Principles of Financial Management

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- Background
- Financial Management P/D/D
- Classification of expenditure
- Two key policy instruments of government
- Receipts and Payments (BD/RD/FD/PD)
- Tools of M.P.
- Objectives of fiscal administration
- Principles of financial administration

Objectives of financial administration

- Management of finances of public household (best application of limited means)
- Implementation of projects and programs (Optimal public investment decisions through project formulation, appraisal, implementation and control)
- Provision of public goods and social services (parks, health and sanitation)
- Growth, employment and price stability (economic growth but no trickle down)

- Capital formation (discriminatory taxation and monetary policy instruments)
- Productive deployment of funds (entrepreneurs preference for ‘risk free’ and quick yielding’ investment opportunities)
- Facilitating smooth flow of parliamentary processes (representative govt.’s control of use of public funds)
- Achievement of equity and equality (progressive taxation, grants and subsidies)

- The principle of primacy of public interest, public choice and public policy (to concentrate on those activities which make a definite and justifiable contribution to public interest; not to impair the goals of the State)
- The principle of political direction and control (Financial administration, a subsystem of Public administration, should conform to ideals expressed in constitution)
- The principle of correspondence. It implies that there should be a causal relationship between objectives of financial administration and the human and material resources necessary to accomplish such objectives.

- The principle of unity of organisation and management. The work of different financial and non financial agencies should be coordinated.
- The principle of stability and balance (manpower planning and HRD)
- The principle of simplicity and flexibility (democratic governments derive power from people, hence…)
- The principle of conduct, discipline and regularity (ethical and upright)
- The principle of public trust and accountability (Publicly accountable for use of funds)

- **Fiscal policy** is the means by which a government adjusts its spending levels and tax rates to monitor and influence a nation's economy. It is the sister strategy to monetary **policy** through which a central bank influences a nation's money supply.

- Tools of fiscal policy
- The two main **tools of fiscal policy** are taxes and spending. Taxes influence the economy by determining how much money the government has to spend in certain areas and how much money individuals should spend.

- Fiscal policy most closely focus on?
- **Fiscal policy most closely** focuses on Managing taxes and spending. **Fiscal policy** is what the government employs to influence and balance the economy, they use taxes and spending to accomplish this.

- Importance of fiscal policy
- **Fiscal policy** is an **important** tool for managing the economy because of its ability to affect the total amount of output produced—that is, gross domestic product. The first impact of a **fiscal** expansion is to raise the demand for goods and services. This greater demand leads to increases in both output and prices.

- Compensatory fiscal policy
- **Compensatory Fiscal Policy**. ... The main thrust of **compensatory fiscal policy** thus is that the government **should** inject extra expenditure to reinstate demand. In effect, the government expenditure was able to compensate for reduced private expenditure. This **fiscal policy** is called **compensatory fiscal policy**.

- Objectives of fiscal policy
- The **objective of fiscal policy** is to maintain the condition of full employment, economic stability and to stabilize the rate of growth. For an under-developed economy, the main purpose of **fiscal policy** is to accelerate the rate of capital formation and investment.

- Countercyclical fiscal policy
- Reducing spending and raising taxes during a boom period, and increasing spending and cutting taxes during a recession.

There are **three main** stances in **fiscal policy**: neutral, expansionary, and contractionary.

- Elements of fiscal policy
- The key **elements of fiscal policy** are government spending and taxation. In times of a recession, the government can increase spending / reduce taxes to stimulate consumption and push towards economic growth.

- Difference between discretionary and nondiscretionary fiscal policy?
- **Discretionary fiscal policy** is the government action that indicates towards planned action to balance the economy whereas **nondiscretionary fiscal policies** are happening automatically.

- Tools of monetary policy?
- **Three** instruments of **monetary policy** are open market operations, the discount rate and reserve requirements. Open market operations involve the buying and selling of government securities.

- Three major types of taxes?
- The **three types of taxes** are the proportional **tax**, the progressive **tax**, and the regressive **tax**. A proportional **tax** imposes the same percentage of **taxation** on everyone, regardless of income.

- What does fiscal policy include?
- **Fiscal policy** refers to the use of government spending and tax **policies** to influence economic conditions, including demand for goods and services, employment, inflation, and economic growth.

