Course: Financing and economic management

Author: pplk. Ing. Petr MUSIL, Ph.D.

Contents

Financial management - development, concept, role

1 Financial Management - the theoretical definition

What includes the area of financial management?

Includes various methods of management of finances, management of financial resources throughout their life cycle - from obtaining financial resources and capital budgeting, allocation and distribution of financial resources, management and efficient use of financial resources, management of financial resources, financial risk management, distribution profit and other financial operations of the organization.

Usually, financial management defines "as subjective economic activity, dealing with obtaining the necessary amount of money and capital from various financial resources (funding), allocating money to various forms of non-monetary assets (investments) and profit distributions (dividend policy) in order to maximize the market value of the equity company assets".[1]

Financing is an integral part of financial management. Financing is understood as a concrete realization of financial management. Financing alone is, generally speaking, the application range of economic and financial rules and principles to maximize the assets of the company or its total enterprise value (firm's wealth).

The goal of financial management in a market economy is to maximize its market value, i.e. the market value equity capital, for which they are responsible to their work and to the managers to the owners of the company or other interest groups (stakeholders). Manager responsible for financial management across the organization is called the Chief Financial Officer (CFO[2]). No one knows exactly when it reaches the maximum market value, even if that objective is considered a priority in the long-term strategy of each company. Other objectives of financial management are to ensure the continuous solvency of the company, for continuing liquidity of assets and ensure the viability of the company.

---

[1] VALACH, Josef a kolektiv. *Finanční řízení podniku.* 2. aktual. a dopl. vyd. Havlíčkův Brod: EKOPRESS, s.r.o., 1999. ISBN 80-86119-2 1-1.

[2] **CFO** (Chief Financial Officer), uses the abbreviation CFO, used to indicate the position of CFO. CFO is a manager in the organization responsible for the financial management throughout the organization. The task of the CFO is responsible for managing corporate finance / organization.

Financial management has the following **main tasks:**[3]

1. Raise capital for ordinary and extraordinary business needs and decisions and its structure and its changes (to get a loan, issue shares or bonds, etc.).
2. Decide on the location of the capital (development of new products and technologies, investments free capital in land, shares, securities, etc.).
3. Decide on the distribution of profits (reinvest or pay it in the form of dividends - to organize the dividend policy of the company).
4. Predict, plan, employ, analyze, control and manage the economics of operation.

Financial management and financing for all types of organizations (from small to large firms) is influenced by two factors, namely **time factor and risk factor.**

Respecting **the time factor** is a principle that can be expressed in an inflationary environment without simple rule: one crown obtained today is worth more than the same crown obtained tomorrow, because today's crown may be invested immediately and bring some effect.

Risk factor in the financial management lies in the fact that the Crown obtained with the risk is worth less than the risk-free crown. Financial management must therefore respect the next time factor and the risk to which they are obtained cash receipts and cash expenditures invested. Biggest importance is the consideration of risks again at long-term strategic financial - investment decisions.

It is influenced by the effect of various factors, namely:

– variability of revenues and expenses,
– diversification of production,
– position firm on the market,
– choice of technology, etc.

We distinguish two levels of risk, namely:

1) **Uncertainty** (broader term).

---

[3] SYNEK, Miroslav a kolektiv. Manažerská ekonomika. 4. aktual. vyd. Praha: Grada Publishing, a.s., 2007. 452 s. ISBN 978-80-247-1992-4

2) **Risk** (short term).

Risk represents the possibility of loss of the invested funds. Risk arises from external causes such as natural disasters, economic crises, inflation, or from internal cause's organizations such as the wrong estimate of demand or wrong investment focus. For financial decisions following rules apply:

- **The higher the risk, the higher the yield of the desired future potential investments,**
- **Prefers always bigger yield before less yield,**
- **Always prefers less risk before a higher risk,**
- **Prefer the money received earlier before the same amount of money received later,**
- **Motivation to invest in a particular action is expected to yield greater than would bring investment to another action (taking into account the level of risk).**

Financial risk is in financial management understood as a certain page in the overall business risk that arises when using certain forms of financing, which necessitate a fixed payment (installment loans, installment bond, interest on loans and bonds, permanent lease payments, etc.). These payments take precedence over operating expenses, using disposable income to finance development, payment of ordinary dividends, etc. The financial risk is particularly apparent loss of the Company's liquidity.

2 Basic concepts in financial management

Financing - Using a series of economic and financial tools and principles to maximize wealth (property) of the company and the value of their shares.

Financial Planning - Complex activity involving the determination of expenditure and income, cost setting limits, future revenues and profit, deciding how to allocate funds and identifying alternative strategies for the case other than the planned development.

Macroeconomic factors – Are wider economic and financial influences and factors that influence directly and indirectly revenue and profit organization (the company).

