

**SOS POLITICAL SCIENCE AND PUBLIC ADMINISTRATION**  
**MBA FA 202**

**SUBJECT NAME: FUNDAMENTALS OF FINANCIAL MANAGEMENT**

---

---

**UNIT V**

**TOPIC NAME: PLOUGHING BACK OF PROFIT**

**PLOUGHING BACK OF**  
**PROFIT**

# PLOUGHING BACK OF PROFITS

- ✘ *The ploughing back of profits is a technique under which all profits of a company are not distributed amongst the shareholders as dividend, but a part of profits is retained or reinvested in the company. This process of retaining and utilization year after year in the business is known as ploughing back of profits.*

*This is also known as*

- ✘ *self financing process*
- ✘ *Internal financing process*
- ✘ *Inter financing process*

# MEANING

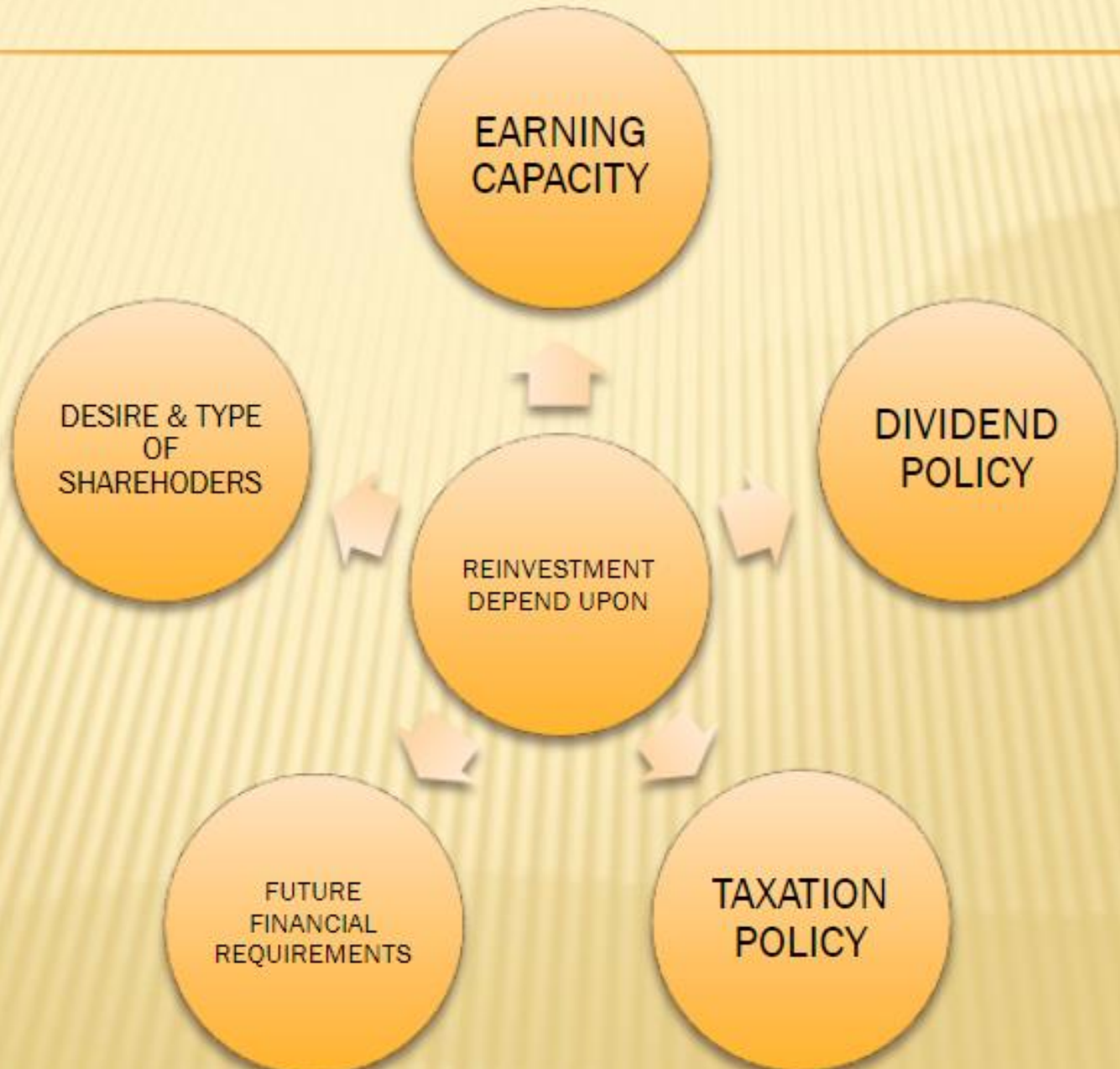
A new company can raise funds only through external sources such as share , debenture , loans etc.

But an existing or a going concern which needs finance for its future growth and expansion can also generate through its internal sources . Such as retained earnings or ploughing back of profits , capitalisation of profits and depreciation.

# NECESSITY OF PLOUGHING BACK



# FACTORS INFLUENCING THE RE-INVESTMENT OF PROFITS



# MERITS OF PLOUGHING BACK OF PROFITS

## *ADVANTAGES TO THE COMPANY*

- A cushion to absorb the shocks of economy
- Economical method of financing
- Aids in smooth & undistributed running of the business
- Helps in following stable dividend policy
- Flexible financial structure.
- Makes the company self dependent
- To redeem long term liabilities

## *ADVANTAGES TO THE SHAREHOLDERS*

- Increase in the value of shares
- Safety of investment
- Enhanced the earning capacity
- No dilution of control
- Evasion of super taxes

## *ADVANTAGES TO THE SOCIETY OR NATION*

- Increases the rate of capital formation
- Stimulates industrialization
- Increases productivity
- Decreases the rate of industrial failure
- Higher standard of living

# LIMITATIONS OF PLOUGHING BACK OF PROFITS

---

*1. Over capitalization*



*2. Creation of monopolies*



*3. Depriving the freedom of the investors*



*4. Misuse of retained earning*



*5. Manipulation in the value of shares*



*6. Evasion of taxes*



*7. Dissatisfaction among shareholders*



## FORMULA OF COST OF RETAINED EARNINGS

$$K_r = \frac{D}{NP} + G$$

$K_r$  = COST OF RETAINED EARNINGS

$D$  = EXPECTED DIVIDEND

$NP$  = NET PROCEEDS OF SHARE ISSUE

$G$  = RATE OF GROWTH

## FORMULA OF COST OF RETAINED EARNINGS TO MAKE ADJUSTMENTS OF TAX & COST OF PURCHASING NEW SECURITIES

$$K_r = \left( \frac{D}{NP} + G \right) \times (1 - t) \times (1 - b)$$

$K_r$  = COST OF RETAINED EARNINGS

$D$  = EXPECTED DIVIDEND

$NP$  = NET PROCEEDS OF SHARE ISSUE

$G$  = RATE OF GROWTH

$T$  = TAX RATE

$b$  = COST OF PURCHASING NEW SECURITIES, OR BROKERAGE COSTS

# **COST OF RETAINED EARNINGS**

THANK YOU

---