UNIT 8 INTRODUCTION TO FINANCIAL MANAGEMENT

Structure **Page Nos.**

8.0 INTRODUCTION

Financial Management means planning, organizing, directing and controlling the financial activities such as procurement and utilization of funds of the enterprise. Financial management has various elements that require specific attention or we may call it the scope of financial management as well.

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

8.1 OBJECTIVES

After going through this unit, you should be able to:

- understand the role and scope of financial management,

- understand the evolution of financial management,
- understand the various decisions taken by financial managers, and
- understand the concept of economic and accounting profit.

8.2 EVOLUTION OF FINANCIAL MANAGEMENT

Financial management emerged as a distinct field of study in the present business scenario. The evolution of financial management may be divided into three broad phases:

i) The traditional phase
ii) The transitional phase
iii) The modern phase.

Let us discuss these phases in brief:
In the traditional phase the focus of financial management was on certain events which required funds e.g., major expansion, merger, reorganization etc. The traditional phase was also characterized by heavy emphasis on legal and procedural aspects as at that point of time the functioning of companies was regulated by a plethora of legislation. Another striking characteristic of the traditional phase was that, a financial management was designed and practiced from the outsiders point of view mainly those of investment bankers, lenders, regulatory agencies and other outside interests.

During the transitional phase the nature of financial management was the same but more emphasis was laid on problems faced by finance managers in the areas of fund analysis planning and control.

The modern phase is characterized by the application of economic theories and the application of quantitative methods of analysis. The distinctive features of the modern phase are:

- Changes in macro economic situation that has broadened the scope of financial management. The core focus is how on the rational matching of funds to their uses in the light of the decision criteria.
- The advances in mathematics and statistics have been applied to financial management specially in the areas of financial modeling, demand forecasting and risk analysis.

8.3 SIGNIFICANCE OF FINANCIAL MANAGEMENT

Financial management provides pathways to attain goals and objectives in an organisation. The main duty and responsibility of a financial manager is to measure organizational efficiency through proper allocation, acquisition and management. It provides guidance in financial planning. It assists in acquiring funds from different sources. The main objective of financial management is, to make optimum utilisation of resources which results in maximum profits. The last five decades have witnessed rapid industrial development and policies of globalisation and liberalisation as a result of which financial activities have undergone tremendous changes. The success or the failure of business operations largely depends upon the financial policies pursued by the firm; as **Irwin Friend** has said "a firm's success and even survival, its ability and willingness to maintain production and to invest in fixed or working capital are to a very considerable extent determined by its financial policies both past and present. In modern time where the ownership of firms is more dispersed, there is a separation of ownership and management and the firms are focusing toward social responsibility the role of financial management has spanned beyond planning and control". In the words of **Ezra Soloman** "Financial management is properly viewed as an integral part of overall management rather than as a staff specialty concerned with fund raising operations. In addition to raising funds, financial management is directly concerned with production, marketing and other functions within an enterprise where decisions are made about the acquisition or distribution of assets". The significance of financial management is discussed as follows:

1) **Determination of Business Success:** Sound financial management leads to optimum utilization of resources which is the key factor for successful enterprises. If we analyse the factors which lead to an enterprise turning sick one of the main factors would be mismanagement of financial resources. Financial Management helps in preparation of plans for growth, development, diversification and expansion and their successful execution.

2) **Optimum Utilisation of Resources:** One of the basic objectives of financial management is to measure the input and output in monetary terms. Since finance managers are responsible for the allocation of resources, they are also responsible to ensure that resources are used in an optimum manner. In fact, the failure of business enterprise is not due to inadequacy of financial resources, but is the result of defective management of financial resources. In a country like India, where capital is scarce effective utilisation of financial resources is of great significance.

3) **Focal Point of Decision Making:** Financial management is the focal point of decision-making as it provides various tools and techniques for scientific financial analysis. Some of the techniques of financial management are comparative financial statement, budgets, ratio analysis, variance analysis, cost-volume, profit analysis, etc. These tools help in evaluating the profitability of the project.

