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What is Finance?

- **Finance** can be defined as the science and art of managing money.
- At the personal level, finance is concerned with individuals' decisions about how much of their earnings they spend, how much they save, and how they invest their savings.
- In a business context, finance involves the same types of decisions: how firms raise money from investors, how firms invest money in an attempt to earn a profit, and how they decide whether to reinvest profits in the business or distribute them back to investors.

financial management

The planning, directing, monitoring, organizing, and controlling of the monetary resources of an organization.

Definition

Business finance

Guthmann and dougall:-" business finance can be broadly defined as the activity concerned with the planning, raising, controlling and administering the funds used in the business".

According to Soloman, "Financial management is concerned with the efficient use of economic resources". **According to Phillippatus**, "Financial management is concerned with management decision that result in acquisition and financing of long-term and short-term credits for the firm".

Objectives of FM

Objectives of FM broadly divided into two parts such as:

1. **Profit maximization**
2. **Wealth maximization.**

Profit max^n:	• **Profit is the measuring techniques to understand the business efficiency of the concern. It is also called as cashing per share maximization.** • **Profit maximization is also the traditional and narrow approach, which aims at, maximizes the profit of the concern.**

2) Wealth maximization

Wealth maximization means maximizing share/stock holders wealth.

symbolically

share holder's wealth = no of shares x owned × **Current stock price per share**

Factors in favor of wealth maximization

- It serves the interests of creditors, employs, shareholders and society.
- Wealth maximization adds to productivity and efficiency of the firm.
- It minimizes the conflict between share holders and management of the company.
- Wealth maximization takes into account time value of money.
- the objective helps in increasing value of shares in the market.

Nature of financial management

- FM is an area of decision making in finance function of the business.
- It is descriptive/ theoretical/ statistical/ historical and analytical in nature.
- It involves application of management principles to the finance function.
- It is applicable to every organization irrespective of its size, nature, place.

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- It deals with accumulation and utilization of financial resources(business resources).
- It is directed towards achieving business objectives.

Scope of Financial Management

- ✓ Estimating financial requirement
- ✓ Deciding capital structure
- ✓ Selecting a source of finance
- ✓ Selecting a pattern of Investment
- ✓ Proper cash management
- ✓ Implementing financial controls
- ✓ Proper use of surpluses

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Need of Financial Management or Financial Decisions

