Course: MCA Part III

Paper: XVII

Topic: Financial Management and Features

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Financial Management means planning, organizing, directing and controlling the financial activities such as procurement and utilization of funds of the enterprise. It means applying general management principles to financial resources of the enterprise.

Scope/Elements

1. Investment decisions includes investment in fixed assets (called as capital budgeting). Investment 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.

Features

Feature # 1.

Estimating Financial Requirements:

The first task of a financial manager is to estimate short-term and long-term financial requirements of his business. For this purpose, he will prepare a financial plan for present as well as for future. The amount required for purchasing fixed assets as well as needs of funds for working capital will have to be ascertained.

The estimations should be based on sound financial principles so that neither there are inadequate nor excess funds with the concern. The inadequacy of funds will adversely affect the day-to-day working of the concern whereas excess funds may tempt a management to indulge in extravagant spending or speculative activities.

Financial Management: Feature # 2.

Deciding Capital Structure:

The capital structure refers to the kind and proportion of different securities for raising funds. After deciding about the quantum of funds required it should be decided which type of securities should be raised. It may be wise to finance fixed assets through long-term debts. Even here if gestation period is longer, then share capital may be most suitable.

Long-term funds should be employed to finance working capital also, if not wholly then partially. Entirely depending upon overdrafts and cash credits for meeting working capital needs may not be suitable. A decision about various sources for funds should be linked to the cost of raising funds.

If cost of raising funds is very high then such sources may not be useful for long. A decision about the kind of securities to be employed and the proportion in which these should be used is an important decision which influences the short-term and long-term financial planning of an enterprise.

Financial Management: Feature # 3.

Selecting a Source of Finance:

After preparing a capital structure, an appropriate source of finance is selected. Various sources, from which finance may be raised, include: share capital, debentures, financial institutions, commercial banks, public deposits, etc.

If finances are needed for short periods then banks, public deposits and financial institutions may be appropriate; on the other hand, if long-term finances arc required then share capital and debentures may be useful.

If the concern does not want to tie down assets as securities then public deposits may be a suitable source. If management does not want to dilute ownership then debentures should be issued in preference to shares. The need, purpose, object and cost involved may be the factors influencing the selection of a suitable source of financing. Financial Management: Feature # 4.

Selecting a Pattern of Investment:

When funds have been procured then a decision about investment pattern is to be taken. The selection of an investment pattern is related to the use of funds. A decision will have to be taken as to which assets are to be purchased? The funds will have to be spent first on fixed assets and then an appropriate portion will be retained for working capital.

Even in various categories of assets, a decision about the type of fixed or other assets will be essential. While selecting a plant and machinery, even different categories of them may be available. The decision-making techniques such as Capital Budgeting, Opportunity Cost Analysis etc. may be applied in making decisions about capital expenditures.

While spending on various assets, the principles of safety, profitability and liquidity should not be ignored. A balance should be struck even in these principles. One may not like to invest on a project which may be risky even though there may be more profits.

Financial Management: Feature # 5.

Proper Cash Management:

Cash management is also an important task of finance manager. He has to assess various cash needs at different times and then make arrangements for arranging cash.