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A review on the importance of financial management in today's economic growth

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Abstract

This paper presents the importance of financial management in a systematic way and explains the key concept of financial management. In the modern era, the business decision is increasing. So, the role and importance of financial and managerial economics also increase. Because it is helpful for many types of business decisions.

Managerial economics decides the business is going towards profit or loss. Managerial economics decides which way is good for the business. And it is only possible when managerial economics plays a very big and important role in cost control decisions. Thus, role and importance of financial and managerial economics in choosing right decisions is very powerful.

In this paper we have reviewed the related concepts with respect to the business management such as the types of finance, financial management, the scope of financial management and overall the objective of financial management.

Keywords: financial management and economic growth

Introduction

Business concern needs finance to meet their requirements in the economic world. Any kind of business activity depends on the finance. Hence, it is called as lifeblood of business organization. Whether the business concerns are big or small, they need finance to fulfil their business activities. In the modern world, all the activities are concerned with the economic activities and very particular to earning profit through any venture or activities. The entire business activities are directly related with making profit. (According to the economics concept of factors of production, rent given to landlord, wage given to labour, interest given to capital and profit given to shareholders or proprietors), a business concern needs finance to meet all the requirements. Hence finance may be called as capital, investment, fund etc., but each term is having different meanings and unique characters. Increasing the profit is the main aim of any kind of economic activity. MEANING OF FINANCE Finance may be defined as the art and science of managing money. It includes financial service and financial instruments. Finance also is referred as the provision of money at the time when it is needed. Finance function is the procurement of funds and their effective utilization in business concerns. The concept of finance includes capital, funds, money, and amount. But each word is having unique meaning. Studying and understanding the concept of finance become an important part of the business concern [1].

Definition of business finance

According to the Wheeler, "Business finance is that business activity which concerns with the acquisition and conversation of capital funds in meeting financial needs and overall objectives of a business enterprise". According to the Guthumann and Dougall, "Business finance can broadly be defined as the activity concerned with planning, raising, controlling, administering of the funds used in the business". In the words of Parhter and Wert, "Business finance deals primarily with raising, administering and disbursing funds by privately owned business units operating in nonfinancial fields of industry". Corporate finance is concerned with budgeting, financial forecasting, cash management, credit administration, investment analysis and fund procurement of the business concern and the business concern needs to adopt modern technology and application suitable to the global environment [2]. According to the Encyclopedia of Social Sciences, "Corporation finance deals with the financial problems of corporate enterprises. These problems include the financial aspects of the promotion of new enterprises and their administration during early development, the accounting problems connected with the distinction between capital and income, the administrative questions created by growth and expansion, and finally, the financial adjustments required for the bolstering up or rehabilitation of a corporation which has come into financial difficulties"

Types of finance

Finance is one of the important and integral part of business concerns, hence, it plays a major role in every part of the business activities. It is used in all the area of the activities under the different names. Finance can be classified into two major parts:

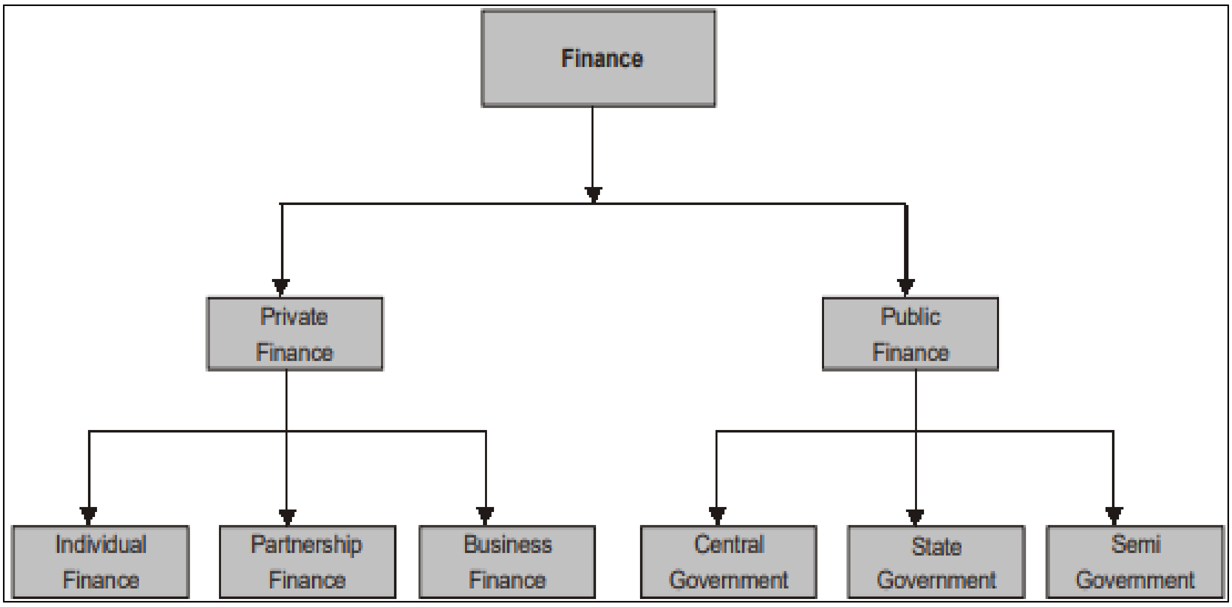

Fig 1: Type of finance

Private Finance, which includes the Individual, Firms, Business or Corporate Financial activities to meet the requirements. Public Finance which concerns with revenue and disbursement of Government such as Central Government, State Government and Semi-Government Financial matters [3].

Definition of financial management

Financial management is an integral part of overall management. It is concerned with the duties of the financial managers in the business firm. The term financial management has been defined by Solomon, "It is concerned with the efficient use of an important economic resource namely, capital funds". The most popular and acceptable definition of financial management as given by S.C. Kuchal is that "Financial Management deals with procurement of funds and their effective utilization in the business". Howard and Upton: Financial management "as an application of general managerial principles to the area of financial decision-making. Weston and Brigham: Financial management "is an area of financial decision-making, harmonizing individual motives and enterprise goals". Joshep and Massie: Financial management "is the operational activity of a business that is responsible for obtaining and effectively utilizing the funds necessary for efficient operations [4]. Thus, Financial Management is mainly concerned with the effective funds management in the business. In simple words, Financial Management as practiced by business firms can be called as Corporation Finance or Business Finance.

Scope of financial management

Financial management is one of the important parts of overall management, which is directly related with various functional departments like personnel, marketing and production. Financial management covers wide area with multidimensional approaches. The following are the important scope of financial management.

1. Financial Management and Economics Economic concepts like micro and macroeconomics are directly applied with the financial management approaches. Investment decisions, micro and macro environmental factors are closely associated with the functions of financial manager. Financial management also uses the economic equations like money value discount factor, economic order quantity etc. Financial economics is one of the emerging area, which provides immense opportunities to finance, and economical areas.
2. Financial Management and Accounting Accounting records includes the financial information of the business concern. Hence, we can easily understand the relationship between the financial management and accounting. In the olden periods, both financial management and accounting are treated as a same discipline and then it has been merged as Management Accounting because this part is very much helpful to finance manager to take decisions. But nowaday's financial management and accounting discipline are separate and interrelated.
3. Financial Management or Mathematics Modern approaches of the financial management applied large number of mathematical and statistical tools and

techniques. They are also called as econometrics. Economic order quantity, discount factor, time value of money, present value of money, cost of capital, capital structure theories, dividend theories, ratio analysis and working capital analysis are used as mathematical and statistical tools and techniques in the field of financial management.

