FINANCIAL MANAGEMENT

21CS602

UNIT - I

TIME VALUE OF MONEY

Financial Management: Concepts and Meaning – Introduction to Finance; Objectives of Financial Management; Profit Maximization; EVA; Changing Role of Financial Managers. Time Value of Money: Techniques and Applications of Compounding And Discounting

1.1 INTRODUCTION

Finance is the life blood of business. Finance may be defined as the art and science of managing money. Finance also is referred as the provision of money at the time when it is needed. Finance function is the procurement of funds and their effective utilization in business concerns.

The term financial management has been defined by Solomon, "It is concerned with the efficient use of an important economic resource namely, capital funds". The most popular and acceptable definition of financial management as given by S. C. Kuchal is that "Financial Management deals with procurement of funds and their effective utilization in the business. Financial management is the operational activity of a business that is responsible for obtaining and effectively utilizing the funds necessary for efficient operations. Thus, Financial Management is mainly concerned with the effective funds management in the business.

Financial management is that activity of management which is concerned with the planning, procuring and controlling of the firm's financial resources. It means applying general management principles to financial resources of the institutions. Financial activities of an institutions is one of the most important and complex activities of a firm. Therefore in order to take care of these activities a financial manager performs all the requisite financial activities. A financial manager is a person who takes care of all the important financial functions of an organization. The person in charge should maintain a far sightedness in order to ensure that the funds are utilized in the most efficient manner. His actions directly affect the Profitability, growth and goodwill of the firm

1.2 DEFINITION OF FINANCIAL MANAGEMENT

"Financial management is the activity concerned with planning, raising, controlling and administering of funds used in the business." – Guthman and Dougal

"Financial management is that area of business management devoted to a judicious use of capital and a careful selection of the source of capital in order to enable a spending unit to move in the direction of reaching the goals." – J.F. Brandley

"Financial management is the operational activity of a business that is responsible for obtaining and effectively utilizing the funds necessary for efficient operations."- Massie

1.3 EVOLUTION OF FINANCE FUNCTION:

Financial management came into existence as a separate field of study from finance function in the early stages of 20th century. The evolution of financial management can be separated into three stages:

1. Traditional stage (Finance up to 1940): The traditional stage of financial management continued till four decades. Some of the important characteristics of this stage are:

i) In this stage, financial management mainly focuses on specific events like formation expansion, merger and liquidation of the firm.
ii) The techniques and methods used in financial management are mainly illustrated and in an organized manner.
iii) The essence of financial management was based on principles and policies used in capital market, equipments of financing and lawful matters of financial events.
iv) Financial management was observed mainly from the prospective of investment bankers, lenders and others.

2. Transactional stage (After 1940): The transactional stage started in the beginning years of 1940"s and continued till the beginning of 1950"s. The features of this stage were similar to the traditional stage. But this stage mainly focused on the routine problems of financial managers in the field of funds analysis, planning and control. In this stage, the essence of financial management was transferred to working capital management.

3. Modern stage (After 1950): The modern stage started in the middle of 1950"s and observed tremendous change in the development of financial management with the ideas from economic theory and implementation of quantitative methods of analysis. Some unique characteristics of modern stage are:
i) The main focus of financial management was on proper utilization of funds so that wealth of current share holders can be maximized.
ii) The techniques and methods used in modern stage of financial management were analytical and quantitative.

Since the starting of modern stage of financial management many important developments took place. Some of them are in the fields of capital budgeting, valuation models, dividend policy, option pricing theory, behavioral finance etc.

1.4 NATURE OF FINANCIAL MANAGEMENT

1. Financial Management is an integral part of overall management. Financial considerations are involved in all business decisions. So financial management is pervasive throughout the organisation.

2. In most of the organizations, financial operations are centralized. This results in economies.

3. Financial management involves with data analysis for use in decision making.

4. The central focus of financial management is valuation of the firm. That is financial decisions are directed at increasing/maximization/ optimizing the value of the firm.

5. Financial management essentially involves risk-return trade-off Decisions on investment involve choosing of types of assets which generate returns accompanied by risks. Generally higher the risk, returns might be higher and vice versa. So, the financial manager has to decide the level of risk the firm can assume and satisfy with the accompanying return.

