

THESE SLIDES ARE FOR
CLASS NOTES ONLY

FINANCIAL MANAGEMENT

Time
Date

Financial Management is a vital activity in any organization. It is the process of planning, organizing, controlling and monitoring financial resources with a view to achieve organizational goals and objectives.

Financial Management means applying management principles to manage the financial resources of an organization.

An example of financial management is the work done by an accounting department for a company.

In a short Financial Management is study of relationship between raising the finance and the deployment of finance.

Objectives of Financial Management:

- To ensure regular and adequate supply of funds to the concern.
- To ensure adequate returns to the shareholders which will depend upon the earning capacity, market price of the share, expectations of the shareholders.
- To ensure optimum funds utilization. Once the funds are procured, they should be utilized in maximum possible way at least cost.
- To ensure safety on investment, i.e, funds should be invested in safe ventures so that adequate rate of return can be achieved.
- To plan a sound capital structure-There should be sound and fair composition of capital so that a balance is maintained between debt and equity capital.

Functions of Financial Management

Estimation of capital requirements: A finance manager has to make estimation with regards to capital requirements of the company. This will depend upon expected costs and profits and future programmes and policies of a concern. Estimations have to be made in an adequate manner which increases earning capacity of enterprise.

Determination of capital composition: Once the estimation have been made, the capital structure have to be decided. This involves short- term and long-term debt equity analysis. This will depend upon the proportion of equity capital a company is possessing and additional funds which have to be raised from outside parties.

Choice of sources of funds: For additional funds to be procured, a company has many choices like-

- Issue of shares and debentures
- Loans to be taken from banks and financial institutions
- Public deposits to be drawn like in form of bonds.

Choice of factor will depend on relative merits and demerits of each source and period of financing.

FUNCTIONS OF FINANCIAL MANAGEMENT

Functions of Financial Management (Contd...)

Investment of funds: The finance manager has to decide to allocate funds into profitable ventures so that there is safety on investment and regular returns is possible.

Disposal of surplus: The net profits decision have to be made by the finance manager. This can be done in two ways:

- Dividend declaration - It includes identifying the rate of dividends and other benefits like bonus.
- Retained profits - The volume has to be decided which will depend upon expansional, innovational, diversification plans of the company.

Management of cash: Finance manager has to make decisions with regards to cash management. Cash is required for many purposes like payment of wages and salaries, payment of electricity and water bills, payment to creditors, meeting current liabilities, maintenance of enough stock, purchase of raw materials, etc.

Financial controls: The finance manager has not only to plan, procure and utilize the funds but he also has to exercise control over finances. This can be done through many techniques like ratio analysis, financial forecasting, cost and profit control, etc.

CAPITAL

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- Capital is typically cash or liquid assets held or obtained for expenditures. In financial economics, the term may be expanded to include a company's capital assets.
- Capital is one of the basic factors of production along with land and labour. It is the accumulated assets of a business that can be used to generate income for the business.
- Capital includes all goods that are made or created by humans and used for producing goods or services. Capital can include physical assets, such as a production plant, or financial assets, such as an investment portfolio.
- Capital means each and every element that is required by a businessman to start an enterprise. e.g. money, land, building, machinery, material, etc. It is a measure of the amount of resources of an enterprise. Also known as Life-blood of business.
- The four major types of capital include debt, equity, trading, and working capital.

CAPITAL MANAGEMENT

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Capital management (CM) is a financial strategy aimed at ensuring maximum efficiency in a company's cash flow. Its aim is for the business to have adequate means to meet its day to day expenses, as well as financial obligations in the short-term.

Fixed & Working Capital

Fixed Capital (Block Capital) : **Fixed capital** is the investments done by the business for accruing long-term benefits/assets.

- Assets which are used over and over again for a number of years
- e.g. Building Equipment and machinery tools Furniture

Working Capital: Capital required for day-to-day needs and expenditures e.g. - Purchase of raw material and supplies, Payment of employees, Storage cost, Equipment and plant maintenance cost, Transportation and shipping expenses etc.

FIXED CAPITAL & WORKING CAPITAL

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Difference between Fixed & Working Capital

Meaning	Fixed capital refers to the investment of the enterprise in long term assets of the company.	Working capital means the capital invested in the current assets of the company.
Requirement	Fixed capital is required for establishment of business.	Working capital is required to utilize fixed assets of the company.
Sources of Funds	The industrial units mobilize fixed capital from various sources like shares, debentures, banks etc. which are to be repaid over long time period.	The industrial units mobilize working capital from the commercial bank loans, profits retained, etc. which are repayable before one year.
Conversion	The fixed capital which is used for fixed assets is not easily convertible into cash.	The working capital investments have high liquidity and can be easily convertible into cash.

