Financial Management

Dr. Ribdi Alsaedi

Post-doctorate of business administration

abstract

financial management is an essential part of the economic and non-economic activities, which leads to decide the efficient optimal use of financial with profitable manner. In the last years the subject financial management was a part of accountancy with the traditional approaches. Now a day it has been enlarged with innovative and multi-dimensional functions in the field of business with the effect of industrialization, financial management has become a vital part of the business concern and they are, concentrating more in the field of financial management. Financial management also developed as corporate finance, business finance, financial economics, financial mathematics and financial engineering. Understanding the basic concept about the financial management becomes an essential part for the students of economic, commerce and management.

Introduction

The concept of financial management is of very recent origin. It gains considerable academic interest. Financial management practically is concerned with the decision-making about the flow of funds in a firm. In other hand, after procuring the funds from various sources, how the said funds are applied that should be analyzed. In short, it deals with the procurement of funds in the most economic manner and utilize the said funds in the most optimum way in order to maximize the rate of return to the shareholders. Financial management receives a prime relevance as a functional area since the procurement of funds and its best utilization is practically the key to the success of any organization. As each and every aspect of business relates to finance, financial management plays a very significant role in all financial transactions. The financial management must be careful about the effective utilization of available resources in the best possible manner so that the ultimate rate of return in maximized. The definition is: financial management is concerned with the managerial decisions that result in the acquisition and financing of long-term and short-term credits for the firm. As such, it deals with the situation that requires selection of specific liability (or combination of liabilities) as well as the problem of size and growth of an enterprise. The analysis of these decisions is based on the expected inflows and outflows of funds and their effects upon managerial objective, philipatus.

Meaning of finance

Finance maybe defined as the art and science of managing money. It includes financial service and financial instruments. Finance also is referred as the provision of money at the time when it is needed. Finance function is the procurement of funds and their effective utilization in business concerns. The concept of finance includes capital, funds, money, and amount. But each word is having unique meaning. Studying and understanding the concept of finance become an important part of the business concern.

Definition of finance

According to Khan and Jain [1] finance is the art and science of managing money. According to oxford dictionary, the word finance connotes management of money. Webster's Ninth (2) New Collegiate Dictionary defines finance as the science on study of the management of funds and the management of fund as the system that includes the circulation of money, the granting of credit, the making of investments, and the provision of banking facilities.

Types of finance

Finance is one of the important and integral part of business concerns, hence, it plays a major role in every part of the business activities. It is used in all area of the activities under the different names.

Finance can be classified into two major parts: 1- private finance, which includes the individual, firms, business or corporate finance activities to meet the requirements.

2- public finance, which concerns with revenue and disbursement of government such as central government, state government and semi-government financial matters.

Introduction to finance management

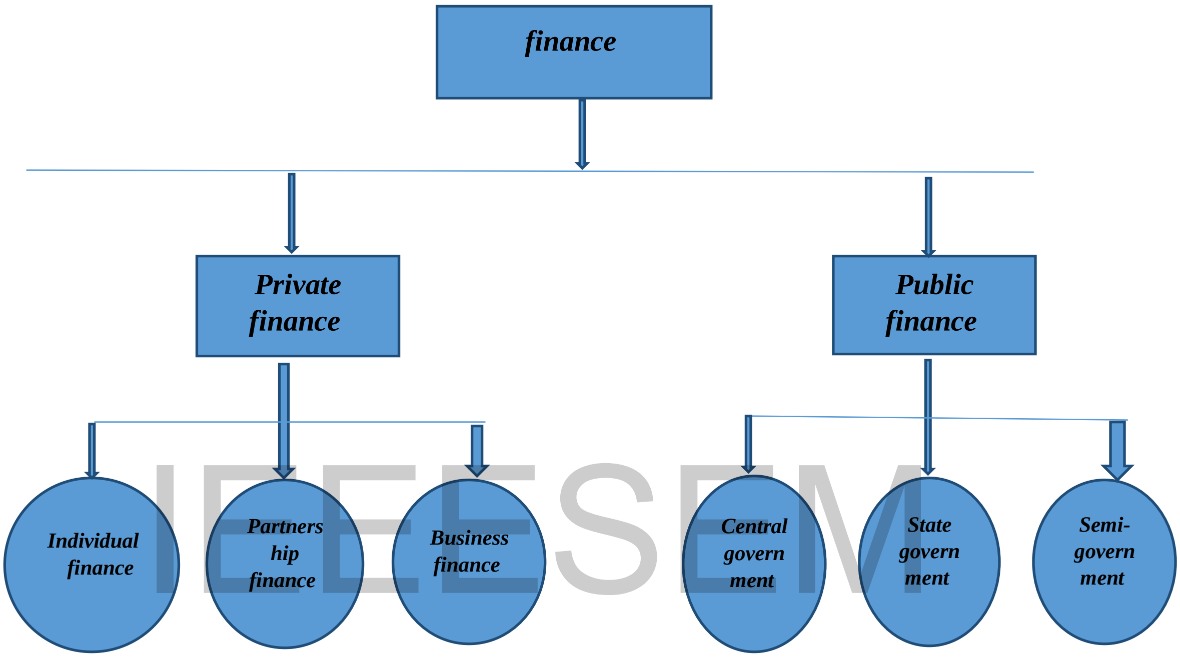


Fig. 1.1 Types of finance

Definition of financial management

financial management is an integral part of overall management. It is concerned with the duties of the financial managers in the business firm.