6. Financial management affects the survival, growth and vitality of the firm. Finance is said to be the life blood of business. It is to business, what blood is to us. The amount, type, sources, conditions and cost of finance squarely influence the functioning of the unit.

7. Finance functions, i.e., investment, rising of capital, distribution of profit, are performed in all firms - business or non-business, big or small, proprietary or corporate undertakings.

8. Financial management is a sub-system of the business system which has other subsystems like production, marketing, etc. In systems arrangement financial sub-system is to be well-coordinated with others and other sub-systems.

9. Financial Management is the activity concerned with the control and planning of financial resources.

10. Financial management is multi-disciplinary in approach. It depends on other disciplines, like Economics, Accounting etc., for a better procurement and utilisation of finances.

1.5 IMPORTANCE OF FINANCIAL MANAGEMENT

The role of financial management is as such that it has a direct impact on all the financial aspects/activities of a company. Certain aspects affected by financial management decisions are

1. ***Size and composition of fixed assets:*** The amount of money invested in fixed assets is an outcome of investment decisions. So, if more amount of capital is decided to be invested in fixed assets, then it will increase the value of the total share of fixed assets by the amount invested.

2. ***Amount and composition of current assets:*** The quantum of current assets and its constituents like cash, bills receivable, inventory etc. is also influenced by management decisions. It is also dependent on the amount invested in fixed assets, decisions about credit and inventory management etc.

3. ***Amount of long-term and short-term funds to be used:*** Financial management determines the quantum of funds to be raised for the short term and long term. In case a firm requires more liquid assets, then it will prefer to have more long-term finance even when their profits will decrease due to payment of more interest in comparison to short-term debts.

4. **Proportion of debt and equity in capital:** Financial management also takes decisions regarding the proportion of debt and/or equity.

5. **All items in profit and loss account:** All items in the profit and loss account are affected by financial management decisions. For example, higher amount of debt will lead to increase in the expense in the form of interest payment in the future.

1.6 FINANCE AND OTHER RELATED DISCIPLINES :

Financial management is an integral part of the overall management, on other disciplines and fields of study like economics, accounting, production, marketing, personnel and quantitative methods. The relationship of financial management with other fields of study is explained below

(i) Finance and Economics

Finance is a branch of economics. Economics deals with supply and demand, costs and profits, production and consumption and so on. The relevance of economics to financial management can be described in two broad areas of economics i.e., micro economics and macroeconomics. Micro economics deals with the economic decisions of individuals and firms. It concerns itself with the determination of optimal operating strategies of a business firm. These strategies include profit maximization strategies, product pricing strategies, strategies for valuation of firm and assets etc. The basic principle of micro economics that applies in financial management is marginal analysis. Most of the financial decisions should be made taken into account the marginal revenue and marginal cost. So, every financial 4 manager must be familiar with the basic concepts of micro economics. Macroeconomics deals with the aggregates of the economy in which the firm operates. Macroeconomics is concerned with the institutional structure of the banking system, money and capital markets, monetary, credit and fiscal policies etc. So, the financial manager must be aware of the broad economic environment and their impact on the decision making areas of the business firm.

(ii) Finance and Accounting

Accounting and finance are closely related. Accounting is an important input in financial decision making process. Accounting is concerned with recording of business transactions. It generates information relating to business transactions and reporting them to the concerned parties. The end product of accounting is financial statements namely profit and loss account, balance sheet and the statements of changes in financial position. The information contained in these statements assists the financial managers in evaluating the past performance and future direction of the firm (decisions) in meeting certain obligations like payment of taxes and so on. Thus, accounting and finance are closely related.

(iii) Finance and Production

Finance and production are also functionally related. Any changes in production process may necessitate additional funds which the financial managers must evaluate and finance. Thus, the production processes, capacity of the firm are closely related to finance.

(iv) Finance and Marketing

Marketing and finance are functionally related. New product development, sales promotion plans, new channels of distribution, advertising campaign etc. in the area of marketing will require additional funds and have an impact on the expected cash flows of the business firm. Thus, the financial manager must be familiar with the basic concept of ideas of marketing.

