Financial Management

- Understand the meaning of financial management

- Know about the various aspects of financial management

- Know about the different terms used in financial management

- Learn about the importance of raising funds and fund allocation through budgeting

Introduction

Every organization, irrespective of its size or ownership pattern, has to manage its finances. The overall objectives of an organization cannot be achieved in the absence of financial management. Many organizations fail in their objectives because of financial mismanagement and this failure rate is quite high among the small business enterprises. Hence, financial management is vital for all types of organizations, profit making as well as non-profit making. In case of non-profit making organizations also the effectiveness and performance depends on their financial resources management.

Financial Management

When we attempt to analyze the financial functions of an organization we find that funds (capital) have to be:

- Procured
- Allocated for various activities
- Used effectively
- Monitored

Further, the results of all these have to be recorded also. All this brings to fore a three dimensional financial process:

- Financial management
- Management Accounting
- Financial Accounting
- All these three are at the same time separate yet overlapping areas of thee financial functions of an organization.

1. Financial Accounting deals with the measurements and reports of the financial position of the organisation and providies this to external users such as the shareholders, creditors, government agencies, etc.

2. " Finacial Accounting is the art of recording, classifying and summarising in a significant anner and in terms of money, transactions and events which are, in part at least, of a financial character and interpreting the results there of".

3. Managerial Accounting deals with procuring of data for the organisation's management i.e. to serve the internal users with necessary accounting information to carry out the management tasks of planning, organising, actualising and controlling. " Management Accounting is the presentation of accounting Information in such a way as to assist management in creation of policy and in the day to day operations of an undertaking".

4. Financial Management deals with the process adopted by an organisation for taking financial decisions through analysing and interpretation of

financial data for meeting the organisations objectives. Hence, the tasks involved in Financial Management include:

- Analysing financial needs
- Forecasting financial needs
- Managing working capital
- Planning capital structures
- Organising financial operations
- Monitoring and controlling finances etc.

In fact raising funds and allocating funds for business are the two prime financial management tasks.

Financial Planning

Financial planning is an appraisal of those financial aspects that may or are likely too occur in future but need immediate decision making. It involves setting financial objectives in terms of profits, sales or acquistion of assets along with financial foorecasting for the organisation. This includes estimation in the areas of:

- Capital requirements
- Capital structure
- Credit policy
- Other financial contigencies.

In fact, Financial Planning is concerned with raising funds and there effective utilisation. The aim here is to maximise the organisation's wealth keeping in view the organisation's objectives.

Generally, financial planning is done through budgeting and this also takes care of resource allocation.

Raising Funds

Both as manager as well as an entrepreneur, you must be aware of the capital generation process or what is termed as raising of funds for doing business. It is a function of the manager or entrepreeur to raise financial resources for not only establishing the business but also for operational

requirements. Such resources are generated internally as well as externally and are for short term as well as long term.
All amounts invested in business by its owners, partners or proprietor as a basis for operations are termed as capital. In other words cappital refers to all company liabilities and owners equity. This includes short term as well as long term capital. The sources of short term finances are:

- Own capital
- Borrowing/deposits from friends, relations and others
- Spontaneous capital through credit facilities from vendors.
- Negotiated credit i.e. short term loans on negotiated basis from commercial banks and finance agencies etc. to be paid back in a specified time.

The long term financial resources include:

- Term loans from banks and other fianancial institutions
- Issue of shares and bonds
- Owners or partners capital
- Loans from government institutions (e.g. Tourism Finance Corporation of India),
- Deposits of loans given by directors/partners of the organisations.

A good manager will scan the internal as well as external environment at the time of raising funds. Answers to following questions will be use for sound finanicial planning while raising funds:

What are the interest rates on borrowings?
What is the repayment capacity of the organisation?
How soon is the oragnisation likely to make profits?
Is the return from the investments made by borrowed funds going to be higher than the interest to be paid on borrowings? Etc.

