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INVESTMENTS IN EDUCATION DEVELOPMENT

Course: Financing and economic management

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Financial management - principles and rules

1 Financing

Financing is called obtaining (procurement), financial resources, generally capital in all its forms, and use them to procure the necessary assets to pay the expenditure of doing business (enterprise).[1] Financing is an important cross-cutting activity linking all factually specialized activities running in the enterprise.

There are several criteria by which we can distinguish the financing in the enterprise. According to distinguish the regularity of financing:

1. Common financing,
2. Extraordinary financing.

According to the source of the funds we distinguish:

1. Equity capital - (issue of shares or. Contributions in kind owners),
2. Foreign capital - (bank loans, bonds, deposits subscribers),
3. Self-financing - (profit, depreciation, financing of reserves, ...).

According to the time during which the capital available to the enterprise, we distinguish financing:

1. Long-term,
2. Short-term.

2 Financial objectives in the enterprise

Finance and financial management in an enterprise in a market economy is the dominant component of the overall economy of the company and its management.

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

Financial objectives (criteria) are a crucial part of business objectives in the short and long term, are the criteria for deciding various alternatives and assessing the overall business efficiency. Before the objective, we must have a vision. Individual areas of the company must be harmonized objectives, and must not be in conflict.

Financial objectives in the enterprise:

1. **Maximizing profit**

Size profit is complicated variable. Gradually it becomes the subject of criticism. For the following reasons:

- is a static variable, we report at the end of the reporting period - we do not progress report on the profit for the year, does not distinguish between short-term and long-term gains
- set out above profit is rather theoretical, characterizing the conduct of the undertaking in a market economy, not on the actual behavior analysis and decision-making business entities
- corporate profits reported in the accounts, is strongly influenced by the chosen concepts of income and expenses, depreciation methods, creation and release of provisions and accrued expenses. Therefore emphasizes the need to use cash flows,
- maximizing profit does not take into account the varying degree of risks to which the profit achieved. It is expected that a higher gain is achieved with the same degree of risk. But this is little realistic assumption - usually more profitable business alternatives, brings a higher risk.

2. **Solvency**

    - Expresses its ability to cover its cash obligations in the amount and time required. Only enterprise able to pay its obligations creates conditions for the continued existence and conservation or increases its value. The goal of financial management is to maintain solvency such that in the enterprise were held excessive funds, which themselves provide no or only a small effect (compared with their positions in the securities or in other forms of property of an enterprise).[2]

[2] VALACH, Josef. *Finanční řízení podniku.* 2. aktual. vyd. Praha: Ekopress, s.r.o., 1999. 324 s. ISBN 80-86119-21-1

3. **Maximizing the company's market value**

– At the profits generated can be seen as the amount that belongs to shareholders. Gain may be paid to shareholders in the form of money (dividends), or arrested in the company and used for investment.

– Shareholders wishing permanent flow of dividends, as well as permanent growth in the market price of the shares. The decision about how much to dividends and how much investment depends on the dividend policy.

The rise in prices of shares depends on the following factors:

- projected income (profit) per share,
- the timing of the flow of income,
- risk of projected incomes,
- the level of use of debt,
- dividend policy.

4. **Maintaining the stability of the company, risk management**

– The financial stability of a company can be expressed as raising capital for ordinary and extraordinary requirements and deciding on its structure, deciding on the location of the capital, distribution of profits and the management of the business.

3 Principles of Financial Management

Financial management should be to successfully meeting their goals based on several principles:

A. **Cash flow principle**

– This principle emphasizes that financial management are important cash flows (both enterprise gets the revenue and how it is issued),

– the financial health of a business depends on its ability to reimburse the cash payments to its creditors, suppliers, employees and owners,

– enterprise that achieves high profits may not be able to pay its liabilities = secondary insolvency.

B. The principle of net present value

– Net present value is calculated as the sum of the present (discounted) value of all cash flows of the investment. This means that it is necessary first to determine the value of each sub-investment cash flow and recalculate these values (discounted) based on a discount rate adopted for evaluating investments. If the sum positive, investment evaluation can be taken. Conversely, if negative, it is an important argument for not taking rated investment - from this perspective takes into account not only the amount of cash and expenditure, but also their temporal distribution.

Financial theory prefers this principle before consideration of return on funds

$$NPV = \sum_{n=1}^{N} CI \frac{1}{(1+i)^n} - CE$$

NPV> 0 → investment is preferred ↑ MV firms

i - the required rate of return

n - number of years

CI – cash income

CE - capital expenditure

C. The principle of respecting the time factor

The principle of respecting time means that one crown held today has more meaning than the same amount held tomorrow. It is an investment and obtaining profits.

$$PV = FV \frac{1}{(1+i)^n}$$

→ FV = PV (1 + i) n

PV = present value

FV = future value

D. Taking into account the principle of risk

Respecting the risk factor is the possibility that the expected situation at the investment does not occur. Generally, the higher the risk, the manager should demand a greater return on investment. Enterprise should defend against risks by investing in different industries and in different markets - diversification of risk.

