E-Content (Submitted To RTMNU e-Shiksha Portal, Rashtrasant Tukdoji Maharaj Nagpur University)

Unit – I

Chapter 1: Business Finance

Chapter Outline
Business Finance: Meaning, Nature, Significance, Objects and Scope of Business Finance, Functions of Financial Executive in an Organization. Recent Development and Reform in Finance Sector. **(Theory)**

Meaning Business Finance

Business cannot be start and run without money, every businesses requires the money. Whatsoever types of business may be? That may be large, small, manufacturing unit, service business etc. money is very essential to perform every activity of the business. Finance means to meet the requirement or the need of businesses in the economic world. Finance is called as life blood of business organisation because every activity of the businesses is depending on the finance. That business may be large, small or any type of business may be? In order to fulfil their business activity they need the finance.

In order to perform the every activity of the business what money is required this is called as finance. Therefore finance means requirement of money, procurement of fund and the proper utilization of the fund, so that business concerned will operate their businesses effectively, efficiently and smoothly. Without sufficient amount of finance business unit cannot move a single step ahead.

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In today's world, normally every activity of businesses is the economic activity therefore business activities are directly related to profit earning. And hence business concerned earning the profit through any activity. Finance may be called as cash; fund, capital and investment etc. because business concerned needs the finance to meet the requirements. But normally business tries to increase their profit because it is main economic activity of businesses.

Finance: finance is the technique of managing the money therefore It is may be defined as the art and science. Finance may be a fund, amount, cash, capital, investment, but every words having their own unique meaning. For the businessman it is very much necessary to understand the concept and importance of finance. Finance includes various financial instruments, financial services etc. Finance means provision of money when it is needed, procurement of fund and proper utilization of fund in the business.

According to ***Khan and Jain,*** "Finance is the art and science of managing money".

Business Finance: Business finance concerned with rising, administrating the need of business and fulfil them. It is also deal with effective and efficient utilization of fund. Whereas finance is mainly involves procurement, allocation and control of the fund

Definition:

According to the ***Guthumann and Dougall***, "Business finance can broadly be defined as the activity concerned with planning, raising, controlling, administering of the funds used in the business".

According to the ***Wheeler*****,** "Business finance is that business activity which concerns with the acquisition and conversation of capital funds in meeting financial needs and overall objectives of a business enterprise".

According to the ***Parhter and Wert,*** "Business finance deals primarily with raising, administering and disbursing funds by privately owned business units operating in non-financial fields of industry".

Nature (Characteristics, Features) of Business Finance

1. Business finance normally involves all the type of fund which is used in the business.

2. Business activity is not possible without finance; Financing is an essential business activity.

3. Business finance is needed in all types of organisations large or small, manufacturing or trading.

4. Small size business organisation needs lesser fund whereas large size business organisation needs larger fund.

5. Business finance includes borrowed fund and owned capital.

6. Business finance is a wider term; it includes planning, acquiring, utilising and managing the fund.

7. 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.

8. Business finance involves estimation of funds.

Significance (Importance, Needs) of Business Finance:

1. **To purchase fixed assets**: Business requires huge amount of money in order to purchase the fixed asset. Fixed asset means the asset which stay in the business more than a financial year, fixed assets are like machinery, land, plant, furniture, building etc.

2. **To meet the day to day expenses of business :** Businesses requires the fund to perform their day to day operations like payment of material , rent, electricity, wages, salary, telephone, taxes etc.

3. **To business growth:** Growth of business may include expansion of existing line of business as well as adding new lines. To finance such growth, one needs more funds.

4. **To bridge the time gap between production and sales:** what amount we invested in the production that will realize when only sales is made. Company require the money because expenses are continue to be incurred, because there is time gap between production and sales and also actual realization of cash.

5. **To meet contingencies:** Business is full of ups and down and some unforeseen problems, so need the money to solve such problem. Sometime there is shortage of raw material and vice versa, therefore he always have to keep sufficient money with him to meet such type of contingencies.

