UNIT 1INTRODUCTION TO FINANCIAL MANAGEMENT

1.1 INTRODUCTION

Finance is the foundational layer on which businesses are setup and run. Access to finances can enable a firm to expand and grow. Similarly, lack of funding can lead to restrained operations and in extreme cases cause a financial collapse of the business altogether. Irrespective of the nature of business, finance is a critical resource which needs to be managed efficiently for a smooth and successful running of companies and markets. Financial management is the process by which a firm creates and implements a financial system which enables it to achieve its goals and drive shareholder value via optimum resource utilisation and deployment in various asset classes.

1.2 OBJECTIVES

The objective of this unit on financial management is to educate potential managers to the basic tenets of financial theory, various terminologies often used in the area such that they are able to make informed decisions relating to investments and finance. After reading this unit the learners will be able to;

- Appreciate concepts like risk-return trade off, liquidity and cash flow, time value of money, performance management etc.
- Comprehend the elements of financial management and their relative importance in varied scenarios.
- Understand the approaches to financial management.
- Differentiate between accounting and financial management.
- Know the finance function and the role of a finance manager.

1.3 WHAT IS FINANCIAL MANAGEMENT?

Financial management is a management function which encompasses the planning, sourcing, deploying and controlling of the financial resources of a firm. In many companies, financial management is nested inside the accounts and finance function and vice versa, due to which it is often confused with accounting. Financial management concerns itself with raising long term and short term capital, investing or deploying it efficiently, asset – liability management, strategic financial planning, performance management etc.

Funds are an important resource for conducting any business activity whether it is day to day operations, expansion projects, inorganic growth etc. Finance is tightly woven in all business decisions and plays a crucial role in the prioritisation of conflicting business goals. Situations of tight financial control warrant different strategies to survive and grow, whereas situations of abundant finance spur several new projects and programs within the company. Infact strategic planning is incomplete without incorporating a strategic financial management plan. Financial management can be seen operating at different levels in an organisation as depicted in the figure below.

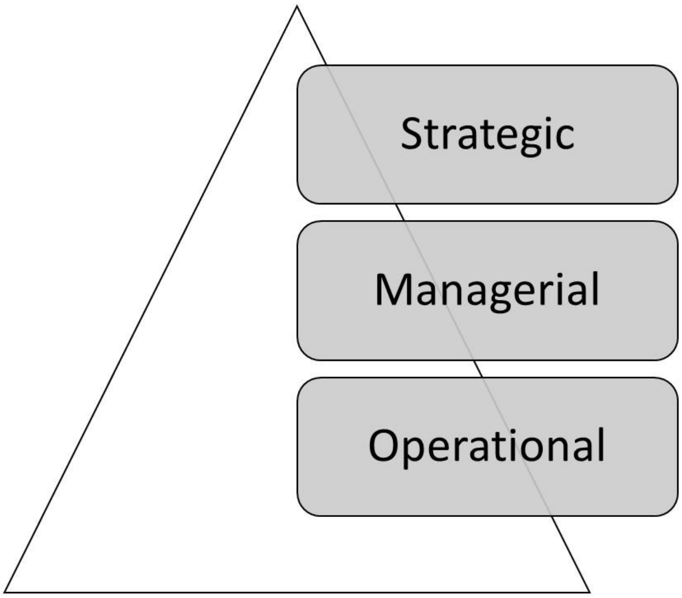


Fig 1.1 Levels of Financial Management

Operational Level – Financial management at the operational level requires managing the firm's routine financial requirements like working capital, cash flow, repayments, costs etc. This level closely interacts within all the functions including accounts, production, sales etc to manage the financial flows with the company on a day-to-day level.

Managerial Level – This level provides a layer of planning, executing and control over the finance function and aligns it with the top management expectations. It provides a critical level of governance and supervision to the smooth functioning of the organisation.

Strategic Level – The strategic importance of financial management has only been recently acknowledged by businesses. The role of the CFO has got enhanced equivalent to the other business function heads participating in the strategic planning and management of an enterprise. Many CFO offices are supported by a strategic finance team which deals with strategic activities like mergers, acquisitions, large investments in expansion of markets, strategic investor relationships etc.

Not all organisations cover all the above levels of financial management. Nature of business, size of operations, its complexity, ambitions of the top management and the phase of the business are some of the parameters which determine the scope of financial management in firms. For example a small mature firm in manufacturing garments would mostly have the accounts and finance function rolled into one and working at the operational level whereas a similar size startup in the field of fintech may have even a strategic financial advisor to align the financing requirements with the growth ambitions of the new company. Therefore, it is essential for a student aspiring to enter the world of finance to appreciate the entire gamut of financial management, its key functions, measurement areas etc.

