Ch. 6 FINANCE& ACCOUNTING

Introduction

Money required for carrying out business activities is called business finance. Almost all business activities require some finance. Finance is needed to establish a business, to run it to modernize it to expand or diversify it. It is required for buying a variety of assets, which may be tangible like machinery, furniture, factories, buildings, and offices or intangible such as trademarks, patents, technical expertise etc.

Also, finance is central to run day to day operations of business like buying materials, paying bills, salaries, collecting cash from customers etc. needed at every stage in the life of a business entity. Availability of adequate finance is very crucial for survival and growth of a business.
Business finance refers to money and credit employed in business. It involves procurement and utilization of funds so that business firms may be able to carry out their operations effectively and efficiently.

The following characteristics of business finance will make its meaning clearer:-

- Business finance includes all types of funds used in business.
- Business finance is needed in all types of organizations large or small, manufacturing or trading.
- The amount of business finance differs from one business firm to another depending upon its nature and size. It also varies from time to time.
- Business finance involves estimation of funds. It is concerned with raising funds from different sources as well as investment of funds for different purposes.

Based on the duration, the **sources of finance** are classified as follows:

Classification	**Example**
Long term finance - *Capital financed for more than 5 years.*	This includes a. Debentures b. Equity Shares c. Issue of right shares d. Leasing e. Loans from financial and industrial institutions

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Medium term finance: *Capital financed for duration of more than one year and below 5 years.*	This includes a. Commercial banks b. Debentures c. Loans from Specialized finance institutions
Short term finance: Capital financed for duration of less than one year.	This includes: a. Advance from customers b. Bank overdraft c. Cash Credit d. Discounting bills e. Finance against bill of lading f. Instalment credit g. Trade creditor open book account

Types of Business Finance

All businesses require an adequate finance. They need money for investment in fixed asset such as land, building, machinery etc. Once business is in operation, money is needed for Working Capital, such as purchase of raw material, payment of wages, utility bills etc.. A going concern also requires extra capital to cover a temporary cash flow crisis, or purchase new improved machinery or simply to expand the business. The financial requirements of a business, on the basis of time duration, are usually classified under three heads which are as follow:-

- Short Term Finance
- Medium Term Finance
- Long Term Finance

1. Short Term Finance

Short term Sources of finance is defined as money raises for investment in business for a period of less than one year, it is also named as working capital or circulating capital or revolving capital.

The purpose and amount of obtaining short term capital varies with the nature and size of the business. Generally the short term capital is required for meeting the day to day expenses of business such as payment of utility bills, wages to the workers, unforeseen expenses, seasonal upswings in business, increasing inventories raw material, work in progress and finished goods etc.

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The various sources of short term finance are as under:-

- Trade creditor open book account
- Advance from customers
- Installment credit
- Bank Overdraft
- Cash credit
- Discounting bills
- Against bill of lading

2. **Medium Term Finance**

Medium term sources of finance are required for investment in business for a medium period which normally ranges from one to five years. The medium term funds are required generally for the repair and modernization of machinery, renovation of the building, adoption of new methods of production, carrying advertisement campaign on large scale in newspapers, television etc. The various sources of medium term finance are as under:-

- **Commercial Banks**
- Debentures
- Loans from Specialized Credit Institutions

3. **Long Term Finance**

Long term sources of finance refer to the funds, which are required for investment in business for a period exceeding up to five years. It is also named as long term capital or fixed capital. Long term**sources of finance** are mostly required for the purchased of fixed assets, such as land, building, machinery etc. modernization and expansion of business. The amount of long term finance varies with the nature of business, size of business, nature of the product manufactured, the number of goods produced, and the method of production etc. The various sources of long term finance are as under:-

- Equity shares
- Issue of right shares
- Debentures
- Loans from industrial and financial institutions
- Leasing
- Ploughing back of profits

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Importance of Business Finance

Business finance is required for the establishment of every business organisation. With the growth in activities, financial needs also grow. Funds are required for the purchase of land and building, machinery and other fixed assets. Besides this, money is also needed to meet day-today expenses e.g. purchase of raw material, payment of wages and salaries, electricity bills, telephone bills etc. Here is how finance is important to business:

Initial Capital: It is popularly said that money is essential for making money. To start the activities of a business, capital investment is required. For ideas to materialize and become products/ services, groundwork for sales, product testing, marketing, etc. seed capital is essential. Businesses have a tough but defining choice between debt and equity financing.