6. **To avail of business opportunities**: In business fund is always requires to avail various business opportunities. For example if company have to submit the tender and have to deposit the money with the application of tender. In such case if company don't have sufficient fund then would not be possible to submit the tender

7. **Helps to Acquisition of Funds:** Business finance involves the acquisition of required fund to the business concern. Firm always try to acquire the fund at minimum cost.

8. **Helps to Proper Use of Funds:** Proper use and allocation of funds leads to improve the operational efficiency of the business concern. Financial manager can reduce the cost of capital and increase the value of firm by proper utilization of fund.

9. **Helps to Improve Profitability:** Profitability of the concern purely depends on the effectiveness and proper utilization of funds by the business concern. By strong financial control devices like cost volume profit analysis, ratio analysis, budgetary control etc, the profitability can be increases.

Objectives of Business Finance

There are two broad objective of business finance or financial management that are as under.

1. **Profit Maximization:** Profit earning is the main motive of every business and it is economic activity. The main objective of business organization is to earn the profit so that cost will be cover and will start the growth in the fund. No business can survive without earning profit. Profit is the element through which businesses measure their efficiency. Therefore profit also serves as protection against risk in the business.

Profit is the main objective of business because profit enables the businesses to face the various types of risk. Financial management helps in devising ways and exercising appropriate cost controls which ultimately help in increasing profitability. The following elements are involved in maximising profits.

(i) Increase in Revenues:

(ii) Controlling Costs:

(iii) **Minimising Risks:**

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2. Wealth Maximization: Wealth maximization is the objective of business finance. In order to maximize the individual utility firm should maximize the stockholder wealth because it is the single substitute for stockholder utility**.** Stockholder current wealth in the firm means it is the product of number of share owned and price of per share.

. Given the number of shares that the stockholder owns, the higher the stock price per share the greater will be the stockholder's wealth. Therefore firm always wish to maximum current stock price. This objective helps in increasing the value of shares in the market. However, the maximization of the market price of the shares should be in the long run.

In order to increase the wealth it is much necessary to increase the current market price of the shares in the particular course of action. Normally financial decisions are based on cost benefit analysis therefore when benefit is more than cost then wealth will be maximise and vice-versa.

Wealth maximisation of the organisation is depending upon following some points.

(i) Interests of owners, (shareholders) as well as other stakeholders in the firm; i.e. suppliers of loaned capital, employees, creditors and society.

(ii) Owners' economic welfare.

(iii) Wealth maximisation implies long-run survival and growth of the firm.

(iv) Risk factor and the time value of money as the current present value of any particular course of action is measured.

(v) The effect of dividend policy on market price of shares is also considered as the decisions are taken to increase the market value of the shares.

Scope of Business Finance

Scope means the research or study that is covered by a subject. The scope of business finance is very broad concept.

1. Financial planning: A business firm must manage and make their financial analysis and planning. The financial manager should have the knowledge about different financial situation so that he can make the planning properly. If he have this basic information then he can manage the strategies and future financial situation of the firm properly in different economic scenario.

2. Financial Control: The financial budget serves as the basis of control over financial plans. Firm is always finding out the deviation between the plan and actual performance and bridge the gap by correct them. That's why financial control is possible.

3. Financial decision: this is also one of the scopes of business finance; to improve the profitability of the organization a strong and perfect financial decision is needed. So, through business finance it is possible to take the right decision about any activity of the business which is connected to finance.

4. Financial Statement Analysis: One of the scopes of business finance is to analyze the financial statements. It also analyses the financial situations and problems that arise in the promotion of the business firm..

5. Optimum return on Investment: While to ensure the proper and optimum return on the investment business finance is play a key role. If there is optimum return on investment the investor becomes very enthusiastic to invest the fund in the future in the organization.

6. Working capital Budget: The financial decision making that relates to current assets or short-term assets is known as working capital management. Short-term survival is a requirement for long-term success and this is the important factor in a business.

