The Fundamentals of Financial Management

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The purpose of any business is the maximization of the wealth of the shareholders. That is the ultimate purpose of every business, every organization, when any entrepreneur starts a business, maybe a startup you can say or a just a sole proprietorship you say, then his ultimate dream is he does not want to end up with or continue with a sole proprietorship, his ultimate dream is to make it as a transnational company and to convert a sole proprietorship organization and taking it up to a transnational company. It requires hard efforts, it requires different inputs, it requires factors of production, it requires a meticulous way of managing the resources, all resources including financial and it needs a professional management approach. So apart from all these things you need, the first and the foremost thing is that is the finance and the financial resources, if you have sufficient amount of finance, if you have the ample amount of the finance then the next question arises, how to make best use of it, how to make best use of it? So, in the firms, when you talk about that the finance, what role it plays, what is the importance of the finance and how to properly manage the finance and what all about we call it as the financial management.

So, many things are involved in this process, that we will learn each and everything one by one and the answers to all the questions will be say given here over a period of time, when will we move forward in the discussion and we will try to say discuss different concepts of the financial management one by one in detail. I will take you back little before understanding or explaining the say importance of this subject or this particular course. For example, you think about that you may be any individual who is after graduating or maybe doing MBA or maybe any other professional program. He has 2 options available. One option available is that he can join any firm, any organization, means through the placement process or the second option is that he may become entrepreneur. This question comes in the mind of an individual, a young graduate, that if he feels that whatever the job profile, he is being offered by any company, any firm and whatever the financial resources, means he has with him and what is the financial package he is being offered by that firm, if he is not satisfied with that, he may think about that my price is not this. I am more capable. I am capable to take more risk. I am acquainted with the better management skills and techniques. So, for me, any job is not meant for I will be opening up my own organization, I will be setting up a startup, I will be starting with an own organization with the business and I will become an entrepreneur. If he decides this that he would like to become an entrepreneur, then what important things come in his mind. Because a person who thinks of becoming an entrepreneur, he needs to have many qualities. He cannot be a normal human being and the qualities are like say, for example, he should be visionary, this is the first and the foremost quality of an entrepreneur, that you should be visionary, you should be means able to see, foresee in the future that what is going to happen in the time to come, how the business process is going to be there? Which sectors are going to grow, what are going to be the government policies, what is going to be the customers the response, what is going to be that other stakeholders' response in the market and which area of the business he has to venture into.

So vision is about most important thing, if the person is visionary enough, then certainly he is capable of becoming an entrepreneur. Apart from that, another important, say quality of a entrepreneur is or the person who wants to go up in the startup is that he should be having the risk taking capacity. Everybody does not have that risk taking capacity and everybody cannot means take all kinds of the risk, especially the business risk. So, the people who think of becoming entrepreneurs moving into their own ventures own startups, they must have the risk taking capacity or the risk taking capability, right. Apart from these two important qualities of that individual who thinks of becoming a entrepreneur and starting his own business. Third important requirement is the financial resources, how many financial resource? How much financial resources you have? And what is the amount of investment, minimum amount of the investment required which you plan to say invest in or the business you want to start in how much funds are required to be invested into that business. Requirement of the financial resources is another important requirement apart from being visionary, apart from having that risk taking capacity you should be a person having the ample amount of the financial resources. With zero amount of the funds in your pocket, you cannot start cannot become an entrepreneur. So, what we can think about that, what is the idea in my mind how I want to go ahead? And what is the financial requirement of giving that idea a shape or converting that idea into a business because mere idea does not this work in any way, this is not going to help you to start any business.

