Wealth Maximization – Corporate knack to ensure concern is in going nature:

Introduction:

Wealth maximization decision criterion is also known as Value Maximization or Net Present-Worth maximization. In the current business literature value maximization is widely accepted as an appropriate operational decision criterion for financial management decision. It removes the technical limitations of the profit maximization criterion. It posses the three requirements of a suitable operational objective of financial courses of action. These three features are exactness, quality of benefits and the time value of money.

Exactness:

The value of an asset should be determined In terms of returns it can produce. Thus, the worth of a course of action should be valued In terms of the returns less the cost of undertaking the particular course of action. Important element in computing the value of a financial course of action is the exactness in computing the benefits associated with the course of action. The wealth maximization criterion is based on cash flows generated and not on accounting profit. The computation of cash inflows and cash outflows is precise. As against this the computation of accounting is not exact.

Quality and Quantity and Benefit and Time Value of Money:

The second feature of wealth maximization criterion is that. It considers both the quality and quantity dimensions of benefits. Moreover, it also incorporates the time value of money. As stated earlier the quality of benefits refers to certainty with which benefits are received In future. The more certain the expected cash in flows the better the quality of benefits and higher the value. On the contrary the less certain the flows the lower the quality and hence, value of benefits. It should also be noted that money has time value. It should also be noted that benefits received in earlier years should be valued highly than benefits received later. The operational implication of the uncertainty and timing dimensions of the benefits associated with a financial decision is that adjustments need to be made in the cash flow pattern. It should be made to incorporate risk and to make an allowance for differences in the timing of benefits. Net present value maximization is superior to the profit maximization as an operational objective. It involves a comparison of value of cost. The action that has a discounted value reflecting both time and risk that exceeds cost is said to create value. Such actions are to be undertaken. Contrary to this actions with less value than cost, reduce wealth should be rejected. It is for these reasons that the Net Present Value Maximization is superior to the profit maximization as an operational objective.

PROFIT MAXIMIZATION VS WEALTH MAXIMIZATION

1. Profit Maximization- It is one of the basic objectives of financial management. Profit maximization aims at improving profitability, maintaining the stability and reducing losses and inefficiencies. Profit in this context can be seen in 2 senses.

a) Profit maximization for the owner.

b) Profit maximization is for others.

Normally profit is linked with efficiency and so it is the test of efficiency. However this concept has certain limitations like ambiguity i.e. the term is not clear as it is nowhere defined, it changes from person to person.

2. Quality of profit - normally profit is counted in terms of rupees. Normally amount earned is called as profit but it ignores certain basic ideas like wastage, efficiency, employee skill, employee's turnover, product mix, manufacturing process, administrative setup.

3. Timing of benefit / time value of profit - in inflationary conditions the value of profit will decrease and hence the profits may not be comparable over a longer period span.

4. Some economists argue that profit maximization is sometimes leads to unhealthy trends and is harmful to the society and may result into exploitation, unhealthy competition and taking undue advantage of the position.

Conclusion:

Evaluating Wealth or Value of the organization will be effective tool for long range financial decision making. Corporate ensuring enhanced life of the organization by maximizing wealth.

Sources: Various books on Financial Management

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