Lecture Notes

On

Introduction of Financial Management

MBA – 2nd sem

BBA – 2nd sem

Subject – Financial Management

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INTRODUCTION

Financial Management is nothing but management of the limited financial resources the organization has, to its utmost advantage. Resources are always limited, compared to its demands or needs. This is the case with every type of organisation. Proprietorship or limited company, be it public or private, profit oriented or even non-profitable organisation.

In general, meaning of finance refers to providing funds, as and when needed. However, as management function, the term 'Financial Management' has a distinct meaning. Finance is the essential requirement of every organisation.

Financial management deals with the study of procuring funds and its effective and judicious utilisation, in terms of the overall objectives of the firm, and expectations of the providers of funds. The basic objective is to maximise the value of the firm. **The purpose is to achieve maximisation of share value to the owners i.e. equity shareholders.**

The term financial management has been defined, differently, by various authors. Some of the authoritative **definitions** are given below:

1. "Financial Management is concerned with the efficient use of an important economic resource, namely, Capital Funds" **—Solomon**

2. "Financial Management is concerned with the managerial decisions that result in the acquisition and financing of short-term and long-term credits for the firm" **—Phillioppatus**

3. "Business finance is that business activity which is concerned with the conservation and acquisition of capital funds in meeting financial needs and overall objectives of a business enterprise" **—Wheeler**

4. "Financial Management deals with procurement of funds and their effective utilisation inthe business" **—S.C. Kuchhal**

The definition provided by Kuchhal is most acceptable as it focuses, clearly, the **Basic requirements of financial management**. From his definition, two basic aspects emerge:

(A) Procurement of funds.

(B) Effective and judicious utilisation of funds.

NATURE OF FINANCIAL MANAGEMENT

Financial management refers to that part of management activity, which is concerned with the planning and controlling of firm's financial resources. Financial management is a part of overall management. All business decisions involve finance. Where finance is needed, role of finance manager is inevitable. Financial management deals with raising of funds from various sources, dependant on availability and existing capital structure of the organisation. The sources must be suitable and economical to the organisation. Emphasis of financial management is more on its efficient utilisation, rather than raising of funds, alone.

The scope and complexity of financial management has been widening, with the growth of business in different diverse directions. As business competition has been increasing, with a greater pace, support of financial management is more needed, in a more innovative way, to make the business grow, ahead of others.

SCOPE OF FINANCIAL MANAGEMENT

Financial management is concerned with optimum utilisation of resources. Resources are limited, particularly in developing countries like India. So, the focus, everywhere, is to take maximum benefit, in the form of output, from the limited inputs. Financial management is needed in every type of organisation, be it public or private sector. Equally, its importance exists in both profit oriented and non-profit organisations. In fact, need of financial management is more in loss-making organisations to turn them to profitable enterprises.

Study reveals many organisations have sustained losses, due to absence of professional financial management. Financial management has undergone significant changes, over the years in its scope and coverage.

Approaches: Broadly, it has two approaches:

a. Traditional Approach-Procurement of Funds

b. Modern Approach-Effective Utilisation of Funds

Traditional Approach

The scope of finance function was treated, in the narrow sense of procurement or arrangement of funds. The finance manager was treated as just provider of funds, when organisation was in need of them. **The utilisation or administering resources was considered outside the purview of the finance function. It was felt that the finance manager had no role to play in decisionmaking for its utilisation.** Others used to take decisions regarding its application in the organisation, without the involvement of finance personnel. Finance manager had been treated, in fact, as an outsider with a very specific and limited function, supplier of funds, to perform when the need of funds was felt by the organisation.

As per this approach, the following aspects only were included in the scope of financial management:

(i) Estimation of requirements of finance,

(ii) Arrangement of funds from financial institutions,

(iii) Arrangement of funds through financial instruments such as shares, debentures, bonds and loans

(iv) Looking after the accounting and legal work connected with the raising of funds.

Limitations

The traditional approach was evolved during the 1920s and 1930s period and continued till 1950. The approach had been discarded due to the following limitations:

(i) No Involvement in Application of Funds: The finance manager had not been involved in decision-making in allocation of funds. He had been treated as an outsider. He had been ignored in internal decision making process and considered as an outsider.

(ii) No Involvement in day to day Management: The focus was on providing long-term funds from a combination of sources. This process was more of one time happening. The finance manager was not involved in day to day administration of working capital management. Smooth functioning depends on working capital management, where the finance manager was not involved and allowed to play any role.

(iii) Not Associated in Decision-Making Allocation of Funds: The issue of allocation of funds was kept outside his functioning. He had not been involved in decision- making for its judicious utilisation.

Raising finance was an infrequent event. Its natural implication was that the issues involved in working capital management were not in the purview of the finance function. In a nutshell, during the traditional phase, the finance manager was called upon, in particular, when his speciality was required to locate new sources of funds and as and when the requirement of funds was felt.

The following issues, as pointed by Solomon, were ignored in the scope of financial management, under this approach:

(A) Should an enterprise commit capital funds to a certain purpose?

(B) Do the expected returns meet financial standards of performance?

(C) How does the cost vary with the mixture of financing methods used?

The traditional approach has outlived its utility in the changed business situation. The scope of finance function has undergone a sea change with the emergence of different capital instruments.

Modern Approach

Since 1950s, the approach and utility of financial management has started changing in a revolutionary manner. Financial management is considered as vital and an integral part of overall management.

The emphasis of Financial Management has been shifted from raising of funds to the effective and judicious utilisation of funds. The modern approach is analytical way of looking into the financial problems of the firm. Advice of finance manager is required at every moment, whenever any decision with involvement of funds is taken. Hardly, there is an activity that does not involve funds.

In the words of Solomon **"The central issue of financial policy is the use of funds. It is helpful in achieving the broad financial goals which an enterprise sets for itself".**

Nowadays, the finance manger is required to look into the financial implications of every decision to be taken by the firm. **His Involvement of finance manager has been before taking the decision, during its review and, finally, when the final outcome is judged.** In other words, his association has been continuous in every decision-making process from the inception till its end**.**