

Career Point University Kota (Raj.)



FINANCIAL MANAGEMENT

Basic Concepts of Financial Management

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What is Finance???



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Meaning of financial management

- * **Financial management** refers to the efficient and effective management of money (funds) in such a manner as to accomplish the objectives of the organization. It is the specialized function directly associated with the top management. The significance of this function is not seen in the 'Line' but also in the capacity of 'Staff' in overall of a company. It has been defined differently by different experts in the field.

Nature of Financial management

- * "Planning is an inextricable dimension of financial management. The term financial management connotes that funds flows are directed according to some plan." By **James Van Horne**.
- * "Financial management is that activity of management which is concerned with the planning, procuring and controlling of the firm's financial resources. " By Deepika & Maya Rani.
- * "Financial Management is the Operational Activity of a business that is responsible for obtaining and effectively utilizing the funds necessary for efficient operation." By Joseph Massie


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- “Business finance deals primarily with raising and administering and disbursing funds by privately owned business units operating in non-financial fields of industry.”– By Kuldeep Roy
 - “Financial Management is an area of financial decision making, harmonizing individual motives and enterprise goals.” -By Weston and Brigham
 - “Financial management is the area of business management devoted to a judicious use of capital and a careful selection of sources of capital in order to enable a business firm to move in the direction of reaching its goals.” – by J.F. Bradlery

Scope of Financial Management

- * Estimating the Requirement of Funds: Businesses make forecast on funds needed in both short run and long run, hence, they can improve the efficiency of funding. The estimation is based on the budget e.g. sale budget, production budget.
- * Determining the Capital Structure: Capital structure is how a firm finances its overall operations and growth by using different sources of funds. Once the requirement of funds has estimated, the financial manager should decide the mix of debt and equity and also types of debt.
- * Investment Fund: A good investment plan can bring businesses huge returns.

