Financial Management

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Financial management is that managerial activity which is concerned with planning and controlling of the firm's financial resources. In other words it is concerned with acquiring, financing and managing assets to accomplish the overall goal of a business enterprise (mainly to maximise the shareholder's wealth).

"Financial Management comprises the forecasting, planning, organizing, directing, co-ordinating and controlling of all activities relating to acquisition and application of the financial resources of an undertaking in keeping with its financial objective." Raymond Chambers

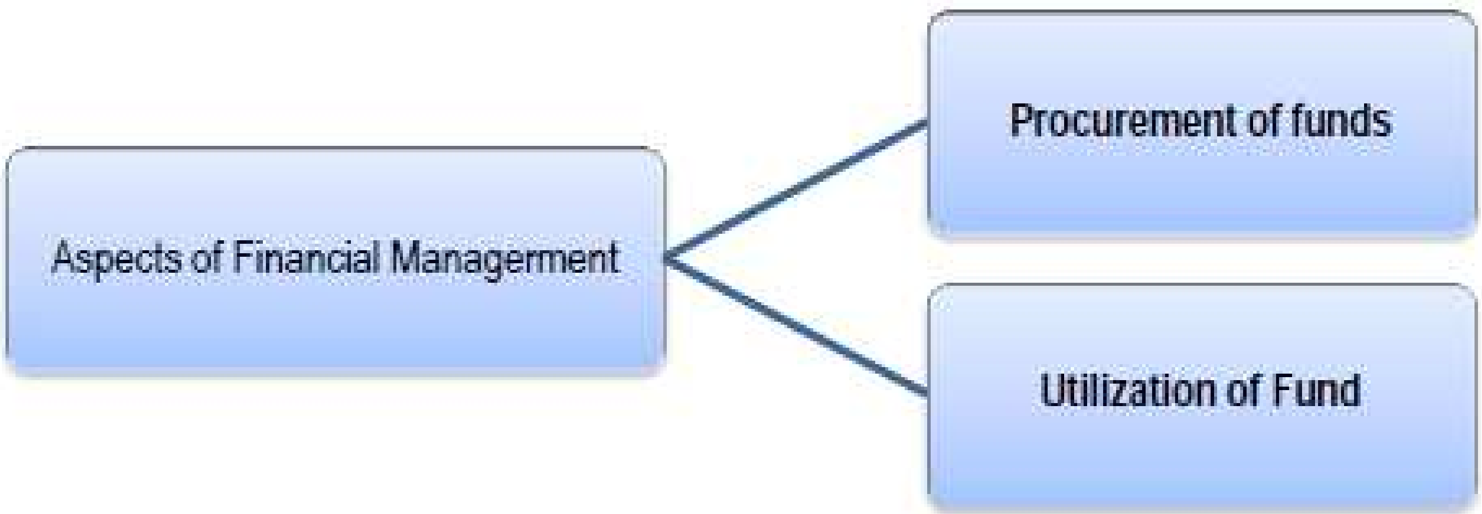
Another very elaborate definition given by Phillippatus is

"Financial Management is concerned with the managerial decisions that result in the acquisition and financing of short term and long term credits for the firm."

Stages of Decision making in FM

Stage 1	Stage 2	Stage 3	Stage 4
Decides which assets to buy	Determining what is the total investment required for buying the assets	Apart from buying the assets the entrepreneur would also need to determine how much cash he would need to run daily operations	The next stage is to decide what all sources does the entrepreneur needs to tap to finance the whole investment The sources can be Share capital, borrowing from banks or investment from financial institutions etc.

