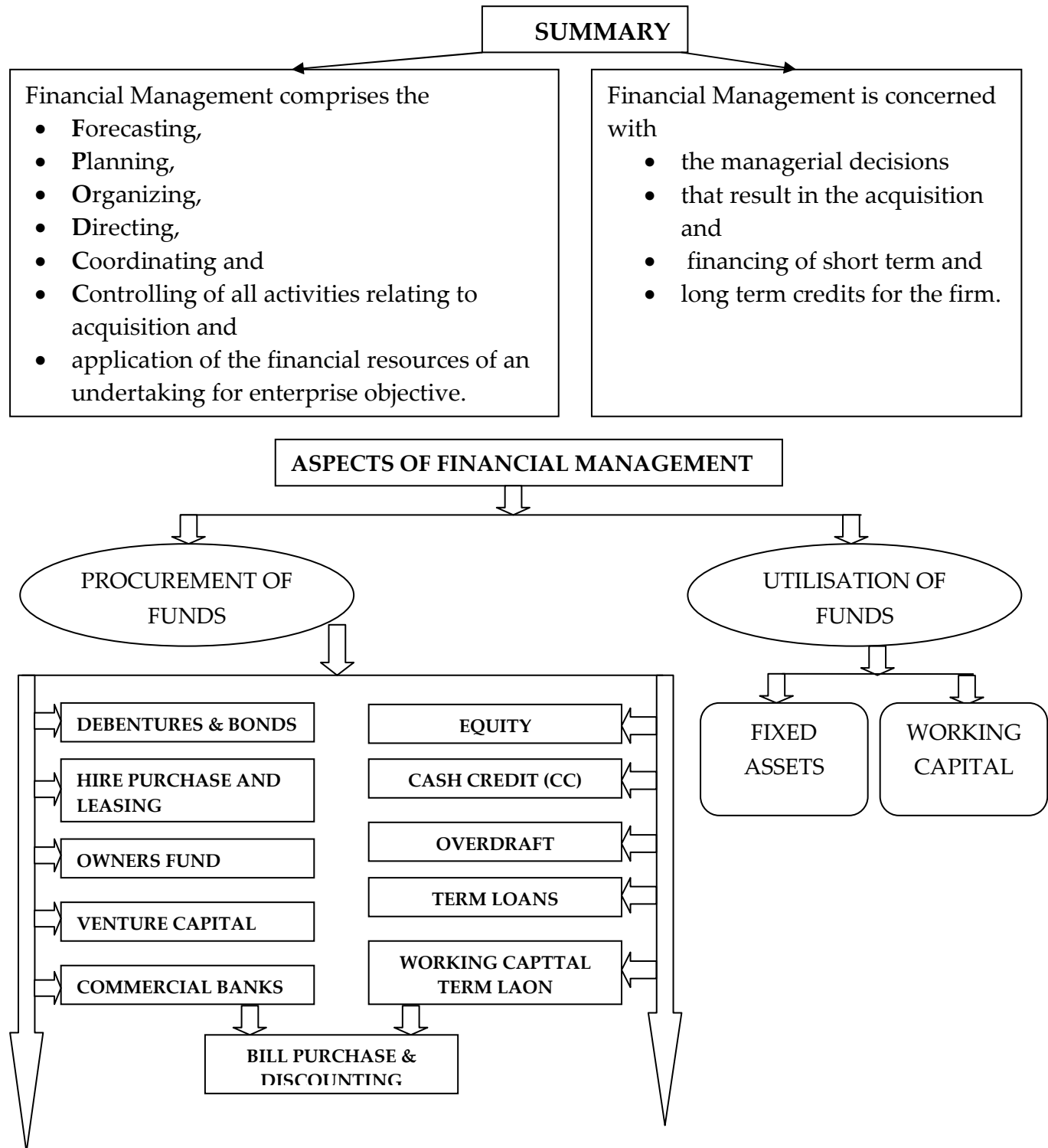


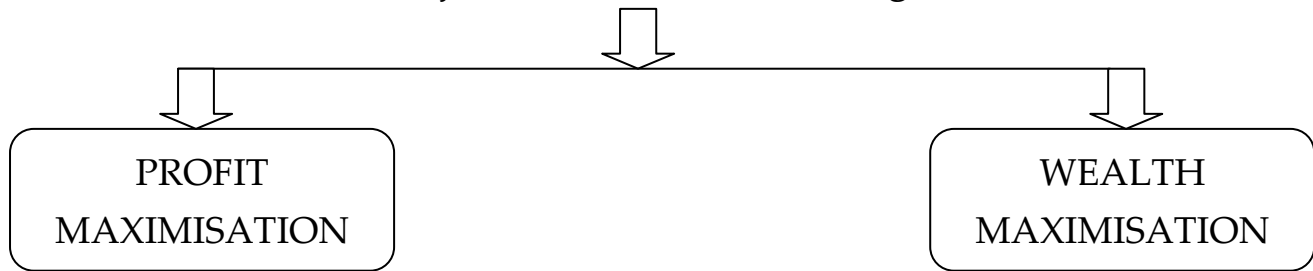
Meaning of Financial Management:

