Star Rating

On the basis of Maximum marks from a chapter Nil

On the basis of Questions included every year from a chapter ☆

On the of Compulsory questions from a chapter Nil

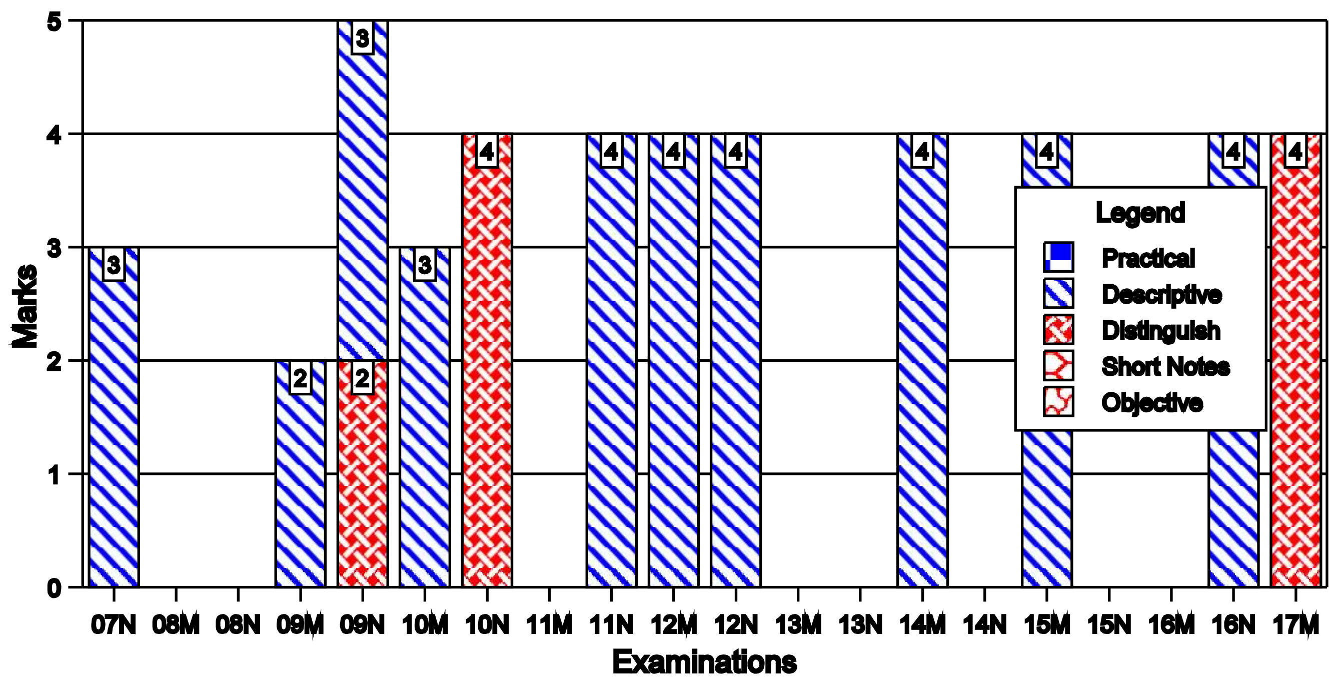
CHAPTER	
1	**Scope and Objectives of Financial Management**

CHAPTER 1 — Scope and Objectives of Financial Management

THIS CHAPTER COMPRISES OF

☞ Meaning ☞ Evolution ☞ Importance ☞ Scope ☞ Objectives of Financial Management ☞ Profit vs. Value Maximisation Principle ☞ Role of CFO ☞ Relationship of Financial Management with Related Disciplines.

Marks of Objective, Short Notes, Distinguish Between, Descriptive & Practical Questions



◗ DISTINGUISH BETWEEN

2009 - Nov [5] Answer the following :

(iv) Differentiate between Financial Management and Financial Accounting. (2 marks)

Answer :

Difference between Financial Management and Financial Accounting

S. No.	Basis of Difference	Financial Management	Financial Accounting
1.	**Decision-making**	Financial Management's primary responsibility relates to financial planning, controlling and decision making.	The chief focus of Financial Accounting is to collect data and present the data.
2.	**Treatment of funds**	In financial management it is based on cash flows. The revenues are recognised only when cash is actually received (i.e. cash inflow) and expenses are recognised on actual payment (i.e. cash outflow).	In Financial Accounting, the measurement of funds is based on the accrual principle of funds.

2010 - Nov [5] (b) Distinguish between the following :

(i) Profit maximisation vs Wealth maximisation objective of the firm.

(4 marks)

Answer :

1. Profit Maximisation :

Profit Maximisation is the main objective of business because profit acts as a measure of efficiency and it serves as a protection against risk.

Arguments in favour of Profit Maximisation :

(i) When profit earning is the main aim of business the ultimate objective should be profit maximisation.

(ii) Future is uncertain. A firm should earn more and more profit to meet the future contingencies.

(iii) The main source of finance for growth of a business is profit. Hence, profits maximisation is required.