You need to have the proper required amount or the financial resources, it may be possible that you need to, for example, invest 1 million rupees, you have only half a million in your pocket, but you should be capable of that half a million will be available from other sources in the market and I will be able to say generate a fund of 10 lakh rupees or 1 million. Next question arises that if you have 1 million rupees now, from different sources from your own pocket from your parents, from the relatives, from different other sources, if you are able to generate the requirement of the funds means the required amount of the funds required to have invested in the business, then how to manage those funds, because management is a very, very important concept. You have to your objective is that you want to magnify with the given amount of the funds with you if you had the 1 million in your pocket. Your plan should be that next year at the end of the 1 year of the business it should be 1.5 million with me, but it may not be possible because initially when we start a business, initially we have the gestation period for that. We incur some losses for the same period of time, initial 2 to 3 to 4 years even sometimes or up to 3 years you can say any new business can be allowed to incur the losses. We expect that the losses will be there, but at least at the end of the third year or in the fourth year, the business must mean be reaching at the breakeven point. And from the say means thereafter onwards, the business should start earning the profits. This all will happen only if you know how to manage the financial resources, I am emphasizing upon the financial resources, because this is the backbone of any business, this is the, this plays the role of the blood as the means as the blood plays in the human body, this finance plays the role like a blood because in the human body, if the blood is not there, sufficient amount of the blood is not there, if you have that lesser amount of blood in the body, we are anemic.

And if you are the more amount of the blood in the body that is also not good for the human body or for the human beings. Similar is the case with that when you talk about the finances, we talk in terms of the finances in the business in terms of the capital. So, how much amount of the capital you require. You have to have that much amount of the capital, because if, if the lesser requirement of the capital, we are undercapitalized and if you have the more amount of the capital invested into the business, we are over capitalized and both the situations are not good or not up to the mark. So, under this process of learning about the financial management, we will have to learn about the optimum amount of financial resources to be invested into the business and the proper management of all those sources of the finances. When you run the business or when you start the business and you start running the business, you have a number of factors of productions, you need land, plant, building machinery, material, capital, labor. So, all these other factors of production depend upon only one factor of production and that is capital in other way around you can call it as finance. If you have the finance, requirement of the finance then you can have the land also, you can have the say material also, you can have the labor also and you can generate other fixed and the current assets in the business also. So, the first and the foremost requirement of any business is having the required amount of finance. Once you have the required amount of finance, you can proceed further you can generate other factors of production, you can give your idea a shape in the form of the business and go ahead with that process and start working with your organization with your business with the objective that I will now magnify the say my finances, my say resources.

Whatever the investment I have made into the business, I will pass through all the hurdles, I will make best possible efforts best managed my organization and then I will achieve that means objective of converting that sole proprietorship into a partnership firm because it is a process. First when we started the business as a sole proprietor, we then convert that into a partnership firm, then we convert that into a private limited company and then we convert that into a public limited company. And then the public limited company has any level, it may be a national company, it may be an international company, it may be a multinational company or it may become a transnational company. So, todays transnational companies if you talk about they were started as a sole proprietor organization sometime back years back, maybe sometime you can call it as decades back and today these companies have seen or risen up to a level that they are now say not in one country or in the one part of that country in which they were started but they have now become the transnational and they are into every part of the world. Talk about these Japanese companies, Toyota, Sony or any other means say your Honda, all these automobile companies, all yours say electronics products, manufacturing companies or the American companies or the UK based companies. These companies were started by the single individuals. If you go back in the history of any company, you will find it that somebody started is at a very small level and today they have become transnational company and they are serving the needs of the people in the different parts of the world. This all happens with the better and the proper management of the business, which we start as a sole proprietorship, which we started you call it as the startup organization and if the idea is well, if the process of managing the resources is well, then certainly we can grow and we can achieve the dream that we want to reach, right.