(v) Finance and Quantitative Methods

Financial management and Quantitative methods are closely related such as linear programming, probability, discounting techniques, present value techniques etc. are useful in analyzing complex 8financial management problems. Thus, the financial manager should be familiar with the tools of quantitative methods. In other way, the quantitative methods are indirectly related to the day-to-day decision making by financial managers. 5

(vi) Finance and Costing

Cost efficiency is a major strategic advantage to a firm, and will greatly contribute towards its competitiveness, sustainability and profitability. A finance manager has to understand, plan and manage cost, through appropriate tools and techniques including Budgeting and Activity Based Costing.

(vii) Finance and Law

A sound knowledge of legal environment, corporate laws, business laws, Import Export guidelines, international laws, trade and patent laws, commercial contracts, etc. are again important for a finance executive in a globalized business scenario. For example the guidelines of Securities and Exchange Board of India [SEBI] for raising money from the capital markets. Similarly, now many Indian corporate are sourcing from international capital markets and get their shares listed in the international exchanges. This calls for sound knowledge of Securities Exchange Commission guidelines, dealing in the listing requirements of various international stock exchanges operating in different countries.

(viii) Finance and Taxation

A sound knowledge in taxation, both direct and indirect, is expected of a finance manager, as all financial decisions are likely to have tax implications. Tax planning is an important function of a finance manager. Some of the major business decisions are based on the economics of taxation. A finance manager should be able to assess the tax benefits before committing funds. Present value of the tax shield is the yardstick always applied by a finance manager in investment decisions.

(ix) Finance and Treasury Management

Treasury has become an important function and discipline, not only in every organization. Every finance manager should be well grounded in treasury operations, which is considered as a profit center. It deals with optimal management of cash flows, judiciously investing surplus cash in the most appropriate investment avenues, anticipating and meeting emerging cash requirements and maximizing the overall returns.

(x) Finance and Banking

Banking has completely undergone a change in today‟s context. The type of financial assistance provided to corporate has become very customized and innovative. Banks provides both long term and short term finance, besides a number of innovative corporate and retail 6

banking products, which enable corporate to choose between them and reduce their cost of borrowings. It is imperative for every finance manager to be up-to date on the changes in services & products offered by banking sector including several foreign players in the field.

(xi) Finance and Insurance

Evaluating and determining the commercial insurance requirements, choice of products and insurers, analyzing their applicability to the needs and cost effectiveness, techniques, ensuring appropriate and optimum coverage, claims handling, etc. fall within the ambit of a finance manager‟s scope of work & responsibilities.

(xii) International Finance

Capital markets have become globally integrated. Indian companies raise equity and debt funds from international markets, in the form of Global Depository Receipts (GDRs), American Depository Receipts (ADRs) or External Commercial Borrowings (ECBs) and a number of hybrid instruments like the convertible bonds, participatory notes etc. Finance managers are expected to have a thorough knowledge on international sources of finance, merger implications with foreign companies, Leveraged Buy Outs (LBOs), acquisitions abroad and international transfer pricing. This is an essential aspect of finance manager‟s expertise. Similarly, protecting the value of foreign exchange earned, through instruments like derivatives, is vital for a finance manager as the volatility in exchange rate movements can erode in no time, all the profits earned over a period of time.

(xiii) Finance and Information Technology

Information technology is the order of the day and is now driving all businesses. It is all pervading. A finance manager needs to know how to integrate finance and costing with operations through software packages including ERP. The finance manager takes an active part in assessment of various available options, identifying the right one and in the implementation of such packages to suit the requirement.

1.7 SCOPE OF FINANCIAL MANAGEMENT/ FUNCTIONS OF FINANCIAL MANAGEMENT

Financial management is mainly concerned with the following decisions:

A. Investment Decisions
A firm must decide where to invest the funds such that it can earn ***maximum returns***. Such decisions are known as investment decisions and can be classified as long-term and short-term investment decisions.

- **Long-term investment decisions**:

It refers to ***long-term investment decisions*** such as investment in a new fixed asset, new machinery or land.They are also known as ***capital budgeting decisions.*** It affects a firm's long-term earning capacity and profitability and also has long-term implications on the ***business***. Moreover, such investment involves a ***large amount of money***, so it is very difficult to revert such decisions. Example: Decision to purchase a new fixed asset, opening a new branch etc.

