

## SECTION – 5

### QUESTION-2.

#### ANSWER:-

#### Preference Share:-

Preference Shares, as its name suggests, gets precedence over equity shares on the matters like distribution of dividend at a fixed rate and repayment of capital in the event of liquidation of the company

The preference shareholders are also the part owners of the company like equity shareholders, but in general, they do not have voting rights. However, they get right to vote on the matters which directly affect their rights like the resolution of winding up of the company, or in the case of the reduction of capital.

The following are the types of preference shares:

Participating Preference Shares

Non-Participating Preference Shares

Convertible Preference Shares

Non-Convertible Preference Shares

Cumulative Preference Shares

Non-Cumulative Preference Shares

#### Equity Share:-

Equity shares are the ordinary shares of the company. The holder of the equity shares are the real owners of the company, i.e. the amount of shares held by them is the portion of their ownership in the company.

Equity shareholders have some privileges like they get voting rights at the general meeting, they can appoint or remove the directors and auditors of the company. Apart from that, they have the right to get the profits of the company, i.e. the more the profit, the more is their dividend and vice versa. Therefore, the amount of dividends is not fixed. This does not mean that they will get the whole profit, but the residual profit, which remains after paying all expenses and liabilities on the company.

#### Key Differences Between Equity Shares and Preference Shares:-

Equity shares cannot be converted into preference shares. However, Preference shares could be converted into equity shares.

Equity shares are irredeemable, but preference shares are redeemable.

The next major difference is the 'right to vote'. In general, equity shares carry the right to vote, although preference shares do not carry voting rights.

If in a financial year, dividend on equity shares is not declared and paid, then the dividend for that year lapses. On the other hand, in the same situation, the preference shares dividend gets accumulated which is paid in the next financial year except in the case of non-cumulative preference shares.

The rate of dividend is consistent for preference shares, while the rate of equity dividend depends on the amount of profit earned by the company in the financial year. Thus it goes on changing.

## **Finance:-**

Financial Management is the activity concerned with the control and planning of financial resources. In business, the finance function involves the acquiring and utilization of funds necessary for efficient operations. Finance is the lifeblood of business without it things wouldn't run smoothly.

### **Objectives:-**

Objective of Business Finance:

Revenue Generation:

Profit Margin:

Managing Operational Activities:

Productivity and Efficiency:

Sustainability:

Customer Satisfaction:

Return on Capital Investment:

Employee Benefits:

Emergency / Contingency Plans:

Leadership and Management:

## **Payback period and Net present value Method (NPV):-**

### **Net Present Value Method**

Under the net present value (NPV) method, you examine all the cash flows, both positive (revenue) and negative (costs), of pursuing a project, now and in the future. You then adjust, or "discount," the value of future cash flows to reflect what they're worth in the present day.

NPV makes this adjustment using a "discount rate" that takes into account inflation, the risk of the project and the cost of capital – either interest paid on borrowed money or interest not earned on money spent to pursue the project. Finally, it adds up the present values of all the positive and negative cash flows to arrive at the net present value, or NPV. If the NPV is positive, the project is worth pursuing; if it's negative, the project should be rejected. When deciding between projects, choose the one with the higher NPV.

### **Payback Period Method**

Under the payback period method, estimate how much it will cost your business to launch the project and how much money it will generate once it's up and running. Then calculate how long it will take the project to "break even," or generate enough money to cover the startup costs. Companies using the payback period method typically choose a time horizon – for example, 2, 5 or 10 years. If a project can "pay back" the startup costs within that time horizon, it's worth doing; if it can't, the project will be rejected. When deciding between projects, choose the one with the shorter payback period.

### **Pros and Cons of Each Method**

The payback period method has some key weaknesses that the NPV method does not. One is that the payback method doesn't take into account inflation and the cost of capital. It essentially equates \$1 today with \$1 at some point in the future, when in fact the purchasing power of money declines over time. Another is that the payback method ignores all cash flows beyond the time horizon – and those cash flows may be substantial. Big moneymakers, after all, sometimes take a while to get going.

On the other hand, the big drawback of the NPV method lies in its assumptions. If you don't get your estimate of the discount rate correct, your calculation will be off – and you won't know it until the project turns into a big money-loser.

### **Combining the Two Methods**

Many businesses use a combination of methods when making capital budgeting decisions. You could use the payback period method to narrow down options, then apply the NPV method to identify the best of the remaining projects. Or you could use the NPV method to separate the "winners" from the "losers" among possible projects, then look at payback periods to see which projects return their costs more quickly.