The financial management has been defined by Solomon [3] it is concerned with the efficient use of an important economic resource namely, capital funds.

The most popular and acceptable definition of financial management as given by S.C. Kuchal [4] is that financial management deals with procurement of funds and their effective utilization in the business.

Joshep and Massie [5] financial management is the operational activity of a business that is responsible for obtaining and effectively utilizing the funds necessary for efficient operations.

Thus, financial management is mainly concerned with the effective funds management in the business. In simple words, financial management as practiced by business firms can be called as corporation finance or business finance.

Scope of financial management

Financial management is one of the important parts of overall management, which is directly related with various functional departments like personnel, marketing and production. Financial

management covers wide area with multidimensional approaches. So, the following are the important scope of financial management.

1 – financial management and economics

Economic concepts like micro and macro- economics are directly applied with the financial management approaches. Investment decisions, micro and macro environmental factors are closely associated with the functions of financial manager. Financial management also uses the economic equations like money value discount factor, economic order quantity. Financial economic is one of the emerging area, which provides immense opportunities to finance, and economical area.

2 – financial management and marketing

Produced goods are sold in the market with innovative and modern approaches. For this, the marketing department needs finance to meet their requirements. The financial manager or finance department is responsible to allocate the adequate finance to the marketing department. Hence, marketing and financial management are interrelated and depends on each other.

3 – financial management and accounting

We can easily understand the relationship between the financial management and accounting. Both financial management and accounting are treated as a same discipline and then it has been merged as management accounting because this part is very much helpful to finance manager to take decisions. But nowadays financial management and accounting discipline are separate and interrelated.

Objectives of financial management

Effective procurement and efficient use of finance lead to proper utilization of the finance by the business concern. It is the essential part of the financial manager. Hence, the financial manager must determine the basic objectives of the financial management. Objectives of financial management maybe broadly divided into two parts such as

A – profit maximization

B – wealth maximization

Profit maximization

Main target of any kind of economic activity is earning profit. A business concern is also functioning mainly for the purpose of earning profit. Profit is the measuring techniques to understand the business efficiency of the concern, profit maximization is also the traditional and narrow approach, which target at, maximizes the profit of the concern. Profit maximization consists of the following important features.

1 – profit maximization is also called as cashing per share maximization. It leads to maximize the business operation for profit maximization.

2 – ultimate target of the business concern is earning profit, hence, it considers all the possible ways to increase the profitability of the concern.

3 – profit is the parameter of measuring the efficiency of the business concern.

4 – profit maximization objectives help to reduce the risk of the business.

Wealth maximization

Wealth maximization is one of the modern approaches, which involves latest innovations and improvements in the field of the business concern. The term wealth means shareholder wealth or the wealth of the persons those who are involved in the business concern. Wealth maximization is also known as value maximization or net present worth maximization. This objective is a universally accepted concept in the field of business.

Approaches to financial management

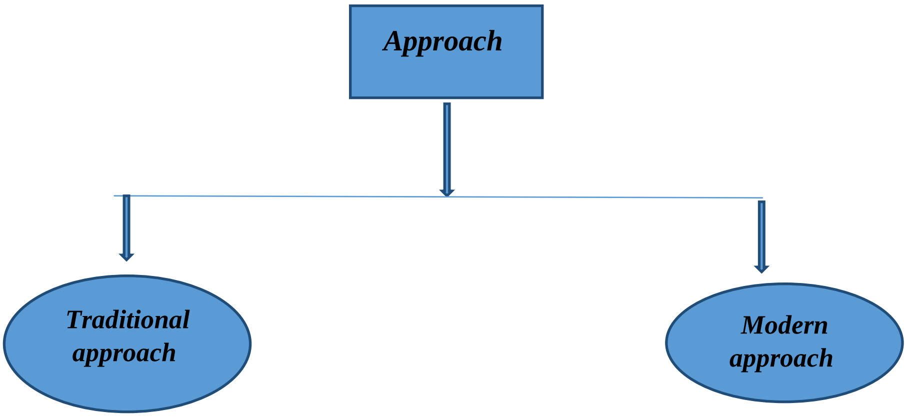


Fig. 1.3 approaches to finance management

Traditional approach

This approach is based on the past experience and the traditionally accepted methods. Main part of the traditional approach is rising of funds for the business concern. Traditional approach consists of the following important area.

