



RAMA UNIVERSITY

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FACULTY OF COMMERCE AND MANAGEMENT

COURSE: B.COM V SEM.

SUBJECT: INTRODUCTION TO FINANCIAL MANAGEMENT

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LECTURE: 2

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LECTURE-2



1.1.1 Functions of Financial Management

A financial manager has to concentrate on the following areas of the finance function.

- **Estimating Financial Requirements**
- **Deciding Capital Structure:**
- **Selecting a Source of Finance**
- **Selecting a Pattern of Investment**
- **Proper Cash Management**
- **Implementing Financial Controls:**
- **Proper use of Surpluses**

Estimating Financial Requirements: The first task of the financial manager is to estimate short term and long-term financial requirement of his business. For this purpose, he will prepare a financial plan for present as well as future. The amount required for purchasing fixed assets as well as the needs of funds for working capital has to be ascertained. The estimation should be based on the sound financial principles so that neither there are inadequate or excess funds with the concern. The inadequacy will affect the working of the concern and excess funds may tempt a management to indulge in extravagant spending.

Deciding Capital Structure: The capital structure refers to the kind and proportion of the different securities for raising funds. After deciding about the quantum of funds required it should be decided which type of security should be raised. It may be wise to finance fixed securities through long term debts. Long-term funds should be employed to finance working capital also. Decision about various sources of funds should be linked to cost of raising funds. If cost of rising funds is high, then such sources may not be useful. A decision about the kind of the securities to be employed and the proportion in which these should be used is an important decision which influences the short term and the long term planning of the enterprise.

Selecting a Source of Finance: After preparing a capital structure, an appropriate source of finance is selected. Various sources from which finance may be raised, includes share capital, debentures, financial deposits etc. If finance is needed for short periods then banks, public's deposits, financial institutions may be appropriate. If long-term finance is required the share capital, debentures may be useful.

Selecting a Pattern of Investment: When fund have been procured then a decision about investment pattern is to be taken. The selection of investment pattern is related to the use of the funds. A decision has to be taken as to which assets are to be purchased? The fund will have to be spent first. Fixed asset and the appropriate portion will be retained for the working capital. The decision making techniques such as capital Budgeting, opportunity cost analysis may be applied in making decision about capital expenditures. While spending in various assets, the principles of safety, profitability, and liquidity should not be ignored.

Proper Cash Management: Cash management is an important task of financial manager. He has to assess the various cash needs at different times and then make arrangements for arranging cash. Cash may be required to make payments to creditors, purchasing raw material, meet wage bills, and meet day to day expenses. The sources of cash may be Cash sales, Collection of debts, Short-term arrangement with the banks. The cash management

should be such that neither there is shortage of it and nor it is idle. Any shortage of cash will damage the creditworthiness of the enterprise. The idle cash with the business mean that it is not properly used. Through Cash Flow Statement one is able to find out various sources and applications of cash.

Implementing Financial Controls: An efficient system of financial management necessitates the use of various control devices. Financial control device generally used are;

- Return Investment
- Ratio analysis
- Break even analysis
- Cost control
- Cost and internal audit.

The **use of various control techniques:** This will help the financial manager in evaluating the performance in various Areas and take corrective measures whenever needed.

Proper use of Surpluses: The utilization of profits or surpluses is also an important factor in financial management. A judicious use of surpluses is essential for the expansion and diversification plans and also protecting the interest of the shareholders. The ploughing back of profit is the best policy of further financing. A balance should be struck in using the funds for paying dividends and retaining earnings for financing expansion plans.