MAGIC BOOK

Financial Management & Strategic Management

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SUMMARISED CHARTS OF

FINANCIAL MANAGEMENT

CHARTS OF CHAPTER 1

OBJECTIVE & SCOPE OF FINANCIAL MANAGEMENT

CHAP 1 SCOPE & OBJECTIVES OF FINANCIAL MANAGEMENT

2 Basic Functions of Financial Management

1. **Procurement of Funds**

Capital structure or financing decisions

- Funds can be obtained from various sources:
1. Long term sources (Equity, preference capital, debentures, term loans, etc.)
2. Short term sources (trade credit, short term advances, bank finance for working capital, etc.)
- Funds procured from various sources have **different characteristics** in term of risks, cost of funds obtained
- While procuring funds from different sources, the objective is **to minimize the cost of funds obtained.**
- Procurement of funds involved the following –
1. Identification of sources of finance.
2. Determination of finance Mix.
3. Raising the funds.
4. Division of profit between dividends and retention of profits i.e., internal funds generation, and
5. Proper balancing of risk, cost and control factors.

2. **Effective Utilization of Funds**

Investing or investing decisions

1. Funds may be invested / utilized in –
2. Fixed assets, capital projects and other long- term investment,
3. Current assets, viz. stock, debtors, and other short -term investment
4. While investing/ utilizing the funds, the objectives are **maximized on investment.**
5. While **investing/** utilized of funds, the **objective** is **to maximized return** on investment.
6. Investing / utilization of funds involved-
- Identification of different investment and business opportunities and their returns,
- Evaluation of various project based on different criteria/ factors.
- Balancing between fixed assets and need for adequate working capital, etc.

Major Considerations Involved in Procurement of Funds

Equity

1. **Risk - Low-Risk – no question of repayment of capital**. Hence, best from view point of risk
2. **Cost - Most expensive –** dividend **expectations of shareholders** are **higher than interest rates.** Also, dividend is not tax -deductible.
3. **Control -** Dilution of control- since the capital base might be expanded

Debt

1. **Risk-High- Risk – capital should be repaid** as per agreement; interest should be paid irrespective of profits earned during a period
2. **Cost-Comparatively cheaper –**Prevailing interest rates are considered only to the extent of **after -tax impact.**
3. **Control-No dilution of control-** generally there is no voting power, except in special situations, e.g., default, etc

CHAPTER 1 OBJECTIVE & SCOPE OF FINANCIAL MANAGEMENT

Evolution of Financial Management

Traditional Phase - In this phase, Financial Management was considered necessary only for special, **significant and occasional events,** e.g., mergers and acquisitions, liquidation etc. The focus of decision-making was primarily oriented towards Shareholders and Lenders (Loan Creditors).

Transitional Phase - In this phase, Financial Management was considered to meet the day-to-day **decision-making requirements of Top-Level Managers.** The focus Of decision-making was towards **funds analysis, financial planning and control**

Modern Phase - Here, Financial Management is viewed as a **supportive and Facilitative** function, not only for Top Management, but for all levels of Managers. Financial Management decisions range from corporate strategies- **mergers &takeovers, option pricing, capital budgeting,** etc. to regular and procedural aspects of financial discipline and control.

Relationship Between Investing, Financing & Dividend Decisions –

- Ultimate Objective of all Decisions is maximization of wealth of Shareholders
- A New Project needs finance , hence Investment Decision is Dependent on Financing Decision
- Financing Decision is dependent on Dividend Decision , whether to pay dividend or keep Retained Earnings

Responsibilities of Finance Manager / CFO

- **Fund Requirement Estimation –** Estimate requirements of funds , purpose of funds , timing of funds
- **Capital Structure –** Proper mix of debt & equity
- **Cash Management Decisions –** All sections / Depts get funds & there is no excessive cash in any division any point of time
- **Performance Analysis** – How effectively funds have been utilized & identifying methods of improvement
- **Dividend Decisions** – How much Amount is to be distributed as dividend & How much can be Retained Earnings
- **Financial Negotiations** – Carry out negotiation with Banks for Funds
- **Market Impact Analysis** – Monitor stock exchange quotations & behavior of share behavior of share prices

Emerging Issues / Priorities Affecting Role of CFO

- **Regulation** - Regulation requirements are increasing and CFOs have an personal stake in regulatory adherence
- **Globalization**- The challenges of globalization are creating a need for finance leaders to develop a finance function that works effectively on the global stage
- **Technology** - Technology is evolving very quickly, providing the potential for CFOs to reconfigure finance processes and drive business insight
- **Risk** - The nature of the risks that organizations face is changing, requiring more effective risk management approaches
- **Transformation** - There will be more pressure on CFOs to transform their finance functions to drive a better service to the business at zero cost impact
- **Stakeholder Management**
- **Strategy** – Make strategy because environment is complex
- **Reporting** – Reporting requirements are increasing