- Financing Decisions
- Investment Decisions
- Dividend Decisions

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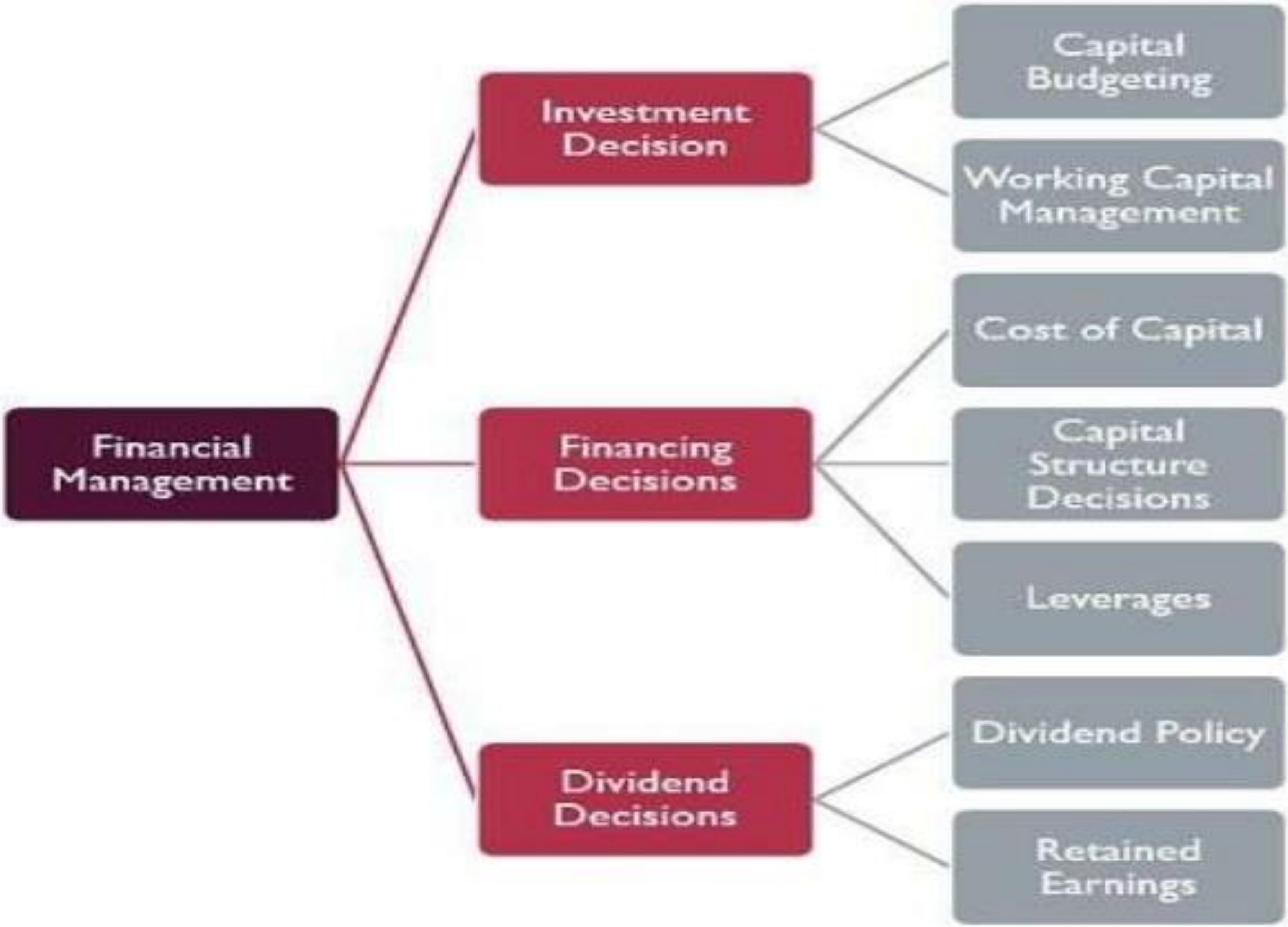
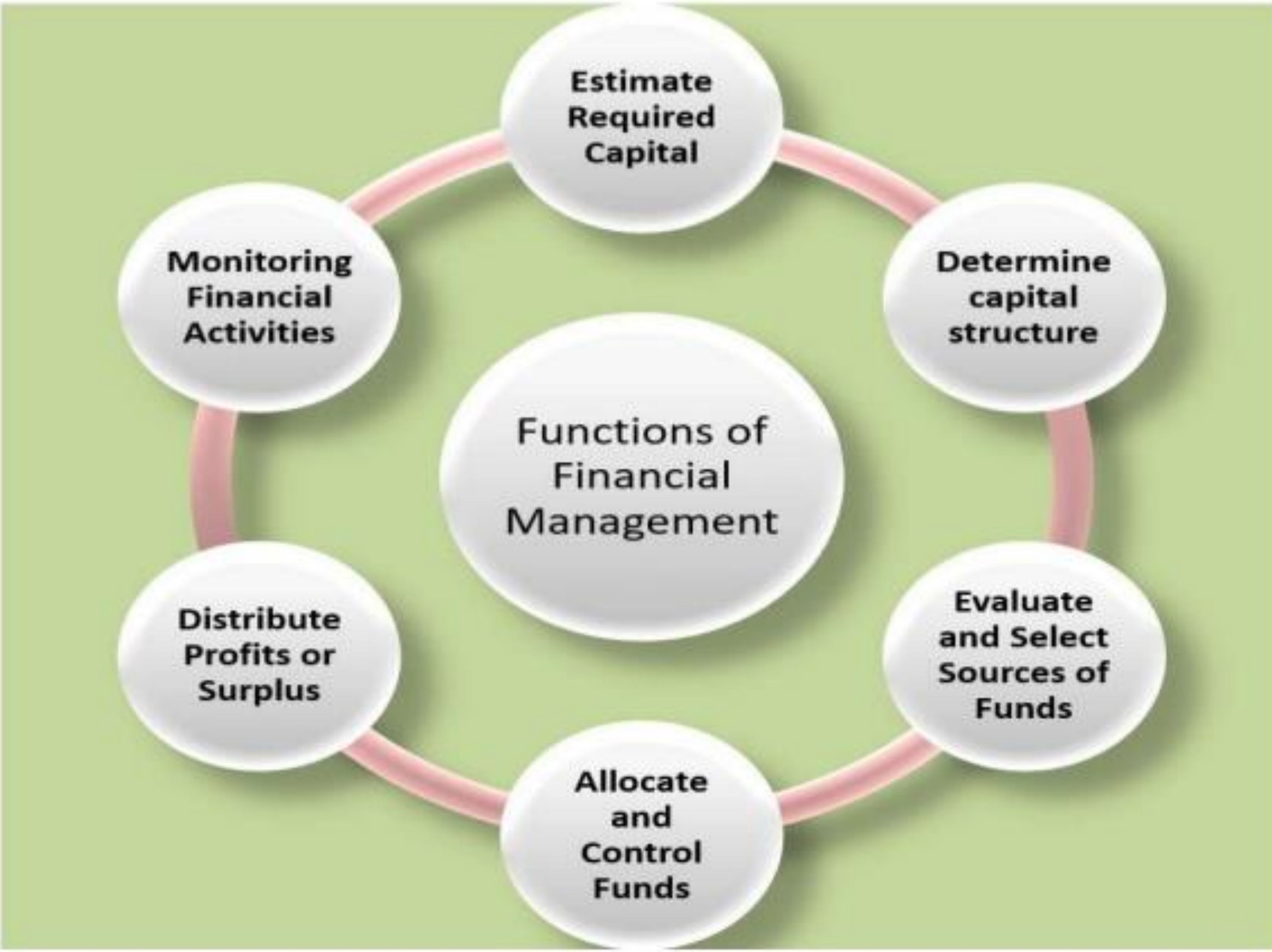

