Financial Management - Meaning, Objectives and Functions

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

1. 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.
2. 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.
3. Dividend decision - The finance manager has to take decision with regards to the net profit distribution. Net profits are generally divided into two:
    a. Dividend for shareholders- Dividend and the rate of it has to be decided.
    b. 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-

1. To ensure regular and adequate supply of funds to the concern.
2. To ensure adequate returns to the shareholders which will depend upon the earning capacity, market price of the share, expectations of the shareholders.
3. To ensure optimum funds utilization. Once the funds are procured, they should be utilized in maximum possible way at least cost.
4. To ensure safety on investment, i.e, funds should be invested in safe ventures so that adequate rate of return can be achieved.
5. 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

1. **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.
2. **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.
3. **Choice of sources of funds:** For additional funds to be procured, a company has many choices like-
    a. Issue of shares and debentures
    b. Loans to be taken from banks and financial institutions
    c. 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.

4. **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.
5. **Disposal of surplus:** The net profits decision have to be made by the finance manager. This can be done in two ways:
    a. Dividend declaration - It includes identifying the rate of dividends and other benefits like bonus.
    b. Retained profits - The volume has to be decided which will depend upon expansional, innovational, diversification plans of the company.
6. **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.
7. **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.

What is Financial Management? Meaning Definition Scope Articles

What is Financial Management? Meaning

The financial management means:

1. To collect finance for the company at a low cost and
2. To use this collected finance for earning maximum profits.

Thus, financial management means to plan and control the finance of the company. It is done to achieve the objectives of the company.

Definition of Financial Management

According to **Dr. S. N. Maheshwari**,

"Financial management is concerned with raising financial resources and their effective utilisation towards achieving the organisational goals."

According to **Richard A. Brealey**,

"Financial management is the process of putting the available funds to the best advantage from the long term point of view of business objectives."

Scope of Financial Management

Financial management has a wide scope. According to **Dr. S. C. Saxena**, the scope of financial management includes the following five A's.

1. **Anticipation**: Financial management estimates the financial needs of the company. That is, it finds out how much finance is required by the company.
2. **Acquisition**: It collects finance for the company from different sources.
3. **Allocation**: It uses this collected finance to purchase fixed and current assets for the company.
4. **Appropriation**: It divides the company's profits among the shareholders, debenture holders, etc. It keeps a part of the profits as reserves.
5. **Assessment**: It also controls all the financial activities of the company. Financial management is the most important functional area of management. All other functional areas such as production management, marketing management, personnel management, etc. depends on Financial management. Efficient financial management is required for survival, growth and success of the company or firm.

Objectives of Financial Management

Objectives of Financial Management: **The objectives of financial management are depicted and discussed below.**

The main objectives of financial management are:-

1. **Profit maximization** : The main objective of financial management is profit maximization. The finance manager tries to earn maximum profits for the company in the short-term and the long-term. He cannot guarantee profits in the long term because of business uncertainties. However, a company can earn maximum profits even in the long-term, if:-
   i. The Finance manager takes proper financial decisions.
   ii. He uses the finance of the company properly.
2. **Wealth maximization** : Wealth maximization (shareholders' value maximization) is also a main objective of financial management. Wealth maximization means to earn maximum wealth for the shareholders. So, the finance manager tries to give a maximum dividend to the shareholders. He

also tries to increase the market value of the shares. The market value of the shares is directly related to the performance of the company. Better the performance, higher is the market value of shares and vice-versa. So, the finance manager must try to maximise shareholder's value.

3. **Proper estimation of total financial requirements** : Proper estimation of total financial requirements is a very important objective of financial management. The finance manager must estimate the total financial requirements of the company. He must find out how much finance is required to start and run the company. He must find out the fixed capital and working capital requirements of the company. His estimation must be correct. If not, there will be shortage or surplus of finance. Estimating the financial requirements is a very difficult job. The finance manager must consider many factors, such as the type of technology used by company, number of employees employed, scale of operations, legal requirements, etc.
4. **Proper mobilisation** : Mobilisation (collection) of finance is an important objective of financial management. After estimating the financial requirements, the finance manager must decide about the sources of finance. He can collect finance from many sources such as shares, debentures, bank loans, etc. There must be a proper balance between owned finance and borrowed finance. The company must borrow money at a low rate of interest.
5. **Proper utilisation of finance** : Proper utilisation of finance is an important objective of financial management. The finance manager must make optimum utilisation of finance. He must use the finance profitable. He must not waste the finance of the company. He must not invest the company's finance in unprofitable projects. He must not block the company's finance in inventories. He must have a short credit period.
6. **Maintaining proper cash flow** : Maintaining proper cash flow is a short-term objective of financial management. The company must have a proper cash flow to pay the day-to-day expenses such as purchase of raw materials, payment of wages and salaries, rent, electricity bills, etc. If the company has a good cash flow, it can take advantage of many opportunities such as getting cash discounts on purchases, large-scale purchasing, giving credit to customers, etc. A healthy cash flow improves the chances of survival and success of the company.