In the case of tourism the central as well as many state governments have come out with special loans schemes on liberal terms. Entrepreneurs and small businesses should keep track of such schemes.

Managing Working Capital

Financial Management also involves proper management of investment of capital in business. Capital investments in any business are of two types:

Investments for permanent or long term purposes (capital structures e.g. acquiring fixed assets, research and development etc.),
Funds needed for current operations (working capital)

Working capital, in simple terms, refers to that ivestment which is needed for day to day business operations and no organisationn can function in its absence. In other words working capital refers to all current assets ans liabilities. The administartion of these current assests and liabilities within the frame work of organisation's stated goals is termed as the management of working capital. It is the task of financial manager to ensure that these financial resources are available to the organisation at the least possible cost and the organisaion can timely repay the obligations.

Current assets are stock-in-trade and cover raw materials, finished goods and work in progress.
Current liabilities are all debts due for payment in a year. These include salaries, interest, trade creditors etc.

While managing current liabilities one should remember not to pay bills till thy fall due nor pay them unduly late and also negotiate discounts for prompt payment.

The working capital requirements of an organization cannot be determined through any set of rules or formula. However, the following points are considered to be relevant in this regard:

The nature and size of business

The duration of the manufacturing cycle i.e. the time taken between purchase of raw materials and production of finished goods or services.
Demand fluctuations of the product (this is frequent in hospitality product)
The production policy
Credit terms
Expansion policy
Delivery policy

Managing Cash

For any business it is essential to have proper estimation of cash requirements. It has been observed that many organizations, inspite of their profit earnings, become bankrupt in the absence of cash. On the contrary there are organizations with excessive cash, which is a waste of resources. The demand for cash is generally because of three behavioral motives:

Transaction Motive i.e. holding cash for day to day business activities.
Precautionary Motive i.e. cash needed to deal with unanticipated delays or other uncertainties.
Speculative Motive i.e. cash needed to take advantage of bargain purchases or availing opportunities out of unexpected developments.

Thus, every organization not only has to determine the optimum cash balance needed but this cash has to be managed also. Management of cash has the following aspects:

Determining the appropriate cash balance
Managing of the storage, collection and disbursement of cash balances
Investments of temporarily idle cash in interest earning assets.

Very often there are sharp fluctuations in cash requirements. A good financial manager should take appropriate defensive action to handle temporary surpluses or shortages. Some of the steps to be taken in this regard are:

All cash collections should be deposited in one account, even if there are more than one-collection centers. This helps the organization in storing cash more effectively.

One should attempt to reduce the time lag between the dispatch of the cheque by the customer and its crediting in the organization's account

There should be constant follow up action for recovery of dues

On early payments incentives in the form of discounts can be given

The disbursement of cash can be withheld till last date

Incase cash by itself yields no income it should be invested. Suitable criteria should be adopted for this after examining the available alternatives.

Budgeting:

As mentioned earlier, besides raising funds, the other major responsibility of a financial manager is to allocate funds and see to it that they are effectively utilized. The available funds have to be allocated between current and long-term assets and for this investment choices have to be made.

What is a Budget?

A budget is a systematic plan for the utilization of manpower and material resources. It represents an estimate of future costs and revenues and is quantified in financial terms. In simple words, budgets are written plans of business activity reduced to rupees or any other monetary term. The main features of a budget are:

1. It is prepared in advance and is derived from the long-term strategy of the organization

2. It is related to future plans, for which objectives have already been laid down,

3. It is related to a specified period of time

4. You may ask the question that what is the purpose of budget. Well a budget helps you in many ways like:

5. It clearly states expectations of your organization and by doing this you can avoid confusion and ambiguity

6. It is a method of communicating the plans and expectations to everyone in the organization so that the employees or the departments in an organization understand, support and implement the policies.