- **Short-term investment decisions**

These decisions are also known as ***working capital decisions*** and affect day-to-day business operations. It also affects the liquidity and profitability of a business. Example: Decisions related to cash management, inventory management etc.

B. Financial Decisions
Financing decisions involve decisions with regard to the ***volume of funds*** to be raised from ***various sources.*** These decisions also include ***identification of sources of finance***. There are two main sources of raising funds, namely ***shareholders' funds*** (equity) and ***borrowed funds*** (debt). Taking into consideration factors such as ***cost, risk and profitability***, a company must ***decide an optimum combination of debt and equity.*** For example, while ***debt proves to be cheaper than equity***, it involves greater financial risk. Financial decisions must be taken judiciously as they have an ***impact on the overall cost of capital*** of the firm and also involves financial risk. Generally, a mixture of both debt and equity funds proves to be beneficial for the company.

C. Dividend Decisions
Dividend decisions involve decisions regarding how the company would ***distribute*** its profit or surplus. Dividend is basically a part of profit which is distributed to shareholders. The company decides whether to distribute it to ***equity shareholders in the form of dividends*** or to keep it in the form of ***retained earnings***. So, the main decision is regarding how much profit is to be distributed and how much is to be retained in the business. This decision is generally taken considering the objective of maximising shareholder's strength and also retaining earnings to increase the future earning capacity of the organisation.

1.8 OBJECTIVES OF FINANCIAL MANAGEMENT

To make wise decisions a clear understanding of the objectives which are sought tobe achieved in necessary. The objectives provide a framework for optimum financial decision-making. In other words, they are concerned with designing a method of operating the internal investment and financing of a firm. We discuss in this section the alternative approaches in financial literature. There are two widely-discussed approaches:

(i) Profit maximisation approach and (ii) Wealth maximisation approach.

It should be noted at the outset that the term "objective" is used in the sense of a goal or decision criterion for the three decisions involved in financial management. It implies that what is relevant is not the overall objective or goal of a business but an operationally useful criterion by which to judge a specific set of mutually interrelated business decisions, namely, investment, financing and dividend policy. The second point that should be clearly understood to that the term objectives provides a normative framework. That is the focus in financial literature is on what a firm should try to achieve and on policies that should be followed if certain goals are to be achieve. The implication is that these are not necessarily followed by firms in actual practice. They are rather employed to serve as a basis for theoretical analysis and do not reflect contemporary empirical industry practices. Thus, the term is used in a rather narrow sense of what a firm should attempt to achieve with its investment, financing and dividend policy decisions.

Profit Maximisation Decision Criterion

According to this approach, actions that increase profits should be undertaken and those that decrease profits are to be avoided. In specific operational terms, as applicable to financial management, the profit maximisation criterion implies that the investment, financing and dividend policy decisions of a firm should be oriented to the maximisation of profits. The term "profit" can be used in two senses. As a owner-oriented concept it refers to the amount and share of national income which is paid to the owners of business,that is, those who supply equity capital. As a variant it is described as profitability. It is an operational concepts and signifies economic efficiency. In other words, profitability refers to a situation where output exceeds input, that is, the value created by the use of resources is more than the total of the input resources. Used in this sense, profitability maximisation would imply that a firm should be guided in financial decision making by one test; select assets, projects and decisions which are profitable and reject those which are not. In the current financial literature, there is a general agreement that profit maximisation is used in the second sense. The rationale & behind profitability maximisation, as a guide to financial decision making, is simple. Profit is a test of economic efficiency. It provides the yardstick by which economic performance can be judged. Moreover, it leads to efficient allocation of resources, as resources tend to be directed to uses which in terms of profitability are the most desirable. Finally, it ensures maximum social welfare. The individual search for maximum profitability provides the famous "invisible hand" by which total economic welfare is maximised. Financial management is concerned with the efficient use of an important economic resource (input), namely, capital. It is, therefore, argued that profitability maximisation should serve as the basic criterion for financial management decisions.