E. The principle of optimizing capital structure

The principle of optimizing the capital structure lies in the fact that the company has to secure financing for their needs to ensure the optimal composition of capital. Financial management is ineffective if the enterprise overcapitalization, i.e. long-term financial resources enterprise funds short-term assets. The situation occurs when the company is undercapitalized, i.e. short-term financial resources, finances long-term assets. They must find the optimum point (ratio) between equity and debt.

F. The principle of matching the level of efficiency of the capital market

This principle reflects the importance of understanding the nature of the capital market and its effectiveness. From this perspective distinguishes three levels of efficiency:

– highly effective - information on securities based both on data from the past, present and future (analysis),

– medium effective - information on securities based on the data from both the past and the present of available resources,

– ineffective - information on the securities are based on data from the past.

G. The principle of planning and analysis of financial data

The principle of planning and analysis of financial data includes the fact that a necessary condition for the achievement of corporate goals is constantly planning and analysis of financial variables. Financial analysis - important, based on the past to predict the future, then based to drawing up the future plan. Financial planning provides for major and related business objectives and corporate strategy, i.e. ways to achieve these goals.

Main areas of financial management:

a) The financial manager must provide financial resources for the establishment and development of the company,

b) Financial manager compiles the optimum capital structure taking into account the structure of assets, the cost of acquiring capital and financial risk

c) Financing and management of current assets - inventory, receivables, cash and selection of the optimal form of short term financing,

d) The financial manager invests funds in fixed assets, selecting the optimal form of long-term financing,

e) The financial manager form of financial analysis (eg. Use of capital), aimed at analyzing liquidity and profitability of invested capital,

f) Financial manager of financial planning consists of the creation and use of internal and external financial resources in the short and long term.

g) The financial manager deals with the internal financial management of large integrated units and uses foreign capital in the financing of corporate activities.

Financial management is usually in larger companies are divided into two groups:

1. financial-management group,
2. financial-control (accounting) group.

The first group focuses on raising capital, cash management, relations with banks and other financial institutions, management of receivables and liabilities of the company, assessing investment plans and financial planning.

The second group focuses on to the cost and financial accounting, budgeting, corporation tax and internal financial control, i.e. controlling.

4 Financial decisions

Financial decisions is a process that select the optimal obtain funds, corporate capital and their use in terms of the fundamental objectives of business and the limiting conditions.

Financial decisions enterprise includes the following phases:

1) Definition of financial problems and concrete setting financial goals (mostly resulting from problems factual nature may arise in the field of finance. In determining financial goals should be respected limiting conditions).
2) Collection and analysis of information and documents needed for decision-making (using data from the financial and managerial accounting, statistics, marketing knowledge, data from the financial market, etc..).
3) The choice of different options:

– setting criteria for selection of the optimal variant (financial decision-making criteria must build on financial goals.)

– evaluation of the various options for selected criteria (here it is necessary to consider any deviation from the original plan, risk),

– selection of the optimal,

– implementation of the selected variant and its verification with respect to the objectives set.

Basic rules in financial decision making financial managers, corporations, departments:

– at greater risk require bigger yield,

– always prefer a larger income before income less,

– always prefer less risk from the risk of larger,

– always prefer money received earlier before the money received later,

– motivation to invest in concrete actions must be expected to yield larger than that which would bring investment into other events, but taking into account the level of risk,

– motivation is to increase the investment of all corporate assets, but operationally general criterion of financial decision making money and liquidity.

The most important types of decision situations in the field of corporate finance are:

a) strategic (long-term) financial decisions,
b) tactical (short-term) financial decisions.

Strategic financial decision contains:

- deciding on the overall amount of capital the company needs to be available,
- deciding on the structure of corporate capital, deciding on the proportion of equity and debt,
- deciding on the structure of business assets, deciding on the proportion of funds in the total corporate assets
- deciding on corporate capital investment, deciding on the use of embedded, funds, decisions on financial or in kind (real) investment
- deciding on the distribution of corporate profits taxed, deciding on the amount of reserve funds.

Short term financial decisions include:

Short term financial decisions are less risky, it does not show as great as the effect of time and changes are easily implemented. In this decision are working with relatively small amounts. Any wrong decision and not endanger the enterprise dramatically impacts of short-term decisions can be quite accurately calculate.