Meeting operational expenses: In the short-term, businesses require finance in the form of working capital to meet operational expenses such as remunerative payments, raw materials, inventory, interest payments, etc. Proper short-term financial planning and maintenance of good working capital flow is crucial to keep the operations going. Though maintain adequate cash flow is always important, it is especially important in the starting stages since revenues will take some time to match the cash outflows.

Scaling up and asset creation: In the long-term, capital is crucial for purchasing assets like machinery, land, equipment, etc. to expand the production scale. Scaling up production will create assets, help the business grow and penetrate existing markets. The business must have sufficient capital budget to do so and cannot depend on short-term finances for this. They must have savings and should be able to raise and infuse capital investment through debt or equity financing.

New products and markets: Without finance and proper financial management, even an established organization will not be able to explore newer markets or develop and test newer solutions/ products. Finance is required for testing and research purposes as well as for marketing and advertising purposes.

Business cycles: Business cycles of growth, boom, recession, depression and renewal caused by changes in the economy and other external factors are a reality. And no matter how well it is doing, the business is bound to bear the consequences and has to be prepared to tackle these cycles. The financial plans must be fool proof and should include plans for when the business takes a hit due economic downturn.

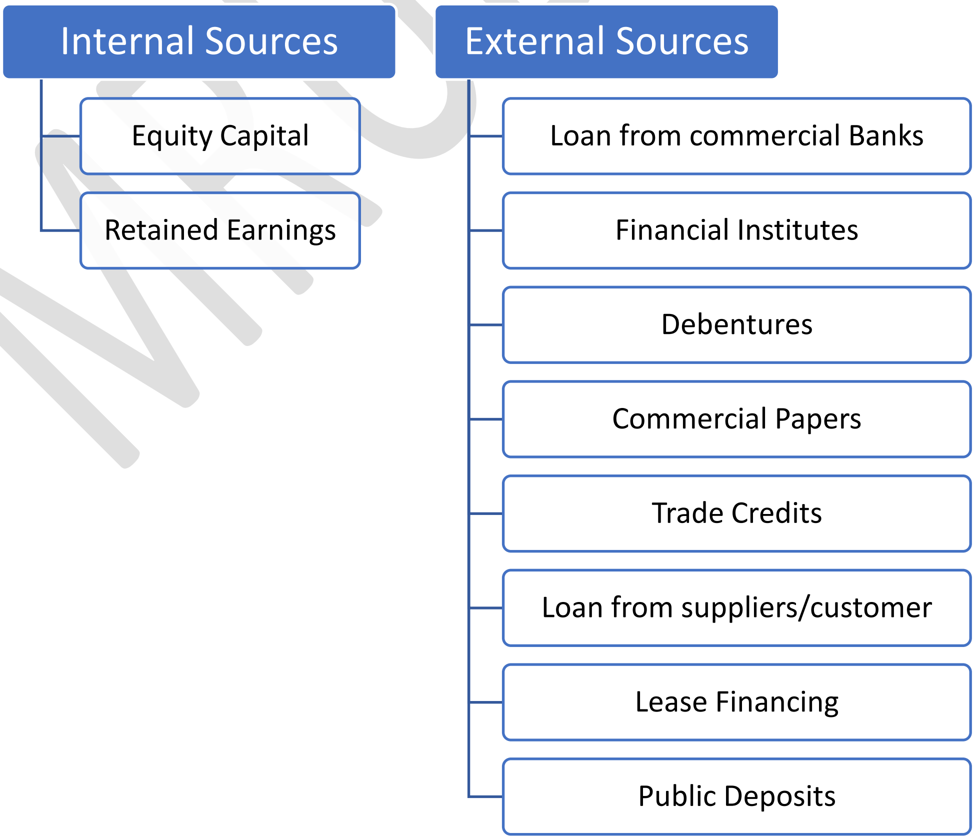
Help to meet contingencies: Funds are always required to meet the ups and downs of business and unforeseen problems. Suppose, some manufacturer anticipates shortage of raw materials after a period, obviously he would like to stock raw materials. But he will be able to do so only when money would be available.

Helps to promote sales: In this era of competition, lot of money is required to be spent on activities for promoting sales like advertisement, personal selling, home delivery of goods etc.

Helps to avail of business opportunities: Funds are also required to avail of business opportunities. Suppose a company wants to submit a tender but some minimum amount is required to be deposited along with the application. In the case of non-availability of funds it would not be possible for the company to apply.

Sources of Funds

Business simply cannot function without money, and the money required to make a business function is known as business funds. Throughout the life of business, money is required continuously. Sources of funds are used in activities of the business. They are classified based on time period, ownership and control, and their source of generation.



