GOVERNMENT POLYTECHNIC BHUBNESWAR-2023

DEPARTMENT OF MODERN OFFICE MANAGEMENTLECTURER NOTES

SEMESTER-5th, PAPER- Financial Management

Prepared by- Smita Subhadarsini Sahoo

UNIT 1

Financial Management means planning, organizing, directing and controlling the financial activities such as procurement and utilization of funds of the enterprise.

Nature of financial management

The nature of financial management includes the following −

- **Estimates capital requirements**

Financial management helps in anticipation of funds by estimating working capital and fixed capital requirements for carrying business activities.

- **Decides capital structure**

Proper balance between debt and equity should be attained, which minimizes the cost of capital.

Financial management decides proper portion of different securities (common equity, preferred equity and debt).

- **Select source of fund**

Source of fund is one crucial decision in every organisation. Every organisation should properly analyse various source of funds (shares, bonds, debentures etc.) and must select appropriate funds which involves minimal risk.

- **Selects investment pattern**

Before investing the amount, the investment proposal should be analyzed and properly evaluates its risk and returns.

- **Raises shareholders value**

It aims to increase the amount of return to its shareholders by decreasing its cost of operations and increase in profits.

Finance manager should focus on raising the funds from different sources and invest them in profitable avenues.

- **Management of cash**

Finance manager observes all cash movements (inflow and outflow) and ensures they should face any deficiency or surplus of cash.

- **Apply financial controls −**

Implying financial controls helps in keeping the company actual cost of operation within limits and earning the expected profits.

Scope/Elements of Financial Management

1. **Investment decisions** –It includes investment in fixed assets (called as capital budgeting). Investments in current assets are 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/Role of a finance manager

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-
   1. Issue of shares and debentures

2. Loans to be taken from banks and financial institutions
3. 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 decisions have to be made by the finance manager. This can be done in two ways:
    1. Dividend declaration - It includes identifying the rate of dividends and other benefits like bonus.
    2. 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.

What is Wealth Maximization?

The ability of a company to increase the value of its stock for all the stakeholders is referred to as Wealth Maximization. It is a long-term goal and involves multiple external factors like sales, products, services, market share, etc. It assumes the risk. It recognizes the **time value of money** given the business environment of the operating entity. It is mainly concerned with the company's long-term growth and hence is concerned more about fetching the maximum chunk of the market share to attain a leadership position.

What is Profit Maximization?

The process of increasing the profit earning capability of the company is referred to as Profit Maximization. It is mainly a short-term goal and is primarily restricted to the accounting analysis of the financial year. It ignores the risk and avoids the time value of money. It primarily concerns the company's survival and growth in the existing competitive business environment.

The fundamental differences between profit maximization and wealth maximization is explained in points below:

1. The process through which the company is capable of increasing earning capacity known as Profit Maximization. On the other hand, the ability of the company in increasing the value of its stock in the market is known as wealth maximization.
2. Profit maximization is a short term objective of the firm while the long-term objective is Wealth Maximization.
3. Profit Maximization ignores risk and uncertainty. Unlike Wealth Maximization, which considers both.
4. Profit Maximization avoids time value of money, but Wealth Maximization recognises it.

5. Profit Maximization is necessary for the survival and growth of the enterprise. Conversely, Wealth Maximization accelerates the growth rate of the enterprise and aims at attaining the maximum market share of the economy.