MANAGING FINANCE

Learning Outcomes

By the end of this unit the learner will be able to:

- ✓ Analyze the role of finance in modern business
- ✓ Evaluate the financial controls of an organization
- ✓ Evaluate the various functions of financial management for an organization

Managing Finance

Financial Management can be defined as a branch of management that deals with the effective use of financial resources in an organization. The work of financial management is to plan, organize and control the use of the funds available for business, and to help the business firm in gaining funds for its operation, and utilize them effectively.

Any actions taken by this management has one end goal, and that is to promote the finances of its business. As such, it is crucial to every business, one cannot work or progress without financial management.

This unit covers the scope, objectives, and functions of financial management, but first it is important to note its basic responsibility and the requirement for planning of funds in this management.

Financial Management attributes of organizations are no longer prerogative and sole responsibility of the higher ranks of management, but are now the everyday accountability of all managers. Imagine a company without cash. It cannot afford to acquire essential assets such as people, materials, or equipment, needed for a business to function and to earn profits.

Financial management involves managing the firm's internal cash flows and its mix of debt and equity financing to maximize the value of the debt and equity claims on the firm to ensure that the company can pay off its obligations when they become due.

Financial managers have the primary responsibility for acquiring monetary resources needed by a firm and for utilizing those monetary resources into projects that will maximize the value of the firm for its owners.

Financial Responsibility & Accountability

Financial management of any organization is financially responsible and accountable to that organization. ~~A~~ Financial Management is accountable to the board of directors, or the head of that organisation, and must report (whenever they call for it) the current budget of the organization, the money that is being spent, the money that is earned, when the management expects to earn and spend the money, and also the assets and the liabilities to the heads of the organisation. Its financial responsibilities include:

- Creating a reasonable budget for the business that would clearly express the goals of the business, the finances required to achieve these goals, and the various sources of funds.
- Generating the funds for the organisation either through external or internal sources and to ensure that it has enough funds to carry on its objectives.
- Ensuring that the organization does not get side tracked or bites off more than it can chew, in financial terms, i.e.: to ensure that it does not accept obligations that would require funds that are not available.

- Paying the various bills, taxes, and clear the financial obligations of the organization on time, and to ensure that enough funds are set aside for this purpose.
- Maintaining a proper and comprehensive record of the funds and the financial activities and decisions of the business. For instance, to divide funds acquired in such a way that it would please the various shareholders, and also keep enough funds for further operations, future projects, and to pay the various sources and elements of production.
- Reporting to the various heads of the organisation, the avenues, current status and the use of the finances.
- Ensuring that the money is being spent in proportion with the income, and if not, to immediately rectify the expenditures.

Investment Avenues

The financial manager recommends the best possible avenues for investments that are safe, so that the company raises profits on a regular basis.
A good financial management branch creates strong financial stability throughout the organization, protects them from the uncertainties in the world of business with constant risks and threats to the economy, prices of materials, and the growing interference of crime and politics.

Planning for Funds

Financial planning is the process of meeting of the goals through proper management of finance. The financial management of any organisation requires a good level of planning. Financial planning deals with the sources, investment, and administration of the capital.
Financial planning begins by making a clear and researched estimation on the amount of money required to carry out the operations within a set period of time. Then, it is important to determine the sources for the funds and its competition.
It is important to plan the finances as it would then help in effectively controlling the funds. This involves overseeing the fund distribution by making short term and long term financial plans.
A financial planner creates a budget that would cover the sudden increases or hikes in prices, and create stability within the organization in spite of the many uncertainties of the financial world. For example, buying a particular investment might help pay off a mortgage faster or might delay retirement significantly.
Financial managers must plan of ways to protect and to increase the business's competitive advantage in its various target markets.

The planning of finances is undertaken with the following objectives in mind:

- To spend funds in such a way that there is no wastage and that there are maximum returns on the investment of these funds, irrespective of the organization's funds being scarce or plenty

- To determine the capital or the funds required in both long term as well as short term projects. This means determining the expenses on the various factors of production for all projects. For instance, the changes that may occur in the cost and the market of various units of production and the expenses required for the functions aside from production,
- To create a system or a policy which deals with the efficient and planned distribution of profits, and makes decisions on where, why and how many funds go to various parties, and controls the current funds.

