

FINANCIAL POLICY & CORPORATE STRATEGY



CA Final | AFM
Last Day Revision Notes / Summary Notes / Concept Notes
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1FIN By IndigoLearn

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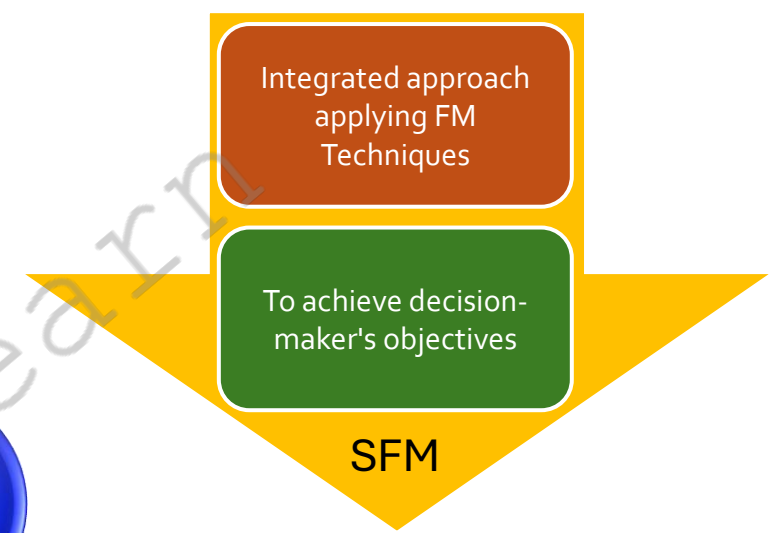
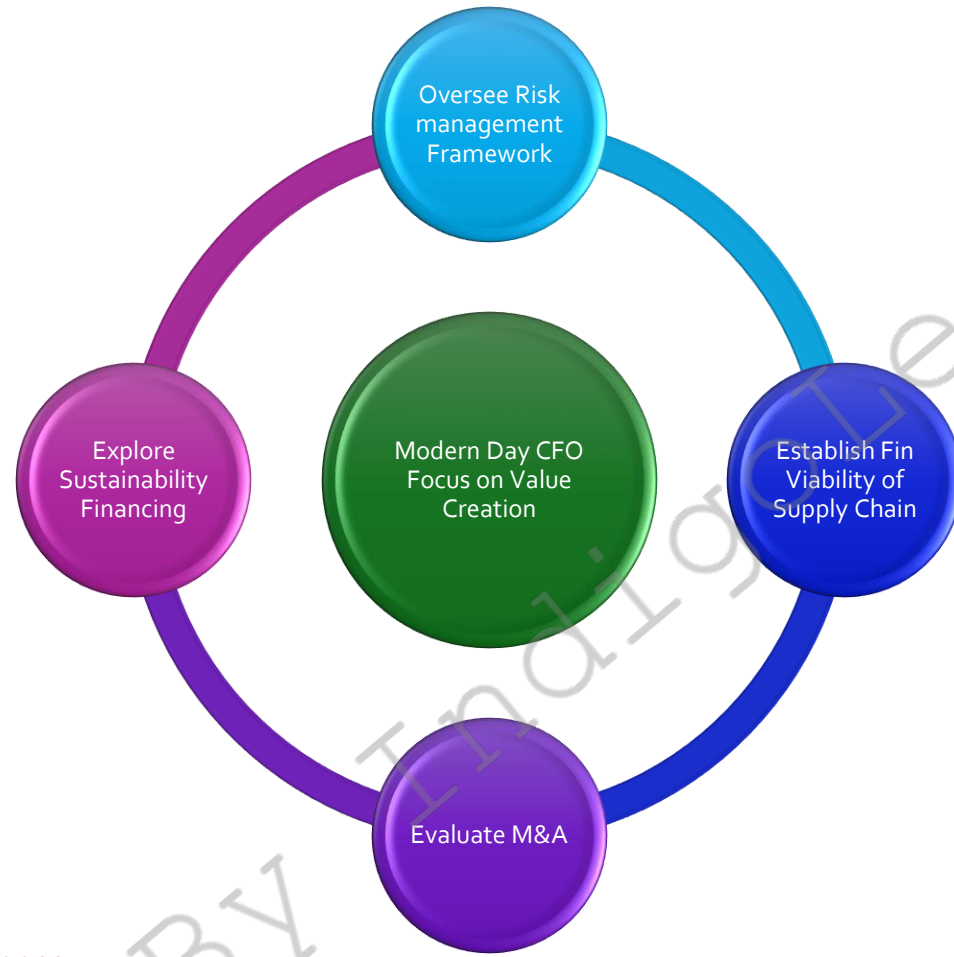
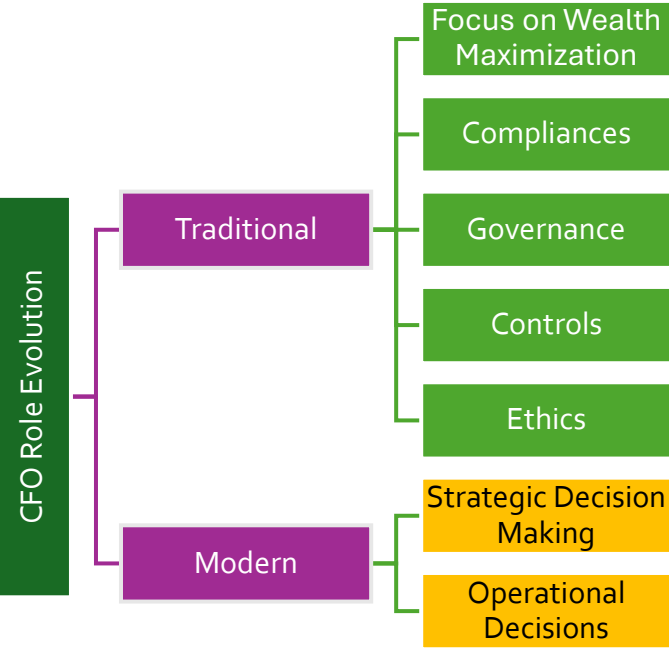
- Co-Founder & CEO, IndigoLearn
- Faculty | CA Final, AFM & CFA
- Taught ~4,000 Students of CA & CFA
- Deeply Passionate about Financial Markets & Economics



