problems and data to make good financial decisions.

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# Acknowledgements

A large number of individuals have contributed in creating this book, **Financial Management**. I am thankful to all of them for their help and encouragement. Like most textbooks, this book has also drawn from the works of a large number of researchers and authors in the field of finance. My writing in this book has also been influenced by a number of standard and popular textbooks in the field. As far as possible, they have been fully acknowledged at the appropriate places. I express my gratitude to all of them. A number of problems, illustrations and exercises in the book have been drawn from or are based on the examinations of universities and management institutes in India as well as the public examinations of the professional bodies in India, the UK and the USA such as the Institute of Chartered Accountants of India, the Institute of Cost Accountants of India, the Institute of Certified Public Accountants (CPA), USA, National Association of Accountants (NAA), USA, and the Institute of Cost and Management Accounting (ICMA), UK. I have tried to give credit to all sources from where I have drawn material in this book. Still there may have remained unintended errors. I shall feel obliged if they are brought to my notice. I have also used published data of a number of companies in India. I am thankful to those companies also.

I express my gratitude to all my colleagues from universities, management schools and professional institutes in India and abroad for adopting the book, or for making suggestions for the improvement of the book, or for extending their support and encouragement. I have mentioned the names of friends who have been a source of motivation to me, and some adopters of the book.

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The book is dedicated to my wife, Meena, who has always been a source of incessant motivation and encouragement to me and who has always extended her unstinted support to me in writing this book. I am thankful to my wife as well as my daughter, Ruchika and son, Abhishek, for their endurance through several months that I spent in writing this book.

I M PANDEY

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# About the Author

I M Pandey, a PhD in Finance from the Department of Commerce, Delhi School of Economics, University of Delhi, currently, holds the position of Director General at Delhi School of Business and Vivekanand Institute of Professional Studies. Earlier, he was a Professor at Indian Institute Management Ahmedabad for more than 25 years where he also served as Acting Director, Dean, Chairman of Doctoral Programme and Chairman of Finance & Accounting Area. He also served in Indian Institute of Management Lucknow as Professor of Research during 2013-14. He also held the position of Dean & Chair Professor, School of Management and Vice President for Academic Affairs, Asian Institute of Technology (AIT). Before joining AIT in the beginning of 2012, he served as Dean of Faculty of Commerce & Business, Delhi University as well as a senior Professor at the Department of Financial Studies and the Department of Commerce, Delhi School of Economics, Delhi University. He has taught at Kansas State University, USA; ESSEC & ESCP, France; University of Birmingham, UK; University of Science Malaysia, and also in Vietnam, Sri Lanka, and Bangladesh.

His areas of research include strategic corporate finance, corporate governance, venture capital and emerging capital markets. His publications include ten books, six research monographs, and about 100 articles and management cases. His articles are published in international refereed journals such as *Managerial Finance*, *International Journal of Managerial Finance*, *Studies in Economics & Finance*, *Asia Pacific Journal of Business & Economics*, *Global Business & Finance*, *Afro-Asia Journal of Finance & Accounting*, *Vikalpa*, *Decision* etc. He was member of the Boards of Directors of Indorama Polymer Limited, Thailand; Industrial Finance Corporation of India; Cochin Shipyard Company, IDBI-Principal Mutual Fund; Ahmedabad Stock Exchange, Gujarat Chemicals, Hindustan Petroleum Company (HPCL) and IDBI's Western Region Advisory Board. He was also a member of the Controller of Capital Issues Advisory Committee. He served as Editor of the IIM Ahmedabad journal, *Vikalpa: Journal of Decision Makers* and has been on the editorial boards of several international journals including *Global Business and Finance Review*, *Afro Asia Journal of Finance & Accounting*, *Journal of Accounting & Finance*, *International Journal of Accounting, Auditing and Performance*.





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☒ = Excel Applications

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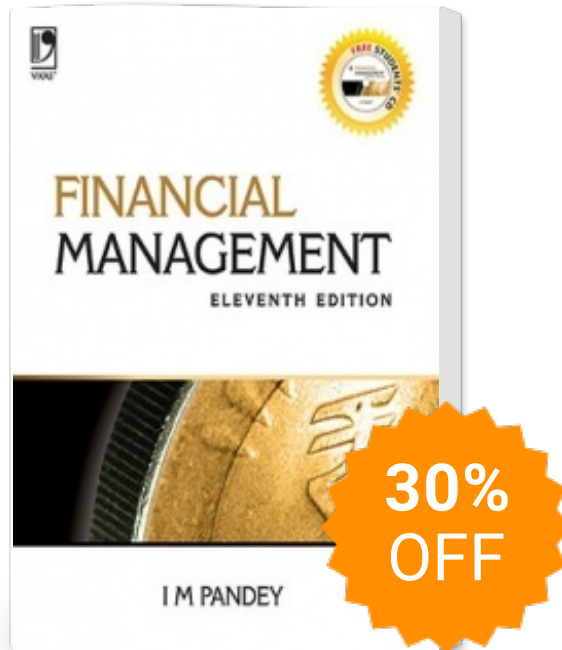
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