4. Financial Management and Production Management Production management is the operational part of the business concern, which helps to multiple the money into profit. Profit of the concern depends upon the production performance. Production performance needs finance, because production department requires raw material, machinery, wages, operating expenses etc. These expenditures are decided and estimated by the financial department and the finance manager allocates the appropriate finance to production department. The financial manager must be aware of the operational process and finance required for each process of production activities [5].
5. Financial Management and Marketing Produced goods are sold in the market with innovative and modern approaches. For this, the marketing department needs finance to meet their requirements the financial manager or finance department is responsible to allocate the adequate finance to the marketing department. Hence, marketing and financial management are interrelated and depends on each other.
6. Financial Management and Human Resource Financial management is also related with human resource department, which provides manpower to all the functional areas of the management. Financial manager should carefully evaluate the requirement of manpower to each department and allocate the finance to the human resource department as wages, salary, remuneration, commission, bonus, pension and other monetary benefits to the human resource department. Hence, financial management is directly related with human resource management.

Objectives of financial management

Effective procurement and efficient use of finance lead to proper utilization of the finance by the business concern. It is the essential part of the financial manager. Hence, the financial manager must determine the basic objectives of the financial management. Objectives of Financial Management may be broadly divided into two parts such as: 1. Profit maximization 2. Wealth maximization.

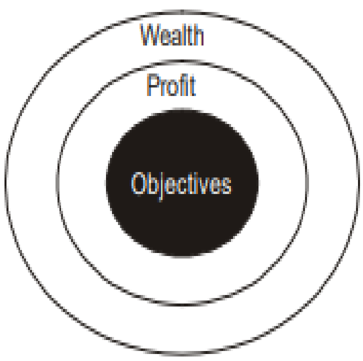

Fig 2: Objectives of financial management

Profit maximization

Main aim of any kind of economic activity is earning profit. A business concern is also functioning mainly for the purpose of earning profit. Profit is the measuring techniques to understand the business efficiency of the concern. Profit maximization is also the traditional and narrow approach, which aims at, maximizes the profit of the concern. Profit maximization consists of the following important features.

1. Profit maximization is also called as cashing per share maximization. It leads to maximize the business operation for profit maximization [6].
2. Ultimate aim of the business concern is earning profit, hence, it considers all the possible ways to increase the profitability of the concern
3. Profit is the parameter of measuring the efficiency of the business concern. So it shows the entire position of the business concern.
4. Profit maximization objectives help to reduce the risk of the business.

Favorable arguments for profit maximization

The following important points are in support of the profit maximization objectives of the business concern:

i) Main aim is earning profit.
ii) Profit is the parameter of the business operation.
iii) Profit reduces risk of the business concern.
iv) Profit is the main source of finance.
v) Profitability meets the social needs also.

Unfavorable arguments for profit maximization

The following important points are against the objectives of profit maximization:

(i) Profit maximization leads to exploiting workers and consumers.
(ii) Profit maximization creates immoral practices such as corrupt practice, unfair trade practice, etc.
(iii) Profit maximization objectives leads to inequalities among the sake holders such as customers, suppliers, public shareholders, etc [7].

Drawbacks of profit maximization

Profit maximization objective consists of certain drawback also:

i) It is vague: In this objective, profit is not defined precisely or correctly. It creates some unnecessary opinion regarding earning habits of the business concern.
ii) It ignores the time value of money: Profit maximization does not consider the time value of money or the net present value of the cash inflow. It leads certain differences between the actual cash inflow and net present cash flow during a particular period.
iii) It ignores risk:
iv) Profit maximization does not consider risk of the business concern. Risks may be internal or external which will affect the overall operation of the business concern.

Wealth maximization

Wealth maximization is one of the modern approaches, which involves latest innovations and improvements in the field of the business concern. The term wealth means shareholder wealth or the wealth of the persons those who are involved in the business concern. Wealth maximization is also known as value maximization or net present worth maximization. This objective is an universally accepted concept in the field of business [8].

Favorable arguments for wealth maximization

(i) Wealth maximization is superior to the profit maximization because the main aim of the business concern under this concept is to improve the value or wealth of the shareholders.
(ii) Wealth maximization considers the comparison of the value to cost associated with the business concern. Total value detected from the total cost incurred for the business operation. It provides extract value of the business concern.
(iii) Wealth maximization considers both time and risk of the business concern.
(iv) Wealth maximization provides efficient allocation of resources.
(v) It ensures the economic interest of the society.