1.4 OBJECTIVES OF FINANCIAL MANAGEMENT

Financial management refers to the application of finance and management principles to plan, organise and direct the financial aspects of an organisation. It typically has the following objectives:

- Maintain a healthy level of funding in the firm for both short-term and long-term requirements
- Achieve high shareholder returns
- Create sound investment opportunities
- Ensure optimum utilisation of funds at the lowest cost
- Manage the financial risk profile of the firm within acceptable levels

The main elements of financial management are

1. Planning – Financial planning requires estimation of a firms short-term and long-term requirements and ensuring availability of the funds at the appropriate time and in the right manner
2. Controlling – Financial control is a monitoring and optimising element of financial management with the objective of efficient resource utilisation in the company
3. Decision-Making – Financial decision-making is the most crucial and ultimate goal of financial management covering areas of investment, financing and shareholder returns. These will be covered in detail in the next couple of sections.

Examples of the kind of decisions which need to be made by finance managers are:

- Whether the company to invest into modernisation of its plant and machinery?
- Whether company should issue debentures or take a bank loan for funding a project?
- What are the working capital requirements of the company and how can they be optimised with respect to value and cost?
- Is the company generating sufficient return on capital?

1.5 APPROACHES TO FINANCIAL MANAGEMENT

We have seen above that financial management covers the entire gamut of an organisation from operational level to strategic level. This scenario has evolved over a period of time in business management theory and financial management has two main approaches:

1. Traditional Approach
2. Modern Approach

1.5.1 TRADITIONAL APPROACH

The traditional approach to financial management can also be referred in the context of corporate finance as used in many firms. As the name suggests it posits that financial management is primarily about procuring adequate finances for the firm to operate and grow in the form of capital, project finance etc. Traditional methods of financing are generally used in this approach led by bank financing in the form of loans, funded & non-funded limits, market financing in the form of debt and equity instruments, financial institution financing in the form of long-term project finance etc. The function of corporate finance in this approach is very event driven and is dependent on the financial requirements of the other business functions or the promoters with little say in the actual deployment, allocation and end-use of those funds. This approach is still practiced in many firms even today even though it suffers from some limitations as given below.

1. Outside-oriented approach – The activities of financial management in the traditional approach revolve primarily around raising capital from external sources such as banks and markets which makes this a very outside-oriented approach. Maintaining working relationships with these entities, managing the perception of the firm and aligning with the overall market scenario are key determinants in such an approach. The finance function is quite detached from the internal working of the firm.
2. Event-driven engagement – Traditional approach is largely event driven. It is required when the firm needs capital say for setting up a new facility or acquiring another business etc. This again isolates the financial management activity from the day-to-day activity and goals of the company.

Thus, the traditional approach is not very suitable in the current business climate which is characterised by lot of inter-dependencies, complexity and uncertainty of business operations. Innovative financial instruments, access to advanced analytics to manage and improve performance and decision-making are easily available to finance managers today. Simply disengaging finance with day-to-day working or with strategic planning is not the ideal way to run a business. Having said that this approach is still followed by companies especially the smaller well-established promoter-driven businesses. However, majority of the organisations today follow the modern approach as explained below.

1.5.2MODERN APPROACH

As stated earlier, the current business climate is quite complex with an interplay of internal and external factors impacting the organisational performance. Students will cover these in detail in the unit on environmental management (part of strategic management). Suffice to mention here that the firms today are operating in a very tightly integrated environment, facing competition from traditional and non-traditional sources and are constantly under threat of technological disruption. A Yale University study has found that, the average lifespan of an organisation in USA has decreased from 67 years in the 1920's to about 15 years in the 2000's.

Thus, in the current context optimum level of efficiencies and resource optimisation including financial resources are a necessary element of survival. Financial performance management has risen from corporate financing to a managerial and strategic level in organisations. This is the modern approach to financial management. It is a broader approach signifying an inter-relationship of finance as a critical resource driving and impacting other business functions whether marketing, production, technology or human resources. It also sees a place in the strategic planning process in determining the right capital structure, risk management, asset allocation, maximising profitability etc. Financial management in many firms has become a profit-centre with its own goals and targets. This modern approach heavily leverages data and analytics as its core driving engines. Multiple scenario analysis, forecasting, balance scorecard are some of the tools used in financial management today. Thus, the role of the finance manager or director requires not only an astute knowledge of finance, but also other skills such as administrative and management skills, strategic thinking, critical thinking and decision-making.

