Group 4

MANAGING THE FINANCE FUNCTION


GOING OUT
OF BUSINESS
GOING OUT
BUSINESS
CLOSING THIS STORE
GOING OUT OF BUSINESS

IMPORTANCE OF FINANCIAL MANAGEMENT

1. Ensures a business has enough money to operate.
2. Helps businesses avoid debt and financial failure.
3. Guides business growth and expansion.

WHAT DO YOU THINK HAPPENS TO A BUSINESS THAT DOESN'T MANAGE ITS FINANCES WELL?

TOPIC OVERVIEW

1. What the Finance Function Is
2. The Determination of Fund Requirements
3. Sources of Funds
4. The Best Source of Financing
5. The Firm's Financial Health
6. Indicators of Financial Health
7. Risk Management and Insurance

WHY DO YOU THINK FINANCIAL MANAGEMENT IS IMPORTANT, EVEN IF YOU'RE NOT A BUSINESS OWNER?

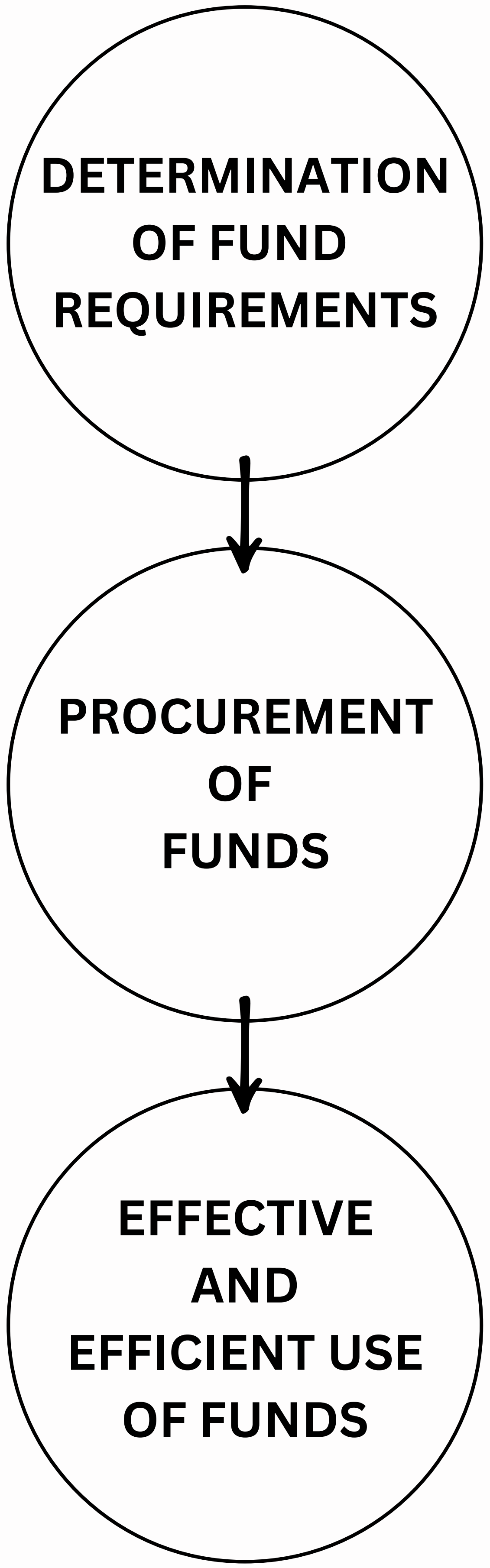
WHAT THE FINANCE FUNCTION IS

FINANCE FUNCTION

- deals with the "procurement and administration of funds with the view of achieving the objectives of businesses."

FINANCE FUNCTION

- one of the three basic management functions. The other two are "production" and "marketing."



1. **Short-term**
2. **Long-term**

1. **Short-term**
2. **Long-term**

1. **Short-term**
2. **Long-term**

The Finance Function: A Process Flow

1. Determination of Fund Requirements

- The finance function analyzes the organization's operational needs, including capital expenditures, working capital requirements, and ongoing expenses.

DETERMINATION OF FUND REQUIREMENTS

1. Short-term
2. Long-term

PROCUREMENT OF FUNDS

1. Short-term
2. Long-term

EFFECTIVE AND EFFICIENT USE OF FUNDS

1. Short-term
2. Long-term

The Finance Function: A Process Flow

2. Procurement of Funds

- The finance function explores internal sources of funding, such as retained earnings, cash reserves, and internal borrowing.

- If internal sources are insufficient, the finance function may seek external funding through debt financing (loans, bonds), equity financing (issuing shares), or other sources.

DETERMINATION OF FUND REQUIREMENTS

1. Short-term
2. Long-term

PROCUREMENT OF FUNDS

1. Short-term
2. Long-term

EFFECTIVE AND EFFICIENT USE OF FUNDS

1. Short-term
2. Long-term

The Finance Function: A Process Flow

3. Effective and Efficient Use of Funds

- The finance function implements effective cash management practices to optimize cash flow and ensure that funds are available when needed.
- The finance function prepares financial statements and reports to track the organization's financial performance and ensure compliance with regulatory requirements.

THE DETERMINATION OF FUND REQUIREMENTS

Any organization, including the engineering firm, Will need funds for the following specific req~ements:

1. to finance daily operations
2. to finance the firm's credit services
3. to finance the purchase of inventory
4. to finance the purchase of ml\ior assets

FINANCING DAILY OPERATIONS

- The day-to-day operations of the engineering firm will require funds to take care of expenses as they come. Money must be made available for the payment of the following:

1. wages and salaries
2. rent
3. taxes
4. power and light

5. marketing expenses like those for advertising, entertainment, travel expense
6. administrative expenses like those for auditing, legal, setvices, etc.

- Any delay in the settlement ofthe foregoing expenses may disrupt the effective flow of work in the company. It may also erode the public's confidence in the ability of the company to operate on a long-term basis. Creditors, for instance, may withhold the extension of credit to the company.

FINANCING THE FIRM'S CREDIT SERVICES

It means figuring out how a company will cover the cost of letting customers buy now and pay later.

- It is oftentimes unavoidable for firms to extend credit to customers. If the engineering firm manufactures products, sales terms vary from cash tp 90-day creclit extensions to customers. Construction firms will have to finance the construction of government projects that will be paid many months later.

WAYS A COMPANY CAN FINANCE CREDIT SERVICES:

- Using Company Funds – If the company has enough cash reserves, it can temporarily cover expenses while waiting for customer payments.
- Bank Loans – The company can borrow money from banks or financial institutions to maintain operations while waiting for payments.
- Supplier Credit – Some suppliers allow delayed payments, giving the company time to collect money from customers first.

- Factoring – The company can sell its unpaid invoices to a factoring company at a discount to get cash immediately.
- Lines of Credit – A business can arrange a credit line with a bank to use when needed for cash flow gaps.

FINANCE THE PURCHASE OF INVENTORY

INVENTORY INCLUDES:

Raw Materials

Supplies

Parts

IMPORTANCE

ENSURING OPERATIONAL CONTINUITY

- Companies must keep raw materials and supplies in storage to avoid production delays.

PREVENTING SUPPLY CHAIN DISRUPTIONS

- Timely availability of inventory ensures smooth workflow and meets customer demand.

REDUCING LEAD TIMES

- Having materials on hand minimizes waiting periods for restocking.

DISADVANTAGE

SIGNIFICANT CAPITAL REQUIREMENT

- Purchasing inventory requires substantial financial investment.

RISK OF OVER-TYING FUNDS

- Excess inventory may lock up funds that could be used elsewhere in the business.

FINANCE THE PURCHASE OF MAJOR ASSET

INVENTORY INCLUDES:

Land

Plant

Equipment

IMPORTANCE

SUPPORTING BUSINESS EXPANSION

- Enables firms to scale operations and increase production capacity.

