SNS COLLEGE OF TECHNOLOGY

DEPARTMENT OF MECHANICAL ENGINEERING

COURSE NAME: 16GE302 Engineering Economics and Cost Analysis

IV YEAR/ VII SEM

Unit-4 FINANCING

Topic : Internal Financing

Profits

A new **company** can raise funds only through external sources such as share, debenture, loans etc.

An existing or a going concern which needs finance for its future growth and expansion can also generate through its internal sources

Source :www.tes.com

Ploughing Back of Profits

In this all the profits of the year are not distributed among the shareholders

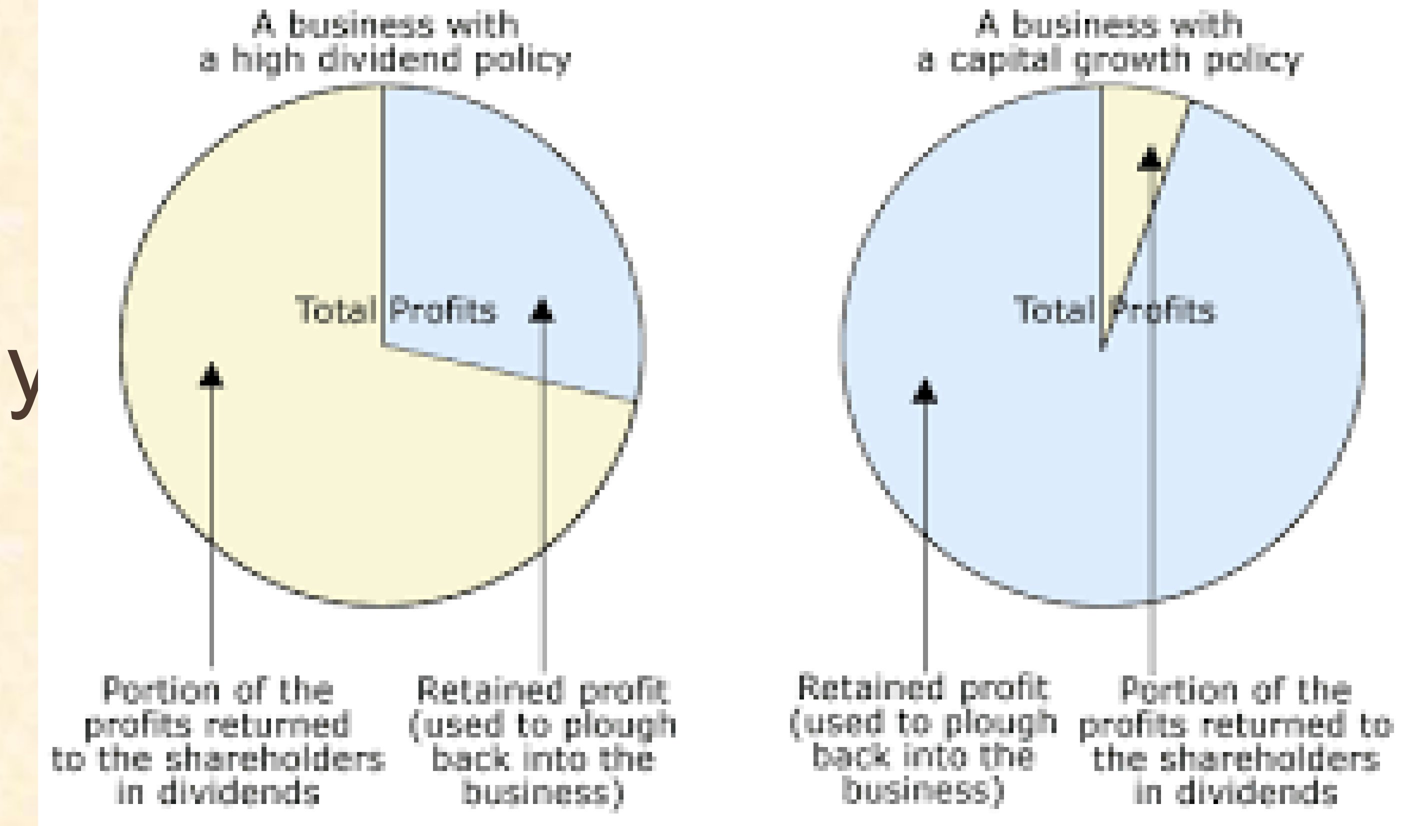
Total profit retained in the firm

The process of retaining profits year after year and their utilization in business known as self financing or inter financing

