FINANCIAL MANAGEMENT-AN OVERVIEW

FINANCIAL MANAGEMENT

It refers to the strategic **planning, organizing, directing, and controlling** of an organization's financial resources to achieve its goals and objectives effectively.

FORMS OF BUSINESS ORGANISATION

FORMS OF BUSINESS ORGANISATION

- Sole Proprietary
- Partnership Firm
- Limited Liability Partnership
- Hindu Undivided Family (Huf)
- Company
- Association Of Persons
- Body Of Individuals
- Co-operative Society

SOLE PROPRIETARY

It is a business structure where a **single individual owns and operates the business**. It has **no legal separation** between the owner and the business itself.

PARTNERSHIP FIRM

It is a form of business organization **where two or more individuals come together to carry out a business** venture with the intention of making a profit

LIMITED LIABILITY PARTNERSHIP (LLP)

- It is a legal business structure that **combines elements of partnerships and limited liability companies**.
- In an LLP, **partners have limited liability** for the debts and obligations of the partnership.

Hindu Undivided Family (HUF)

- It is a legal entity that consists of a **group of individuals from the Hindu religion**, usually **belonging to the same family,** who come together to form a joint family and pool their income and assets
- The firm is owned by the **members of undivided Hindu family**, **called co-parceners**. The business of an HUF is typically managed by the senior-most male member, also known as **Karta or Manager**

COMPANY

- A company is an **association of persons** who contribute money or money's worth to a common stock and **use it for a common purpose.**
- A company is considered a legal entity created by law, **separate and distinct from its members or shareholders**.

ASSOCIATION OF PERSONS

- This is a **group of individuals or entities** who come together for a **common purpose or to carry out a specific activity**.
- Members of the AOP can be **natural or artificial persons**.

BODY OF INDIVIDUALS

It is a group or association of individuals (natural persons) who come together for a **common purpose or objective.**

FINANCIAL DECISIONS IN A FIRM

These decisions mainly related with the **acquisition and utilization of financial resources** in meeting the financial needs and overall objectives of the firm.

ESTIMATING THE CAPITAL REQUIREMENTS

Capital requirements are estimated based on **organizational objectives and investment needs** in fixed assets and working capital.

DECIDING THE CAPITAL STRUCTURE/COMPOSITION

Finance executives are responsible for deciding the capital composition, including determining the **appropriate proportions of owner's risk capital and borrowed capital**.

DECIDING ON SOURCES OF FUNDS

- Identifying the best available **sources of funds based on the capital structure decision.**
- Sources of funds include **equity or preference issue, public deposits, debentures, or term loans**.

USE OF LONG-TERM FUNDS

- Long-term investment decisions **involve selecting capital assets or investment proposals** with long-term benefits.
- Decisions may include **acquiring new assets or replacing old ones** based on benefits and returns.

CORPORATE STRATEGY/MERGERS AND ACQUISITIONS

- The growth strategy of an organization can encompasses both **organic and inorganic approaches**.
- **Mergers and acquisitions** provide faster expansion by acquiring other firms' businesses

USE OF SHORT-TERM FUNDS/WORKING CAPITAL MANAGEMENT

- It is concerned with the management of the **current assets and liabilities of the firm.**
- The primary objective in working capital management is to **find a balance between profitability and liquidity.**

FINANCIAL CONTROL

- Financial activities are continuously **monitored to identify inefficiencies and take corrective action**s.
- Techniques like ratio analysis, costing, and budgetary control are used for financial control.

DECISION OF DIVIDEND/RETAINED PROFIT

- The decision regarding **the distribution of profits as dividends** and retention for expansion or other financial needs is made.
- Shareholder interests and organizational objectives are considered in the decision-making process.

TYPES OF FINANCIAL DECISIONS

INVESTMENT DECISION

It is concerned with **how the firm's funds are invested in different assets**. Investment decision can be **long-term or short-term.**

FINANCING DECISION

It is concerned with how finance **to be raised from various long-term sources** of funds like, **equity shares, preference shares, debentures, bank loans etc**.

DIVIDEND DECISION

It is concerned with deciding how much of the **profit earned by the company should be distributed among shareholders** (dividend) and how much should be retained for the future contingencies (retained earnings) is called dividend decision.

