FINANCE MANAGEMENT.

Meaning of Finance.

Finance is the " art and science of managing money", Khan and Jain.

What is BUSINESS FINANCE?

According to the Wheeler, "Business finance is that business activity which concerns with the acquisition and conversation of capital funds in meeting financial needs and overall objectives of a business enterprise"

Finance can be classified into two categories:

- Private Finance, which includes the Individual, Firms, Business or Corporate Financial activities to meet the requirements.
- Public Finance which concerns revenue and disbursement of Government such as Central Government, State Government and Semi-Government Financial matters.

FINANCIAL MANAGEMENT.

Financial management is a critical process within any organization as it involves planning, organizing, directing, and controlling a company's finances. It involves all aspects of a company's financial activities, from raising capital to investing it to managing risk.

The goal of financial management is to ensure that a company has the resources it needs to achieve its financial goals. This includes making sure that the company has enough cash on hand to meet its short-term obligations, that it is investing its money in profitable assets, and that it is managing its risk effectively.

What's Finance Management?

"Financial Management deals with procurement of funds and their effective utilization in the business", S.C. Kuchhal.

SCOPE OF FINANCIAL MANAGEMENT.

The scope of financial management is broad and encompasses various functional departments within an organization, including personnel, marketing, and production. Below are the key aspects of the scope of financial management:

1. Financial Management and Economics:

   Financial management incorporates economic concepts such as micro and macroeconomics. Investment decisions and the impact of micro and macro environmental factors are closely linked to the functions of financial managers. Financial management also utilizes economic equations like money value discount factor and economic order quantity. Financial economics is an emerging field that offers opportunities for integration between finance and economics.
2. Financial Management and Accounting:

   Financial management is closely related to accounting, as accounting records contain financial information. Initially, financial management and accounting were considered as a single discipline and were merged into management accounting. However, in recent times, financial management and accounting are separate yet interrelated disciplines.
3. Financial Management and Mathematics:

   Modern financial management relies on mathematical and statistical tools and techniques, also known as econometrics. Various mathematical and statistical methods such as economic order quantity, discount factor, time value of money, present value of money, cost of capital, capital structure theories, dividend theories, ratio analysis, and working capital analysis are used in financial management.
4. Financial Management and Production Management:

   Financial management and production management are interconnected. Production management is responsible for transforming resources into profits, and finance is required for production activities such as raw materials, machinery, wages, and operating expenses. The financial department estimates and allocates the appropriate finance to the production department, considering the financial requirements of each production process.
5. Financial Management and Marketing:

   Marketing activities require finance to implement innovative and modern approaches for selling goods in the market. The financial manager or finance department allocates the necessary funds to the marketing department. Marketing and financial management are interrelated and dependent on each other.

6. Financial Management and Human Resources:

    Financial management is also linked to the human resources department, which provides manpower to all functional areas of the organization. The financial manager evaluates the manpower requirements of each department and allocates finance for wages, salaries, remuneration, commissions, bonuses, pensions, and other monetary benefits to the human resources department. Financial management has a direct relationship with human resource management.

Some of the benefits of good financial management:

- Increased profits: By effectively managing its finances, a company can increase its profits by making better investment decisions, reducing costs, and managing risk.
- Improved competitive position: By having a strong financial position, a company can be more competitive in its industry. This can lead to increased sales and market share.
- Achieved long-term goals: By carefully managing its finances, a company can achieve its long-term goals, such as expanding into new markets or developing new products.

OBJECTIVES OF FINANCIAL MANAGEMENT.

The proper utilization of finance in a business is achieved through effective procurement and efficient use, making it a crucial responsibility of the financial manager. Therefore, the financial manager must establish the fundamental objectives of financial management. These objectives can be broadly categorized into two parts:

1. **Profit maximization:**

    The aim of profit maximization is to generate the highest possible profits for the business. This objective focuses on increasing the earnings and overall profitability of the organization. Profit maximization considers factors such as revenue generation, cost control, and optimizing operational efficiency to ensure that the business generates substantial profits.

2. **Wealth maximization:**

    Wealth maximization entails increasing the long-term value and wealth of the business for its shareholders. It focuses on enhancing the market value of the company's shares and generating higher returns for investors. Wealth maximization considers the time value of money, risk assessment, and investment decisions that can lead to sustainable growth and increased shareholder wealth.

FUNCTIONS OF FINANCE MANAGER.

The role of a finance manager is vital within the business organization as they are responsible for various functions related to finance. These functions are interconnected with other departments such as personnel, marketing, production, and research and development. In today's business landscape, finance has become a crucial aspect that reflects the overall operational efficiency and profitability of a company. The primary goal of the finance manager is to make sound financial decisions that align with the organization's objectives.

