Financial management principles

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20 April 2007 Financial s and Intermediation Financial s are essential components of financial systems. Taken from an economic point of view, financial institutions function in maintaining the equilibrium and stability in the system by balancing the demand and supply of funds. Because of this, financial institutions are intermediaries which channels excess fund to parties which requires financing for profitable investments and other purposes (Mishkin 2004).

The establishment of financial institutions can be traced to the need of minimizing the risk faced by parties entering a transaction which is often referred to as information asymmetry. It should be noted that a lender cannot simply lend his excess fund to potential borrower without making sure that the latter will not default on his payment. In this situation, an intermediary should exist in order to gather information about both parties and mitigate risk (Mishkin 2004). Financial institutions are able to minimize the risk of information asymmetry by building their reputation in the industry. Thus, individuals are not cautious in putting their money in a bank's savings account which are then lend to parties who are in need of funds. Financial institutions like banks, as stated above, carry out the important function of making financial resources available to parties who need them. By building expertise in information search and reputation in undertaking their financial functions, financial institutions serve as a great help for individuals and business organizations which require help in financing. On the other hand, individuals and companies who want to invest their money can trust in the efficiency of financial institutions in ensuring return to their investments.

As the illustration above shows, as financial institutions carry out their role in

the financial system, they take on the risk which should be handled by the borrower and lender. Thus, financial institutions also take measures in minimizing the risk that they take by ensuring that their borrowers will not default on their payment obligations. This scrutiny is even more highlighted when a company which borrows from the financial institution conducted its Initial Public Offering. As the company becomes public, it exposes itself from the critical eye of its current and potential creditors.

A company can cope with this increased financial intermediation scrutiny by adhering to the standards set by accounting institutions. It should also instill tighter measures in ensuring the truthfulness of its financial reports and accounts. This means a stricter verification on the recording of different financial transactions that the business organization entered into. In order to avoid accounting fiascos, the company should also strive to make an efficient corporate governance policy (Keown 2005).

The company which undertook IPO should also maintain its image to the financial institutions. This can be done through regular and prompt payments of its interest obligations. Generally, the business organization should attain its goal of maximizing shareholder value through profitability, efficiency, stability, and liquidity (Keown 2005).

Works Cited

Keown, A. J., Martin, J. D., Petty, J. W., and Scott Jr., D. F, 2005, Financial Management principles and applications, Pearson/Prentice Hall International Edition, 10th Edition.

Mishkin, F 2004, The Economics of Money, Banking, and Financial Markets, Addison-Wesley, 7th Edition