THE ROLE OF MANAGERIAL FINANCE IN ORGANIZATIONS

ALEXANDRU CRISTIAN DOBRE *

ABSTRACT: *We discuss in this article about the importance of the managerial finance framework for organizations to activate in their markets. The decisions made by financial managers must be directed by certain objectives and by financial principles that stabilize economic activity. Financial managers base their decisions in order to help business owners. Managerial finance guides decisions for investments that create value for business owners, These decisions create shareholder value which in turn helps develop finance opportunities for organizations. Businesses need funds for short term and long term planned activities. Financial markets direct funds from investors to organizations. Capital growth is the main objective of investors and can only be obtained by good financial decisions. The value that financial managers create can promote funding for the organization and build trust for investors.*

KEY WORDS: *Management, finance, role*

JEL CLASSIFICATION: *G00, M00*

1. INTRODUCTION

Finance is a sector that is variate and in constant change. Finance is also the main department that gives direction to companies for finding hiring solutions, extending services with the construction of new buildings or even dictates the promoting of brands. Every decision that businesses make is supervized by financial background. Finance can be a interesting new career opportunity for the young generation. The resources of a business are often managed by the financial manager.

The ideas can be shared to the business decision makers more easily through a transparent communication of number based statistics that sustain an idea. The understanding of the financial background can be beneficial to both consumers and investors. Consumers can learn more about the product they are buying and investors can learn more about the business.

* *Assist. Prof., Ph.D., University of Petroșani, Romania,* cristiandobre@upet.ro

Through the financial department, organizations can grow funds and direct them towards new investments. The adaptation of financial theory to business specific activities is guided by finance. What the manager of funds needs to do in a organization is dictated by managerial finance. A financial manager must consult the finance principles to undertake his responsabilities. Both in the personal sphere and the business sphere, decisions must be guided by finance principles.

In personal life finance can organize the amount of spending, saving and investing. Finance can also help consumers understand when it is a good time for taking a loan. Similarlly in organizations there are the same decisions being taken. Financial managers need to earn money from investors an use it to create added value for them. Another financial decision is the one between reinvesting earnings or paying dividends and adopting payout strategies for the organization.

2. MAXIMIZING SHAREHOLDER WEALTH

Through finance managers can increase the wealth of the organizations owners and shareholders. Though the affirmation can be debatable, The Economist once wrote that maximizing value for the owners can be the most powerful idea in business. Warren Buffet is also an advocate of value maximization. Other finance celebrities like Jack Welch affirm that value maximization is not such a good idea even though the firm he managed reached great heights in share price during the long years. The share price is one signifficant indicator of the firm value. Managers make great effort to make decisions that increase the share price.

There exist many oppinions that the maximization of value for shareholders is often a minus for customers and even employees of the organization. This line of thinking is often not correct as the relationships between the company and the customers is very important even for the stake-holders. The organization can only provide dividend sif the customers are happy and they provide profits. The relationship with suppliers, customers, employees, creditors and other important groups is essential for a good management and a good prospect for stakeholders also. For the creation of wealth for shareholders it is thus essential to adress the needs of essential stakeholders.

The continuous competitions between companies for their customers, work force, supply chain and even creditors force them to be in good relationships with other stakeholders for a greater performance. We can consider other objectives for a firm also rather than just increasing the price of the shares. Even if every action implemented in the organization has the objective to increase the wealth of it’s owners, this can be difficult to attain in most cases. Implementing this idea is often not easy because with every action there has to be a prognosis of how it will affect cash flow. Therefore we try to describe in this article some ways that financial managers do create more value for shareholders.

Therefore, we contend that the firm's and its managers' primary objective should be to increase owner wealth, which is generally the same as maximizing stock price. Managers should only make decisions that are anticipated to raise shareholder wealth, according to this purpose. Although this objective seems straightforward, carrying it out is not always simple.