Financial Management
Investment Decision
Financing Decisions
Dividend Decisions
Capital Budgeting
Working Capital Management
Cost of Capital
Capital Structure Decisions
Leverages
Dividend Policy
Retained Earnings


Estimate Required Capital
Determine capital structure
Evaluate and Select Sources of Funds
Allocate and Control Funds
Distribute Profits or Surplus
Monitoring Financial Activities
Functions of Financial Management

Time Value of Money

- Time value of money means that the value of money is different in different time periods. The value of money received today is more than the value of same amount receivable at some other time in future.
- The difference in the value of money today and tomorrow is referred as time value of money.
- Therefore, given a choice of receiving a sum of money today or in the future, a rational person will always choose to receive the money now as it has more value today than in the future.

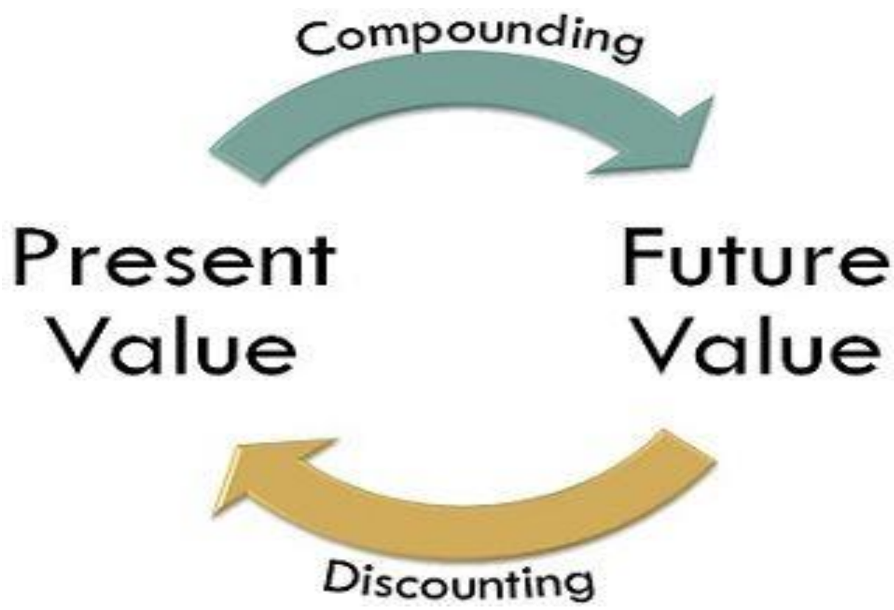
- Four reasons may be attributed to the individual's time preference for money:
- Investment Opportunities
- Risk (Future is uncertain and risky)
- Personal Consumption Preference
- Inflation (Purchasing power)

Techniques of Time Value of Money

Two most common methods of adjusting cash flows for time value of money:

Compounding—the process of calculating future values of cash flows and

Discounting—the process of calculating present values of cash flows.



Compounding is the method used in finding out the future value of the present investment. The future value can be computed by applying the compound interest formula which is as under:

Future Value:

$$\text{Single Cash Flow} = \text{Amount } (1+R)^n$$

$$\text{Annuity} = \text{Amount X } \frac{[(1+R)^n - 1]}{R}$$

- Where n = number of years
  R = Rate of return on investment.

- Discounting is the process of converting the future amount into its Present Value. The current value of the given future value is known as Present Value. The discounting technique helps to ascertain the present value of future cash flows by applying a discount rate. The following formula is used to know the present value of a future sum:

$$\text{Present Value} = \frac{FV_1}{(1+R)^1} + \frac{FV_2}{(1+R)^2} + \frac{FV_3}{(1+R)^3} + \ldots\ldots\ldots\ldots + \frac{FV_n}{(1+R)^n}$$

- Where 1,2,3,…..n represents future years
  FV = Cash flows generated in different years,
  R = Discount Rate

Reason for Time value of Money.

- *There are certain reason which determine that money has time value following are the reason;*

1. **Risk and Uncertainty** – *As we know future is never certain and we can't determines the risk involved in future because outflow of cash is in our hand as payment where as there is no certainty for future cash inflows.*
2. **Inflation** - *In an inflationary economy, the money received today, has more purchasing power than the money to be received in future. In other words, a rupee today represents a greater real purchasing power than a rupee in future.*

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3. **Consumption** - *Individuals generally prefer current consumption to future consumption.*
4. **Investment opportunities** - *An investor can profitably use the received money today to get higher return tomorrow or after a certain period of time.*

e.g.- if an individual is given an alternative either to receive Rs. 10,000 now or after one year, he will prefer Rs.10,000 now. This is because, today, he may be in a position to purchase more goods with this money than what he is going to get for the same amount after one year.