CHAPTER - III

FINANCIAL MANAGEMENT PRACTICE

3.1	INTRODUCTION	55
3.2	MEANING AND NATURE OF FINANCIAL MANAGEMENT	55
3.3	SCOPE OF FINANCIAL MANAGEMENT	57
3.4	FUNCTIONS OF FINANCIAL MANAGEMENT	58
3.5	RATIO ANALYSIS	63
3.6	SOURCES AND USES OF FUNDS	66

CHAPTER III

FINANCIAL MANAGEMENT PRACTICE

3:1 INTRODUCTION :

In this chapter on Financial Management Practices efforts have been made to give its meaning and other theoritical concepts.

3:2 MEANING AND NATURE OF FINANCIAL MANAGEMENT :

Financial Management is that managerial activity which is concerned with the planning and controlling of the firms financial resources. The subject of financial management is of immense interest boths to the academicians and the practicing managers. The practicing managers are interested in this subject because among the most crucial decisions of the firm are those which relate to finance and an understanding of the theory of financial management provides them with conceptual and analytical insights to make these decisions skillfully.

Financial Management, as an intigral part of the over all management, is not a totally independent area. It has got its origin since Industrial Revolution, but it got fully developed in the 18th

Century. It draws heavily on related disciplines and fields of study namely, economics, accounting, marketing, production, and quantitative methods. Management in general deals with the effective procurement and utilisation of basic inputs like men, machines, material and money. Finance is the common thread that passes through a wide spectrum of business activities and management of finance is the key variable that determines the success or failure of any kind of business.

DEFINITIONS :

"Financial Management" has been defined by various authors in various ways. Few are given below:

1) Hogland :- Financial Management deals with how the corporation obtains funds and how it user them".[1]

2) Sherlekar :- "Financial Management is the custodian of corporate funds. It helps to plan, organize and control the finance of the enterprise".[2]

3:3 SCOPE OF FINANCIAL MANAGEMENT :

The three important activities of the business firm are -

(1) Finance,

(2) Production, and

(3) Marketing.

The firm secures capital it needs and employs it (finance activity) and generates returns onthe invested capital (Production and Marketing activity). In otherwords Financial Management is broadly concerned with the acquisition and use of funds by a business firm. Its scope may be defined in terms of -

* How large should the firm be and how fast should it grow.
* What should be the composition of the firms assets.
* What should be the mix of the firms financing.
* How should the firm analyse, plan and control its financial affairs.[3]

The raising of capital funds and using them for generating returns and paying returns to the suppliers of funds are called finance function of the firm.

3:4 FUNCTIONS OF FINANCIAL MANAGEMENT :

Although it may be difficult to seperate the finance functions from production, marketing and other functions, yet the functions themselves can be readily identified. We may identify two kinds of finance functions.

1) Managerial/Executive Finance Function.

2) Routine Finance Function.

In performing managerial finance function, one may require skilful planning control and execution of financial activities. Routine finance function, on the other hand, do not require a great management ability to carry them out.[4]

1) Managerial/Executive Finance Function :

The three important managerial finance functions are investment decision, financing decision and dividend decision.

The investment decision relates to the selection of assets in which funds will be invested

by a firm. The assets which can be acquired full into two groups.

a) Long Term Assets.

b) Short Term or Current Assets.

The asset selection decision of a firm for the first category is known as capital budgeting. The aspect of financial decision making with reference to currnet assets or short term assets is popularly designated as working capital management.[5]

The financing decision of a firm relates to the choice of the proportion of these sources to finance the investment requirements. There are two aspects of the financing decision. First, the theory of capital structure which shows the theoritical relationship between the employment of debt and the return to the shareholders. A proper balance between debt and equity capital is called the optimum capital structure. Thus, one diamension of the financing decision is to have a optimum capital structure, and the other is capital structure decision.[6]

The third major decision of financial management is the decison relating to the dividend policy. The dividend decision should be analysed in

relation to the financing decision of a firm. Two alternatives are available in dealing with the profits of a firm, they can be distributed to the shareholders in the form of dividends or they can be retained in business. The decision will depends upon the preference of the shareholders and the investment opportunities available with the firm.[7]

In addition to the above, he has to keep his watchful eye over the process of production and marketing activities and other functions of the firm. This will enable him to increase the size growth and profitability and risk of the firm and ultimately the value of the firm.

The functions of financial management is to review and control decisions to commit to re-commit funds to new or on-going uses. Thus, in addition to raising funds financial management is directly concerned with production, marketing and other functions with an interprise whenever decisions are made about the acquisition or distribution of asset.[8]

2) ROUTINE FINANCE FUNCTION :

For the effective execution of the managerial finance functions, the incidental or routine

functions have to be performed. A number of economic and enviornment factors, such as the increasing pace of industrialisation, technological innovation and inventions, intense competition increasing intervention of government on account of management inefficiency and failure, populaltion growth and widened, markets etc. during and after mid 1950's necessiated efficient and effective utilisation of the firms resources, including financial resources. Happily the development of a number of management skills and decision - making techniques facilitated to implement a system of optimum allocation of the firms resources. As a result the approach to and the scope of financial management also changed. The emphasis shifted from episodic financing to the managerial financial problems, from raising of funds to efficient and effective use of funds.