Limitations of Profit Maximization Objective

- Time Factor is Ignored
- It is vague , it is not clear , it is economics profit , PAT , PBT
- Maximisation is ambiguous
- It ignores Risk Factor

CHAPTER 1 OBJECTIVE & SCOPE OF FINANCIAL MANAGEMENT

Profit Maximization

- Does not consider the **effect of future cash flows, dividend decisions, EPS, etc.**
- A Firm with Profit Maximization objective **may refrain from payment of dividend** to its Shareholders.
- Ignores **time pattern of returns**
- Focus on **Short-Term**
- **Does not consider** the effect of **uncertainty / risk**
- Comparatively easy to determine the **relationship between financial decisions and profits.**
- Leads to too naive decisions, e.g. **avoiding investments which result in immediate cash losses**, but substantial revenues in the long- run, (b) **postponing replacement expenditure** to ensure short-term profits, etc.
- Focus on **Entity's short- term gains and profits**

Wealth Maximization

- Recognizes the effect of all **future cash flows, dividends, EPS, etc.**
- A Firm with **Wealth Maximization** objective may pay regular dividends to its Shareholders
- Recognizes the **time pattern of returns**
- Focus on **Medium / Long-Term**
- Recognizes the **risk-return relationships**
- Offers **no clear or specific relationship** between **financial decisions and share market prices**
- Leads to **systematic decisions using the tools and techniques of Capital Budgeting**, Risk-Return Trade-off, Leverage Effect, etc.
- Focus on **long-term wealth of Entity, Shareholders and Society as a whole**

Difference Between Financial Accounting & Financial Management

Financial Accounting

- Financial Accounting generates **information relating to operations of the Entity.**
- Financial Accounting is **past-oriented**, in the sense that transactions/ events which happen, are recorded
- **Measurement, Recognition and Disclosure** are the dominant aspects considered in accounting
- **Measurement of Funds** (i.e., Revenue, Expenses, etc.) is largely based on the accrual concept
- Accounting is guided by **principles,standards, legal requirements, etc.**

Financial Management

- Financial Management seeks to **use the information generated by the accounting function, for decision-making**
- Financial Management is **future- oriented**, i.e., to guide the Entity in future course of action
- **Procurement of Funds and them Effective Utilization** are the dominant aspects of Financial Management
- Decision-making requires the **analysis of funds in terms of Cash Inflows and Cash Outflows**
- Financial Management is **guided by tools and techniques for decision- making**

Scope of Financial Management

- **Determination of size of the enterprise** and determination of **rate of growth**
- Determining the **composition of assets of the enterprise**
- Determining the **mix of enterprise's financing** i.e. consideration of level of debt
- **Analysis, planning and control** of financial affairs of the enterprise.

Hence Financial Manager in modern times takes 3 Decisions Capital Structure , Investing & Financing Decisions

Chap 1 – Objective & Scope of Financial Management

Agency Problem & Agency Cost

In theory managers should act in the best interest of **shareholders**, however in **reality, managers may maximize their individual goal** like salary, perks etc. So, there is a principal agent try to relationship **between managers and owners**, which is known as **Agency Problem.** In A nutshell, Agency Problem is the chances that managers may place **personal goals ahead of the goal of owners**. Agency Problem leads to Agency Cost. Agency cost is the additional cost borne by the shareholders to monitor the manager and control their behaviour so as to maximize shareholders wealth . Generally, Agency Costs are of four types **(i) monitoring (ii) bonding (iii) opportunity (iv) structuring**

Agency problem between **the managers and shareholders can be addressed** if the interests of the **managers are aligned to the interests of the share- holders.**
following efforts have been made to address these issues :

1. **Managerial compensation** is linked to profit of the company to some extent
2. Employee is also designed to address the issue **maximization of the stock price is the objective of the investors**
3. **Effecting monitoring** can be done

Importance of Financial Management

Financial management is all about **planning investment, funding the investment**, **monitoring expenses** against budget and managing gains from the investments

The best way to demonstrate the importance of good financial management is to describe some of the tasks that it involves –

- **Taking care** not to over-invest in fixed assets
- **Balancing** cash-outflow with cash-inflows
- **Ensuring** that there is a sufficient level of short-term working capital
- **Setting** sales revenue targets that will deliver growth
- **Increasing** gross profit by setting the correct pricing for products or services
- **Controlling** the level of general and administrative expenses by finding more cost-efficient ways of running the day-to-day business operations, and
- **Tax planning** that will minimize the taxes a business has to pay.