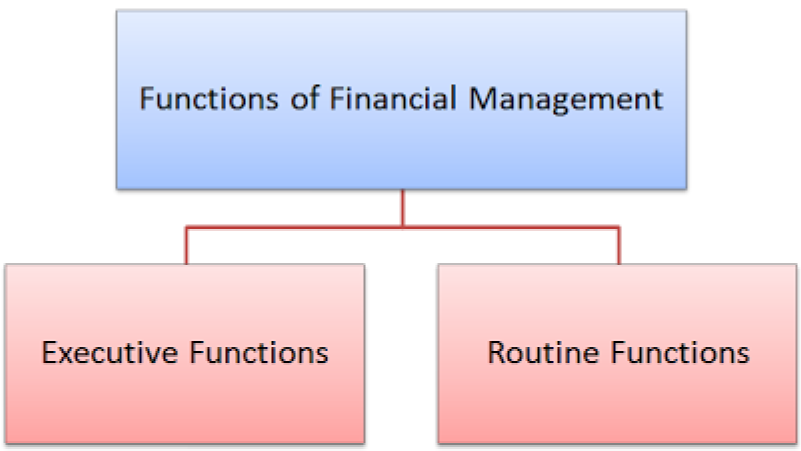
7. **Survival of company** : Survival is the most important objective of financial management. The company must survive in this competitive business world. The finance manager must be very careful while making financial decisions. One wrong decision can make the company sick, and it will close down.
8. **Creating reserves** : One of the objectives of financial management is to create reserves. The company must not distribute the full profit as a dividend to the shareholders. It must keep a part of it profit as reserves. Reserves can be used for future growth and expansion. It can also be used to face contingencies in the future.
9. **Proper coordination** : Financial management must try to have proper coordination between the finance department and other departments of the company.
10. **Create goodwill** : Financial management must try to create goodwill for the company. It must improve the image and reputation of the company. Goodwill helps the company to survive in the short-term and succeed in the long-term. It also helps the company during bad times.
11. **Increase efficiency** : Financial management also tries to increase the efficiency of all the departments of the company. Proper distribution of finance to all the departments will increase the efficiency of the entire company.
12. **Financial discipline** : Financial management also tries to create a financial discipline. Financial discipline means:-
    1. To invest finance only in productive areas. This will bring high returns (profits) to the company.
    2. To avoid wastage and misuse of finance.
13. **Reduce cost of capital** : Financial management tries to reduce the cost of capital. That is, it tries to borrow money at a low rate of interest. The finance manager must plan the capital structure in such a way that the cost of capital it minimised.
14. **Reduce operating risks** : Financial management also tries to reduce the operating risks. There are many risks and uncertainties in a business. The finance manager must take steps to reduce these risks. He must avoid high-risk projects. He must also take proper insurance.
15. **Prepare capital structure** : Financial management also prepares the capital structure. It decides the ratio between owned finance and borrowed finance. It brings a proper balance between the different sources of.

capital. This balance is necessary for liquidity, economy, flexibility and stability.

Executive and Routine Functions of Financial Management

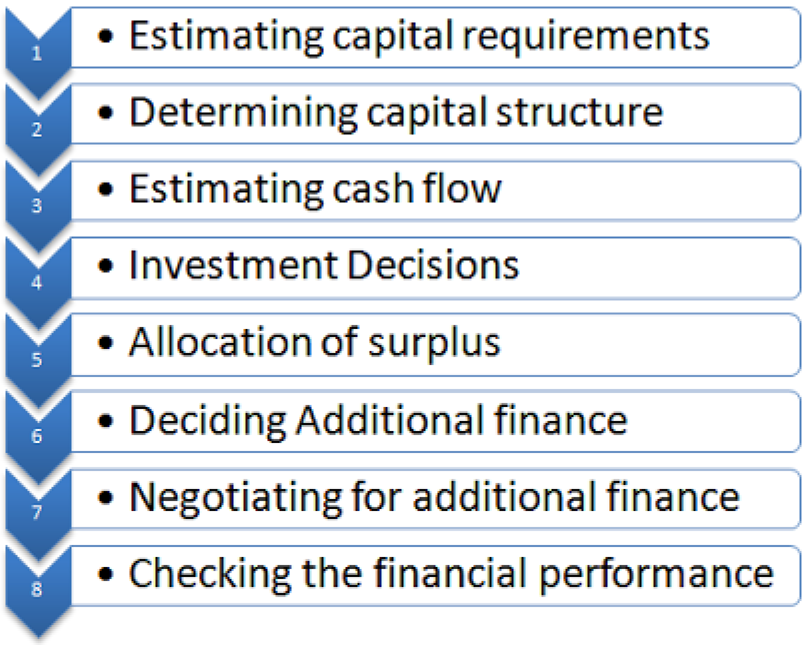
Functions of financial management

Functions of financial management can be broadly divided into two groups:



1. Executive functions of financial management, and
2. Routine functions of financial management.

Following image depicts eight executive functions of financial management.