Some of the functions performed by a finance manager include:

1. **Forecasting Financial Requirements:** The finance manager is responsible for estimating the financial needs of the business, including the funds required for acquiring fixed assets and meeting working capital requirements in the future.

2. **Acquiring Necessary Capital**: After determining the financial requirements, the finance manager focuses on mobilizing the required finance and identifying potential sources of capital. This task involves careful analysis and decision-making.

3. **Investment Decision:** The finance manager plays a crucial role in selecting the best investment opportunities for the organization. They utilize capital budgeting techniques to evaluate investment alternatives and consider factors such as return on investment, safety, liquidity, and profitability.

4. **Cash Management:** Effective cash management is essential for the proper utilization of cash resources and maintaining short-term liquidity. The finance manager must ensure that the organization has an efficient cash management system in place.

5. **Interrelation with Other Departments:** The finance manager collaborates with various functional departments such as marketing, production, personnel, systems, and research and development. They should possess knowledge and understanding not only in finance but also in these areas to effectively communicate and cooperate with other departments. Maintaining good relationships with all departments is crucial for the overall success of the organization.

IMPORTANCE OF FINANCE MANAGEMENT.

Finance serves as the lifeblood of any business organization, as it is essential to meet its requirements. Adequate finance is necessary for the smooth operation of the business and to achieve its goals. Effective management of finance plays a critical role in attaining the objectives of the business concern. The importance of financial management cannot be overlooked in any situation. The following are some key points highlighting the significance of financial management:

1. **Financial Planning:**
   Financial planning is the process of developing a comprehensive financial plan that outlines an organization's financial goals and strategies for achieving them. This includes developing financial projections, setting financial targets, and identifying key performance indicators (KPIs) to monitor financial performance. Financial planning is important because it helps organizations to identify potential financial risks and opportunities and develop strategies to manage them.
2. **Budgeting:**
   Budgeting is the process of creating a financial plan that outlines an organization's expected revenues and expenses for a given period. The budget is a critical tool for financial management because it helps organizations to allocate financial resources efficiently and effectively. A well-prepared budget provides a clear picture of an organization's financial position, enabling management to make informed decisions about investments, expenditures, and other financial activities.
3. **Financial Analysis:**
   Financial analysis involves analyzing financial data to identify trends and patterns that can help organizations make informed decisions about their investments and operations. Financial analysis typically involves reviewing financial statements, such as balance sheets, income statements, and cash flow statements, to identify trends in revenue, expenses, and cash flow. This analysis can help organizations identify areas where they can improve financial performance, such as reducing costs or increasing revenue.
4. **Investment Planning:**
   Investment planning involves developing a strategy for investing an organization's financial resources in order to maximize returns while minimizing risk. This may involve investing in stocks, bonds, real estate, or other financial instruments. The investment plan should take into account the organization's financial goals, risk tolerance, and time horizon.
5. **Risk Management:**
   Risk management involves identifying and mitigating financial risks that could impact an organization's financial performance. This includes risks such as market risk, credit risk, and operational risk. Effective risk management involves developing strategies to mitigate risks and monitoring risk exposure on an ongoing basis.

6. **Cash Management:**
   Cash management involves managing an organization's cash flow to ensure that it has sufficient cash on hand to meet its financial obligations. This includes managing accounts receivable and accounts payable, forecasting cash flows, and developing strategies to manage cash surpluses or shortfalls.
7. **Financial Reporting:**
   Financial reporting involves preparing financial statements and other reports that provide insight into an organization's financial performance. These reports are used by stakeholders, such as investors, creditors, and regulators, to evaluate an organization's financial health.
8. **Cost Management:**
   Cost management involves controlling and reducing the costs associated with an organization's operations. This includes identifying cost-saving opportunities, negotiating with vendors to reduce costs, and implementing cost-cutting measures. Effective cost management helps organizations to increase profitability and improve their financial performance.
9. **Capital Budgeting:**
   Capital budgeting is the process of evaluating potential investment opportunities and determining which projects should receive funding. This involves analyzing the expected return on investment (ROI) and the risks associated with the investment. Capital budgeting helps organizations to allocate their financial resources to projects that are most likely to generate a positive return.
10. **Financial Compliance:**
    Financial compliance involves ensuring that an organization's financial practices and reporting comply with applicable laws and regulations. This includes complying with accounting standards, tax laws, and regulations related to financial reporting. Effective financial compliance helps organizations to avoid legal and financial penalties and maintain their reputation.
11. **Performance Measurement:**
    Performance measurement involves assessing an organization's financial performance against its goals and objectives. This involves tracking key financial metrics, such as revenue growth, profitability, and return on investment. Performance measurement helps organizations to identify areas where they are excelling and areas where they need to improve.
12. **Financial Forecasting:**
    Financial forecasting involves predicting future financial performance based on historical trends and current conditions. This includes forecasting revenue, expenses, and cash flow. Financial forecasting helps organizations to prepare for future financial challenges and opportunities.