This decision making in particular include:

– The size and structure of the components of current assets (cash optimization, choice of various forms of short-term securities, decisions on claims, the optimal amount of inventory of materials, é unfinished and finished products)

– deciding on the optimal form of short-term capital, e.g. the possibilities of using trade credit, different variants of short-term financial reserves, the use of short-term financial advances, issuing short-term marketable (commercial paper), etc.,

– deciding how to protect against different forms of risk arising from fluctuations in prices, interest rates, exchange rates and influencing the financial results of the company (financial futures contracts, option contracts, swaps, etc.).

Financial decisions based short-term nature and are greatly influenced by the long-term financial decisions.

Factors influencing financial decisions:

a) yield,
b) the time,
c) risk.

This creates magic triangle.

5 Deciding on public finances - public choice

The public sector is the part of the national economy, of which production (production of public goods) are not decided on the market, but a public option. Public choice theory deals with the public and decision-making mechanisms. For public choice is to negotiate between the different actors of public choice according to predetermined rules.

Public choice is decided:

- the extent to which the state may intervene in a market economy,
- what tools to apply
- the size of the public sector,
- about the structure.

In public choice have four entities:

1. decision-making subject - one that prepares, presents and justifies solutions
2. target group - something we propose, we know what people want? People do not have the same opinion as to what I suggest,
3. executors of decisions - administrative and government officials,
4. hide players - lobbing, unions.

Each stakeholder has its own objectives and preferences (different), whose implementation aims in the context of public choice and public expenditure.

The focus of public policy, selection of options and solutions using the outputs of public policy decisions are made in the process of public choice. From the perspective of public choice theory, we can distinguish three basic types of collective decision-making that we apply in public policy. They are: **individual decisions, consensual decision-making and decision-making based on the use of majority rules.** Each has its advantages and disadvantages. Individual decision-making is based on the assumption that decides the only subject of public policy (e.g. the minister, deputy, director of the department, local government representatives).

The second form of decision-making is consensual decision (unanimous) decision making. This is a public policy implemented e.g. level councils, advisory and expert bodies.

In public policy is the most used majority voting. Its essence is that it is selected the option that gets the most votes. A majority vote is based on majority rule. The advantage of majority rule is that, while eliminating the possibility of blackmail individual, but does not exclude that the majority does not abuse its dominant position in their favor.

What maximizing politicians?[3]

Economic theory understands the motivation of politicians simply as an effort to maintain the privileged position of power and a consequential motivation "to please voters, respectively some of their groups.

This increases the importance of the median voter preferences. In political systems where there are two strong parties (USA, UK etc.) can be traced quite clear tendency to convergence of political programs of the parties. This trend fully reflects the assumptions of rational behavior of political parties as subjects maximizing their benefit. Both sides now want to maximize the number of votes received. On the way to this goal is to estimate as accurately as possible, what is the preference center and try to satisfy it.

The bureaucracy[4]

For each state measures decided by politicians through democratic processes and implemented by state officials - bureaucracy. The success of state intervention is closely linked to its competence, performance and motivation.

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[3] OCHRANA, František. *Veřejné rozpočty jako nástroj veřejné politiky a strategického vládnutí. Veřejná politika, veřejná volba, veřejný zájem.* CESES FSV UK. Praha: 2005. ISSN: 1801-1659

[4] MALÝ, Ivan. *Veřejná volba a veřejná kontrola I.* Praha: Verlag Dashofer, 1998. Územní samospráva v praxi.

Economic analysis is based on the fact that the officials maximize their utility function, like all other subjects - consumers, entrepreneurs. The question arises - what is the content of utility functions officials? The answer may not be clear. It is obvious that here we encounter many different ways of behavior. On the other hand, probably we can say that a general trend behavior bureaucracy exists. I really do not confuse if we assume that the goal is to maximize the extent of bureaucracy clerical activities, respectively budget of the institution. From here it is derived individual prestige and ultimately to personal income officer.

Interest Groups[5]

In the real world often reflects the outcome of the political process political force specially interested groups. This is also apparent from the fact that individuals have little incentive to conduct elections and in particular to obtain information relating to the various alternatives. Interest groups attempt to reduce the "costs" associated with the choice of voters and gathering information, especially to reduce the cost of those voters who are likely to be given interest group support. In addition, interest groups trying to mediate information about the preferences of politicians to their voters.

List of tasks for students:

1) **Explain the nature and content aspect of financing.**
2) **Characterize financial objectives.**
3) **Explain the principles of financial management.**
4) **Define the financial decisions. What do you know phases and types of financial decisions.**
5) **Explain decisions on public expenditure in public choice.**
6) **Characterize the other subjects in decision-making in public choice.**

[5] in the same place