Chapter 1
Introduction
CHAPTER – 1

INTRODUCTION

1.0 INTRODUCTION:-

Finance is one of the basic foundations of all economic efforts and the Financial Management is entire gamut of managerial efforts devoted to the management of finance, both its resources and use of funds for business firms or organizations. There are two approaches to finance –

i. Traditional Approach

ii. Modern Approach

According to traditional approach the word “finance” means the arrangements of funds for the required project or investment proposal and was limited to the procurement of funds. But on the other hand modern approach is an extension previous one. It says finance does not mean only arrangement and getting funds but it involves proper distribution of funds also. So according to modern approach finance is procurement of funds as well as proper allocation and control of funds.

Management of finance is the Financial Management which revolves around the most economical way of fund raising for the business and the optimum ways to invest these funds to get the best returns and the value of the firm in the future to obtain the optimum growth so it deals with these managerial
decisions which result in acquisition and financing of long-term and short-term of assets. These managerial decisions related to finance are based on sound conceptual knowledge of fundamental concepts, methods and techniques of financial management are coupled with personal judgment, opinion and intuition. There is no thumb rule or fixed decision or line of action. Financial decisions are varied and differ case to case.

The working capital meets the short-term financial requirements of a business enterprise. It is a trading capital, not retained in the business in a particular form for longer than a year. The money invested in it changes form and substance during the normal course of business operations. The need for maintaining an adequate working capital can hardly be questioned. Just as circulation of blood is very necessary in the human body to maintain life, the flow of funds is very necessary to maintain business. If it becomes weak, the business can hardly prosper and survive. The management of working capital is important to the financial health of businesses of all sizes. The amounts invested in working capital are often high in proportion to the total assets employed and so it is vital that these amounts are used in an efficient and effective way. However, there is evidence that small businesses are not very good at managing their working capital. Given that many small businesses suffer from undercapitalization, the importance of exerting tight control over working capital investment is difficult to overstate. A firm can be very profitable, but if this is not translated into cash from operations within the same operating cycle, the firm would need to borrow to support its continued working capital needs. Thus, the twin objectives of profitability and liquidity must be synchronized and one should not impinge on the other for long. Investments in current assets are inevitable to ensure delivery of
goods or services to the ultimate customers and a proper management of same should give the desired impact on either profitability or liquidity. If resources are blocked at the different stage of the supply chain, this will prolong the cash operating cycle. Although this might increase profitability (due to increase sales), it may also adversely affect the profitability if the costs tied up in working capital exceed the benefits of holding more inventory and/or granting more trade credit to customers. Another component of working capital is accounts payable, but it is different in the sense that it does not consume resources; instead it is often used as a short term source of finance. Thus it helps firms to reduce its cash operating cycle, but it has an implicit cost where discount is offered for early settlement of invoices.

Financial Management is very important for any business organization because it takes care of the business from the starting and continues to be very important as business proceeds further and it grows if sound financial decisions are taken. Keeping in view the importance of financial management in the business, the researcher decided to study and analyse the financial management practices of private sector firms/organizations of Bundelkhand region.

1.0-1-REVIEW OF LITERATURE

Small Business and SMEs
The role played by SMEs in any society is undoubtedly important. Nowadays, entrepreneurship and firm creation is mostly related to small and
micro firms, which lead us to look at them as an important development agent in any society (Nelson, 2000). “One of the important sources of competitiveness for SMEs has been to serve as agent of change, as the engine for new idea generation and innovative activity” (OECD, 2000: 73). This is especially true if we evaluate the role of small firms in newly emerging sectors like biotechnology and computer software (Audretsch, 1995). SMEs have made significant contribution towards technological development and exports. SMEs have been established in almost all-major sectors in the Indian industry such as: Electro-medical equipment, Textiles and Garments, Leather and leather goods, Meat products, Bio-engineering, Sports goods, Plastics products, Computer Software, Food Processing, Agricultural Inputs, Chemicals & Pharmaceutical, Engineering etc (Rai, S., 2002). The SMEs significantly account for the gross domestic product of a country. Though all firms face financial constraints, but as far as the SMEs are concerned, the picture is quite diverse and worse than other organizations. Few major reasons for this can be attributed to the dearth of finance, defective economic system, and imperfect financing and investment decisions. Other limitations of SME’s are: Low Capital base, Concentration of functions in one / two persons, inadequate exposure to international environment, inability to face impact of WTO regime, inadequate contribution towards R & D and lack of professionalism (Sanjeev Gupta, 2007). The future of their countries competitiveness and economic growth will heavily depend on the private sector in which SMEs play a major role (Issack Allan, 1997). SMEs are of great socio-economic significance although their long-term growth and competitiveness has been compromised by the chronic and often acute constraints on their access to formal-sector finance, among other systemic and institutional problems in developing
countries, including ASEAN. SME financing problems are due to both demand- and supply-side factors which have to be addressed as part and parcel of the on-going development and modernization of the financial sector in response to the increasing volume and complexity of business transactions associated with the integrated growth and globalization of ASEAN economies (Thitapha Wattanapruttipaisan, 2003). There is a digital divide in business and Small and Medium Enterprises (SMEs) are the have-nots. SMEs lack familiarity with IT technically trained manpower that can be expensive and often, difficult to retain. Yet, in the age of globalization, the leveraging of IT by SMEs remains crucial and important (Pankaj Jain, 1996). Cost of capital estimation is becoming increasingly important for property-liability insurers. Value of productivity is the value added per employee per hour worked and the unit labour cost is calculated by dividing the labour cost per hour by the value of productivity (Auto components industry, 2003). A study on nature of pressures and constants under emerging dynamic market condition finds the need for flexibility in developing strategies by Indian SME’S in the electronic sector for improving their performance at the national and international level, such strategies may be added for making new investment, development of competencies etc. (Singh, Garg & Deshmukh, 2005). Research work on small business at U.K. (Nayak and Greenfield, 1994) shows that firms which do not do well is not because of lack of business records and lack of awareness of key business factors, but due to the lack of adequate accounting knowledge and proper financial records. There is a wide gap between theory and practices of management accounting in case of small business. On the other hand financial accounting system is based on the traditional “Mahajani System” and is incomplete in nature (Soral and Jain,
1994). A study by Holmes and Nicholas (1998) concluded that the amount and nature of the accounting information prepared or acquired is dependent on number of operating environmental variables like, business size, age, industrial grouping, owner-manager education etc. Rice and Hamilton (1979) in their study found that small business man employs multidimensional, stochastic, non quantitative decision processes which are primarily informal in nature. Another study (LeCormu, et.al. 1996) has grown light on financial objective on small business units. They found that financial management of small enterprises should be qualitatively as well as quantitatively different from that of large enterprises.