The profit maximisation criterion has, however, been questioned and criticized on several grounds. The reasons for the opposition in academic literature all into two broad groups: (i) those that are based on misapprehensions about the workability and fairness of the private enterprise itself, and (2) those that arise out of the difficulty of applying this criterion management, refers to an explicit operational guide for the internal investment and financing of a firm and not the overall goal of business operations. We, therefore, focus on the second type of limitations to profit maximisation as an objective of financial management. The main technical flaws of this criterion are ambiguity, timing of benefits, and quality of benefits.

Ambiguity: One practical difficulty with profit maximisation criterion for financial decision making is that the term-profit is a vague and ambiguous concept. It has no precise connotation. It is amenable to different interpretations by different people. To illustrate, profit may be short term or long term; it may be total profit or rate of profit; it may be before-tax or before-tax or after-tax; it may be return on total capital employed or total assets or shareholders equity and so on. If profit maximisation is taken to be the objectives, the question arises, which of these variable of profit should a firm try to maximise? Obviously, a loose expression like profit of operational criterion for financial management.

Timing of Benefits. A more important technical objection to profit maximisation, as a guide to financial decision making, is that it ignores the differences in the time pattern of the benefits received from investment proposals or courses of action. While working out profitability, the bigger the better principle is adopted, as the decision is based on the total benefits received over the working life of the asset, irrespective of when they were received. Consider Table 1.1 below

	Alternative A (Rs. Lakhs)	Alternative B (Rs. Lakhs)
Period I	50	–
Period II	100	100
Period III	50	100
Total	**200**	**200**

It can be seen from Table 1.1 that the total profits associated with the alternatives, A and B, are identical. If the profit maximisation is the decision criterion, both the alternatives would be ranked equally. But the returns form both the alternatives differ in one important respect, while alternative A provides higher returns in earlier years, the returns from alternative B are larger in later years. As a result, the two alternative courses of "action are not strictly identical. This is primarily because a basic dictum of financial planning is the earlier the better as benefits received sooner are more valuble than benefits'. received later. The reason for the superiority of benefits now over benefits later lies in the fact that the former can be reinvested to earn a return. This is referred to as time value of money. The profit maximisation criterion does not consider the distinction between returns received in different time periods and treats all benefits irrespective of the timing, as equally valuable. This not true in actual practice as benefits in early years should be valued more highly than equivalent benefits in later years. The assumption of equal value is inconsistent with the real world situation.

Quality of Benefits. Probably the most important technical limitation of profit maximistion as an operational objective, is that it ignores the quality aspect of benefits associated with a financial course of action.2 The term quality here refers to the degree of certainty with which benefits can be expected. As a rule, the more certain the expected return, the higher is the quality of the benefits. Conversely, the more uncertain/fluctuating is the expected benefits, the lower is the quality of the benefits. An uncertain and fluctuating return implies risk to the investors. It can be safely assumed that the investors are risk-averters, that is they want to avoid or at least minimise risk. They can, therefore, be reasonably expected to have a preference for a return which is more certain in the sense that it has smaller variance over the years. The problem of uncertainty renders profit maximisation unsuitable as an operational criterion for financial management as it considers only the size of benefits and gives no weight to the degree of uncertainty of the future benefits. This is illustrated in Table 1.2.

[illegible]

State of Economy	Alternative A	Alternative B
Recession (Period I)	9	0
Normal (Period II)	10	10
Boom (Period III)	11	20
Total	**30**	**30**

It is clear from Table 1.2 that the total returns associated with the two alternatives are identical in a normal situation but the range of variations is very wide in case of alternative B, while it is narrow in respect of alternative A. To put it differently, the earnings associated with alternative. B are more uncertain (risky) as they fluctuate widely depending on the state. of the economy. Obviously, alternative A is better in terms of risk and uncertainty, The profit maximisation criterion fails to reveal this, To conclude, the profit maximisation criterion is inappropriate and unsuitable as an operational objective of investment, financing and dividend decisions of a firm. It is not only vague and time value of money. It follows from the above that an appropriate operational decision criterion for financial management should (i) be precise and exact, (ii) be based on the ‘bigger the better’ principal, (iii) consider both quantity and quantity dimensions of benefits, and (iv) recognise the time value of money. The alternative to profit maximisation, that is wealth maximisation is one such measure.