FUNDAMENTAL PRINCIPLES OF FINANCE

Principles act as a guideline for investment and financing decisions.

TIME VALUE OF MONEY

- The principle of the time value of money recognizes that the **value of money decreases over time.**
- The value of **100 rupee today** is considered **higher than the value of 100 in the future due** to the impact of inflation and other factors.
- The **required rate of return** on investments should exceed the inflation rate to ensure that the returns earned can offset the loss in purchasing power caused by inflation.

OPPORTUNITY COST OF MONEY

It refers to the **potential return or benefit that is foregone** by choosing to allocate funds towards a particular investment or expenditure instead of pursuing an alternative option.

RISK AND RETURN

- The principle of Risk and Return emphasizes that investors **need to consider both risk and return.**
- In any investment **higher the risk higher the rates of return**, and the lower the risk, the lower the rates of return.
- When it comes to **business financing**, it is important to **assess the return potential in relation to the associated risk**.

LIQUIDITY AND RETURN

- The principle of liquidity and return states that **investments with higher liquidity tend to offer lower return**s, while investments with higher returns often come with lower liquidity.
- This principle is based on the concept that investors require **compensation in the form of higher returns for giving up liquidity**.

DIVERSIFICATION

The principle of diversification suggests that it is preferable to **spread the risk across multiple investments** rather than concentrating all the funds in one or a few investments.

REDUCING ASSET-LIABILITY MISMATCH/HEDGING

The principle suggests that it is advisable, to the extent possible, to **match long-term funding requirements with long-term sources** and fulfil short-term funding needs using short-term sources.

RISK-RETURN TRADE OFF

- It suggests that investments with higher expected returns generally come with higher levels of risk, and vice versa.
- A **proper balance between return and risk** should be maintained to get optimum return from the investment.
- Such balance is called Risk-Return Trade off and every financial decision involves this trade off.

REQUIRED RATE OF RETURN

It refers to the **minimum return an investor expects** to achieve in exchange for taking on the risk **of investing in a particular asset or project.**

Required Rate of Return = Risk-free Return + Risk Premium

AGENCY PROBLEM IN FINANCIAL MANAGEMENT

AGENCY

Agency is a legal relationship, where **one person appoints another to perform on the transactions on his behalf**.

PRINCIPAL

The person **who appoints the other** to take care of his transactions is the principal.

AGENT

The person **who looks after the transaction of the principal** is the agent.

AGENCY PROBLEM

- When agents **don't properly represent the best interests of principals**, it creates an agency problem.

- A conflict of interest occurs when responsible **people misuse their authority and power for personal benefits**

TYPES OF AGENCY PROBLEM

- Shareholders v/s management
- Shareholders v/s creditors
- Majority shareholders' v/s minority shareholders
- Shareholders v/s other stakeholders

Mitigating the Agency Problem in an Organization

- Ensuring complete **transparency across all operations** to reduce information asymmetry.
- Implementing **restrictions or limitations on the decision-making authority** of agents/managers.
- Establishing a **compensation structure for agents** that is directly linked to the financial gains or performance of the principals.