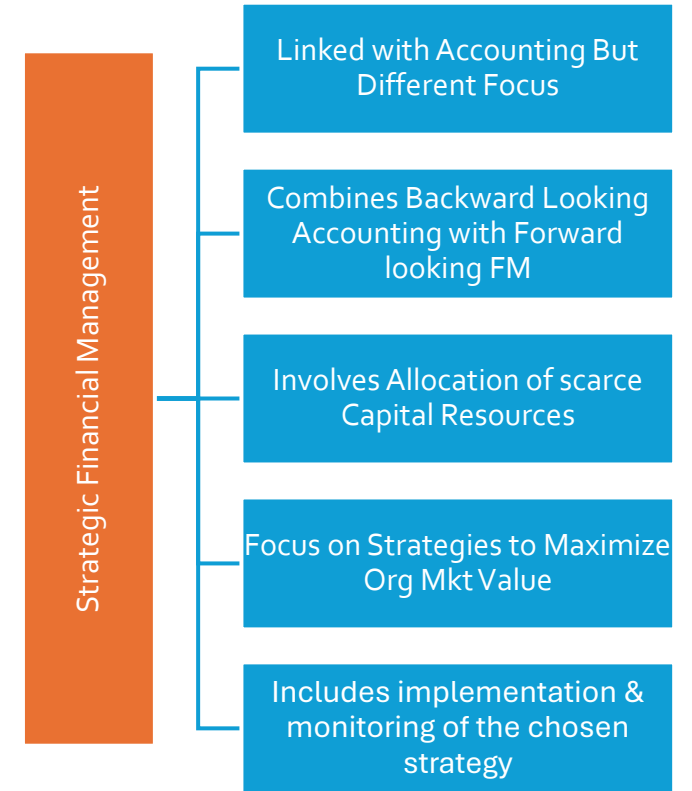
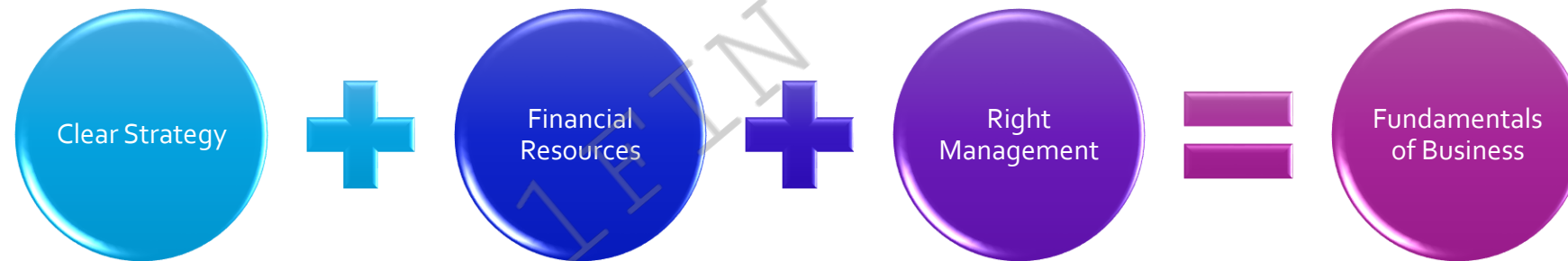
CFA