Raising Capital, Capital Structure, Cost of Capital, Long Term Investment Planning (Capital Budgeting) and Dividend Decisions

The SME needs to adopt an entirely different approach to strategic planning and management which can enable it to deploy an extensive infrastructure network based on shared resources with other firms (Emmanuel Tetteh, Janice Burn, 2001). Wickramansinghe & Sharma (2005) explained that the virtual marketplace is rapidly fostering the growth of new business models that require restructuring of their value chains for current businesses. To be a player in this competitive arena, a large investment in personnel and infrastructure is required. Technological, organizational and marketing hurdles are also making it more difficult for SMEs to succeed in knowledge-based economies. For raising capital from right source, David Mayers said that convertibles provide the best of both worlds: they provide issuers with “cheap” debt in the sense that they carry lower rates than straight debt; and, if the firm performs well and the bonds convert into equity, they allow issuers to sell stock “at a premium” over the current share price. Kiku (2006)
shows that long run risks model can account for the violations of the CAPM. Further, the model can capture the entire transition density of value or growth returns, which underscores the importance of long run risks in accounting for equity markets behavior (Ravi Bansal, 2006). A number of theories link capital structure choices to the cost of equity. For example, static trade-off theories note that firms desire a capital structure that minimizes the overall cost of capital. This target capital structure equates the marginal costs and benefits of additional debt financing [Jensen and Meckling (1976), Myers (1977), and Jensen (1986)]. Costs include financial distress and agency costs of debt. The benefits include lower agency costs of equity, and the tax deductibility of interest payments. The net benefit of additional debt is evaluated against the marginal cost of additional equity. If the cost of equity were lowered, there would be less benefit from additional debt financing and less debt would be used (Mortal, Marc & Lipson, 2004).

The willingness of investors to supply equity to risky new firms varies over time and that this variation explains observed trends in idiosyncratic risk. The fundamental source of this variation could be related to cross-border trade and capital flows as suggested by Rajan and Zingales (2003), the emergence of low priced stocks, as suggested by Brandt, Brav, and Graham (2005), or other factors. Nonetheless, the resulting variation in the types of firms undertaking new issues appears to explain not only the trend in idiosyncratic risk but also trends in other important firm characteristics such as size, profit margin, growth opportunities, and dividend policy (Gregory Brown & Nishad Kapadia, 2006).
As per Arab Monetary Fund, Economic Policy Institute (UAE) and John Pointon, University of Plymouth- "For the contracting and real estate sector, which has a higher cost of capital, fixed asset backing is another key variable". Paulo argues that the weighted average cost of capital (WACC) is subject to serious reservations if used as a capital budgeting discount rate. He claims that a discount rate based on sequential marginal costing (SMC) will provide superior valuations to those based on the WACC. This subject is very important because the firm can not make the correct investment decisions without a proper discount rate. (Wang, Louie K, 1994) Financing and capital structure choices are among the key strategic decisions a firm has to make. Important progress is largely a result of the recognition that issues involved are related to fundamental choices “which should support and be consistent with the long term strategy of the firm” and that strategic management research should be inclusive of financial decisions (Wilson Nicholas, 2000).

