Role of Financial Management

by Sophia

WHAT'S COVERED

Do you have a budget? If you do, what do you think would happen if you didn't follow it? Would you have enough money to do the things that you wanted to do? Well, in business, budgets are very important. This tutorial will cover the role of financial management. Our discussion breaks down as follows:

1. Role of Financial Management

The role of financial management is to plan for an organization's current needs as well as future needs.

- In smaller companies, the owner is responsible. If you recall from an earlier tutorial, we discussed the sole proprietor and the workload that they take on. This is a big part of it—making sure that their financial management is sound.
- In larger organizations, a financial department is typically responsible for financial management.

Businesses exist to sell goods or services at a profit, but the fact is, organizing money is an ongoing need within that business. It's important for a business to manage their money because debt can develop; they need to monitor this debt to make sure it's not going to be too much for the business to handle.

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2. Budgets

The **budget** is a researched projection of what funds are needed for a specific period of time, such as, for instance, a year or three months. A business has to have a budget; it can't simply spend money haphazardly. They need to have a plan for those expected expenses.

Now, finance managers ensure that results are in line with what is planned for an organization. Finance managers watch the budget to ensure that where they are and where they need to be are lining up along the way. If not, they'll need to make adjustments to how they're managing the money.

Financial management makes decisions that will maximize value for the organization. In addition, they make decisions about alternative sources of funding that are inside as well as outside the company. Proper financial management helps ensure both of these things.

TERM TO KNOW

Budget

A researched projection of what funds are needed for a specific period of time.

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3. Proper Financial Management

Proper financial management's goal is to monitor finances to ensure financing priorities are created to be complementary to the organizational goals. When you're managing the money, it's critical to do it in a way that's complementary to where the business wants to go. If the money's going in one direction and the business wants to go in another direction, something has to give, and typically, it's going to be the business—which means the money people are out of a job.

Finance managers ensure that there is sufficient financing available. Funds need to be available now and if the company finds itself in a position to need that extra financing later, it needs to be available in the future.

Finance managers also ensure that a business is spending effectively and that the spending is planned and controlled, versus spending money erratically with no plan on how to control that spending.

They also want to raise the organization's credit score so that it continues to improve as the organization grows.

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4. Financing Options

Finance managers seek financing options for the company that fit the needs of the business both now and later, as mentioned before. Let's take a look at two different financing options.

4a. Short-Term Financing

Short term financing is financing that is for one year or less, to be used for short term needs. Now, short term financing is good for a variety of different things.

Uses for Short Term Financing	Description
Immediate cash flow	This refers to when a business doesn't have enough money on hand to pay their current needs, such as making payroll or buying an order of something very quickly. In this case, short-term financing can be used to get over that hump.
Current inventory purchases	This refers to anything that you may buy to support the organization's day-to-day operations—those physical goods that are required to run the company.
Monthly expenses	These expenses include everything from salary to inventory, as mentioned or paying suppliers or utilities. It could be anything that happens on a monthly basis, and a case in which a business is a little short one particular month.
Short-term promotional needs	These needs include needs like running an immediate unplanned campaign. A business needs to have short-term financing for these because they aren't necessarily something that was planned for.

Speculative production	These funds cover the time between when a product is made and when it's actually sold and the business gets paid for the sale.

DID YOU KNOW

Companies don't always get paid right away in full for the things that they sell. Therefore, you want to make sure you have money to cover the gap between when the product is sold to the customer and when the customer actually pays for it.

TERM TO KNOW

Short-Term Financing
Financing that is for one year or less.

4b. Long-Term Financing

Long-term financing is a little different; it is financing that is for more than one year. Long-term financing is good for many things.

Uses for Long-Term Financing	Description
Business startups	This includes all those costs that are associated with launching a new business.
Mergers and acquisitions	When a company merges with someone else or wants to acquire another company or product, it can use long-term financing to purchase that company or division, to make the organization better.
New product development	This refers to investing in research and testing of new products to bring that next big idea to market. These are longer-term goals that will be much more permanent.
New equipment	As a business, you may need new equipment in order to do your job better or to replace something that has broken. Again, these are bigger ticket items—things that are going to last the company a long while. Therefore, doing something long-term with financing is a good idea.

TERM TO KNOW

Long-Term Financing
Financing that is for more than one year.

SUMMARY

Today we learned about the **role of financial management**. We also learned about **budgets** and why they're important to a business. We discussed what **proper financial management** entails and explored some **financing options**: **short-term financing** versus **long-term financing**.

Good luck!

Source: adapted from sophia instructor james howard

TERMS TO KNOW

Budget

A researched projection of what funds are needed for a specific period of time.

Long-Term Financing

Financing that is for more than one year.

Short-Term Financing

Financing that is for one year or less.