Aspect of FM


Aspects of Financial Managerment
Procurement of funds
Utilization of Fund

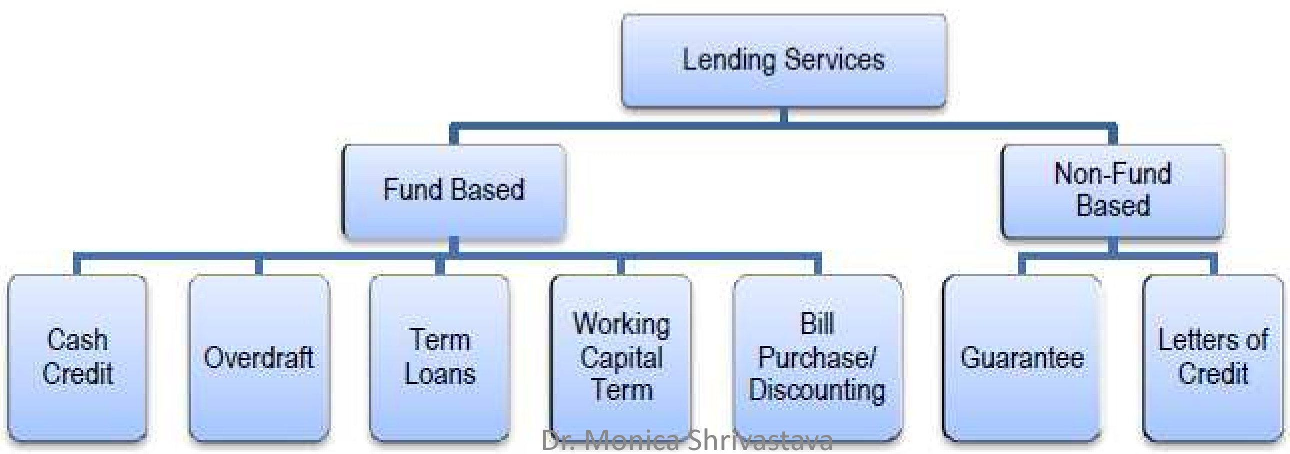
Procurement of Funds

Methods of Procuring funds

- Equity - The process of raising capital through the sale of shares in an enterprise. Equity financing essentially refers to the sale of an ownership interest to raise funds for business purposes
- Debentures – It is a unit of loan amount. When a company intends to raise a loan amount from the public it issues debentures. It is a document issued under the seal of the company. It is an acknowledgement of the loan received by the company equal to the nominal value of the debenture. It bears the date of redemption and rate and mode of payment of interest

Commercial Banks

- Funding from Banks – Commercial banks play an important role in funding of the business enterprises. Apart from supporting businesses in their routineactivities (payments, deposits etc.) they play an important role in meeting the long term and short term needs of a business



Definitions

- Letter of credit - A letter from a bank guaranteeing that a buyer's payment to a seller will be received on time and for the correct amount. In the event that the buyer is unable to make payment on the purchase, the bank will be required to cover the full or remaining amount of the purchase
- Overdraft - An extension of credit from a lending institution when an account reaches zero. An overdraft allows the individual to continue withdrawing money even if the account has no funds in it. Basically the bank allows people to borrow a set amount of money.
- Working Capital term Loan - A loan whose purpose is to finance everyday operations of a company. A working capital loan is not used to buy long term assets or investments. Instead it's used to clear up accounts payable, wages, etc.
- Cash Credit - A Cash Credit is a type of loan account provided by banks under corporate solution which helps to support working capital requirement. As the business requirements changes daily so is the working capital. A perfect product “Cash Credit” is a loan or continuous overdrawn facility unlike current a/c were overdrawn facility is provided occasionally

- Bills payable/discount - While discounting a bill, the Bank buys the bill (i.e. Bill of Exchange or Promissory Note) before it is due and credits the value of the bill after a discount charge to the customer's account. The transaction is practically an advance against the security of the bill and the discount represents the interest on the advance from the date of purchase of the bill until it is due for payment.

  Guarantee - A guarantee from a lending institution ensuring that the liabilities of a debtor will be met. In other words, if the debtor fails to settle a debt, the bank will cover it.

Venture Capital

- Money provided by investors to startup firms and small businesses with perceived long-term growth potential. This is a very important source of funding for startups that do not have access to capital markets. It typically entails high risk for the investor, but it has the potential for above-average returns.

Angel Investors

- An investor who provides financial backing for small startups or entrepreneurs. Angel investors are usually found among an entrepreneur's family and friends. The capital they provide can be a one-time injection of seed money or ongoing support to carry the company through difficult times.

Angel/Venture

- Angel investors (high net-worth individuals) represent an essential source of funding for early stage, high-risk ventures.
- Angel investors are estimated to provide 90% of all seed and start-up capital, while the venture capital community provides less than 2% of start-up financing.

Hire Purchases or Leasing

- Hire purchase (HP) or leasing is a type of asset finance that allow firms or individuals to possess and control an asset during an agreed term, while paying rent or installments covering depreciation of the asset, and interest to cover capital cost.