Role of CFO in value creation

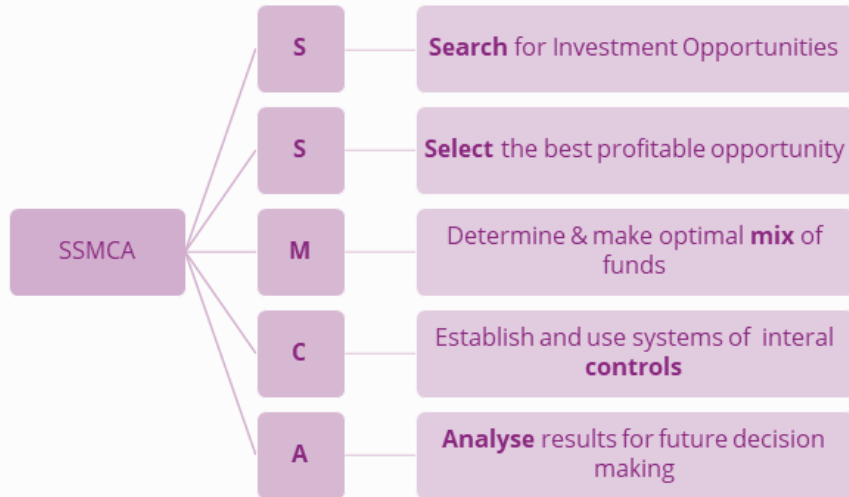


3 Fundamental / essential elements of a business



Functions of SFM (Investment & Financing Decisions)

SFM part of the corporate strategic plan – Combines investing & financing decisions for attaining overall objectives.