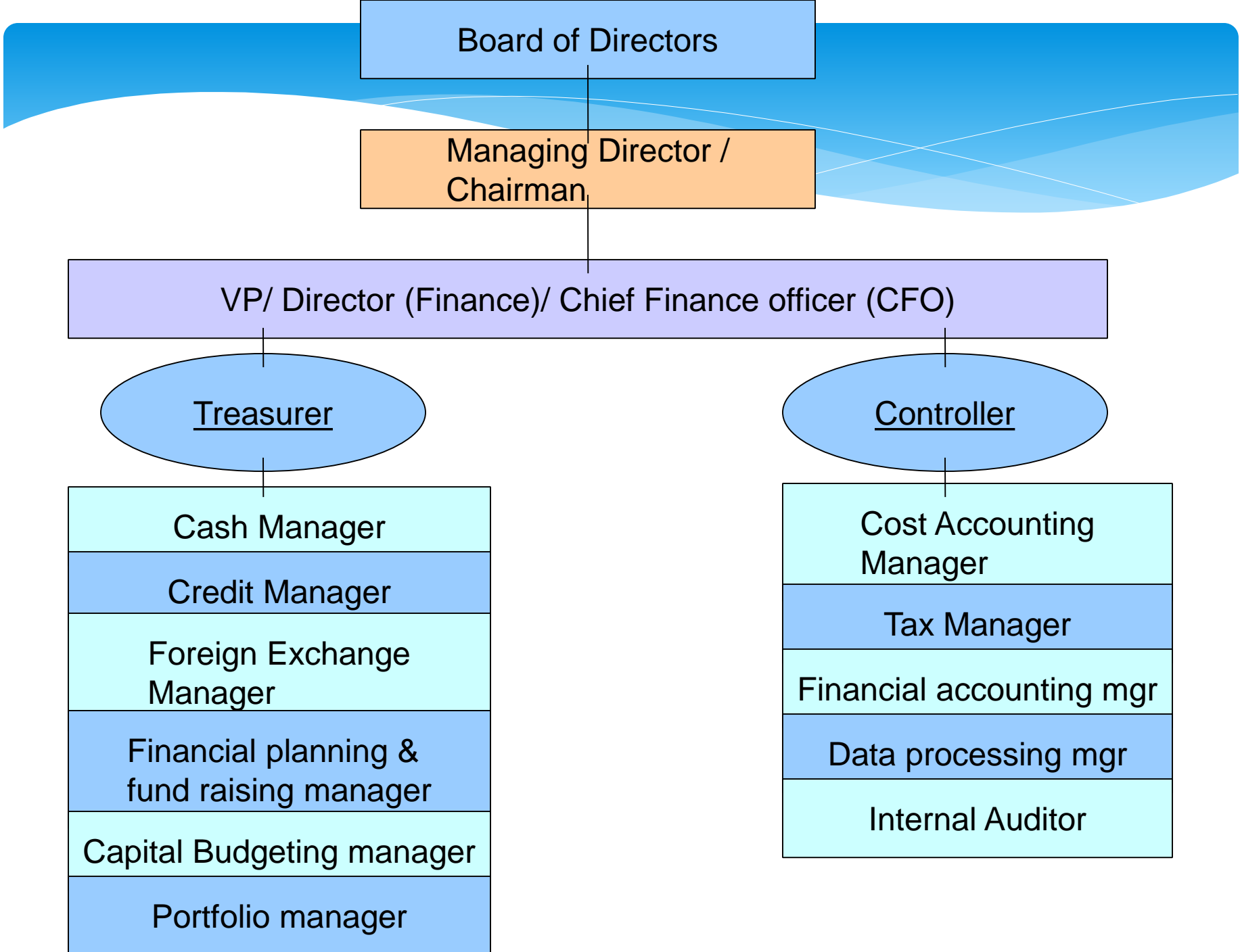
Objective of Financial Management

- * Profit maximization occurs when marginal cost is equal to marginal revenue. This is the main objective of Financial Management.
- * Wealth maximization means maximization of shareholders' wealth. It is an advanced goal compared to profit maximization.
- * Survival of company is an important consideration when the financial manager makes any financial decisions. One incorrect decision may lead company to be bankrupt.

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- Maintaining proper cash flow is a short run objective of financial management. It is necessary for operations to pay the day-to-day expenses e.g. raw material, electricity bills, wages, rent etc. A good cash flow ensures the survival of company.
 - Minimization on capital cost in financial management can help operations gain more profit.



ORGANISATIONAL STRUCTURE



Board of Directors

Managing Director /
Chairman

VP/ Director (Finance)/ Chief Finance officer (CFO)

Treasurer

Controller

Cash Manager

Credit Manager

Foreign Exchange
Manager

Financial planning &
fund raising manager

Capital Budgeting manager

Portfolio manager

Cost Accounting
Manager

Tax Manager

Financial accounting mgr


Data processing mgr

Internal Auditor

Function of Financial Management

Finance functions are carried on to achieve the objective of the firm. There are mainly two approaches to express the "Financial Function". The first approach relates it to the collection of funds. The second approach relates finance functions to the procurements of funds and their effective utilization.

The first ignores the uses of funds it was. It was major finance function at the early stage of the development of finance. The second is comprehensive and universally accepted; we are following the Second One.

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- * **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 programmers and policies of a concern. Estimations have to be made in an adequate manner which increases earning capacity of enterprise.
 - * **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.

Finance Function

Executive Finance Function

Routine Finance Function

1) Investment decision

1) Supervision of cash receipts and disbursements

2) Financial Decision

2) Safeguarding of cash balances

3) Dividend Decision

3) Custody and safeguarding of valuable documents
Like securities and policies


4) Working Capital Decision


4) taking care of mechanical details of financing


5) Record keeping of the financial performance of the Firm.

6) Reporting the top management

7) supervision of fixed assets and current assets

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- **Choice of sources of funds:** For additional funds to be procured, a company has many choices like-
 - Issue of shares and debentures
 - Loans to be taken from banks and financial institutions
 - 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.