FINANCIAL STATEMENT ANALYSIS.

Financial Statement, what is it?

According to Hamptors John, a financial statement is a systematically organized collection of data that follows consistent accounting procedures. Its purpose is to provide an understanding of the financial aspects of a business firm. Financial statements can present the financial position of a company at a specific point in time, as seen in a balance sheet, or they can depict the financial performance over a given period, as seen in an income statement.

Financial statements serve as a summary of the accounting process and offer valuable information to both internal and external parties. John N. Nyer further defines financial statements as a summary of the accounting records of a business enterprise, with the balance sheet reflecting the assets, liabilities, and capital at a particular date, and the income statement showing the results of operations during a specific period.

Typically, financial statements consist of two primary statements:

1. **Income Statement or Profit and Loss Account:** This statement provides information about the revenues, expenses, gains, and losses of a company during a given period. It helps assess the profitability and operating performance of the business.

2. **Balance Sheet or Position Statement:** The balance sheet represents the financial position of a company at a specific point in time by presenting its assets, liabilities, and owner's equity. It provides insights into the company's financial health, liquidity, and solvency.

In addition to these two main statements, businesses may also prepare other statements that are primarily used for internal purposes, such as:

1. **Statement of Changes in Owner's Equity:** This statement shows the changes in the owner's equity (shareholder's equity) of the business over a specific period. It includes information about capital contributions, withdrawals, net income, and other equity-related transactions.

2. **Statement of Changes in Financial Position:** This statement illustrates the changes in a company's financial position by comparing the data from the balance sheets of two different periods. It provides insights into the company's cash flows, investing activities, and financing activities.

Types Of Financial Statement Analysis.

Financial statement analysis plays a crucial role in understanding the financial position of the business during a specific period as it involves studying the relationships among various financial factors as disclosed in a set of statements, as well as analyzing the trends of these factors across a series of statements. There are two main types of financial statement analysis based on the material used and the methods of operation.

1. **Based on Material Used:**

    a) **External Analysis:** This type of analysis is conducted by external parties who are indirectly involved in the business, such as investors, creditors, government organizations, and credit agencies. External analysis relies on the published financial statements of the business to gain insights into its financial and operational position. However, it provides limited information about the company.

    b) **Internal Analysis:** Internal analysis involves examining the operational performance of different departments and units within the company. This type of analysis utilizes valuable information disclosed by the company itself. It helps in making decisions related to achieving the business's goals.

2. Based on Method of Operation:

    a) **Horizontal Analysis:** In horizontal analysis, financial statements are compared over several years to identify trends and changes. Typically, the figures of the current year are compared with a base year (considered as 100), allowing for an assessment of how the financial information has changed over time. This analysis is also known as dynamic analysis.

    b) **Vertical Analysis:** Vertical analysis focuses on the relationship between various items within a financial statement for a specific period. It measures the relative proportions or percentages of different items, typically against a base item (often sales or revenue). This analysis, also known as static analysis, helps determine the relative significance of different items in the financial statement.

SOURCES OF FINANCING.

As mentioned earlier, Finance is crucial for the functioning of a business as it is interconnected with all its activities. Just as proper blood circulation is vital for the human body to function, arranging finance appropriately is essential for the business system to operate smoothly. Managing the required finance for each department of a business is a complex task that requires careful decision-making. The amount of finance needed depends on the nature and situation of the business.

There are two broad categories of financial requirements for a business:

1. **Long-term Financial Requirements or Fixed Capital Requirement:**
    - Long-term financial requirements refer to the funds needed for acquiring land, buildings, purchasing plant and machinery, and other fixed expenses. It is also known as fixed capital requirement, as it is used to purchase fixed assets of the company.

2. **Short-term Financial Requirements or Working Capital Requirement:**
    - In addition to capital expenditures, the business will also require funds for day-to-day operational expenses such as procurement of raw materials, payment of wages, and other routine expenditures. These financial needs are met through short-term financial requirements, which are known as working capital.