Arrangement of funds from lending body

Arrangement of funds through various financial instruments

Finding out the various sources of funds

Modern approach

This approach is globalization and liberalization of world economy has caused to bring a tremendous reform in financial sector. Which targets at promoting diversified, efficient and competitive financial system in the country. The financial reforms coupled with diffusion of information technology has caused to increase competition, mergers, takeovers, cost management, quality improvement, and financial discipline.

Globalization has caused to integrate the national economy with the world economy and it has created a new financial environment which bring new opportunities and challenges to the individual business concern. This has led to total reformation of the finance function and its responsibilities in the organization.

In view of modern approach, the finance manager is expected to analyze the firm and to determine the following

1 – the total funds requirement of the firm

2 – the assets to be acquired, and

3 – the pattern of financing the assets.

Basic concepts in finance

Having knowledge of the basic concepts of finance is important not only for business owners, corporate executives and financial planners; ultimately, financial planning is each individual's responsibility. Three of the most fundamental concepts in finance are the time value of money, asset valuation, that is, how the value of stocks, bonds, real estate, and other investments is determined, and finally, risk management. While the time value of money is the basic for the other concepts, financial planning and investing ultimately require an understanding of risk management. This article will approach the basic concepts of finance for the individual and provide an overview of financial and investment products.

It is becoming increasingly important for individuals to assume responsibility for planning a financial future. Successful financial planning, in turn, requires one to understand the basic concepts of finance since this understanding will afford one the ability to save and invest wisely. This means that the individual needs to have knowledge of a variety of financial products and investments and comprehend how these vehicles work. Moreover, for many people, the largest investment they will make is purchasing a home. Having knowledge of the basic concepts of finance will enable them to understand mortgages and consumer debt in general. Saving, other investments and managing debt are all based upon the foundation of the first financial concept- the time value of money. Further, this concept is a building block to asset valuation and risk management. Asset valuation requires one to understand how the value of assets such as stock, bonds, and real estate are determined. Finally, understanding such concepts as compound interest and inflation can empower an individual to manage the risk of their investments over time.

Decreased savings and increased debt

However, many people are financial illiterate- they don't have an understanding of the basic concepts of finance. People can't differentiate between individual stocks and stock mutual funds, nor do they comprehend that investing in individual stock is riskier than investing in mutual funds. Further, there is a general lack of knowledge about compound interest and inflation. This lack of knowledge reflects the fact that many people don't understand how money works. And this in turn is manifested in the way people invest or fail to invest their money. For many, their primary investment vehicle is their company provided defined benefit plan or a defined contribution plan. A defined benefit plan is commonly referred to as a fully funded pension. However, pension plans are becoming less common as employers are shifting this benefit to a defined contribution plan. Unfortunately, many people aren't aware of the difference between these two types of plans and some aren't certain which type of plan their employer provides. This result of this lack of knowledge is that the overall savings rate declined dramatically during the late twentieth and early twenty-first centuries (Carlson, 2005) [6] ***and only started to rise in the wake of the 2007 recession (Samavati, Adilov, and Dilts, 2013)*** [7]

More importantly, the amount of consumer debt dramatically increased as the twentieth century came to a close. This is reflected by the fact that more people carried higher amounts of unsecured consumer debt such as credit cards. This trend, as is the case with the overall savings rate, has slightly reversed since the 2007 recession (Brown, Haughwout, Donghoon, & Van der Klaauw, 2013) [8] ***In addition to an expansion of unsecured debt, the rise in home ownership over the last 20 years combined with the rising value of real property has resulted in a surge of mortgage debt. In order for the individual to be able to adequately finance this debt requires an understanding of the basic concepts of finance.***

Successful saving

While having an understanding of the basic concepts of finance is important to understanding the value of savings and investing, saving is really a matter of common sense money management. In this regard, there are four ways to simply start saving.

A – first, large amounts of cash should not be kept on hand, but rather deposited into a savings account.

B – second, although paying outstanding bills on time is important, there is no benefit derived from paying bills early and this money can continue to earn interest.

C – further, some people intentionally have more taxes withheld in order to obtain a refund. However, that excess money could also be put to better use by earning interest.

