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: 3

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LECTURE-3

1.1.2 Objectives of the Financial Management

The main objective f a business is tom maximize the owner's economic welfare. Financial management provides a framework for selecting a proper course of action and deciding a commercial strategy.

The objectives can be achieved by:
(i) Profit maximization
(ii) Wealth maximization

Profit Maximization:

Profit earning is the main aim of every economic activity. A business being an economic institution must earn profit to cover its cists and provide funds for growth. No business ca survives without earning profit. Profit is a measure of efficiency of a business enterprise. Profit also serves as a protection against risks which cannot be ensured.

Arguments in favor of Profit Maximization

When profit earning is the aim of the business then the profit maximization should be the obvious objective.

Profitability is the barometer for measuring the efficiency and economic prosperity of a business enterprise, thus profit maximization is justified on the ground of the rationality.

Profits are the main source of finance for the growth of the business. So a business should aim at maximization of the profits for enabling its growth and development.

Profitability is essential for fulfilling the social goals also. A firm by pursuing the objectives of profits maximization also maximizes the socio economic welfare.

A business may be able to survive under unfavorable condition only if it had some past earnings to rely upon.

Arguments against of Profit Maximization

It is precisely defined. It means different things for different people. The term ‘Profit’ is vague and it cannot be precisely defined. It means different things for different people. Should we mean (i) Short term profit or long term profit? (ii) Total profit or earning per share? (iii) Profit before tax or after tax? (iv) Operating profit or profit available for the shareholders?

It ignores the time value of money and does not consider the magnitude and the timing of earnings. It treats all the earnings as equal though they occur in different time periods. It ignores the fact that the cash received today is more important than the same amount if cash received after, say, three years.

It does not take into consideration the risk of the prospective earning stream. Some projects are more risky than others. Two firms may have same expected earnings per share, but if the earning stream in one is more risky the market share of its share will be comparatively less.

The effect of the dividend policy on the market price of the shares is also not considered in the objective of the profit maximization. In case, earnings per share is the only objective then the enterprise may not think of paying dividends at all because it retains profits in the business or investing them in the market may satisfy this aim.