Relation of Financial Management with other disciplines

Financial management is one of the important parts of overall management, which is directly related with various functional departments like personnel, marketing & production. Financial management covers wide area with multidimensional approaches. Financial Management has relationship with several disciplines:

1. **Financial Management & Economics:** Economic concepts like micro & macroeconomics are directly applied with the financial management approaches. Investment decisions, micro & macro environmental factors are closely associated with the functions of financial manager. Financial management also uses the economic equations like money value discount factor, economic order quantity etc. Financial economics is one of the emerging area, which provides immense opportunities to finance, and economical areas.
2. **Financial Management & Accounting:** Accounting records includes the financial information of the business concern. Hence, we can easily understand the relationship between the financial management and accounting. In the olden periods, both financial management & accounting are treated as a same discipline and then it has been merged as Management Accounting because this part is very much helpful to finance manager to take decisions. But nowadays financial management and accounting discipline are separate & interrelated.
3. **Financial Management & Mathematics:** Modern approaches of the financial management applied large number of mathematical & statistical tools & techniques. They are also called as econometrics. Economic order quantity, discount factor, time value of money, present value of money, cost of capital, capital structure theories, dividend theories, ratio analysis & working capital analysis are used as mathematical & statistical tools & techniques in the field of financial management.
4. **Financial Management & Production Management:** Production management is the operational part of the business concern, which helps to multiple the money into profit. Profit of the concern depends upon the production performance. Production performance needs finance, because production department requires raw material, machinery, wages, operating expenses etc. These expenditures are decided & estimated by the financial department & the finance manager allocates the appropriate finance to production department. The financial manager must be aware of the operational process and finance required for each process of production activities.
5. **Financial Management & Marketing:** Produced goods are sold in the market with innovative & modern approaches. For this, the marketing department needs finance to meet their requirements. The financial manager or finance department is responsible to allocate the

adequate finance to the marketing department. Hence, marketing & financial management are interrelated & depends on each other.

6. **Financial Management & Human Resource:** Financial management is also related with human resource department, which provides manpower to all the functional areas of the management. Financial manager should carefully evaluate the requirement of manpower to each department and allocate the finance to the human resource department as wages, salary, remuneration, commission, bonus, pension & other monetary benefits to the human resource department. Hence, financial management is directly related with human resource management.

Financial Decisions

Financial decisions refer to the decisions concerning financial matters to a business concern. Decisions regarding magnitude of funds to be invested to enable a firm to accomplish its ultimate goal, kind of assets to be acquired, pattern of capitalization, pattern of distribution of firm's income and similar other matters are included in financial decisions. These decisions are crucial for the well-being of a firm because they determine the firm's ability to obtain plant & equipment when needed to carry the required amount of inventories and receivables, to avoid burdensome fixed charges when profits & sales decline & to avoid losing control of the company.

A few specific points in this regard are:

- Financial decisions are taken by a finance manager alone or in conjunction with his other management colleagues of the enterprise.
- A finance manager is responsible to handle all such problems as involve financial matters.
- The entire gamut of financial decisions can be classified in 4 broad categories: **Investment Decision, Financing Decision, Dividend Decision, & Working Capital Decision**

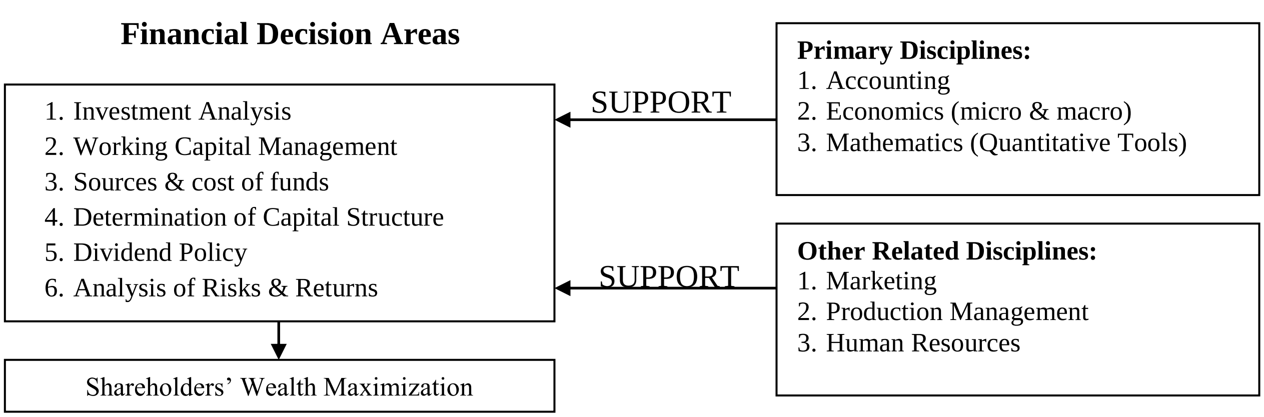

Fig. : Financial Decisions & Support System

Note: These decisions have been discussed earlier in the scope of Financial Management.

As depicted in the figure, several disciplines i.e., economics, accounting, marketing, production management, human resources etc. help & support the financial manager to take financial decisions.

Inter-relationship Amongst these Decisions

The interrelationship between these types of financial decisions centers around the following issues:

1. ***Which decision comes first investment or financing?***

   One often wonders whether the financing decision comes first or the investment decision. The difficulty with such a question is that any answer in favour of the one or the other is bound to be wrong. **For example,** why would any management want to raise any capital unless it had some kind of project already in mind? Alternatively, how can a management consider undertaking a new project unless it already had some ideas as to how it is going to raise the necessary finances? So how does one decide which comes first? ***Chicken or the egg?*** The answer in our context is somewhat simpler than the moot question concerning the egg and its parent. The two decisions are in reality simultaneous. In fact neither decision by itself makes sense without the other. There would be no financing decisions to make in the absence of investment decisions and vice versa.

2. ***Investment Decision Vs Financing Decision- Fundamental Difference***

   This, however, is not to imply that the line dividing the two is difficult. In fact, conceptually the two kinds of decisions are quite different & it is important to recognize them as such. What is the fundamental difference between the two? Evidently, both, financing as well as investment decisions involve a certain selection of cash flows. Typically, a financing decision involves accepting cash today (inflows) from the capital market & repaying the same together with interest or dividend subsequently over a period of time (outflows). **On the other hand,** an investment decision involves investing the cash today in the product market (outflow) & receiving a stream of earnings (inflows) subsequently. Now, the cash invested in the product market is, in fact, the cash which is raised from the capital market.

3. ***Inter-linkage between Investment & Financing Decision through NPV***

   If after paying all lenders their interest & shareholders their normally expected dividends, some surplus are left, obviously, it will belong to the shareholders thereby increasing their wealth. Usually, however, it is extremely cumbersome, though not impossible, to match the cash flows arising from the financing decisions & the cash flows accruing from the investment decisions on a period basis on account of the possible mismatch between their timings. It is therefore far simpler to capture the financing cash flows through their cost (of capital & to use this rate for discounting the operating cash flows. Under this framework, obtaining a positive net present value (NPV) implies the same thing as minimizing the cost of capital. The point becomes further clear if we take another look at the NPV formula:

i.e. **NPV=Co+C1 /(1+r)** where C0 and C1 are cash flows occurring at time 0 & 1

A close look into the formula would readily show that 'r' and NPV are inversely related. **A higher 'r' would mean lower NPV & vice versa.** The 'r' being the rate of discount which normally represents cost of capital. It clearly highlights the inter-linkage between the financing & the investment decisions & provides an explicit justification of the NPV rule as the basic rule of financial decision making.