    - Working capital is used to cover the operational expenses of the business on a short-term basis.

SOURCES OF FINANCE

Sources of finance refer to the methods or ways through which companies mobilize funds to meet their long-term and short-term requirements. These sources can include existing or new companies that need finance for various purposes, such as purchasing fixed assets, constructing office buildings, procuring raw materials, and covering day-to-day expenses.

Businesses should carefully evaluate their financial needs, the cost of borrowing, and the terms and conditions associated with each source of finance before making a decision. A combination of these sources can be used based on the specific requirements and circumstances of the business.

Various categories exist in regards to the sources of finance in an organization, the following highlights these categories.

1. **Based on the Period:**
   - ***Long-term sources*: ** Finance mobilized with a large amount and repayable over a period exceeding five years. Includes share capital, debentures, long-term loans from financial institutions, and commercial banks.
   - ***Short-term sources:*** Finance generated through loans and advances from commercial banks, moneylenders, etc. Meets the operational expenditure of the business concern.

2. **Based on Ownership:**
   - ***Ownership sources:*** Includes share capital, retained earnings, surplus, and profits.
   - ***Borrowed capital:*** Includes debentures, bonds, public deposits, and loans from banks and financial institutions.

3. **Based on Sources of Generation:**
   - ***Internal sources:*** Includes retained earnings, depreciation funds, and surplus.
   - ***External sources:*** Includes share capital, debentures, public deposits, and loans from banks and financial institutions.

4. **Based on Mode of Finance:**
   - ***Security finance:*** Mobilized through the issue of securities such as shares and debentures. Plays a role in deciding the capital structure of the company.
   - ***Internal finance:*** Generated from retained earnings, depreciation funds, and surplus.
   - ***Loan finance:*** Obtained through long-term loans from financial institutions and short-term loans from commercial banks.

The above can be classified into three major classifications of sources of finance:

1. Security finance
2. Internal finance
3. Loan finance

Let's discuss each one of these classification in more detail:

1. Security Finance:
Also called Corporate Finance, Security finance refers to raising funds by issuing securities to investors. These securities can be in the form of shares or bonds.

- ***Shares:*** Companies can raise funds by issuing shares of their ownership, known as equity shares or common stock. Investors who purchase these shares become shareholders of the company and have ownership rights, such as voting rights and entitlement to dividends. The company can raise capital by selling shares in the primary market through an initial public offering (IPO) or in the secondary market through stock exchanges.

- ***Bonds:*** Bonds are debt instruments issued by companies to borrow money from investors. When an organization issues bonds, it promises to repay the principal amount along with periodic interest payments. Bonds are typically traded in the market, and investors can buy and sell them.

  Examples of bonds include corporate bonds, government bonds, and debentures.

***2*. Internal Finance:**
Internal finance, also known as self-finance or retained earnings, refers to the generation of funds from within the business itself. It involves utilizing the company's own accumulated profits and resources.

- ***Retained Earnings:*** When a company earns profits, it can choose to retain a portion of those earnings rather than distributing them as dividends to shareholders. These retained earnings can be reinvested in the business for expansion, purchasing assets, or meeting financial requirements. This source of finance does not involve external borrowing or dilution of ownership.
- ***Depreciation Reserves:*** Businesses allocate a portion of their profits to create reserves for the replacement of assets. Depreciation is the reduction in the value of assets over time due to wear and tear or obsolescence. By setting aside funds for asset replacement, companies ensure they have resources available when needed.
- ***Sale of Assets:*** Another form of internal finance is selling surplus or unused assets of the company. This can include selling land, buildings, machinery, or any other valuable assets that are no longer required for business operations. The proceeds from these sales can be reinvested in the company or used to meet financial obligations.

3. Loan Finance:

Loan finance involves borrowing funds from external sources, such as banks, financial institutions, or private lenders. Loans can be secured or unsecured, depending on whether collateral is provided.

- ***Bank Loans:*** Businesses can obtain loans from commercial banks based on their creditworthiness and ability to repay. Bank loans may have fixed or variable interest rates and specified repayment terms. The loan amount and terms are typically determined based on the borrower's financial stability, credit history, and purpose of the loan.
- ***Trade Credit:*** Trade credit is a form of loan finance where suppliers allow the business to purchase goods or services on credit. It provides a certain period, known as the credit period, during which the company can pay the supplier. Trade credit is a common source of short-term financing.
- ***Debentures:*** Debentures are a type of loan finance where companies issue debt instruments to investors. Debenture holders are creditors of the company and have a claim on the company's assets. Debentures usually have a fixed interest rate and a specified maturity period.