**Semester : VI (UG)**

**Subject : Financial Management**

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**Lecture 1**

**FINANCIAL MANAGEMENT : Meaning**

Finance is the life blood of business. Without adequate finance, no business can survive and without efficient financial management, no business can prosper and grow. Finance is required for establishing, developing and operating the business efficiently. The success of business depends upon supply of finance and its efficient management.

Finance is called science of money. It is not only act of making money available, but its administration and control so that it could be properly utilized. The world “Financial Management” is the composition of two words i.e. “Financial” and “Management”. Financial means procuring or raising of money supply (funds) and allocating (using) those resources (funds) on the basis of monetary requirements of the business. The word “Management” means planning, organizing, coordinating and controlling human activities with reference to finance function for achieving goals/ objectives of organization. Besides raising and utilization of funds, finance also includes distribution of funds in the form of dividend to share holders and retention of profit for growth and developments.

The most popular and acceptable definition of financial management as given by **S.C. Kuchal** is that “Financial Management deals with procurement of funds and their effective utilization in the business”.

**Howard and Upton** : Financial management “as an application of general managerial principles to the area of financial decision-making.

**Weston and Brigham** : Financial management “is an area of financial decision-making, harmonizing individual motives and enterprise goals”.

 **Joshep and Massie** : Financial management “is the operational activity of a business that is responsible for obtaining and effectively util izing the funds necessary for efficient operations.

 Hence, three key areas of finance are:

**I) Raising of funds** – Based on the total requirements of capital/funds for use in fixed assets, current assets as well as intangible assets like goodwill, patent, trade mark, brand etc. crucial decision are:- When to raise (time) - Sources from which to raise - How much (quantum of money) - In which form (debt or equity) - Cost of raising funds

**II) Investment of funds** – Funds raised need to be allocated/ invested in: (i) Fixed assets – also known as capital assets or capital budgeting decision. These decisions are based upon cost and return analysis through various techniques (ii) Current assets – also known on working capital management. These are assets for day today running the business like cash, receivables, inventory, short form investments etc. Decision about investment of funds are taken keeping in view two important aspects - Profitability and Liquidity

**III) Distribution of funds** - Profit earned need to be distributed in the form of dividend. Higher the rates of dividend, higher world be the price of shares in market. Another crucial decision under it would be the quantum of profit to be retained. The retained profit is cost free money to the organization.

**OBJECTIVES OF FINANCIAL MANAGEMENT**

Effective procurement and efficient use of finance lead to proper utilization of the finance by the business concern. It is an essential part of the financial manager. Hence, the financial manager must determine the basic objectives of the financial management. Objectives of Financial Management may be broadly divided into two parts such as:

1. Profit maximization

2. Wealth maximization.

**Profit Maximization**

Main aim of any kind of economic activity is earning profit. A business concern is also functioning mainly for the purpose of earning profit. Profit is the measuring techniques to understand the business efficiency of the concern. Profit maximization is also the traditional and narrow approach, which aims at, maximizing the profit of the concern.

Profit maximization consists of the following important **features**.

1. Profit maximization is also called as cashing per share maximization. It leads to maximize the business operation for profit maximization.

2. Ultimate aim of the business concern is earning profit, hence, it considers all the possible ways to increase the profitability of the concern.

3. Profit is the parameter of measuring the efficiency of the business concern. So it shows the entire position of the business concern.

4. Profit maximization objectives help to reduce the risk of the business.

 **Favourable Arguments for Profit Maximization**

The following important points are in support of the profit maximization objectives of the business concern:

 (i) Main aim is earning profit.

(ii) Profit is the parameter of the business operation.

 (iii) Profit reduces risk of the business concern.

(iv) Profit is the main source of finance.

(v) Profitability meets the social needs also.

**Unfavourable Arguments for Profit Maximization**

The following important points are against the objectives of profit maximization:

 (i) Profit maximization leads to exploiting workers and consumers.

(ii) Profit maximization creates immoral practices such as corrupt practice, unfair trade practice, etc.

(iii) Profit maximization objectives leads to inequalities among the sake holders such as customers, suppliers, public shareholders, etc.

 **Drawbacks of Profit Maximization**

 Profit maximization objective consists of certain drawback also:

 **(i) It is vague**: In this objective, profit is not defined precisely or correctly. It creates some unnecessary opinion regarding earning habits of the business concern.

**(ii) It ignores the time value of money**: Profit maximization does not consider the time value of money or the net present value of the cash inflow. It leads certain differences between the actual cash inflow and net present cash flow during a particular period.

**(iii) It ignores risk**: Profit maximization does not consider risk of the business concern. Risks may be internal or external which will affect the overall operation of the business concern.

**Wealth Maximization**

Wealth maximization is one of the modern approaches, which involves latest innovations and improvements in the field of the business concern. The term wealth means shareholders’ wealth or the wealth of the persons those who are involved in the business concern. Wealth maximization is also known as **Value Maximization** or **Net Present Worth Maximization**. This objective is an universally accepted concept in the field of business.

 **Favourable Arguments for Wealth Maximization**

(i) Wealth maximization is superior to the profit maximization because the main aim of the business concern under this concept is to improve the value or wealth of the shareholders.

 (ii) Wealth maximization considers the comparison of the value to cost associated with the business concern. Total value detected from the total cost incurred for the business operation. It provides extract value of the business concern.

(iii) Wealth maximization considers both time and risk of the business concern.

 (iv) Wealth maximization provides efficient allocation of resources.

(v) It ensures the economic interest of the society.

 **Unfavourable Arguments for Wealth Maximization**

(i) Wealth maximization leads to prescriptive idea of the business concern but it may not be suitable to present day business activities.

(ii) Wealth maximization is nothing, it is also profit maximization, it is the indirect name of the profit maximization.

 (iii) Wealth maximization creates ownership-management controversy.

(iv) Management alone enjoys certain benefits.

 (v) The ultimate aim of the wealth maximization objectives is to maximize the profit.

(vi)Wealth maximization can be activated only with the help of the profitable position of the business concern.