

IMPORTANCE OF FINANCIAL MANAGEMENT

Financial management is a managerial activity concerning the finances of the firm. It deals with planning, control, and management of financial resources of the firm. It is not enough to only raise the finance for industrial activity; it is necessary to manage it properly as well. Financial management is assuming importance in the modern context what with the most crucial decisions of the firm being those which relate to finance. A small industries unit has to undertake four important activities as a part of its business: (1) Finance, (2) Production, (3) Marketing, and (4) Human Resource Management.

There exists an inseparable relationship between finance function on the one hand and the production, marketing and other functions on the other. Finance is at the root of any business activity. Therefore, there is a need to properly manage it.

Functions of Financial Management

Financial management involves two types of functions: (i) Managerial finance functions and (ii) Routine finance functions.

Managerial finance functions require skilful planning, control, and execution of financial activities. Routine finance functions, on the other hand, do not require great managerial ability to be carried out. They are clerical in nature and incidental to the effective handling of the managerial finance functions.

Managerial finance functions for small industries are as follows.

- (1) Estimating financial requirement
- (2) Identifying sources of finance
- (3) Raising of finance
- (4) Proper use of finance
- (5) Control of finance

(1) **Estimating financial requirement:** Before starting an industrial unit, it is necessary that an entrepreneur estimate its financial requirement. He should scientifically calculate the fixed capital and working capital requirements.

The project report must be prepared with the help of a finance expert or a consultant.

- (2) **Identifying sources of finance:** Once the total financial requirement is known, the entrepreneur should identify the sources from which finance can be raised. There are many sources open to a small industrial unit such as (i) personal funds, (ii) funds from friends, (iii) banks, (iv) financial institutions, and (v) public deposits.

After a careful analysis the entrepreneur should decide from which source he can raise funds.

- (3) **Raising of finance:** Raising of finance does not mean mere collection of funds. It has four important dimensions: (i) Right source, (ii) Time schedule, (iii) Cost, and (iv) Adequacy.

The raising of finance should be adequate, at the right time, from a power source, and at the right price or cost. Finance raised should be adequate and sufficient. This helps in the smooth running of business.

An entrepreneur should select the right type of source to raise finance from. This requires a lot of thought. The projection of time, that is, when the finance is needed, at what stage and so on should also be given consideration. All the finance is not required on the first day. One can phase out the time for collecting funds. Funds should be collected as and when required. This will reduce the cost (interest charges). Finance should be so arranged that it becomes available at the proper time, neither too early nor late. The cost aspect should also be considered while raising funds.

SNAPSHOT

Financial Management involves two types of functions:

- ◆ Managerial finance functions
- ◆ Routine finance functions

(I) Managerial finance functions for small Industries are as given below.

- ◆ Estimating financial requirement
- ◆ Identifying sources of finance
- ◆ Raising of finance
- ◆ Proper use of finance
- ◆ Control of finance

(II) Routine finance functions are listed below.

- ◆ Supervision of cash receipts and payments
- ◆ Safeguarding cash balances
- ◆ Record keeping (i.e. accounting)
- ◆ Custody and safeguarding of securities, insurance policies, and other important documents
- ◆ Taking care of mechanical details of outside finance
- ◆ Regular return of borrowed funds

- (4) **Proper use of finance:** Finance raised for the purpose of business activity should be carefully used. The project report prepared by the entrepreneur with the help of experts indicates clearly how the finance collected should be used. Financial discipline has to be observed to keep the enterprise in good health. Money should not be used for any purpose other than purely business activity. Many units become sick because of lack of proper use of finance.

- (5) **Control of finance:** Control relates to establishing proper procedures and systems to check the financial activity of the business enterprise. A business should be carried out as planned in the project report. Income and expenditure should be kept under control. A review should be made periodically to know whether the business is being carried out on proper lines or not.

Routine finance is incidental to the effective execution of the managerial finance functions. They involve a lot of paper work and time. They deal with procedural aspects. Important routine finance functions are listed below.

- (1) Supervision of cash receipts and payments
- (2) Safeguarding cash balances
- (3) Record keeping (accounting)
- (4) Custody and safeguarding of securities, insurance policies, and other important documents
- (5) Taking care of mechanical details of outside finance
- (6) Regular return of borrowed funds.

Financial management at the firm level also requires proper management of fixed assets, working capital, and costs. Fixed assets themselves cannot generate profits. Idle fixed assets do not generate profits. They should be properly used and managed. Repairs, maintenance, replacement, and revaluation of assets needs skilful management.

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The management of working capital has become an important activity. The proper management of capital ensures good health for business. It is also essential that an entrepreneur should make continuous cost analysis and try to minimise costs by evolving effective methods.

“Do not borrow funds which you cannot repay. That harms your reputation and business.”

“Financial discipline is of utmost importance for business and industry.”