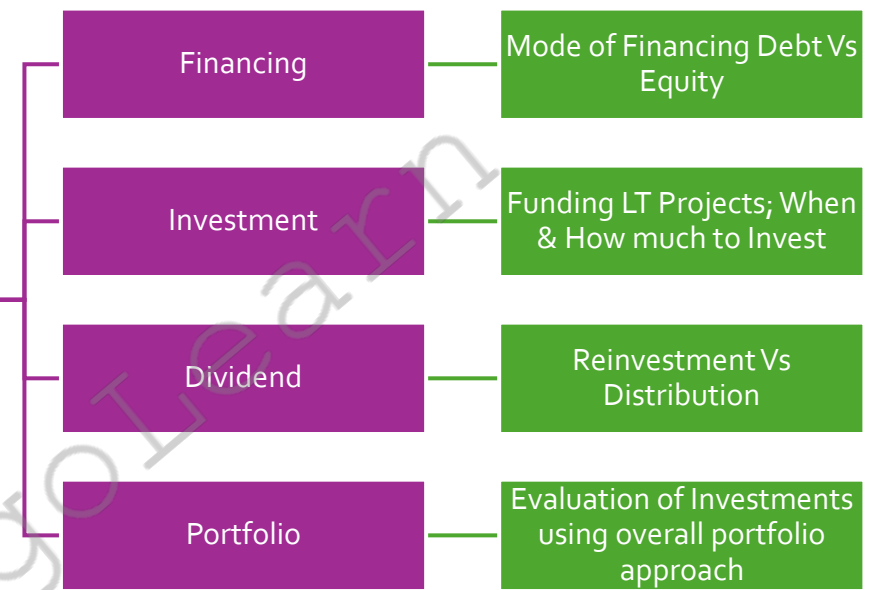


Focus on Allocating limited funds between alternative uses

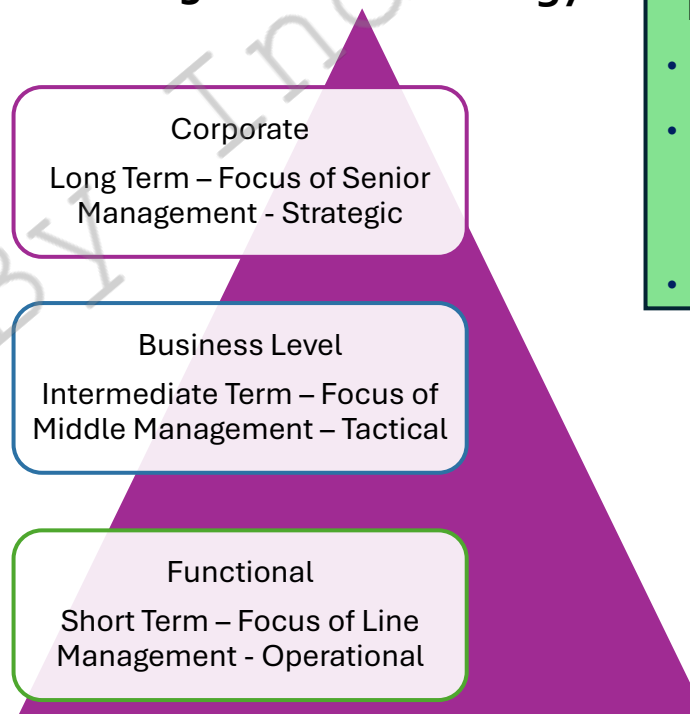
Corporate level strategy Answers 3 Questions

Suitability	Whether the strategy would work for the accomplishment of common objective of the company.
Feasibility	Determines the kind and number of resources required to formulate and implement the strategy.
Acceptability	It is concerned with the stakeholders' satisfaction and can be financial and non-financial.

Key Decisions in Financial Strategy



3 Levels of Strategy



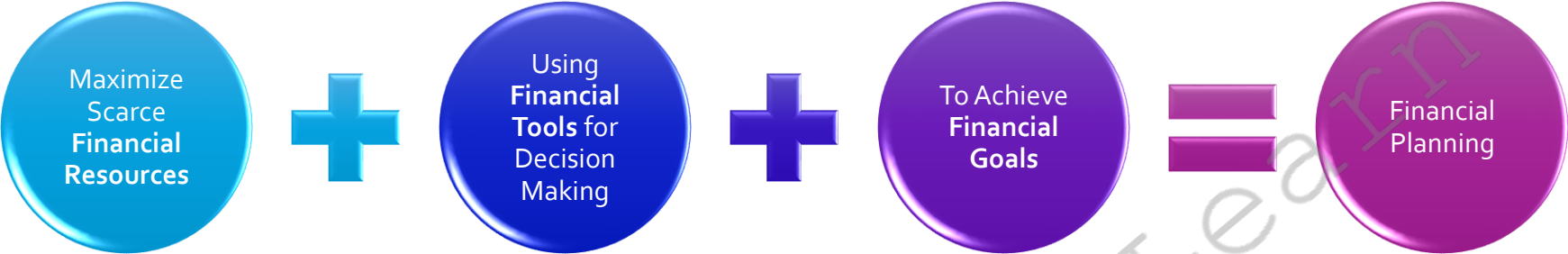
Focus of Functional Level Strategy

- Execution of BU Level strategies at floor or on site.
- Functional units provide input to the business unit level and corporate level strategy, on customer responses or on resources and capabilities
- Higher-level strategies can be based on these inputs.

