**INTRODUCTION**

**Financial management is that managerial activity which is concerned with the planning and controlling of the firm’s financial resources**. It was a branch of economics till 1890, and as a separate discipline, it is of recent origin. Still, it has no unique body of knowledge of its own, and draws heavily on economics for its theoretical concepts.

In general financial management is the effective & efficient utilization of financial resources. It means creating balance among financial planning, procurement of funds, profit administration & sources of funds.

**Definitions of financial management:**

* According to **Solomon**, “Financial management is concerned with the efficient use of an important economic resource, namely, capital funds.”
* According to **J. L. Massie**, “Financial management is the operational activity of a business that is responsible for obtaining and effectively utilizing the funds necessary for efficient operation.”
* According to **Weston & Brigham**, “Financial management is an area of financial decision making harmonizing individual motives & enterprise goals.”
* According to **Howard & Upton**, “Financial management is the application of the planning & control functions of the finance function.”
* According to **J. F. Bradley**, “Financial management is the area of business management devoted to the judicious use of capital & careful selection of sources of capital in order to enable a spending unit to move in the direction of reaching its goals.”

**Main features of financial management:**

On the basis of the above definitions, the following are the main characteristics of financial management-

* **Analytical Thinking-**Under financial management financial problems are analyzed and considered. Study of trend of actual figures is made and ratio analysis is done.
* **Continuous Process-**previously financial management was required rarely but now the financial manager remains busy throughout the year.
* **Basis of Managerial Decisions-** All managerial decisions relating to finance are taken after considering the report prepared by the finance manager. The financial management is the base of managerial decisions.
* **Maintaining Balance between Risk and Profitability-**Larger the risk in the business larger is the expectation of profits. Financial management maintains balance between the risk and profitability.
* **Coordination between Process-** There is always a coordination between various processed of the business.
* **Centralized Nature-** Financial management is of a centralized nature. Other activities can be decentralized but there is only one department for financial management.

**[Areas/Scope of financial management](http://www.mbaknol.com/financial-management/areasscope-of-financial-management/)**

Financial management, at present is not confined to raising and allocating funds. The study of financial institutions like stock exchange, capital, market, etc. is also emphasized because they influenced under writing of securities & corporate promotion. The scope of Financial Management has widened to cover capital structure, dividend policies, profit planning and control, AND depreciation policies. Some of the functional areas covered in financial management are as follows:-

1. **Determining financial needs:-** A finance manager is supposed to meet financial needs of the enterprise. For this purpose, he should determine financial needs of the concern. Funds are needed to meet promotional expenses, fixed and working capital needs. The requirement of fixed assets is related to types of industry. A manufacturing concern will require more investments in fixed assets than a trading concern. The working capital needs depend upon scale of operations. Larger the scale of operations, the higher will be the needs for working capital. A wrong assessment of financial needs may jeopardize the survival of a concern.
2. **Choosing the sources of funds:-** A number of sources may be available for raising funds. A concern may be resort to issue of share capital and debentures. Financial institutions may be requested to provide long-term funds. The working capital needs may be met by getting cash credit or overdraft facilities from commercial bands. A finance manager has to be very careful & cautions in approaching different sources.
3. **Financial analysis and interpretation:-** The analysis & interpretation of financial statements is an important task of a finance manager. He is expected to know about the profitability, liquidity position, short term and long-term financial position of the concern. For this purpose, a number of ratios have to be calculated. The interpretation of various ratios is also essential to reach certain conclusions Financial analysis and interpretation has become an important area of financial management.
4. **Cost-volume profit analysis:-** This is popularly known as “CVP relationship”. For this purpose, fixed costs, variable costs and semi variable costs have to be analyzed. Fixed costs are more or less constant for varying sales volumes. Variable costs vary according to the sales volume. Semi-variable costs are either fixed or variable in the short-term. The financial manager has to ensure that the income of the firm will cover its variable costs, for there is no point in being in business, if this is not accomplished. Moreover, a firm will have to generate an adequate income to cover its fixed costs as well. The financial manager has to find out the break-even point that is, the point at which the total costs are matched by total sales or total revenue.
5. **Working capital management:-** Working capital refers to that part of firm’s capital which is required for financing short-term or current assets such as cash, receivables and inventories. It is essential to maintain proper level of these assets. Finance manager is required to determine the quantum of such assets.
6. **Dividend policy: -** Dividend is the reward of the shareholders for investments made by them in the shares of the company. The investors are interested in earning the maximum return on their investments whereas management wants to retain profits for future financing. These contradictory aims will have to be reconciled in the interests of shareholders and the company. Dividend policy is an important area of financial management because the interest of the shareholders and the needs of the company are directly related to it.
7. **Capital budgeting: -** Capital budgeting is the process of making investment decisions in capital expenditures. It is an expenditure, the benefits of which are expected to be received over a period of time exceeding one year. It is expenditure for acquiring or improving the fixed assets, the benefits of which are expected to be received over a number of years in future. Capital budgeting decisions are vital to any organization. Any unsound investment decision may prove to be fatal for the very existence of the concern.