Examining Indian software companies, it is observed that the capital structure of new technology-based firms is consistent with the findings on financing for other small businesses. Internal funds are the most important source of funding in new technology-based firms. However, in apparent contradiction to the pecking order hypothesis, the use of debt is rare and equity financing is the prime source of external finance (Hogan & Hutson, 2003). The massive use of derivatives and securitization for public debt and deficit management is a growing phenomenon in financial markets. Financial innovation can modify risks effectively run and alter the stability of the public sector finance. Financial stability of the public sector in India is analyzed considering financial innovation use. The use of financial
innovation can have various effects over debt and deficit management, given binding external burden (like the European criteria) as far as risks are properly considered, expectations of fiscal policy are coherent with that of markets, and no exogenous shock occurs (Oldani & Savona, 2004). The link between ownership structure and firm value/ performance/efficiency has been the subject of an on-going debate. Berle & Means, (1932 suggested that firms with a wide dispersal of shares tend to under-perform. In general, a positive relation between ownership concentration and firm efficiency is predicted and many studies have confirmed this. (Shleifer & Vishny, 1986; Short, 1994; Gedajlovic & Shapiro, 1998; Thomsen & Pederson, 2000; Gorton & Schmidt, 1996; Kang and Shivadasani, 1995). Further Stulz (1988) formalized a concave relationship between managerial ownership and firm valuation: an increase in managerial ownership and control will first increase firm value; but at a higher level of managerial ownership, firm value will decrease because of entrenchment effects. Demsetz and Lehn (1985) however argued that concentration is endogenous to value and therefore has no effect. Much of this variation in these results may however be attributable to the difficulties in obtaining a uniform measure of firm performance, firm value or efficiency (Luiss University, 2005).

Longer run integration between major operating divisions in General Motors was achieved via the Capital budgeting system devised in 1923 by Donaldson Brown, GM’s chief financial officer (Jones & Thompson, 2004). In Indian automobile sector also the importance of Capital budgeting is highlighted by the study of Neelam Singh (2006) that says “with proliferating new vehicle models, flexible manufacturing techniques are required for numerous components”. About 80% of the lifetime cost of
purchasing and upgrading a computer system is actually spent on software purchase, license, development (in-house or outsourced) and maintenance (Miller, Barr & Tessler, 1969). In long term investment decision, wealth maximisation is achieved when the investment in all available projects have a positive net present value (NPV). To compute NPV the firm needs to know the appropriate discount rate to use to discount the future cash flow from the project. This discount rate is the cost of capital which is the minimum require rate of return on investment. It represents the opportunity cost of funds for the firm. That is the minimum rate of return that the firm or investor could achieve in another investment (McGowan, 2004). Due to the lack of access to the capital markets, the allocation of capital in small firm is very important.

Effective Capital budgeting can improve asset acquisitions (Brigham, Gapenski & Ehrhardt, 1999). Although capital budget is important to small firms, they do not use the tools that have been developed to improve these decisions (Runyon, 1983). Studies shows that many small firms are more likely to rely on the pay back approach, even though the NPV and IRR methods are both superior to the payback (Graham & Harvey, 1999 quoted in Brigham & Houston, 2001; Walker, Burns & Denson 1993). Runyon (1983) showed that a small business may put itself at a serious competitive because it fails to use sophisticated discounted cash flow methods.

The asset's beta with respect to the long run growth risk is positive, and that for volatility risk is negative. Both these risk sources contribute towards a positive risk premium (Ravi Bansal, 2006). One of the major determinants of the competitiveness of a market is the ease at which new firms can enter or
exit. Bain (1956) discussed the types of barriers and he makes three major classifications: absolute cost advantages, product differentiation advantages, and economies of scale. Absolute cost advantage means that a firm can produce a level of output at a less expensively than another (Grace & Klein). Asset allocation is generally defined as the allocation of an investor's portfolio among a number of "major" asset classes. Clearly such a generalization cannot be made operational without defining such classes. Once a set of asset classes has been defined, it is important to determine the exposures of each component of an investor's overall portfolio to movements in their returns. Such information can be aggregated to determine the investor's overall effective asset mix. If it does not conform to the desired mix, appropriate alterations can then be made (William F. Sharpe, 1992). Studies which use modern portfolio theory (MPT) to calculate the optimal allocation to property in a multi-asset portfolio are fundamentally flawed.

These suggest optimal theoretical allocations for property which are much higher than actual allocations to property. Criticism can be made of: the exclusion of other eligible assets from the analysis (McGregor & Nanthakumaran, 1992). Academic researchers discuss the advantages of placing equities in taxable accounts and taxable bonds in tax deferred accounts in order to maximize the tax efficiency of one's overall portfolio. Their research indicates that the relative proportions of taxable and tax-deferred wealth affect one's overall optimal asset allocation. Dammon & Poterba (1998) also has researched asset location issues such as different investment horizons and different tax rates during accumulation and distribution phases. Choosing the right asset location for a pair of asset classes is more important when the tax rate differential between the two
types of assets is greater and when the rate of return on the relevant assets is high (Spatt, & Zhang, 1990). According to these Samuelson award winning authors, other factors being equal, an investor's optimal equity allocation will be higher when a larger proportion of his/her total wealth is held in taxable accounts, and that his/her optimal bond allocation will be higher if the bulk of his/her wealth is held in tax-deferred accounts. The ideal situation occurs when the desired asset allocation is reached by investing the entire tax deferred account in bonds and the entire taxable account in equities. The authors state that for maximum tax efficiency, individuals should not hold mixed portfolios of equities and bonds in both their taxable and tax-deferred accounts.