Focus of BU Level Strategy

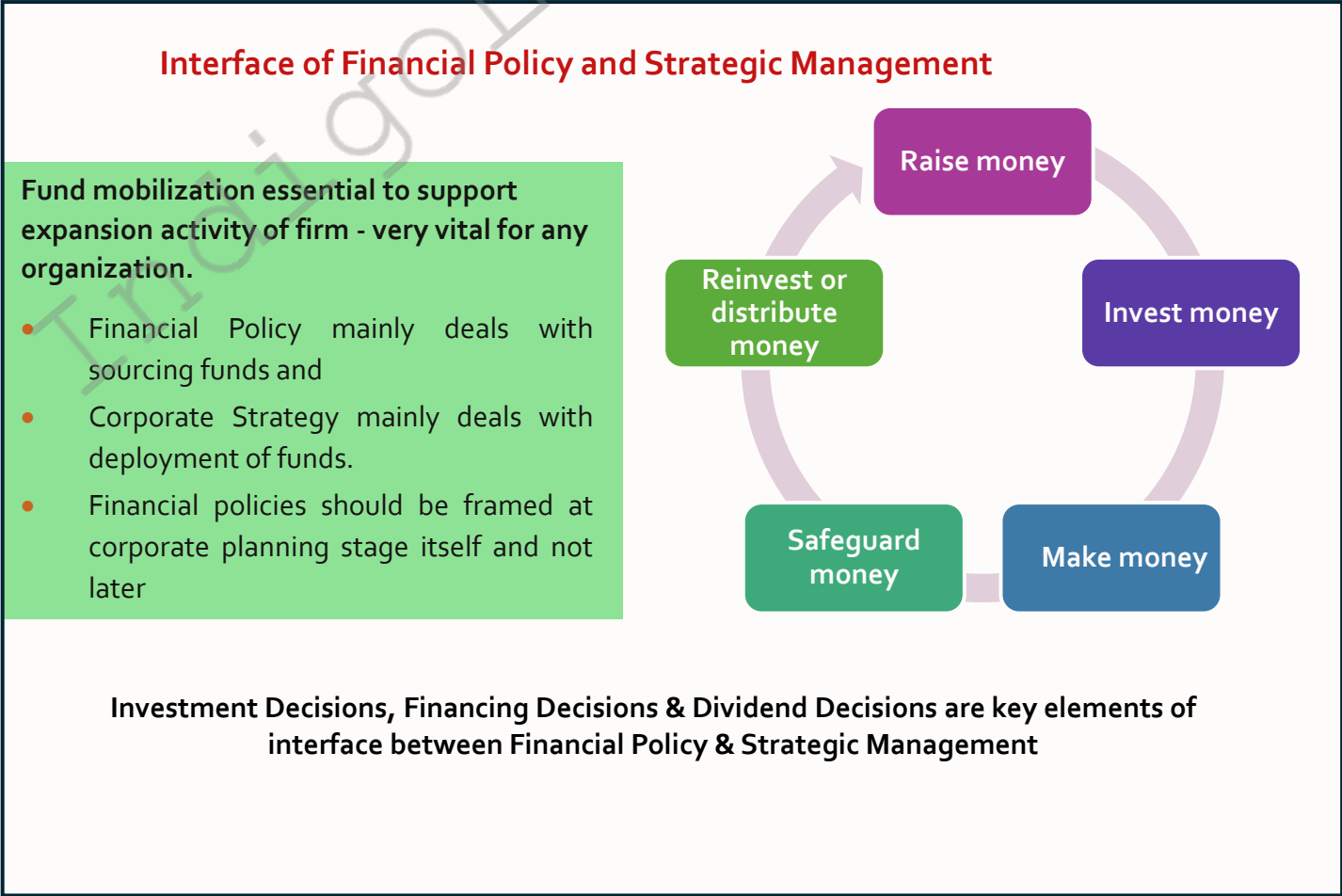
- practical coordination of operational units
- supervision of operations in the unit
- meet deadlines and targets set by Corporate Level in developing and sustaining products and services