So, here, the overall management of the business, I will emphasize upon that if your manager finances well, in this course, we will learn about different ways, processes and means that if you manage your finances well, if you manage your resources well, then certainly you are going to achieve your dream where you wanted to reach at one day or at the one point of time, but if the financial management of any organization is poor, then certainly whatever the other resources you have, they are not going to deliver the results, they are not going to deliver the value. So, managing your finances well, you need to create 2 situations in your firm, in your business, in your organization. Every organization has 2 important structures; one structure is called as the operating structure of the firm. Second structure is called as the financial structure of the firm, right. Under the operating structure of the firm, we talk about the operations part, there if you talk about in terms of the financial statements, we prepare 2 broad financial statements, one is the income statement which has the 2 components and the second statement is the say balance sheet. So, the first statement which is income statement it has 2 components, trading account and the profit and loss account and the second statement is the balance sheet. In the trading account we talk about the operations or the operating part of the firm and in the say lower part in the profit and loss account, which is the second part of the income statement, we talked about the financial structure of the firm. So if the operating structure of the firm is good, but the financial structure of the firm is poor it may be possible that sometimes when we start a new business, we borrow the funds from such sources which are very-very expensive, the rate of interest we are paying to these sources is very high and sometimes whatever the revenue we are earning larger part of that is spent only on servicing the debt or the funds generated from those sources, right.

It may be possible in the beginning because your idea is new, your business is new, your concept is new, you're even the firm as a startup is new. Many established financial sources may not be ready to come forward, you cannot start the equity means you cannot issue the equity capital in the beginning of your business. Even you go to the bank and you start borrowing or you ask for borrowing some money from the bank to start your business bank will not take any kind of the risk because you are just a beginner in the business. You have not proven your potential in the market. So, you may not get the funds from the bank also. Even you go to your friends, your relatives, and you ask for the money for that, it may be possible that sometimes they have a doubt in their mind that this is a new concept, this is new idea, this person is going to start the business for the first time he is very young. So, it may be possible that the business does not grow well and it may collapse before it has started growing. There are kind of that, this kind of apprehensions are there in the mind of everybody. So, your relatives, your friends, even your parents are not ready to support you, but your conviction and your faith in yourself it gives you a, say the feeling that I should go ahead. So, there in that case, you end up generating the funds from the very-very expensive sources. For example, you go to the venture capitalist or you raise the funds from such other sources maybe from the Angel investors which are very expensive, sometimes the interest goes up to 40-45% also. So, what happens when you raise the funds from such kind of very expensive sources, financial structure of the firm becomes weak. But if your operating structure is good, means if your idea is good and you know that I am sure about that, if I start generating this service and rendering the service to the people in the market, certainly there is a market and there will be the buyers for that or if you start manufacturing some product and start distributing in the market.

You should be sure about that, yes, there will be the that the people who will start liking my product and certainly I will generate market for my product, then that is your confidence and if the operating structure means that is a manufacturing process and the product or service, which we are generating out of it if it is very good and acceptable to the people. So, you can say your operating structure is very strong means certainly the operating structure of the firm is very strong and slowly and steadily your weak financial structure that the expensive financial resources which you have invested in the business, you would be able to replace those resources with the cheaper and the say affordable financial resources. So this all depends upon how well we manage our organization, how will we manage the firms and which direction we give it to because first and the foremost requirement of starting and growing with any businesses is the finance. And the proper financial management is that the beginning of any good business, this is a prerequisite that you should be knowing that finance is very-very scarce source, I should be learning about managing it very carefully, meticulously, so that my business grows and the ultimate objective of maximization of the value of the firm I am able to achieve, right. So, now I will take you to the forward this take forward to the towards a formal discussion here and when we talk about the different important parts that what we are going to learn about in this subject will be talking about certain things like, say, this beginning is this is the introductory lecture and I am say just trying to build a foundation about this subject and this particular course, finance and the financial management. So, ultimately, we are going to learn about the finance and the financial management as a whole, which is very important for any business manager or particularly people are dealing in the say a finance and accounting department of any organization and especially for the CFOs, right.