Unfavorable arguments for wealth maximization

(i) Wealth maximization leads to prescriptive idea of the business concern but it may not be suitable to present day business activities.
(ii) Wealth maximization is nothing, it is also profit maximization, it is the indirect name of the profit maximization.
(iii) Wealth maximization creates ownership-management controversy.
(iv) Management alone enjoy certain benefits.
(v) The ultimate aim of the wealth maximization objectives is to maximize the profit.
(vi) Wealth maximization can be activated only with the help of the profitable position of the business concern

Approaches to financial management

Financial management approach measures the scope of the financial management in various fields, which include the essential part of the finance. Financial management is not a revolutionary concept but an evolutionary. The definition and scope of financial management has been changed from one period to another period and applied various innovations. Theoretical points of view, financial management approach may be broadly divided into two major parts [9].

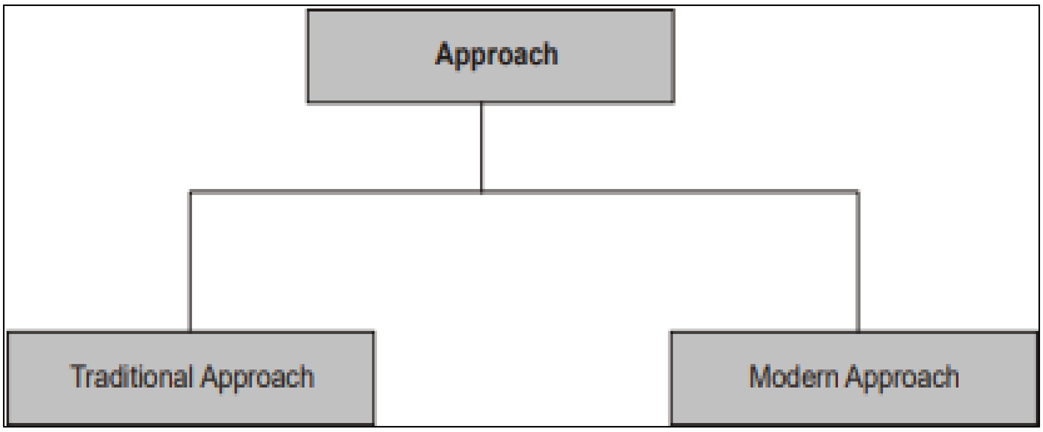

Fig 3: Approaches to finance Management

Traditional approach

Traditional approach is the initial stage of financial management, which was followed, in the early part of during the year 1920 to 1950. This approach is based on the past experience and the traditionally accepted methods. Main part of the traditional approach is rising of funds for the business concern. Traditional approach consists of the following important area. Arrangement of funds from lending body. Arrangement of funds through various financial instruments. Finding out the various sources of funds [10].

Functions of finance manager

Finance function is one of the major parts of business organization, which involves the permanent, and continuous process of the business concern. Finance is one of the interrelated functions which deal with personal function, marketing function, production function and research and development activities of the business concern. At present, every business concern concentrates more on the field of finance because, it is a very emerging part which reflects the entire operational and profit ability position of the concern. Deciding the proper financial function is the essential and ultimate goal of the business organization. Finance manager is one of the important role players in the field of finance function. He must have entire knowledge in the area of accounting, finance, economics and management. His position is highly critical and analytical to solve various problems related to finance. A person who deals finance related activities may be called finance manager. Finance manager performs the following major functions**:**

1. **Forecasting Financial Requirements:** It is the primary function of the Finance Manager. He is responsible to estimate the financial requirement of the business concern. He should estimate, how much finances required to acquire fixed assets and forecast the amount needed to meet the working capital requirements in future.

2. **Acquiring Necessary Capital:** After deciding the financial requirement, the finance manager should concentrate how the finance is mobilized and where it will be available. It is also highly critical in nature.