Financial Distress with Insolvency

- There are various factors like price of the product/ service, demand, price of inputs e.g., raw material, labor etc., which is to be managed by an organization on a continuous basis.
- **Proportion of debt also need to be managed** by an organization very delicately.
- **Higher debt** requires **higher interest and if the cash inflow is** not sufficient then it will put lot of pressure to the organization.
- **Both short term and long term creditors** will put stress to the firm.
- If **all the above factors are not well managed** by the firm, it can **create situation known as distress, so financial distress** is a **position where Cash inflows of a firm are inadequate**
- So, **insolvency basically means inability of a firm to repay various debts and is a result of continuous financial distress**

SUMMARISED CHARTS OF

STRATEGIC MANAGEMENT

CHARTS OF CHAPTER 1

INTRODUCTION TO STRATEGIC MANAGEMENT

CHAPTER 1 INTRODUCTION TO STRATEGIC MANAGEMENT

STRATEGY

Strategy is between What we are & What we want to be

It is framed to achieve goals

It seeks to relate goals of organization to means to achieve them

It is Long Range Blue Print of the organization

Corporate Strategies are formulated by Top Level

Strategy is partly Pro-Active & partly Reactive

Strategy is no substitute for sound , alert & responsible management

It can never be perfect , flawless & optimal

So always allowances are made for possible miscalculations & unanticipated events

Importance of Strategic Management

Proactive LCD

It helps us in being Pro-active instead of being reactive

It helps to enhance longevity of Business by analysing environment

It serves as Corporate Defence Mechanism against mistakes

It helps to develop Core Competencies & Competitive Advantage

It gives framework for all major decision of organization

It gives Direction to the Company to move ahead

Limitations of Strategic Management (4C'S)

Environment is Highly Complex , it is difficult to understand the whole environment & then make strategy

SM is time-consuming process , because it takes lot of time to prepare strategy

It is Costly Process , since it involves Top Level in making decisions

In Competitive Scenario , it is difficult to estimate Competitive responses to our

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OBJECTIVES	GOALS
Objectives are precise & expressed in specific terms They are framed to achieve Goals They are organization's performance targets They help in allocation of resources They serve as Benchmark for Organisational activity **CHARACTERISTICS OF OBJECTIVES (SMART-DP)** • They are Concrete & **Specific** • They should be **Measurable** & Controllable • They should be within **constrains of Organisation resources & External Environment** • They should relate to **time frame** • They should be **Challenging** • hey provide **basis for Strategic decision making** • They should provide **standards for Performance appraisal** • They should help in achievement of **mission & purpose**	Purpose to which our efforts are directed They are Generic They are long term **To achieve Long Term Prosperity we establish Long Term Objectives in 7 Areas :** **CEPT** Competitive Position Employee Development Employee Relations Profitability Productivity Public Responsibility Technological Leadership

STRATEGIC LEVELS IN ORGANISATION &LINKAGES BETWEEN THEM

3 LEVELS IN ORGANISATION

Corporate Level – It includes CEO , BOD , Other Senior Executives & Corporate Staff

- They make strategies define mission & goals , which Business we should start & allocate resources in which area

Business Level – It includes Divisional Level Managers & Staff

- They make strategies of their Business Units , these are Business Level Heads who make strategies specific to their particular Business
- They should listen to ideas of Functional Level managers

Funtional Level – It includes Functional Managers

- They are responsible for specific Business Functions or operations
- They make Functional Strategies which will help to achieve Strategic objectives set by Business & Corporate Level general managers
- They are closer to Customer

3 RELATIONSHIPS BETWEEN LEVELS OF MANAGEMENT

- **Functional & Divisional Relationship** – Each Functional or divisional head runs functions or division independently and reports directly to Business head , which is Corporate Level . Functions can be Production , Finance & Divisions can be kids toys , Teenager toys etc
- **Horizontal Relationship** – In these everyone from Top Level to Staff level employees are considered at same level , more suitable for start-ups , leads to openness & transparency in work culture & focused more on idea sharing & innovation
- **Matrix Relationship** – In these we make teams of people from various departments for temporary task based projects . Eg – Movie Mission Mangal . It helps conglomerates to manage work , where it is impossible to track each functional level team . More than one Business level managers , for each functional level teams . Useful for Large organisations