7. Wealth of owner's capital: it is the responsibility of business organization to maximize the wealth of the shareholder i. e. owners, increasing the wealth means to maximize the value of the share.

Functions of Financial Executive in an Organization

Financial executive is one of the important role players in the field of finance function. The position of financial manager is very important in he organisation therefore he requires the knowledge from every domain. A person who deals finance related activities may be called financial executive. Financial executive have to perform the following major functions in an organisation:

1. **Forecasting Financial Requirements:** It is the primary function of the financial executive. Financial manager have to make estimate that how much amount is needed to acquire the fixed assets and what fund will be require to meet the working capital need in the future.

2. **Procurement of Capital:** This is the second function of financial executive after deciding the financial requirement; the financial executive should concentrate how the finance is mobilized and where it will be available. It is also highly critical in nature.

3. **Investment Decision**: The financial executive has to carefully select best investment alternatives and consider the reasonable and stable return from the investment. He must have strong knowledge about capital budgeting and investment. The finance executive must concentrate to principles of safety, liquidity and profitability while investing capital.

4. **Cash Management:** cash management is very important to maintain the short term liquidity position of the company due to which cash can be effectively utilized.

5. **Interrelation with Other Departments**: Financial executives are deals with every department of the company therefore financial executive should have sound knowledge not only in finance related area but also well versed in other areas. There should be good relation of him with every department of the organisation.

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Recent Development and Reform in Finance Sector

There are major four elements of finance sector in India, like Banks, Financial Institutions, Instruments and markets through which resources are mobilised from surplus sector to channelized needy sector in the economy. The recent development and reforms in finance sector are broadly divided into following different area.

1. Reforms of Regulators.
2. Reforms of Indian banking sector.
3. Reforms of Non-banking finance companies.
4. Reforms of Insurance sector.
5. Reforms of capital market.
6. Reforms of Mutual funds.
7. Reforms of Foreign Exchange Market.
8. Overall approach to reforms

1. **Reforms of Regulators:** The Finance Ministry constantly formulated major strategies in the field of financial sector of the country. The Government acknowledged the important role of regulators. There is different regulator for different finance sector, like banking sector is control and manage by RBI, Insurance sector governed by IRDA(Insurance regulatory development authority), and security and stock market is control by SEBI(security and exchange board of India). Again one opinion is there should be super regulator whose will control whole finance sector in India.

2. **Reforms of Indian banking sector:** The main objective of banking sector reform was to diversified, efficient financial system which will improve the efficiency of resources. In India RBI have given the licence new private sector banks, Industrial houses, etc for making the liberalization though many banks yet to deliver the services to the small business, agriculture finance, retail trade, industrial finance etc. Major change observed by individuals is much transformation in policies of the banking sector..

The major reforms related to banking system are.....

- The banks which are based on capital, that will be grow by public equity, recapitalisation and subordinate dent.
- Prudential norms were introduced.
- Pre-emption of bank resources by government was reduced.
- Grand the licence to private sector banks and also branch licensing were relaxed.

Some operational reforms also introduced in the area of credit policy.

- Consortium regulations were relaxed substantially.
- Credit delivery from cash credit to loan credit.
- Maximum permissible bank finance was abolished

3. **Reforms of Non-banking finance companies (NBFCs):** The financial sector reforms measure has impact on the overall efficiency and stability of the Non-Banking Financial Corporation's in India. As soon as the new economic policy is introduced the banking concept is totally changed in India. It was measured fairly mature financial services practices in India particularly in Non-Banking Financial Corporation's (NBFCs) in terms of services offered by this sector. In Indian financial system NBFCs play a very vital role for enhancing competition, scattering risk, as a complementary banking system, diversification in financial sector etc. That's why NBFCs called as engine of growth of Indian financial market. Non-Banking Financial Corporation's in India represent a varied group of privately-owned, medium & small-sized financial intermediaries which offers a variety of services including equipment leasing, hire purchase, loans, investments and chit fund activities, loan against gold etc. NBFCs play important role to provide the finance to small borrower and unorganised sector in India.
4. **Reform of the Insurance Sector:** In India Insurance act is passed in 1938, life insurance corporation act is passed in 1956, general insurance business act was passed in 1972 and in order to control insurance sector the IRDA (Insurance regulatory development authority were formed in 1999. Like in banking sector, insurance sector was also liberalised in India. And therefore private sector participants enter in insurance sector and public sector monopoly were abolished.