4) **Measurement of Performance:** The performance of the firm is measured by its financial results. The value of the firm is determined by the quantum of earnings and the associated risk with these earnings. A financial decision which increases earnings and reduces risk will enhance the value of the firm.

5) **Basis of Planning, Co-ordination and Control:** Each and every activity of the firm requires resource outlays which are ultimately measured in monetary terms. The finance department being the nodal department is closely associated with the planning of most of the activities of the various departments. Since most of the activities of the firm require co-ordination among various departments, the finance department facilitates this co-ordination by supplying the requisite information. Since the results of various activities are measured in monetary terms, again the finance department is closely involved in control and monitoring activities.

6) **Advisory Role:** The finance manager plays an important role in the success of any organisations.

7) **Information Generator for Various Stakeholders:** In this modern era where business managers are trustees of public money, it is expected that the firm provides information to the various stakeholders about the functioning of the firm. One of the major objectives of financial management is to provide timely information to various stakeholders.

8.4 PRINCIPLES OF FINANCIAL MANAGEMENT

Financial management is the process of managing the funds both for individuals and organizations to ensure proper utilization of funds. The principles of financial management work as a guideline for managing financial activities. If you follow the core principles then you will never become financially loser. To get the most benefit from a financial action, the person needs to be careful enough to handle the risk and return trade balance. The broad principles of corporate finance are:

1) Investment Decision
2) Financing Decision
3) Dividend Decision
4) Liquidity Decision

8.4.1 Investment Decision

The firm has scarce resources that must be allocated among competing uses. On the one hand the funds may be used to create additional capacity which in turn generates additional revenue and profits and on the other hand some investments results in lower costs. In financial management the returns, from a proposed investment are compared to a minimum acceptable hurdle rate in order to accept or reject a project. The hurdle rate is the minimum rate of return below which no investment proposal would be accepted. In financial management we measure (estimate) the return on a proposed investment and compare it to minimum acceptable hurdle rate in order to decide whether or not the project is acceptable. The hurdle rate is a function of riskness of the project, riskier the project higher the hurdle rate. There is a broad argument that the correct hurdle rate is the opportunity cost of capital. The opportunity cost of capital is the rate of return that an investor could earn by investing in financial assets of equivalent risk.

8.4.2 Financing Decision

Another important area where financial management plays an important role is in deciding when, where, from and how to acquire funds to meet the firm's investment needs. These aspects of financial management have acquired greater importance in recent times due to the multiple avenues from which funds can be raised. Some of the widely used instruments for raising finds are ADRs, GDRs, ECBs Equity Bonds and Debentures etc. The core issue in financing decision is to maintain the optimum capital structure of the firm that is in other words, to have a right mix of debt and equity in the firm's capital structure. In case of pure equity firm (Zero debt firms) the shareholders returns should be equal to the firm's returns. The use of debt affects the risk and return of shareholders. In case, cost of debt is used the firm's rate of return the shareholder's return is going to increase and vice versa. The change in shareholders return caused by change in profit due to use of debt is called the financial deverage.

8.4.3 Dividend Decision

Dividend decisions is the third major financial decision. The share price of a firm is a function of the cash flows associated with the share. The share price at a given point of time is the present value of future cash flows associated with the holding of share. These cash flows are dividends. The finance manager has to decide what proportion of profits has to be distributed to the shareholders. The proportion of profits distributed as dividends is called the dividend pay out ratio and the retained proportion of profits is known as retention ratio. The dividend policy must be designed in a way, that it maximises the market value of the firm's share. The retention ratio depends upon a host of factors– the main factor being the existence of investment opportunities. The investors would be indifferent to dividends if the firm is able to earn a rate or return which is higher than the cost of the capital. Dividends are generally paid in cash, but a firm may also issue bonus shares. Bonus share are shares issued to the existing shareholders without any charge. As far as dividend decisions are concerned the finance manager has to decide on the question of dividend stability, bonus shares, retention ratio and cash dividend.

