SOS POLITICAL SCIENCE AND PUBLIC ADMINISTRATION

MBA FA 202

SUBJECT NAME: FUNDAMENTALS OF FINANCIAL MANAGEMENT

UNIT-V **TOPIC NAME: MANAGEMENT EARNIGS**

Meaning of Management of Earning:

Every growing concern needs finances for its development and expansion.These finances may come by way of share capital, borrowings or self financing. The dexterity of management lies more in the management of earnings than in the procurement of capital.

The efficient use of capital is not only dependent upon the acquisition of capital in the proper amounts at the right time but also upon the careful formulation of internal financial policies and constant vigilance in their administration. The raising of capital may not entail so much of foresight and prudence as the effective utilisation of the available resources.

Defective administration of income, inadequate provision for depreciation and ill-planned resources are likely to be the results of an absence of scientific internal financial control and may lead to liquidation.

The abundance of capital instead of mitigating the evil will aggravate the disease as it will provide temptation to the management for manipulation. Capital is one of the important ingredients of business success and it needs constant and intelligent handling by the management.

Earnings refer a company’s reported profits i.e. profits after all expenses including depreciation, interest and taxes have been deducted. Management of earnings means how these earnings are utilised i.e. how much is paid to the shareholders in the form of dividends and how much is retained and ploughed back in the business. The way companies allocate their after tax earnings between dividends and retention are termed as ‘management of earnings’.

A well-established policy regarding management of earnings must be formulated to secure the maximum benefits for the body corporate and its owners. The prime criterion for every decision-making in this regard is the expected effect of a decision upon the value of the enterprise. The decisions relating to management of earnings require proper consideration as to its effect on the firm’s cost of capital, its growth and its share prices.

All the business concerns are established to earn profits. The foremost duty of an enterprise is economic performance, which means the preservation and increase in the value of economic resources entrusted to it. To achieve this object, the enterprise must earn profits at a certain minimum rate.

Nature and Scope of Management of Earning:

- **Investment decision-** Financial management is involved in managing all investment decisions of an organization. Investment decisions involve risk evaluation, measuring the cost of capital and estimating benefits expected out of a particular project. Managers are responsible for deciding how available funds should be invested in fixed or current assets to earn optimum returns.
- **Working Capital decision-** Taking working capital decisions properly is another important scope of financial management. These decisions are concerned with investment in current assets or current liabilities. Working capital decisions revolve around working capital and short-term financing. Current assets include cash, inventories, receivables, short-term securities, etc. whereas current liabilities include creditors, bank overdraft, bills payable.
- **Financing decision-** Financing decisions involves deciding how the required funds should be raised from available long term or short term sources. Financial manager is required to form proper finance mix or optimum capital structure of the company to raise its value. They are required to maintain a proper balance between equity and debt to provide maximum return to shareholders.

- **Dividend decision-** Financial management involves taking all dividend decisions of the company. These decisions involve developing a proper dividend policy regarding the distribution or retaining of company profits. The finance manager should decide an optimum dividend payout ratio out of available profit. He should consider all expansion and growth opportunities available to the organization and should avail them by retaining a proper amount of profit.
- **Ensures liquidity-** Maintaining proper liquidity in an organization is another important role played by financial management. The finance manager ensures that there is a regular supply of funds in an organization. He monitors all cash-inflows and cash-outflows and avoids any underflow or overflow like situations. Ensuring the optimum level of liquidity in an organization is one of the important scope of financial management.
- **Profit management**– Financial management aims at increasing the profit of the company. It works towards reducing the cost of various activities through proper monitoring and setting up proper price policy. The finance manager measures the cost of capital and chooses cheap sources of capital by properly analyzing different sources available.
- **Estimates Capital Requirements-** Financial management helps in anticipation of funds required for running the business. It estimates working and fixed capital requirements for carrying out all business activities. The finance manager prepares a budget of all expenses and revenues for a particular time period on the basis of which capital requirements are determined.
- **Decides capital structure-** Deciding optimum capital structure for an organization is a must for attaining efficiency and earning better profits. It involves deciding the proper portion of different securities like common equity, preferred equity, and debt. The proper balance between debt and equity should be attained which minimizes the cost of capital.
- **Select sources of Fund-** Choosing the source of funds is one of the crucial decision for every organization. There are various sources available for raising funds like shares, bonds, debentures, venture capital, financial institutions, retained earnings, owner investment, etc. Every business should properly analyze different sources of funds available and choose one which is cheapest and involves minimal risk.
- **Selects investment pattern-** Once funds are procured it is important to allocate them among profitable investment avenues. Investment proposal should be properly analyzed regarding its safety, profitability and liquidity. Before investing any amount in it all risk and return associated with it should be properly evaluated.
- **Raises Shareholders value-** Financial management works towards raising the overall value of shareholders. It aims at increasing the amount of return to shareholders by

reducing the cost of operations and increasing the profits. Finance manager focuses on raising cheap funds from different sources and invest them in most profitable avenues.

- **Management of cash-** Financial management monitors all funds movement in an organization. Finance managers supervise all cash movements through proper accounting of all cash inflows and outflows. They ensure that there is no situation like deficiency or surplus of cash in an organization.

- **Apply financial controls-** Implying financial controls in business is a beneficial role played by financial management. It helps in keeping the company actual cost of operation within the limit and earning the expected profits. There are various processes involved in this like developing certain standards for business in advance, comparing the actual cost or performance with pre-established standards and taking all required remedial measures.