Functions of Business Finance:

1. Financial Goals: Every business has a bottom-line because every business has objectives. Functions of Business finance helps companies define their objectives by setting financial goals, a business will know if they're remaining stagnant whether they've reached the threshold of profitability. The reason is that without well financial plans which are strategic organizations might possibly not have that knowledge on how to achieve profitability. Because strategies and techniques are the backbone to the ongoing company's goals, finance is tasked with the obligation to meeting the bottom-line goal of business finance.

2. Financial Planning: Financial planning is a key functions of business finance that could be the procedure of determining how much reserves the company should keep for a rainy day, how much money is required for a business to operate on, how a company will receive the money (loans, income) and exactly how that money should be spent and allocated through the organization. Budgeting is really a type that is popular of planning tool. Business finance creates budgets through forecasting efforts. Budgets are ready on spreadsheets containing line items, which represent buck values for how much money will undoubtedly be budgeted for that expense that is particular. They're especially helpful for keeping task that is financial track, as well as gauging a company's spending and saving practices.

3. Managerial Functions: There are some of the essential concepts and functions of business finance in an organization decisions of a finance manager.

- Financing Decision: the next function of the business financial manager is to determine about the allocation of dividend among its stakeholders. In this full case, retained earnings may also be considered.
- Long-term Capital Investment: Capital budgeting can be involved for investing in term project where the next things are thought: general assets and cost, expected the return that is future the risk of expected return, cost of money.
- Short-term Capital Investment: in this instance investment is manufactured in current assets for one or lower than one.
- Investment decision: Investment decision is taken by valuing projects that are different expected the return and danger are considered.

4. Business Finance Formula's: Generally, business formulas offer certain information pertaining to investments made for growth opportunities and business operations. Each formula can help you compare the cost that is total of decisions that can impact your organization financially in terms of profits or losses. Formulas are commonly used in various functions of business finance to determine specific things like net present value, return on investment, payback period and more. This formula is important to assist you ensure the viability that is long-term of organization.

5. Forecasting: Forecasting is a type of forecast that determines exactly what a company's future financials will look like. For example: company's product sales volumes will be and what forms of capital expenses they could have. Stakeholders and investors are particularly interested in financial forecasts as this data will inform them of whether company will likely be profitable or not. If forecasts do maybe not seem financially promising, financial risk is elevated and stakeholders could withdraw their investments if the return on investment isn't in their favour. Company professionals may then use forecasts to develop brand new strategies that might help the business understand more growth that is future.

6. Budgeting: Financial planning leads to the functions of business finance, which is budgeting. Budgeting is a popular planning that is financial that comes from forecasting efforts. Generally, you prepare budgets with numerous line items that represent the rupee value of how much money is allocated for the cost that is particular. Most organizations find that creating and adhering to a spending plan is useful in maintaining task that is financial track. Exactly like in individual finances, a budget will gauge spending and saving practices that may help or hinder objectives that are economic.

7. Misconceptions and Considerations: As a whole, you should not count solely on formulas when you require creating business decisions such as assessing growth that is brand new. A qualitative analysis can round out the decision-making process by including expertise and individual experience for some companies. You can use survey results or any other type of non-measurable information. With qualitative analysis, you apply subjective information that cannot be quantified when determining an opportunity. Rather, an additional analysis tool might provide you with a greater amount of comfort once you come towards final decision.

8. Initiate Reality Check: The thing that is great business finance is that mathematical or statistical formulas can create factual economic results associated with business information. Internal business formulas are typically

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based on ways to eliminate waste and maximize production output in operations. For external company finance formulas, you examine potential opportunities that are connected with goals and objectives. You can even establish facts based on present conditions that are economic whether the marketplace is ready for the product or plan.

9. Manages Payable and Receivables: Using business finance to manage payable and receivables is a component that is natural of your organization. Generally, you will have a finance department to manage cash inflows and outflows. Creditors, vendors and employees expect prompt repayments. You need the quantity that is right of to keep operations running smoothly.

10. Manage Accounting: Depending on the complexity and size of your organization, the bookkeeping process is quick or long. One of the important functions of business finance is that you can have a process that is simple chronicle financial transactions that occur, or you might have a complicated system to record, evaluate and interpret day-to-day deals. In Conclusion, the growth and success of your business is greatest whenever there are principles and procedures to be followed. As a whole, functions of business finance notes represent the backbone of your organization. Functions of business finance is that task that will be concerned with the acquisition and conservation of capital funds in fulfilling the financial requirements while the objective that is general of business enterprise.

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