It is generally accepted that the payment of dividends is the most important and most widely used instrument for the distribution of value to shareholders. Shareholders also prefer to receive regular dividends rather than irregular cash payments. The dividend decision is widely regarded as one of the most important financial decisions to be taken from a strategic point of view. The dividend decision, which is determined by a firm's dividend policy, affects the level of equity retained in a firm (Ang, J.S. 1998). If dividends that are paid out are not replaced in value terms by new equity, then this decision also influences the financial structure of the firm, at least briefly. The importance of a dividend decision is therefore based on the fact that it has implications for both the investment decisions and the financing decisions that are taken. The more cash that a firm pays out in the form of dividends, the less funds it has available to finance future attractive investment opportunities and the greater the probability that it will have to issue new shares to raise more capital (Lease, John, Kalay, Loewenstein &
Sarig, 1999). Profitability, size and business risk are factors that determine dividend policy of both financial and non-financial firms. Government ownership, leverage and age have a significant impact on the dividend policy of non-financial firms but no effect on financial firms. On the other hand, agency costs, tangibility, and growth factors do not appear to have any impact on the dividend policy of both financial and non-financial firms. The factors that influence the probability of paying dividends are the same factors that determine the amount of dividends paid for both financial and non-financial firms (Naceur, Goaied, & Belanes, 1996). Rozeff [1982] presents evidence that the dividend payout level for unregulated firms is negatively related to its level of insider holdings.

Additionally, in the context of the investment and financing decision, Myers and Majluf [1984] show that the level of insider holdings is itself a signal of firm value. Crutchley and Hansen [1989] examine the relationship between ownership, dividend policy, and leverage and conclude that managers make financial policy tradeoffs to control agency costs in an efficient manner. Smith and Watts [1992] investigate the relations among executive compensation, corporate financing, and dividend policies. Jensen, Solberg and Zorm [1992] link the interaction between financial policies (dividend payout and leverage) and insider ownership to informational asymmetries between insiders and external investors. Moyer, Rao, and Tripathy [1992] suggest that regulated electric utilities use dividends as a way of subjecting the regulatory body to market discipline, in keeping with the Smith [1986] hypothesis.
Working Capital Management, Management of Cash, Receivables and Inventory

Working capital refers to investment in current assets. The assets are normally convertible into cash within one accounting year. The current assets include cash, near cash assets (short term marketable securities), bill receivables, inventory (raw materials, semi finished goods and finished goods. SMEs raise funds not only for financing the fixed assets but also for financing the current assets to help start and maintain operation (Gentry, et al., 1979). The major components of gross working capital include stocks (raw materials, work-in-progress and finished goods), debtors, cash and bank balances. The composition of working capital depends on a multiple of factors, such as operating level, level of operational efficiency, inventory policies, book debt policies, technology used and nature of the industry. While inter-industry variation is expected to be high, the degree of variation is expected to be low for firms within the industry (International Review of Business Research Papers, 2006).

The better a company manages its working capital, the less the company needs to borrow. The less Working Capital used to attract sales, the higher is likely to be the return on investment. The higher the profit margin, the lower is likely to be the level of Working Capital tied up in creating and selling titles. It may refer to the firm’s investment in capital assets. In practice it is necessary for a firm to know its investment in current assets as well as financing need. Capital liabilities such as suppliers credit provider a ready source of financing current assets. These involve managing the relationship between a firm's short-term assets and its short-term liabilities. Working capital requirements of a business should be monitored at all times to ensure
that there are sufficient funds available to meet short-term expenses (Rangarajan & Misra, 1995). Working capital constitutes an important aspect of corporate financial management with considerable bearing on shareholder value creation. The broad general parameter of Indian companies as regard their Working capital and profitability are related to each other (Parashuraman, 2007). Temporary needs for funds arise in response to a temporary need for current assets. These include current assets that the firm does not plan to hold throughout the indefinite future. Permanent needs for future arise in conjunction with a permanent need for certain assets. These assets consist of fixed assets plus the firm’s minimum level of investment in current assets (Stobaugh, R., 1969). To find out the determinants of working capital management, net liquid balance and working capital requirements are used as measures of a company’s working capital management.

In a study by Dr Jeng-Ren & Li Cheng that indicates the debt ratio and operating cash flow affect the company’s working capital management, yet we lack consistent evidence for the influence of the business cycle, industry effect, growth of the company, performance of the company and firm size on the working capital management. Chapman, (1972) found following factors as determinant of working capital requirements: Nature of business, size of business, stage of development, time of production, rate of stock turnover, buying and selling terms, seasonal consumption, seasonal production, capital invested by the owners.

If a company's current assets do not exceed its current liabilities, then it may run into trouble paying back creditors in the short term. The worst-case
scenario is bankruptcy. A declining working capital ratio over a longer time period could also be a red flag that warrants further analysis. Working Capital management is about the commercial and financial aspects of Inventory, credit, purchasing, marketing, and royalty and investment policy (Rangarajan & Misra, 1995). In practice it is necessary for a firm to know its investment in current assets as well as financing need. Capital liabilities such as suppliers credit provider a ready source of financing current assets. These involve managing the relationship between a firm's short-term assets and its short-term liabilities. The goal of Working capital management is to ensure that the firm is able to continue its operations and that it has sufficient cash flow to satisfy both maturing short-term debt and upcoming operational expenses. Working capital also gives investors an idea of the company's underlying operational efficiency. Money that is tied up in inventory or money that customers still owe to the company cannot be used to pay off any of the company's obligations. If a company is not operating in the most efficient manner (slow collection) it will show up as an increase in the working capital. This can be seen by comparing the working capital from one period to another; slow collection may signal an underlying problem in the company's operations (Wachowicz, Strategic Management Journal, XII).