FIXED CAPITAL & WORKING CAPITAL

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Difference between Fixed & Working Capital

Nature	Fixed capital is a one-time investment to purchase fixed assets for starting a business or for expanding a business.	Working capital is required constantly for day to day business activities of the organization.
Duration	Fixed capital in long-term investment i.e it is invested at the for long periods of time.	Working capital is usually a short term investment for running of businesses day to day operations.
Returns	Fixed capital aims at long-term return to the organization.	Working capital is generally focused on meeting the daily requirements for operational activities of the organization.
Amount Required	Fixed capital constitute a very large amount of investments done by the organization.	Working capital required is considerably less in amount when compared to Fixed Capital of the organization.

Sources of finance :

1. Internal Sources
2. External Sources
 - a. Permanent or long term sources
 - b. Medium term sources
 - c. Short term sources d
 - d. Specialist Institutions

SOURCES OF FINANCE

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1. Internal Sources of Finance

- Retained Equity Earning

Retaining of earning of shareholders for internal investments

- Depreciation Provision

Old machinery has less amount of tax (e.g. Car Insurance)

- Deferred Taxation

Relaxation in taxes if time lag between the earning of profit and payment is more, In this case profit in balance sheet less, less amount, so less tax

- Personal Funds saved or inherited

2. External Sources of finance

(a) Permanent or long term sources of finance:

Sources raised for the period of more than 10 years

- ✓ Savings: Life insurance, shares, mutual funds, bonds, fixed deposits
- ✓ Loans: From friends and relations, money lending institutes, banks
- ✓ Shares: Issuing shares to investors in return of cash
- ✓ Public Deposits: Deposits or loans collected from general public, employees and shareholders
- ✓ Adding partner to business

2. External Sources of finance (Contd...)

- ✓ **Debentures:** - Debentures is certificate of indebtedness issued by corporations. Debenture holders paid a fixed rate of interest over a stated number of years in debentures - Debentures are paid whether company is in profit or loss
- ✓ **Corporate bonds:-** **Unsecured bonds:** also known as debentures. **Secured bonds:** claim on assets of corporations if they failed to pay interest.

2. External Sources of finance (Contd...)

(b) Medium term sources of finance: Finance raised for a period of more than 1 year.

- ✓ Bank Loans
- ✓ Hire Purchase: buying goods in instalments
- ✓ Sale and lease back: For getting funds, sell some if the property with rights to lease back at agreed rent.
- ✓ Equipment leasing
- ✓ Profit plowback : Whole profit is not distributed to shareholders as dividend, rather a portion of it is retained in business and used for growth and finance expansion.

2. External Sources of finance (Contd...)

(c) Short term sources of finance: Finance raised for a period of less than 1 year.

- ✓ Credit facilities: Obtain goods and services on credit
- ✓ Trade credit: Purchase goods without paying cash or paying the supplier at later time.

(d) Financial Institution: Finance may be obtained by borrowing from:

- ✓ Insurance company
- ✓ Investment company
- ✓ Industrial development corporations.

Budget ?

- “It is an instrument of management used as an aid in planning, programming and control of business activity.”
- “It is a written plan of action, includes financial requirement of different sections of the business for a specific duration to achieve an estimated profit”.

Objectives of budget:

1. It should specify units to be produced, precise size, style, and cost of production.
2. It should analyze all the factors affecting the department as well as business
3. It should help in removing waste and raise profit of the business
4. Prediction about capital expenditure for future
5. It should help in coordination among departments, stabilizing the production.

BUDGET

Time
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- **Fixed Budget:** A fixed or static budget shows one plan, one volume of output or sales and the related fixed cost.

It depends upon the ability to predict income, sales with accuracy and no provision is made for any changes that may occur during the budget period

E.g. research project, hospitals, schools and collages, etc.

- **Variable Budget:** A variable or flexible budget recognizes the unreliability of income or sales predictions and makes provision in advance for variation in production and expenditure in accordance with the variation.

It shows the range of volumes or sales or cost for each spending's.

Variable budget takes account only those cost which varies the output and over which department has control over it.

