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BUSINESS FINANCE

FINANCIAL PLANNING

Financial planning is essentially preparation of a financial blueprint of an organisation's future operations. The objective of financial planning is to ensure that enough funds are available at right time. If adequate funds are not available the firm will not be able to honour its commitments and carry out its plans. On the other hand if excess funds are available, it will unnecessarily add to the cost and may encourage wasteful expenditure. It must be kept in mind that financial planning is not equivalent to or a substitute for financial management. Financial management aims at choosing the best investment and financing alternatives by focusing on their costs and benefits. Its objective is to increase the shareholders wealth. Financial planning on the other hand aims at smooth operations by focusing on fund requirements and their availability in the light of financial decisions. For example, if a capital budgeting decisions is taken, the operations are likely to be at a higher scale. The amount of expenses and revenues are likely to increase. Financial planning process tries to forecast all the items which are likely to undergo changes. It enables the management to foresee the fund requirements both the quantum as well as the timing. Likely shortage and surpluses are forecast so that necessary activities are taken in advance to meet those situations. Thus, financial planning strives to achieve the following twin objectives.

(a) To ensure availability of funds whenever these are required: This include a proper estimation of the funds required for different purposes such as for the purchase of long-term assets or to meet day- to-day expenses of business etc. Apart from this, there is a need to estimate the time at which these funds are to be made available. Financial planning also tries to specify possible sources of these funds.

(b) To see that the firm does not raise resources unnecessarily: Excess funding is almost as bad as inadequate funding. Even if there is some surplus money, good financial planning would put it to the best possible use so that the financial resources are not left idle and don't unnecessarily add to the cost.

Thus, a proper matching of funds requirements and their availability is sought to be achieved by financial planning. This process of estimating the fund requirement of a business and specifying the sources of funds is called financial planning. Financial planning takes into consideration the growth, performance, investments and requirement of funds for a given period. Financial planning includes both short- term as well as long-term planning. Long-term planning relates to long term growth and investment. It focuses on capital expenditure programmes. Short-term planning covers short-term financial plan called budget. Typically, financial planning is done for three to five years. For longer periods it becomes more difficult and less useful. Plans made for periods of one year or less are termed as budgets. Budgets are example of financial planning exercise in greater details. They include detailed plan of action for a period of one year or less. Financial planning usually begins with the preparation of a sales forecast. Let us say a company is making a financial plan for the next five years. It will start with an estimate of the sales which are likely to happen in the next five years. Based on these, the financial statements are prepared keeping in mind the requirement of funds for investment in the fixed capital and working capital. Then the expected profits during the period are estimated so that an idea can be made of how much of the fund requirements can be met internally i.e., through retained earnings (after dividend payouts). This results in an estimation of the requirement for external funds. Further, the sources from which the external funds requirement can be met are identified and cash budgets are made, incorporating these factors.