A firm invests in inventories because of the expected benefits derived from holding inventory. Likewise, the firm acquires fixed assets because of the future cash flows those assets are expected to generate. Cash refers to total liquid assets made up of working cash balance interest bearing securities and deposits. One measure of cash flow is provided by the cash conversion cycle - the net number of days from the outlay of cash for raw material to receiving payment from the customer. As a management tool, this metric
makes explicit the inter-relatedness of decisions relating to inventories, accounts receivable and payable, and cash. Because this number effectively corresponds to the time that the firm's cash is tied up in operations and unavailable for other activities, management generally aims at a low net count. Firms hold cash (liquid assets) for executing financial transactions and for precautionary purposes. Analysts look at these items for signs of a company's efficiency and financial strength (Van Horne, 1998). The UK firms had been active in terms of reducing stock levels or the debtors' credit period, on average tended to be more active in respect of working capital management practices (Peel & Wilson, 1996). Simultaneously investigating accounts receivable and payable issues, Hill, Sartoris, and Ferguson (1984) find differences in the way payment dates are defined. With limited access to long term capital markets, these firms tend to rely more heavily on owner financing, trade credit and short term bank loans to finance their needed investment in cash, accounts receivable and inventory. However, the failure rate among small business is very high as compared to the large businesses. Week financial management – particularly poor working capital management and inadequate long term financing is a primary cause of failure among small business.

Working capital starvation is generally credited as a major cause if not the major cause of small business failure in many developed and developing countries (Rafuse, 1996). While the performance levels of small businesses have traditionally been attributed to general managerial factors such as manufacturing, marketing and operations, working capital management may have a consequent impact on small business survival and growth (Kargar and Blumenthal, 1994). Although working capital is the concern of all firms,
it is the small firms that should address this issue more seriously. Given their vulnerability to a fluctuation in the level of working capital, they cannot afford to starve of cash. The success of a firm depends ultimately, on its ability to generate cash receipts in excess of disbursements. The cash flow problems of many small businesses are exacerbated by poor financial management and in particular the lack of planning cash requirements (Jarvis et al, 1996). The study undertaken by (Peel et al., 2000) revealed that small firms tend to have a relatively high proportion of current assets, less liquidity, exhibit volatile cash flows, and a high reliance on short-term debt. The recent work of Howorth & Westhead (2003), suggest that small companies tend to focus on some areas of working capital management where they can expect to improve marginal returns. For small and growing businesses, an efficient working capital management is a vital component of success and survival; i.e both profitability and liquidity (Peel & Wilson, 1996). They further assert that smaller firms should adopt formal working capital management routines in order to reduce the probability of Business closure, as well as to enhance business performance. The study of Gribbolsky (1976) and others have showed a significant relationship between various success measures and the employment of formal working capital policies and procedures. Managing cash flow and cash conversion cycle is a critical component of overall financial management for all firms, especially those who are capital constrained and more reliant on short-term sources of finance (Walker and Petty, 1978; Deakins et al, 2001).

Given these peculiarities, Peel & Wilson (1996) have stressed the efficient management of working capital and more recently good credit management practice as being pivotal to the health and performance of the small firm
sector. Along the same line, Berry et al (2002) finds that SMEs have not developed their financial management practices to any great extent and they conclude that owner-managers should be made aware of the importance and benefits that can accrue from improved financial management practices. The study conducted by De Chazal Du Mee (1998) revealed that 60% enterprises suffer from cash flow problems. Narasimhan and Murty (2001) stress on the need for many industries to improve their return on capital employed (ROCE) by focusing on some critical areas such as cost containment, reducing investment in working capital and improving working capital efficiency. The pioneer work of Shin and Soenen (1998) and the more recent study of Deloof (2003) have found a strong significant relationship between the measures of WCM and corporate profitability and discussed that most firms had a large amount of cash invested in working capital. It can therefore be expected that the way in which working capital is managed will have a significant impact on profitability of those firms. On basis of these results he suggested that managers could create value for their shareholders by reducing the number of days’ accounts receivable and inventories to a reasonable minimum.

Their findings suggest that managers can increase profitability by reducing the number of day’s accounts receivable and inventories. This is particularly important for small growing firms who need to finance increasing amounts of debtors. Ghosh and Maji (2003) made an attempt to examine the efficiency of working capital management of the Indian retail firms. For measuring the efficiency of working capital management, performance, utilization, and overall efficiency indices were calculated instead of using some common working capital management ratios. In this respect,
Elliehausen and Woken (1993), Petersen and Rajan (1997) and Danielson and Scott (2000) show that small and medium-sized US firms use vendor financing when they have run out of debt. Thus, efficient working capital management is particularly important for smaller companies. Maynard E. Rafuse (1996) argues that attempts to improve working capital by delaying payment to creditors are counter-productive to individuals and to the economy as a whole. Maynard claims that altering debtor and creditor levels for individual tiers within a value system will rarely produce any net benefit and also proposes that stock reduction generates system-wide financial improvements and other important benefits.