3. **Investment Decision:** The finance manager must carefully select best investment alternatives and consider the reasonable and stable return from the investment. He must be well versed in the field of capital budgeting techniques to determine the effective utilization of investment. The finance manager must concentrate to principles of safety, liquidity and profitability while investing capital.

4. **Cash Management:** Present days cash management plays a major role in the area of finance because proper cash management is not only essential for effective utilization of cash but it also helps to meet the short-term liquidity position of the concern.

5. **Interrelation with Other Departments:** Finance manager deals with various functional departments such as marketing, production, personel, system, research, development, etc. Finance manager should have sound knowledge not only in finance related area but also well versed in other areas. He must maintain a good relationship with all the functional departments of the business organization [11].

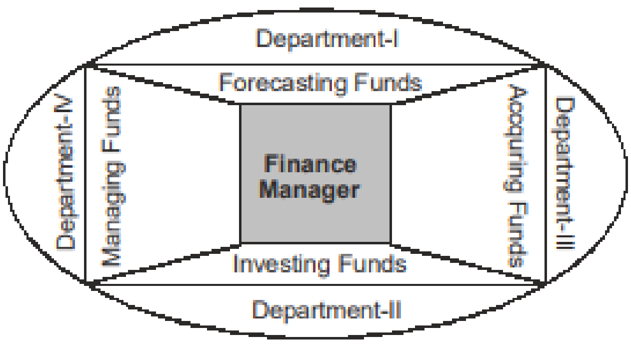

Fig 4: Function of financial manager

Importance of financial management

Finance is the lifeblood of business organization. It needs to meet the requirement of the business concern. Each and every business concern must maintain adequate amount of finance for their smooth running of the business concern and also maintain the business carefully to achieve the goal of the business concern. The business goal can be achieved only with the help of effective management of finance [12]. We can’t neglect the importance of finance at any time at and at any situation. Some of the importance of the financial management is as follows:

Financial planning

Financial management helps to determine the financial requirement of the business concern and leads to take financial planning of the concern. Financial planning is an important part of the business concern, which helps to promotion of an enterprise.

Acquisition of funds

Financial management involves the acquisition of required finance to the business concern. Acquiring needed funds play a major part of the financial management, which involve possible source of finance at minimum cost.

Proper use of funds

Proper use and allocation of funds leads to improve the operational efficiency of the business concern. When the finance manager uses the funds properly, they can reduce the cost of capital and increase the value of the firm.

Financial decision

Financial management helps to take sound financial decision in the business concern. Financial decision will affect the entire business operation of the concern. Because there is a direct relationship with various department functions such as marketing, production personnel, etc.

Improve profitability

Profitability of the concern purely depends on the effectiveness and proper utilization of funds by the business concern. Financial management helps to improve the profitability position of the concern with the help of strong financial control devices such as budgetary control, ratio analysis and cost volume profit analysis.

Increase the value of the firm

Financial management is very important in the field of increasing the wealth of the investors and the business concern. Ultimate aim of any business concern will achieve the maximum profit and higher profitability leads to maximize the wealth of the investors as well as the nation [13].

Promoting savings

Savings are possible only when the business concern earns higher profitability and maximizing wealth. Effective financial management helps to promoting and mobilizing individual and corporate savings [14]. Nowadays financial management is also popularly known as business finance or corporate finances. The business concern or corporate sectors cannot function without the importance of the financial management [15]

Conclusion

The importance of financial management in running business organizations cannot be overemphasized. Developing a strategic vision which sets critical direction and guides resource allocation within the organization is key. Crafting strategy, effective implementation, monitoring, evaluating performance and developing corrective interventions where necessary, are some of the critical aspects that can assist organizations in creating and maintaining sustainable competitive advantage. The role of the board of directors in the crafting and execution of strategy is also a very important component of corporate governance. Organizational boards and management teams therefore need to give strategic management in all its facets the attention it deserves for ensuring superior performance in their respective industries.

Finally the paper have discussed different fundamental concepts of financial management.

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