So, we will start with the basic discussion, the introductory part of this particular course, financial management, and slowly and steadily build up this pyramid and we will try to means learn about the different other concepts of financial management. As we move forward into the discussion we will be learning about the different concepts of financial management. So, today in this beginning in the introductory lecture, I would like to give you the overall means a feeling of this course, and the overview of this course that what all we are going to discuss in the say the days to come or maybe in the next subsequent lectures and what different things we are going to involve in this learning process about this financial management. So, we will learn the basics of the financial management which you can call it as the fundamentals of financial managements. Then, after that I will take you towards the time value of money, time value of money is a very-very important concept, you all understand, I think to some extent, that a money or a rupee today in my pocket or with anyone amongst us is more valuable as compared to a rupee coming after 1 month, right. So, earlier the value or earlier the money or earning or any resources, financial resources you are earning, it has more value as compared to the financial resources coming to us at some later point of time. So, it means we will be then from this basic foundation, I will take you to the time value of money, from the time value of money then after that, we will start talking about the proper business finance there we will talk about the say a capital structure of the firms that how to decide the financial mix for the firms. Then similarly, we will be talking about the other important components like your cost of capital and then yours say other important concept like say financial risk management and other important areas will be discussing.

So, means it will be a complete course, that at the end of means the total discussion of 30 hours you will be able to means very clear, be clear in your mind that what is the financial management and what is means all about we talk about the financial management as area of learning. So, let us start with the foundation and the basics of the financial management and this is the beginning I have done in this a few slides and if you talk about that, the first thing is the finance and the financial management, what is finance and what is a financial management? You would agree with me and you know it I think to some extent because you must have some idea about the finance and the financial management. Finance has 2 important components one is called as a money which we all use for our daily purposes for the daily needs and any individual any human being, if he uses any finance for his consumption purpose for buying the goods and services for himself or his family or for his other near and dear that is called as money. Because the benefit of that finance if you are able to enjoy only for once only for the say at one point of time that money was with me, I purchased the goods and services from the market, I consume that that money is gone benefit I enjoyed, and that part is over, right. But the funds which we use in the business which we invest in the business which we use in the business, they are called as capital, the name of that finance is capital. So, we will be learning about, that what is that, it is the beginning of the business, how to invest that capital into the business, how to say appreciate that capital, how to maximize that capital and financial resources and how to grow with any startup or any say small level of the organization maybe you call it as the sole proprietorship, right. So, for example, what I have written here is finance may be defined as the art and science of managing money, is the art and science of managing money.

For example, if I have 100 rupees, and if I go to market and purchase some goods and services, that 100 rupees is gone, there can be another guy that he can buy that say, some goods for 100 rupees, he can sell those goods for 150 rupees in the market to some other customers, where they are are not easily available and he can make it say 50 rupees with the help of that 100 rupee. So, his 100 rupee becomes 150 rupees. So, this is the art and science of managing the money. When we are managing it only for one purpose, one single use of the money it is called as money, but when it is say use for the multiplication for the investment in the business for the purpose of the business, then it is called as capital and the second part which we are calling as capital, investing any amount of the money into business and maximizing those financial resources, we are going to talk about that. So, difference between the money and the capital is finance is same, the 100 rupees is same, but the money is that once you go to market you consume that only for once that is called as money, but if you invest the same 100 rupees into any kind of business and then you grow up with those funds, you make it 150, 200, 300 rupees, it becomes capital. So, we will have to make our minimum resources maximum resources and that is how we can do it that is only possible with the help of learning the concepts of financial management. Second important point here is financial management is concerned with the duties of the financial managers in the business firms, duties of the financial managers in the firms. What financial managers do? You would means agree with me that every firm has a different department, organization maybe a small, big or medium sized organization that is divided into different departments and every department is doing a different kind of the functions they are performing different kinds of jobs, different kinds of functions. We have for example the purchase department, they purchase raw material, different kinds of raw material, their job is to seek the requirement from the production department and purchase the best quality of the material at the very competitive prices.