8.4.4 Liquidity Decision

A firm must be able to fulfill its financial commitments at all points of time. In order to ensure that the firm should maintain sufficient amount of liquid assets. Liquidity decisions are concerned with satisfying both long and short-term financial commitments. The finance manager should try to synchronise the cash inflows with cash outflows. An investment in current assets affects the firm's profitability and liquidity. A conflict exists between profitability and liquidity while managing current assets. In case, the firm has insufficient current assets it may default on its financial obligations. On the other hand excess funds result in foregoing of alternative investment opportunities.

☞ **Check Your Progress 1**

1. List the three broad phases of evolution of financial management.

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2. List the significance of financial management.

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3. What are the major principles of financial management?

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8.5 OBJECTIVES OF FINANCIAL MANAGEMENT

For optimal financial decisions, it is essential to define objectives of financial management. These objectives serve as decision-criterion. Financing is a functional area of business and, therefore, the objectives of financial management must be in tune with the overall objectives of the business. The main objectives of business are survival and growth. In order to survive in the business and to grow, a business must earn sufficient profits. It must also maintain good relations with investors, employees, customers and other groups of society. Financial management of an organisation may seek to achieve the following objectives:

- ensure adequate and regular supply of funds to the business,
- provide a fair rate of return to the suppliers of capital,
- ensure efficient utilisation of capital according to the principles of profitability, liquidity and safety,
- devise a definite system for internal investment and financing,
- minimise cost of capital by developing a sound and economical combination of corporate securities,

- co-ordinate the activities of the finance department with the activities of other departments of the organisation.

Generally, maximization of economic welfare of its owners is accepted as the financial objective of the firm. But, the question is, how does one maximise the owners' economic welfare? Financial experts differ while finding a solution to this problem. There are two well known criteria in this regard:

i) Profit Maximisation
ii) Wealth Maximisation.

Profit Maximization

The process of increasing the profit earning capability of the company is termed to as Profit Maximization. It is basically a short-term goal and is primarily confined to the accounting analysis of the financial year. It ignores the risk and avoids the time value of money. It is mainly concerned as to how the company will survive and grow in the existing competitive business environment. The very objective of every business enterprise is the welfare of its owners. It can be achieved by the maximisation of profits. Therefore, according to this criterion, the financial decisions (investment, financing and dividend) of a firm should be oriented to the maximisation of profits (i.e. select those assets, projects and decisions which are profitable and reject those which are not profitable). In other words, actions that increase profits are be undertaken and vice versa. Profit maximisation as an objective of financial management can be justified on the following grounds:

1) Rational
2) Test of Business Performance
3) Main Source of Inspiration
4) Maximum Social Welfare
5) Basis of Decision-Making

Drawbacks of Profit Maximisation Concept

1) It is vague
2) It ignores time value of money
3) It ignores risks
4) It ignores social responsibility

From the above description, it can be easily concluded that profit maximisation criterion is inappropriate and unsuitable as an operational objective of financial management. In imperfect competition, the profit maximisation criterion will certainly encourage concentration of economic power and monopolistic tendencies. That is why, the objective of wealth maximisation is considered as the appropriate and feasible objective as against the objective of profit maximisation.

Wealth Maximisation

The ability of a company to increase the value of its stock for the stakeholders is known as Wealth Maximization. It is a long-term goal and involves various external factors like sales, products, services, market share, etc. It assumes the risk and recognizes the time value of money . It is mainly concerned with the long-term growth of the company and hence is concerned more about fetching the maximum chunk of the market share to attain a leadership position.

The objective of profit maximisation, as discussed above, is not only vague and ambiguous, but it also ignores the two basic criteria of financial management i.e. (i) risk and (ii) time value of money. Therefore, wealth maximisation is taken as the basic objective of financial management, rather than profit maximisation. It is also known as 'Value Maximisation' or 'Net Present Value Maximisation'. According to **Ezra Soloman** of Stanford University, the ultimate objective of financial management should be the maximisation of wealth. **Prof. Irwin Friend** has also supported this view.