1.5.3 LONG-TERM AND SHORT-TERM APPROACH

Another approach to financial management is to bucket the activities into long-term and short-term. The decisions, tools and techniques of long-term vary with those of short-term. For example, capital investment or budgeting is typically a long-term activity requiring tools like project finance, net present value (NPV) of investment options, uncertainty assessment etc. The decisions to be taken in such an activity would be asset allocation and prioritisation of projects, capital structuring choices like issuing new debt or equity. Cash flow management, working capital are examples of short-term activities. These activities require techniques of working capital assessment, debtor days, debt-equity ratios, cash flow statements etc. The decisions made for the short term activities would be how much funded or non-funded limits are required and from where, supplier finance policies, treasury activities for deployment of surplus cash etc.

1.6 THREE PILLARS OF FINANCE FUNCTION

Considering the modern more holistic approach to financial management, the finance function rests on 3 key pillars:

1. Investment
2. Funding or financing
3. Shareholder returns such as dividends etc.

Take an example of a capital investment decision to be made by an organisation to maximise shareholder value. A corporate may evaluate multiple project options on the basis of net present value and incorporate an appropriate discount rate to factor the risk element. Subsequently financing of these projects need to be worked out and the cost of financing incorporated in the net expected returns for each project being evaluated. Projects must yield the expected returns for the shareholder else the company may reject all projects and return the cash to shareholders in the form of dividends.

Fig 1.2 Pillars of Financial Management

Thus, we can see that each pillar has to be considered in the context of the strategic objectives and goals of an organisation. They are inter-related and hence cannot be evaluated in isolation without impacting the other pillars. Let us understand each of these in detail.

1.6.1 INVESTMENT

This is by far the most important pillar on which decisions need to be made by the finance function. Investment entails deciding the asset allocation and the funding priorities of the firm. It also includes liquidity management in the form of long-term, medium-term and short-term cashflow requirements of a company. This is often a complex and tedious task as several conflicting demands are made on the funds of a firm and the finance function has to decide how much to allocate where. Finance managers need to arrive at an objective set of parameters to evaluate various asset classes and avenues to arrive at the optimum mix which will maximise the expected returns while containing the risk within acceptable levels and ensuring smooth cash flow for running of the firm's operations and key events.

Long term assets typically require capital budgeting to be done. Capital budgeting requires the finance function to choose investment proposals by evaluating their risk-return trade-offs. Since these are long-term in nature there is an inherent risk of uncertainty in every investment proposal arising from external and internal factors and of the forecasting process itself. This has to be factored in while assessing the expected benefits stated in the proposal. Due diligence exercise is typically carried out to ascertain the risk and uncertainty and to estimate the cost of risk avoidance and mitigation. Some of the commonly uses metrics for comparing options are internal rate of return (IRR), hurdle rate, cut-off rate etc[1]. Many companies incorporate the cost of capital in arriving at the benchmarks for rates of return. Base value of cost of capital can be the return the promoters derive from deploying the capital in a low-risk instrument or the cost of borrowing of the company etc.

Historically many firms even though showing a healthy capital situation are brought down simply due to the lack of free cash flow. Cash flow or liquidity is one of the most understated and trickiest parameter of financial management. Daily working of a firm is dependent on achieving the right balance between short term assets and liabilities which translates into an optimum level of cash in the company. We say optimum level because if a firm has too much cash it is missing out on growth opportunities and wasting capital in unproductive avenues. Similarly, if the firm has less cash it impacts the smooth running of the firm and could potentially impact the image of the company if it starts defaulting on timely payments to suppliers, employees etc. Liquidity trade-off with profitability is incorporated in this part of decision-making.

ACTIVITY: RBI on October 2019, placed restrictions on PMC Bank depositors to withdraw their money from the bank. Explore the reasons why RBI would have resorted to such an extreme measure in light of liquidity management. (Hint: you may use online resources to understand the situation at PMC Bank at that time to do this activity)

1.6.2 FINANCING

While the investment decision-making activity described above determines the asset mix of the firm, the financing activity determines the funding mix viz. the sources of finance which the firm requires in its operations and investments. In larger organisations this could mean determining the optimum capital structure of the firm by choosing among multiple

[1] Students are advised to refer to the recommend book of Financial Management for further understanding these concepts

instruments of financing like equity, bank finance, market borrowings etc. The right debt – equity structuring is critical to maximising shareholder value with manageable risk. There are several theories of capital structuring e.g. capital structure theory, which will be detailed in the subsequent parts of the course. Knowledge of these theories is essential for students who want to specialise in finance and financial management.

