

Introduction to Financial Management

Chapter Outline

- Concepts & Objectives of Financial Management
- Functions of Financial Management
- Scope and Role of Financial Management
- Capital Structure
- Determination of Capital Requirements

Key Concepts and Skills

Have a good understanding of:

- The basic types of financial management decisions and the role of the financial manager
- The goal of financial management
- The financial implications of the different forms of business organization
- The conflicts of interest that can arise between owners and managers

Basic Areas Of Finance

1. Corporate finance = Business Finance
2. Investments
3. Financial institutions
4. International finance



Introduction

Finance is an important functional area of Business.

It deals with the timely procurement of funds and their effective utilization.

FINANCIAL MANAGEMENT—

It is concerned with the managerial activities related to procurement and utilization of funds for business purpose

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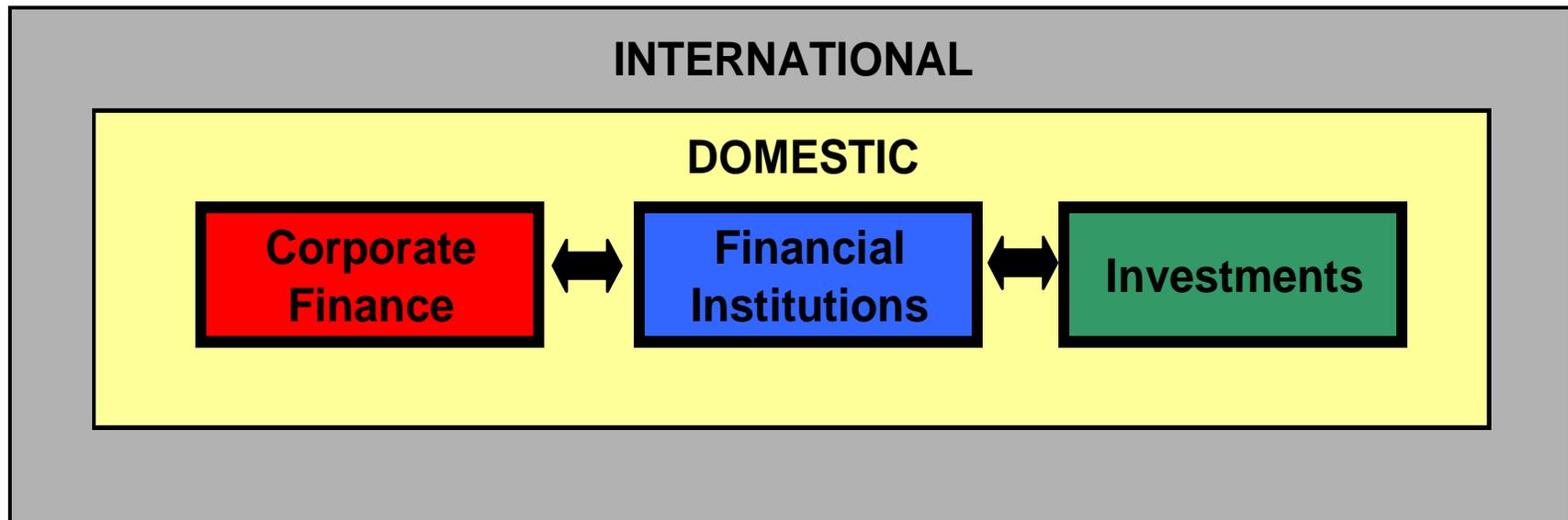
Objectives of F M

1. Procurement of Funds
2. Utilization of funds
3. Optimum capital Structure
4. Return to Shareholders
5. Expansion and Growth
6. Coordination

Functions of Financial Management

1. Formulation of Objectives
2. Estimating of Requirements of Capital
3. Determining the structure of Capital
4. Choice of Sources of Finance
5. Investment Decision
6. Disposal of Surplus
7. Management of Cash
8. Financial Controls

Basic Areas Of Finance



Why Study Finance?

- Marketing
 - Budgets, marketing research, marketing financial products
- Accounting
 - Dual accounting and finance function, preparation of financial statements
- Management
 - Strategic thinking, job performance, profitability
- Personal finance
 - Budgeting, retirement planning, college planning, day-to-day cash flow issues

Business Finance

- Some important questions that are answered using finance
 - What long-term investments should the firm take on?
 - Where will we get the long-term financing to pay for the investments?
 - How will we manage the everyday financial activities of the firm?