Managers must evaluate the return (defined as cash inflows less cash outflows) and risks (defined as variability of net cash flows) of a certain course of action to determine whether it will boost or reduce shareholder wealth.

3. MAXIMIZING PROFIT

It might seem obvious that increasing a company's stock price will increase earnings.
This assumption is not always true, though. Earnings per share (EPS), usually represents the sum earned for each outstanding share during the period, is the standard unit of measurement for profits in corporations. EPS is calculated by dividing the total revenues available to shareholders for the period by the total number of outstanding shares.

Does maximizing profits result in the biggest stock price? The response is frequently "no" for at most three factors. Timing is of the importance, first. An investment that yields a small return early versus one that yields a higher return later on may be desirable. Second, cash flows and earnings are not the same thing. Profit is merely an estimation of a company's performance, and it is influenced by the numerous accounting decisions that companies make when they create their financial reports.

Profit is a more complex indicator of how much money is coming into and going out of the business than cash flow. Cash flow is more important to financial managers and investors than profits since businesses must pay their debts with cash, not profits. Third, danger should be taken into account. The value of a company may be higher if it generates a low but consistent profit as opposed to a company with wildly fluctuating profitability.

Some things never change, like the idea that getting cash earlier rather than later is preferable since a business may utilize the cash it has now to make investments that will increase its future revenue. Cash flows that are accessible to shareholders are not always the outcome of profits. Even when a company's cash withdrawals outpace its cash inflows, the accounting techniques and assumptions it uses can nevertheless enable it to display a positive profit. Sometimes, all this need is time.

Consider the scenario where an electronics retailer purchases a notebook from a vendor in December at $1,000 and offers it for $1,500 a few days later. What will be the cash flow on this deal in December, despite the $500 profit? The shop really experiences a net cash flow in December if it pays its vendor $1,000 in December but permits the client to pay for the notebook in January.

Even when there is a profit, cash flow might still be negative if a company makes significant new investments. For instance, Exxon Mobil declared a profit of roughly $15 billion in 2019, yet the company's cash flow was negative since it spent upwards of $24 billion to grow its operations. Exxon Mobil will continue to generate revenue from such expenditures for a number of years, therefore the money spent on new equipment and plant does not entirely count as an expenditure against profits for the year it gets spent. As a result, even though the company lost money, it seemed lucrative. Higher earnings may not always lead to a greater stock price for the reasons mentioned above and other factors. Stock prices rise as earnings growth that portends growth in the future cash flows occurs.

For instance, a business could boost profits at this time by cutting maintenance costs. However, if this results in future worse product quality, the company's competitive position may suffer, as well as the share price may fall as a result of investors' expectations for reduced future cash flows. Lower stock prices can result from sacrificing future cash flow to boost earnings today.

Risk is not taken into account in the pursuit of profit maximization, and there is a possibility that the outcomes will not be as anticipated. There is an trade-off between risk and return which is a fundamental idea in finance. Shareholders are often risk adverse, which means they will only accept risks if they believe they will be compensated for them. In other terms, investors expect larger returns from riskier assets while accepting lower returns from more secure ones.

In terms of the company's goal, this indicates that maximizing earnings might not increase stock price. Let's say one company is marginally more profitable than the other but engages in a considerably riskier sector of the economy. Investors can be more inclined to pay more for a company's stock that produces lower but more stable returns. Combining these last two concepts, we may state that risk and cash flow have differing effects on stock values. Shareholders will pay higher prices for the shares of a company with better cash flows when risk is fixed (ie, higher yields). In contrast, investors would pay more for companies that are not as risky by maintaining a stable cash flow since they dislike risk.