D – finally, once the amount of money a person is saving begins to accumulate, it can then be invested in other ways to earn even more interest such as by opening an interest bearing checking account (Miller, 2003)[9]

Real Estate

Interest rates on consumer loans are important to understand if a person in buying a home. Financing an investment in real estate usually requires obtaining a mortgage from a financial institution. A mortgage is a debt instrument a lender uses to place a lien on real property purchased by the borrower. A lien is a creditor's claim, in this case the lender, against property (Downes, 2006)[10] *By understanding the time value of money, a person will be better able to understand how much a mortgage will actually cost over 30 years. By understanding asset valuation, a person can determine the value of the house, or the asset. An asset, moreover, is anything with financial value that is owned by a business or person.*

Stocks, Bonds and Mutual Funds

Individual can invest in stocks, bonds and mutual funds. Investing in stock essentially means to have an ownership interest in a corporation. Shares issued by the corporation represent stock ownership, and these are claims against a company's earning and assets. The value of stock is determined by a number of factors overtime. On the other hand, an individual can also invest in bonds, basically, a bond is an interest-bearing government or corporate instrument that requires the issuer to pay specific amount of money at certain time intervals until the debt is paid in full by a set date (also referred to as the maturity date). Another way to invest in stocks and bonds is to invest in a mutual fund. A mutual fund is an investment vehicle that is operated by an investment company. Money is raised from shareholders, and that money is used to invest in stocks, bonds, and other investments (Downes, 2006) [10] *The benefit of investing in mutual funds is that the investment company manages the risk.*

Time value of money

The first and foremost principle in finance is the time value of money because financial decisions are spread out over time. This concept essentially is a means of calculating the value of a sum of money in the present or in the future. While the outcome of financial decisions cannot be known with certainly, being able to calculate the value of money at some time in the future affords one the ability to manage risk. Understanding the time value of money allows one to calculate present and future values. In the parlance financial planning present value (PV) means the present value of an amount that will be received in the future. On the other hand, future value or (FV) is the future worth of a present amount. For example,

Understanding PV will enable a bond investor to determine the value now of a $1,000 bond that will mature in 10 years, on the other hand, FV will enable an individual to determine how much a $1,000 saving account will have at the end of the year if it pays 2% interest compounded annually (Clare, 2002)[11]

Interest calculations

There are fundamentally two ways to calculate interest simple interest and compound it.

1 – simple interest is a calculation based only on the original principle amount of the asset or debt. For instance, in the example mentioned above, a $1,000 deposit in a savings account at 2% simple interest would earn $20 per year (2%of $1,000=$20). At the end of the first year, the amount of the principle and interest in the account would equate to $1,020.

2 – on the other hand, compound interest is interest earned on the principle plus any interest that was previously earned for example, a $1,000 deposit at 5% compound interest at the end of the first year would earn $50 in the first year (5% of 1,000=$50). If no additional deposits are made in the *second year the balance in the account would be $1,102.50 or 5% of $1,050= $52.50; $1,050 + $52.50 = $1,102.50 (Downe, 2006)* [10]

Goals of financial management

There are a number of classifications which can be used to define the specified goals of financial management. 1 – profit – risk approach to financial goals, and
2 – liquidity – profitability approach to financial goals.

1 – profit- risk approach to financial goals
Under this approach, in order to maximize profits at a given level of risk, finance deals with creating the proper framework. For this purpose, the firm must develop controls over flows of funds which allows sufficient flexibility to respond to change in the operating environment.
A – maximize profits
Generally, finance pursues for a high level of long-term profit and, at the same time, a short-term profit.
B – minimize risk
Finance seeks a course of action which avoids unnecessary risk and anticipates problem areas and ways of overcoming difficulties.
C – maintain control
Funds which are flowing in and out should always be monitored in order to assure that they are safeguarded and properly utilized.
D – achieve flexibility
We all know that a firm has to deal with an uncertain future. Flexibility can be maintained provided there is careful management of funds and activities. Where there is a sufficient source of funds in advance of needs, it is flexible when actual requirement is made.

2 – Liquidity-Profitability Approach to Financial Goals

There are two goals which are to be achieved by a financial manager, liquidity and profitability.

(i)- Liquidity
Liquidity means one's ability to meet claims and obligations as and when they become due. In other word, the firm can pay all its bills as soon as they become owing and have to meet certain contingencies. On the other hand,

(ii)- profitability
Profitability of a firm is represented by the rate of return on its capital employed (which is measured by Net Profit to Capital Employed). It requires the firm's operation to yield a long-term profit for shareholders as part of the overall goal of maximizing the present value of common stock.

