FINANCIAL MANAGEMENT

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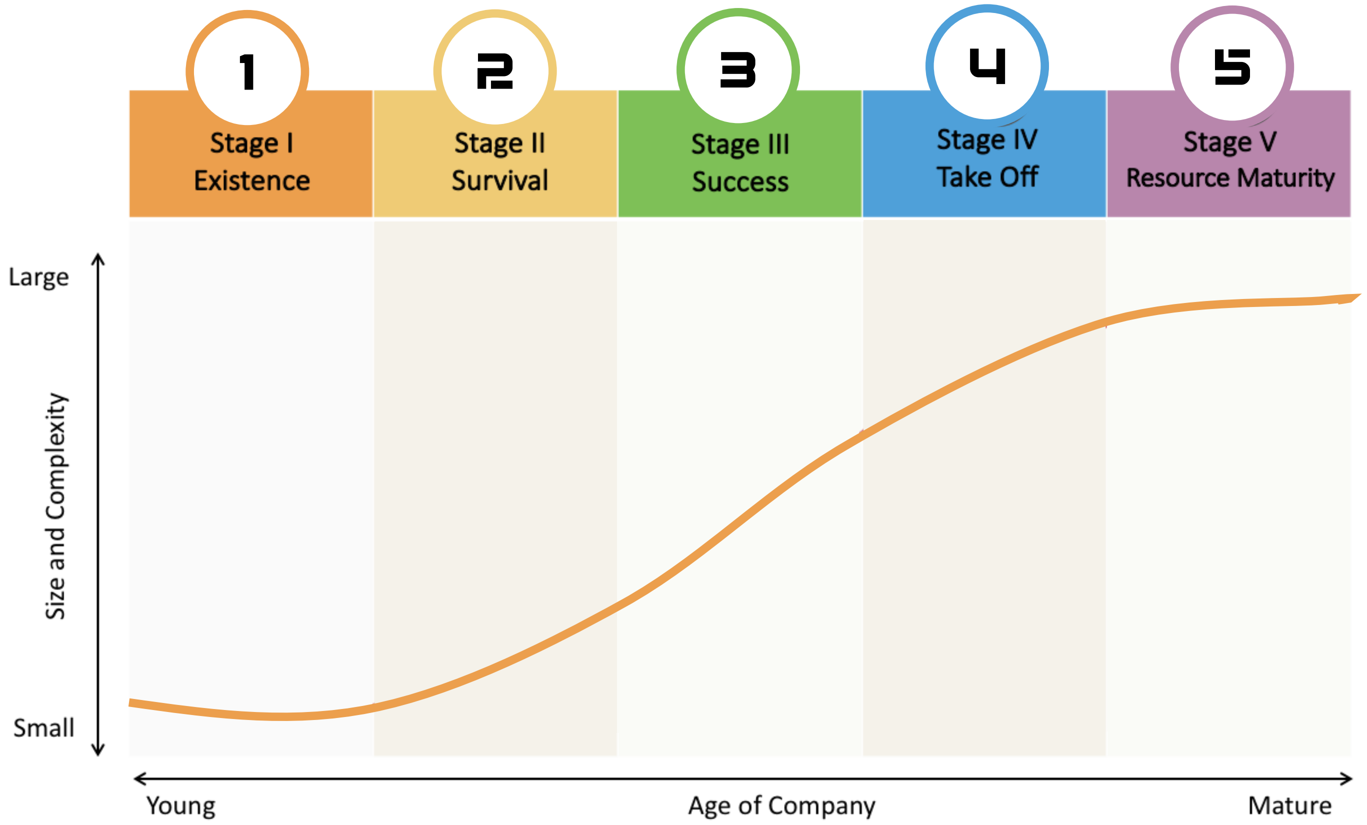
THE BIG PICTURE

WHY MONEY MATTERS?

Why finance is **THE MOST IMPORTANT** part of a any business?



THE BIG PICTURE

WHY MONEY MATTERS?

