

Basics of Finance

Dr. Radhika Meenakshi Shankar

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

	Equity	Debt
Cash Flow	Dividend	Interest, Principal Repayment , Tax Shield
Collateral	Not required	Required – assets are collateralized
Ownership	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

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

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

