

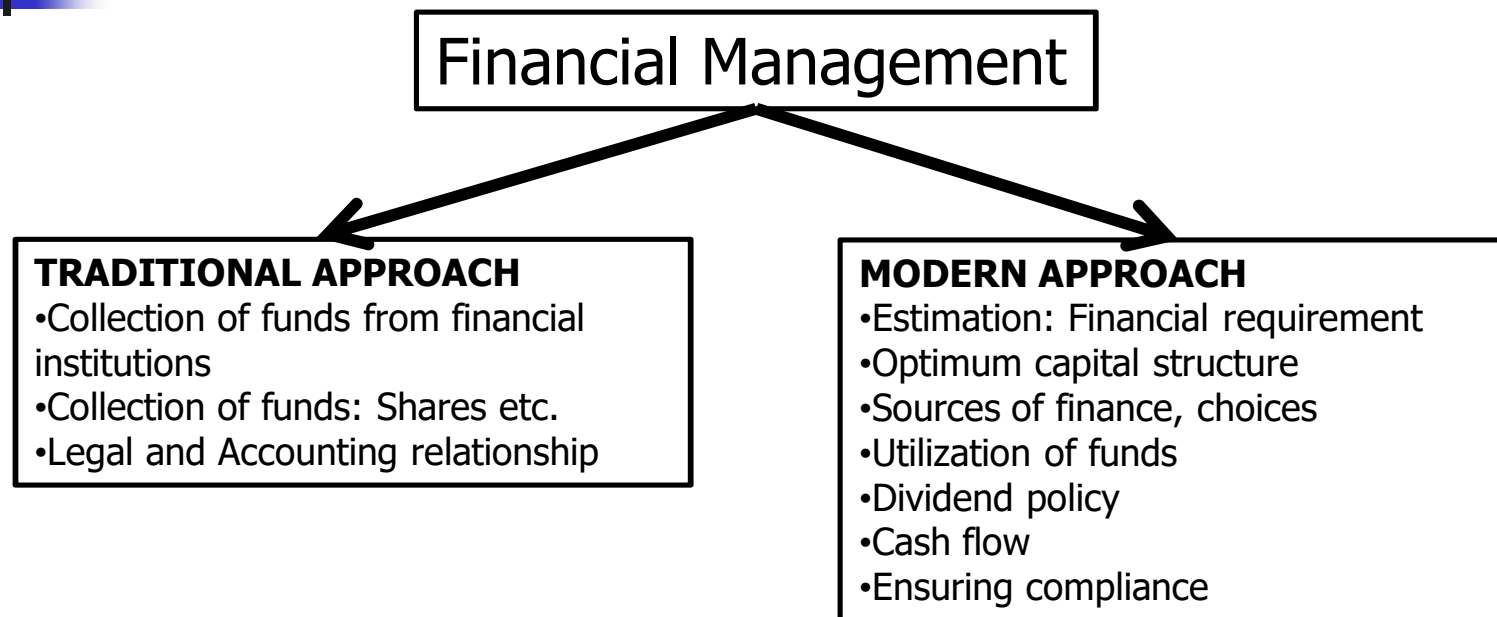


Financial Management

- Definition: Managerial activity that is concerned with planning, implementing, and controlling financial resources of an organization



Scope





Functions

- Financial functions: plan, structure, raise
- Investing functions: investment, utilization
- Dividend distribution functions
- Liquidity maintaining function: cash, inventory, receivable, working capital
- Profit earning functions: expected profit, cost control, pricing
- Controlling functions
- Other functions: ensure compliance, creation of reserve, new projects



The role: Chief Financial Officer

- Financial planning
- Financing
- Controlling the use of funds
- Appropriation of profit
- Manage and control treasury



Profit maximization

- Business normally aims to earn profit
 - Owner oriented, Output is more than the input
- How much?
 - Efficient use of capital
 - Consider other factors like society, environment etc.
- May have lack of definiteness:
 - Indistinct – which profit?
 - Time value of money
 - Risk and uncertainty



Wealth maximization

- Maximization of Net Present Value (NPV)
- NPV: the more – the better
- Negative NPV: not acceptable normally

$$NPV = \frac{A1}{(1+K)^1} + \frac{A2}{(1+K)^2} + \dots + \frac{An}{(1+K)^n} - C$$

A1, A2 ... An: cash inflows – y1, y2.....yn

K: rate of discount

C: initial capital outlay for undertaking the project



NPV and compounding

Say P is the investment and $r\%$ is the interest rate pa:

$$A1 = \text{Value at the end of } Y1 = P + P \times r\% = P(1 + r)^1$$

$$A2 = \text{Value at the end of } Y2 = P(1 + r)^2$$

....

$$An = \text{Value at the end of } Yn = P(1 + r)^n$$

Also, for given An and discounting of K , the NPV is $\frac{An}{(1+K)^n}$



Maximization: profit vs. wealth

Profit maximization	Wealth maximization
Traditional approach	More modern approach
Type of profit - not properly defined	Net Present Value: defined
Risk, uncertainty - ignored	Risk, uncertainty - considered
Rate of discount not required	Rate of discount required
Time value of money is not considered	Time value of money is considered



Benefit to cost ratio

With present value of benefits = PVB, Initial investment = I

Benefit-cost ratio: $BCR = \frac{PVB}{I}$

Net benefit-cost ratio: $NBCR = \frac{PVB - I}{I}$

$$NBCR = BCR - 1$$

When BCR

>1

=1

<1

or NBCR

>0

=0

<0

Rule is

May accept

Indifferent

May reject



Benefit to cost ratio example

Initial investment:		₹1,00,000
Benefits:	Year 1	25,000
	Year 2	40,000
	Year 3	40,000
	Year 4	50,000

The benefit-cost ratio measures for this project are:

$$BCR = \frac{\frac{25,000}{(1.12)} + \frac{40,000}{(1.12)^2} + \frac{40,000}{(1.12)^3} + \frac{50,000}{(1.12)^4}}{1,00,000} = 1.145$$

$$NBCR = BCR - 1 = 0.145$$