

Introduction to Financial Management

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Key concepts, objectives, and tools for effective decision-making in organizations

1. What Is Financial Management?

Definition	Scope
The planning, organizing, directing, and controlling of financial activities to achieve the organization's objectives.	• Acquisition of funds (capital budgeting, financing)
	• Allocation of resources (investment decisions)
	• Management of cash flows and liquidity
	• Monitoring performance and risk

2. Core Objectives

Primary Objective	Description
Profit Maximization	Increase net income over a given period.
Wealth Maximization (Shareholder Value)	Maximize the market value of the firm's equity; focuses on long-term returns and risk-adjusted earnings.
Liquidity Management	Ensure sufficient cash to meet short-term obligations.
Financial Stability	Maintain an optimal capital structure and adequate reserves.
Sustainable Growth	Support expansion while preserving solvency.

Note: Modern practice prioritizes wealth maximization because it integrates risk considerations and aligns with shareholder interests.

3. The Financial Management Process

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1. Strategic Planning

- Set financial goals aligned with corporate strategy.
- Forecast revenue, costs, and capital needs.

2. Capital Budgeting (Investment Decisions)

- Identify viable projects.
- Evaluate using techniques such as NPV, IRR, Payback Period, and Profitability Index.

3. Financing Decisions (Capital Structure)

- Choose the mix of debt, equity, and internal funds.
- Assess cost of capital (WACC) and leverage implications.

4. Working Capital Management

- Manage cash, receivables, inventory, and short-term financing.
- Apply cash conversion cycle analysis.

5. Performance Evaluation

- Use ratio analysis, EVA, and balanced scorecards.
- Compare actual results with budgets and benchmarks.

6. Risk Management

- Identify financial risks (market, credit, liquidity, operational).
- Apply hedging, diversification, and insurance strategies.

4. Key Financial Statements (The “Four-Statement” Model)

Statement	Purpose	Primary Users
Balance Sheet	Snapshot of assets, liabilities, and equity at a point in time.	Creditors, investors, regulators
Income Statement	Shows revenues, expenses, and profit over a period.	Management, analysts

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Statement	Purpose	Primary Users
Cash Flow Statement	Details cash inflows/outflows from operating, investing, and financing activities.	Treasury, investors
Statement of Changes in Equity	Tracks movements in shareholders' equity (issues, dividends, retained earnings).	Shareholders, auditors

Interrelationships: Net income from the Income Statement → retained earnings in the Balance Sheet; cash from operations links to the Cash Flow Statement.

5. Fundamental Analytical Tools

Tool	Formula / Concept	Typical Use
Net Present Value (NPV)	$NPV = \sum_{t=0}^n \frac{CF_t}{(1+r)^t}$	Accept projects with $(NPV > 0)$.
Internal Rate of Return (IRR)	Rate (r) that makes $NPV = 0$	Compare IRR to required return.
Weighted Average Cost of Capital (WACC)	$WACC = \frac{E}{V}k_e + \frac{D}{V}k_d$	