Superiority of Wealth Maximization

We have discussed the goals or objectives of financial management. Now, the question arises as to the choice i.e., which should be the goal of financial management in decision –making i.e., profit maximisation or wealth maximisation. In present day changed circumstances, wealth maximisation is a better objective because it has the following points in its favour:

- It measures income in terms of cash flows, and avoids the ambiguity now associated with accounting profits as, income from investments is measured on the basis of cash flows rather than on accounting profits.
- It recognises time value of money by discounting the expected income of different years at a certain discount rate (cost of capital).
- It analyses risk and uncertainty so that the best course of action can be selected from different alternatives.
- It is not in conflict with other motives like maximisation of sales or market value of shares. It helps rather in the achievement of all these other objectives.

The key difference between Wealth and Profit Maximization is that Wealth maximization aims at long term objective of the company to increase the value of the stock by increasing shareholders wealth to attain the leadership position in the market, whereas, profit maximization aims at increasing the capability of earning profits in the short run for the survival and growth of the company in the existing competitive market. The difference between both can be viewed as follow:

Basis	Wealth Maximization	Profit Maximization
Definition	It is defined as the management of financial resources aimed at increasing the value of the stakeholders of the company.	It is defined as the management of financial resources aimed at increasing the profit of the company.
Focus	Focuses on increasing the value of the stakeholders of the company in the long term.	Focuses on increasing the profit of the company in the short term.
Risk	It considers the risks and uncertainty inherent in the business model of the company.	It does not consider the risks and uncertainty inherent in the business model of the company.
Usage	It helps in achieving a larger value of a company's worth, which may reflect in the increased market share of the company.	It helps in achieving efficiency in the company's day-to-day operations to make the business profitable.

8.6 ECONOMIC PROFIT VS. ACCOUNTING PROFIT

Accounting and economic profit are two ways to measure a company's earnings. These measurements can help organizational leaders and investors make future business decisions and assess their company's current health. Accounting profit is a company's net earnings on its income statement, whereas economic profit is the value of cash flow that's generated above all other costs. Accounting profit is the net income shown by its Income Statement. The figure includes all revenue the company generates and deducts all expenses. Economic profit differs quite significantly from accounting profit. Instead of looking at net income, economic profit considers a company's free cash flow, which is the actual amount of cash generated by a business. Economic profit is the difference between revenues and costs where costs include both the actual businesses costs like such as wages, material costs, rent, or costs of goods sold (the explicit costs) and the implicit costs. The implicit costs are the payments that are necessary to secure the needed resources, the cost of capital. Basically, implicit costs are the opportunity costs of factors of production that a business already owns. And, implicit costs are what the company would give up to use its resources (e.g., using an asset instead of renting it). Therefore, both can be expressed through equation as follow:

Accounting Profit = Total Revenue – Explicit Costs

Economic Profit = Total Revenue – (Explicit Costs + Implicit Costs)

8.7 AGENCY RELATIONSHIP

When firms are small they usually function as sole proprietorship firms or partnership firms where owner/partners make the decisions. As the volume and complexity of business increases the sole proprietorship partnership firms convert themselves into public limited companies or joint stock companies. With increased geographical spread and other complexities, often it is not possible for owners to look after all the aspects of the business. The decision making power is delegated to the managers (agents). An agent is a person who acts for, and exerts power on behalf of another person or group of persons. The person (or group of persons) whom the agent represents is referred to as the principal. The relationship between the agent and the principal is an agency relationship. There is an agency relationship between the managers and shareholders of a company.