Scope of Financial Management

Financial management can be broken down into three major areas: the investment decisions, the financial decisions, and the asset management.

- ### Investment Decisions

  Investment decisions are the most important of the firm's three major decisions. It begins with the determination of the total amount of assets needed to be held by the firm.Investment decisions are often supported by decision tools. The modern portfolio theory is often applied to help the investor achieve a satisfactory return compared to the opportunity costs.

  The modern portfolio theory aims at gaining the most from the expected portfolio returns despite the given amount of portfolio risk. On the other hand, the theory explains that one can minimize risk for a given level of expected return. This is done by carefully choosing the proportions of various assets.

- ### Financing Decisions

  The financial manager is concerned with the makeup of the right-hand side of the balance sheet. In addition, dividend policy must be viewed as an integral part of the firm's financing decision. The dividend pay-out ratio determines the amount of earnings that can be retained in the firm. Retaining a greater amount of current earnings in the firm means that a little money will be available for current dividend payments. The value of the dividends paid to stockholders must therefore be balanced against the opportunity cost of retained earnings lost as means of equity financing.

- ### Asset Management

  Once assets have been acquired and appropriate financing provided, these assets must still be managed efficiently. The financial manager is charged with varying degrees of operating responsibility over existing assets.

  These responsibilities require that the financial manager be more concerned with the management of current assets than with that of fixed assets.

Objectives of Financial Management

The main objective of the financial management is to gather, manage, and spend money of the company effectively, so that it can gain profits and prosper. Here are the objectives undertaken by this management:

- ✓ Preserve assets.
- ✓ Proper Credit Management.
- ✓ Increase shareholder value over time.
- ✓ Exercise good risk management in investing.
- ✓ Control costs.
- ✓ Create a plan of work that is balanced in its expenditure and in its income.
- ✓ Profit maximization through minimum expenditure of acquired funds in such a way that there is no unnecessary cost and the returns derived from the investments of the business are in the max.
- ✓ Increase wealth by making investments in projects or organization that provide a maximum return, and to ensure that the investment is safe.
- ✓ Provide adequate insurance protection against personal risk of death, disability, income loss, medical care, property and liability, and unemployment.

Functions of Financial Management

- ### Financial Forecasting

Typically, financial forecasting reflects on what will happen to a company's cash flow and capital either in short-term, midterm, or long-term. Therefore, it is a foundation which influences the firm in decision and policy making and prepares it for the next years.
It makes decisions on the investments of the funds of the organization. An investment means putting our efforts, interests, or resources into a particular proceeding in the hope of gaining a profit.
The forecasting methods provide the means for a business to express its goals and focus areas and to ensure that they are aligned to the company's vision and mission. It also facilitates the business in determining the asset requirements and needs for external finances.
In general, financial forecasting is a reliable tool to determine whether the business will succeed or fail or incur gains or losses.

- ### Capital Budgeting

Capital budgeting or investment appraisal is the process of planning expenditures on assets in which cash flows are expected to operate further than one year.

Through this, a business decides whether projects such as building a new plant or investing in a long-term venture are worth pursuing. Often times, a feasible project's lifetime cash inflows and outflows are assessed in order to determine whether the returns generated meet a satisfactory target benchmark. This aspect also involves making decisions relating to the various sources of finance, the time required to acquire the funds, the type of the source of finance, the duration for which it would finance the organization, the amount that it would contribute, and the means to return the funds to the source.