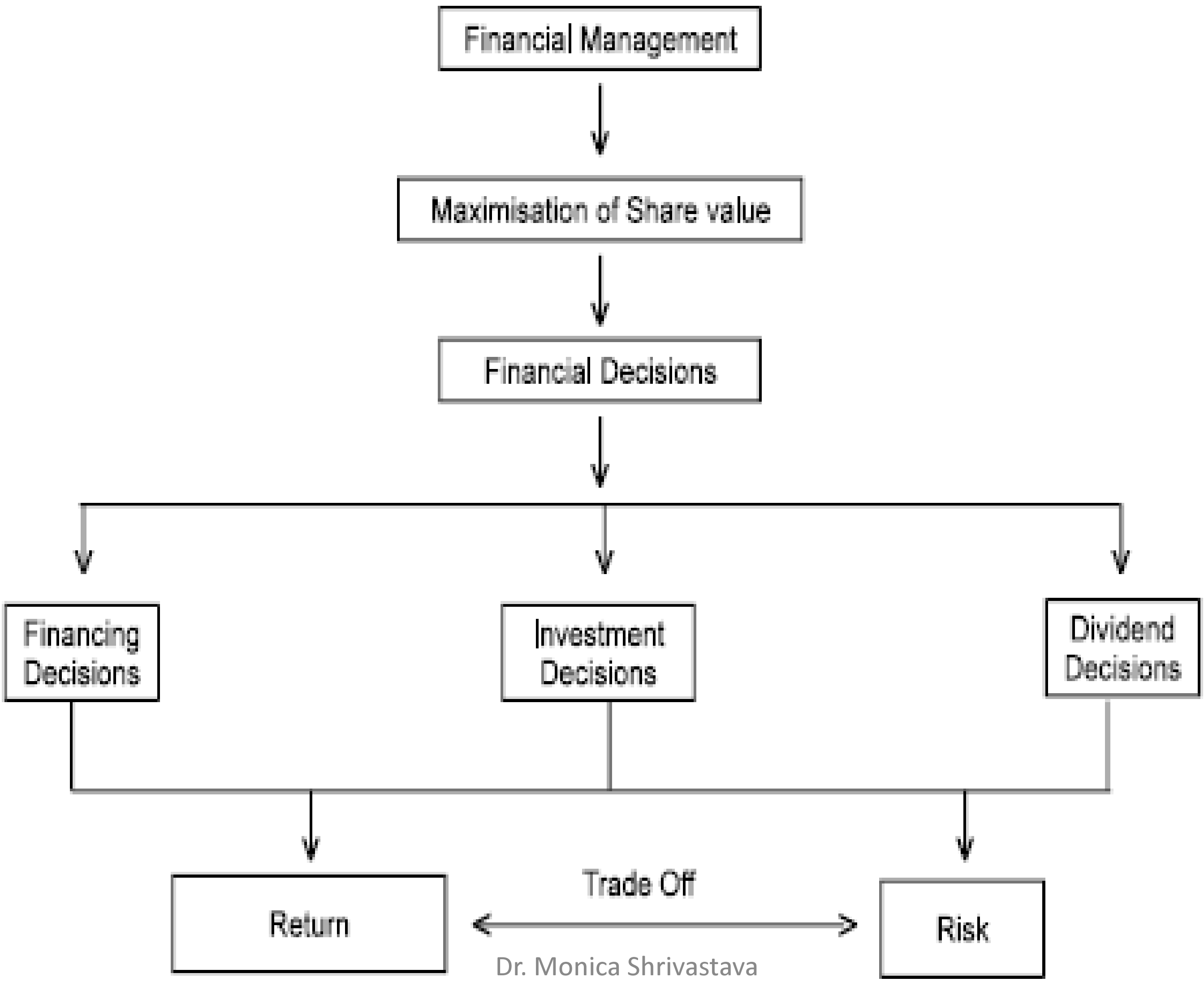
Effective utilization of funds

- Utilization of fixed assets- The funds are to be invested in the manner so that the company can produce at its optimum level without endangering its financial solvency. For this the finance manager would be required to posses sound knowledge of technique of capital budgeting.

- Capital budgeting is a type of planning process used to determine whether a firm's long term investments such as new machinery, replacement machinery, new plants, new products, and research and development projects would provide the desired return (profit).

- Utilization of working capital – The finance manager should also keep in view the need for adequate working capital and ensure that while the firms enjoy an optimum level of working capital they do not keep too much funds blocked in inventories, book debts, cash etc.

Scope and functions of FM



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.

Importance of Financial Management

- 1. Profitability – for the organization to minimise cost and to maximize return
- 2. Liquidity – the ability to meet its operating activities
- 3. Safety or security – to overcome undue risk
- 4. Decision making – scope of decisions extends to the following areas

Importance of Financial Management

- a. Investment decision which include Short-term: working capital management and Long-term: capital budgeting.
- b. Financing decision includes decision about fixing Financing mix and determining capital structure.
- c. Dividend decisions are about Dividend policy: zero, residual, constant, stable dividend policies.

- Financial management primarily deals with Maximization of return to the shareholder and peripherally deals with Secondary objectives like customer satisfaction, increase in market shares, Growth, Survival and innovation.
- To satisfy various stakeholders like Shareholders, Environment, Employees, Government, Management, Supplier, Community, and Customers is also within the scope of financial management

Objectives of FM

- 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 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 programs 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.

- **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 expansion, 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, maintenance 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.