Financial Planning & its 3 Major Components



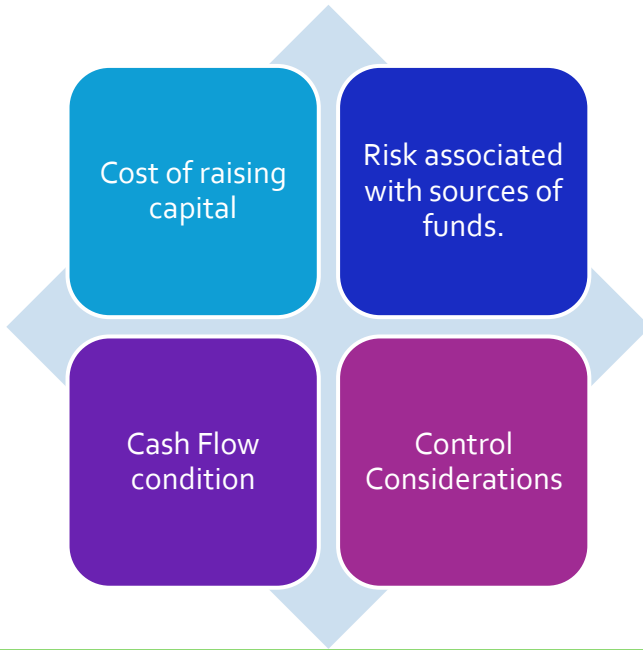
Outcomes of the Financial Planning

- Financial objectives:**
 - To be decided at the very outset so that rest of the decisions can be taken accordingly.
 - They need to be consistent with the corporate mission and corporate objectives.
- Financial decision making**
 - Helps in analysing financial problems that are being faced by the corporate and accordingly deciding the course of action to be taken by it.
- Financial measures**
 - Ratio analysis, analysis of cash flow statement are used to evaluate the performance of the Company.
 - Selection of measures again depends upon the corporate objectives.



Financing Decisions

Focused on Sources of Funds & Capital Structure

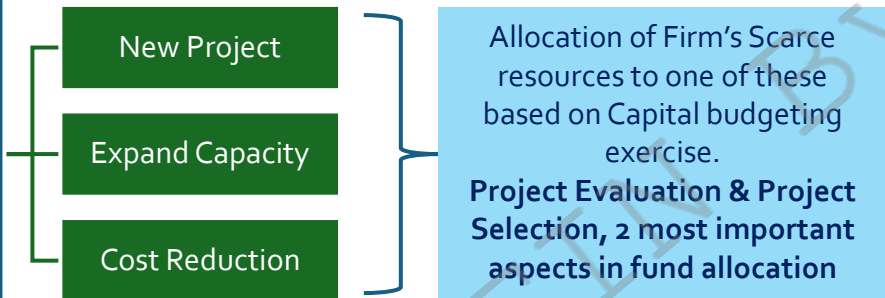


Elements determining the capital structure

Region	• Geographical position , Developed or underdeveloped
Industry	• Capital Intensive (high debt equity) or labour intensive
Sector	• Public (ideal is 1:1) or Private (ideal is 2:1)
Maturity	• Stage in the business life cycle

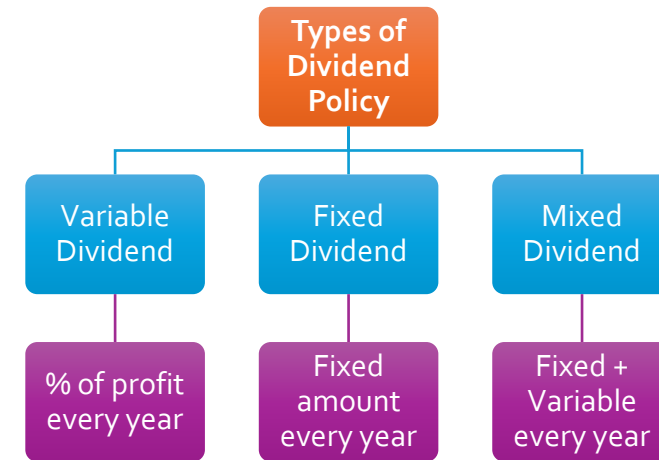
Investments Decisions

Focus on investment of a Firm's Funds into different assets to earn highest possible returns & fulfil Stakeholder expectations