- **Major Areas of Finance**
  - **Financing**
    - Source of Fund
    - Cost of Capital
    - Capital Structure
  - **Investment**
    - Working Capital
    - Capital Budgeting
  - **Payout (Dividend)**
    - Dividend
    - Retained Earnings

Sources of Finance

To start a business and run daily activities, it is very much essential to make correct decision about **financing**. **Required fund can be collected from various sources, but at first all available sources to listed, then appropriate sources to be chosen for raising required fund.** Not only to raise fund is important, but also to use fund properly, effectively and profitably is important for a business.

Sources of Finance

Financing options for Startups

The founders
Have some savings left yourself? Just received a nice bonus? Why not invest it in your own company! You don’t necessarily have to invest in terms of cash. If a co-founder or a partner invests his/her hours in helping you start your business next to his/her job that is also an investment.

The 3F’s: family, friends and fools

Angel Investors

Crowdfunding
In general there are three types of crowdfunding: loans, pre-orders/donations and convertible loans.

Financing options for Startups

- **Get Funding From Business Incubators & Accelerators:**
- **Venture capital/private equity**
- **Get Business Loans From Microfinance Providers or NBFIs**
- **Govt Programs That Offer Startup Capital**
- **Debt financing: Commercial Banks**
- **Factoring**

Sources of Financing

Internal Sources

1. Promoters’ Initial capital
2. Retained Earnings
3. General Reserves
4. Provident Fund of Officers and Employees
5. Sale of fixed asset

External Sources

1. Commercial Bank
2. Non-Bank Financial Institutions
3. Specialized Financial Institutions
4. Leasing
5. Issuance of Financial Assets- Share, Bond
6. Trade Credit
7. Mortgage Loan

Sources of Internal Financing

- **Promoters' initial capital-** This is the capital brought by owners when they start a business. According to the formation and nature of organization the amount of owners capital vary.

- **Retained earning-** it is the amount of net profit after distribution of dividend to the shareholders. It is an important source of internal capital. It can be in the form of Internal Financing

- **General reserve-** It is the amount of reserve accumulated for general purpose rather than distributing it as dividend from the net profit. The largest amount of accumulated profit is transferred to this reserve.

Sources of Internal Financing

- **Provident fund of officers and employees-** in order to make sure that the employees do not suffer from insecurity in their old age a portion of fund in kept aside from their salary. The amount accumulated in their fund will be paid at the end of their service so in the time being this can be used for internal financing.

- **Sale of fixed asset and overuse of fixed asset-** many a times companies have asset that has been left unused, overused or does not have any more utility, fund can be accumulated by selling these assets. Sometimes overused asset are further used to avoid huge amount of cash outflow needed to replace it with a new one.

Sources of External Financing

1. **Commercial Bank**
2. **Non-Bank Financial Institutions**
3. **Specialized Financial Institutions**
4. **Leasing**
5. **Issuance of Financial Assets- Share, Bond**
6. **Trade Credit**
7. **Mortgage Loan**

Sources of External Financing

Commercial Banks is the main source among the institutional sources. It acts as a middle man by borrowing excess funds from the public at a fixed rate of interest. Usually fund is provided for establishment of new plant, expansion or modernization of product line etc. Loans can be in the form of long term secured loan or short term non secured loan.

Non-Bank Financial Institutions:
Non Bank Financial Institutions (FIs) are those types of financial institutions which are regulated under Financial Institution Act, 1993 and controlled by Bangladesh Bank. Now, **34 FIs** are operating in Bangladesh while the maiden one was established in 1981.

Specialized Financial Institutions: HBFC, PKSF, Bangladesh Krishi Bank, RKUB, Samabay Bank etc.

Leasing companies- Industrial Development Leasing Company(IDLC) and United Leasing company these two companies provide medium term financing by allowing companies to use their required asset for few years.

Sources of External Financing

Issuance of Financial Assets:
Share capital refers to the portion of a company's equity that has been obtained by trading stock to a shareholder for cash.

Bond and Debenture- Big Blue Chip companies usually raise fund by issuing bonds and the difference with common share is a fixed rate of interest needs to be paid. Depending on the terms of repayment, interest rate there may be different types of bonds.

Trade Credit- many a times goods are purchased on credit for the purpose of selling and repaying the money later once it is sold. These short term credit is called trade credit. However these sort of credits are given only when the wholesaler purchase goods from the manufacturer or when the retailer from the wholesaler.

