Business finance – it is a continuous process in which management must undertake where critical decisions are made while taking advantage of available opportunity

A business must invest on assets so owners have to make proper financial decisions on assets to buy that will generate maximum returns or maximum growth

Roles of managers in financial decision making

1. Tasked with role of managing funds and decisions around capital budgeting
2. Sourcing for funds – decide on the most affordable source of finance with regards to business needs
3. Allocation of the funds
4. Monitoring role

Financial decision-making process

1. Defining objectives – clear outcomes from the decision
2. Identify possible courses of action- list all possible options that can be taken
3. Analyzing data- make comparisons i.e. advantages and advantages
4. Decision implementation -decide on options with ma returns with min risks
5. Monitor effect of the decision

Business goals/firm goals

1. Maximization of profit
2. Maximization on return of capital
3. Survival of business
4. Growth of business
5. Maximization of shareholders worth

Agency theory - attempts to explain and resolve disputes between principals and their agents

Agency relationships

1. Shareholders and company executives
2. Investors and fund managers
3. Board of directors and CFO
4. Shareholders and creditors

Sources of finance

1. Owners’ investment
2. Funds from investors and banks
3. Crowd sourcing
4. Debentures – type of bond or debt with no collateral
5. Ordinary shares
6. Leasing

Time value of money

Compounding refers to practice of money increasing in value due to interest

Terms in compounding

1. Interest – amount demanded from that sacrificed for example 2000 as principal and 3000 as returned interest is 1000
2. Principal this is the base money or seed money
3. Time – duration when investment is earning return

Compound interest =

Future value = NB = annually = 12, quarterly = 4 semi = 2

Future value of annuity =

Present value of lump sum=

Present value of annuity =

Net present value = present value of future – initial investment

Profitability index

Present value of future cashflows\initial investment

Payback period = initial investment\net present value

Financing decisions and sources

Advantages of debt financing

1. Fast to obtain
2. Owners have maximum control of business (unless can’t repay)
3. Interest on debt is tax deductible

Disadvantages

1. The interest has to be repaid on time yet sometimes cashflows not able to support
2. Interest rate being a variable the debt may balloon
3. Some companies may not be able to pay hence assets are auctioned off

Securities exchange – market for selling shares to the public used for raising finances

Advantages of share capital as a means of financing

1. Compared to debt it Is cheaper as no interest is paid
2. Its more permanent as company does not pay back the money unless it buys the shares
3. Raising money from public is more suitable for long term
4. The business is not at risk of losing its assets
5. More media attention and visibility

Disadvantages

1. The requirements for listing are stringent
2. Loss of control

N.S.E

Joining nse – first step is opening an account with central depository and settlement cooperation

* Next is depositing money with cdsc

Trading at nse – happens between stockbrokeers

Reasons for investing in stock exchange

1. As investments that is growth of wealth
2. Shares are used as securities
3. Source of return in dividends

FINANCIAL MARKET

This is a market linking borrowers and lenders where people saving money for future sue lend to those who need it immediately at a cost that is interest

There are two

Money market and Capital market

Money market – this is a short term less than an year for company and individual to borrow and lend money

Examples pf money market

* Tertiary bills and bonds where gvt borrows and promises to return with interest bills are short term while bonds are long term
* Commercial papers companies with good reputation borrow and promise to pag

Capital market – sales and purchase of long term debt

Differences between money and capital markets

|  |  |
| --- | --- |
| MONEY MARKET | CAPITAL MARKET |
| This are short term debt instruments | Usually long term instruments |
| Mostly carried out by financial institutions like banks and gvt | Carried out by companies seeking long term  financing |
| The debt has to be repaid within a short period of a month to six months | The debt is of long-term duration even exceeding 10 years |
| Deals with liquid and safe securities (good credit rating from borrower) | Not easy to convert to cash unless is publicly listed |
| Less risk but low returns | High risk more returns |

Why capital markets are undeveloped in Kenya

1. Lack of proper governance and regulation
2. Corruption
3. Lack of technical skills
4. Informal economy
5. Fewer companies