Dividend Decisions

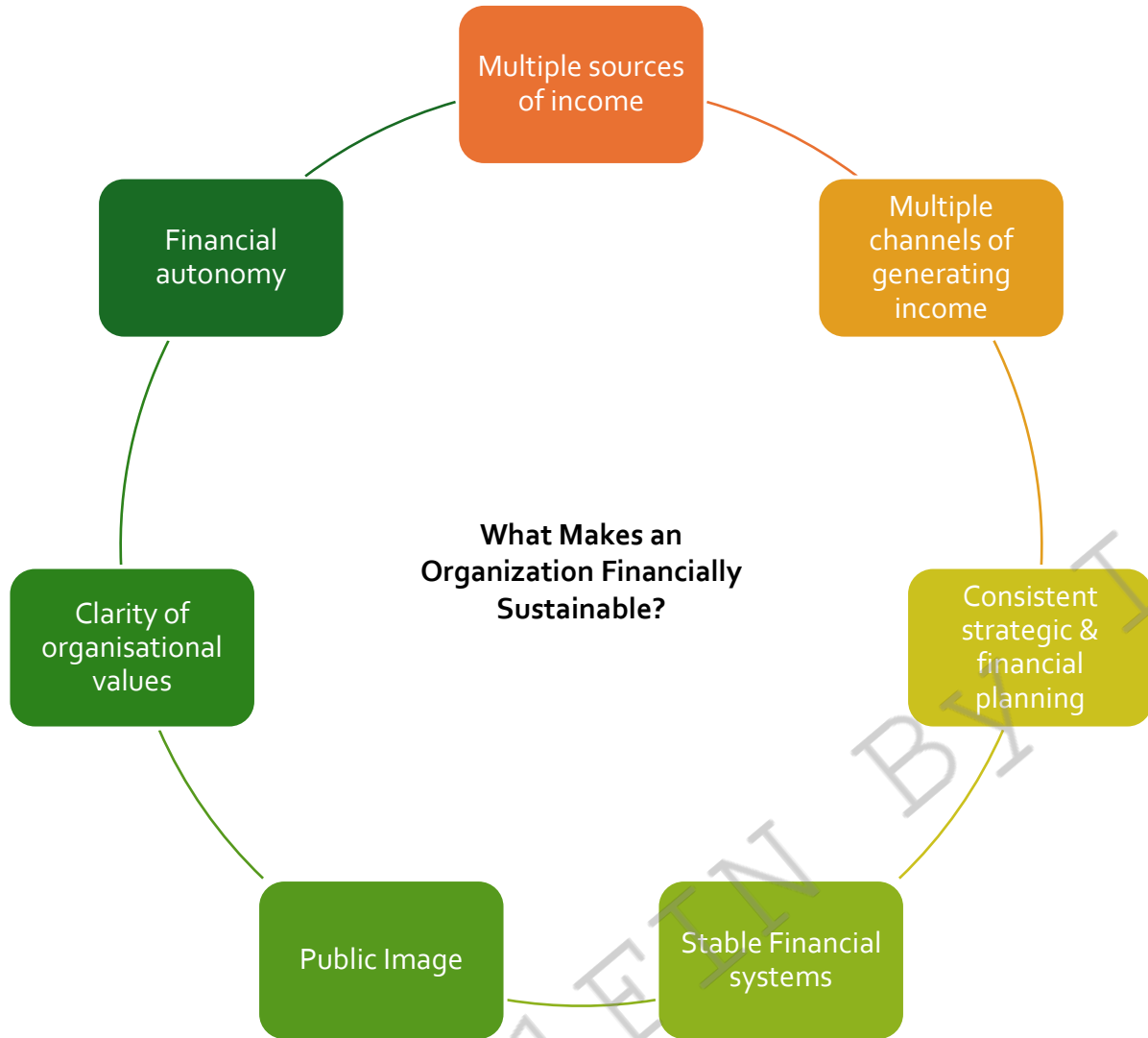
Firms' decide how much they will pay-out to shareholders in the form of dividends



Involves deciding between investment in Business Vs payout to Shareholders; Companies explore cash / Stock Dividends too

