

Basics of Finance

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FINANCIAL MANAGEMENT GOALS

TO MAXIMISE THE WEALTH OF THE
SHAREHOLDERS

TRIPLE BOTTOM APPROACH IN DECISION
MAKING

PEOPLE – PLANET - PROFIT

3 IMPORTANT FINANCIAL DECISIONS

- **INVESTMENT**
- **FINANCING**
- **DISTRIBUTION**

INVESTMENTS

- What we need to expend to put the business in action
- CAPEX – Capital expenses- Fixed Assets-LT
- OPEX - Operating expenses- Current Assets - ST

How Much Money Do We Need?

- Capital Expenses (Capex) – Capital Budgeting
 - Money for capital investment
 - Examples: Equipment, Building
- Operating Expenses (Opex) – Working Capital
 - Permanent Working Capital for operating the business
 - Level of permanent WC grows as business grows
 - Temporary Working Capital
 - To meet seasonal or peak periods

Capital Budgeting

- Money for investment in Fixed assets/Capacity/ infrastructure the benefits of which are received over period of time
- They are generally:
 - Irreversible
 - Non-flexible
 - Expensive
 - Affect profitability of the concern
- Methods used to evaluate proposals:
 - Pay back period
 - NPV

Working Capital Management

- Working Capital (WC) is so called because it is required to make the fixed assets work
- The amount of WC is determined by:
 - the nature of the business, size of the fixed assets,
 - the complexity of the production process
- WC should be adequate (neither too much nor too little) to meet day-to-day operational needs of the business

Working Capital

AMOUNT REQUIRED FOR DAY TO DAY
OPERATIONS OF THE CONCERN.

Working capital = Current Assets – Current Liabilities

Financing

- How much money we need for investments
- Sources for raising the money- Debt / Equity
- Terms of raising and their financial costs

TO PONDER

- **Internal financing OR** External financing ?
 1. Should the business have 'borrowed' capital?
If so, how much?
 2. What is the correct mix of 'Long term' and 'Short term' funds?

DISTRIBUTION OF PROFITS & IMPACTS

Impact assessment parameters

- People- employment generation etc
- Planet- effect on environment-
emissions/ecological impacts
- Profits- Retention & Distribution of profits

ACCOUNTS

- Accounting is the art of recording, classifying and summarising the transactions of financial nature and interpreting the results to know about the health of the organisation

Major Financial Statements

**Profit & loss
A/C**

**Balance
Sheet**

**Statement of
Cash flows**

**Statement to
stock holder's
equity**

**Notes to
Accounts**

Financial Statements

Financial Statements consist of:

- the **Balance Sheet** which is a **snap shot** of the financial position of the business as **on a particular date**
- the **Income Statement** (Profit & Loss Account) which shows the **results** of the operations **during a period**
- the **Cash Flow Statement** which shows **the receipts and payments** of cash/money **during a period**

Balance Sheet

Sources/Liabilities	Application/Assets
Shareholders' Funds (Owner's Capital) Paid up capital Reserves & Surplus (Profits retained)	Fixed Assets Gross Block Less: Depreciation Net Block
Loan Funds Secured/Unsecured Loans	Current Assets Inventories/Stocks, Debtors/ Receivables, Cash & Bank Balances, Loans & Advances Less: Current Liabilities Creditors/Payables Net Current Assets

Total liabilities = Total Assets

Format of Income Statement

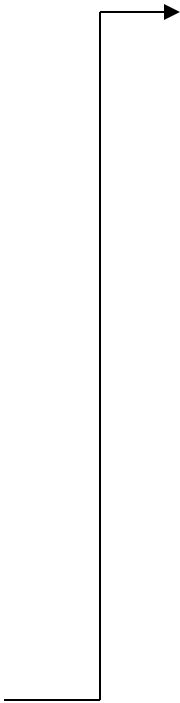
Income statement for the year ending

A. Income

Sale of goods / services
Financial income
 Interest / Dividend received
 Profit on sale of Investment
Misc. receipts (scrap sales etc)

B. Expenditure

Cost of goods sold
Employee expenses
Bought-out services
Depreciation
Operating expenses



Financial expenses (eg: Int paid)
Provision for expenses/losses
 (eg: Bad Debts, Obsolete goods)
Amortization of expenses

C. Profit Before Tax (PBT) (A – B)

Less :Tax provision

=

D. Profit After Tax (PAT)

Less: Transfer to Reserves

=

E. Profit for Distribution

Cash Flow Statement

- A cash flow statement shows the sources and uses of cash in the business:
 - operating activities
 - financing activities
 - investing activities

The acid test of any business is its ability to pay the financial obligations (eg: employees salary, supplier payments, loan repayment etc) as and when they fall due

The 3 activities can be found in certain parts of the FS

– Operating activities

- Income Statement (after adjusting for non-operating items)
- Balance Sheet (current assets & current liabilities)

– Investing Activities

- Balance Sheet (fixed assets)

– Financing Activities

- Balance Sheet (non-current liabilities & Equity)

Financial Plan

Is a statement showing the project's intended plan of action and their financial implications and the impacts it proposes to create.

Value of financial plans

- ◎ Explains how the project implementor plans to meet all financial obligations and maintain liquidity in order to either pay off the debtor or provide a good Return on Investment
- ◎ 3 years of projected financial data and monthly data of flows for the first year is an ideal recommendation for your financial planning

Budgeting

- Budgets are most important tools of finance.
- Understanding project budget implications on your department budget is vital.
- Budgets are made of forecasts based on assumptions.
- Risk analysis is vital in FM.

Financial Planning – its functions

- Estimate financial requirements for future
- Identify sources
- Arrange for the finance
- Proper allocation & control

THANK YOU

Sources of Finance: Equity

- Inside equity:
 - founders, friends, family
- Angel Investors
- Venture Capital
- Public Offering:
 - The ultimate in wealth creation
- DEBT- BORROWINGS

Components of an Operating Cash Cycle