So, that is the only function of the purchase department, they place the orders, they received the materials, they take the material to the warehouse, and finally the material is available with us all the times. Then the another department is a production department, production department job is converting the raw material into finished product and then passing it on to the warehouse and partly even from the plant some material goes to the market. So, we have the production department. Once the production is over after that we have the marketing department, marketing department has 2 broad functions, they have the say advertising function also and they have the sales and distribution function also. So, they are largely their major chunk of operations is involved into sales and distribution of the product, but at the same time, they keep on advertising the product, having the feel of the market, knowing about the customer requirements and giving the feedback back to the firm or to the production departments. So that the product and services can be modified as per the requirements of the customers in the market so that is the job of the marketing department, right. Then after that, we have the after sale service department. So, means once we sell the product in the market, it requires after sale service. So, we have the after sale service department in the firm whose job is to keep the people or our customers satisfied. In between, there is one department which is called as finance department, accounting and finance department. There are other departments also for example, human resource department, HR department, they deal with the total human resources and taking care of all the Human Resources hiring of the people, properly managing those resources within the firm and then taking care of all their financial and physical requirements.

So there is HR department also, apart from all these departments. Your purchase department, production department, your marketing departments, human resource department, sales and distribution department after sale service department, we have a very-very important department which is called us finance department CFO means the firm is the head of that department, Chief Financial Officer is the, who is in the firm CFO of the firm is the one who heads their finance and accounting department. And the job of the finance department is always arranging the funds to be invested in the business and fulfilling the financial requirements of different departments. Because purchase, people cannot purchase the material until and unless you give them sufficient amount of funds. Production people cannot produce if you provide them different inputs and different inputs come from the market and they need funds. Marketing people cannot go for marketing functions until and unless they are supported by the financial say requirements or by the finance department. Similarly, your HR department need funds, your after sale service department need funds everybody need funds. So, it means when people need funds, it means if you have finance required amount of the finance in the business, other things can be arranged, but you do not have the required amount of the finance, other things cannot be arranged. This is the one part, second part is having the funds is one thing, but properly managing the funds is another important thing. That is why we remain very careful and we need very good and expert people who know what is the finance, what is the importance of the finance in the business and how to properly manage the finance, right? So, here when we are talking about financial management is concerned with the duties of financial managers in the business firms, that what the financial managers do for the whole day in the firm that all is called as the financial management.

Then important part is financial managers actively manage the financial affairs of any type of the business namely financial and non-financial, private and public large and small, profit seeking and not for profit, any kind of the business you talk about whether we are a profit making organization. Whether we are not for the profit making organization, whether we are a small firm, we are a large firm, we are a manufacturing firm, we are a service rendering organization, everywhere you need the funds. Everywhere you need finance and proper management of the finance is most important thing. If you are not managing your finances properly, even a, maybe a firm having the ample amount of the resources may become insolvent or if you are managing your finances properly then even a firm starting the business from very smallest micro level can become a transnational company. So, it all depends upon that how well we manage our funds and how well we perform the financial management functions and how active and professionally managed your finance department is. So, we will have to give more importance to the finance because if the finances are properly managed, nicely managed, then the other departments can automatically be but if the funds are not managed, then certainly other things cannot happen. So, it means finances equally important for all kinds of the organizations even for the profit making organizations even for the firms who are not for profit, right. So, it means you can understand now the slowly and steadily the importance of finance. Now, in this part we are going to talk about financial decision areas. We are going to talk about financial decision areas, I have laid down here 6 important points and the 6 important financial decision areas and this all will be talking about till this say end of the discussion for the 30 hours in this course, right. And apart from these major 6 financial decision areas, we have some other supportive areas also, which you call it as the say support, department support areas and you can call it as support also the primary areas and some other related disciplines which support the finance function in any firm or the financial management in any firms or in any kind of the firms, right.

