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The Financial Manager's Roles

Introduction:

Who is a financial manager? What is his or her role? A **financial manager** is a person who is responsible, in a significant way, to carry out the finance functions. It should be noted that, in a modern enterprise, the financial manager occupies a key position. He or she is one of the members of the top management team, and his or her role, day-by-day, is becoming more pervasive, intensive and significant in solving the complex funds management problems. Now his or her function is not confined to that of a scorekeeper maintaining records, preparing reports and raising funds when needed, nor is he or she a staff officer–in a passive role of an adviser. The finance manager is now responsible for shaping the fortunes of the enterprise, and is involved in the most vital decision of the allocation of capital. In his or her new role, he or she needs to have a broader and farsighted outlook, and must ensure that the funds of the enterprise are utilized in the most efficient manner. He or she must realize that his or her actions have far-reaching consequences for the firm because they influence the size, profitability, growth, risk and survival of the firm, and as a consequence, affect the overall value of the firm.

The financial manager, therefore, must have a clear understanding and a strong grasp of the nature and scope of the finance functions. The financial manager has not always been in the dynamic role of decision-making. About three decades ago, he or she was not considered an important person, as far as the top management decision-making was concerned. He or she became an important management person only with the advent of the modern or contemporary approach to the financial management. What are the main functions of a financial manager?

1. Fund Raising:

The traditional approach dominated the scope of financial management and limited the role of the financial manager simply to funds raising. It was during the major events, such as promotion, reorganization, expansion or diversification in the firm that the financial manager was called upon to raise funds. In his or her day-to-day activities, his or her only significant duty was to see that the firm had enough cash to meet its obligations. Because of its central emphasis on the procurement of funds, the finance textbooks, for example, in the USA, till the mid1950s covered discussion of the instruments, institutions and practices through which funds were obtained. Further, as the problem of raising funds was more intensely felt in the special events, these books also contained detailed descriptions of the major events like mergers, consolidations, reorganizations and recapitalizations involving episodic financing. The finance books in India and other countries simply followed the American pattern. The notable feature of the traditional view of financial management was the assumption that the financial manager had no concern with the decision of allocating the firm's funds. These decisions were assumed as given, and he or she was required to raise the needed funds from a combination of various sources.

The traditional approach did not go unchallenged even during the period of its dominance. But the criticism related more to the treatment of various topics rather than the basic definition of the finance function. The traditional approach has been criticised because it failed to consider the day-to-day managerial problems relating to finance of the firm. It concentrated itself to looking into the problems from management's–the insider's point of view.5 Thus, the traditional approach of looking at the role of the financial manager lacked a conceptual framework for making financial decisions, misplaced emphasis on raising of funds, and neglected the real issues relating to the allocation and management of funds.

2. Fund Allocating:

The traditional approach outlived its utility in the changed business situation particularly after the mid-1950s. A number of economic and environmental factors, such as the increasing pace of industrialization, technological innovations and inventions, intense competition, increasing intervention of government on account of management inefficiency and failure, population growth and widened markets, during and after mid-1950s, necessitated efficient and effective utilization of the firm's resources, including financial resources. The development of a number of management skills and decision-making techniques facilitated the implementation of a system of optimum allocation of the firm's resources. As a result, the approach to, and the scope of financial management, also changed. The emphasis shifted from the episodic financing to the financial management, from raising of funds to efficient and effective use of funds. The new approach is embedded in sound conceptual and analytical theories.

The new or modern approach to finance is an analytical way of looking into the financial problems of the firm. Financial management is considered a vital and an integral part of overall management.

In this broader view the central issue of financial policy is the wise use of funds, and the central process involved is a rational matching of advantages of potential uses against the cost of alternative potential sources so as to achieve the broad financial goals which an enterprise sets for itself.' Thus, in a modern enterprise, the basic finance function is to decide about the expenditure decisions and to determine the demand for capital for these expenditures. In other words, the financial manager, in his or her new role, is concerned with the efficient allocation of funds. The allocation of funds is not a new problem, however. It did exist in the past, but it was not considered important enough in achieving the firm's long run objectives.

In his or her new role of using funds wisely, the financial manager must find a rationale for answering the following three questions:

• How large should an enterprise be, and how fast should it grow?

• In what form should it hold its assets?

• How should the funds required be raised?

As discussed earlier, the questions stated above relate to three broad decision areas of financial management: investment (including both long and short-term assets), financing and dividend. The 'modern' financial manager has to help making these decisions in the most rational way. They have to be made in such a way that the funds of the firm are used optimally. We have referred to these decisions as managerial finance functions since they require special care and extraordinary managerial ability.

As discussed earlier, the financial decisions have a great impact on all other business activities. The concern of the financial manager, besides his traditional function of raising money, will be on determining the size and technology of the firm, in setting the pace and direction of growth and in shaping the profitability and risk complexion of the firm by selecting the best asset mix and financing mix.

3. Profit Planning:

The functions of the financial manager may be broadened to include profit-planning function. Profit planning refers to the operating decisions in the areas of pricing, costs, volume of output and the firm's selection of product lines. Profit planning is, therefore, a prerequisite for optimizing investment and financing decisions.8 The cost structure of the firm, i.e. the mix of fixed and variable costs has a significant influence on a firm's profitability. Fixed costs remain constant while variable costs change in direct proportion to volume changes. Because of the fixed costs, profits fluctuate at a higher degree than the fluctuations in sales. The change in profits due to the change in sales is referred to as operating leverage. Profit planning helps to anticipate the relationships between volume, costs and profits and develop action plans to face unexpected surprises.

4. Understanding Capital Markets:

Capital markets bring investors (lenders) and firms (borrowers) together. Hence the financial manager has to deal with capital markets. He or she should fully understand the operations of capital markets and the way in which the capital markets value securities. He or she should also know how risk is measured and how to cope with it in investment and financing decisions. For example, if a firm uses excessive debt to finance its growth, investors may perceive it as risky. The value of the firm's share may, therefore, decline. Similarly, investors may not like the decision of a highly profitable, growing firm to distribute dividend. They may like the firm to reinvest profits in attractive opportunities that would enhance their prospects for making high capital gains in the future. Investments also involve risk and return. It is through their operations in capital markets that investors continuously evaluate the actions of the financial manager.