4.2 FINANCIAL MANAGEMENT

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MEANING OF FINANCIAL MANAGEMENT

- Financial Management means planning, organizing, directing and controlling the financial activities such as procurement and utilization of funds of the enterprise. It means applying general management principles to financial resources of the enterprise.

SCOPE/ELEMENTS

- Investment decisions includes investment in fixed assets (called as capital budgeting). Investment in current assets are also a part of investment decisions called as working capital decisions.
- Financial decisions - They relate to the raising of finance from various resources which will depend upon decision on type of source, period of financing, cost of financing and the returns thereby.
- Dividend decision - The finance manager has to take decision with regards to the net profit distribution. Net profits are generally divided into two:
  - Dividend for shareholders- Dividend and the rate of it has to be decided.
  - Retained profits- Amount of retained profits has to be finalized which will depend upon expansion and diversification plans of the enterprise.

OBJECTIVES OF FINANCIAL MANAGEMENT

- The financial management is generally concerned with procurement, allocation and control of financial resources of a concern. The objectives can be-

- To ensure regular and adequate supply of funds to the concern.
- To ensure adequate returns to the shareholders which will depend upon the earning capacity, market price of the share, expectations of the shareholders.
- To ensure optimum funds utilization. Once the funds are procured, they should be utilized in maximum possible way at least cost.
- To ensure safety on investment, i.e, funds should be invested in safe ventures so that adequate rate of return can be achieved.
- To plan a sound capital structure-There should be sound and fair composition of capital so that a balance is maintained between debt and equity capital.

FUNCTIONS OF FINANCIAL MANAGEMENT

- **Estimation of capital requirements:** A finance manager has to make estimation with regards to capital requirements of the company. This will depend upon expected costs and profits and future programmes and policies of a concern. Estimations have to be made in an adequate manner which increases earning capacity of enterprise.

- **Determination of capital composition:** Once the estimation have been made, the capital structure have to be decided. This involves short- term and long-term debt equity analysis. This will depend upon the proportion of equity capital a company is possessing and additional funds which have to be raised from outside parties.

- **Choice of sources of funds:** For additional funds to be procured, a company has many choices like-
  - Issue of shares and debentures
  - Loans to be taken from banks and financial institutions
  - Public deposits to be drawn like in form of bonds.
- Choice of factor will depend on relative merits and demerits of each source and period of financing.

FUNCTIONS OF FINANCIAL MANAGEMENT

- **Investment of funds:** The finance manager has to decide to allocate funds into profitable ventures so that there is safety on investment and regular returns is possible.
- **Disposal of surplus:** The net profits decision have to be made by the finance manager. This can be done in two ways:
  - Dividend declaration - It includes identifying the rate of dividends and other benefits like bonus.
  - Retained profits - The volume has to be decided which will depend upon expansional, innovational, diversification plans of the company.
- **Management of cash:** Finance manager has to make decisions with regards to cash management. Cash is required for many purposes like payment of wages and salaries, payment of electricity and water bills, payment to creditors, meeting current liabilities, maintainance of enough stock, purchase of raw materials, etc.
- **Financial controls:** The finance manager has not only to plan, procure and utilize the funds but he also has to exercise control over finances. This can be done through many techniques like ratio analysis, financial forecasting, cost and profit control, etc.

ROLE OF A FINANCIAL MANAGER:

1. Raising of Funds

- In order to meet the obligation of the business it is important to have enough cash and liquidity. A firm can raise funds by the way of equity and debt. It is the responsibility of a financial manager to decide the ratio between debt and equity. It is important to maintain a good balance between equity and debt.

ROLE OF A FINANCIAL MANAGER:

2. Allocation of Funds

- Once the funds are raised through different channels the next important function is to allocate the funds. The funds should be allocated in such a manner that they are optimally used. In order to allocate funds in the best possible manner the following point must be considered
  - The size of the firm and its growth capability
  - Status of assets whether they are long-term or short-term
  - Mode by which the funds are raised
- These financial decisions directly and indirectly influence other managerial activities. Hence formation of a good asset mix and proper allocation of funds is one of the most important activity

ROLE OF A FINANCIAL MANAGER:

3. Profit Planning

- Profit earning is one of the prime functions of any business organization. Profit earning is important for survival and sustenance of any organization. Profit planning refers to proper usage of the profit generated by the firm.

- Profit arises due to many factors such as pricing, industry competition, state of the economy, mechanism of demand and supply, cost and output. A healthy mix of variable and fixed factors of production can lead to an increase in the profitability of the firm.

- Fixed costs are incurred by the use of fixed factors of production such as land and machinery. In order to maintain a tandem it is important to continuously value the depreciation cost of fixed cost of production. An opportunity cost must be calculated in order to replace those factors of production which has gone thrown wear and tear. If this is not noted then these fixed cost can cause huge fluctuations in profit.

ROLE OF A FINANCIAL MANAGER:

4. Understanding Capital Markets

- Shares of a company are traded on stock exchange and there is a continuous sale and purchase of securities. Hence a clear understanding of capital market is an important function of a financial manager. When securities are traded on stock market there involves a huge amount of risk involved. Therefore a financial manger understands and calculates the risk involved in this trading of shares and debentures.
- Its on the discretion of a financial manager as to how to distribute the profits. Many investors do not like the firm to distribute the profits amongst share holders as dividend instead invest in the business itself to enhance growth. The practices of a financial manager directly impact the operation in capital market.

FINANCIAL PLANNING

Definition of Financial Planning

- Financial Planning is the process of estimating the capital required and determining it's competition.

- It is the process of framing financial policies in relation to procurement, investment and administration of funds of an enterprise.

OBJECTIVES OF FINANCIAL PLANNING

- Financial Planning has got many objectives to look forward to:
- **Determining capital requirements-** This will depend upon factors like cost of current and fixed assets, promotional expenses and long- range planning. Capital requirements have to be looked with both aspects: short- term and long- term requirements.

- **Determining capital structure-** The capital structure is the composition of capital, i.e., the relative kind and proportion of capital required in the business. This includes decisions of debt- equity ratio- both short-term and long- term.

- **Framing financial policies** with regards to cash control, lending, borrowings, etc.

- A finance manager **ensures that the scarce financial resources are maximally utilized in the best possible manner** at least cost in order to get maximum returns on investment.

IMPORTANCE OF FINANCIAL PLANNING

- Financial Planning is process of framing objectives, policies, procedures, programmes and budgets regarding the financial activities of a concern. This ensures effective and adequate financial and investment policies. The importance can be outlined as-

- Adequate funds have to be ensured.
- Financial Planning helps in ensuring a reasonable balance between outflow and inflow of funds so that stability is maintained.
- Financial Planning ensures that the suppliers of funds are easily investing in companies which exercise financial planning.
- Financial Planning helps in making growth and expansion programmes which helps in long-run survival of the company.
- Financial Planning reduces uncertainties with regards to changing market trends which can be faced easily through enough funds.
- Financial Planning helps in reducing the uncertainties which can be a hindrance to growth of the company. This helps in ensuring stability an d profitability in concern.

ASSIGNMENT 7

Q 1. What is financial management ? Explain its scope.

Q 2. What are the objectives of financial management.

Q 3. What are the functions of financial management ?

Q 4. What is the role of a financial manager ?

Q 5. What is financial planning ? What are its objectives ?

Q 6. What is the importance of financial planning ?