Kesseven Padachi (2006) in his review of trends in working capital management and its impact on firm's working capital management is also of a great importance to the small businesses. Bank financing is the major source to fulfill the capital requirement of the SMEs. About 75-90 per cent of SME entrepreneurs depend largely on their own savings, internal resources of the firm (such as retain earnings and other enterprise funds), short-term (unsecured) borrowings from relatives and friends (also known as business angels). A substantial portion of the SME sector does not have sufficient collateral required for collateral based lending, and does not have high enough returns to justify the risks taken by venture capitalists. In addition, many markets have little or unreliable information, limiting the effectiveness of financial statement lending and credit scoring. This has led to the SME finance gap. The finance gap is particularly pronounced in emerging economies. There have been two approaches to overcome the SME finance gap:- The first is to broaden the collateral based approach by encouraging collateral based lenders to finance SMEs with insufficient
collateral. This is largely done through an external party providing the collateral or guarantee.

Unfortunately, this method has seldom been based on free market principles and has largely been unsustainable. The second has been to broaden the viability based approach. Since the viability based approach is concerned with the business itself, the approach is to provide business development assistance to reduce risk and increase returns. This is driven through the detailed review and assistance with the business plan.(European Commission(2003-05-06), Recommendation 2003/361/EC: SME). A recent research by Firat Damir (2008) examines the dynamic relationship between the volatility of short-term capital flows and socio-political instability. Accordingly, the socio-political risk is found to be endogenously determined with the volatility of short term capital inflows such that increasing volatility by disrupting market activities, domestic investment and growth increases socio-political risk, which further feeds into the volatility of such flows.

1.1 INTRODUCTION TO BUNDELKHAND REGION:-

Bundelkhand is a geographic region of central India. The region is divided between the states of Uttar Pradesh and Madhya Pradesh. The Bundelkhand Region of central India is a semi-arid plateau that is located in the central Hindi belt south of the Yamuna river, between the fertile Gangetic plain stretching across northern UP and the highlands of central MP. At present Bundelkhand region covers seven districts of Southern Uttar Pradesh (Jhansi, Lalitpur, Jalaun, Hamirpur, Banda, Mahoba and Chitrakoot) and seven districts of Northern Madhya Pradesh (Datia, Tikamgarh, Chattarpur,
Panna, Shivpuri, Sagar and Damoh) along with the two tahsils- Lahar (Bhind District) and Bhandar (Gwalior District), and some parts of Guna, Chanderi, Harpalpur of Madhya Pradesh. Chitrakoot district is also part of Bundelkhand, which has parts in both U.P. and M.P.

This is typically a backward area. Several aspects of Bundelkhand are covered in this study for example historical background, climate, socio-cultural heritage, population & human development, natural vegetation and soil etc. They are not directly related to the topic of the study hence details related to these aspects are given in annexures.

**Topography and Geology:**

Bundelkhand is an old landmass composed of horizontal rock beds resting on a stable foundation. The landscape is rugged, featuring undulating terrain with low rocky outcrops, narrow valleys, and plains. Surface rocks are predominantly granite of the Lower Pre Cambrian/Archaen period. Some Dharwarian and Vindhyan rocks present in the region contain minerals of economic value. Sandstone, shales and limestone of high quality, along with Dyhes, Sills and the famous pink Archaean gneiss rocks, are also found in places.

Bundelkhand lies between the Indo-Gangetic Plain to the north and the Vindhya Range to the south. It is a gently-sloping upland, distinguished by barren hilly terrain with sparse vegetation, although it was historically forested. The plains of Bundelkhand are intersected by three mountain ranges, the Vindhya, Fauna and Bander chains, the highest elevation not exceeding 600 meters above sea-level. Beyond these ranges the country is
further diversified by isolated hills rising abruptly from a common level, and presenting from their steep and nearly inaccessible scarps eligible sites for forts and strongholds of local kings. The general slope of the country is towards the northeast, as indicated by the course of the rivers which traverse or bound the territory, and finally discharge themselves into the Yamuna River.

The principal rivers are the Sindh, Betwa, Ken, Bagahin, Tons, Pahuj, Dhasan and Chambal. The Kali Sindh, rising in Malwa, marks the western frontier of Bundelkhand. Parallel to this river, but further east, is the course of the Betwa. Still farther to the east flows the Ken, followed in succession by the Bagahin and Tons. The Yamuna and the Ken are the only two navigable rivers. Notwithstanding the large number of streams, the depression of their channels and height of their banks render them for the most part unsuitable for the purposes of irrigation, which is conducted by means of ponds and tanks. These artificial lakes are usually formed by throwing embankments across the lower extremities of valleys, and thus arresting and impounding the waters flowing through them.

The major towns are Jhansi, Datia, Lalitpur, Sagar, Damoh, Orai, Panna, Banda, Chitrakoot, Tikamgarh (Orcha) and Chhatarpur (Khajuraho). However, the city of Gwalior is under a wide influence of Bundelkhand. Bundelkhand's most well known place, however, are Jhansi and Khajuraho which are known for Rani Laxmi Bai and a number of 10th century temples devoted to fine-living and eroticism respectively. The mines of Panna have been famous for magnificent diamonds; and a very large one dug from the last was kept in the fort of Kalinjar.
Bundelkhandi is the most common Hindi dialect spoken in the area. The region is predominantly Hindu. Jainism is historically significant, and several Jain Tirthas are located in this region. Many prominent Jain scholars of the 20th century have been from this region.

