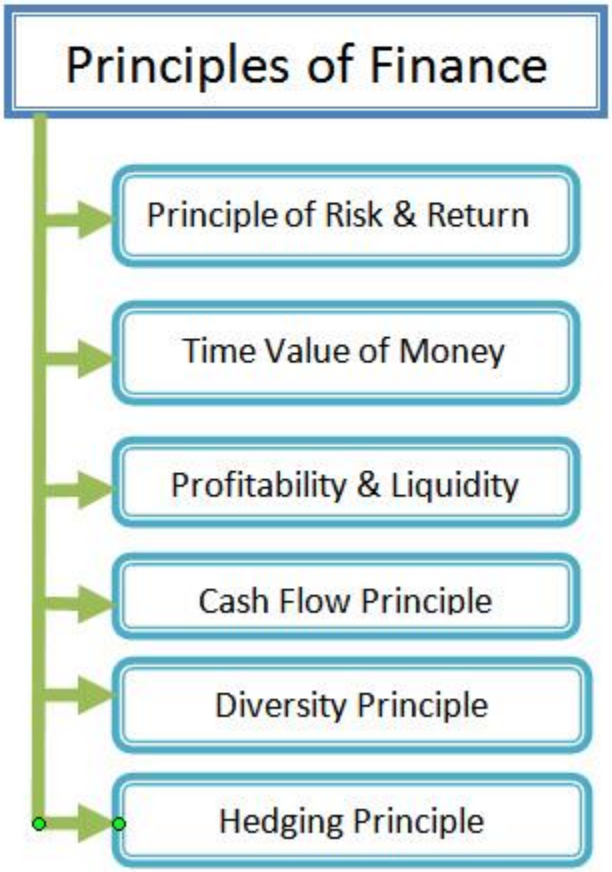
6 Principles of Finance You Must Know

Principles act as a guideline for the investment and financing decision. Financial managers take operating, investment, and financing decisions. Some of this related to the short term and some long term. The 6 Principles of Finance everyone should know whether it is for individuals or organizations.



There are six principles of finance you must know:

1. The Principle of Risk and Return
2. Time Value of Money Principle
3. Cash Flow Principle
4. The Principle of Profitability and liquidity
5. Principles of diversity and
6. The Hedging Principle of Finance

Risk and Return

The principle of Risk and Return indicates that investors have to conscious both risk and return, because higher the risk higher the rates of return and lower the risk, lower the rates of return. For business financing, we have to compare the return with risk. To ensure optimum rates of return investors need to measure risk and return by both direct measurement and relative measurement.

Time Value of Money
This principle is concerned with the value of money, that value of money is decreased when time passes. The value of $1 of the present time is more than the value of $1 after some time or years. So before investing or taking funds, we have to think about the inflation rate of the economy and the required rate of return must be more than the inflation rate so that return can compensate for the loss incurred by the inflation.

Cash Flow
The cash flow principle mainly discusses the cash inflow and outflow, more cash inflow in the earlier period is preferable than later cash flow by the investors. This principle also follows the time value principle that's why it prefers earlier more benefits rather than later years benefits.

Profitability and Liquidity
The principle of profitability and liquidity is very important from the investor's perspective because the investor has to ensure both profitability and liquidity. Liquidity indicates the marketability of the investment i.e. how much easy to get cash by selling the investment. On the other hand, investors have to invest in a way that can ensure the maximization of profit with a moderate or lower level of risk.

Diversity
This principle helps to minimize the risk by building an optimum portfolio. The idea of a portfolio is, never put all your eggs in the same basket because if it falls then all of your eggs will break, so put eggs by separating in a different basket so that your risk can be minimized. To ensure this principle investors have to invest in risk-free investment and some risky investment so that ultimately risk can be lower. Diversification of investment ensures minimization of risk.

Hedging
Hedging principle indicates us that we have to take a loan from appropriate sources, for short-term fund requirement we have to finance from short-term sources and for long-term fun requirement we have to manage fund from long-term sources. For fixed asset financing is to be done from long-term sources.

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