Micro decision – Are internal decisions within the company that affect revenues, help control costs and profit organization (the company).

Risk/return trade-off - Required rate of profit (income), which makes the investment in a particular level of risk.

Finances - Represents the portion of assets (property), organization (the company), which takes the form of cash, various forms of deposits with financial institutions and cash equivalents (i.e. Valuables, checks, vouchers for goods and services).

Financial resources:

1) The financial resources can be considered sources that provide funds and venture capital.
2) Financial resources are summaries of money that the company makes for a certain period of time and by selling their performances.
3) Financial resources are all sales company (the most common definition).

Wealth maximization - This is to increase enterprise value by choosing the investment strategies that deliver the best risk/reward.

Budgeting scarce resources - Key role of contemporary financing and financial planning in particular, consisting in finding the optimal sources of funding (enterprise) based on the conditions the rarity of various sources of capital and option combinations according to their origin and allocation in the enterprise.

3 Development of methods and financial management

Financial management has gradually evolved from the early twentieth century and began to separate from other activities in the organization. Until the crisis in the thirties, the issue of finance focused in particular on the creation and establishment of new organizations (enterprises) and the possibility of obtaining the necessary financial resources. At this time he began to dominate the view that financial management is the highlight of the whole management of the company (previously it was seen only as a supplement). Period of economic crisis brought about companies dealing with extinction, liquidity organization (the company) and improvement of financial analysis. Theorists have solved the problems of the external and internal capital and bonds. Since that time, financial management separates as an independent discipline, began to develop self-control departments that deal with financial flows and financial management. In the 50s tendency is to evaluate the organization (enterprise) according to the course of financial flows. However, especially under the influence of the use of operational analysis was to manage the organization's current assets (business) and approached to the issue of evaluating technological and investment plans. A large impact on the emerging concept of financial management should also introduction of information technologies. Summers 60 and 70 provide further improved and extended application of quantitative methods in the wider use of computer technology. The area of interest has focused on the valuation of risk and the possibility of protection against various types of risks associated e.g. with investments. With that came an interest in the portfolio theory. In the 70s, there was a steep change in the neighborhood organizations (enterprises) and the management organization (the company) tried to adapt (e.g. the energy crisis) their financial decisions in order to optimize behavior of the organization (company). In the 80s there was an increased interest in the new financial market instruments. Currently, efforts to improve the methods and improve access to information, rationalize financial management.

In the area of financial management as a theoretical discipline, attention has focused in recent decades on the design of tools to enable managers to solve particular problems of motion control **working capital, financial analysis** based on the analysis of the content and links within accounting or **financial statements**. In the last years, however, attention shifts in budgeting and resource planning, based on their limitations (budgeting of scarce resources) and to strive to achieve and make the right investment decisions in individual investment projects or items of assets (property), which guarantee the best ratio risk/profit. For such a decision is characterized by the existence of numerous variants and studying and evaluating their effect on business value. Similarly characteristic of the concept of today's financial assessment is correct proportion between equity and debt financing (stock and debt financing).

Financial management is generally be described as a process where through funds we manage, organize and determine and influence the objective organization.

Financial management by Kryštůfka T. is a dynamic process that is constantly changing according to current conditions. The result should be fluent business operations, sufficient cash resources to work effectively with the resources, property coverage and safely incurred free resources investments that will enable the company to grow.[4]

The financial management of the organization (business) is secured using various kinds of methods and indicators.

[4] ERP - Enterprise resource planning, available from: http://cz.linkedin.com/in/tomaskrystufek.

Methods based financial management (based) on different financial indicators (metrics) and statements. To this set of indicators includes:[5]

- **Indicators profit** - EAC, EAT, EBT, EBIT, EBITDA, Gross margin, NOPAT, economic profit, net profit after taxes plus interest,
- **Value criteria for measuring business performance**
  - CFROI (Cash Flow Return on Investment) - CF investment return
  - CROGA (Cash Return on Gross Assets) - CF return on gross assets,
  - EVA - Economic Value Added,
  - etc.
- **Indicators based on cash-flow**
  - Cash flow per share,
  - CF return on assets - ROA (CF)
  - CF return on total capital,
  - CF return on sales - ROS (CF)
  - CF solvency
  - CF interest coverage costs
  - etc.
- **Indicators ratios**
  - CR - Current Ratio,
  - CPR (Cash Position Ratio) - Immediate liquidity,
  - QAR (Quick Asset Ratio) - quick ratio,
- **Indicators of return**
  - ROA - Return on Assets,
  - ROC (Return on Capital) - Return on costs,
  - ROCE (Return on Capital Employed) - Return on invested capital in the long term,

[5] *Managementmania: Územní samospráva* [on-line]. Praha: Managementmania. [2014-07-23]. Dostupné z: https://managementmania.com/cs/ekonomika-a-finance

- ROGIC (Return on Invested Capital Gross) - Return on gross capital invested,
- ROI - Return on Investments,
- ROIC - Return on Invested Capital,
- etc.