Financial management is that managerial activity which is

- concerned with planning &
- controlling of the firm's financial resources
- acquiring, financing and managing assets
- to accomplish the overall goal of a business enterprise.



Objectives of Financial Management



PROFIT MAXIMISATION:

- The primary objective of a company is to earn profit; hence the objective of financial management is also profit maximisation.
- This implies that the finance manager has to make his decisions in a manner so that the profits of the concern are maximised.
- Profit maximisation cannot be the sole objective of a company. If profit is given undue importance, a number of problems can arise. These are as under

1. The term Profit Maximization is a vague concept:

- It is not clear about what profits are
- Whether it is absolute amount of Income or Earning per Share (EPS) or Return on investment or profit before tax or after tax.

2. Profit maximisation has to be attempted with a realisation of risks involved:

- There is a direct relationship between risk and profit.
- Higher the risk, higher is the possibility of profits.
- If profit maximisation is the only goal, then risk factor is altogether ignored.
- This implies that finance manager will accept highly risky proposals also, if they give high profits.
- Risk is very important consideration and has to be balanced with the profit objective.

3. Profit maximisation as an objective does not take into account the time pattern of Returns:

- Profit maximisation is adopted as criteria then proposals giving returns at very later stage and with highly varying amounts may be accepted.
- It is very harmful to the organization since here timing and risks are not adjusted.

4. Profit maximisation as an objective is too narrow:

- It fails to take into account the social considerations as also the obligations to various interests of workers, consumers, society, as well as ethical trade practices.
- If these factors are ignored, a company cannot survive for long.
- Profit maximisation at the cost of social and moral obligations is a short sighted policy.