So, when you talk about the financial decision areas, we have the 6 financial important financial decision areas, one is the investment analysis. Second is the working capital management, third one is the sources and the cost of funds. Fourth one is the determination of the capital structure and then is the dividend policy and then is the analysis of the risk and returns. Because ultimate purpose of any business is having the maximum returns at the optimum level of risk. I will not say minimum level of risk, you cannot do that, because there is a direct relationship between risk and return, there is a direct relationship between risk and return. So, higher the return risk will also be higher and lesser the return risk can also be lower that is quite possible. But our job as a good financial manager is that we have to maximize the returns of the firm because ultimate purpose of any business is the value maximization or the wealth maximization of the shareholders. People who provide the finance after performing your purchase function, production function, marketing function, distribution function after sales service function, HR functions, you have to run the business in such a manner that ultimately the return on the shareholders' investment is maximized and that all is going to happen. If you are managing your finances properly, if we are providing the required amount of funds to the different departments at the required amount of time then only you are going to think about that the best results will be available. If we are not able to do it, means at the right amount of time, it may be possible that the CFO is not able to look forward into the future and what is happening in that case, sometimes we are running short of funds, sometimes we have the ample amount of the funds, even you are running short of the funds, you are undercapitalized, you will not be able to fulfill the requirements of all the departments on time and there are obstructions in the business, if you have the more than required amount of the funds that is also not good for the business.

So, what we have to learn here is we have to have the optimum amount of the funds, so that the businesses optimally capitalized, we are optimally fulfilling the requirements of all of our departments and we are optimally managing our financial resources by taking the optimum amount of the risk and maximizing the returns on whatever the investment we are making in the market. So, this all will depend upon if your overall financial management functions are properly performed in the organization. So, now we will talk about the 6 decision areas, financial decision areas. First thing is the investment analysis. Spend more time, maximum time on the investment analysis, spend maximum time on the investment analysis, because if the analysis is better, we understand that when we are going to take any investment decision in the business, if we have properly analyzed it from the different angles, then certainly the end result is going to be better. But sometime any decision which is taken in the haste that is going to mess up with the things, going to create problems for the managers for the stakeholders of the business and it may be possible that overall idea of making investment in the business may not means come out with the desired results, it may be possible that, that investment may prove to be a bad investment and we are not able to generate sufficient returns out of it. And sometimes it becomes a loss making business and losses are so, high that you are not able to convert that business into profit within the given amount of time and finally, we take a decision that a business has to be closed down, right.

So, it means investment analysis is the most important thing and for the investment analysis, but we do, first of all we have an idea in our mind and that idea when we think of converting that into a business, first question comes up. That the product which I will say generate or the service which I will generate out of this entire business means putting all these factors of production into the job and then say converting that into that idea into the business and then business will start producing the product or generating the services who will buy that product or service from my organization, is there sufficient market available? Proper market analysis is required to be done. Market and demand analysis is the backbone of the success or failure of any business, if you have the market, if you think that you will be able to have the market, sufficient market in the initial years of your business, then there is no issue at all there is no problem at all. But if the market is not there or the market analysis has not been properly done in that case, what happens. That we manufacture the product and when we go with that product in the market, we do not find the buyers in the market. We do not find sufficient buyers in the market and if the buyers are not there in the market, then sufficiently means the sufficient buyers are not there in the market for whom you are manufacturing the product then, you generate a service and no, means buyer of that or subscriber to that service is available in the market. Then for whom you are going to means have that service. So, it means what you have to do is you have to have the ample amount of the market for your product and that you have to see beforehand that you have to see beforehand that when you start manufacturing the product, you have to think about that is there sufficient market for that? So, every investment analysis starts with the market and demand analysis, right. Similarly, then the other analysis is there apart from the market and demand analysis, then you go for the technical analysis, right, that okay market is there, demand is there, because my product is new, my concept is new, my idea is good, right? And it is acceptable to the people, we can conduct a survey and we can get good results.

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