1.6.3 SHAREHOLDER RETURNS

One of the important objectives of a company is to maximise shareholder wealth. Afterall it is the shareholders who have invested in the company with the expectation that the company will do well and provide a healthy return on their investment. Depending on the nature of the company whether public or privately held the form of returns could vary. Form of returns could also be dictated by majority shareholder like in case of government controlled undertakings; dividends are the more desired form of shareholder returns. In all cases big or small, dividends and profit distribution forms the crux of decision-making. This mostly vests in the form of a dividend policy, share buybacks or preferential allotments. Dividend distribution for example could impact the cashflow of a company while a preferential allotment is in a non-cash form. Alongwith cash flow, tax treatment, requirement of reserves etc. are also important parameters in determining the shareholder return policy of the firm.

1.7 BALANCING RISK *VS*. RETURN

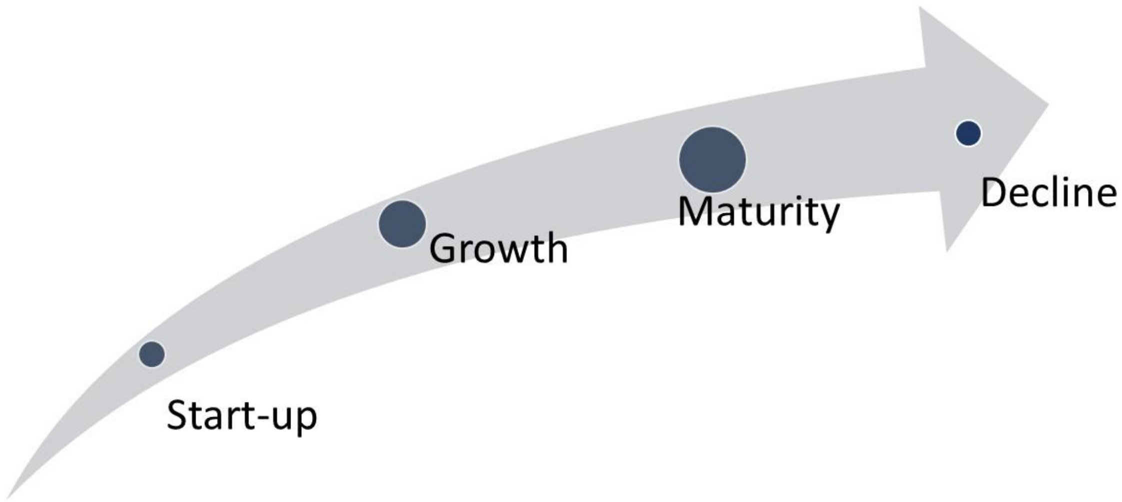
One of the most important concepts in financial management is the concept of a trade-off between risk and return. Many would have heard the tagline 'high risk with high returns and vice versa'. This is true in majority of the cases and many have been fooled into believing zero-risk on certain investment categories offering high returns. Put in simple terms:

Risk-weighted return = Risk-free return + risk premium

Risk-free return is often the return which can be expected in a zero-risk asset. Though there is no truly zero-risk asset; sovereign risk can be taken as the closest to being zero risk (though in multi-national operations this assumption will also not hold true, but we will ignore it here). Based on a firm's appetite for risk, the risk premium will vary across companies and hence the target risk weighted return can be calculated. It is therefore a core function of the finance manager to carefully maintain this balance of risk-return. Too much risk-averseness will yield sub-optimal returns to the company while over exposure to high risk will make the firm susceptible to financial ruin.

1.8 BUSINESS LIFE CYCLE IMPACT ON FINANCIAL MANAGEMENT

We have seen above that financial management is not a 'one size fit all' for all types of organisations. Financial management is one of the prime responsibilities of the management of a firm as it has far-reaching consequences on the overall health, direction and survival of the organisation. It varies with multiple parameters, phase of business being one of them. Financial management strategies and tools vary with the business lifecyle phases viz. startup phase, growth phase, maturity phase and decline phase as explained below.



Business Life-Cycle of a Firm

Fig 1.3 Business Life Cycle of a Firm

1.8.1 START-UP PHASE

Starting up a business is always the most stressful time in the life cycle of any business. It is characterised by limited resource availability in all forms. Many companies experience negative cash flows and losses during this period when they are seeking to establishing themselves in the market. Financial management in such a scenario is required to be hands-on, conservative and creative. The finance function itself may not be very well established in the company and may not have access to adequate tools and resources. Cash flow management and funding are the prime concerns to be addressed at this stage. Tough negotiations with buyers and suppliers, accurate cash projections, managing bank relationships and strong financial control are required at this stage till the business grows and becomes profitable.