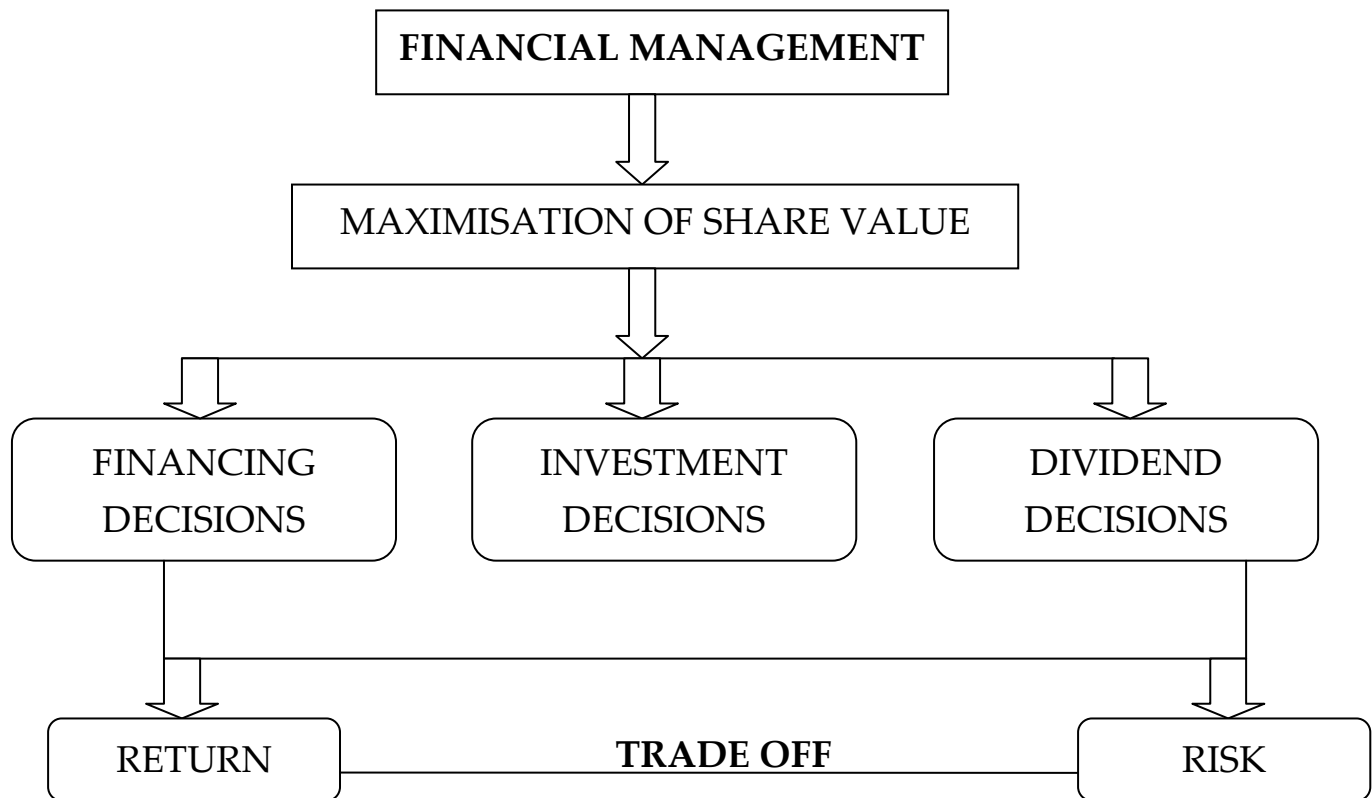
Wealth Maximisation

- The concept of wealth in the context of wealth maximisation objective refers to the shareholders' wealth as reflected by the price of their shares in the share market.
- Thus it means maximisation of the market price of the equity shares of the company.
- This maximisation of the price of the company's equity shares should be in the long run by making effective decisions which are desirable for the growth of a company and are valued positively by the investors at large and not by manipulating the share price in the short term.

Wealth Maximisation objective is superior to the Profit Maximisation objective:		
S.No.	Wealth Maximisation	Profit Maximisation
1	The wealth maximisation objective of a firm considers all future cash flows, dividends, earning per share, risk of a decision etc.	Profit maximisation objective does not consider the effect of EPS, dividend paid or any other returns to shareholders or the wealth of the shareholder.
2	A firm that wishes to maximise the shareholders wealth may pay regular dividends	A firm with the objective of profit maximisation may refrain from dividend payment to its shareholders.
3	Shareholders would prefer an increase in the firm's wealth against its generation of increasing flow of profits.	
4	The market price of a share reflects the shareholders expected return, considering the long-term prospects of the firm, reflects the differences in timings of the returns, considers risk and recognizes the importance of distribution of returns.	
5	The maximisation of a firm's value as reflected in the market price of a share is viewed as a proper goal of a firm.	The profit maximisation can be considered as a part of the wealth maximisation strategy.

Importance of Financial Management:

- Taking care not to over-invest in fixed assets.
- Balancing cash-outflow with cash-inflows.
- Ensuring that there is a sufficient level of short-term working capital.
- Setting sales revenue targets that will deliver growth.
- Increasing gross profit by setting the correct pricing for products or services.
- Controlling the level of general and administrative expenses by finding more cost efficient ways of running the day-to-day business operations, and
- Tax planning that will minimize the taxes a business has to pay.

SCOPE OF FINANCIAL MANAGEMENT

To achieve wealth Maximisation objective, the finance manager has to take the following decisions:

1. Investment Decisions:

- These decisions relate to the selection of assets in which funds will be invested by a firm.
- Funds procured from different sources have to be invested in various kinds of assets.
- Long term funds are used in a project for various fixed assets and also for current assets.
- The investment of funds in a project has to be made after careful assessment of the various projects through capital budgeting.
- A part of long term funds is also to be kept for financing the working capital requirements.
- Asset management policies are to be laid down regarding various items of current assets.

2. Financing Decisions:

- These decisions relate to acquiring the optimum finance to meet financial objectives and seeing that fixed and working capital are effectively managed.
- The financial manager needs to possess a good knowledge of the sources of available funds and their respective costs and needs to ensure that the company has a sound capital structure, i.e. a proper balance between equity capital and debt.
- Financing decisions also call for a good knowledge of evaluation of risk, e.g. excessive debt carried high risk for an organization's equity because of the priority rights of the lenders.

3. Dividend Decisions:

- These decisions relate to the determination as to how much and how frequently cash can be paid out of the profits of an organisation as income for its owners/shareholders.
- The owner of any profit-making organization looks for reward for his investment in two ways:
 - i. The growth of the capital invested and
 - ii. The cash paid out as income as dividends.