(iv) Profit maximisation is justified on the grounds of rationality as profits act as a measure of efficiency and economic prosperity.

Arguments against Profit Maximisation :

(i) It leads to exploitation of workers and consumers

(ii) It ignores the risk factors associated with profit.

(iii) Profit in itself is a vague concept and means differently to different people.

(iv) It is a narrow concept at the cost of social and moral obligations.

Thus, profit maximisation as an objective of financial management has been considered inadequate.

2. Wealth Maximisation:

Wealth maximisation is considered as the appropriate objective of an enterprise. When the firms maximises the stockholder's wealth, the individual stockholder can use this wealth to maximise his individual utility. Wealth maximisation is the single substitute for a stockholder's utility.

Arguments in favour of Wealth Maximisation:

(i) Due to wealth maximisation, the short term money lenders get their payments in time.

(ii) The long time lenders too get a fixed rate of interest on their investments.

(iii) The share of employees in the wealth gets increased.

(iv) The various resources are put to economical and efficient use.

Arguments against Wealth Maximisation :

(i) It is socially undesirable.

(ii) It is not a descriptive idea.

(iii) Only stockholder's wealth maximisation does not lead to firm's wealth maximisation.

(iv) The objective of wealth maximisation is endangered when ownership and management are separated.

2017 - May [5] (d) Distinguish between 'Profit Maximization' and 'Wealth Maximization' objective of a firm. (4 marks)

◗ DESCRIPTIVE QUESTIONS

2007 - Nov [8] Answer the following :

(ii) Explain the limitations of profit maximization objective of Financial Management. (3 marks)

Answer:

Arguments against Profit Maximisation	1. It leads to exploitation of workers and consumers 2. It ignores the risk factor associated with profit. 3. Profit in itself is a vague concept and means differently to different people. 4. It is a narrow concept at the cost of social and moral obligations.
Limitation of Profit Maximization objectives	1. It ignores the risk factor as well as timing of returns. 2. The concept of profit maximisation is vague and narrow. 3. It emphasizes the short-run profitability and short-term projects. 4. It may cause decrease in share price. 5. It fails to consider the social responsibility of business. 6. It may allow decisions to be taken at the cost of long run stability and profitability of the concern. 7. The profit is only one of the many objectives of a modern firm. 8. It ignores the time and risk factors

2009 - May [5] Answer the following :

(iv) Discuss conflict in profit versus wealth maximisation objective. (2 marks)

Answer:

Please refer 2010 - Nov [5] (b) (i) on page no.368

2009 - Nov [8] Answer the following :

(i) Explain the two basic functions of Financial Management. (3 marks)

Answer :

The two basic aspects of F.M. are		1. Procurement of funds 2. Effective use of these funds
1.	**Procurement of fund**	Procurement of funds includes : (i) Identification of sources of finance (ii) Determination of finance mix (iii) Raising of funds (iv) Division of profit

		(v) Retention of profit There are various **sources of procurement of funds** such as: Share capital, debentures, bank, financial institution, ADR, GDR, FDI, FII etc. Every source has an element of risk, cost and control attached with it. Whatever be the source, the cost of the fund should be at the minimum, balancing the risk and the control function.
2.	**Effective use of fund**	The funds once procured cannot be left to remain idle. The funds are to be invested in such a way that the business yields maximum return along with maintaining its solvency. Thus the effective use of the funds would require that adequate funds should be maintained to meet the working capital requirement and avoiding the blockage of funds in inventories, book debts, cash etc.

2010 - May [8] Answer the following:

(ii) State the role of a Chief Financial Officer. (3 marks)

Answer :

The finance manager occupies an important position in the organisational structure. Earlier his role was just confined to raising of funds from a number of sources. Today his functions are multidimensional.

The functions performed by today's finance managers are as below :

1.	**Forecasting the financial requirement**	A financial manager has to make an estimate and forecast accordingly the financial requirements of the firm.
2.	**Planning**	A finance manager has to plan out how the funds will be procured and how the acquired funds will be allocated.
3.	**Procurement of fund**	A finance manager has to select the best source of finance from a large number of options available. The finance manager's decisions regarding the selection of source is influenced by the need, purpose object and the cost involved.

4.	**Investment/Allocation of fund**	A finance manager has also to invest or allocate funds in best possible ways. In doing so a finance manager cannot but ignore the principles of safety profitability and liquidity.
5.	**Maintaining proper liquidity**	A finance manager plays an important role in maintaining proper liquidity. He determines the need for liquid assets and then arrange them in such a way that there is no scarcity of funds.
6.	**Cash management**	A finance manager has also to manage the cash in an efficient way. Cash is to be managed in such a way that neither there is scarcity of it nor does it remains idle earning no return on it.
7.	**Dividend decision**	A finance manager has also to decide whether or not to declare a dividend. If dividends are to be declared, then what amount is to be paid to the shareholders and what amount is to be retained in the business.
8.	**Evaluation of financial performance**	A finance manager has to implement a system of financial control to evaluate the financial performance of various units and then take corrective measures wherever needed.
9.	**Financial negotiations**	In order to procure and invest funds a finance manager has to negotiate with the various financial institutions, banks, public depositors in a meticulous way.
10.	**To ensure proper use of surplus**	A finance manager has to see to the proper use of surplus fund. This is necessary for expansion and diversification plan and also for protecting the interest of shareholders.