1.8.2 GROWTH STAGE

Growth stage is also called a cash-guzzling stage of a business. The firm may or may not be profitable as it enters the growth stage but does require enormous quantities of cash to finance the growth. The finance manager here needs to be an ardent planner in forecasting the future financing requirements and a creative thinker in tapping sources of finance while containing finance costs. Managing demand while keeping a control on the financial ratios such as leverage, cost of capital, economic value etc. characterise financial management at this stage of the business.

1.8.3 MATURITY

Mature phase of business lifecycle is a steady state of normal operations. The firm is making profits, generating internal cash flows and has a stable operating cycle. Most of the expansion spurts are completed and the business is consolidating its position in the market. Key relationships with buyers, suppliers, banks have been established on mutually beneficial terms. The financial management function while ensuring a steady state of funds flow may also decide to undertake investment activity with surplus funds. The shareholder may also expect returns from their investments in the form of dividends. Optimisation of financial parameters and resource utilisation can be undertaken by management during this phase.

1.8.4 DECLINE

Though no business expects or plans for a decline in economic activity, it is part of the larger economy and industry life cycle. Declines in business can be temporary or permanent. Temporary declines could be a result of a recession in the economy (like financial crisis of 2008) while a permanent decline could be due to the demise of the product or service (like Kodak camera) or a result of a scandal (like Enron). Financial management for a business in decline phase needs to focus on liquidity management and ensuring financial viability of the firm at all times by adopting cost-cutting measures, putting on hold growth plans etc.

1.9 OBJECTIVES OF AN ORGANISATION – PROFIT VS WEALTH

We have seen above that the more common modern approach involves a holistic and analytical approach to financial management in the context of the strategic objectives of an organization. We have also discussed above that maximization of shareholder wealth is one of the common objectives of any organization. This could manifest itself in 2 forms in any company:

1. Profit maximization
2. Wealth maximization

Profit maximization as the name suggests involves increasing a firm's profits. In the traditional profit equation,

Revenue – Cost = Profit

This will translate into increasing revenue and/or decreasing cost. Profit maximisation is firmly grounded in modern economic theory which postulates that under conditions of perfect competition, profit maximization actually leads to the firm allocating its resources most efficiently and with maximum social welfare. Capital is a scarce resource and yet the driver of a firm's activities, thus it makes sense for the finance manager to focus on efficiently utilizing this resource to maximise the profit of the firm. Critics of profit maximization say that it is a single-minded pursuit of a figure at the end of the day be it profit after tax, profit before tax, gross profit etc. It often ignores fundamental tenets of financial management like time value of money, risk-return trade-off, liquidity-return trade-off etc. It also ignores the raison d'etre of the firm's existence such as producing quality output for its customer or technological excellence etc.

Profits define the firm's objective in a very narrow manner and in general does not agree with the holistic approach to financial management. This brings us to the second, more holistic concept of wealth maximization. It overcomes the limitations of profit maximization by introducing a broader concept of wealth. The Cambridge Oxford dictionary defines wealth as 'the abundance of something good'[2]. It can be associated with material possessions such as money as well as other items of value which are non-material in nature such as goodwill. Thus, wealth maximization can more closely align with both the material and non-material value objectives of a firm. More specifically this concept incorporates the following aspects:

1. Wealth maximization seeks to maximize the present value of the expected returns. Present value is an important concept to understand and comprehend for a finance manager as it is used in multiple scenarios where inflows and outflows are distributed over time and varying rates. For example, current returns are more valued as compared to the same quantity of future returns.
2. It incorporates a quality as well as a quantity dimension which serves a firm well both in the short and long term in creating shareholder value. For example, the goal of a company could be to provide cutting edge technology for its customers thus maximizing it's brand wealth.

It can be seen above that wealth maximization is a broader concept as compared to profit maximization. It incorporates the fundamentals of finance to look at parameters like net present value or internal rate of return to determine whether an activity is enhancing the

[2] https://dictionary.cambridge.org/dictionary/english/wealth

firm's value or diminishing it. It further looks at qualitative aspects of long-term shareholder value creation as part of its objective.