ENHANCING EFFICIENCY AND COMPETITIVENESS

- Upgrading equipment and facilities improves productivity.

LONG-TERM VALUE CREATION

- Major assets contribute to sustained business growth and stability.

Financing of the purchase of major assets must come from long-term sources.

DISADVANTAGE

HIGH INITIAL COSTS

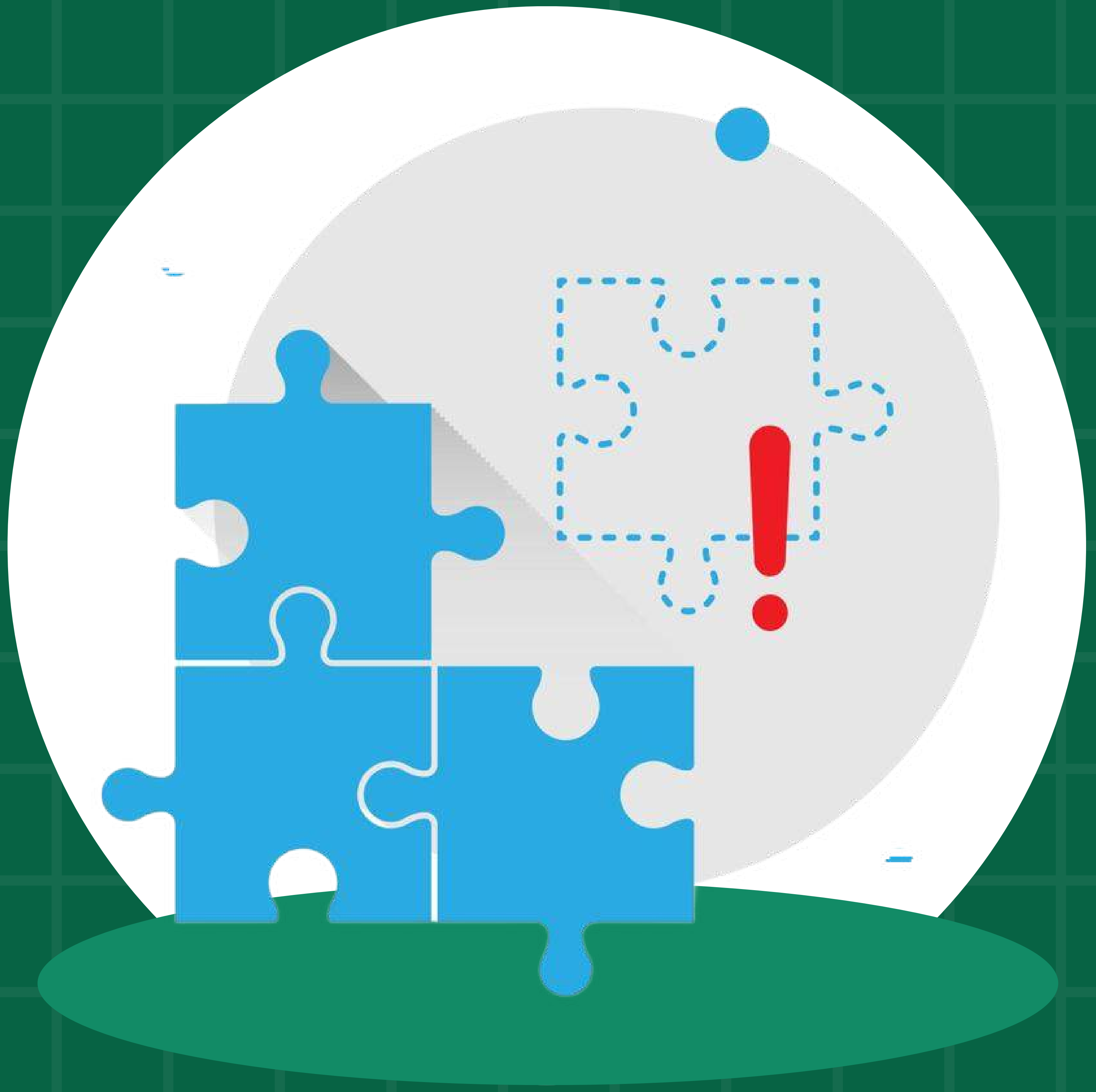
- Purchasing major assets such as real estate, equipment, or technology requires a large upfront investment, which can strain cash flow

INTEREST RATE FLUCTUATIONS

- If financing is done through variable-rate loans, rising interest rates can increase repayment costs.

UNDERUTILIZATION

- If the asset is not used efficiently, it may not generate enough revenue to justify the investment.



SOURCES OF FUNDS

Engineering firms require funds to operate, expand, and manage projects.

CASH SALES

- cash inflows when firm sells its products or services
- e.g. payment for a building design services

COLLECTION OF ACCOUNTS RECEIVABLE

- cash received from customers who bought on credit
- e.g. client pays the balance for a project

LOANS & CREDITS

- borrowing from financial institutions when funds are insufficient
- e.g. bank loan

SALES OF ASSETS

- selling company assets to generate funds
- e.g. selling an old excavator to raise funds

OWNERSHIP CONTRIBUTION

- additional funds from owners or partners to support the business
- e.g. business partners invest more capital for a new project

ADVANCES FROM CUSTOMERS

- customers pay a portion of the cost before work begins
- e.g. client pays a percentage of down payment

SHORT-TERM SOURCES OF FUNDS

Short-term sources of funds are those with repayment schedules of **less than one year**. These funds are used to cover **immediate financial needs**.

SUPPLIES OF SHORT-TERM FUNDS

- TRADE CREDIT
- COMMERCIAL BANKS
- COMMERCIAL PAPER HOUSES
- BUSINESS FINANCE COMPANIES
- FACTORS
- INSURANCE COMPANIES

TRADE CREDIT

Suppliers extend credit for manufacturing, processing, or reselling goods for profit.

SELL

BUY

INTRUMENTS USED:

1. Open-Book Credit
2. Trade Acceptance
3. Promissory Notes

SELL

BUY

OPEN-BOOK CREDIT

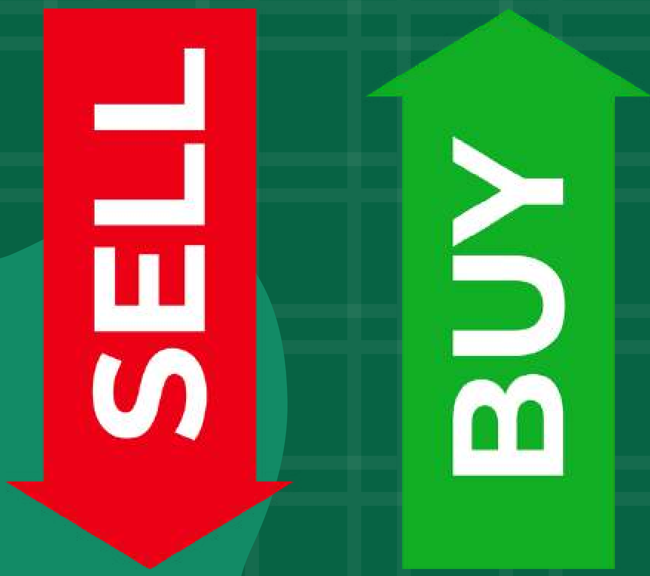
- unsecured and permits the customer to pay for goods delivered to him in a specified number of days.

TRADE ACCEPTANCE

- a time draft (a written order to pay) drawn by the seller upon the buyer. The buyer accepts the draft to acknowledge the debt and agrees to pay at a specified time.

PROMISSORY NOTE

- Unconditional written promise to pay a sum on demand or at a set time.