**Industrialization:**
Bundelkhand region is known for one of the lowest per capita income in the country. This region also has low literacy and very low literacy level in women. The region lacks basic raw materials and also has poor infrastructure, transport and communication facilities. Perhaps this is the reason that why Bundelkhand region is industrially underdeveloped and has very few large scale industries. This region has mostly small scale or household industries which consist of stone crushing units, granite and sand stone mining, cutting and polishing units, rolling mills, handlooms (Ranipur), charcoal making, flour mills, oil mills etc. Industrial area of Orai (District-Jalaun) is considered the best industrial location having presence of HLL, Vegeepro, Urvashi Synthetics etc. In Jhansi, BHEL (Public Sector Unit), Diamond Cement (Birla Group), Indo-Gulf Explosives, Sri Niwas Fertilizers etc. are good names. K.P. Solvex is in Niwari, a part of Tikamgarh District. Tikamgarh and Chattarpur districts have seen growth in hospitality industry and have good number of hotels in Orcha and Khajuraho.

1.2 OBJECTIVES AND IMPORTANCE OF THE STUDY
1.2-1 OBJECTIVES OF THE STUDY:

The main objective of this research is to study and analyze the current scenario of Financial Management practices adopted by the private sector enterprises in Bundelkhand region having minimum networth of rupees one crore.

Objectives of this research can be classified as under:

1. To study and analyze current Practices on Capital Structures and Cost of Capital adopted by the enterprises in Bundelkhand Region.
2. To study and analyze Capital Budgeting Practice adopted by the enterprises in Bundelkhand Region.
3. To study and analyze Working Capital Management Practice in Bundelkhand Region.
4. To study and analyze Practices related to Management of Cash, Receivables and Inventory.

1.2-2 IMPORTANCE OF THE STUDY:

Financial Management is very important for any business organization because it takes care of the business from the starting and continues to be very important as business proceeds further and it grows if sound financial decisions are taken. Keeping in view the importance of financial management in the business, the researcher decided to study and analyze the financial management practices of private sector firms/organizations of Bundelkhand region.
So far the researcher could not find any research on financial management practices, particularly in Bundelkhand region. This research will open scope for future research.

1.3 RESEARCH METHODOLOGY:-
This study is descriptive as well as analytical and is based on both primary and secondary data. To do the comprehensive study the methodology adopted in this research is as follows -

1.3 I- IDENTIFICATION OF THE PROBLEM

1.3 I-1  Situation Analysis

Financial Management has a leading part to play in the decision making process which ensure profitability and growth of a firm. Therefore firms market positions and investment opportunities will be assessed carefully for implementation so that they should be beneficial to owners, management, employees and customers. In the practical world, the financial objectives may be defined as a continuous maximization of the present value of future benefits of share holder’s wealth. Sound Financial Management is inevitable.

So the researcher decided to work on the study and analysis of Financial Management practices by private sector enterprise to find out weather these
enterprises are really utilizing the conceptual knowledge of Financial Management and also to analyse that how can these enterprises do better than what they are doing now to improve the financial position, profitability, financial stability and ultimately to increase the wealth of the enterprise. For this purpose the researcher has targeted those companies/organizations which had minimum networth of Rs. 1.0 crore. The researcher chose the Bundelkhand region as a base of study because this is an industrially underdeveloped area which has lack of resources i.e. infrastructure, communication, transport etc. which leads to less industrialization. Also it is observed that there is a lack of entrepreneurship in this region. People tend to do traditional businesses rather than to explore new business opportunities. Because the researcher belongs to this region so the researcher has natural feeling to contribute something for the betterment of this region. Having this aim in mind the researcher has done this study to identify the prevailing financial management practices, find out the fallouts in the financial management practices and to suggest the better ways, means, sources and control for effective and efficient financial management. The study will facilitate local businessmen to be more professional and encourage them to become entrepreneurs.

1.3 I-2 Experience Survey

The researcher has interviewed employees and entrepreneurs to know their experiences related to the subject matter of the study in Bundelkhand region.
1.3 I-3 Review of Literature

A thorough search of literature available in different libraries, Internet etc. has been made by abstracting and indexing journals both published and unpublished, besides tapping sources like academic journals, books etc. As such literature surveys relevant to the project are being made. The researcher has reviewed available literature of financial management practices on SME sector that was nearest to the subject matter of the study as no literature was available on small or medium size industries in Bundelkhand region.

1.3 II- CONCEPTUALISATION OF THE RESEARCH PROJECT

1.3 II-1 Formulation of Hypothesis

Hypothesis is an assumption, which indicates about a population parameter (Levin & Richard, p.366).

Research studies being carried out in developed countries formulate their hypothesis in the form of question hierarchy. In the present study the researcher has tried to find out the validity about various facets of financial management practices such as cost of capital, capital structure, capital budgeting, dividend decision and working capital management including cash, receivables and inventory management, used by different private sector enterprises in Bundelkhand region in the following form.
1. Different financial management practices used by the companies.

2. In each financial management practice, different methods/techniques used by different companies.

3. There is no difference in conceptual/theoretical financial management and financial management in practice.

1.3 II-1 a. Management Question

"Are private sector companies using major financial management practices?"

1.3 II-1 b. Research Question

"What and to what extent the major financial management practices are mostly used by these select companies in the select region?

1.3 II-1 c. Investigative Questions

I. Are companies managing their capital structure?

II. Do they change their capital structure considering the change in cost of different sources?

III. What is the most favorable source of fund for the companies?

IV. Are companies planning for long term investments (Capital Budgeting)?

V. What is/are the most popular technique/s for capital budgeting?

VI. Do companies consider and try to minimize risk in capital budgeting decisions?
VII. Do companies follow any dividend policy to distribute its profits?