1.9.1 CONFLICTING OBJECTIVES

We have seen the twin objectives of profit and wealth maximisation earlier as being of importance to financial management. This may work well in some situations like in owner-promoter organizations or small-scale firms where the objectives of the management and owners are aligned. More often than not, in practice however things are not as simple and uni-directional as they seem. Demarcation between owners and management is seen as a sign of good governance and a professionally run organization. However, this demarcation creates potential conflict between the priorities of the owners and management. Throw into this mix other stakeholders such as government, employers, customers, suppliers and we have a mix of priorities which can be sometimes at conflict with each other and with the original objective of wealth maximization. Thus, we circle back to the strategic level of financial management which aligns with the strategic objectives of the organization

Activity: Many Indian companies put-up their strategic goals and objectives in their annual reports or their website. List down the strategic objectives of any one Indian company and classify the objectives into financial and non-financial. For the non-financial objectives, derive a related financial objective. For example, if the company's objective is 'expansion into overseas markets', this will mean arranging funding, cross-border risk management as some of the financial objectives due to this non-financial strategic objective. (hint : you can look at https://investors.tatamotors.com/financials/73-ar-html/strategic-priorities.html as one such example)

With the completion of the above activity students will now be able to comprehend that the goals and objectives of the firm may or may not contain financial goals at the first level. The vision/mission of the firm could centre around market leadership or customer delight or operational excellence. Does this mean that financial goals are not important for the firm or that there is no need for financial management? Obviously, the answer to that is NO. Every stated strategic goal of the organization will have a financial aspect manifest in the goal at the next level. Therefore, it is for the CFO or Finance Director to derive that from the goals and steer the finance function and financial management of the organization in accordance with the same. One of the mechanisms which can be used to do the same and also measure the performance of the firm is 'Balanced Score Card'.

Check Your Progress-A

Q1. What is Financial Management?

Q2. What are the two approaches to financial management?

Q3. What is involved in financial management at strategic level?

Q4. Give some tools and techniques used in making investment decisions.

Q5. Fill in the Blanks with appropriate word or words.

a) The 4 stages of a business cycle are …………………, ………………., ……………. and …………………..

b) ………………….. is the head of the finance function in a typical organisation

c) Financial management operates at all levels of the organization namely …………………, ………………… and …………………..

d) The full form of IRR and NPV are ……………………. and ………………………….

e) In the risk-return trade-off, it is normally said ………… risk and …………returns go together.

f) The closest to a zero-risk instrument can be taken as …………………………

Q6. State whether True or False.

a) Accounting and financial management are one and the same.

b) Traditional approach to financial management is an outside-looking approach

c) In the decline phase of business, financial management will focus on liquidity management for survival

d) All other things being equal, 2 projects yielding the same profits but at different periods of time will have the same NPV

e) Financial management need not be concerned with cash flows in a company

1.10 TYPICAL ORGANISATION OF FINANCE FUNCTION

Finance function is a core element in the functioning of every organization. It's form, structure and size will vary between organisations based on various parameters such as nature of business, size and complexity of operations, industry-type, type of company etc. Given below is a typical organization structure of a fairly comprehensive finance function in an organization. Needless to say, terminologies of various roles will also vary between companies. Moreover, multi-national or multi-divisional organisations would have this function replicated across countries and divisions with an overarching group finance function.