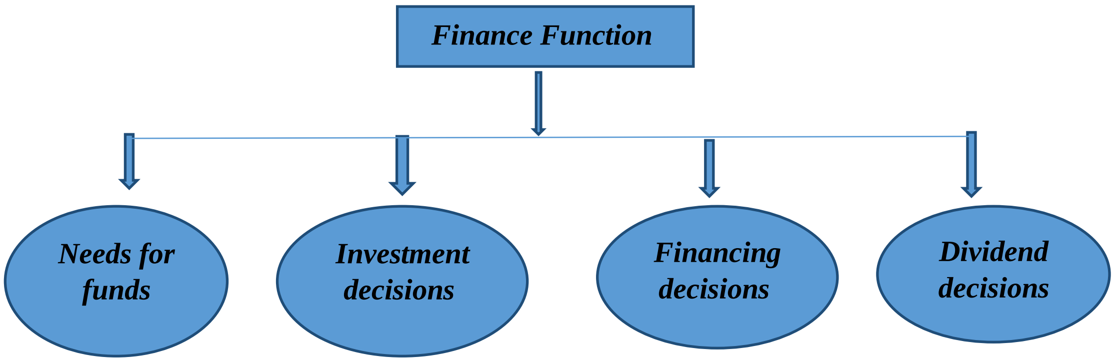
However, the above two classifications are to some extent similar and overlapping, under the former, an element in minimizing risk is the achieving of liquidity, whereas, under the latter, achieving liquidity requires the maximization of risks. Therefore, the financial manager must understand the firm's goal and the goals of the finance function.

Finance Functions

The financing decisions play a very important role of a corporate body wherever the question of finance comes. Financing decisions affect all financial matters of a firm. Thus, the areas of financial management are:

(i)- Need for Funds;

(ii)- Investment Decisions;
(iii)- Financing Decisions; and
(iv)- Dividend Decisions.



Need for funds
We all know that funds are required by a firm for different purposes. Naturally, how much fund is required depends on the nature and type of business enterprise.
Generally, two well-known classifications are:
(a)- Investment in fixed assets, and
(b)- Investment is current Assets

Fixed assets (Land & building, Plant & Machinery, Furniture & Fixture etc.) are required not for sale as they usually owned. They help to continue the production function for goods and services in order to earn revenue. Investment in fixed assets must be made in such a way that they are properly utilized, so, investments in fixed assets needs the following further considerations:
(i)- Provision to be made for adequate planned capital expenditure;
(ii)- proper evaluation of the project to be made before the actual execution; and
(iii)- Estimates and schedules are made for approved capital projects.

Current assets (Stock, Debtors, Cash, Bank etc.) are required for working capital purposes. The funds for investment in working capital must also be properly utilized since idle working capital will increase cost. We are also to remember that investment in current assets are usually financed from short-term sources which usually don't create any problem. But there must be a synchronization of cash (cash receipts and cash payments) for maintaining liquidity position of the enterprise. On the contrary, if current assets are financed from own sources or long-term sources, no problem will appear. In that case, net working capital position of the firm would be always positive having sufficient liquid sources in the hands of the firm.

Investment Decisions
At present, efficient use and allocation of capital are the most important functions of financial management. Practically, this function involves the decision of the firm to commit its funds in long-term assets together with other profitable activities. However, the decision of the firm to invest funds in long-term assets needs considerable importance as the same tends to influence the firm's wealth, size, growth and also affects the business risk. No doubt, rate of return. But there are other considerations as well, risk factor. In short, risk factor also plays a significant role in investment decisions.

Financing Decisions
Financing decisions deal with the composition of capital structure of a firm, the proportion of debt/borrowed capital and equity capital. In other words, these two sources are the primary sources of funds. Debt or borrowed capital mean the funds supplied by the outsides against fixed rate of interest. Although debt capital bears a fixed rate of interest payment, it is cheaper than the cost of equity capital. Moreover, it has tax advantages. Trading on

equity can be made possible by the application of debt capital which, again, gives a better return to the equity shareholders. But it possesses a risk element in it, the payment of fixed rates of interest to the bondholders or others, if a firm unable to pay the interest on such as bondholders, it may be bringing an insolvency of a firm. Moreover, when debt capital will mature for payment a huge amount of liquid sources of funds will be required which adversely affect the liquidity position of an enterprise, in spite of having such limitations every firm takes the risks of having borrowed / debt capital just to enjoy the benefit of trading on equity.
On the other hand, equity financing doesn't involve either the committed amount of paying return on investment or the questions of repayment will arise, question of outflow of funds doesn't arise either for paying fixed amount of return or for the repayment of capital contributed by the shareholders. But if doesn't enjoy the benefit of tax advantages. It must be remembered that preference share capital is just like the debt / borrowed capital which needs fixed rates of dividend and needs funds for repayment in future.
In real world situation, we find that every firm employs both debt or borrowed capital as well as equity capital, the composition of debt capital and equity capital. However, from the standpoint of long-term solvency of a firm, proportion of equity or owned capital should be higher than the borrowed capital, debt- equity ratio must be normal.

