

# 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?

# Important issues to consider

	<b>Equity</b>	<b>Debt</b>
<b>Cash Flow</b>	Dividend	Interest, Principal Repayment , Tax Shield
<b>Collateral</b>	Not required	Required – assets are collateralized
<b>Ownership</b>	Dilution Loss of control	Not affected

# 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

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

**Total liabilities = Total Assets**



# Format of Income Statement

Income statement for the year ending .....

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## 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

# Income Statement



- It is ***incorrect*** to use the terms **Profit** and **Income** interchangeably.
  - Income relates to Sales/Revenue
  - Profit relates to ‘Results’  
(net of Sales *minus* Expenditure )

# 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

# 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