The new approach is an analytical way of looking into the financial problems of the firm. Financial management is considered a vital and an intigral part of overall management. "In this broader view the central issue of financial policy is the wise use of funds, and the central process involved is a rational matching of advantages of

potential uses against the cost of alternative potential sources so as to achieve the broad financial goals which an enterprise sets for itself."

In the recurring function it will include, planning for fund, raising of fund, allocation of fund, allocation of income, and control of funds. Some of the important routine functions are -

1) Supervision of cash receipts and payments and safeguarding the cash balance.

2) Custody and safeguarding of securities, insurance policies and other valuable papers.

3) Taking care of the mechanical details of new outside financing.

4) Record keeping and reporting.

Generally, the chief finance executive is mainly involved in the managerial finance functions only at higher level and the routine finance functions are carried out by the employees at lower level i.e. Accountants, Assistants and Other clerical staff.

In this study the general performance is evaluated through ratio analysis technique, and fund

flow statement.

3:5 RATIO ANALYSIS :

The roots of ratio technique can be traced to economic administration and financial management in Ancient India Manu, the great law giver, prescribed in that badding era of human civilization a progressive ratio of fine to be imposed for loss of money altributable to a public servant in successive cases such as 1:1 for the first offence, 2:1 in respect of the second event, 3:1 on the third occasion and so on. The celebrated Indian economist/administrator (Kautilya/Chanakya) had conceived of input - output ratios over 2000 years backs.

MEANING OF RATIO ANALYSIS :

The latin word 'ratio' stands for reason, and so also its derivative 'rationcinari'. In English language rationcinate means to reason, whereas 'ratio' stands for the relation or the proportion of one thing to another. As applied to mathematics, it is the quotient of some quantity divided by another of the same kind. In context of music, the term ratio refers to the relation between vibration

numbers of two tones which may be vital for harmony and melody. This relationship can be fixed or variable in charactor. Ratio analysis is not confined to the four walls of financial management. There are vast and various opportunities for its application to other fields such as, production, personal, marketing and general management.

TYPES OF RATIOS :

There are various types of ratios. These ratios can be grouped into various classes according to the financial activity or function to be achieved. Short term creditors main interest is in the liquidity position or the short term solvency of the firm, long terim creditors, one the other hand are more interested in the long term solvency and profitability of the firm. Similarly, owners concentrates on firms profitability analysis in evaluating every activity of the firms financial condition. Management are interested in evaluating every activity of the firm.

1) Liquidity Ratios.
2) Leverage Ratios.
3) Activity Ratios.
4) Profitability Ratios.

Liquidity ratios measure the ability of the firm to meet its current obligation. A proper balance between the two contradictory requirements i.e. liquidity and profitability is required for effecient financial management.

Leverage ratios shows the proportion of debt and equity in financing the firms assets. As a general rate there should be an "appropriate" mix of debt and equity in financing the firms assets. The use of the fixed charges sources of funds, such as debt and preference copy alongwith the owners equity in the capital structure is described as financed leaverage or trading on equity.

Activity ratios are employed to evaluate the efficency with which the firm managers and utilises its assets. Activity ratios involue a relationship between sales and the various assets, and presume that there exist an aprpriate balance between sales and the various assets.

Profitability ratios measures the overall performance of the firm generally two types of profitability ratios are calculated viz. profitability in relation to sales and profitability

3:6 SOURCES AND USES OF FUNDS :

The statement showing sources and uses of funds popularly known as "fund flow statement" is a condensed report of how the activities of business of enterprises have been financed and how its financial resources have been used during the period covered by the statement. It is an operating statement as it summerises financial activities for a period of time. It shows the ebb and flow of fund in and out of business. The basic purose of this statement is to indicate on a historical basis where funds came from and where they were used.

Financial statements are thus, the condensed form of such "data banks" and the tools and techniques of there appraisal have been evolved to make them more meaningful and useful to their users. These tools and techniques have been tested and refined. They have made the financial statement to serve the society in the way in which they had never served in the past.

REFERENCES

CHAPTER III

1) Saxsena S.C. "Business Administration and Management, Sahitya Bhavan, Agra.

2) Ibid.

3) Prasanna Chandra :- Tata Mc Graw Hill Publishing Company Ltd., New Delhi.

4) Pandey I.M. :- Vikas Publishing House Pvt. Ltd., New Delhi, 1989.

5) Khan M.Y. and Jain P.K. :- Tata Mc Graw Hill Publishing Co. Ltd., New Delhi.

6) Ibid : Page No. 10.

7) Ibid : Page No. 10

8) Ezra Solomon : "The Theory of Financial Management" Columbia University Press 1969 as quoted by Pandey I.M., Ibid Page No. 5.

#######