Dividend Decisions
Another important criterion is the dividend decisions. The shareholder who has acquired the shares expects always a better return on his investment by way of dividend. Declaration of dividend depends on the earning capacity of the company together with the cash position (as dividend can never be paid in kind). Moreover, certain legal restriction are there before declaring and paying dividend to shareholders. It is an appropriation of profit. The directors in the general meeting decide to pay the rate of dividend considering all other financial aspects. The market value of a share goes up if the rate of paying dividend is very high, and the other way around in the opposite case. So, dividend decision plays a very important role in finance functions. There are many factors which affect the dividend policy of a firm, (a) External factors (general state of economy, capital market considerations, legal, contractual constraints and restrictions; tax policy, inflation, stability of dividend). And (b) Internal factors (liquidity position, growth rate, $\frac{D}{P}$ ratio).

Elements of financial forecasting and planning

Financial forecasting involves preparation of proforma financial statements and also the preparation of cash Budget. Therefore, it includes the preparation of:
1 – proforma income statement;
2 – proforma Balance sheet; and
3 – Cash Budget.

Proforma Income statement
This statement is a projection of income for a period to time in future which, in other words is to furnish a fair and reasonable estimate of expected revenue, cost, profits, taxes, dividends, and other financial items. It is prepared around the estimate of the expected sales for the forecast period. The most accurate forecast may be made available with the help of a detailed analysis of purchases, productive wages and overhead costs. Sometimes, cost of goods sold are estimated on the basic of past rations of cost of goods sold to sales.

The estimate is made for administrative and selling expenses. Since both of them are generally budgeted in advance, their estimates are seldom accurate. Further estimates are made for other incomes and expenses along with interest in order to ascertain the net income before taxes. Dividend payments have to be predetermined at the appropriate level which are also to be deducted from the estimated net income/ profit- after tax.

			Proforma Income Statement			
			for the year ending 31st Dec. 1990			
Revenues				Rs.		Rs.
	Sales					8,00,000
Expenses						
	Cost of Gooda Sold:					
	Raw Materials			2,00,000		
	Direct Wages			3,00,000		
	Factory Overheads			50,000		
						5,50,000
		Gross Profit				2,50,000
	Administrative Expenses			40,000		
	Depreciation			20,000		
	Interest			10,000		
	Selling & Distribution Ezoenses			30,000		
						1,00,000
	Operating Profits / Net Income before Tax					1,50,000
Less :	Taxes 50%					75,000
	Profit after Tax / Net Income					75,000
Add :	Retained Earning b/d					25,000
						1,00,000
Less :	Dividend					50,000
		Retained Earning c/d				50,000

Therefore, the proforma income statement helps us to analyze the composition of expected future income statement and balance sheet with the help of different financial ratios. These rations, along with the raw figures, maybe compared with the present and past Balance Sheets. The financial manager, with the help of these information, realizes the changes in the financial position together with the performances of the firm over the past, present and future.

Proforma Balance Sheet

This Balance Sheet depend on the information available in the proforma income statement together with different schedules and budgets. Preparation of a proforma Balance Sheet is based on:
A – the net worth the company-calculated after adjusting the projected income.
B – the comparison of the projected assets with the total sources of fund, if assets exceed the total expected liabilities, the difference will represent additional sources which must be accounted for and, in the opposite case, the excess will indicate the additional cash.
C – the liabilities which are based on past indications;
D – the net investment in each component of the assets of the company in order to achieve the planned levels of production.

Proforma Balance Sheet items

Assets:
1 – fixed Assets
In order to acquire, replace or disposal of fixed Assets over a number of years, Capital Budget plan is to be drawn up and adjustments have to be made accordingly. Depreciation on assets should also be considered before arriving at the values of fixed Assets for preparing the projected Balance Sheet. Other assets will remain as they are unless specially mentioned.
2 – Current Assets (i)Sundry Debtors, (ii)Inventories and (iii)Cash

Sundry Debtors
It depends on the number of day's credit allowed to customers which can be ascertained by either:

A - $\frac{credit\ Sales}{Average\ Debtors}$

Or

B - $\frac{Debtors}{Credit\ Sales} \times 365$

Inventories
The inventory level in relation to production programmer which is to be maintained is an important item in this regard. As soon as the level is fixed by the management, the same will be an item of the proforma Balance Sheet. These are ascertained as

Stock Turnover Ratio = $\frac{Cost\ of\ Goods\ Sold/Sales}{Average\ Inventories}$

Cash
A minimum amount of cash is to be maintained in hand for different purposes. But where the flexible bank borrowing is available, the cash balance will represent the difference between the assets and the liabilities

Liabilities

1 – Shareholders fund / Net worth
It represents the amount of Share Capital and Reserves and Surplus (Fixed Assets Plus Current Assets minus Current and Long-term Liabilities). But for this purpose, fresh issue of Shares, redemption of Preference Shares, and retained earnings from profit should also be taken into consideration.

