Concept of Financial Management

The term 'finance' in real world has been interpreted variously by different scholars and experts. This is due to change in the concept of finance with changes in time and circumstances. In the early days of its evolution finance was concerned with the raising of funds. But in the current literature a broader scope has been included in addition to procurement of funds. Efficient use of 'resources pooled' is universally recognized as important as raising of funds.

The modern literature on financial management largely reflects this concept. "Financial Management" according to Solomon and Pringle, "is concerned with the efficient use of an important economic resource namely, capital funds". The emphasis of this definition is on effective and optimal utilization of scarce financial resource. Weston and Brigham define financial management on the basis of functions and responsibilities that the financial managers discharge in the modern organisations. According to them, "financial management is concerned with planning for acquiring and utilizing funds in ways that maximize the efficiency of the organisation's operations". This definition has its stress on the importance of sound knowledge on the part of the managers of the
financial markets from which funds could be drawn and of how good investment decisions could be made to stimulate efficient utilization of such funds for effective operations of the organisation through financial and investment planning and control. To Walker, "financial management is the application of planning and control functions to the finance function". This definition is concerned with the "act of deciding in advance the financial activities that are necessary if the firm is to achieve its primary goals."

Authors like Guthmann and Dougall, Osborne and Bonneville and Dawly have seen financial management as planning and controlling of funds used in the business. Francis viewed financial management as an integrated and composite subject. According to him "Financial Management is the use of accounting knowledge, economic models, mathematical rules and aspects of system analysis and behavioural science for the specific purpose of assisting management in its functions of financial planning and control". Thus financial management welds much of the materials that are found in other subjects and uses these other disciplines as its tools. It should be noted that this definition stresses on the basic functions of finance, namely, planning and control. Hampton says, "Finance, or financial management is an applied field of business administration. Principles developed by financial managers are borrowed from accounting, economics, or other fields and they are applied to the problem of managing the finance".
To sum up, financial management is concerned with the managerial decisions relating to the acquisition of funds and financing of assets. The analysis of such decisions is mainly based on the expected cash inflows and outflows and their influence upon the objectives of financial management.

Functions of Financial Management

The financial functions are classified into routine finance functions and managerial finance functions. Routine finance functions are chiefly clerical and are incidental to the effective handling of the managerial finance functions. Managerial finance functions are so called because they require skillful planning, control and execution of financial activities. The managerial finance functions involve major decision areas like capital budgeting decision, financing decision, working capital decision and dividend policy decision.

Capital Budgeting Decision: The term capital budgeting refers to "commitment of resources made in the hope of realizing benefits that are expected to occur over a reasonably long period of time in future". This is also known as investment decision. Investment decision forms the framework for a company's future development. It is a major determinant of efficiency and corporate power. It has a profound effect upon a company's future earnings and growth. A number of factors combine to make this decision the most important one in financial management. First, the decision maker makes a commitment into the future and losses some flexibility. Second,
Investment decision involves commitment of large amount of funds. Third, the investment decision is irreversible. Fourth, it is a difficult decision to make because it involves a complex and scientific decision process.

The factors that need to be considered in formulating capital budget are the prospective yield, the cost and the risk involved in the business. Decision in these areas help the management to achieve the objective of value maximization by maximizing the return and minimizing the risk.

**Financing Decision:** All the assets need to be financed. The firm can finance its assets by raising funds from various sources such as issue of common stock and preferred stock, issue of bonds, debentures, raising loans and by retaining a portion of the earnings. This composition is called capital structure. The use of fixed cost sources of funds like debt and preference capital is described as financial leverage. Leverage affects the return and risk of the shareholders. The basic idea in employing leverage is that the owners of the firm can enjoy a higher rate of return on their capital than that earned by the firm on its total capital by using fixed cost sources of funds provided that the rate of fixed cost sources is less than the overall rate of return on the firm's capital. Simply stated, the financing decision is concerned with minimization of cost of capital thereby maximization of return through developing an appropriate capital structure.
Working Capital Decision. Working capital is required to keep the current operations going. It is a firm's investment in current assets and therefore it is essentially an investment activity. Working capital management includes all aspects of the administration of current assets and current liabilities. It refers to the decisions regarding the firm's current assets and how they are financed. The focus of the working capital management is on "optimizing the levels of inventories, receivables, cash and near cash assets to be held by a business enterprise at a point of time".12