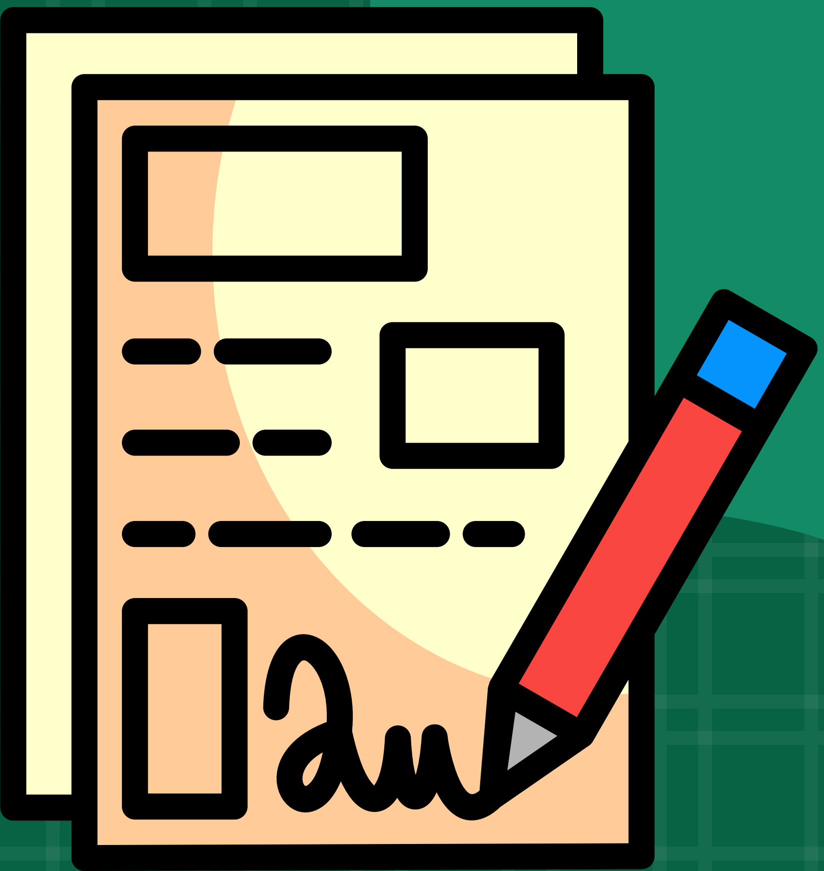
COMMERCIAL BANKS

Institutions which individuals or firms may tap as source of short-term financing.

- ☑ WITH COLLATERAL
- ☑ WITHOUT COLLATERAL

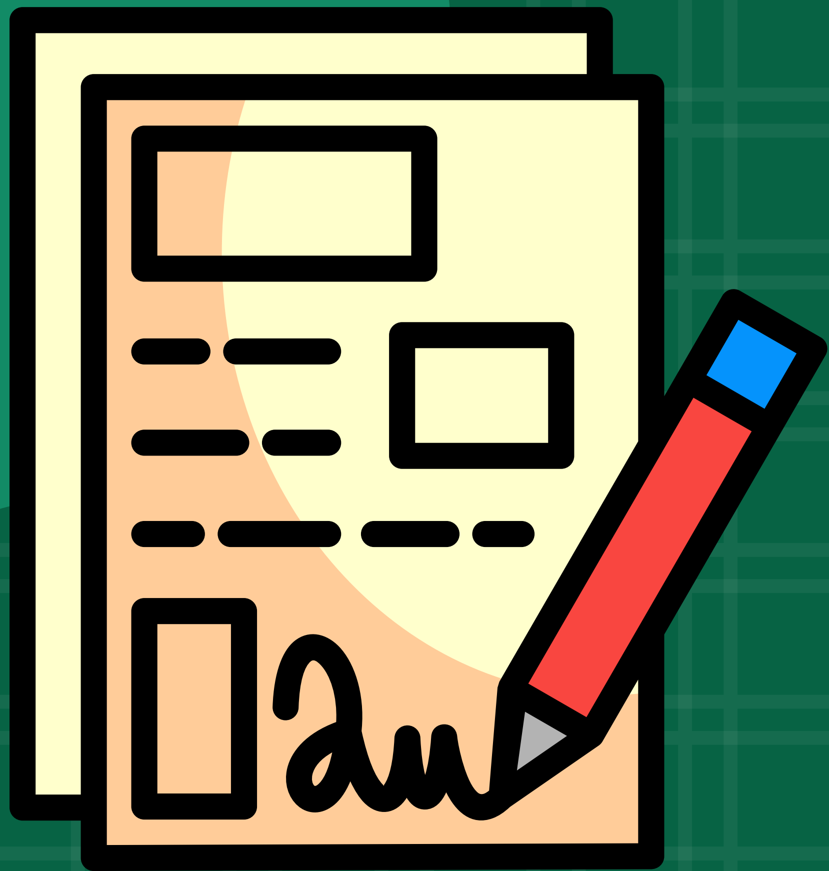
COMMERCIAL PAPER HOUSES

Help business firms in borrowing funds from the money market through commercial paper.



BUSINESS FINANCE COMPANIES

Financial institutions that finance inventory and equipment of almost all types and sizes of business firms.



FACTORS

Institutions that buy the accounts receivables of firms, assuming complete accounting and collection responsibilities.

INSURANCE COMPANIES

Invest in short-term commercial papers and promissory notes for short-term funding.

ADVANTAGES OF SHORT-TERM CREDITS

Short-term sources of funds are those with repayment schedules of <u>less than one year</u>. These funds are used to cover <u>immediate financial needs</u>.

1 Easier to obtain

- The risks involved in short-term lending is also short-term. Thus, short-term credits are made easily available to qualified borrowers

2 Less costly

- Since short-term financing is favored by creditors, they make it available at less cost

3

Flexible

- Short-term financing offers flexibility to the borrower. After the borrower has settled his short-term debt, he may consider other means of financing.

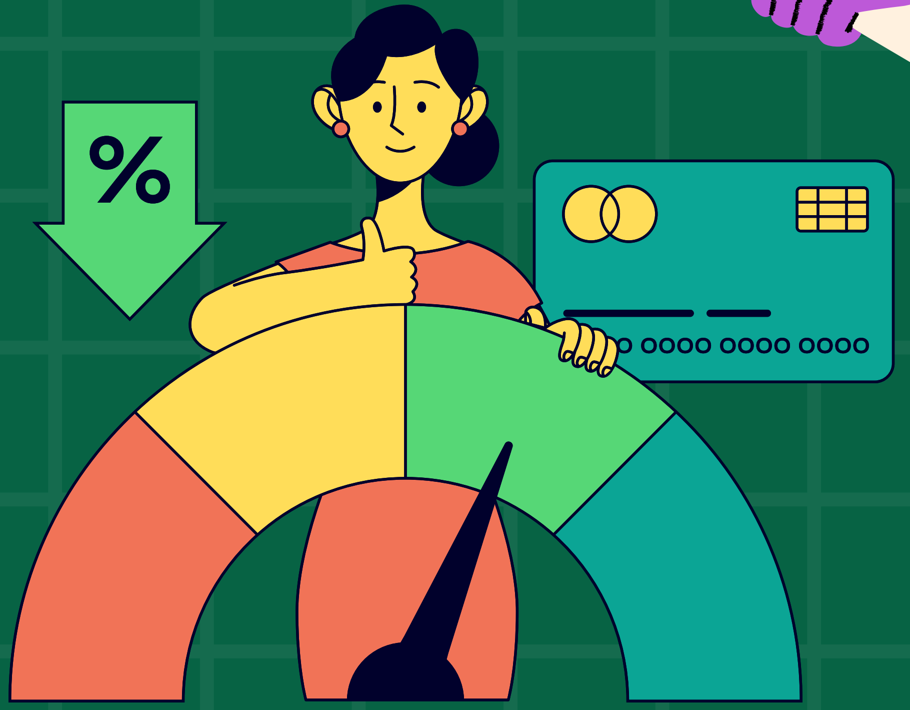
DISADVANTAGES OF SHORT-TERM CREDITS

1 Mature frequently

- When the frequency of the firm's cash inflows are more than twelve months apart, there's a possibility of the firm not being able to meet its short-term obligations.