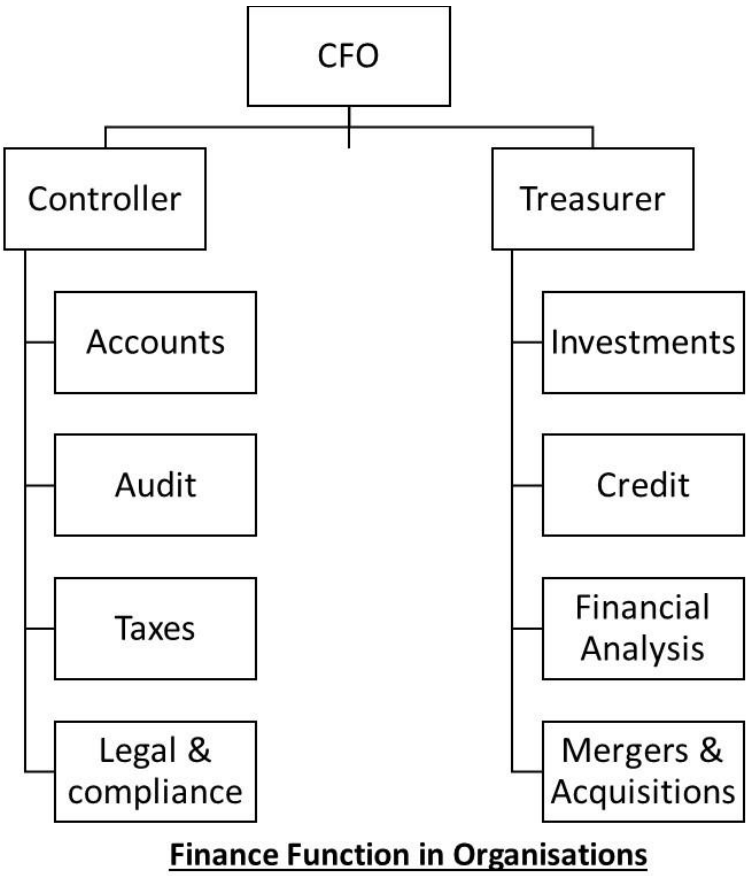


Fig 1.4 Finance Function in Organizations

Chief financial Officer (CFO) or Finance Director is the person who owns the finance function of the organization and reports to the Chief Executive Officer and to the Board of Directors. CFO is responsible for aligning the finance function with the strategic plan of the organization and vice versa to provide inputs to the strategic plan of the organization by highlighting the financial aspects and realities. Financial management policies laid out under the CFO direct the financial direction and health of the organization.

The CFO will have a team comprising of controllers, treasurers, credit managers, financial analysts, risk managers etc. A treasurer function will be responsible for cash management, investments, investor relations and addressing the financing requirements of the firm. While a controller function typically covers the accounting function. It will have a team of accountants, taxation managers, auditors, budgeting and planning managers etc. Financial statements, forecasts, regulatory reporting, audit and compliance comes in the ambit of the controller’s function, while strategies for funding, investment strategies, mergers & acquisitions are functions of a treasurer function.

1.11 FINANCE AND ACCOUNTING

Finance and accounting are often used interchangeably and misunderstood as meaning the same. It is possible that in small enterprises both these functions are discharged by the same person or team. However, as finance professionals it is important to understand the inter-dependence and the differences between the 2 functions. Accounting in its purest form is the reporting of facts and figures of a company’s financial aspects in the form of profit and loss accounts, expense statements, balance sheets etc. It forms an essential input to the finance function and hence has to be rendered under utmost control and compliance. Finance utilizes this data provided by accounts alongwith other sources of data to perform analytical operations on them. Assessing the firm’s performance, predicting future growth, identifying areas of inefficiencies, spotting opportunities and weaknesses are all outputs of these analytical operations. Output of finance provides an input for decision-making across many levels and many functions including its own.

While accounting is very rule-driven and often governed tightly by treatment and accounting guidelines, creative accounting is a term which has garnered a bad image in the face of mega scandals such as Enron, Lehman Brothers etc. Though they are accounting failures, the finance function takes an equal blame for the same. A good and effective finance function could have spotted trouble or areas of inconsistencies much earlier than when it was discovered (by which time it was too late).

Accounting is typically seen as a reporting of past financial transactions while financial management is seen as planning for the future.

Another point of difference between accounting and financial management stems from their outlook to figures. While those in accounting function focus on the technique whether figures have been attributed to the right categories, whether the relevant principles of accounting (e.g. GAAP) have been followed etc. While financial management is focused on analysis and assessment of the figures in the context of targets, benchmarks, goals and objectives. They may evaluate the overall health of the financial situation in the organization to spot red flags, they may perform benchmarking with a bid to optimize cash flows or reduce supplier finance.

Thus, we can see above the differences between finance and accounting and yet the inter-relationship between the two in managing the finance and compliance of an organization.

1.12 ROLE OF FINANCE MANAGER

We have seen above that financial management is the function which engages in planning, executing and controlling the finance-related activities of a firm. Thus, finance managers of a firm are responsible for the financial health of their organization by engaging in various investment and financing related activities. In general, a finance manager's role comprises the following functions:

- Perform analysis of financial and non-financial data
- Create financial management reporting, forecasts, performance reports etc. for senior management
- Advise the management on ways to improve the financial performance of the organization or warn them of possible trouble areas in future
- Monitor and provide governance on compliance and other legal and regulatory aspects
- Participate in development of strategies and plans for achievement of goals and objectives of the firm
- Execute investment and financing decisions
- Benchmark competitors, analyse trends, spot opportunities and threats to the financial health of the company
- Interact with analysts and other external entities in case of publicly held companies

Some of critical skills required by a finance manager are

- Analytical skills – the need to be able to analyse data, spot trends, areas of optimization, perform scenario analysis
- Communication skills – communicating analysis effectively by using visualization, written and oral forms
- Core knowledge of finance areas – knowledge of sound financial theory, ratios, benchmarks, hidden issues in financial figures

- Organisation and relationship skills – ability to manage inter-departmental relationships and external relationships to achieve role objectives. Self-organisation to handle diverse activities in a time-bound effective manner.