Financial Manager

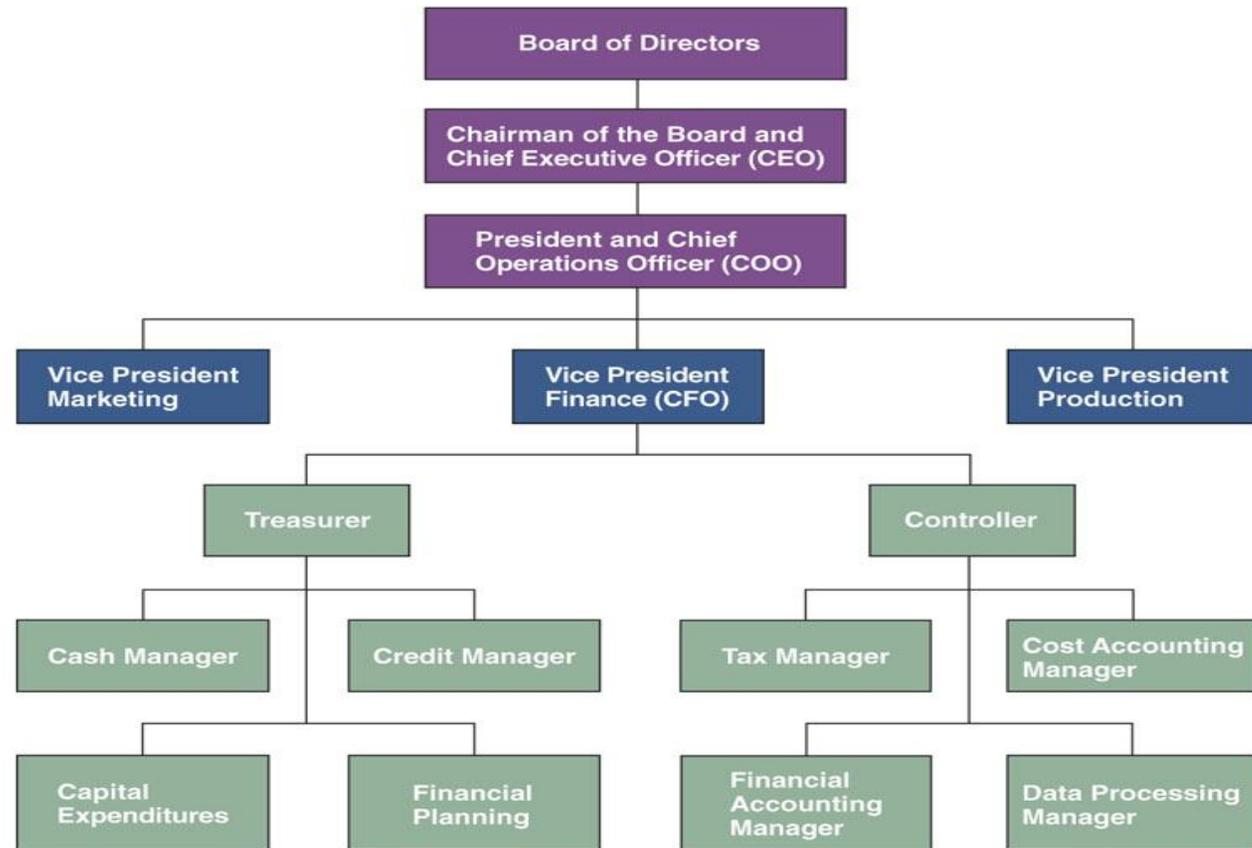
- Financial managers try to answer some, or all, of these questions
- The top financial manager within a firm is usually the Chief Financial Officer (CFO)
 - Treasurer – oversees cash management, credit management, capital expenditures, and financial planning
 - Controller – oversees taxes, cost accounting, financial accounting, and data processing

Corporate Organization Chart

Figure 1.1

FIGURE 1.1

A simplified organizational chart.
The exact titles and organization differ from company to company



Financial Management Decisions

- Capital budgeting
 - What long-term investments or projects should the business take on?
- Capital structure
 - How should we pay for our assets?
 - Should we use debt or equity?
- Working capital management
 - How do we manage the day-to-day finances of the firm?

Scope And Role of Financial Management

- Financial Decisions---
- 1. Investment Decisions
- 2. Working Capital Decisions
- 3. Financing Decisions
- 4. Dividend Decisions

Assignments-

- 1. Define financial management .Explain its objectives and function
- 2. Discuss the scope of financial management.Explain the financial decisions also.

Capital Structure

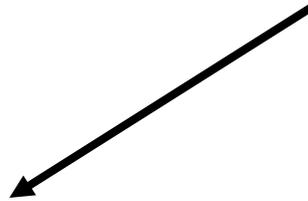
- Meaning:-
- Capital structure refers to the proportion of different kind of securities raised by a firm as long term finance.

Types of Securities:--

1. Equity Shares
2. Preference Shares
3. Long – term Loans(including Debentures)

Shares

- Equity Shares
- Preference Shares



Capital Gearing

- Capital gearing determines the ratio
- Between various type of securities
- And total capitalisation
- - It may be calculated by the determining the ratio between the amount of Equity Capital and the total amount of securities (equity shares , preference shares and debentures) issued by company

Goal Of Financial Management

- What should be the goal of a corporation?
 - Maximize profit?
 - Minimize costs?
 - Maximize market share?
 - **Maximize the current value per share of the company's existing stock**
 - *Maximize the market value of the existing owners' equity*

Goal Of Financial Management

- Does this mean we should do anything and everything to maximize owner wealth?
 - Outsourcing?
 - Off-shoring?
 - Enron?
 - Corporate support of charities?