Wealth Maximisation Decision Criterion

This is also known as value maximisation or net present worth maximisation. In current academic literature value maximisation is almost universally accepted as an appropriate operations decision criterion for financial management decisions as it removes the technical limitations which characterise earlier profit maximisation criterion Its operational features satisfy all the three requirement of a suitable operation objective of financial courses of action, namely, exactness, quality of benefits and the time value of money. The value of an asset should be viewed in terms of the benefits it can produce. The worth of a course of action can similarly be judged in terms of the value of the benefits it produces less the cost of undertaking it. A significant element in computing the value of a financial course of action, is the precise estimation of the benefits associated with it. The wealth maximisation criterion is based on the measurement of benefits in the case of the profit maximisation criterion. Cash flow is a precise concept with a definite connotation. Measuring benefits in terms of case flow avoids the ambiguity associated with accounting profits. This is the first operational feature of the net present worth maximisation criterion. The second important feature of the wealth maximisation criterion is that it considers is that it considers both the quantity and quality dimensions of benefit. At the same, it also incorporates the time value of money. The operational implication of the uncertainty and timing dimensions of the benefits emanating from a financial decision is that adjustment should be made in the cash flow pattern, firstly, to incorporate risk and, secondly, to make an allowance for differences in the timing of benefits. The value of a course of action must be viewed in teams of its worth to those providing the resources necessary for its undertaking. In applying the value maximisation criterion, the term value is used in terms of worth to the owners, that is, ordinary shareholders. The capitalisation (discount) rate that is employed is, therefore, the rate that reflects the time and risk preferences of the result of higher risk longer time period. Thus, a stream of case flows that is quite certain might be associated with a rate a 5 per cent, while a very risky stream may carry a 15 per cent discount rate. For the above reason the net present value maximisation is superior to the profits maximisation as an operational objective. As a decision criterion, it involves a comparison of value to cost. An action that has a discounted value – reflecting both time and risk that exceeds its cost can be said to create value. Such actions should be undertaking.

Conversely, actions, with lees value than cost, reduce wealth and should be alternative with the greatest net present value should be selected. In the words of Ezra Solomon, The gross present worth of a course of action is equal to the capitalised value of the flow of future expected benefit, discounted (or capitalised) at a rate which reflects their certainty or uncertainty. Wealth or net present worth is the difference between gross present worth and the amount of capital investment required to achieve the benefits being discussed. Any financial action which creates wealth or which has a net present worth above zero is a desirable one and should be undertaken. Any financial action which does not meet this test should be rejected.

1.9 ECONOMIC VALUE ADDED

Economic Value Added (EVA) It is a popular measure currently being used by several firms to determine whether an existing/proposed investment positively contributes to the owners'/shareholders' wealth. The **EVA** is equal to after-tax operating profits of a firm less the cost of funds used to finance investments. A positive EVA would increase owners' value/wealth. Therefore, only investments with positive EVA would be desirable from the viewpoint of maximising shareholders' wealth. To illustrate, assuming an after-tax profit of ₹40 crore and associated costs of financing the investments of ₹38 crore, the EVA = ₹2 crore (₹40 crore – ₹38 crore). With a positive EVA, the investment would add value and increase the wealth of the owners and should be accepted. The computation of the after-tax operating profits attributable to the investment under consideration as well as the cost of funds used to finance it would, however, involve numerous accounting and financial issues.

• **Economic value added** is equal to after-tax operating profits of a firm less the cost of funds used to finance investments.

The **merits** of EVA are: **(a)** its relative simplicity and **(b)** its strong link with the wealth maximisation of the owners. It *prima facie* exhibits a strong link to share prices, that is, positive EVA is associated with increase in prices of shares and *vice versa*. However, EVA is, in effect, a repackaged and well-marketed application of the NPV technique of investment decision. But EVA is certainly a useful tool for operationalising the owners' value maximisation goal, particularly with respect to the investment decision.