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- * **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.
 - * **Disposal of surplus:** The net profits decision have to be made by the finance manager. This can be done in two ways:
 - * Dividend declaration - It includes identifying the rate of dividends and other benefits like bonus.
 - * Retained profits - The volume has to be decided which will depend upon expansion, innovational, diversification plans of the company.

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- **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, maintenance of enough stock, purchase of raw materials, etc.
 - **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.

Responsibility of Financial Manager

* Raising of Funds:

In order to meet the obligation of the business it is important to have enough cash and liquidity. A firm can raise funds by the way of equity and debt. It is the responsibility of a financial manager to decide the ratio between debt and equity. It is important to maintain a good balance between equity and debt.

* Allocation of Funds:

Once the funds are raised through different channels the next important function is to allocate the funds. The funds should be allocated in such a manner that they are optimally used. In order to allocate funds in the best possible manner the following point must be considered

- * The size of the firm and its growth capability
- * Status of assets whether they are long-term or short-term
- * Mode by which the funds are raised

These financial decisions directly and indirectly influence other managerial activities. Hence formation of a good asset mix and proper allocation of funds is one of the most important activity

* Profit Planning

1. Profit earning is one of the prime functions of any business organization. Profit earning is important for survival and sustenance of any organization. Profit planning refers to proper usage of the profit generated by the firm.
2. Profit arises due to many factors such as pricing, industry competition, state of the economy, mechanism of demand and supply, cost and output. A healthy mix of variable and fixed factors of production can lead to an increase in the profitability of the firm.
3. Fixed costs are incurred by the use of fixed factors of production such as land and machinery. In order to maintain a tandem it is important to continuously value the depreciation cost of fixed cost of production. An opportunity cost must be calculated in order to replace those factors of production which has gone through wear and tear. If this is not noted then these fixed cost can cause huge fluctuations in profit.

Understanding Capital Markets:

- * Shares of a company are traded on stock exchange and there is a continuous sale and purchase of securities. Hence a clear understanding of capital market is an important function of a financial manager. When securities are traded on stock market there involves a huge amount of risk involved. Therefore a financial manger understands and calculates the risk involved in this trading of shares and debentures.
- * Its on the discretion of a financial manager as to how to distribute the profits. Many investors do not like the firm to distribute the profits amongst share holders as dividend instead invest in the business itself to enhance growth. The practices of a financial manager directly impact the operation in capital market.

Related Discipline

* Finance and Accounting:

1. The two are embedded with different disciplines. The finance is the discipline which is mainly based on the cash basis of operations but the accounting is totally governed by the accrual system.
2. Accounting is mainly vested with the collection and presentation of data, but the finance is closely connected with the decision making of the organization.
3. Till this moment, the differences are discussed only to know the role of finance over the accounting of any organization. The following is the major relationship which lies in between the finance and accounting as follows "Finance begins where accounting ends"

- * **Finance and Marketing:** These two disciplines are interrelated to plan for introduction of new product. The major reason is that the introduction of new product normally warrants huge sum of money for research and development; which needs immense planning and execution to succeed over the other competitors.
- * **Finance and Production:** The changes in the production policy of the organization will impact the capital expenditures. The fixed assets of the organization should be effectively utilized which neither over capitalization nor under capitalization.
- * **Finance and Quantitative methods:** These are inter related to solve complex problems in order to take decisions.

Meaning of Financial statement

In financial accounting, a **balance sheet** or **statement of financial position** is a summary of the financial balances of an individual or organization, whether it be a sole proprietorship, a business partnership, a corporation, private limited company or other organization such as Government or not for profit entity. Assets, liabilities and ownership equity are listed as of a specific date, such as the end of its financial year. A balance sheet is often described as a "snapshot of a company's financial condition". Of the four basic financial statements, the balance sheet is the only statement which applies to a single point in time of a business' calendar year.