2 – Creditors
It depends on the number of days the credit is allowed by suppliers. This can be ascertained for the purpose of Proforma Balance Sheet either by

(I) $\frac{Credit\ Purchase}{Average\ Creditors}$
Or,

(2) $\frac{Creditors}{Credit\ Purchase} \times 365$

3 – Outstanding liabilities

These are ascertained on the basis of the pattern of wages payment, tax payment, . for this purpose, past and future data relating to them are also to be taken into consideration while preparing a Proforma Balance Sheet.

4 – Provision for Tax and Dividends

Proper provisions for Taxes and Dividends should also be made for the Proforma Balance Sheet. They also depend on past and future data of the rate of Tax and Dividend.

Once we estimate / ascertain all the components for Proforma Balance Sheet, they are combined and presented in a Balance Sheet. Moreover, all the Balance Sheet item can be estimated by projecting financial ratios for the future.

A Cash Budget method is an available way for preparing a Proforma Statement. Where such budget isn't available, bills (Receivable and Payable), Debtors and Creditors, Accrued Wages and Expenses are based on historical relationship between production and sales.

		Budegted Balance Sheet				
		March 31, 2014				
	Assets				Liabilities	
Current assets				Current liabilities		
Cash		$18,000		Accounts payable		$12,000
Accounts receivable		12,000		Salary and commiss-		
Iventory		16,000		iones payable		1,400
Prepaid insurance		2,200		Total liabilities		$13,900
Total current assets		$48,200			Stockholders' Equity	
Plan assets				common stock		16,000
Equipment and				Retained earning		33,000
fixtures		45,000		Total stockholders'-		
Less: Accumulated				equity		$49,300
depreciation		30,000		Total liabilities and-		
Total Plan assets		$15,000		stockholde-		
Total assets		$63,200		equity		$63,200

			Big Bad			
			Budgeted Balance Sheet			
			December 31, 2019			
			Jan. 1		Dec. 31	
Cash			$13,000		$36,000	
Accounts Receivable			0		78,250	
Allowance for Doubt-full					-22,000	
Inventory			0		42,629	
Machiery and equipment			15,000		23,500	
Accumulated Depreciation			-2,000		-22,000	
Total Assets			$26,000		$136,822	
Accounts payable			$0		$6,000	
Line of credit						
Common Stock			15,000		20,000	
Returned Earning			11,000		110,000	
Total Liabilities and owner's						
equity			$26,000		$136,822	

Financial Behavior and Financial Knowledge

In the most basic sense, financial behavior can be considered as the follow up of individuals' personal financial situations, their doing shopping carefully, managing their savings and investments, personal debts and loans and evaluating their investments in the short and long term. (Xiao, 2008)[12] examined the concept of financial behavior as result-oriented and defined it as making plan on how to spend money, keeping the written account of the money spent, reviewing fixed expenses and creating a written budget. (Dew & Xiao, 2011)[13] dividend financial behavior tendency into three basic sub-factors and defined them as saving and investment.

Cash management and credit management. Certain forms of positive financial behavior are supported by financial knowledge and literacy. The connection between financial literacy and good financial behavior should be established in order to clarify the benefits of consumers who are financially literate (Monticone, 2010)[14]

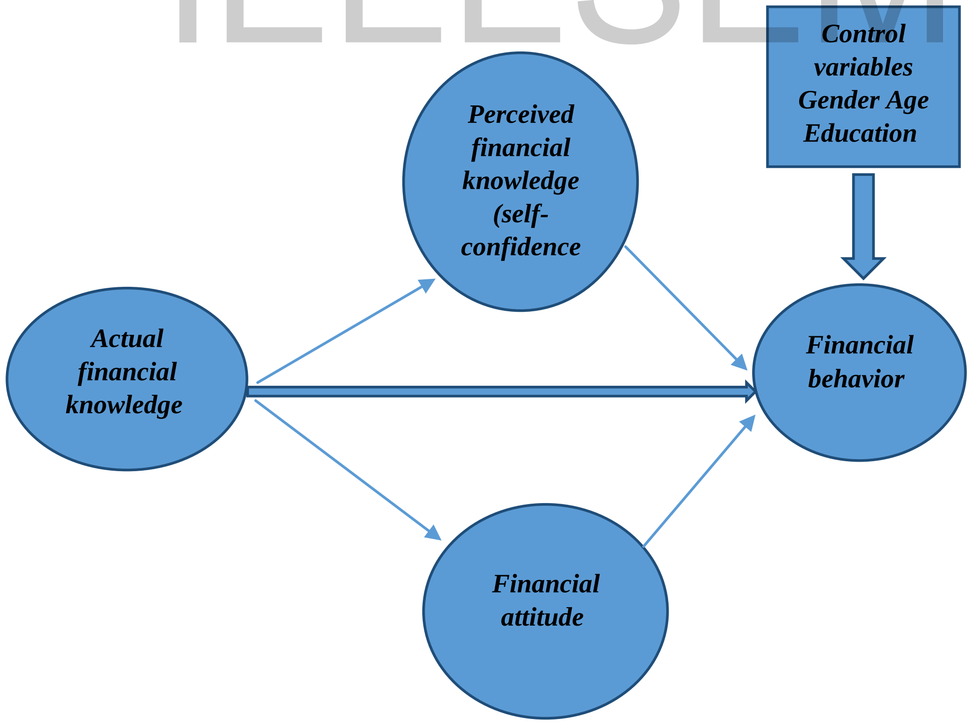
The relationship between financial literacy and financial behavior has been indicated in some studies. The establishment of a relationship between financial knowledge and financial behavior was take the lead in by (Lusardi & Mitchell, 2007b) [15] and they used the questions in surveys demonstrating this kind of behavior concerning knowledge in a sense, the questions weren't just about an evaluation of the knowledge itself but about the economic outputs of knowledge.