1.10 ORGANIZATION OF FINANCE FUNCTION

The finance function is almost the same in most enterprises. The details may differ but the important features are universal in nature. The finance function occupies such a major place that it cannot be the sole responsibility of the executive. The important aspects of the finance function have to be carried on by the top management i.e., the Managing Director and the Board of Directors. It is the Board of Directors, which makes all the material final decisions involving finance. Financial management in many ways is an integral part of the jobs of managers who are involved in planning, allocation of resources and control. The responsibilities for financial management are disposed throughout the organization.

Example:

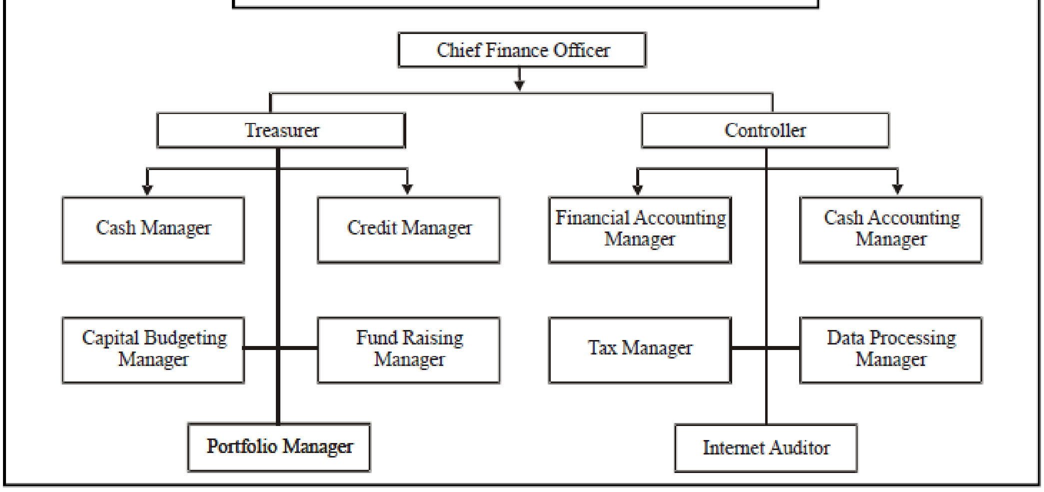
1. The engineer, who proposes a new plant, shapes the investment policy of the firm.
2. The marketing analyst provides inputs in the process of forecasting and planning.
3. The purchase manager influences the level of investment in inventories.
4. The sales manager has a say in the determination of receivable policy.
5. Departmental managers, in general, are important links in the financial control system of the firm.

The Chief Financial Officer (CFO) is basically to assist the top management. He has an important role to contribute to good decision-making on issues that involve all the functional areas of the business. He must clearly bring out financial implications of all decisions and make them understood. CFO (his designation varies from company to company) works directly under the President or the Managing Director of the company. Besides routine work, he keeps the Board of Directors informed about all the phases of business activity, including economic, social and political developments affecting the business behaviour. He also furnishes information about the financial status of the company by reviewing from time-to-time. The CFO may have different officers under him to carry out his functions. Broadly, the functions are divided into two parts.

1. Treasury function
2. Control function

Treasury function (headed by financial manager) is commonly responsible for handling financial activities, such as financial planning and fund raising, making capital expenditures decisions, managing cash, managing credit activities, managing the pension fund and managing foreign exchange. The control function (headed by Chief Accountant/Financial Controller) typically handles the accounting activities such as corporate accounting, tax management, financial accounting and cost accounting. The treasurer's focus tends to be more external, the controllers' focus is more internal:

Figure 1.1: Organizational chart of Finance function



1.11 DUTIES AND RESPONSIBILITIES OF FINANCIAL MANAGER (OR) FUNCTIONS OF FINANCIAL MANAGER OR) ROLE OF FINANCIAL MANAGER.

Finance manager is an integral part of corporate management of an organization. With his profession experience, expertise knowledge and competence, he has to play a key role in optimal utilization of financial resources of the organization. With the growth in the size of the organization, degree of specialization of finance function increases. In large undertakings, the finance manager is a top management executive who participants in various decision making functions.