Balance Sheet:

The balance sheet is the critical “what do we have” statement. The balance sheet shows what the company owns (*assets* such as cash, accounts receivable and equipment) and what the company owes (*liabilities* such as accounts payable and loans). Any remaining difference between these two amounts (the assets and the liabilities) shows what belongs to the owners as their *equity interest*. These three amounts should always be in balance (see the fundamental accounting equation). The balance sheet presents a picture of where the company is at a certain point in time.

Components of the Balance Sheet:

The balance sheet contains statements of assets, liabilities, and shareholders' equity. Assets represent things of value that a company owns and has in its possession, or something that will be received and can be measured objectively. They are also called the resources of the business, some examples of assets include receivables, equipment, property and inventory. Assets have value because a business can use or exchange them to produce the services or products of the business.

Liabilities are the debts owed by a business to others—creditors, suppliers, tax authorities, employees, etc. They are obligations that must be paid under certain conditions and time frames. A business incurs many of its liabilities by purchasing items on credit to fund the business operations.

A company's equity represents retained earnings and funds contributed by its owners or shareholders (capital), who accept the uncertainty that comes with ownership risk in exchange for what they hope will be a good return on their investment.

OLD FORMAT OF BALANCE SHEET

Liabilities	Amount (Rs)	Assets	Amount (Rs)
Share capital		Fixed assets	
Add: net profit/less: net loss		Land & building	.....
Less: drawings	Plant & machinery	.....
Long-term liabilities		Furniture & fixtures	.....
Debentures	Vehicles	.....
Loans & advances from banks	Goodwill	.....
Other loans & advances	Investments	.....
Current liabilities		Current assets, loans & advances	
Sundry creditors	Sundry debtors	.....
Bills payable	Cash in hand	.....
Bank overdraft	Cash at bank	.....
Outstanding expenses	Bills receivable	.....
Income received in advance	Prepaid expenses	.....
Provisions		Closing stock	.....
For taxation		
For dividend		

NEW FORMAT OF BALANCE SHEET

BALANCE SHEET

Balance Sheet as at 31st March, 2011

Particulars	Note No	Figures as at the end of current reporting period	Figures as at the end of previous reporting period
I. EQUITY AND LIABILITIES			
(1) Shareholder's Funds			
(a) Share Capital			
(b) Reserves and Surplus			
(c) Money received against share warrants			
(2) Share application money pending allotment			
(3) Non-Current Liabilities			
(a) Long-term borrowings			
(b) Deferred tax liabilities (Net)			
(c) Other Long term liabilities			
(d) Long term provisions			
(4) Current Liabilities			
(a) Short-term borrowings			
(b) Trade payables			
(c) Other current liabilities			
(d) Short-term provisions			
Total			
II.Assets			
(1) Non-current assets			
(a) <i>Fixed assets</i>			
(i) Tangible assets			
(ii) Intangible assets			
(iii) Capital work-in-progress			
(iv) Intangible assets under development			
(b) Non-current investments			
(c) Deferred tax assets (net)			
(d) Long term loans and advances			
(e) Other non-current assets			
(2) Current assets			
(a) Current investments			
(b) Inventories			
(c) Trade receivables			
(d) Cash and cash equivalents			
(e) Short-term loans and advances			
(f) Other current assets			
Total			

Major Difference between Old Schedule VI vs. Revised Schedule VI (Balance Sheet)