2 May, at times, be more costly than long-term

- When short-term debts are used to finance long-term expenditures, the frequent renewals, adjustment of terms, and shopping for new sources may prove to be more costly



LONG TERM SOURCES OF FUNDS

Long-term source of funds is classified as:

1. Long- Term Debts

2. Common Stocks

3. Retained Earnings

1. Long term Debts:

- A Company's debts that has maturity <u>over a year</u> and expanding with in <u>30 years.</u>

2 types Long term Debts

<u>Term Loan</u>

"commercial loan from a commercial bank, commonly used for plant and equipment, working capital, etc."' Term loans have maturities of 2 to 30 years.•

2 types Long term Debts

<u>BONDS</u>

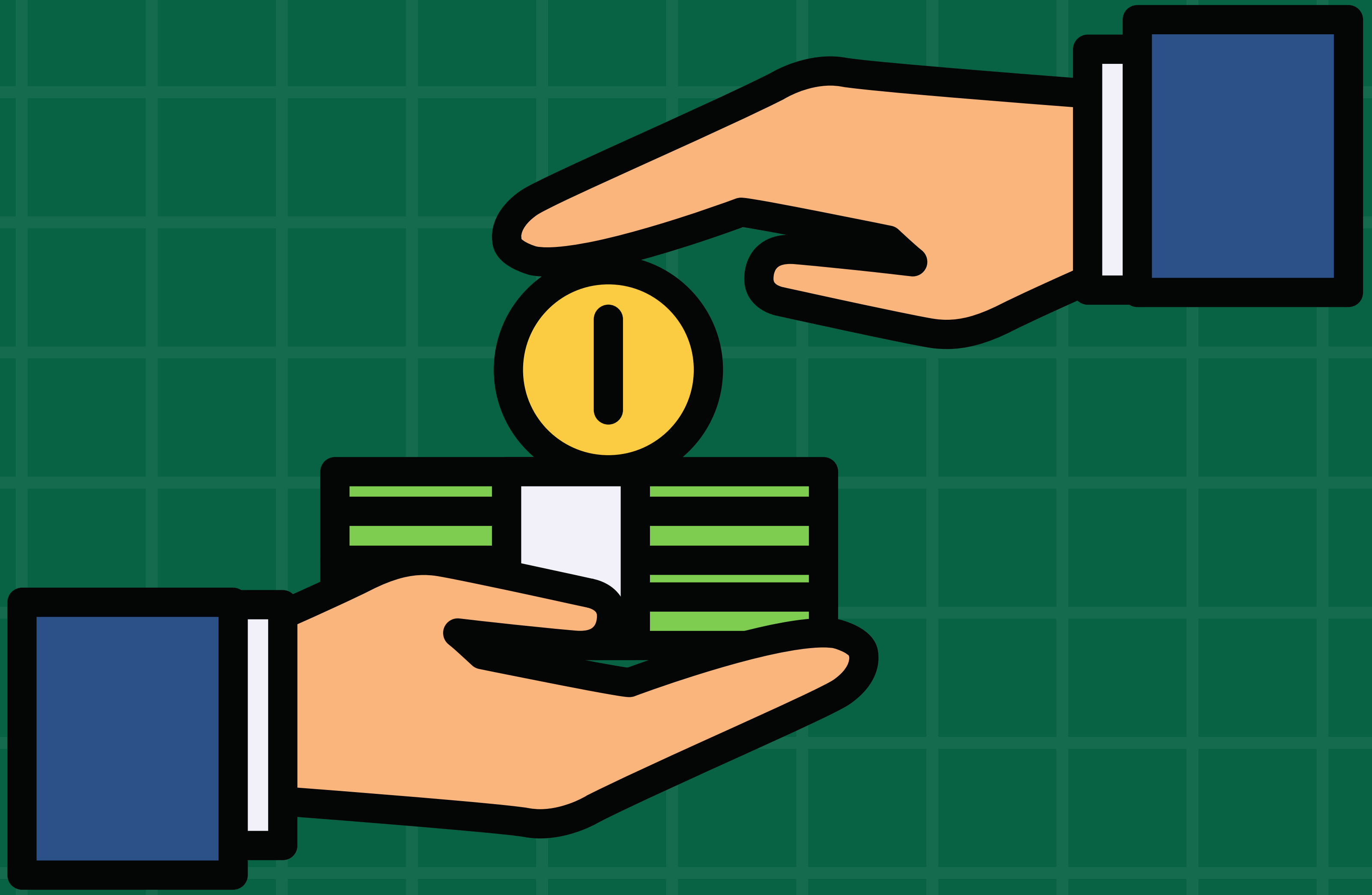
A bond is a certificate of indebtedness issued by a corporation to a lender. It is a marketable security that the firm sells to raise funds.

Types of Bonds

1. Debentures
2. Mortgage Bond
3. Collateral Trust Bond
4. Guaranteed Bond
5. Subordinated Debentures
6. Convertible Bonds
7. Bonds with Warrants
8. Income Bonds