8.7.1 Problems Related with Agency Relationship

In an agency relationship the agent is charged with the responsibility of acting for the principal and in the best interest of the principal. But, it is possible that the agent may act in a fashion which serves his/her own self-interest rather than that of the principal. In recent years we have witnessed numerous corporate frauds i.e. Enron, Xerox, etc., where the agents had misappropriated the authority vested in them by the principal. The problems associated with agency relationship can manifest it in many ways. The most common being the misuse of power and authority by the managers, which includes financial misappropriation, using the funds of the company for the personal self (fringe benefits) etc. In case the reward and compensations are based on certain parameters, for example sales; managers may indulge in practices which would yield result in the short run but prove detrimental in the long run, i.e., overstocking the various intermediaries in the supply chain, offering huge discounts, dumping of goods in the territory of another manager etc. Another facet of this problem is, where managers put a little effort towards expanding and exploring the market for new business. In a nutshell the problem with agency relationship is that the managers act in a fashion which serves their own interest rather than that of the shareholders.

8.7.2 Costs of the Agency Relationship

In order to minimise the potential for conflict between the principal's interest and the agent's interest certain costs are to be incurred by the principal as well as the agent and the cumulative effect of these costs is referred to as the agency costs. Agency costs are of three types: monitoring costs, bonding costs and residual cost.

Monitoring Costs

These are the costs incurred by the principal to monitor and limit the actions of the agent. In companies the shareholders may require the managers to periodically report on their activities via audited financial statements. The cost of resources spent on preparing these statements is monitoring cost. Another example is the implicit cost incurred when the principal limits the decision making power of the agent; by doing so, the principal may miss profitable investment opportunities. The foregone profit is the monitoring cost.

Bonding Costs

These are the costs incurred by the agents to assure the principal that they will act in the best interest of the principal.

Residual Costs

A residual cost is the remaining costs after taking into consideration of the above costs (i.e., monitoring costs, bonding costs).

8.8 THE CHANGING FINANCIAL LANDSCAPE

Every company has various business units that help it function and grow. Of all these departments, it is probably finance that exists even before a company has started working. It is the finance people who decide if a venture is viable and how it can earn revenue to sustain itself. For such an important department, it is essential to have excellent management. Finance is a necessary and critical part of any organization. It is difficult for profit-making or other organizations to sustain themselves for long without proper finances. Apart from this reason, the efficient management of these financial resources is essential to be sustainable and viable in the long run. Financial Management helps organizations to do so. This term refers to the effective and efficient planning, organizing, directing, and controlling the financial activities and processes of an organization. This includes fund procurement, allocation of financial resources, utilization of funds, etc., apart from various other functions.

The past two decades have been witnessing radical changes in the financial system world over. The significant changes which have been taking place over the years are:

a) Low interest rate regime
b) Exchange control and convertibility
c) Development of capital markets
d) Less intermediation
e) Introduction of hybrid financial instruments
f) Increase in risk exposure
g) Volatility in commodity prices
h) Substantial lowering of custom duty (Removal of trade barriers).

These changes coupled with changing customer needs, technology driven innovations and regulatory changes are imposing substantial changes in the financial systems world over.

The impacts of these changes are as follows:

1) Increased competitions have resulted in the rationalization of pricing and costs. Companies having high cost structure are being forced to rationalize operations.
2) National financial system is now more closely integrated with international financial system.

8.9 ORGANISATION OF FINANCIAL MANAGEMENT

You are aware about organizing the activities of an organization as well as organizing the activities within a function. Since Finance function is very vital for every type of organization, it is necessary to set up a sound and efficient organization. No standard organization can be suggested for all the enterprises. Organisation of financial management means the division and the classification of various functions which are to be performed by the finance department. The responsibilities for financial management are spread throughout the organisation in the sense that financial management is, to an extent, an integral part of the job for the managers involved in planning, allocation of resources and control. For instance, the production manager (engineer) shapes the investment policy (proposal of a new plant) the marketing manager/analyst provides inputs in forecasting and planning the purchase manager influences the level of investment in inventories and the sales manager has a say in the determination of receivables policy. Financial management is highly specialized in nature and is handled by various specialists. Financial decisions are of crucial importance. It is, therefore, essential to set up an efficient organisation for financial management functions.
Finance is a major/critical functional area of management, the ultimate responsibility for carrying out financial management functions lies with the top management, that is, board of directors/managing director/chief executive or the cornerstone of the board. However, the exact nature of the organisation of the financial management function differs from firm to firm depending upon factors such as size of the firm, nature of its business type of financing operations, ability of financial officers and the financial philosophy, and so on. In some cases, they are known as finance managers while in others as vice-president (finance), director (finance), and financial controller and so on.