VIII. Whether companies are planning and managing for working capital?

IX. What is the important source of working capital finance?

X. Do companies plan their cash inflows and outflows in advance?

XI. How do they manage their receivables?

XII. What method/s do companies adopt for Inventory Management?

XIII. Do companies plan for their payables?

1.3 II-2 Types and Sources of Data

Primary Data is the data that is collected to help solve a problem or take advantage of an opportunity on which a decision is pending (Tull, Donald S. and Hawkins, p.102).

For collecting primary data, the researcher has contacted the companies having minimum networth of Rs. 1.0 crore only, as mentioned above. The researcher has furnished the questionnaire to the respondents (employees and owners) in target companies and sought their observations and practices adopted by them. On the basis of interview, information is obtained from them. The questionnaire has covered all aspects of Financial functions relating to capital budgeting, capital structure, cost of capital, working capital, inventory and cash management.
Secondary Data is the data that is developed for some purpose other than helping to solve the problem at hand (Tull, Donald S. and Hawkins, p.102).

The researcher has taken help of available secondary data and gone through the research done on financial management practices in the past, various books, journals, internet and gathered information required for the study. As such the present research project is primary data based study.

1.3 II-3 The Survey Instrument

A questionnaire is simply a formalized set of questions for eliciting information (Tull, Donald S. and Hawkins, p.330).

A questionnaire is prepared to answer the management question, the research question and the investigative questions as described above. The researcher has taken 15% of the total respondents covering study, prior to the research work as sample and pre-tested it. The sequence of questions in the research instrument is mostly close-ended questions as are used commonly in business research.
1.3 II-4 Sample Design

A sample is that part of universe which researcher select for the purpose of investigation. A sample should exhibit the characteristics of the universe; it should be a ‘microcosm’ a word which literally means ‘small universe’ (S. P. Gupta, p-E-4.3).

There are two methods of selecting samples from population, non-random or non-probability sampling and random or probability sampling. In probability sampling, all the items in the population have a chance of being chosen in the sample. In non-random sampling, personal knowledge and opinion are used to identify those items from the population that are to be included in the sample (Levin & Richard I, p.275).

There are three type of non-probability sampling Judgment, Quota and Convenience Sampling.

Here in this research judgment sampling has been used. Judgment sampling is in which the researcher select the respondents by his or her judgment. In this study the researcher has taken responses of total 50 respondents.
1.3 III- ACTUALISATION OF THE RESEARCH PROJECT

1.3 III-1 Collection of Data

This study is based on primary data the researcher has contacted people involved in financial decision making and/or owners/promoters of the selected organizations in Bundelkhand region.

1.3 III-2 Classification and Tabulation of Data and Graphs

After collection and editing of data the first step towards further processing the same is classification. Classification is the grouping of related facts into classes (S. P. Gupta, p-E-5.2).

A table is systematic arrangement of statistical data in columns and rows (S. P. Gupta, p-E-5.18).

In this study the data is classified for separate financial management function and then tabulated. The data collected through the questionnaires has processed manually as well as mechanically and common statistical methods have been used by the researcher for the analysis of the data. The secondary data is also collected and used for this purpose. Analysis of the data has been done with the help of tabulation which is a part of technical
procedure where the classified data are put together in the form of tables to facilitate the comprehensive study and analysis purpose. A great deal of data has been tabulated by computer to save the time and to make it possible to study large number of variables affecting a problem simultaneously.

Bar Diagram and pie charts has been used for representing the tabulated data.

1.3 III-3 Scaling
Nominal, interval and ratio scales are used for the study.

1.3 III-4 Testing of Hypothesis
Validation is done by using ‘Chi Square’ test to know the acceptability of hypothesis.

1.3 III-5 Analysis and Interpretation
Analysis has been done for every question and interpretation and findings are done separately after the analysis. After the tabulation analysis has been done by applying various well defined statistical formulas.
1.3 III-6 Communication of findings

Non-technical methods are used for findings without any graphs and diagrams

1.4 LIMITATIONS OF THE RESEARCH

1. In pilot survey, the researcher found reluctance to divulge specific financial details by the respondents so questionnaire was reframed to obtain relevant information.

2. Due to the above mentioned limitation, analysis of financial health; liquidity, activity, solvency, profitability and other ratios and analysis of respondent companies could not be done for any reference.

3. Only various financial management practices adopted by the companies are studied.

4. In most of the companies respondents were not properly qualified and faced problems in understanding questions and answering. They referred to the owner/auditor of the company (CA) for some information.
5. Respondent bias in answering the questions related with financial decision making and selection of a particular method/s can be there.

6. The area of study is economically under developed hence most of the private companies are under SME sector. So literature review is primarily based on financial management practices in SME.

7. There may be other methods also for validation of results than the Chi-square method. But researcher decided to use one method for validation.

8. Researcher has used Chi-square test for validation of results statistically to the best of his knowledge and hence limitations of this method may also be limitation of this study too.

9. Some results of Chi-square testing are contradicting to the answers obtained and then analysed through Bar Diagrams. This may be the limitation of the statistical analysis.
10. This study is not ultimate in itself but it is a link between Past and Future study and hence has a scope of improvement.

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