S.No.	Particulars	Old Schedule VI	Revised Schedule VI
1	Rounding off of Figures appearing in financial statement	<p>Turnover of less than Rs. 100 Crs - R/off to the nearest Hundreds, thousands or decimal thereof</p> <p>Turnover of Rs. 100 Crs or more but less than Rs. 500 Crs - R/off to the nearest Hundreds, thousands, lakhs or millions or decimal thereof</p> <p>Turnover of Rs. 500 Crs or more - R/off to the nearest Hundreds, thousands, lakhs, millions or crores, or decimal thereof</p>	<p>Turnover of less than Rs. 100 Crs - R/off to the nearest Hundreds, thousands, lakhs or millions or decimal thereof</p> <p>Turnover of Rs. 100 Crs or more - R/off to the nearest lakhs, millions or crores, or decimal thereof</p>
2	Net Working Capital	Current assets & Liabilities are shown together under application of funds. The net working capital appears on balance sheet.	Assets & Liabilities are to be bifurcated in to current & Non-current and to be shown separately. Hence, net working capital will not be appearing in Balance sheet.
3	Fixed Assets	There was no bifurcation required in to tangible & intangible assets.	Fixed assets to be shown under non-current assets and it has to be bifurcated in to Tangible & intangible assets.

4	Borrowings	Short term & long term borrowings are grouped together under the head Loan funds sub-head Secured / Unsecured	<p>Long term borrowings to be shown under non-current liabilities and short term borrowings to be shown under current liabilities with separate disclosure of secured / unsecured loans.</p> <p>Period and amount of continuing default as on the balance sheet date in repayment of loans and interest to be separately specified</p>
5	Finance lease obligation	Finance lease obligations are included in current liabilities	Finance lease obligations are to be grouped under the head non-current liabilities
6	Deposits	Lease deposits are part of loans & advances	Lease deposits to be disclosed as long term loans & advances under the head non-current assets
7	Investments	Both current & non-current investments to be disclosed under the head investments	Current and non-current investments are to be disclosed separately under current assets & non-current assets respectively.

8	Loans & Advances	Loans & Advance are disclosed along with current assets	Loans & Advances to be broken up in long term & short term and to be disclosed under non-current & current assets respectively.
9	Deferred Tax Assets / Liabilities	Deferred Tax assets / liabilities to be disclosed separately	Deferred Tax assets / liabilities to be disclosed under non-current assets / liabilities as the case may be.
10	Cash & Bank Balances	Bank balance to be bifurcated in scheduled banks & others	Bank balances in relation to earmarked balances, held as margin money against borrowings, deposits with more than 12 months maturity, each of these to be shown separately.
11	Profit & Loss (Dr Balance)	P&L debit balance to be shown under the head Miscellaneous expenditure & losses.	Debit balance of Profit and Loss Account to be shown as negative figure under the head Surplus. Therefore, reserve & surplus balance can be negative.
12	Sundry Creditors	Creditors to be broken up in to micro & small suppliers and other creditors.	It is named as Trade payables and there is no mention of micro & small enterprise disclosure.
13	Other current liabilities	No specific mention for separate disclosure of Current maturities of long term debt	Current maturities of long term debt to be disclosed under other current liabilities.
		No specific mention for separate disclosure of Current maturities of finance lease obligation	Current maturities of finance lease obligation to be disclosed.

14	Separate line item Disclosure criteria	any item under which expense exceeds one per cent of the total revenue of the company or Rs. 5,000 whichever is higher; shall be disclosed separately	any item of income / expense which exceeds one per cent of the revenue from operations or Rs. 1,00,000, whichever is higher; to be disclosed separately
15	Expense classification	Function wise & nature wise	Expenses in Statement of Profit and Loss to be classified based on nature of expenses
16	Finance Cost	Finance cost to be classified in fixed loans & other loans	Finance cost shall be classified as interest expense, other borrowing costs & Gain / Loss on foreign currency transaction & translaton.
17	Foreign exchange gain / loss	Gain / Loss on foreign currency transaction to be shown under finance cost	Gain / Loss on foreign currency transaction to be separated into finance costs and other expenses
18	Purchases	The purchase made and the opening & closing stock, giving break up in respect of each class of goods traded in by the company and indicating the quantities thereof.	Goods traded in by the company to be disclosed in broad heads in notes. Disclosure of quantitative details of goods is diluted.



THANK

you

CAREER POINT