Competitive insurance sector industries started providing different diversified financial products to fulfil the needs of customer and therefore start to increase the saving in the insurance sector. Due to increase in the insurance start to improve capital market in India, and then create the flow of finance in the corporate sector and start reducing the deficit. Therefore reforms in insurance sector give a spark to grow Indian financial sector.

5. **Reforms of capital market:** A capital market is not a compact unit, but a highly decentralized system made up of three major parts: (1) stock market, (2) bond market, and (3) money market. It also works as an exchange for trading existing claims on capital in the form of share. The capital market is deals in capital securities which are long term mean having more than one year period. Offer by both private businesses and government undertakings. Capital market is governed and regulated by government accredited organisation that is SEBI (security and exchange board of India).
    1. Primary market: The market where fresh or firsthand securities are bought and sold this is called as primary market. There are four ways ti raised the capital from primary market like, right issue, private placement, bonus issue and prospectus etc.
    2. Secondary market: secondary market is the market where second hand securities are bought and sold. Secondary market determines the fair price of the security. Secondary market comprises debt market and equity market.
    3. Money market: the market where most liquid able and short term marketable securities having maturity period less than one year are bought and sold this market is called as money market. Various money market instruments like, commercial paper, treasury bill, call money, certificate of deposit etc.

Some latest and recent development in the Indian capital market as per below:

- Establishment of security and exchange board of India (SEBI) in 1988 and got the legal status in 1992.
- Establishment of credit rating agencies in India like, CRISIL in 1988, ICRA in 1991 and CARE etc.
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- The merchant Banking Activity was increases.

- Increases foreign Institutional Investors because due to growing speed of Indian economy in last few years.
- Due to technological advancement increase the electronic transactions and paper work.
- Initially in India there was only Bombay stock exchange (BSE), but now a days number of stock exchanges increase in India. NSE(National stock exchange) also set up in India.
- In India central government set up investor education and protection fund in 2001 therefore got the protection to the investors under the SEBI.
- Since 2000 derivative transaction was increases because NSE introduces derivative transactions in equities.
- In India Multi commodity exchange (MCX) was set up an started trading in various commodities.

6. **Reforms of Mutual funds:** By the year 1970, the industry had 361 Funds with combined total assets of 47.6 billion dollars in 10.7 million shareholder's account. From 1970 mutual fund industry as adversely affect by growth because of many reason like stock market stagnation, inflation, rising interest rates, some other reservation about profitability of mutual fund etc. Therefore there were need to introduce new types of mutual fund, innovation is made like funds with no sales commission means "No load fund", in 1971 fund is started that is money market mutual fund and then started attracting to small and individual investor to the mutual fund.
7. **Reforms of Foreign Exchange Market**: Foreign exchange market reforms started in India from 1993 under this reform bank have been given the power to perform the activity and various operations. Additionally, the entry of new companies has been allowed in the market. And therefore foreign exchange becomes easier in India.
8. **Overall approach to reforms:** In India improvement if financial market contributors, regulatory authority and government also following good approaches, entry of foreign multinational companies, technological development, interbank interest rate benchmark, debt market and derivative market developed, such types of overall reform in Indian economy carried out.

Theory Questions:

1. What is Business finance? Explain its Nature.
2. Explain the concept of business finance with its significance.
3. Illustrate objectives and scope of business finance with meaning.
4. What functions have to perform to financial executive in an organisation?
5. Discuss in detail recent reforms in financial sector in India.
6. Write short note on business finance.