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# Study of Financial Management Techniques and Methods for Organisation Effectiveness

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## ABSTRACT

***Finance is always the strength of an organisation and firms' survival is not possible without it. Every organisation, whether operating on small scale or big, requires finance to carry on operation and also in order to expand its operations. Every organisation needs to ensure how efficiently a manager is acquiring and utilizing the funds. Finance manager has to ensure that funds need to be managed in such a way that it generates maximum revenue for the entity. A balance between liquidity and investment has to be taken care so that company has adequate cash reserve to pay short term liabilities and meet emergencies like day-to-day expenses, bills, payment to suppliers etc. On the other hand, long term source of finance is allocated for meeting out the long-term obligations like project investment, unexpected large purchases, repayment of long-term loans etc. Thus, allocation of funds requires qualified skilful financial expert as fund need to be allocated in such a way that it meets financial requirement adequately. In the present research the focus is on the various financial management tools. The information has been gathered through secondary sources. Thus, paper has made an attempt to highlight the financial management techniques and methods used in India***

***Keywords: Financial management, Funds, Procurement and Finance Manager***

## 1. INTRODUCTION

Finance is considered as the blood of an organisation because it's the foundation for all economic activities. Organisation financial activity is that activity which is focuses on how to procure and allocate funds so as to fulfil financial requirements and organisational goal (wealth maximisation). Finance is acts as a backbone of an organisation which has given birth to financial management concept. Financial management is process includes management process, i.e., to plan and control the funds of the entity. It procures fund from the most suitable sources and efficiently allocate it in such project which generates fund. Financial management plays an imperative role in every business and also in the development of a country. It has a close relationship between finance and management. Funds need to be controlled and managed by implementing effective financial techniques and methods. Finance is considered as the blood for every business and without finance and its management organisation growth turns motionless. Earlier venture's objective was to maximise earnings and grow business. But with the change in the time, business has to fulfil social corporate responsibilities, thus the firm's existence relies on the progress of entity's stakeholders. Now, the objective of any venture is to maximise the shareholders wealth and enhance the value of the firm. Thus, concept of financial management is attaining attention in the recent years. For fulfilling this objective, financial managers are professionally armed with latest techniques and methods. These financial management techniques and methods helps finance manager to take right financial related decisions and utilise funds efficiently and effectively. Thus, sound financial management ensures success of the organisation. Modern financial management is concerned for shareholders wealth maximisation along with the enhancing the value of the firm. Thus, finance manager needs to monitor environment and adapt the changes occurring in the economic environment conditions. Finance manager ability of finding financial sources and manage it, determines the success of the enterprise and economy. The role of financial management is assuming great importance in solving complex business problems. Earlier financial management role was confined only to the obtaining of money on reasonable terms and its utilisation was out of its peripheral. With the change in business circumstance since the mid-1950, traditional outlook of finance function outlived. A number of factors like technology, innovations, business operation size, intense competition etc necessitated to ensure efficient and effective utilisation of firm's financial resources. Thus, the scope of financial management changed and the modern approach was developed which includes both obtaining and effective utilisation.

## 2. OBJECTIVES

- Utilization of fund in such a way that it maximizes wealth of the organization.
- Allocation of fund in such a manner that it generates revenues timely also with the least cost.

- **Concept Financial Management**

By Joseph l. Massie "Financial Management is the area of business management means effective and efficient formation, administrating, organizing, pointing and regulating the financial transaction. Vital Role of Financial

Management Financial management plays important role in every organization, first identify the goal of the organization and second maximize wealth of investors. Financial management is concerned with the management of fund, i.e. to plan and control the funds. It includes activities like procurement and allocation of funds into business activities. Finance manager apply financial techniques and methods to evaluate the worth of the project.

## 3. IMPORTANCE OF THE STUDY

Role of funds in an organisation need no stress. Every business, irrespective of size, need money to do operational activities and expansion of business. Finance holds key to business activities and its success. Business survival is dependent on how efficiently the funds are acquired and utilised. Thus, finance plays very important role for the business and that's how financial management concept emerged. Thus, the study undertaken helps and guide financial manager to take right decisions like acquiring of funds, right investment, good returns and sharing profits with the shareholders.