Dividend Policy Decision: Dividend, in the common parlance, refers to that portion of the earning that is paid to stockholders. The dividend policy has to determine the amount of surplus that is to be distributed to the shareholders and the amount to be retained in the business of the firm. Retained earnings is a significant internal source for financing the growth of the firm; and it increases the firm's value. "The company's ultimate objective in making this decision should be to maximize the present value of future dividends and appreciation in the price of the stock".111

All the four functions are equally important. They are interrelated. They should be jointly considered for optimal financial decision making. They should all be related to the objectives of financial management for optimal result.
Objectives of Financial Management

There are two widely discussed and debated objectives of financial management. They are: i) profit maximization and ii) wealth maximization. Profit maximization as a decision criterion has been criticised on several grounds. Prominent among them are: i) it is a vague concept ii) it does not consider the time value of money iii) it is often referred as ill-gotten gains. Hence, the objective of profit maximization has been replaced by wealth maximization. Wealth maximization simply refers to maximising the value of the firm through maximising the value of the shares. Wealth maximization as an objective has been accepted as i) it considers the time value of money, and ii) it is unambiguous.

Objectives of Financial Management in Cooperative Firm

The goal of financial management in cooperatives needs to be identified. In operational terms, the maximization of the present wealth of the equity shareholders means maximising the market value of equity shares. This is achieved by increasing the rate of earnings per equity share through appropriate financial leverage, maintenance of a certain rate of growth in dividend rate and declaration of bonus shares from time to time capitalising general reserves. These factors have a positive impact on the market value of equity shares. This process of wealth maximization is relevant to an enterprise meant for earning profits for the owners by selling some product or service to the customers.

But a cooperative organisation is not meant for earning profits for its members by doing business with others. It is rather meant for
promoting the interest of its members by meeting their common economic needs - credit/supply/distribution/marketing/employment - at as low cost as possible. Its members are not investors but the users of its services. Therefore the primary interest of its members is not to get higher rate of dividend on their shareholdings, but to get the service of the society at a reasonable cost. Hence a cooperative society does not aim at earning profits in the normal sense of the word. It should rather aim at bringing down its total cost of administration - both operational and financial cost - to the minimum in order to render service to its members economically. Strictly speaking, a cooperative society is expected to render service at cost to its members, but because of the various practical difficulties, involved in following 'Cost' pricing policy in practice, 'Cost Plus' pricing policy is followed.14

Naturally, a society may earn a surplus. This surplus is utilised for creating reserves, and other funds like common good fund and for distribution of patronage dividend to the member-users by way of returning the overcharge levied on them through cost-plus pricing policy. A part of the surplus may also be utilised for paying interest on paid-up capital subject to the maximum rate prescribed in the bylaws. Further, the share capital contributed by members is primarily for satisfying the eligibility requirement for availing the society’s services and incidentely for providing a capital base to the society. It is not a form of investment as in private enterprises. Hence shares in cooperatives are not traded in stock exchanges and thus the question of market value does not arise.10
Thus the objective of maximisation of the value of equity shares is totally irrelevant to a cooperative society. Then what else can be the objective of financial management in cooperatives?

As a cooperative society's primary objective is to render service to its members at a minimum cost, it should aim at minimising its cost of administration. The cost of administration includes cost of capital. Therefore, the objective of financial management in a cooperative enterprise is to bring down the cost of capital to the minimum.\(^{16}\)

Cooperatives, as economic firms, perform all the four functions of financial management viz. capital budgeting decision, capital structure decision, working capital decision and dividend decision. All these decisions in cooperatives should aim at reducing the cost of capital.

**Working Capital Management**

The concept and the significance of working capital, approaches to working capital and finally the significance of working capital management in cooperative firm are presented. The purpose of presenting an overview of working capital management is to provide a backdrop for the study.

An enterprise needs fund to operate. The working capital of a business reflects the short-term uses of funds. Apart from the investment in the long-term assets such as buildings, plant and
equipment, funds are needed for meeting the day-to-day operating expenses.

One may hardly find a running business firm which does not require some amount of working capital. Even, a fully equipped manufacturing firm is sure to collapse without an adequate supply of raw materials to process, cash to meet the wage bill, the capacity to wait for the marketing of its finished products and the ability to grant credit to its customers. Similarly, a commercial enterprise is virtually good for nothing without merchandise to sell. Any organisation, whether profit-oriented or otherwise, will not be able to carry on its day-to-day activities without adequate working capital. Working capital, therefore, is the life-blood of a business.

Concept of Working Capital: The working capital refers to that part of the firm's capital which is invested for managing the current assets such as cash, debtors, inventories and marketable securities.