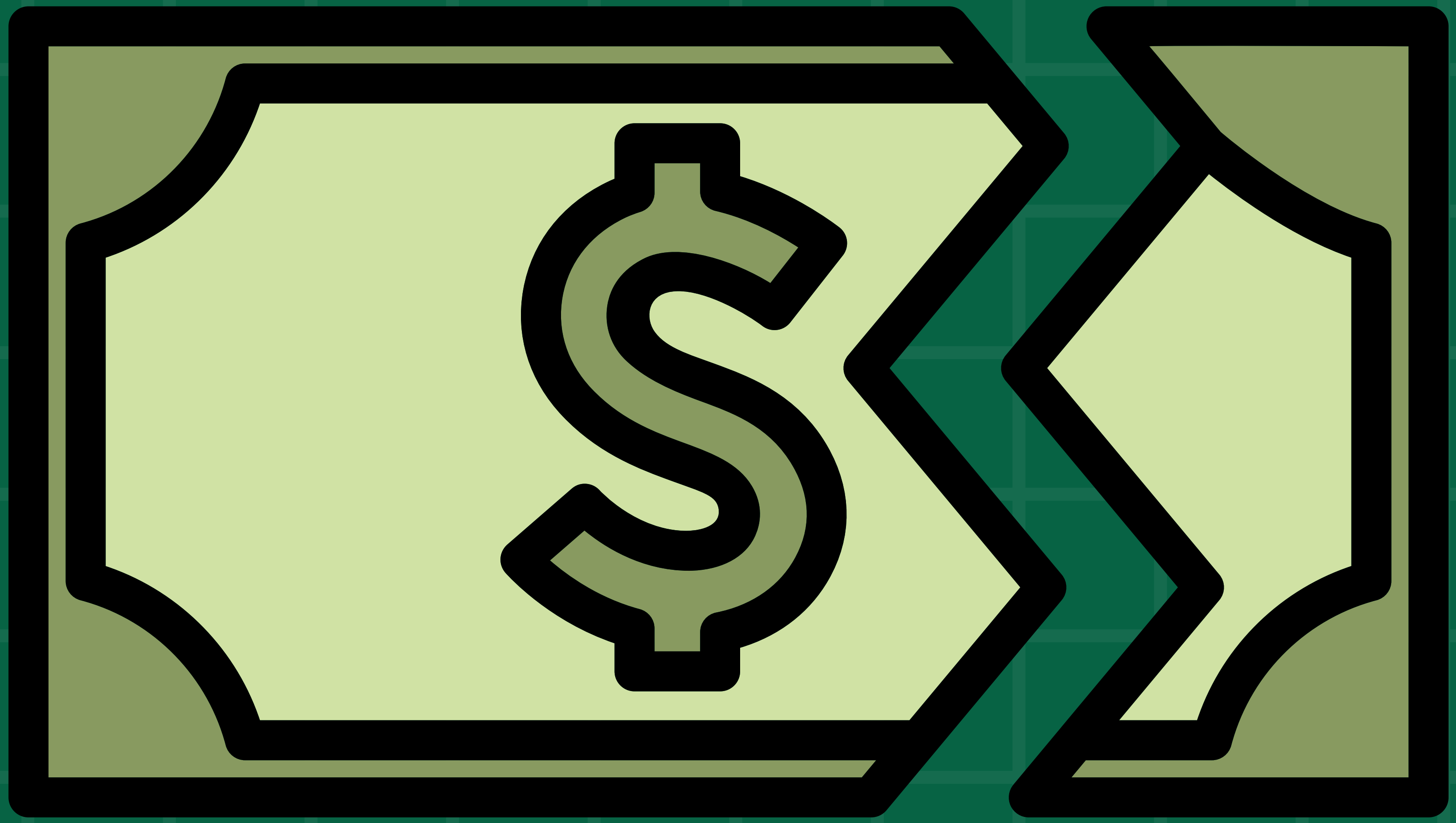
2. Common Stocks

- Basically the share of a person to the company's ownership.



3. Retained Earnings

- the part of a company's profits that are not paid out as dividends to shareholders.



THE BEST SOURCE OF FINANCING

Factors

(Schall and Haley)

1. Flexibility

- short-term fund sources offer more flexibility than long-term sources

Example: Collaterals

1. Flexibility

- short-term fund sources offer more flexibility than long-term sources

Example: Collaterals

2. Risk

- chance that the company will be affected adversely when a particular source of financing is chosen.

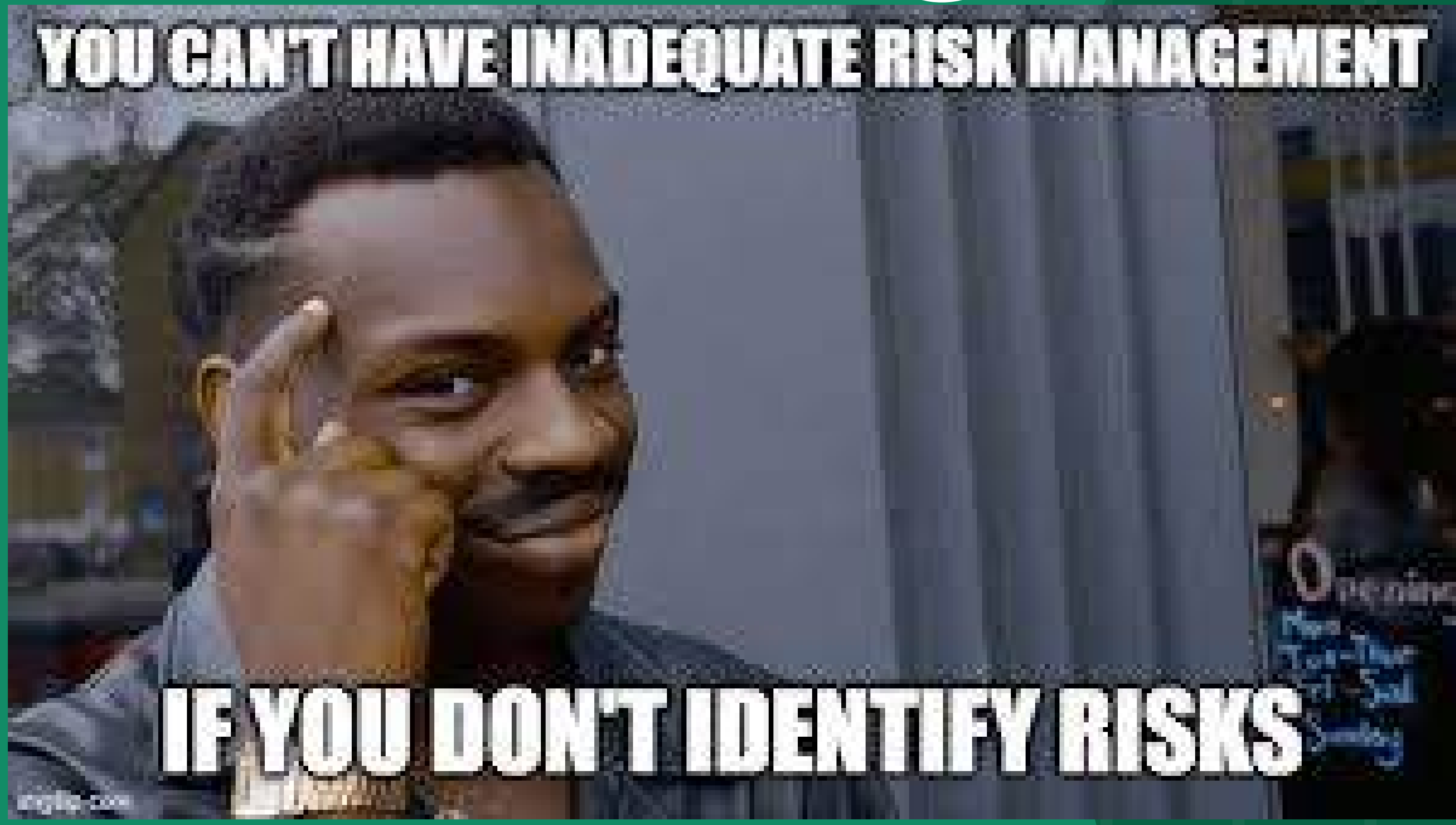
Example: Interest rate risk, operational risk, reputation risk

bahay, lupa, alahas

2. Risk

- chance that the company will be affected adversely when a particular source of financing is chosen.