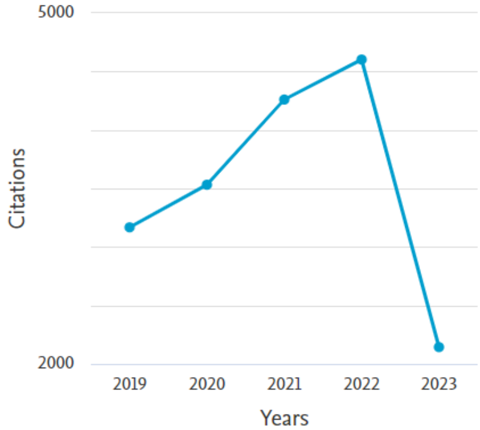


Figure 1: Citations

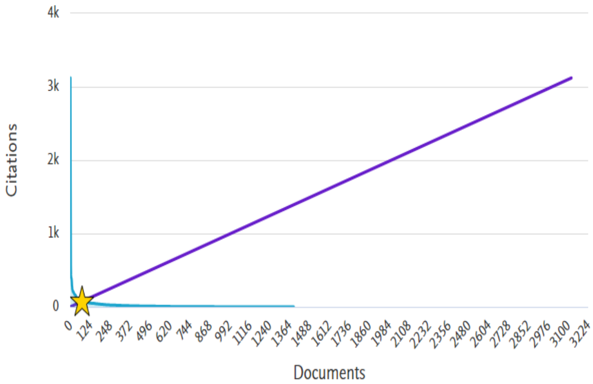


Figure 2: H Index

Fig 1 shows the number of publications done during the period 2000 till 2023. These documents H index is 80 which means that they have been cited 80 times (Fig 2).

## 4. FINANCIAL MANAGEMENT TECHNIQUES AND METHODS IN ACHIEVEING THE OBJECTIVES

Finance manager of any firm has to face three problems regarding which decision has to be made

- Regarding Investment
- In context of Financing
- In relation to Dividend

The most important function of financial management

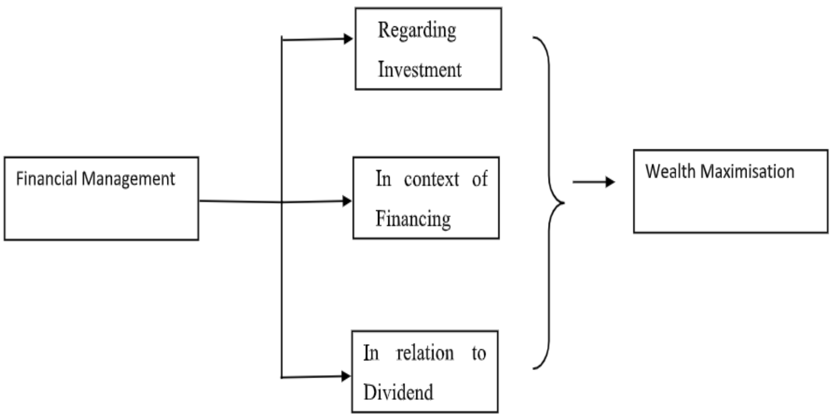


Fig. 3: Finance Manager - Three problems

- **Regarding To Investment**

The imperative function of finance manager is to arrange funds and then allocate the same in efficient and effective way, i.e funds disbursement in various assets and projects. Investment Decision of funds in long term assets are called capital budgeting decisions.

Capital budgeting is the process which helps in making investment decisions regarding capital expenditure. The benefits of these outlays are likely to be received over a long period of time. Thus, financial manager has to access the profitability of various projects before allocating funds. Following capital budgeting techniques and methods are used by financial managers:

**a. Payback Period**: It is simplest yet most employed traditional method which is used to appraise the capital investment decisions. Through PB, financial manager gets an idea that in how years would be required to recover the ignition outlay amount invested in a project. If a project generates constant cash inflow each year and over a period of time then the payback period can be computed in following way

Formula :

$$\text{Pay Back Period} = \frac{\text{Investment}}{\text{Cash Inflow (Annual)}}$$

**b. Net Present Value method (NPV)**: NPV is the most popular method of capital budgeting techniques. Net present value (NPV) is the difference between the present value of cash inflows which is discounted at cost of capital rate and the present value of investment over a period of time. It helps in understanding whether the project in which investment is to be done should be accepted or rejected. If NPV is greater than zero indicated that the projected earnings of the project exceed the anticipated cost. In that case it will be profitable and should be accepted whereas as negative NPV means loss. Thus, this technique guides finance manager to take decision of investment. It indicated that only those investment should be made where NPV values are positive.