2011 - Nov [7] Answer the following :

(a) Elucidate the responsibilities of Chief Financial Officer. (4 marks)

Answer :

Please refer 2010 - May [8] (ii) on page no. 371

2012 - May [7] Answer the following:

(a) "The profit maximization is not an operationally feasible criterion." Comment on it. (4 marks)

Answer:

The profit maximisation is not an operationally feasible criterion.

- The aforesaid statement is true because profit maximisation can be a short-term objective for any organisation and cannot be its sole objective.
- Profit maximization fails to serve as an operational criterion for maximizing the owner's economic welfare.
- It fails to provide an operationally feasible measure for ranking alternative courses of action in terms of their economic efficiency.

It suffers from the following limitations:

Please refer 2007 - Nov [8] (ii) on page no. 370

2012 - Nov [7] Answer the following:

(a) Discuss the conflicts in profit versus wealth maximization principle of the firm. (4 marks)

Answer:

Please refer 2010 - Nov [5] (b) (i) on page no.368

2014 - May [5] (c) Discuss emerging issues affecting the future role of Chief Financial Officer (CFO). (4 marks)

Answer:

Emerging issues affecting the future role of Chief Financial Officer (CFO):		
1	**Regulation**	Regulation requirements are increasing and CFOs have an increasingly personal stake in regulatory adherence.
2	**Globalisation**	The challenges of globalisation are creating a need for finance leaders to develop a finance function that works effectively on the global stage and that embraces diversity.
3	**Technology**	Technology is evolving very quickly, providing the potential for CFOs to reconfigure finance processes and drive business insight through 'big data' and analysis.

4	**Risk**	The nature of the risk that organisation face is changing, requiring more effective risk management approaches and increasingly CFOs have a role to play in ensuring an appropriate corporate ethos.
5	**Transformation**	There will be more pressure on CFOs to transform their finance functions to drive a better service to the business at zero cost impact.
6	**Stakeholder Management**	Stakeholder management and relationship will become important as increasingly CFOs become the face of the corporate brand.
7	**Strategy**	There will be a greater role to play in strategy validation and execution, because the environment is more complex and quick changing, calling on the analytical skills CFOs can bring.
8	**Reporting**	Reporting requirements will broaden and continue to be burdensome for CFOs.
9	**Talent and capability**	A brighter spotlight will shine on talent, capability and behaviour in the top finance role.

2015 - May [7] Answer the following:

(d) Discuss the conflicts in Profit versus Wealth maximization principle of the firm. (4 marks)

Answer:

Please refer 2010 - Nov [5] (b) (i) on page no.368

2016 - Nov [5] (c) List the emerging issues (any four) affecting the future role of CFO. (4 marks)

Answer:

Please refer 2014 - May [5] (c) on page no. 373

KZ - 1	Knowledge Zone
Basic Finance Function	
The basic finance function includes : 1. Investment decision. 2. Financing decision. 3. Dividend decision.	

All the above three decisions are inter-related because the ultimate aim of all these is wealth maximisation. Moreover, they influence each other in one way or the other.

For e.g. Investment decision should be backed up by finance for which financing decisions are to be taken. The financing decision in turn influences and is influenced by dividend decision.

Let us examine the three decisions in relation to their inter-relationship.

Investment Decision: The funds once procured have to be allocated to the various projects. This requires proper investment decision. The investment decisions are taken after careful analysis of various projects through capital budgeting & risk analysis.

Only those proposals are accepted which yield a reasonable return on the capital employed.

Financing Decision: There are various sources of funds. A finance manager has to select the best source of finance from a large number of options available.

The financing decision regarding selection of source and internal financing depends upon the need, purpose, object and the cost involved.

The finance manager has also to maintain a proper balance between long term & short term loan. He has also to ensure a proper mix of loans fund and owner's funds which will yield maximum return to the shareholders

Dividend Decision : A finance manager has also to decide whether or not to declare dividend. If dividends are to be declared then what portion is to be paid to the shareholders and what portion is to be retained in the business.

Thus, we see that investment, financing and dividend decisions are all inter-related.

Similarly Asked Questions*

No.	Category	Question	Marks	Frequency
1	Descriptive/ Dt. Between	Discuss the conflicts in Profits versus Wealth maximisation principle of the firm . 09 - May [5] (iv), 10- Nov [5] (b) (i), 12 - Nov [7] (a), 15 - May [7] (d), 17 - May - [5] (d)	2, 4, 4, 4,4	5 Times
2	Descriptive	List the emerging issues (any four) affecting the future role of CFO. 14 - May [5] (c), 16 - Nov - [5] (c)	4, 4	2 Times

* This table contains the Similarly Asked Questions. Please pay more attention to such questions.