Mortgage- Large organization sometimes obtain loan by mortgaging their permanent and temporary assets. Here the amount of loan along with term and rate of interest is to be mentioned. If the person taking loan by mortgaging property fails to repay loan as par mortgage contract then the lender has the right to recover the amount form the property that has been mortgaged.

Types of Finance Based on Duration

1. Short Term Financing- [0 t0 1 year]

2. Intermediate Term Financing- [more than 1 to 5 years]

3. Long Term Financing [more than 5 years]

The Choices in Financing

- There are only two ways in which a business can make money.
  - **The first is debt.** The essence of debt is that you promise to make fixed payments in the future (interest payments and repaying principal). If you fail to make those payments, you lose control of your business.
  - Example- Taking loan from a Bank, Selling Bond, Taking loan from friend.
  - **The other is equity.** With equity, you do get whatever cash flows are left over after you have made debt payments.
  - Example- Investment by owner.

What Is Capital Structure?

- "Capital," in the business world, is simply money. Therefore, capital structure is the way that a business finances its operations.

- Specifically, capital structure details a business's composition of debt and equity.

What Is Cost of Capital?

- Cost of capital is simply the cost of raising capital.
- **Cost of Capital** is the rate of return the firm expects to earn from its investment
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- Cost of capital is the minimum rate of return that a business must earn before generating value.

What Is Cost of Capital?

Sources	Amount	Cost	Weight	Cost * Weight
Brac Bank	20	9%	26.67%	2.4%
DBBL	15	10%	20.00%	2.0%
Owner/Shareholders	40	15%	53.33%	8.0%
Total Capital	75			12.40%
				Cost of Capital

Investment Options	Return	Accept/Reject
Option 1	10%	Reject
Option 2	12%	Reject
Option 3	15%	Accept

What Is Depreciation?

Depreciation is an accounting method of allocating the cost of a tangible or physical asset over its useful life or life expectancy.

#1 Straight-Line Depreciation Method

Straight-line depreciation is a very common, and the simplest, method of calculating depreciation expense. In straight-line depreciation, the expense amount is the same every year over the useful life of the asset.

Depreciation Formula for the Straight Line Method:

Depreciation Expense = (Cost – Salvage value) / Useful life

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#2 Double Declining Balance Depreciation Method

Compared to other depreciation methods, double-declining-balance depreciation results in a larger amount expensed in the earlier years as opposed to the later years of an asset's useful life. The method reflects the fact that assets are typically more productive in their early years than in their later years – also, the practical fact that any asset (think of buying a car) loses more of its value in the first few years of its use. With the double-declining-balance method, the depreciation factor is 2x that of the straight-line expense method.

Depreciation formula for the double-declining balance method:

Periodic Depreciation Expense = Beginning book value x Rate of depreciation

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Banks

There are **61 scheduled banks** in Bangladesh who operate under full control and supervision of Bangladesh Bank which is empowered to do so through Bangladesh Bank Order, 1972 and Bank Company Act, 1991. Scheduled Banks are classified into following types:

- State Owned Commercial Banks (SOCBs): There are **6 SOCBs** which are fully or majorly owned by the Government of Bangladesh.

- Specialized Banks (SDBs): **3 specialized banks** are now operating which were established for specific objectives like agricultural or industrial development. These banks are also fully or majorly owned by the Government of Bangladesh.

Banks

- Private Commercial Banks (PCBs): There are **43 private commercial banks** which are majorly owned by individuals/the private entities. PCBs can be categorized into two groups:

  - Conventional PCBs: **33 conventional PCBs** are now operating in the industry. They perform the banking functions in conventional fashion i.e interest based operations.
  - Islami Shariah based PCBs: There are **10 Islami Shariah based PCBs** in Bangladesh and they execute banking activities according to Islami Shariah based principles i.e. Profit-Loss Sharing (PLS) mode.

- Foreign Commercial Banks (FCBs): **9 FCBs** are operating in Bangladesh as the branches of the banks which are incorporated in abroad.

Break Even Analysis

[See the Pdf Material]