Factors Affecting Capital Structure:-

1. Trading on Equity
2. Exercise of Control
3. Flexibility of Financial Structure
4. Cost of Financing
5. Period of Financing
6. Statutory Requirements
7. Capital Market Conditions
8. Type of Investors

Sound capital Structure

1. Clear-cut Objectives
2. Balance
3. Safety
4. Control
5. Economy
6. Dynamic

Determinants of Capital Requirements:-

1. Promotional Expenses
2. Cost of Current Assets
3. Cost of Fixed Capital
4. Cost of Financing
5. Cost of Developing Business

➤ Fixed Capital Requirements:-

➤ 1.Nature of Business 3.Manufacturing

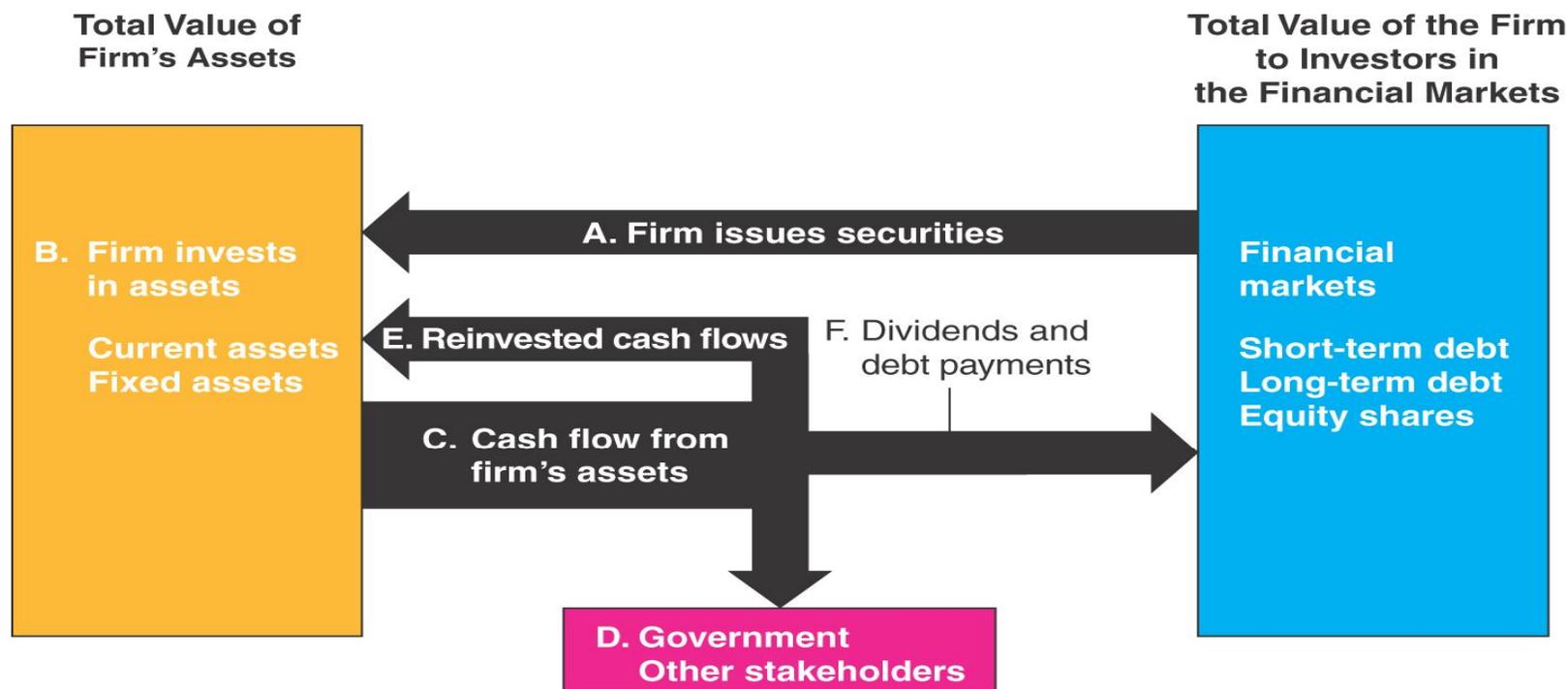
➤ 2. Scale of Operation

Working Capital :---

- Business require working capital for holding current assets like:--
- Stock of materials and finished goods
- Bills Receivable
- Accounts Receivable
- Cash for meeting current expenses like salaries, wages, texes rent etc.

Cash Flows Between the Firm and the Financial Markets

Figure 1.2



- A. Firm issues securities to raise cash.
- B. Firm invests in assets.
- C. Firm's operations generate cash flow.
- D. Cash is paid to government as taxes. Other stakeholders may receive cash.

- E. Reinvested cash flows are plowed back into firm.
- F. Cash is paid out to investors in the form of interest and dividends.

Determinants of Working Capital

1. Nature of Business
2. Volume of Business
3. Time consumed in Manufacturing
4. Turn-over of Working capital
5. Terms of Buying And Selling
6. Current Expenses

Assignments:-

- What are the four basic areas of finance?
- What is capital structure? Describe the factors that determine it.
- What is working capital? Explain three determinants of working capital needs.
- What are the essentials of sound capital structure?