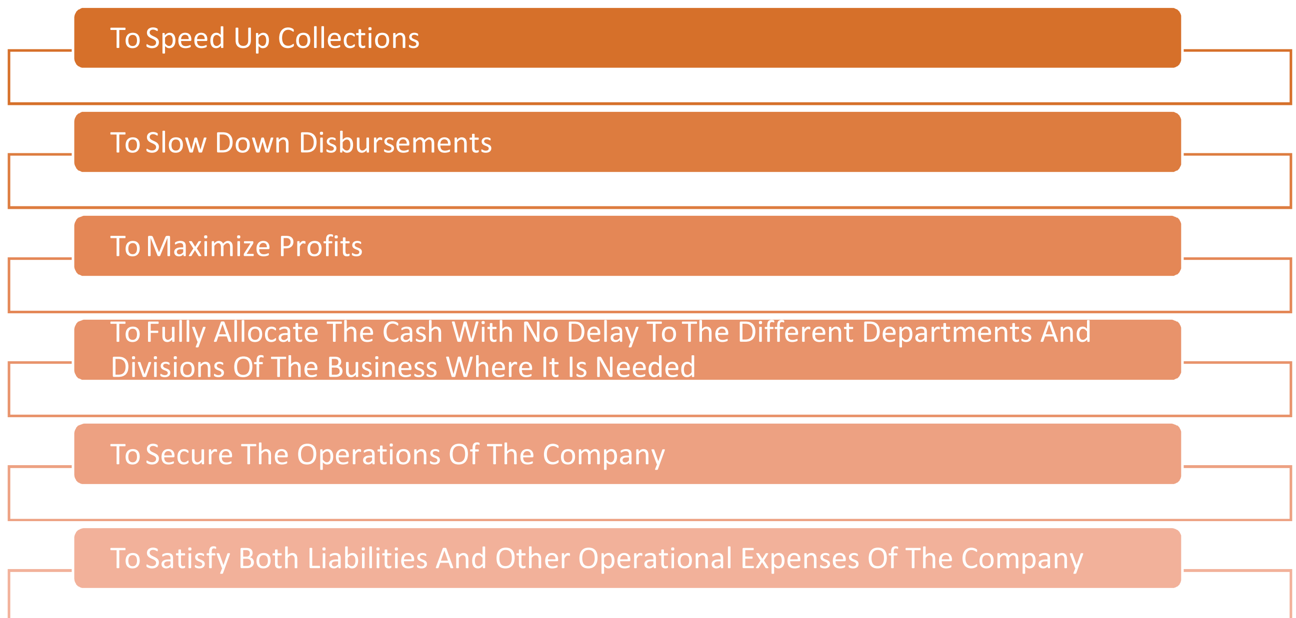
The commonly used methods of capital budgeting include net present value (NPV), internal rate of return (IRR), discounted cash flow (DCF), and payback period.

- ## Capital Management

Capital management involves strategies that strive to maintain sufficient and equal levels of working capital, current assets, and current liabilities.

This helps a company to attend total expense obligations while also managing and tracking cash flows that are related to short-term financial decisions.

The following are the goals of capital management:



- ## Risk Management

Risk management is the process of identifying, analyzing and minimizing the uncertainties in investment decision-making.

Fundamentally, risk management commences anytime an investor or fund manager analyzes and quantifies the potential gains and losses in an investment and executes the appropriate actions and omissions based from their investment objectives and risk tolerance.

Inadequate risk management can result in severe consequences for companies as well as to its individual workers. For instance, the recession that began in 2008 was largely caused by the failure of the credit risk management of the directly involved financial firms.

- **Accounting**

Accounting in financial management includes creation of financial statements, cash flow reports, capital statement, and etc. Such reports will be used to provide information about the business' performance not only within the company but also to third parties such as investors, creditors, and government to ensure the business' profitability and solvency. It will also serve as one of the real and concrete bases for the next financial decision making. They must distribute the finances in such a way that there is enough left over for profit even after taking care of the wages of workers, bills of the factories and offices, returns to the sources and shareholders, any debt payment, production costs, etc. A financial manager must control the expenditures of the organisation along with managing and procuring funds.

- **Credit Management**

Credit management is concerned with decision making on credit limits, acceptable levels of risk, and terms of payment to their customers. Simply put, it is the process for controlling and collecting payments from customers.

An effective credit management system helps in reducing the amount of capital against the debtors and protects the company's good credit standing and good credit management practices from bad debts.

Further Reading:

- ✓ *Introduction to Finance: Markets, Investments, and Financial Management. John Wiley & Sons, 15 Jun 2011. By Ronald W. Melicher*