[Objectives of Financial Management](http://www.mbaknol.com/financial-management/objectives-of-financial-management/)

Financial management provides a frame work for selecting a proper course of action and deciding a viable commercial strategy.  The main objective of a business is to maximize the owner’s economic welfare.  This objective can be achieved by;

1. Profit Maximization, and
2. Wealth Maximization.

**1. Profit Maximization.** Profit earning is the main aim of every economic activity.  A business being an economic institution must earn profit to cover its costs and provide funds for growth.  No business can survive without earning profit.  Profit is a measure of efficiency of a business enterprise.  Profits also serve as a protection against risks which cannot be ensured.  The accumulated profits enable a business to face risks like fall in prices, competition from other units, adverse government policies etc.  Thus, profit maximization is considered as the main objective of business.  The following arguments are advanced in favor of profit maximization as the objective of business:

1. When profit-earning is the aim of business then profit maximization should be the obvious objective.
2. Profitability is a barometer for measuring efficiency and economic prosperity of a business enterprise
3. Economic and business conditions do not remain same at all times.  There may be adverse business conditions like recession, depression, severe competition etc. A business will be able to survive under unfavorable situation, only if it has some past earnings to rely upon. Therefore, a business should try to earn more and more when situation is favorable.
4. Profits are the main sources of finance for the growth of a business. So, a business should aim at maximization of profits for enabling its growth and development.
5. Profitability is essential for fulfilling social goals also.  A firm by pursuing the objective of profit maximization also maximizes socio-economic welfare.

However, profit maximization objective has been criticized on many grounds. They are:

* A firm pursuing the objective of profit maximization starts exploiting workers and the consumers. Hence, it is immoral and leads to a number of corrupt practices.
* It is also argued that profit maximization should be the objective in the conditions of perfect competition and in the wake of imperfect competition today, it cannot be the legitimate objective of a firm
* One has to reconcile the conflicting interests of all the parties connected with the firm.  Thus, profit maximization as an objective of financial management has been considered inadequate.  Even as an operational criterion for maximizing owner’s economic welfare, profit maximization has been rejected because of the following drawbacks;
* The term ‘profit’ is vague and it cannot be precisely defined.  It means different things for different people. Should we consider short-term profits or long-term profits? Does it mean total profits or earnings per share? Even if, we take the meaning of profits as earnings per share and maximize the earnings per share, it does not necessarily mean increase in the market value of share and the owner’s economic welfare.
* Profit maximization objective ignores the time value of money and does not consider the magnitude and timing of earnings.  It treats all earnings as equal when they occur in different periods. It ignores the fact that cash received today is more important than the same amount of cash received after, three years.
* It does not take into consideration the risk of the prospective earnings stream.  Some projects are more risky than other.
* The effect of dividend policy on the market price of shares is also not considered in the objective of profit maximization.

**2. Wealth Maximization.** Wealth maximization is the appropriate objective of an enterprise. When the firm maximizes the stockholder’s wealth, the individual stockholder can use this wealth to maximize his individual utility.  It means that by maximizing stockholder’s wealth the firm is operating consistently towards maximizing stockholder’s utility.

A stockholder’s current wealth in the firm is the product of the number of shares owned, multiplied with the current stock price per share.

This objective helps in increasing the value of shares in the market. The share’s market price serves as a performance index or report card of its progress.  It also indicates how well management is doing on behalf of the shareholder.

However, the maximization of the market price of the shares should be in the long run. Every financial decision should be based on cost-benefit analysis.  If the benefit is more than the cost, the decision will help in maximizing the wealth.

**Implications of Wealth maximization.** There is a rationale in applying wealth maximizing policy as an operating financial management policy.  It serves the interests of suppliers of loaned capital, employees, management and society.  Besides shareholders, there are short-term and long-term suppliers of funds who have financial interests in the concern.  Short-term lenders are primarily interested in liquidity position so that they get their payments in time. The long-term lenders get a fixed rate of interest from the earnings and also have a priority over shareholders in return of their funds. Wealth maximization objective not only serves shareholder’s interests by increasing the value of holdings but ensures security to lenders also. The economic interest of society is served if various resources are put to economical and efficient use.

**Criticism of Wealth Maximization.** The wealth maximization objective has also been criticized by certain financial theorists mainly on following accounts;

1. It is a prescriptive idea. The objective is not descriptive of what the firms actually do.
2. The objective of wealth maximization is not necessarily socially desirable.
3. There is some controversy as to whether the objective is to maximize the stockholders wealth or the wealth of the firm which includes other financial claimholders such as debenture holders, preferred stockholders, etc.,
4. The objective of wealth maximization may also face difficulties when ownership and management are separated as is the case in most of the large corporate form of organizations.

In spite of all the criticism, we are of the opinion that wealth maximization is the most appropriate objective of a firm and the side costs in the form of conflicts between the stockholders and debenture holders, firm and society and stock holders and managers can be minimized.