1. Estimating capital requirements,
2. Determining capital structure,
3. Estimating cash flow,
4. Investment decisions,
5. Allocation of surplus,
6. Deciding additional finance,
7. Negotiating for additional finance and
8. Checking the financial performance.

These executive functions of financial management (FM) are explained below.

1. **Estimating capital requirements** : The company must estimate its capital requirements (needs) very carefully. This must be done at the promotion stage. The company must estimate its fixed capital needs and working capital need. If not, the company will become over-capitalized or under-capitalized.
2. **Determining capital structure** : Capital structure is the ratio between owned capital and borrowed capital. There must be a balance between owned capital and borrowed capital. If the company has too much owned capital, then the shareholders will get fewer dividends. Whereas, if the company has too much of borrowed capital, it has to pay a lot of interest. It

also has to repay the borrowed capital after some time. So the finance managers must prepare a balanced capital structure.

3. **Estimating cash flow** : Cash flow refers to the cash which comes in and the cash which goes out of the business. The cash comes in mostly from sales. The cash goes out for business expenses. So, the finance manager must estimate the future sales of the business. This is called Sales forecasting. He also has to estimate the future business expenses.
4. **Investment Decisions** : The business gets cash, mainly from sales. It also gets cash from other sources. It gets long-term cash from equity shares, debentures, term loans from financial institutions, etc. It gets short-term loans from banks, fixed deposits, dealer deposits, etc. The finance manager must invest the cash properly. Long-term cash must be used for purchasing fixed assets. Short-term cash must be used as a working capital.
5. **Allocation of surplus** : Surplus means profits earned by the company. When the company has a surplus, it has three options, viz.,
    1. It can pay dividend to shareholders.
    2. It can save the surplus. That is, it can have retained earnings.
    3. It can give bonus to the employees.
6. **Deciding additional finance** : Sometimes, a company needs additional finance for modernization, expansion, diversification, etc. The finance manager has to decide on following questions.
    1. When the additional finance will be needed?
    2. For how long will this finance be needed?
    3. From which sources to collect this finance?
    4. How to repay this finance?

    Additional finance can be collected from shares, debentures, loans from financial institutions, fixed deposits from public, etc.

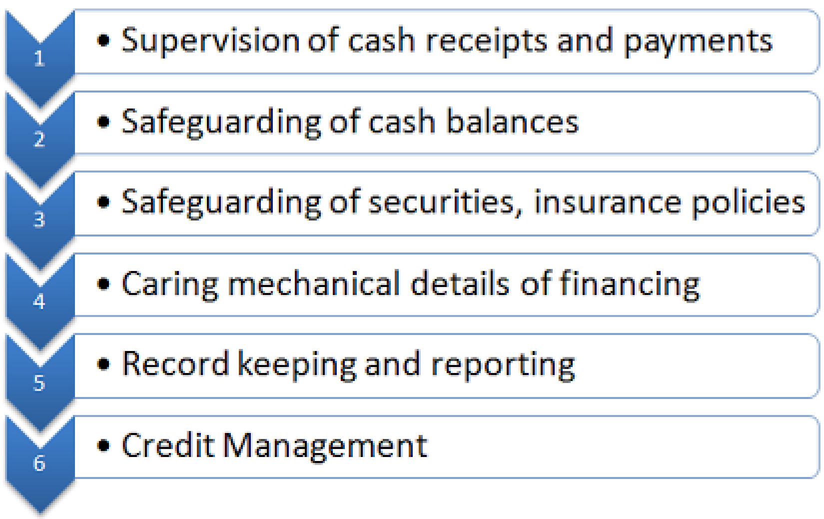
7. **Negotiating for additional finance** : The finance manager has to negotiate for additional finance. That is, he has to speak to many bank managers. He has to persuade and convince them to give loans to his company. There are two types of loans, viz., short-term loans and long-term loans. It is easy to get short-term loans from banks. However, it is very difficult to get long-term loans.
8. **Checking the financial performance** : The finance manager has to check the financial performance of the company. This is a very important finance

function. It must be done regularly. This will improve the financial performance of the company. Investors will invest their money in the company only if the financial performance is good. The finance manager must compare the financial performance of the company with the established standards. He must find ways for improving the financial performance of the company.

The routine functions are also called as **Incidental Functions**.

Routine functions are clerical functions. They help to perform the Executive functions of financial management.

The six routine functions of financial management are listed below.



1. Supervision of cash receipts and payments.
2. Safeguarding of cash balances.
3. Safeguarding of securities, insurance policies and other valuable papers.
4. Taking proper care of mechanical details of financing.
5. Record keeping and reporting.
6. Credit Management.