Example: Interest rate risk, operational risk, reputation risk



bahay, lupa, alahas

3. Income

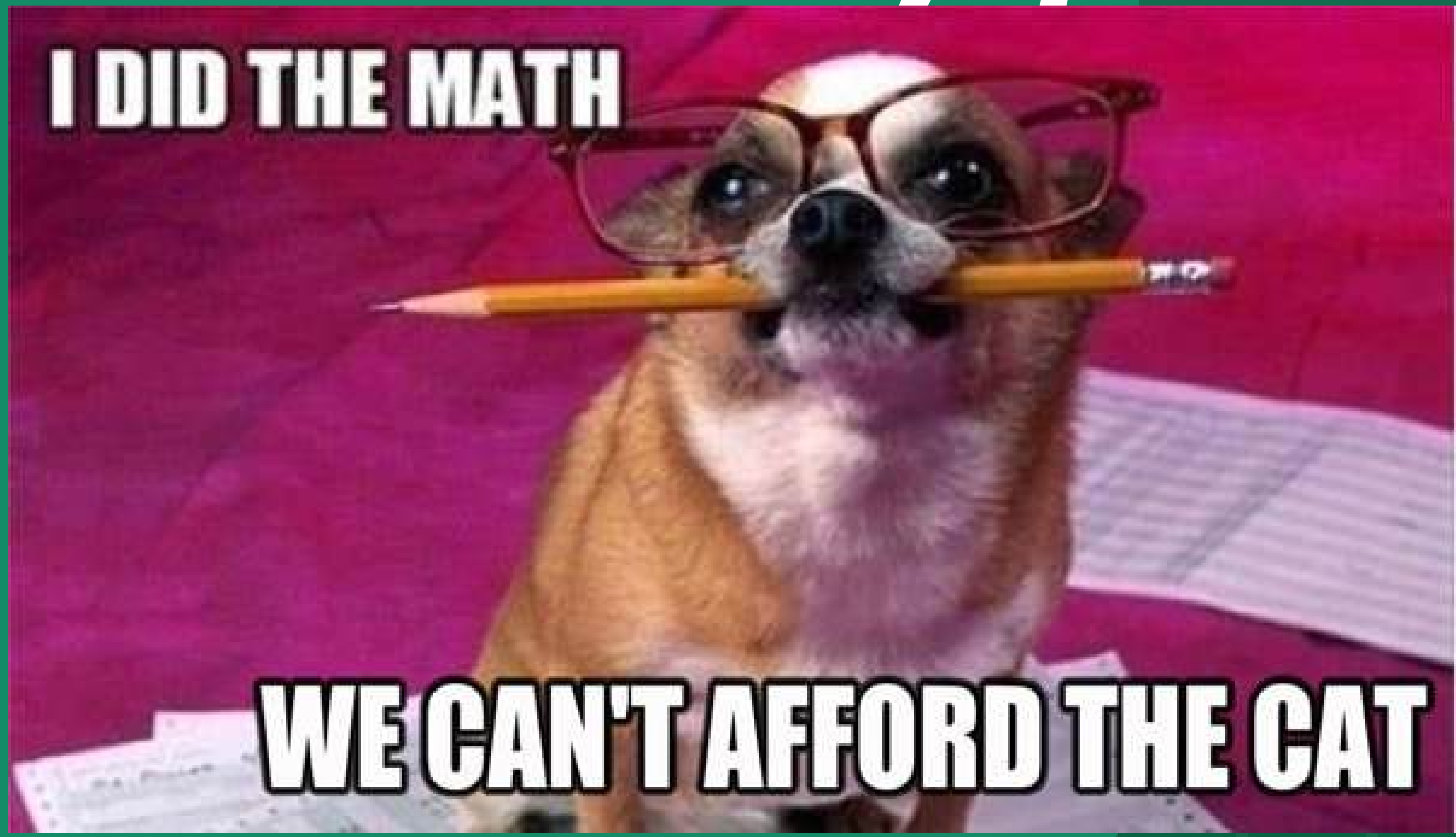
- it must generate enough income to cover the cost of borrowing and still be left with sufficient returns for the owners

Example: Budgeting

bahay, lupa, alahas

3. Income

- it must generate enough income to cover the cost of borrowing and still be left with sufficient returns for the owners



Example: Budgeting

bahay, lupa, alahas

4. Control

- current group of owners may lose control of the firm
- consider other means of financing

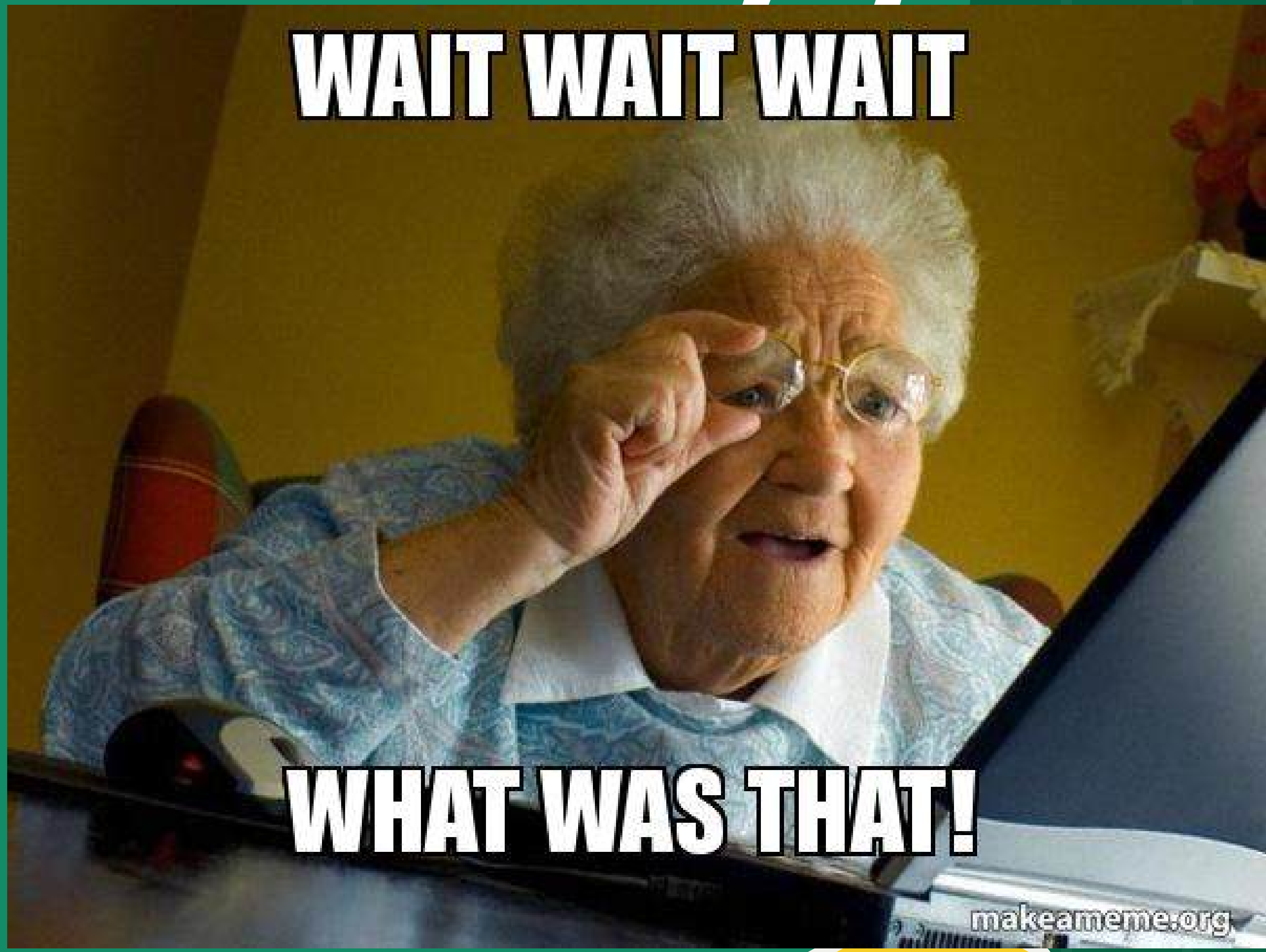
Example: Private equity

bahay, lupa, alahas

4. Control

- current group of owners may lose control of the firm
- consider other means of financing

Example: Private equity



bahay, lupa, alahas

5. Timing

- there are times when certain means of financing provide better benefits than at other times.

Example: Interest rate discount, cash back incentives, free consultation, limited-time offers

bahay, lupa, alahas

5. Timing

- there are times when certain means of financing provide better benefits than at other times.