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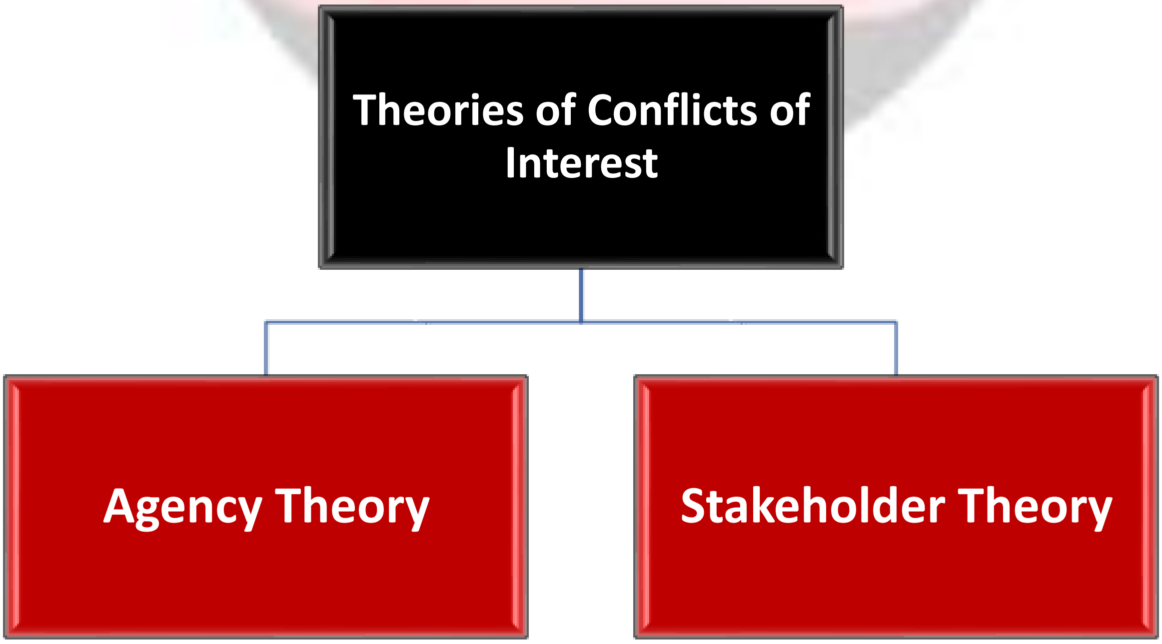
- Aligning CEO **compensation directly** with the **performance of the company's stock price.**
- Regulating **principal-agent relationships** through **contractual agreements.**

THEORIES OF CONFLICTS OF INTEREST

- These theories are **conceptual frameworks or models** that help explain the **underlying causes and dynamics of conflicts of interest**.
- These theories aim is to provide insights into **why conflicts of interest occur,** how they manifest, **and potential strategies to manage or mitigate them.**



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Agency Theory

- It examines conflicts of interest that arise when **there is a separation between ownership and control in an organization**.
- It focuses on the **relationship between principals and agents** and explores how conflicting goals and incentives can lead to agency conflicts.

Stakeholder Theory

- This theory considers conflicts of interest that emerge due to the **competing interests of different stakeholders** such as shareholders, employees, customers, suppliers, in an organization.
- It emphasizes the importance of **balancing the needs and interests of all stakeholders** to achieve long-term sustainability.

BUSINESS ETHICS & SOCIAL RESPONSIBILITY

ETHICS

It refers to the **moral principles and values** that guide individuals and organizations in determining **what is right and wrong**, and in making decisions that affect others.

BUSINESS ETHICS

- It refers to the **moral principles and values** that guide the behaviour and **decision-making process within an organization**.
- It involves conducting **business activities with integrity, fairness, and responsibility** towards various stakeholders.

IMPORTANCE OF BUSINESS ETHICS

Enhancing reputation and Trust

- Ethical business practices help build a **positive reputation for an organization.**
- When a company consistently demonstrates **integrity and ethical behaviours, it earns the trust and loyalty**.

Customer Loyalty and Satisfaction

Ethical business **practices help build customer loyalty**, increase customer satisfaction, and drive positive word-of-mouth recommendations.

Attracting and retaining employees

Ethical companies tend to **attract top talent and have higher employee retention rates**.

Positive impact on society and the environment

- Ethical business practices contribute to the **overall well-being of society and the environment.**
- By embracing sustainable practices, **minimizing waste and pollution** can make a positive impact on society.

PRINCIPLES OF CODE OF CONDUCT/ETHICS

- Honesty
- Integrity
- Loyalty
- Fairness
- Empathy
- Respect
- Compliance
- Leadership
- Reputation
- Responsibility
- Trustworthiness

SOCIAL RESPONSIBILITY

- It refers to the **ethical obligations and actions** that organizations have towards society and the environment.
- It is the commitment of businesses to **operate in a way** that benefits not only their own interests but also the **well-being of the broader community.**

Legal aspects of Corporate Social Responsibility (CSR)

- Under the Companies Act, 2013 in India, companies are legally obligated to **spend at least 2% of their average net profits from the previous three financial years** on Corporate Social Responsibility (CSR) activities in the current financial year.
- Section 135 of the Companies Act, 2013 outlines the statutory obligations and provides a list of activities that companies can undertake as part of their CSR initiatives.