4. MAXIMIZING STAKEHOLDERS WELFARE

Those who disagree with the idea that managers should work to increase shareholder wealth have put out a different goal that encourages a balanced evaluation of the interests of other stakeholders and shareholders. Stakeholders are regular people who don't own the firm but nonetheless have a financial stake in it. Stakeholders can be consumers, suppliers, staff, or even residents of the neighborhood where a business is located. Maximizing value for shareholders as a company purpose is, according to proponents of stakeholder focus, a much too constrained goal. While investor focus is more typical in the USA and the United Kingdom, this stakeholder perspective is ubiquitous and is mirrored in the corporation law of nations like Germany, France, and Japan.

The suggestion that businesses disregard interests of shareholders in favor of a larger stakeholder perspective has a number of faults that are clear. First, maximizing shareholder wealth does not in any way imply that managers should disregard the interests of all other parties involved in a corporation. Managers cannot increase a company's worth if their staff, clients, and suppliers are consistently unhappy. Frequently, anyone engaged in the firm's operations is free to work with other businesses. According to one study, companies' stock values increased when they were listed among the best to work for by Fortune magazine (presumably an indicator of labor-friendly policies).

The study's authors came to the conclusion that labor-friendly policies are more advantageous than unfavorable ones based on this evidence. It seems that what's good for the workforce is also excellent for the bottom line.

Secondly, advocates of the participants ’ perspective frequently assert that in an effort to maximize shareholder value, managers make decisions that boost the stock price in the near term at the expense of the company's success over the long term. In reality, managers must consider the long-term effects of their decisions in order to increase shareholder value since investors will undoubtedly do so.

Third, adopting a stakeholder viewpoint is inherently challenging, and those who support the notion that managers should take into account the concerns of all stakeholders frequently fail to provide guidance on how to do so.

- How much focus, for instance, should managers give to various stakeholder groups' interests?
- Are staff interests more or less significant than customer preferences?
- Should local residents who don't do business with the company have the same say as the company's suppliers or creditors?
- How do managers make crucial decisions in cases where several stakeholder groups disagree on the course of action that the company should take?

The shareholder maximization goal, on the other hand, makes clear the steps management should take.

Fourth, the phrase "managers should maximize shareholder wealth" is frequently misinterpreted to indicate that managers should do anything—including immoral or illegal - that will inevitably raise the share price. Even the most fervent supporters of making shareholder value maximization the main goal of the company understand that managers must behave morally and legally.

5. THE ROLE OF BUSINESS ETHICS

Business ethics are moral principles or standards of behavior that apply to those who work in the business world. These rules can be violated in a number of ways, including "creative accounting," earnings management, falsifying financial projections, insider trading, fraud, bribery, and other practices. In recent years, there have been numerous reports of these breaches involving well-known corporations like Facebook, which received a high fine for managing user data, and Volkswagen, whose engineers came up with sophisticated schemes to get around emission laws.

In these and other similar instances, the violating businesses paid fines to governmental agencies, made restitution to plaintiffs in legal proceedings, or lost sales as a result of clients who stopped doing business with them as a result of the enterprises' improper conduct. Although adherence and implementation of these standards varies, the majority of businesses have established ethical standards in place. These standards are intended to encourage market and business participants to abide by both the spirit and the letter of laws and rules governing professional and commercial behavior. Most business leaders think that by upholding strong ethical standards, organizations really improve their competitive standing.

Positive outcomes from a good ethics program can increase organizational value. It can lower prospective lawsuit expenses, preserve a positive corporate reputation, increase shareholder confidence, and win the stakeholders' loyalty, commitment, and respect.

Such efforts can enhance the company's share price by preserving and enhancing cash flow and lowering perceived risk. Therefore, in order to maximize owners' wealth, the company must act ethically.

6. THE FUNCTIONS OF MANAGERIAL FINANCE

Every aspect of a company is impacted by financial managers since everything a company does has some sort of financial consequence. Finance department staff members assist with cost management at the manufacturing level. They examine the potential market for novel goods and services. The costs and advantages of recruiting more staff are quantified. They aid in reducing the dangers brought on by unforeseen changes in interest rates, commodities prices, and exchange rates. The management finance role encompasses both the daily practices of financial managers as well as the work they do.

