

SCOPE AND OBJECTIVES OF FINANCIAL MANAGEMENT

Question 1

What are the main responsibilities of a Chief Financial Officer of an organisation?

(PCC-May2007)(3 marks)

Answer

Responsibilities of Chief Financial Officer (CFO)

The chief financial officer of an organisation plays an important role in the company's goals, policies, and financial success. His main responsibilities include:

- (a) *Financial analysis and planning*: Determining the proper amount of funds to be employed in the firm.
- (b) *Investment decisions*: Efficient allocation of funds to specific assets.
- (c) *Financial and capital structure decisions*: Raising of funds on favourable terms as possible, i.e., determining the composition of liabilities.
- (d) *Management of financial resources* (such as working capital).
- (e) *Risk Management*: Protecting assets.

Question 2

Explain the limitations of profit maximization objective of Financial Management.

(PCC-Nov. 2007)(3 marks)

Answer

Limitations of Profit Maximisation Objective of Financial Management

- (a) Time factor is ignored.
- (b) It is vague because it is not clear whether the term relates to economic profit, accounting profit, profit after tax or before tax.
- (c) The term maximization is also ambiguous.
- (d) It ignores the risk factor.

Question 3

Discuss conflict in profit versus wealth maximization objective. (PCC-June 2009)(2 marks)

Answer

Conflict in Profit versus Wealth Maximization Objective

Profit maximisation is a short-term objective and cannot be the sole objective of a company. It is at best a limited objective. If profit is given undue importance, a number of problems can arise like the term profit is vague, profit maximisation has to be attempted with a realisation of risks involved, it does not take into account the time pattern of returns and as an objective it is too narrow.

Whereas, on the other hand, wealth maximisation, is a long-term objective and means that the company is using its resources in a good manner. If the share value is to stay high, the company has to reduce its costs and use the resources properly. If the company follows the goal of wealth maximisation, it means that the company will promote only those policies that will lead to an efficient allocation of resources.

Question 4

Differentiate between Financial Management and Financial Accounting.

(PCC-Nov. 2009)(2 marks)

Answer

Differentiation between Financial Management and Financial Accounting

Though financial management and financial accounting are closely related, still they differ in the treatment of funds and also with regards to decision - making.

Treatment of Funds: In accounting, the measurement of funds is based on the accrual principle. The accrual based accounting data do not reflect fully the financial conditions of the organisation. An organisation which has earned profit (sales less expenses) may said to be profitable in the accounting sense but it may not be able to meet its current obligations due to shortage of liquidity as a result of say, uncollectible receivables. Whereas, the treatment of funds, in financial management is based on cash flows. The revenues are recognised only when cash is actually received (i.e. cash inflow) and expenses are recognised on actual payment (i.e. cash outflow). Thus, cash flow based returns help financial managers to avoid insolvency and achieve desired financial goals.

Decision-making: The chief focus of an accountant is to collect data and present the data while the financial manager's primary responsibility relates to financial planning, controlling and decision-making. Thus, in a way it can be stated that financial management begins where financial

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accounting ends.

Question 5

Explain the two basic functions of Financial Management.

(PCC-Nov. 2009)(2 marks)

Answer

Two Basic Functions of Financial Management

Procurement of Funds: Funds can be obtained from different sources having different characteristics in terms of risk, cost and control. The funds raised from the issue of equity shares are the best from the risk point of view since repayment is required only at the time of liquidation. However, it is also the most costly source of finance due to dividend expectations of shareholders. On the other hand, debentures are cheaper than equity shares due to their tax advantage. However, they are usually riskier than equity shares. There are thus risk, cost and control considerations which a finance manager must consider while procuring funds. The cost of funds should be at the minimum level for that a proper balancing of risk and control factors must be carried out.

Effective Utilization of Funds: The Finance Manager has to ensure that funds are not kept idle or there is no improper use of funds. The funds are to be invested in a manner such that they generate returns higher than the cost of capital to the firm. Besides this, decisions to invest in fixed assets are to be taken only after sound analysis using capital budgeting techniques. Similarly, adequate working capital should be maintained so as to avoid the risk of insolvency.