Example: Interest rate discount, cash back incentives, free consultation, limited-time offers

bahay, lupa, alahas

6. Other Factors

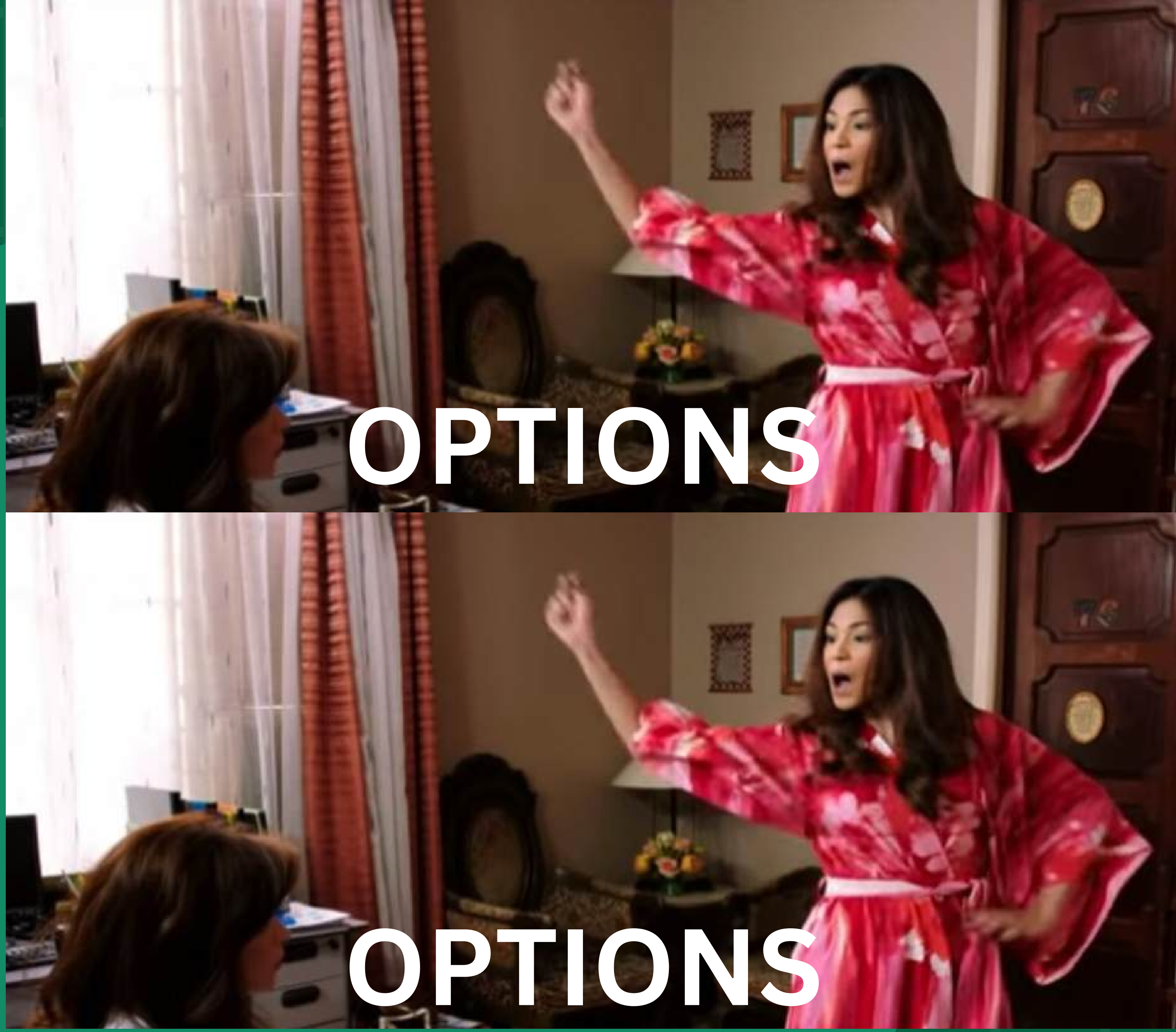
1. Collateral values: Are there assets available as collateral?
2. Flotation cost: How much will it cost to issue bonds or stocks?
3. Speed: How fast can the funds required be raised?
4. Exposure: To what extent will the firm be exposed to other parties?

6. Other Factors

1. Collateral values: Are there assets available as collateral?
2. Flotation cost: How much will it cost to issue bonds or stocks?
3. Speed: How fast can the funds required be raised?
4. Exposure: To what extent will the firm be exposed to other parties?

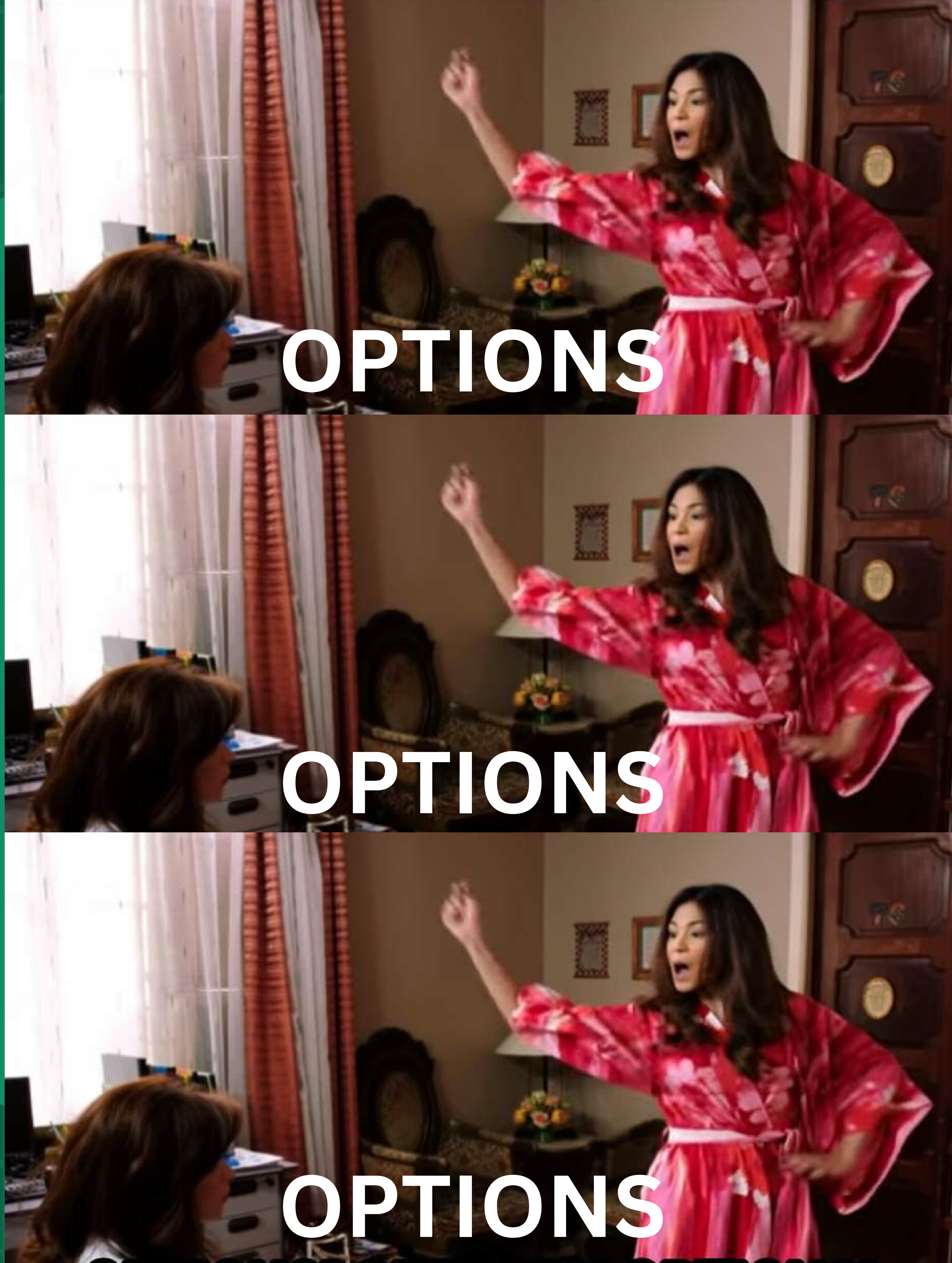
6. Other Factors

1. Collateral values: Are there assets available as collateral?
2. Flotation cost: How much will it cost to issue bonds or stocks?
3. Speed: How fast can the funds required be raised?
4. Exposure: To what extent will the firm be exposed to other parties?