All functional policies are interlinked with financial policy and they should be designed along with corporate strategy and not in isolation. Financial Policy & Corporate Strategy are interdependent and affect each other and are affected by each other

Balancing Financial Goals vis-a-vis Sustainable Growth



Sustainable Growth Rate (SGR)

Return On Equity \times Retention Ratio

SGR is the Maximum Sales Growth achievable by a Company given its Profitability, Asset Utilization & Dividend Payout & No Additional Borrowings

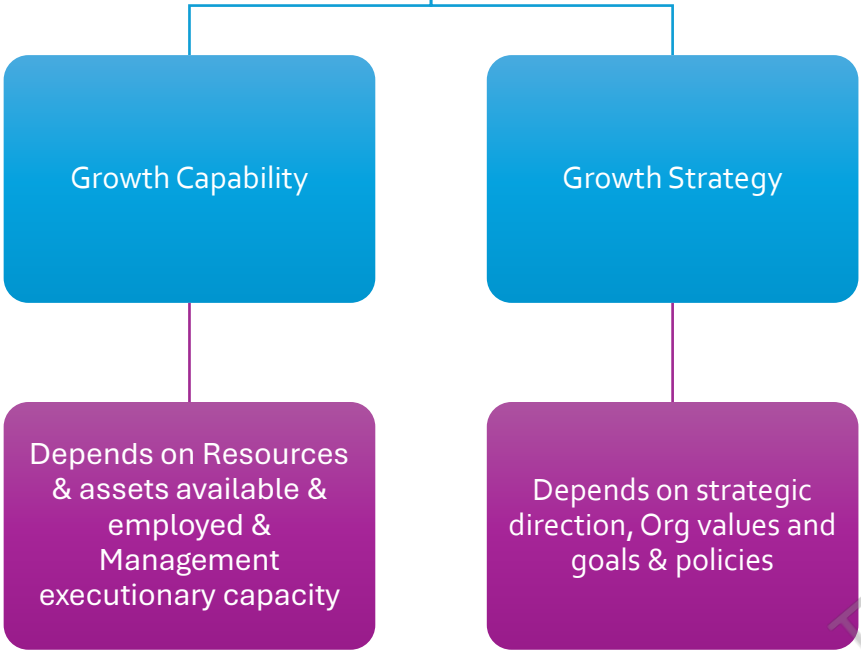
Assumptions underlying SGR

- Targeted capital structure maintained.
- Defined dividend payout policy i.e dividend payment ratio fixed and maintained; and
- No fresh equity raised

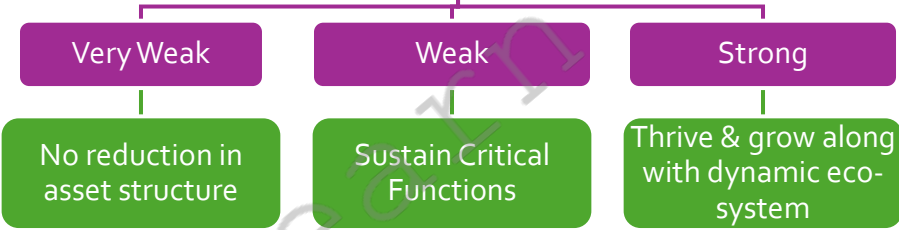
Sales can grow Faster if a firm issues additional debt or equity else SGR is the Maximum

Linkage Between

Both are inter-dependent - long-term growth is impossible with just one & not other



SG Policy



- If an Org is Growing < SGR, better to return money through Dividends or Buy Back => lower SGR or Acquire Companies to Grow
- High Inflation => Higher external financing => Higher DE Ratio.
- If creditors require that a firm's historical cost Constant DE ratio, inflation lowers SGR
- Inflation > SGR (in a Mature Industry) => funds will be blocked in WC => Lower Reinvestment => Lower SGR

To Maintain a Growth rate with constraints over DE ratio and / or Current Ratio, an Org may raise External Financing, Debt or Equity

$$EFR = \frac{TA}{Sales} \times \Delta S - \frac{Payable\ and\ Liabilities}{Sales} \times \Delta S - mS_1(1 - d)$$

m = PAT%

What Makes an Organization Sustainable?





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