




**COMPETITIVE REVIEW OF
FINANCIAL STATEMENTS
FOR FUND RAISING**



So you think you are a Non- Finance person!

Is Finance Management all about collecting and compiling financial data, recording it, and preparing the various financial statements?

Just because your job does not involve book keeping does not mean that you are a non-Finance person!
It only makes you a non-Accounting person.

The ability to take financially intelligent decisions is what financial management is all about.

Whether you run your own company, lead a multinational operation, work in the ranks or are planning a start-up, you have a responsibility towards the profitability of the organization.

And you will be able to fulfil this responsibility only if you learn to understand the impact of every one of your actions on the organization's bottom line.

The two basic Financial Statements

every Organization must prepare

All financial transactions that take place in an organization are recorded, then summarized and presented in two financial statements

All financial transactions that take place in an organization are recorded. These accounting records form the main source of information from which the two most important financial statements are prepared, the Profit & Loss Account and the Balance Sheet.

The Profit & Loss Account

Why is a Profit & Loss Account made?

Why would you want to find out whether you have made profit or not?

How would you know whether or not a business is making profit?

The Balance Sheet

Balance Sheet *The Balance Sheet is a quantitative summary of a company's financial condition at a specific point in time, which includes assets, liabilities and net worth. It is a snapshot of the financial health of an entity.*

Balance Sheet	
Liabilities	Assets
Capital	Fixed Assets Land, Building, Plant, Machinery
Loan	
Current Liabilities Creditors, Bank Overdraft	Current Assets Debtors, Bank Balance, Inventory



A closer look at the Balance Sheet

How do organizations raise and deploy funds?

The Sources and Uses of funds

Let's first examine the sources.

How do organizations raise funds?

There is only one way:

When an organization needs money, it borrows. It borrows from owners and from outsiders.

When an organization needs money, it has to borrow. When it borrows from the owners, it is called capital. When money is borrowed from outsiders it is called a loan. Since both are in the nature of borrowings, both appear on the Liabilities' side of the Balance Sheet.

Should you have less money or more?

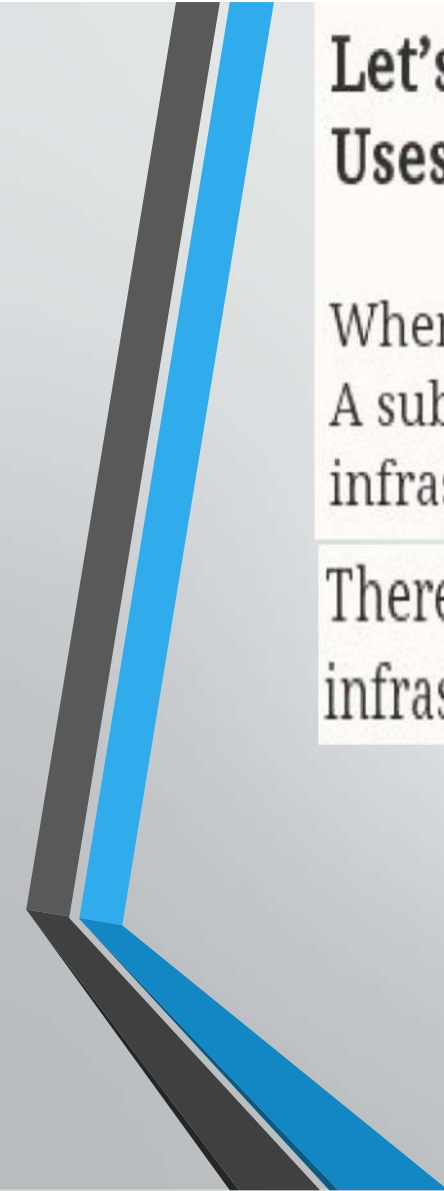
One important question we must consider here is, why is this organization going around collecting funds from all and sundry?

It collects money from the owners, and also from outsiders. It collects from owners directly as well as indirectly.

From outsiders it takes loans in cash and also in kind.

Is this an arbitrary collection of money or must it be as per a plan?

The answer is that if this organization wishes to be successful, its collection of funds had **better** be as per a plan!



Let's now look at the Uses' side of the Balance Sheet

Where will a typical organization spend the funds it collects?