6. Other Factors

1. Collateral values: Are there assets available as collateral?
2. Flotation cost: How much will it cost to issue bonds or stocks?
3. Speed: How fast can the funds required be raised?
4. Exposure: To what extent will the firm be exposed to other parties?



THE FIRM'S FINANCIAL HEALTH

Definition

refers to its ability to generate profit, meet financial obligations, and sustain long-term operations.

In general, the objectives of engineering firms are as follows:

1. To make profits for the owners
2. To satisfy creditors with the repayment of loans plus interest
3. Maintaining the firm's viability ensures continuous service for customers, job security for employees, and a stable market for suppliers

INDICATORS OF FINANCIAL HEALTH

Definition

Indicators of financial health refer to key financial statements used to assess a company's stability and performance. These include the balance sheet (financial position), income statement (operations), and statement of changes in financial position (cash flow and equity changes)

- Balance sheet – It shows a company's assets, liabilities, and equity at a specific time, helping assess its financial health.

XYZ COMPANY
Balance Sheet
12/31/2017

ASSETS	
Current Assets:	
Cash	$12,000
Accounts Receivable	35,000
Inventory	120,000
Prepaid Rent	8,000
Total Current Assets	$175,000
Long-Term Assets	
Land	$126,000
Buildings & Improvements	300,000
Furniture & Fixtures	50,000
General Equipment	125,000
Total Fixed Assets	$601,000
TOTAL ASSETS	**$776,000**
LIABILITIES	
Current Liabilities:	
Accounts Payable	$60,000
Taxes Payable	25,000
Salaries/Wages Payable	30,000
Interest Payable	25,000
Total Current Liabilities	$140,000
Long Term Liabilities:	
Loan 1	$322,000
Total Long Term Liabilities	$322,000
TOTAL LIABILITIES	**$462,000**
OWNER'S EQUITY	
Paid in Capital	$64,000
Retained Earnings	250,000
TOTAL OWNER'S EQUITY	**$314,000**
TOTAL LIABILITIES & OWNER'S EQUITY	**$776,000**

- Income statement – It shows a company's revenues, expenses, and profits over a period, measuring its financial performance.

Sample Products Co.
Income Statement
For the Five Months Ended May 31, 2018

Sales		$100,000
Cost of goods sold		75,000
Gross profit		25,000
Operating expenses		
Selling expenses		
Advertising expense	2,000	
Commissions expense	5,000	7,000
Administrative expenses		
Office supplies expense	3,500	
Office equipment expense	2,500	6,000
Total operating expenses		13,000
Operating income		12,000
Non-Operating or other		
Interest revenues		5,000
Gain on sale of investments		3,000
Interest expense		(500)
Loss from lawsuit		(1,500)
Total non-operating		6,000
Net Income		$ 18,000

• Statement of changes in financial position - It shows how a company's cash, equity, and liabilities change over time, tracking fund sources and usage.

SAMPLE COMPANY
Statement of Financial Position
March 31, 2023
(Amounts in Dollars)

ASSETS		
Current assets		
Cash	45,000	
Accounts receivable, net	3,300	
Office supplies	500	
Total current assets		48,800
Noncurrent assets		
Equipment, net	22,020	
Vehicles, net	31,200	
Total noncurrent assets		53,220
Total assets		**102,020**
LIABILITIES AND EQUITY		
Liabilities		
Accounts payable	6,000	
Accrued expenses	1,500	
Utilities payable	3,360	
Total liabilities		10,860
Owner's equity		
You, capital		91,160
Total liabilities and equity		**102,020**

ACCOUNTDEMY

RISK MANAGEMENT AND INSURANCE

Definition

Risk refers to the uncertaintiy concerning loss or injury. The engineering firm is faced with a long list of exposure to risks, some of which are as follows:

1. fire
2. theft
3. floods
4. accidents
5. nonpayment of bills by customers (bad debts)
6. disability and death
7. damage claim from other parties.

TYPES OF RISK

PURE RISK

- "there is only a chance of loss."
- with no possibility of gain.
- insurable and may be covered by insurance.

Ex. Risk of a company's motor car being stolen.

SPECULATIVE RISK

- Involves the possibility of both loss and gain.
- This type of risk is not insurable, requires knowledge and management skills.

Ex. Risk in investing in stocks.

RISK MANAGEMENT

Risk management is "an organized strategy for protecting and conserving assets and people."The purpose of risk management is "to choose intelligently from among all the available methods of dealing with risk in order to secure the economic survival of the firm"

Risk management is designed to deal with pure risks, while the application of sound management practices are directed towards speculative risks that are inherent and cannot be avoided.

METHODS OF HANDLING RISKS

There are several methods to deal with risk effectively:

1. Risk Avoidance
2. Risk Retention
3. Hazard Reduction
4. Loss Reduction
5. Risk Shifting

RISK AVOIDANCE

- One way to handle risk is by avoiding it altogether.
- e.g. not purchasing a property

RISK RETENTION

Risk retention occurs when an organization or individual decides to bear the risk. This can be:

- Planned (Self-insurance)
- Unplanned (Unidentified risks)

HAZARD REDUCTION

- Implementing preventive measures to reduce risks.

LOSS REDUCTION

Minimizing severity of losses through strategies such as:

- Separating buildings
- Storing inventory in multiple locations
- Maintaining duplicate records

RISK SHIFTING

Transferring risk to another party through:

- Hedging
- Subcontracting
- Incorporation
- Insurance

WHICH RISK MANAGEMENT METHOD IS THIS?

1. A construction company refuses to take on projects in earthquake-prone areas to avoid potential structural failures and safety hazards.
2. A contractor decides not to purchase insurance for minor equipment damages, believing the cost of repairs is low and manageable.
3. A bridge construction project requires workers to wear safety harnesses and helmets to prevent falls and head injuries.
4. A high-rise building is designed with an advanced fire suppression system and emergency exits to minimize damage in case of a fire.
5. A road construction company purchases insurance to cover any claims related to worker injuries or project delays.

SUMMARY

1. Why is financing an engineering firm an important management activity?

A) It helps in designing projects more efficiently

B) It ensures that funds are available when needed

C) It focuses only on reducing operational costs

D) It guarantees that all employees receive bonuses

2. What is the first concern in financial management?

A) Determining the best investment opportunities

B) Identifying the exact amount of fund requirements

C) Finding external investors immediately

D) Reducing the number of employees to save money

3. Why is it important to analyze different sources of funding?

A) Each source has its own strengths and limitations

B) All sources provide the same benefits

C) It is illegal to use multiple funding sources

D) Only banks can provide financing for engineering firms

4. What should an engineering firm do when internal funds are insufficient?

A) Shut down operations temporarily

B) Seek external sources such as loans and credit

C) Reduce employee salaries to save costs

D) Invest in unnecessary assets

5. Which of the following is NOT a factor in determining the best source of financing?

A) Flexibility

B) Risk

C) Employee satisfaction

D) Timing

6. Which of the following is NOT a broad category of financial health indicators?

A) Liquidity

B) Efficiency

C) Popularity

D) Profitability

7. Why is risk management important in financial management?

A) It helps protect assets and human resources

B) It increases the cost of operations

C) It guarantees a company will never face financial losses

D) It is only needed for large corporations

8. Which of the following is NOT a method of handling risks?

A) Risk avoidance

B) Risk shifting

C) Loss reduction

D) Profit maximization

THANK YOU

+123-456-7890 www.reallygreatsite.com 123 Anywhere ST., Any City