Opinions do differ on the concept of working capital. For instance, Guthmann Dougall 17 has defined "working capital as the excess of current assets over current liabilities." According to Shubin, 18 "working capital is the amount of funds necessary to cover the cost of operating the enterprise."

The Annual Survey of Industries (1961) 19 defined "working capital as the stock of materials, stores, fuels, semi-finished goods including work in process and finished goods and by-products; cash in
hand and bank and the algebraic sum of sundry creditors as represented by (a) outstanding factor payment e.g. rent, wages, interest, dividend; (b) purchase of goods and services; (c) short term loans and advances and sundry debtors comprising amounts due to the factory on account of sale of goods and services and advances towards tax payments.

There are two concept of working capital. They are: gross and net. The gross working capital concept is the sum total of all current assets involving funds of the creditors, customers, owners and of the bankers. In short, the gross working capital refers to the amount of funds invested in current assets. The net working capital concept is the difference between the current assets and current liabilities or the excess of current assets over current liabilities.

Gross and net working capital concepts are not mutually exclusive. Gross concept of working capital helps to bring a trade-off between excessive and inadequate investment in current assets and to avoid dangers of both excessive and inadequate aspects of working capital of the business firms. On the other hand, the net working capital concept helps to indicate the liquidity position and to suggest the extent of working capital to be financed by long term sources of finance.
Significance of Working Capital

Management of working capital is more important to keep the concern going on in the world of competition. It is reported that more than half of the business failures are caused either by inadequacy of working capital or by mismanagement of working capital. Guthmann has rightly said, "just as a circulation of blood is very necessary in the human body to maintain life, the working capital is the life blood in controlling the nerve centre of the business". It is with working capital that fixed assets are utilised; without which they remain idle. Working capital only keeps the production facilities in motion to produce better results in the form of goods and services to improve the national economy, to give profit to the owners, to provide better wages to the labourers, to distribute quality goods to consumers, and to create the reputation and goodwill among the general public. Further, fixed capital requires a few but vital decisions, whereas working capital requires constant attention as it is a day-to-day need. Hence, the financial managers should be constantly alert to plan, review and replan the utilization of working capital which is a scarce resource. Failure to manage any component of working capital effectively is very dangerous and may lead to technical insolvency and ultimately to business failure.

Components of Working Capital

There are three major components of working capital. They are: cash, receivables and inventory. Therefore, the management of
working capital is concerned with the management of these components.

Cash Management: This is one of the key areas of working capital management. Apart from the fact that cash is the most liquid current asset, it is the common denominator to which all current assets can be reduced because the other major liquid assets like receivables and inventory get eventually converted into cash. This underlines the significance of cash management.

The basic objective of cash management is to reconcile two mutually contradictory and conflicting tasks to meet the payment schedule and to minimize funds committed to cash balances. The factors that determine the required cash balances are: i. synchronization of cash flows, ii. the cost associated with a shortfall in the firm's cash needs, iii. excess cash balance cost, iv. cost associated with establishing an operating cash management staff and activities, and v. the impact of uncertainties on cash management strategy. The cash management strategies are intended to minimize the operating cash balance requirements. The basic strategies that can be employed are i) stretching accounts payable without affecting the credit of the firm ii) efficient inventory management and iii) speedy collection of accounts receivable. Accounts payable cannot be stretched nor delayed in cooperatives as the members of the cooperatives are creditors. They are financially weak; they need to be paid the amount on time.
Cash budget is probably the most important tool in cash management. It is a device to help a firm to plan and control the use of cash. The cash position of the firm, as it moves from one period to another period, is highlighted by the cash budget. A cash budget has normally three parts, namely cash collections, cash payments and cash balances.

Receivables Management: The objective of receivables management is to have a trade-off between the benefits and costs associated with the extension of credit. The benefits are increased sales and associated increased profit/marginal contribution. The major categories of cost of accounts receivables are collection costs, capital costs, delinquency costs and default costs.

The management of receivables involves crucial decision in three areas viz, credit policies, credit terms, and collection policies. The credit policy of a firm provides the framework to determine whether or not to extend credit to customer and how much credit to extend. The two broad dimensions of credit policy decision of a firm are credit standards and credit analysis. The term credit standards represents the basic criterion for the extension of credit to customers. The criterion and, therefore, standards can be tight/ restrictive or liberal/ non-restrictive. The credit analysis component of credit policies includes obtaining credit information from different sources and its analysis.
The second decision area in receivables management is the credit terms. The credit terms specify the repayment term comprising credit period, cash discount, if any, and the cash discount period.