A substantial portion of the funds collected will be invested in the creation of infrastructure.

There should be money left after purchasing fixed assets, since to put the infrastructure to use a business needs a continuous supply of **Working Capital**.



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Where to invest?

You must not invest your money in any opportunity where//
you cannot generate a return which is at least equal to your
cost of capital

Balance Sheet

Liabilities		Assets	
24% Capital	300	Fixed Assets	750
15% Reserves	200		
12% Loan	400	Current Assets	250
18% Creditors	100		
	1,000		1,000

Calculation of Weighted Average Cost of Capital (WACC)

300 from the SHAREHOLDERS @**24%** ➔ **72**

200 by way of RESERVES @**15%** ➔ **30**

400 from BANK LOANS @**12%** ➔ **48**

100 from CREDITORS @**18%** ➔ **18**

TOTAL CAPITAL is **1000** COST is **168** WACC is **16.8%**

Calculation of the Real Cost of Capital

TOTAL CAPITAL is **1000** COST is **168** WACC is **16.8%**



If PAs perform for 2/3rds of the year → **50.4%**



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What are the components of working capital?

Inventory

Cash & Bank Balance

Debtors

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5 C's of Credit: Enhance Your Credit Quality

□ Capacity

- Measures a borrower's ability to repay a loan by comparing income against recurring debts
- Can the borrower generate adequate cash to repay the loan?

□ Capital

- Refers to the net worth, or equity, of a business
- Is the borrower adequately capitalized within industry standards to withstand unexpected loss?

□ Conditions

- The economic, industry, and market environment can and will change; the state of the borrower or the state of the economy
- Is the borrower flexible enough to adapt?



❑ Collateral

- Helps secure the debt.
- Is there an alternative source of repayment in case the primary source fails?

❑ Character

- Personal integrity of business owners and officers
- Is management willing to repay the loan and will it attempt to do so under adverse conditions?

How to Read a Balance Sheet

using the Rule II Perspective

A good Balance Sheet for an equity investor may not be so for a lender.

What is the best way to describe a healthy organization?

Balance Sheet **A**

Liabilities		Assets	
Share Capital	450	Fixed Assets	750
Reserves & Surplus	300		
Long-Term Loans	200	Current Assets	250
Creditors	50		
	1,000		1,000

Balance Sheet **B**

Liabilities		Assets	
Share Capital	150	Fixed Assets	750
Reserves & Surplus	100		
Long-Term Loans	650	Current Assets	250
Creditors	100		
	1,000		1,000

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rb1

owners contribution
rakesh bajaj, 18/Jun/2022

outsiders funds (LTf/ LTS)

Balance Sheet

Liabilities		Assets	
Share Capital	} LTS	Fixed Assets	LTU
Reserves & Surplus			
Long-Term Loans		Current Assets	STU
Current Liabilities	STS		

Balance Sheet: Example 1

Liabilities		Assets	
LTS	4,752	LTU	5,154
STS	2,598	STU	2,196
	7,350		7,350

Balance Sheet: Example 2

Liabilities		Assets	
LTS	11,670	LTU	11,670
STS	3,750	STU	3,750
	15,420		15,420

Balance Sheet: Example 3

Liabilities		Assets	
LTS	6,450	LTU	5,460
STS	3,300	STU	4,290
	9,750		9,750

Net Working Capital

and the 'Credibility Trap'

Examine the role played by Current Assets and Current Liabilities to arrive at the Net Working Capital and understand how to avoid the 'Credibility Trap'



