[Frequently Asked Questions]

Financial Management Introduction - Part: 2

Subject:	Business Economics
Course:	B.A., 3rd Semester, Undergraduate
Paper No. & Title:	Paper – 303 Business Finance
Unit No. & Title:	Unit – 1 Financial Management Introduction
Lecture No. & Title:	Lecture – 2 Financial Management Introduction - Part: 2

Frequently Asked Questions

Q1.Explain the concept of time value of money

A1. Time value of money is the value of money is different in different time periods. Rs 100 now are less valuable one year after. Since value of money received today is more, investors would prefer current receipt to future receipt.

Q2. Explain the concept of discounting and compounding

A2. Discounting is the technique of determining the present value of a future amount. Compounding is the technique of determining future value from present value of amount.

Q3. Define Annuity and discuss its types

A3. Annuity is the equal amount of payments made and received at regular periods. There are two types of Annuity: Annuity Due and Annuity Regular. Annuity regular which occurs at the end of the period and annuity due is one which takes place in the beginning of the year.

Q4. Define the concept of perpetuity

A4. Perpetuity is the annuity with indefinite life.

Q5. Differentiate between the present value and future value

A5. Present value is the value of rupee now. It is the current value of a future amount. Future value is the value of money in future. In order to determine present value, discounting technique is used and for future value determination compounding technique is used.

Q6. Explain briefly how future value of annuity can be determined?

A6. Compound value annuity factor is to be multiplied with the annuity to determine its future value. This compound value annuity factor can be obtained from the Table values for the specified number of years and the specified rate. Symbolically, Fv= CVAF * A, where A represents annuity.

Q7. Distinguish between nominal rate of interest and effective rate of interest.

A7. When compounding is done annually, there is no difference between nominal and effective rate of interest but when compounding is done for multiple times say semi annually, quarterly, daily then effective rate of interest is higher and increases with an increase in the frequency of compounding. The nominal rate of interest is the coupon rate of interest.

Q8. Define Risk. How it is different from uncertainty.

A8. Risk is a situation where probabilities can be assigned for the outcome to occur whereas uncertainty is the situation which is completely new and assignment of probabilities is not possible. When actual cash flows are different from the expected cash flows it gives rise to risk or the variability in returns is defined as risk.

Q9. Define Return

A9. It is the earning which an investor earns on the investment. It could be in the form of interest or dividend and capital gain. Usually return is expressed in percentage.