In small organisations where partners or proprietors have main say in the running of the firm, no separate finance department is established. At the most they may appoint a person for book keeping and liasioning with banks and debtors.

In medium size organisations a separate department to organise all financial activities may be created at the top level under the direct supervision of the Board of Directors or a very senior executive. The important feature of this type of set up is that there is no further sub division based on various functional areas of finance.

In large size organisations the finance department is further sub divided into functional areas. In these organisations two main sub-divisions are that of the Financial Controller and the Treasurer. The Financial Controller is concerned with planning and controlling, preparation of annual reports, capital and working capital budgeting, cost and inventory management maintenance of books and records and pay-roll preparation. The treasurer is concerned with raising of funds both short term and long term. In addition to this the treasurer is responsible for cash and receivable management, auditing of accounts, protection and safe keeping of securities and the maintenance of relations with banks and institutions.

8.10 TASKS AND RESPONSIBILITIES OF MODERN FINANCIAL MANAGER

In the modern enterprise, a finance manager occupies a very important position, he being one of the most dynamic members of corporate managerial team. Now a days, his role is becoming more and more pervasive and significant in solving complex managerial problems. Earlier, the role of a finance manager was confined to raising funds from various sources, but due to recent developments taking place in the socio-economic and political scenario throughout the world, he is placed in a central position in the organisation. Finance manager is responsible for shaping the fortunes of the enterprise and is supposed to involve in the most vital decision of allocation of capital like mergers, acquisitions, etc. A finance manager, unlike other members of the corporate team cannot be averse to the fast developments, around him and has to take note of the changes in order to take relevant steps in view of the dynamic changes in circumstances. Financial activities of a firm are one of the most important and complex activities of a firm. Therefore in order to take care of these activities, a financial manager needs to perform various financial activities. The task and responsibilities of finance managers vary from organisation to organisation depending upon the nature and size of the business, but inspite of these variations the main tasks and responsibilities of finance manager can be classified as follows:

a) Compliance with policy and procedures laid by the Board of Directors.
b) Compliance with various rules and procedures as laid by law.
c) Information generation for various stakeholders.
d) Effective and efficient utilisation of funds.

The main tasks and responsibilities of a financial manager are discussed below:

1) **Financial Planning and Forecasting:** Financial manager is also concerned with planning and forecasting of production, sales and level of inventory. In addition to this, he has also to plan and forecast the requirement of funds and the sources from which the funds are to be raised.

2) **Financial Management:** Fund management is the primary responsibility of the finance manager. Fund management includes effective and efficient acquisition, allocation and utilisation of funds. The fund management includes the following:

   - ***Acquisition of funds:*** The finance manager has to ensure that adequate funds are available from the right sources at the right cost at the right time. The finance manager will have to decide the mode of raising fund, whether it is to be through the issue of securities or lending from the bank.

   - ***Allocation of funds:*** Once funds are acquired the funds have to be allocated to various projects and services as per the priority fixed by the Board of Directors.

   - ***Utilization of funds:*** The objective of business finance is to earn profiles, which on a very large extent depend upon how effectively and efficiently allocated funds are utilized. Proper utilisation of funds is based on sound investment decisions, proper control and asset management policies and efficient management of working capital.

3) **Disposal of Profits:** Finance manager has to decide the quantum of dividend which the company wants to declare. The amount of dividend will depend upon mainly the future requirement of funds for expansion and the prevailing tax policy.

4) **Maximisation of Shareholder's Wealth:** The objective of any business is to maximize and create wealth for the investors, which is measured by the price of the share of the company. The price of the share of any company is a function of its present and expected future earnings. The finance managers should pursue policies which maximises earnings.