The assumption financial knowledge is positively associated with consumer financial behavior and causality runs from knowledge to behavior is affirmed by several empirical studies (Hathaway and Khatiwada, 2008; Meier & Sprenger, 2008; Willis, 2008) [16] A significant interrelationship between financial knowledge and financial behavior was found by Hilgert, Hogarth and Beverly, 2003, and also Matin, 2007 [17]. A relationship has also been built between housing counseling (which involves suggestion about the management of mortgage repayment, budgeting and other skills related to purchasing a house) and lower delinquency and default rates (Lyons, White and Howard, 2008) [18] Nevertheless, the fact

that a confusing interrelation with causality is observed in the study carried out by the Federal Reserve Bank of Cleveland is a critical defect. It is possible that causality runs both ways despite the presence of an explicit interrelation between knowledge and behavior in personal finance (Hathaway and Khatiwada, 2008)[16]

The causal bond from financial knowledge to positive financial attitudes regarding money, which affects the behavior, is supported by empirical studies (Borden et al; 2008)[19] *The advancement of credit counseling clients was monitored by Elliehausen, Lundquist and Staten, 2007*[20] *and they determined that the people who received counseling were capable of reducing their debts, developing their credit card management and further reducing their delinquency rates compared to people who didn't receive counseling. It was determined by Hartaska and Gonzalez-Vega, 2005* [21] *that people who took financial counseling possessed a lower default hazard despite the fact that the repayment frequency wasn't highly affected. There are also significant findings in the study of Courchane & Zorn, 2005*[22] *that demonstrate a causal bond from financial knowledge to financial behavior and associate this behavior with credit outcomes. What variables were the most significant in certain forms of behavior was examined by the researchers via a three-stage process. For instance, at the second stage, knowledge was the most significant determining factor of the dependent variable of financial self-control (budgeting, saving and the ability to control finances) (Courchane and Zorn, 2005)*[22]

Financial literacy



Source: authors (2017), Financial literacy in Brazel. Financial literacy conceptual model.

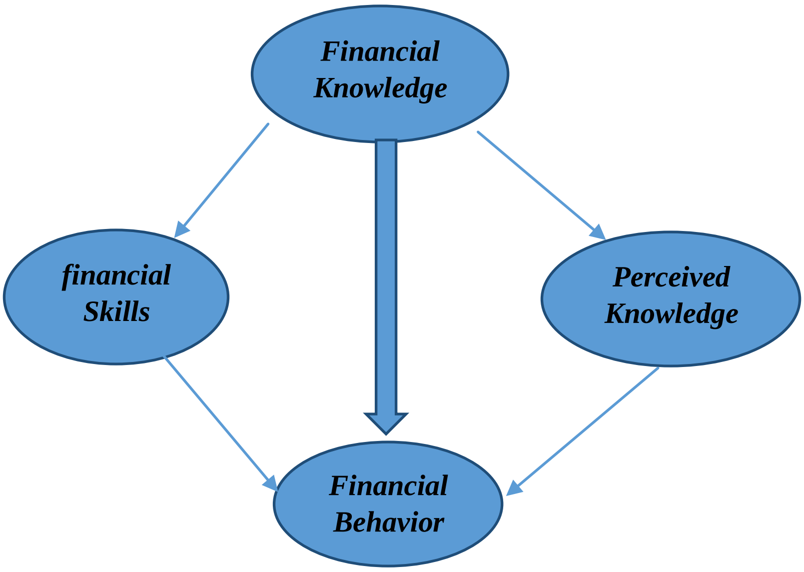


Figure 1. conceptual mode of financial literacy (Hung et a. 2009).

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