– **Evaluation techniques on investment (investment variants)**

- NPV - Net Present Value,
- IRR - Internal Rate of Return,
- PI Profitability Index,
- PP – Payback Period,
- ABPM (Accounting-Based Profitability Measures) - The average yield on book value,
- etc.

– **Debt indicators**

- Creditor Risk Indicator (Total Debt to Total Assets)
- The ratio of equity capital to total assets,
- Financial leverage,
- The ratio of capital creditors and shareholders' capital (Debt to Equity Ratio)
- etc.

– **Activity indicators**

- Total Assets Turnover Ratio - Turnover assets,
- ACP (Average Collection Period) - The maturity of debt,
- Creditors Payment Period - Maturity of short-term liabilities,
- etc.

– **Indicators of market value (stock market)**

- The activation ratio (Plowback Ratio),
- Net income per share (EPS - Earnings Per Share),
- Dividend Cover,

- Dividend Yield,
- PEG ratio (Price to Earnings Ratio to Growth),
- The ratio of prices and sales per share (P/S - Price to Sales Ratio),
- The ratio of the market price of a share and its book value (P/B - Price Book Value, M/B - Market to Book Ratio),
- etc.

– **Productivity indicators**

- Total productivity (TFP - Total Factor Productivity),
- EVA - Economic Value Added.

Other financial indicators:

- Altman analysis (Altman Z-score) - index Altman, Altman analysis,
- CAGR (Compound Annual Growth Rate),
- DAR (Debt/Asset ratio) - the proportion of the company's assets that are financed through debt,
- etc.

– **Absolute indicators**

- Horizontal analysis,
- Vertical analysis,

– **Differential indicators**

– **Proportion (relative) indicators (evaluative, synthetic indicators)**

- Activity indicators,
- Ratios indicators,
- Indicators of market value (capital market)
- The profitability indicators
- Debt ratios,

– **System of interrelated indicators - see eg. BSC**

– **Basic financial statements are**

- Balance Sheet,
- Profit and loss account (income statement)
- Statement of cash flows (cash flow).

4 Public sectors - Financial management

The definition of the public sector by economic dictionary *"is a part of the economy, whose goods and services are financed mainly from public budgets."*[6] **Basically** the public sector is a specific part of the economy, and is part of the services sector. **The goal is** not profit but achieving benefits.

The public sector includes a wide range of services sector:

- General public services (public administration),
- Defense,
- Public order and safety,
- Economic Affairs
- Environmental protection,
- Housing and community amenities,
- Health Care,
- Recreation, culture and religion,
- The education sector - public sector,
- Social Affairs (Social Services).

Economic policy determines the function of the public sector, tasks, priorities and instruments to achieve those objectives, as well as financial instruments - financial limits, financial indicators of the level of subsidies, …

[6] HINDLS, Richard. HOLMAN, Robert. HRONOVÁ, Stanislava. *Ekonomický slovník.* 1. vyd. Praha: C. H. BECK, 2003, 519 s. ISBN 80-7179-819-3.

We distinguish these basic functions of the public sector:

1. **Economical,**
2. **Social,**
3. **Political,**
4. **Ethical.**

The basic activities of the public sector include the provision of public goods, then the production of public goods efficiently allocate funds from the budget system through redistribution processes. Ensuring the efficiency of the public sector is one of the biggest problems.

Public good - the good, service, whose consumption is indivisible (cannot be divided between consumers, irreducibility, noncompetitive consumption) and not excludable (cannot effectively stop its consumption).

The key outcome of the public sector is public services. In terms of management of public sector organizations is therefore essential ability to manage services. Given the diversity of the public sector but are applied almost all areas of management.

Achieving the organization's objectives can be best ensured good harmony managerial functions (**Continuous managerial functions** - planning, organizing, selection and placement of employees, Leadership, Control; **Parallel managerial functions** - Analyzing the problems to be solved, deciding, realization, or implementation).

Parts of the public sector are also public finances. **Public finances** are one of the tools for the implementation of public policy and are essentially determine the existence, scope, structure and functioning of the public sector.

Public finance - *"associated with the public sector and its financing. More specifically budgets include central, regional, local, public sector organizations budgets and off-budget funds. In a wider sense also include the actors on the interface of the system of public finance - state enterprises, state-owned banks, insurance companies and other state government agencies and business support institutions."*[7]

[7] HINDLS, Richard. HOLMAN, Robert. HRONOVÁ, Stanislava. *Ekonomický slovník.* 1. vyd. Praha: C. H. BECK, 2003, 519 s. ISBN 80-7179-819-3.