Gross Working Capital = Current Assets

**Net Working Capital = Current Assets
(-) Current Liabilities**

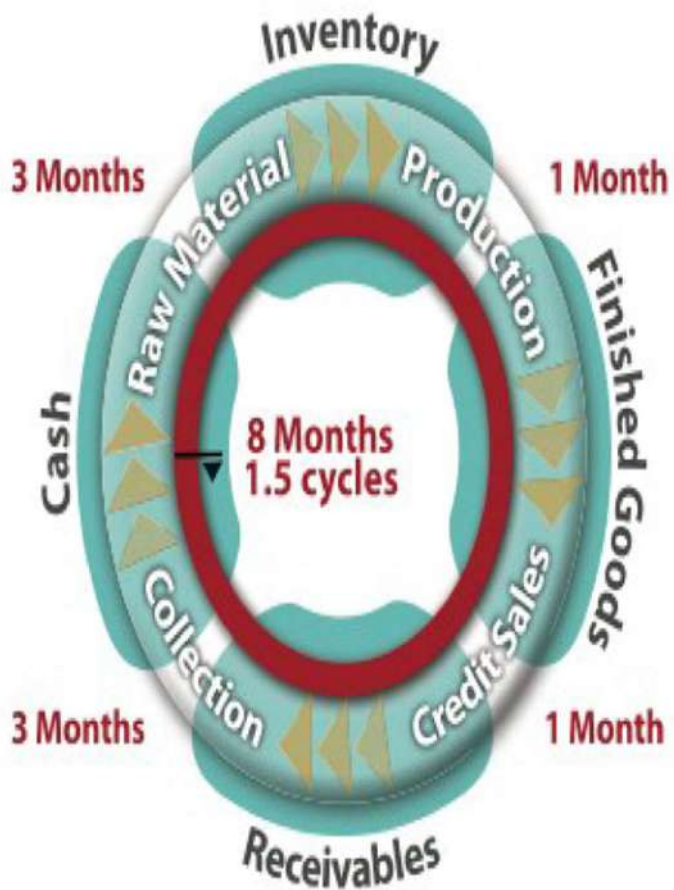
Working Capital Cycle



Working Capital Cycle

Working capital cycle is the length of time it takes a business to convert net working capital, like current assets and liabilities, into cash.

- Long cycles means your capital is tied up for longer periods of time without earning a return.
- Short cycles means you are able to free up cash faster with a quicker turnaround time.



The Credibility Trap

As you have just seen, current liabilities play the role of reducing the working capital required to finance current assets.

the greater the credibility that a firm enjoys, the lower would be its net working capital requirement.

there is a trap in this.

I		Balance Sheet			
Liabilities		Assets			
CL	10	CA	20	NWC 10	CR 2:1

II		Balance Sheet			
Liabilities		Assets			
CL	15	CA	20	NWC 5	CR 1.33:1

III		Balance Sheet			
Liabilities		Assets			
CL	20	CA	20	NWC Nil	CR 1:1

Organizations with a bad current ratio are not necessarily 'bad organizations' but they are 'entrapped organizations'; where those in charge of running them did not understand the principles of good financial management.

RATIOS CONSIDERABLE TO BANK

- **DEBT EQUITY RATIO:**

WHAT THE DEBT-TO-EQUITY RATIO TELLS YOU

The debt-to-equity ratio tells you if your company's debt is too high for your business. Higher debt ratios indicate higher risk of closure or bankruptcy. A lower debt-to-equity ratio indicates lower risk.



Debt to Equity Ratio

$$\text{Debt to Equity Ratio} = \frac{\text{Total Liabilities}}{\text{Shareholders' Equity}}$$

Accounting Liquidity

$$\text{Current Ratio} = \frac{\text{Current Assets}}{\text{Current Liabilities}}$$

$$\text{Quick Ratio} = \frac{\text{Current Assets} - \text{Inventories}}{\text{Current Liabilities}}$$

$$\text{Cash Ratio} = \frac{\text{Cash and Cash Equivalent} + \text{Short term Investments}}{\text{Current Liabilities}}$$

Debt Service Coverage Ratio Formula

There are two ways to calculate this ratio:

$$\text{Debt Service Coverage Ratio} = \frac{\text{EBITDA}}{\text{Interest} + \text{Principal}}$$

$$\text{Debt Service Coverage Ratio} = \frac{\text{EBITDA} - \text{Capex}}{\text{Interest} + \text{Principal}}$$

Statement showing calculation of PAT

	A	B
Equity Shares of 100 each	1 500,000	500,000
10% Loan	500,000	1 500,000
= Capital Employed	2 000,000	2 000,000
PBIT (@30%)	600,000	600,000
(-) Interest	50,000	150,000
= PBT	550,000	450,000
(-) Income Tax (assumed @40%)	220,000	180,000
= PAT	330,000	270,000

How to look at the top line and understand the bottom line

	Year 1	Year 2				
		Option 1	Option 2	Option 3	Option 4	Option 5
Sales	100	200	200	200	200	200
Profit	20	40	60	80	100	120