- What are the three types of government budgets?
- Depending on the feasibility of these estimates, **budgets** are of **three types** -- balanced **budget**, surplus **budget** and deficit **budget**. Depending on the feasibility of these estimates, **budgets** are of **three types** -- balanced **budget**, surplus **budget** and deficit **budget**.

- What are the problems of fiscal policy?
- Budget Deficit.
- Expansionary **fiscal policy** (cutting taxes and increasing spending will cause an increase in the budget deficit which has many adverse effects. A higher budget deficit will require higher taxes in the future and may cause crowding out.

- What are the basic objectives of fiscal policy highlight the major problems of fiscal policy?
- One of the **main objective of fiscal policy** is to control inflation and stabilize price. Therefore, the government always **aims** to control the inflation by Reducing **fiscal** deficits, introducing tax savings schemes, Productive use of financial resources.

- What are the goals of fiscal policy?
- The usual **goals** of both **fiscal** and monetary **policy** are to achieve or maintain full employment, to achieve or maintain a high rate of economic growth, and to stabilize prices and wages.

- What is discretionary fiscal policy?
- A **discretionary fiscal policy** is a government **policy** that changes government spending or taxes. Its purpose is to expand or shrink the economy as needed.

- What is automatic fiscal policy?
- **Policies** or institutions (built into an economic system) that automatically tend to dampen economic cycle fluctuations in income, employment, etc., without direct government intervention. For example, in boom times, progressive income tax automatically reduces money supply as incomes and spendings rise.

- **Counter-cyclical fiscal measures** are policy measures which counteract the effects of the economic cycle.
- For example, counter-cyclical fiscal policy actions when the economy is slowing would include increasing government spending or cutting taxes to help stimulate economic recovery.

- What is restrictive fiscal policy?
- **Contractionary fiscal policy** is when the government either cuts spending or raises taxes. It gets its name from the way it contracts the economy. It reduces the amount of money available for businesses and consumers to spend.

CASELET

- ‘Adwitiya’ is a company enjoying market leadership in the food brands segment. It’s portfolio includes three categories in the Foods business namely Snack Foods, Juices and Confectionery. Keeping in line with the growing demand for packaged food it now plans to introduce Ready- To-Eat Foods. Therefore, the company has planned to undertake investments of nearly Rs. 450 crores for its new line of business. As per the current financial report, the interest coverage ratio of the company and return on investment is higher. Moreover, the corporate tax rate is high.
  In context of the above case:
- As a financial manager of the company, which source of finance will you opt for? Explain by giving reasons.
- Why are the owners of the company likely to gain from the company borrowing funds?

- As a financial manager of the company, I will opt for debt to raise the required amount of capital.
- Reasons:
  - **Interest coverage ratio:** The interest coverage ratio of the company is high so it can easily meet its fixed commitment of payment of interest and repayment of capital.
  - **Tax rate:** The tax rate is high which makes debt relatively cheaper as the amount of interest paid on debt is treated as a tax deductible expense.
- The shareholders of the company are likely to gain from the issue of debt by the company because the return on investment is higher. It helps a company to take advantage of trading on equity to increase the earnings per share.

- After completing his education in travel and tourism, Arjun started Travel Angels Pvt. Ltd. along with his twin brother Bheem. Their company seeks to provide travel solutions to its clients like ticket booking for airways, railways and road ways, hotel booking, insurance etc. Although the business is doing well both of them have realised that they are not good in managing finance, and feel confused and frustrated sometimes due to financial crises that may suddenly arise. In order to avoid such situations in the future, they hire Nakul and Sehdev as financial managers, who have done a degree certification course in financial management. The company wishes to convert itself into a public company.
  In context of the above
- Give the meaning of financial management.
- Outline the role of Nakul and Sehdev as the financial management team of the Travel Angels Pvt. Ltd

- Nakul and Sehdev will play a very important role as the financial management team of the Travel Angels Pvt. Ltd. in managing the financial health of the company:
  - To determine the capital requirements of business both long-term and short term.
  - To determine the capital structure of the company and determine the sources from where required capital will be raised keeping in view the risk and return matrix.
  - To ensure efficient management of cash in order to ensure both liquidity and profitability.
  - To exercise overall financial control in order to promote safety, profitability and conservation of funds.