A) Determining financial needs:-

One of the most important functions of the financial manager is to ensure the availability of adequate financing, financial needs have to be assessed for different purposes. Money may be required for initial promotional expenses, fixed capital and working capital needs. Promotional expenditure includes expenditure incurred in the process of company formation.

B) Determining sources of funds:

The financial manager has to choose source of funds. He may issue different types of securities and debenture, may borrow form a number of finance institutional and the public. The financial manager must definitely know what he is doing, workout strategies to ensure good financial health of the firm.

C) Financial analysis:

It is the evaluation & interpretation of a firm"s financial position and operation and involves a comparison and interpretation of accounting data. The financial manager has to interpret different statements.

D) Optimal capital structure:

The financial manager has to establish an optimum capital structure and ensure the maximum rate of return on investment and the liabilities carrying – fixed charges has to be defined.

E) Cost –volume profit analysis;

This is popularly known as the CVP relationship for this purpose are fixed cost, variable cost and semi-variable cost must be analyzed.

F) Profit planning and control:

Profit planning and control have assumed great importance in the financial activities of modern business. Profit planning ensures the attainment of stability and growth. The break-even analysis and cost volume profit it analysis are important tools in profit planning and control of the firms.

G) Fixed assets management:-

A firms fixed assets are land, building, machinery and equipment, furniture and such intangibles as patents, copy rights and goodwill. These fixed assets are justified to the extent of the utility or their production capacity.

H) Capital budgeting:

It refers to the long-term planning for (1) investment in projects and fixed assets and (2)methods of financing the approved projects. It includes the methods of mobilization of long-terms funds and their deployments in profitable projects. Capital budgeting is considered as the process of making investment decisions on capital expenditure.

i) Dividend policies:

The dividend policy of a firm determines the magnitude of the earnings distributed to share holders. The net operating profit or profit after tax (PAT) has to be intelligently apportioned between divided payments, and investments. The dividend policy determines the amount of dividend payment to be made to the shareholders, the date of payments of dividends and the effect of the dividend policy on the value of the firm.

J) Acquisition and mergers

A merger is a transaction where two firms agree to integrate their operations on a relatively equal basis because they have resources and capabilities that together may create a stronger competitive advantage. Two or more companies combine to form either a new company or one of the combining companies survives, which is generally the acquirer.

1.12 EMERGING ROLE OF FINANCIAL MANAGER IN INDIA

Reflecting the emerging economic and financial environment in the post-liberalisation era, the role/job of financial managers in India has become more important, complex and demanding. The key challenges are, *inter-alia*, in the areas specified below: **(a)** financial structure, **(b)** foreign exchange management, **(c)** treasury operations, **(d)** investor communication, **(e)** management control and **(f)** investment planning. The main elements of the changed economic and financial environment, *inter alia*, are the following:

- Considerable relaxation in industrial licensing framework in terms of the modifications in the Industries Development (Regulations) Act;
- Abolition of the Monopolies and Restrictive and Trade Practices (MRTP) Act and its replacement by the Competition Act;
- Repeal of Foreign Exchange Regulation Act (FERA) and enactment of a liberalised Foreign Exchange Management Act (FEMA);
- Abolition of Capital Issues (Control) Act and the setting-up of the Securities and Exchange Board of India (SEBI) under the SEBI Act for the regulation and development of the securities market.and the protection of investors;
- Enactment of the Insurance Regulatory and Development Authority (IRDA) Act and the setting-up of the IRDA for the regulation of the insurance sector and the consequent dismantling of the monopoly of LIC and GIC and its subsidiaries;
- Emergence of the capital market at the centre-stage of the financing system and the disappearance of the erstwhile development/public financial/term lending institutions from the Indian financial scene;
- Emergence of a highly articulate and sophisticated money market;
- Globalisation, convertibility of rupee, liberalised foreign investments in India, Indian foreign investment abroad;
- Market-determined interest rate, emergence of highly innovative financial instruments;
- Growth of mutual funds; credit rating, other financial services;
- Rigorous prudential norms, credit risk management framework for banks and financial institutions;
- Access to Euro-issues, American Depository Receipts (ADRs);
- Privatisation/disinvestment of public sector undertakings.