Inter relationship between Investment, Financing and Dividend Decisions:

1. Investment decision is influenced by financing decisions because only that investment proposal is accepted which is expected to generate returns more than the cost of financing, thus maximise their wealth.
2. Financing decision is influenced by investment decisions because the sources from which the funds should be raised depends upon the requirements of funds for long term and short term purpose which are provided by investment decisions. An optimal mix of various sources increases returns to equity shareholders and thus maximise their wealth.
3. Financing decision is influenced by dividend decisions because availability of retained earnings as source of funds depends on the dividend decisions. An optimal mix of internal and external sources of funds increases returns to equity shareholders and thus maximise their wealth.
4. Dividend decision (i.e. how much to retain and how much to distribute as Dividend) is influenced by Investment decisions because dividend decisions also depends on the requirements of funds for future growth. An optimal dividend payout ratio maximise the shareholders' wealth.
5. Dividend decision is influenced by financing decisions because dividend decision also depends on company access to capital market for raising funds required for investment purpose.

Role of Chief Financial Officer (CFO)		
S.No	Basis	Functions and Responsibilities
1	Financial analysis and planning	Determining the proper amount of funds to employ in the firm, i.e. designating the size of the firm and its rate of growth.
2	Investment decisions	The efficient allocation of funds to specific assets.
3	Financing and capital structure decisions	Raising funds on favorable terms as possible i.e. determining the composition of liabilities.
4	Risk management	Protecting assets.
5	Management of financial resources	Working capital, cash management
6	Dividend Decisions	How much profit to retain as source of funds and how much to distribute as Dividend

Functions of Finance Manager:		
S.No.	Primary functions	Subsidiary functions
1	Estimating the capital requirements	Ensuring the optimum level of inventory and receivables
2	Financing or capital structure decisions	Supplying funds to all parts of the organisation.
3	Utilization of funds or investment decisions	Evaluating financial performance of various units of the organisation.
4	Disposal of surplus or dividend decisions	Carrying out financial negotiations with financial institutions, banks, underwriters etc.
5	Management of cash	Keeping track of stock exchange quotations and behavior of share prices.
6	Financial control	

Role of Finance Manager in the Changing Scenario of Financial Management in India:

- In the modern enterprise, the finance manager occupies a key position and his role is becoming more and more pervasive and significant in solving the finance problems.
- He is now responsible for shaping the fortunes of the enterprise, and is involved in the most vital decision of allocation of capital like mergers, acquisitions, etc.
- He is working in a challenging environment which changes continuously.
- Emergence of financial service sector and development of internet in the field of information technology has also brought new challenges before the Indian finance managers.

Some of the important changes in the environment are

1. Free pricing and book building for IPOs
2. Shares buy back and reverse book building.
3. Raising resources globally through ADRs/GDRs.
4. Options and futures and other Derivative instruments.
5. External Commercial Borrowings.
6. Treasury Management

Financial Management and Financial Accounting		
Basis	Financial Management	Financial Accounting
Objective	Its objective is to maximise the wealth of shareholders.	Its objective is to provide information about overall financial performance and financial position of the organisation.
Treatment of funds	The treatment of funds is based on cash flows. The revenues and expenses are recognized on actual cash inflows/ outflows.	The treatment of funds is based on Accrual principle. The revenue and expenses are recognized on accrual basis irrespective of whether received/paid or not.
Focus	Its focus on financial planning, controlling and decision making	Its focus on External reporting.
Historical/Future Data	It uses both present and future data.	It uses historical data.
Monetary/Non-Monetary data	It considers both monetary & non-monetary data.	It considers only monetary data.
Interested parties	Internal management	Internal as well as External parties.

Examination Questions
1. Explain as to how the wealth maximisation objective is superior to the profit maximisation objective. 2. Discuss the conflicts in Profit versus Wealth maximization principle of the firm. 3. "The profit maximization is not an operationally feasible criterion." Comment on it. 4. "The information age has given a fresh perspective on the role of finance management and finance managers. With the shift in paradigm it is imperative that the role of Chief Financial Officer (CFO) changes from a controller to a facilitator." Can you describe the emergent role which is described by the speaker/author? 5. Discuss the functions of a Chief Financial Officer. 6. Explain two basic functions of Financial Management. 7. Write short notes on the following: a) Inter relationship between investment, financing and dividend decisions. b) Finance function 8. Explain the role of Finance Manager in the changing scenario of financial management in India. 9. What are the main responsibilities of a Chief Financial Officer of an organisation? 10. Explain the limitations of profit maximization objective of Financial Management. 11. Differentiate between Financial Management and Financial Accounting.