Formula:

$NPV = \{R_1/(1+K)^1 + R_2/(1+K)^2 + \ldots\ldots\ldots + R_n/(1+K)^n\} - I$

R = Cash Inflows

K= Cost of Capital

I= Cash Outflows at different time periods

**c. Internal Rate of return method (IRR)**

Internal rate of return is that rate at which the PV of cash outflows is equal to the PV of cash inflows. At this rate NPV of the project is 0. It helps in understanding whether the project in which investment is to be done should be accepted or rejected. If IRR is greater than cost of capital then in that case it will be profitable to invest in that project and should be accepted whereas as if IRR is less than cost of capital then it indicates loss. Thus, this technique guides finance manager in taking investment decisions.

Formula:

IRR = Lower rate + (NPV at lower rate/ NPV at lower rate- NPV at higher rate) * difference in higher and lower rates

**d. Profitability Index**

Another method to evaluate a project is profitability Index method. It measures the present value of future cash inflows per rupee invested. If PI is more than one then the project will be accepted and vice versa. If PI is one then the project might be accepted on the basis of non-financial consideration.

Formula:

PI = Cash Inflows (PV) / Cash Outflows (PV)

- **In Context of Financing (Capital Structure)**

Capital Structure of a firm means how it finances its activities, assets and expansion through a combination of long-term financial resources like debt, equity, preference etc. A firm's capital structure typically consists of two major components: Debt and Equity. A firm's capital structure impacts its profitability, solvency and valuation. Company use borrows funds because it helps in increasing the possible return on an investment or project. There are various approaches for capital structure

a. **Net Operating Income**: This approach is suggested by David Durand. This technique proposes that if firm's debt ratio increases then it raises the value of the firm and lowers down the overall cost of capital ($K_{o)}$ and increases EPS.

b. **Net Income**: This approach is also offered by David Durand. It proposes that firm's worth is independent of its capital structure because a firm's market value is determined by its operational income and capital structure.

$V = EBIT / K_o$

c. **MM Approach**: It is profound by Franco Modigliani and Merton Miller. It suggests that firm's value is not impacted by its capital structure under perfect market scenario where there are no taxes whereas under imperfect market scenario a firm's value can be increase by using more debt as this will create tax shield for interest payment. According to this approach $K_e$ increases to offset the benefits accrued by increase debt.

d. **Traditional Approach**: This approach is the mid-way of NI and NOI approach. according to this approach capital structure is optimal where $K_o$ is minimised and Value of the firm is maximised.

- **In Relation to Dividend**

Walter's Model: This model is formulated by James E. Walter. According to Walter's model dividends are important. This model helps firm to determine the optimal dividend policy which should be followed because it beliefs that firm's investment policy and dividend policy are interrelated. This model is based on assumption that the value of the firm is determined by its earnings and dividend policy it adopts. This model assumes that firm either reinvest back all earnings back into the company or paid out as dividends. This approach is based on the relationship between firm's rate of return ( ROI, i.e r) and required rate of return(i.e. k).
Relationship between Dividend Decision and Value of a firm
According to the approach, D/P will impact the shares value in the following ways:

| | | | |
|---|---|---|---|
| r> k | Firm's retain earnings (such firms are called growth firms) | Maximises equity shareholders wealth | D/P is lowest, value of the shares is highest |
| r < k | Optimum dividend policy would be to distribute entire earnings as dividend | For maximising shareholders wealth | D/P is highest, value of the shares is highest |
| r= k | Doesn't matter whether distributes or retains its earnings. (in the case of normal firms) | Value of the shares remains the same | D/P ratio does not have any impact on the value of the shares |

Valuation Formula and its denotations

$$P= D +r/k(E-D)/ k$$

Where
D= Dividend per share
K= cost of equity
r= internal rate of return
E= Earnings per share

**Modigliani and miller's Approach (MM):** As per MM approach, dividend policy is irrelevant as it does not affect the wealth of the organisation. They believe that the value of the firm depends on the firm's earnings which has association with its investment policy. Under MM approach, r is equal to the discount rate and is identical for all shares. MM approach has certain assumptions:

a. Works in perfect capital market
b. Fixed Investment Policy
c. Risk of uncertainty does not exist

Valuation Formula

$$P_1 = P_o * (1+k) - D$$

Where,
$P_1$ = Share's Market Price (End of a period)
$P_0$ = Share's Market Price (Starting of a period)
k = Cost of the capital
D = Dividends received at the end of a period

## 5. CONCLUSION

The success of an organisation depends on how efficiently monetary resources are being utilised. The financial management techniques and tools helps and guide financial manager so that they can take right decisions in the context of capital structure, investment proposals, working capital, dividend policy etc. It helps financial managers to ensure that funds are procured in such manner that the risk, cost and control considerations are properly balanced in the given circumstances and there is optimum utilisation of funds.

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