7. It helps in maximizing the use of organizational resources

8. It helps in reducing wastage and losses

9. It helps in taking timely corrective action and controlling ongoing operations

10. It serves as a basis for both motivating and evaluating the manager's performance

The process of budget preparation consist of certain steps like:

Establishing financial objectives – Generally, the major financial objective for any organization is long-term profit maximization. This is true of hospitality industry where profits start coming from second or third year only. At the same time, in hospitality and tourism enterprises, certain other objectives are also included while determining the financial objectives of the organization.

These include:

- Providing high quality services
- To be the lead organization, in the area of business
- To be recognized as having the best reputation
- To be the fastest growing organization

Forecasting revenues – For forecasting revenues in tourism sector enterprises, one should have information regarding the economic environment like economic trends in the tourist generating markets, expected inflation for the budget year, expected variations in the costs of specific purchases, nature of competitive conditions and travel trends etc.

Estimating expenses – The expenses to be incurred for the budgeted period must be estimated and for this managers must obtain information regarding expected cost increases for supplies and labour costs in order to forecast their variable expenses.

Determining net income – Generally, revenues minus expenses are equal to net income. Hence in the budget making process, the net income for the budget time period should be determined.

Reviewing and approval - Once the budget is made, it should be reviewed and approved by the competent authority in the organization. This could be a Board of Directors, a Budget Committee or an owner manager of a sole-proprietorship business.

Types of Budgets

Every organization has a master budget i.e. the total comprehensive budget of that organization. It sets out the plan of operation for all departments for the budget period. Out of his master budget, different types of budgets are prepared for various purposes like sales budget, production budget, purchasing budget, administrative expenses budget etc.
Revenues are allocated to meet the estimated expenses of different departments.

Budgets can be classified on the basis of Time, Function and Flexibility:

1. In terms of time, a budgets can be long term, short-term, current or a rolling budget. For example, an organization may have a long-term budget say for the next ten years, this can be further divided into a short-term yearly budget which can further be subdivided into current monthly budget. Where as some organizations follow a practice of preparing a rolling budget where a budget for a year in advance is always there i.e. immediately after a month or quarter passes a new budget is prepared for the next 12 months. The figures for the month/quarter, which has rolled down, are dropped and figures for the next month/quarter are added.

2. In terms of functions, the budgets can be classified into sales, production, purchase, research etc. For example, a sales budget will take into account the projected sales and this generally the starting point for budgeting. This is because production and inventory levels are generally geared to the rate of sales activity. A production budget provides estimates of total volume of production. A production budget is prepared on the basis of sales budget and then the purchasing budget is based on production budget because the total materials to be purchased depend on the level of production. Similarly, a cash budget is a summary statement of your organization's expected cash inflows and outflows over a particular period of time. It involves projection of future cash receipts and cash disbursements. It helps the management in determining the future cash needs, planning for financing of those needs and exercising control over cash and liquidity of the firm.

3. In terms of flexibility, we have two types of budgets i.e. fixed budget and flexible budget:

a) A fixed budget is designed to remain unchanged irrespective of the level of activity and is prepared on the basis of a standard of fixed level of activity.

b) A flexible budget is designed to change in accordance with the level of activity.

In the case of hospitality organizations, a flexible budget is desirable because:

- The nature of business and sales are largely unpredictable,
- It is difficult to foresee the demand in case of new ventures,
- The business is subject to nature variations.

Budgetary Control

The process of the comparison of actual performance with budgeted performance is called budgetary control. This is a crucial activity because every organisation has to evaluate whether the activities and operations are going in the right direction for achieving the organisational objectives. The actual performance has to be compared with the budgeted performance on the basis of actual level of activity. The actual performance of each area of responsibility is measured through general accounting system in financial terms.

Financial managers also go in for periodical review of budgetary performance and then apply corrective measures to ensure that the future performance is as per the budgets.

There are many other aspects related to financial management and it is suggested that an entrepreneur should utilize the services of a financial consultant.