FREQUENTLY ASKED QUESTIONS:

FUNDAMENTALS OF FINANCE

What is meant by finance function?

Finance function is the science and art of management of money and other valuables which can be converted to cash or cash equivalents in the foreseeable future.

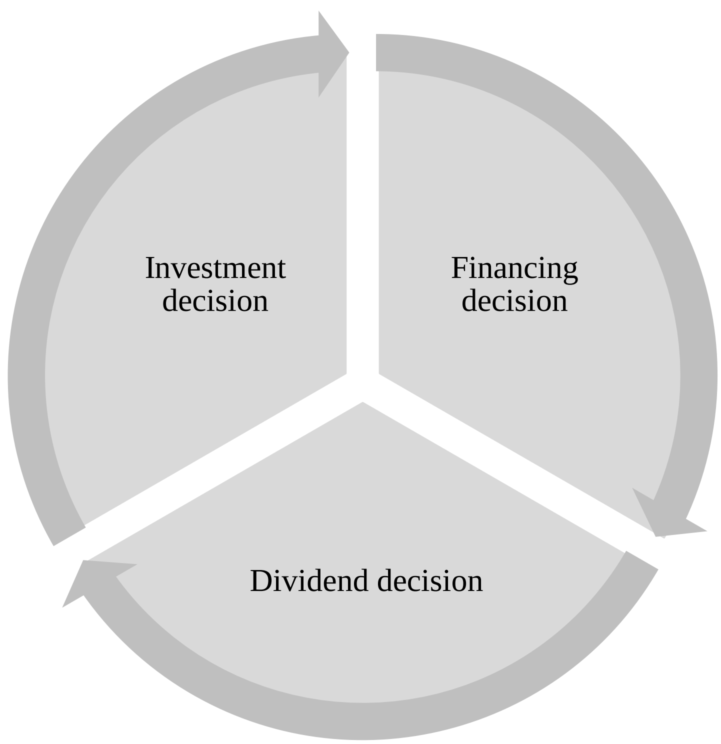
What are the objectives of finance function?

The objective of finance is to manage and enhance wealth creation and economic value to the business and its shareholders. It encompasses the following:

- Planning
- Sourcing
- Investment and
- Monitoring and control

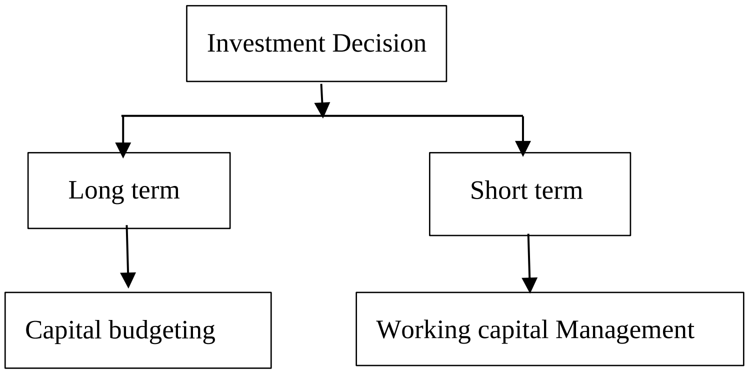
What are the basic concepts of finance?

The basic concepts of Finance centre around the following areas as explained in the chart below:



What does investment decision relate to?

The **Investment Decision** relates to the decision made by the investors or the top-level management with respect to the amount of funds to be deployed in the investment opportunities. Investment decision may be identified as long term and short term.



What does long term investment decision relate to?

Long term investment decision relates to the process of selecting the asset or an investment proposal that will yield returns over a long period. In other words, it is called capital budgeting.

How are long term investment utilized?

Long-term funds are utilized towards following areas depending on setting of priority by the top management:

- Expansion of business segments or divisions
- Acquisition of assets (tangible and intangible), and
- Diversification of business
- Productivity improvement
- Product improvement
- Investment in Research and Development
- Mergers and acquisitions.

What is the concept of time value of money?

Time value of money is the idea that money that is available at the present time is worth more than the same amount in the future, due to its potential earning capacity.

This core principle of finance holds that provided money can earn interest, any amount of money is worth more the sooner it is received. One of the most fundamental concepts in finance is that money has a time value attached to it. In simpler terms, it would be safe to say that a rupee was worth more yesterday than today and a rupee today is worth more than a rupee tomorrow. This is explained in the equation below.

Future Money = Current Money + Time

It can be explained with the following example.

If we invest one rupee (PV) for one year (N) at 8% (I), we will receive Rs.1.08 (FV). This would be the same as saying the present value of Rs.1.06 we expect to receive in one year, is only Rs.1.00 (PV). This calculation can be replicated in the number of future periods to work out the present value of the future cash flows. This is called Discounted Cash Flow technique.

What is meant by short term investment decision?

The investment decision related to current assets or short-term assets is termed as **Working Capital Management**. The working capital management deals with the management of current assets that are highly liquid in nature. The key areas related to working capital investment decisions centre around broadly the following:

- Review of operating cycle of the business,
- Accordingly decide how much inventory to keep
- Deciding ratio of cash and credit sales
- Effective administration of bills receivables and payables
- Proper management of cash and investment of surplus cash if any to marketable securities for generating adequate return

What does financing decision relate to?

The financing decision involves around the risk of default on payment of periodic interest and repayment of capital on 'borrowed funds' and this is called financial risk.

How do we manage the capital structure?

A firm's capital structure or financing decision is concerned with obtaining funds to meet firm's long-term investment and short-term funding requirements.

With respect to long-term investment decisions the firm looks at a specific blend of long-term debt and equity, which the firm uses to finance its assets. The Treasurer of the firm must decide exactly how much funds that needs to be raised, from which sources and by when.

The optimal capital structure is one which minimizes overall cost of capital and maximizes firm's value. Capital structure decision gives rise to financial risk of a firm.

What does dividend decision signify?

Dividend decision is a decision, which evaluates deciding how much of the profit earned by the company should be distributed among shareholders (dividend), and how much should be retained for the future contingencies (retained earnings).

How is Accounting defined?

Accounting is the structure and mechanics that create the financial numbers in a business.

How do we explain Accounting equation?

Accounting equation is

Assets = Liabilities + Stockholder equity.

This equation represents the three sections of the balance sheet.