BUDGET

Time
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FIXED BUDGET					
For year ending.....					
	Hours		Budget to capacity %	Total cost	Details schedule No.
	Capacity	Budgeted			
1. Factory					
2. Selling and Distribution					
3. Administration					
4. R & D.					
Rs....					

VARIABLE BUDGET			
For year ending.....			
Labour	Volume of output		
	5,000	10,000	20,000
	Rs.	Rs.	Rs.
1. Turner	10,000	17,000	30,000
2. Fitter	8,000	12,000	20,000
3. Welder	10,000	16,000	28,000
4. Molder	6,000	9,000	13,000
5. Painter	2,000	4,000	6,000
	36,000	58,000	97,000

Production Budget:

- Prepared by production manager.
- It includes quantity of product to be manufactured based on –
 - Sales budget
 - Factory Capacity
 - Stock Requirement
 - Availability raw
- Production budget is a part of manufacturing budget. Manufacturing budget helps in keeping production at even rate and controlling the use of labour, material, equipment, etc.
- It includes estimated volume of production, division of estimated output into types of product, scheduling of operation by month and quarters, etc.

Labour Budget:

- It contains an estimation of labour required to manufacture the product shown on production budget.
- While Preparing labour budget following this are considered-
Calculation of manpower requirement's for the department, determine the grade(i.e. male or female) and the number of workmen/worker
- Set standard wage rate for workmen.

BUDGET

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A. B. C. Co. PRODUCTION BUDGET For the year ending.....						
	Units of Output					
	Jan.	Feb.	Mar.	2nd Quarter	3rd Quarter	4th Quarter
1. Department-X - product-x	4,000	4,000	4,000	13,000	14,000	15,000
2. Department-Y - product-y	2,500	2,500	3,000	9,000	9,500	10,000
Total x+y	6,500	6,500	7,000	22,000	23,500	25,000

A. B. C. Co.
DIRECT LABOUR BUDGET

Period : From.....
To.....

Department.....A.....

Output :
2000 Units-X
3000 Units-Y
1000 Units-Z

Total standard hours = 24000

Workers	Number	Hours	Standard rate (Rs.)	Direct Labour cost (Rs.)	Total (Rs.)
Skilled	10	8	300/day	300	3000
— male					
— female					
Semiskilled					
— male					
— female					
Unskilled					
— male					
— female					

“A fee charged by govt. on product, income or service is called Tax.”

Taxes are levied in almost every country of the world, primarily to raise revenue for government expenditures, although they serve other purposes as well.

Excise Tax (Indirect Tax)

Excise taxes are taxes required on specific goods or services like fuel, tobacco, and alcohol. It is indirect because the manufacturer or provider of the goods or services has to charge the purchaser tax for the item, and pass the payment on to the government - unlike a direct government tax.

Excise taxes are sometimes used to charge taxes on goods or services deemed by society as unnecessary or even harmful.

Excise Tax (Indirect Tax)

There are two main **types of Excise taxes**:

- **Ad Valorem**: these taxes are levied on a fixed percentage of the value of a good or service. Property tax is a form of ad valorem tax. *Ad Valorem* is Latin for "according to value."
- **Specific**: a tax charged 'per unit sold.' As an example, think of gasoline taxes, which you pay in the price per 9/10 of a gallon, thinking you're just paying for the price of the gasoline.

Service Tax (Indirect Tax)

Service tax is a tax levied by the government on service providers on certain service transactions, but is actually borne by the customers. It is categorized under Indirect Tax and came into existence under the Finance Act, 1994.

This tax is payable only when the value of services provided in a financial year is more than Rs 10 lakh. This tax is not applicable in the state of Jammu & Kashmir.

The consumer pays the service tax to the service provider while paying the bill (eg. Restaurant bill has a component of service tax). The government in turn collects the tax from the service providers.

Income Tax (direct Tax)

An **income tax** is a tax imposed on individuals or entities (taxpayers) that varies with respective income or profits (taxable income).

Any individual or artificial body or group of individuals that earns more than the basic exemption limit are expected to pay income tax. Under the Income Tax Act, the persons liable to pay income tax include individuals, Association of Persons, Hindu Undivided Families, Body of Individuals, companies, artificial judicial persons, firms and local authorities.

Income Tax department has launched "e-Proceeding" facility to conduct proceedings electronically.

Value Added Tax

A **value-added tax (VAT)** is a consumption **tax** placed on a product whenever **value** is **added** at each stage of the supply chain, from production to the point of sale.

The amount of VAT that the user pays is on the cost of the product, less any of the costs of materials used in the product that have already been taxed.