Functions of public finances

The mission of the public finances is to ensure the non-profit and especially the public sector and contribute to achieving stability and efficiency of the national economy. The main functions of public finance include:

- **Allocative function** - the state through public budgets allocated, i.e. deploys some resources into production, i.e. the provision of different types of public goods.

When allocating arises following main problems:

- how to determine the composition produced public goods,
- for who mainly produce,
- how to select a quantitative relationship between the amount of public and private goods,
- how to ensure effective funding the production of public goods.

The main groups of public goods whose production is covered by public budgets include:

- costs of activities of educational institutions,
- cost of equipment for recreation (parks, etc.),
- cost of maintenance and rehabilitation of roads,
- costs of sanitation services and operation of sanitary facilities,
- some of the costs of air protection, to ensure water clarity etc.

Prices for public goods in the form of taxes and various fees should be set so burdened in particular consumer consumption of the public good, like the prices established and applied in competitive markets for private goods

The aim of the allocation of resources, which always manages some level of government, is to achieve the so-called social optimum, i.e. the best allocation of social resources.

- **Distribution function** - effort to equitable distribution of pensions and property.

- **Stabilizing function -** using public money to ensure the level of employment, price level stability, economic growth, etc.

Crucial in this is the role of the state. The classic features of its legislative and administrative ranks from 30 years of the last century economic function. In characterizing the state still emphasizes it’s called coercive powers.

Public finances are important from two points of view, in terms of:

- practical,
- political.

Generally, public finance functions needed to correct deficiencies economic decisions implemented standard economic mechanisms through state intervention, implemented fiscal instruments.

Public budgets exist in the Czech Republic in the form of so-called Public budgetary system. Public budgetary system in the Czech Republic is divided into two levels: **central and local government.** From a structural point of view, public budgetary system consists of individual elements (budgets).

In the Czech Republic the basic elements of public budgetary system consists of:

- State budget,
- Budgets of state funds,
- Budgets of government departments and budget-funded organizations,
- Budgets of local governments.

In the system of budgeting is the most important state budget, because it leads to the largest portion of revenue of taxes and fees. From the state budget will depend on other budgets.

5 Defense sector - Financial management

Financial management subsystem is the main part of the system of economic management. Within this subsystem is implemented budgeting, decision making and organizing financing MoD.[8]

In the defense sector, particularly at the tactical level brigade - battalion, it is important how can managers, specialists and officials planning authorities correctly formulate the objectives by codebooks objectives of concrete actions - tasks as part of measures aimed at achieving set objectives. That objective must comply with conditions such as:

- reachability;
- simplicity, brevity and clarity;
- concreteness.

The role of financial management is to find ways for improvement of the various activities and use of funds, which the Ministry of Defense for the calendar year, and so fulfill the assigned tasks.

The order of the Ministry of Defense No. 72/2012 Financial management and financial security than previously valid warrant specifically defines financial management *"as a tool for manager's objectives as an integral part of economic management, ensuring economical, efficient and effective allocation and use of funds at a specified time and in accordance with objectives of the Ministry of Defense."*[9]

Financial management is carried out in the budgeting process, the realization personnel expenditures, financing, accounting, financial control and controlling:

- determining the desired state funds (state approved budget, budget changes after a final budget) and their structure (state funds for budget sentences, Art. 10) depending on the utilization of personnel and property, and their correction within a specified time;
- recording and monitoring balance of funds, receivables, payables and property;

[8] RYCHEL, Jozef a Jozef STRNÁDEK. Financování vojenských schopností a vojenské strategie počátku 21. století. *Vojenské rozhledy*. Praha: 2002, č. 4, s. 62. ISSN: 1210-3292.

[9] R MO č. 72/2012. *Finanční řízení a finanční zabezpečení*. Praha: MO, 2012, čl. 3.

– organizing employee activities economic services.

For creating the concept and methodology of financial management and financial support in the Ministry of Defense is responsible Deputy Defense Minister for Economy and Deputy Assistant Secretary of Defense for the economy - Director of the Economics Department of Defense by the scope specified in the Rules of Organization of the Ministry of Defense.

The administrator of this chapter is the senior employee is designed to perform the scope of the chapter administrator Organizational Regulations of the Ministry of Defense.[10]

List of tasks for students:

1) **Explain the nature and content side of financial management.**
2) **Explain these concepts in the area of financial management - financial management, financing, funds, financial resources, financial planning, uncertainty, risk, public good.**
3) **Explain the development of financial management and enumerate some indicators of liquidity, profitability, based on cash-flow.**
4) **Try to define the content of defense planning (defense plan, planning documentation, principles, and objectives hierarchy - basic concepts).**
5) **Characterize financial management in the public sector.**
6) **Explain financial management in the defense sector.**

[10] Article 256, Annex no. 1, Organizational Rules of the Ministry of Defense.