The majority of the choices that financial managers make, or assist others in making, fall into one of three broad categories: working capital decisions, financing decisions, or investment decisions. There are some specialized areas of managing finance that do not cleanly fall into one of these 3 groups, but these three categories account for the large number of financial managers' decisions.

Investment choices are made with an eye on large projects that will eventually determine whether the company generates wealth for its owners. Investment decisions for a tech firm like Intel are based on how much cash the company should invest on new factories, the amount of spend on R&D (Intel gets to spend over $13 billion in annual), and the amount it should invest in its conventional microprocessors vs the chips for relatively new Internet - of - things devices and wearables.

These are the decisions that businesses make that have the biggest impact on whether or not they prosper or fail in the longterm. Financial managers participate in these choices by carrying out a capital budgeting study. A tool that managers can use to select the projects that will benefit shareholders the most is capital budgeting.

Fundamentally, capital budgeting finds opportunities for investments where the advantages outweigh the disadvantages, which are precisely the projects which project leaders should pursue to fulfill the goal of increasing firm value. Businesses must choose where to obtain financing for their investments after deciding how they wish to invest.

How businesses raise the funds required for investment opportunities is decided upon in the financing process. Businesses require funds from investors both at the beginning of their operations and as they expand. Capital is the cash that businesses raise to fund their operations. Because of this, the finance choice is sometimes referred to as the capital structuring choice.

Businesses can generate cash by taking out loans from bankers or other lenders, or they can get cash from financiers who are interested in a share of the company. Profitable businesses have access to additional money through reinvesting their earnings. The mix of finance sources a corporation chooses to use has significant ramifications, even though those selections are likely less crucial than those relating to investments.

For instance, even if business operations worsen, a corporation that chooses to borrow more money is still required to pay back the loan. Shareholders may benefit from borrowing money, in part because doing so is encouraged by the tax laws in many nations. The US corporation tax code permits businesses to deduct interest payments paid to creditors (which lowers the firm's after-tax cost of borrowing), but does not enable businesses to do the same with dividend payout fees paid to shareholders.

Financing decisions typically relate to items on the balance sheet's right side, whereas investment decisions typically refer to those on the left. We can see that financial managers don't base their choices on the accounting rules used to create a balance sheet, but rather on how they will effect the firm's worth.

Financial managers devote more time making various forms of short-term financial decisions, even though daily business decisions on investments and financing frequently involve significant strategic objectives. Making judgments on working capital has to do with how a company manages its short-term resources.

These choices include tracking and predicting the company's financial position, making sure the company pays its creditors on schedule and receives payments from consumers on time, and figuring out how much inventory the company should have on hand at all times. The resources a company uses to purchase things like cash, inventory, receivable accounts, and accounts accessible are collectively referred to as the company's working capital.

7. GUIDING MANAGERS' DECISIONS

A single set of financial concepts governs financial managers' decisions and the guidance they offer to coworkers in other activities, despite the fact that they hold a variety of diverse responsibilities within a huge corporation. We specifically pay attention to five fundamental ideas in managing finance. Money has a time value, therefore timing is important in finance. It is better to have money now rather than later since firms and people can invest it. A dollar invested today will eventually increase to even more than a dollar.

This principle implies for managers that, with all other things being equal, investments with faster returns are favoured over those with slower returns. This is not meant to imply that businesses should place an excessive amount of emphasis on quick results, but rather that when returns on investments appear in the far distant, those gains must be higher in order to justify their anticipation.

Better risk must be accepted by investors who want higher profits. Or, from such a business standpoint, a company that invests money from investors in risky initiatives needs to give those investors greater returns. This exchange means that any examination of various investment initiatives should measure both the earnings the investments can give and the dangers they pose for financial managers entrusted with advising corporations on investment decisions.

When comparing shareholder value maximizing and profits, cash is the primary factor to take into account because cash flow and profit are two different ideas. Because businesses could only pay shareholders with cash and not with profits, cash flow is more important in finance than profit.