Q:1 Financial management focuses on the optimal use of financial resources to achieve a company's goals and

objectives. Financial management is mainly concerned with______

a) All aspects of acquiring and utilizing financial resources for firms' activities
b) All aspects of acquiring financial resources but not their utilization for firms' activities.
c) The utilization of financial resources but not their acquisition for firms' activities.
d) Primarily the management of non-financial resources within the firm.

Q:2 Financial management encompasses a wide range of activities related to the acquisition, allocation, and utilization of funds in an organization. The ultimate aim of financial management is_______.

I. To maximize the value of the firm
II. To minimize the cost of capital

III. To ensure the availability of funds

IV. To reduce financial risks to zero

a) I, III, IV

b) II, III, IV

c) I, II, IV

d) I, II, III,

CASE STUDY ON FORMS OF BUSINESS ORGANISATION

Q: 1 Which of the following statement is correct regarding Sole proprietorship?

I. It is a type of firm owned and run by one person.

II. There is a legal distinction between the owner and the firm.

III. The owner is personally liable for all the debts and obligations of the business.

IV. It faces limitation of capital as the resources of the proprietor are limited.

a) I, III, IV

b) II, III, IV

c) I, II, IV

d) I, II, III,

Q: 2 A partnership firm is a type of business entity where two or more individuals come together to carry out business activities with a common goal of earning profits. Which of the following statement is not correct regarding Partnership Firm.

a) The relationship between partners, including their rights, duties, profit-sharing ratios, and other terms, is typically governed by a partnership agreement.

b) Partners share the management and decision-making responsibilities of the business. The extent of each partner's involvement can vary depending on the partnership agreement.

c) A partnership firm does not have a separate legal identity from its partners, meaning the firm and its partners are legally the same entity.

d) Partners usually have limited liability, meaning they are not personally responsible for the firm's debts and obligations.

Personal assets cannot be used to settle business debts if necessary.

Q: 3 Which of this statement defines HUF?

I. HUF is a form of business is governed by the provisions of the Hindu Law.

II. It comes into existence by birth in a Hindu family and no contract and agreement is required.

III. HUF holds joint ownership of the business property, and the head of the family is known as the Karta.

IV. For the sake of income tax, the HUF is considered as a separate entity and is taxed separately

a) I, III, IV

b) II, III, IV

c) I, II, IV

d) I, II, III, IV

Q: 4 Which of this statement is not correct regarding Limited liability partnership?

a) It is introduced in India by Limited Liability Partnership Act, 2008.

b) Partnership in which some or all partners have limited liabilities.

c) There is no legal distinction between the owner and the firm.

d) All of the above

Q:3 Investment decision is concerned with how the firm's funds are invested in different assets. Investment decision can be long-term or short-term. Which of the following is an example of an investment decision?

I. Purchasing new machinery.

II. Acquiring a new business.

III. Issuing equity shares.

IV. Research and development projects.

a) I, III, IV

b) II, III, IV

c) I, II, IV

d) I, II, III, IV

Q:4 Financing decision involves determining the best capital structure for a firm. Which of the following is a financing decision?

a) Choosing between different investment projects

b) Deciding the amount of profit to retain

c**)** Issuing new shares to raise capital

d) Analysing the profitability of a new product

Q:5 The Time Value of Money (TVM) refers to the concept that money available today is worth more than the same amount in the future due to its potential earning capacity. What does the Time Value of Money suggest about the required rate of return on investments?

a) It should be lower than the inflation rate

b) It should be equal to the inflation rate

c) It should be higher than the inflation rate

d) It should be adjusted for currency fluctuations

Q:6 Imagine you have 500000 to invest. Instead of putting all your money into a single stock or sector. You allocate

20,0000 to invest in stocks of different companies,15,0000 in government and corporate bonds,10,0000 towards real estate investment trusts (REITs) that invest in commercial properties. To further diversify, you invest 5,0000 in commodities such as gold and silver. This investment strategy explain which principle ?

a) Risk And Return

b) Liquidity And Return

c) Diversification

d) All of the above

Q:7 Financial control refers to the process of monitoring and managing the financial activities of an organization to minimize financial risk and to ensure they align with established goals, plans, and policies. Which of the following techniques are used for financial control?

I. Costing

II. Budgetary control

III. Ratio analysis

IV. Human Resource Management

a) I, III, IV

b) II, III, IV

c) I, II, IV

d) I, II, III,