5) **Interpretation and Reporting:** Interpretation of financial data requires skills. The finance manager should analyse financial data and find out the reasons for variance from standards and report the same to the management. He should also assess the likely financial impact of these variances.

6) **Legal Obligations:** All the companies are governed by specific laws of the land. These laws relate to payment of taxes, salaries, pension, corporate governance, preparation of accounts etc. The finance manager should ensure that a true and correct picture of the state of affairs should be reflected in the statement of accounts. He should also ensure that the tax returns and various other information should be submitted on time.

☞ **Check Your Progress 2**

1. What are the significant changes taking place in the financial system?

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2. List the main tasks and responsibilities of a Financial Manager.

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8.11 SUMMARY

Financial Management has undergone several changes over the last five decades as more and more companies are raising funds from markets both domestic and overseas. The modern phase of financial management is characterized by the application of economic theories and advanced mathematical and statistical tools. Financial management's significance is increasing day by day as it play the role of facilitator among various departments. The objective of the firm has also changed from profit maximization to that of wealth maximization. The agency problem is concerned with how managers behave when, delegated with decision making powers.

8.12 KEY WORDS

Accounting profit is net income earned after subtracting all costs from total revenue. it shows the amount of money a firm has left over after deducting the explicit costs of running the business.

Economic profit is the difference between the revenue a commercial entity has received from its outputs and the opportunity costs of its inputs.

Investment decision relates to as how the funds of a firm are to be invested into different assets, so that the firm is able to earn highest possible return for the investors.

Financing decisions refer to the decisions that companies need to take regarding what proportion of equity and debt capital to have in their capital structure.

Dividend decision determines the division of earnings between payments to shareholders and retained earnings.

Liquidity decision is concerned with the working capital management or current assets management. It is yet another important finance function.

8.13 ANSWER TO CHECK YOUR PROGRESS

☞ **Check Your Progress 1**

1. The three broad phases of evolution of financial management are as follows:

   a) The traditional phase
   b) The transitional phase
   c) The modern phase

2. The significance of financial management are:

   a) Determination of business success
   b) Optimum utilization of resources
   c) Focal point of decision making
   d) Measurement of performance
   e) Basis of planning coordination and control
   f) Advisory role
   g) Information generator for various stakeholders

3. The broad principles of corporate finance are:

   a) Investment Decision
   b) Financing Decision
   c) Dividend Decision
   d) Liquidity Decision

☞ **Check Your Progress 2**

1. The following are the significant changes taking place in the financial system:

   a) Low interest rate regime
   b) Exchange control and convertibility
   c) Development of capital markets
   d) Less intermediation
   e) Introduction of hybrid financial instruments
   f) Increase in risk exposure
   g) Volatility in commodity prices

h) Substantial lowering of custom duty

2. The main tasks and responsibilities of a financial manager are

a) Financial planning and forecasting
b) Financial management
c) Disposal of profits
d) Maximization of shareholder's wealth
e) Interpretation and reporting
f) Legal obligations

8.14 SELF-ASSESSMENT QUESTIONS/EXERCISES

1) "Finance is the life blood of industry." Elucidate this statement with suitable illustrations.

2) What is the finance function? Explain in brief the different approaches (or concepts) to Finance Function.

3) What is Financial Management? How does a modern financial management differ from traditional financial management?

4) What is meant by 'Financial Management'? What are the salient features of Financial Management?

5) Define Financial Management and discuss its main functions.

6) Explain the scope of financial management. What role should the financial manager play in modern enterprise?

7) What do you understand by 'Financial Management'? Discuss its significance in business management.

8) "The importance of financial management has increased in modern times". Elucidate.

9) "Sound Financial Management is a key to the progress for corporation." Explain.

10) "Without adequate finance no business can survive and without efficient financial management, no business can prosper and grow." Comment on this statement bringing out the role of financial management.

11) Discuss the objectives and goals of Financial Management.