The value of the company is ultimately determined by the retained earnings that investors currently receive or anticipate receiving in the future. Even though its financial accounts indicate a profit, a company cannot pay investors if it does not have a positive cash flow. Bills should be paid in cash in order to maintain a firm's connections with its suppliers, workers, and anybody else it owes money to. The competition between businesses in the sectors of goods and services, such as Coca-Cola against Pepsi, Samsung against Apple, and so on, is typically what comes to mind when we think of something like the concept "competition" in a commercial context. But there is another way that businesses compete.

In the financial markets, they compete for access to capital that is under the control of investors. Most businesses occasionally need to raise capital to fund new investments, and in order to do so, they must persuade market players that their plans are on par with or superior to those of other businesses looking for funding. Investors are diligently seeking possibilities that provide the maximum returns for a certain level of risk, therefore businesses who are unable to persuade them that their investment strategies will yield attractive rates of return may find it difficult to obtain money.

Additionally, financial markets continuously inform management on their performance, at particular for publicly traded companies. Since investors trade rapidly as they gain new knowledge about businesses, stock prices react swiftly to breaking news. A company's stock price increases when investors learn good news about it, as when it reports better-than-expected financial results.

How should managers react when the stock market sends signals? Managers should keep a close eye to what market is saying them, even though shareholders' opinions, as shown by changes in a company's stock price, aren't always accurate. Investors have a strong motivation to assess the data they learn about companies objectively. Managers should realize that the market is dubious about the new investment if a company reports plans for a significant new investment (such as the purchase of another company) and their share price drops. They should work to understand this skepticism.

Managers need incentives to run businesses in a way that benefits shareholders. Incentives for managers are not appropriately matched with those of shareholders. Consider the scenario where a business offers to purchase another business. The buyer's offer is particularly alluring in that it offers a price that is far more than the target company's shares' current market value. The best course of action for shareholders seems to be to accept the offer.

The CEO of the target, however, might reject the offer because he understands that, should the purchase go through, he will likely lose his position and the hefty compensation that comes with it. Similar to the buyer in the last scenario, the senior managers here could not have the interests of their shareholders in mind. Perhaps the desire to acquire another business is related to the fact that CEOs and other top executives typically earn better incomes when they are in charge of larger firms. In reality, CEO pay can depend more on whether an acquisition deal closes than on whether it adds value for shareholders.

The aforementioned instance exemplifies the major issue that develops when owners and directors of a company aren't the same individuals and the representatives fail to operate in the principals' best interests. In this situation, managers' perceived self-interest and what is best for shareholders may not be in line.

Large organizations, in which there is a significant degree of distance between a company's owners and managers, are most affected by this issue.

8. CONCLUSIONS

Because the fundamentals of making wise financial decisions are largely the same for both businesses and individuals, most students, regardless of their career path, will gain by having a grasp of finance. Regardless of the job route a person chooses, mastering sound financial analysis tools will help them not only take better decisions as consumers but also understand the effects of critical company decisions.

What goal should managers aim to achieve? There are a lot of options for answering this question. Some may contend that managers should provide their undivided attention to client satisfaction. Businesses working toward this objective could monitor their product market shares to determine their progress.

A company that offers goods or services is known as a firm. A more thorough response, however, strives to illuminate the purpose of businesses. Investors' need for access to riskier investment possibilities is the reason they are there. In other words, corporations are risky business entities that would struggle to raise the necessary operating capital if it weren't for the desire of investors to assume the risk. Firms manage risky investments, pull investment resources, and make risky investment choices on behalf of shareholders who would not otherwise be able to do so successfully or efficiently on their own.

It is recommended that managers inspire and encourage workers first; in this situation, employee turnover can be the most important success metric to monitor. Choosing a goal is an essential factor in determining how organizations operate because it will undoubtedly influence several of the decisions that managers make.

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