The third area involved in the management of receivables is collection policies. It refers to the procedure followed to collect accounts receivable when they become due. The two relevant aspects of collection policies are the degree of efforts to collect the overdues and the type of collection effort.

The framework of analysis of all the three decision areas in receivables management is to secure a trade-off between the costs and benefits of the measurable effects on the sales volume, capital cost due to change in accounts receivable, collection costs and bad debts. The alternative will be selected when the benefits exceed the costs.

Inventory Management: The term inventory refers to assets which will be sold in future in the normal course of business operations. The assets which the firm stores as inventory in anticipation of need are raw materials, work-in-process/semi-finished goods and finished goods. The management of inventory from the view point of financial manager is different from the management of: other current assets. The job of the finance manager is to reconcile the conflicting view points of the various functional areas regarding the appropriate inventory level.
The objectives of inventory management consists of two counter-balancing parts, namely, to minimize investments in inventory and to meet the demand for products by efficient production and sales operations. In operational terms, the goal of inventory management is to have a trade-off between costs and benefits at different levels of inventory. The costs of holding inventory are ordering cost and carrying cost. The major benefits of holding inventory are in the area of purchasing production and sales.

Working Capital Policy

An important working policy decision is concerned with the level of investment in current assets. There are broadly three policies in this regard. They are:

> conservative policy, also referred to as flexible policy
> aggressive policy also known as restrictive policy
> moderate policy.

A firm that follows conservative policy invests a very high amount in current assets. This means that the firm maintains huge balance of cash in marketable securities, carries a large amount of inventories and grants generous terms of credit to the customers which leads to a high level of debtors. A flexible policy has its own consequences. It results in fewer production stoppages, ensures quick deliveries to customers and stimulate sales as liberal credit is granted
to customers. These benefits, of course, come at the cost of higher investment in current assets.

Under restrictive policy, the investment in current assets is low. It may lead to frequent production stoppages, delayed deliveries to customers and loss of sales. These are the costs that the firm may have to bear to keep its investment in current assets low.

The firms that follow moderate working capital policy are those which neither follow aggressive nor conservative policies. They resort to a middle course between these two extreme policies.

Determination of the working capital policy is largely influenced by risk and return. A firm should have the working capital policy which would minimize the risk and maximize the return. The risk here refers to liquidity and return refers to the profitability.

Management of Working Capital in Cooperatives

Importance of effective management of working capital in cooperative enterprises need not be overemphasized. It is like a heart in cooperative business. If it becomes weak the cooperative business can hardly survive. Effective management of working capital in cooperative enterprises assumes paramount significance. First, adequate working capital enables the cooperatives to avail cash discount facilities offered by the suppliers. Cash discount received reduces the cost of purchases which in turn would help to bring down
the cost of goods sold. Secondly, it enables the cooperative firms to operate its business more efficiently and there won't be any delay in getting loans from banks and others on easy and favourable terms. Thirdly, fixed assets can be fully utilised with adequate working capital which in turn increases productivity and brings down the costs. Fourthly, it permits carrying of inventories at a level that will enable the cooperatives to satisfactorily serve the needs of its customers. Fifthly, it facilitates meeting situations of crises and emergencies. Sixthly, effective management of working capital enable the cooperatives to make proper payment which is a base to create and maintain goodwill among the suppliers. Seventhly, a sound system of working capital enables cooperatives to pay regular dividends to its investors. This would instill confidence in the minds of investors which in turn creates a favourable market to raise additional funds in future. Finally, effective management of working capital creates an environment of security, confidence and high morale and thus leads to overall efficiency of cooperative enterprises.

Working Capital viz., cash, receivables and inventory need to be managed properly for it decides the profitability, liquidity and solvency of a cooperative enterprise. Many times on the eve of failure of many cooperative enterprises, the main reason pronounced is either inadequate working capital or mismanagement of working capital.

Cooperatives are organisations of the people of small means who contribute only a nominal amount to commence the business of the society. Hence, it is natural that cooperatives highly depends on
principles depends on its financial viability which in turn largely hinges on efficient financial management. Working capital management occupies a pivotal position in financial management as it is a day-to-day phenomenon. Effective management of working capital results in better profitability and liquidity. Cooperatives in order to become financially viable and to effectively serve its members need to be diligent to manage its working capital. The objective should be to minimize the cost of managing the different components of working capital which in turn would help the cooperatives to preserve its core principles.
Reference


4. Ibid’, p. 1


6. /Mr/., p11.

7. Ibid., p. 11.


18. Ibid, p.11.


20. Ibid., p.557.

22. Ibid., p. 557.

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