BBA 4th , Financial Management, Unit 1

(Topic 1) 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 is 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.

(Topic 2) Role and Function of Financial Manager

1. **Estimating Financial Requirements:** The first task of any financial manager is to determine short-term and long-term financial requirement of his/her business. For this purpose, the financial manager will prepare a financial plan for the present as well as future. The amount required for purchasing fixed assets as well as the needs of funds for the working capital has to be adequately estimated.

2. **Deciding Capital Structure:** The capital structure refers to the kind and proportion of the different securities for raising funds. After deciding on the quantum of funds required it should be determined which type of security should be built. Financing fixed securities through long-term debts may be wise. Long-term funds should be employed to finance working capital also.
3. **Selecting a Source of Finance:** After preparing a capital structure, an appropriate source of finance is selected. Various sources from which finance may be raised, includes share capital, debentures, commercial deposits, etc.
4. **Selecting a Pattern of Investment:** When fund have been procured, then a decision about investment pattern is to be taken. The selection of investment pattern is related to the use of the funds. A decision has to be taken as to which assets are to be purchased? The fund will have to be spent first. Fixed asset and the appropriate portion will be retained for the working capital.
5. **Proper Cash Management:** Cash management is an essential task of a financial manager. He has to assess the various cash needs at different times and then make arrangements for arranging cash. Cash may be required to make payments to creditors, purchasing raw material, meet wage bills and meet day to day expenses.

(Topic 3) profit vs. wealth maximization

PROFIT MAXIMIZATION

Profit Maximization is the traditional approach, in this process Companies undergo to Determine the best Output and price levels in order to maximize its return. The company will usually adjust influential factors such as production costs, sale price, and output levels as a way of reaching its profit goal. The overall objective of business enterprises to earn at least satisfactory returns on the funds invested to sustain in the market for long periods.

WEALTH MAXIMIZATION

Wealth maximization is almost universally accepted and appropriate goal of a firm. According to wealth maximization, the managers should take decisions that maximize the net present value of the shareholders or shareholders’ wealth. The wealth maximization principle implies that the fundamental objective of a firm is to maximize the market value of its shares.

PROFIT MAXIMIZATION	WEALTH MAXIMIZATION
Profit Maximization is based on the increase of sales and profits of the organization.	Wealth Maximization is based on the cash flows into the organization.
Focused On	
Profit Maximization emphasizes on short term goals.	Wealth Maximization emphasizes on long term goals.
Time Value of Money	
Profit Maximization ignores the time value of money. Time value of money refers the money receivable today is more valuable than the money which is going to be recieved in future.	Wealth Maximization considers the time value of money. In wealth maximization, the future cash flows are discounted at an suitable discounted rate to represent their present value.
Risk	
Profit Maximization ignore the risk and uncertainity.	Wealth Maximization considers the risk and uncertainty.
Reliability	
In the new business environment Profit maximisation is regarded as unrealistic, difficult, inappropriate and immoral.	Wealth maximisation objectives ensures fair return to the shareholders, reserve funds for growth and expansion, promoting financial discipline in the management.
Objective	
Profit Maximization objective leads to exploiting employees and consumers. it also leads to inequalities and lowers human values.	Wealth Maximization provides efficient allocation of resource, It ensures the economic interest of the society.