The role of finance manager has evolved from static reporting and monitoring to that of an astute business advisor to the senior management. Hence, a finance manager in the current times requires a blend of finance knowledge, industry understanding and technological foundation to be able to perform this role. Technology has become an important element in the area of analysis and reporting and hence an essential skill to have.

1.13 SUMMARY

- Financial management is a system of planning, executing, controlling and optimizing the financial resources of a firm
- Sound financial management is essential in realizing the strategic goals and objectives of a firm and enhancing its value. It helps in implementing the business strategies and growth ambitions of top management
- Financial management has 2 approaches viz. traditional approach and modern approach. Its scope varies across organizations based on their size, complexity, stage of business etc.
- Financial management has 3 elements of planning, controlling and decision-making. Decision-making itself rests on 3 pillars of investment decisions, funding or financing decisions and decisions related to shareholder returns.
- Time-value of money, risk-return trade-offs, liquidity management are foundational concepts of financial management theory
- Tools like balance scorecard are useful in a holistic approach to performance management.
- Finance function varies from organization to organization but is broadly comprising of a controlling and a treasurer function
- The role of Chief Financial Officer has evolved to a strategic level as a critical participant in the strategy formulation, planning and execution process
- Financial management and accounting are both distinct and yet inter-related concepts
- A finance manager is a complex role requiring expertise in multiple skills and knowledge areas.

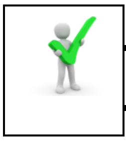
1.14 GLOSSARY

Financial management– The continuous assessment, organization, management and control of the economic activity of a firm

Dividends – Payments usually paid out of profits of a company to its shareholders periodically

Net present value – The present value of future cash inflows and outflows of a project or investment arrived at by incorporating a time value of money using a discount rate

Corporate finance – Area of finance which primarily deals with the accounting and controlling function of financial management using appropriate tools, techniques and guidelines.



1.15 ANSWERS TO CHECK YOUR PROGRESS

Check Your Progress –A

5. Answer

a) startup, growth, maturity, decline

b) Chief Financial Officer or Finance Director

c) Operational, Managerial and Strategic

d) High/High Or Low/Low

e) Internal Rate of Return, Net Present Value

f) sovereign risk

6. Answer

a) False, Financial management and accounting are distinct from each other

b) True

c) True

d) False, NPV of both projects will be different due to the discounting of the returns over varying periods of time.

e) False, Liquidity management and cash flows are an important element in financial management

1.16 REFERENCES

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- M.Y. Khan and P.K. Jain, Basic Financial Management, Tata McGraw-Hill Education India; (2000)
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- Rober S Kaplan and David P. Norton (1992). The Balanced Scorecard—Measures that Drive Performance available at https://hbr.org/1992/01/the-balanced-scorecard-measures-that-drive-performance-2

1.17 SUGGESTED READINGS

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2. Financial Management: I.M. Pandey.

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4. Financial Management: Khan and Jain.
5. Corporate Financial Management: Arnold Alen, London, Pitman 1998.
6. Corporate financial management: Emery Douglas R, Pearson Education Asia, 1997.
7. Indian corporate financial management: Vijay Gopalan E., Bombay: Himalaya, 1997.
8. Additional Reading : https://www.bizmanualz.com/be-a-better-boss/what-are-the-top-ten-cfo-responsibilities.html

1.18 TERMINAL QUESTIONS

Q1. Differentiate between the traditional and modern approach to financial management. In your view which approach will suit a small mature company? Why?

Q2. What are the 3 pillars of financial management decision-making? Explain each pillar in detail

Q3. Is financial management same for all organisations? Discuss your answer with examples supporting it.

Q4. Profit maximisation vs wealth maximisation – which is a better metric for a firm? Support your argument with examples

Q5. Discuss the differences and inter-relationship between financial management and accounting

Q6. Draw an organisation structure of a finance function in an organisation. Discuss the various roles in the same

Q7. How has the role of the CFO evolved over years?

Practical Question

Q8. Looking at the role of a finance manager, create a balance scorecard for evaluating the performance of a finance manager in a typical firm. You may use online resources (https://hbr.org/1992/01/the-balanced-scorecard-measures-that-drive-performance-2) to understand more about the quadrants of a balance scorecard for filling it up.