Source :www.learnpic.com

Need of Ploughing Back of Profits

- For replacement of old asset which have been obsolete
- For expansion and growth
- For making company self dependent
- For redemption of loan and debenture
- For satisfy the working capital needs of company



Source :www.dividendsranking.com

Merits

Economic method

Help to redeem liabilities

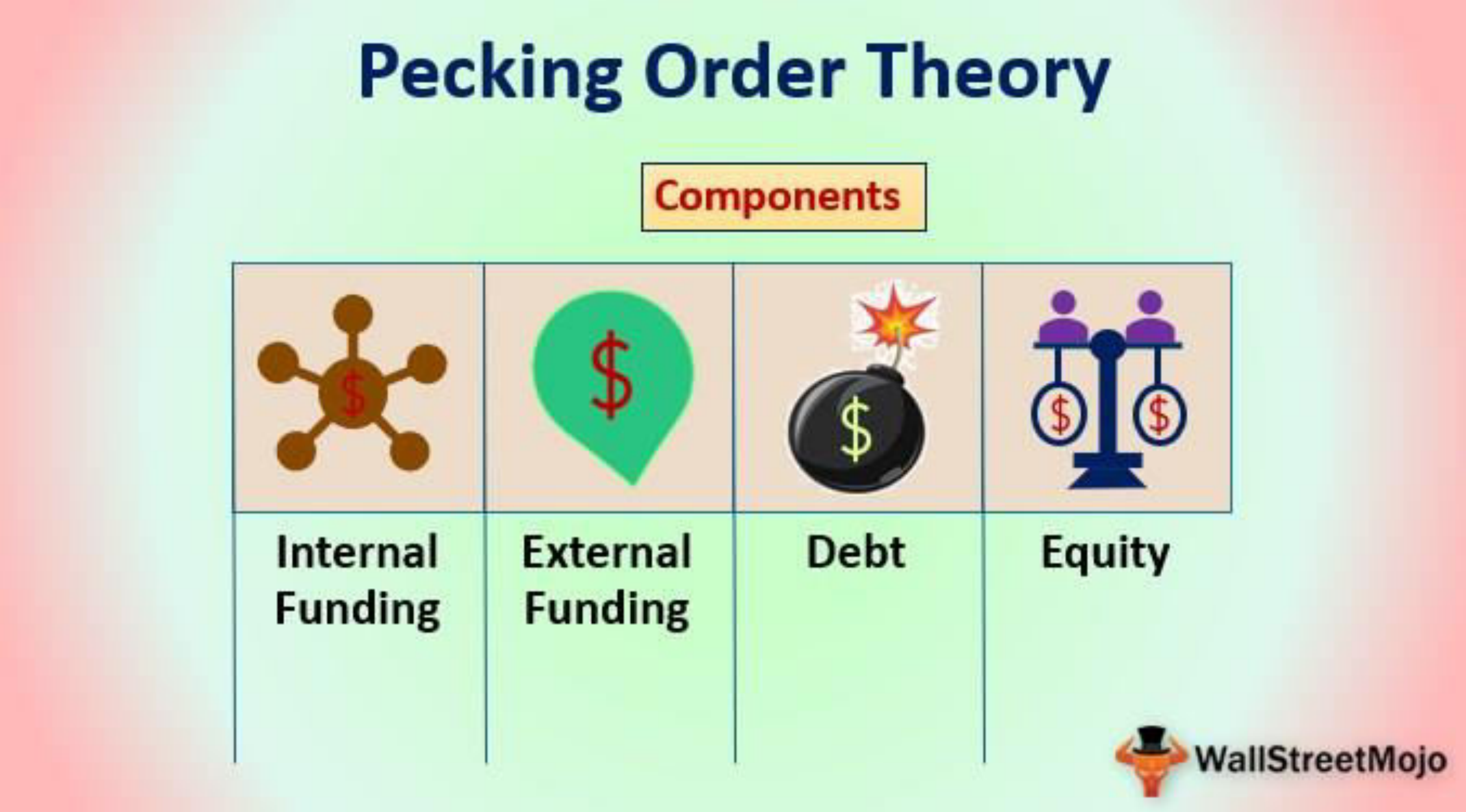
Increase productivity

Decrease the risk of failure

Safety of investment

Make company self dependent

Flexible financial structure



Source : www.wallstreetmojo.com

Capitalisation

Over capitalisation

Creation on monopolies

Depriving the freedom of the investor

Misuse of the retained earning

Manipulation in value of shares

Evasion of tax

Dissatisfaction among the shareholder

Source : www.slideshare.net

Depreciation as a Source of Finance

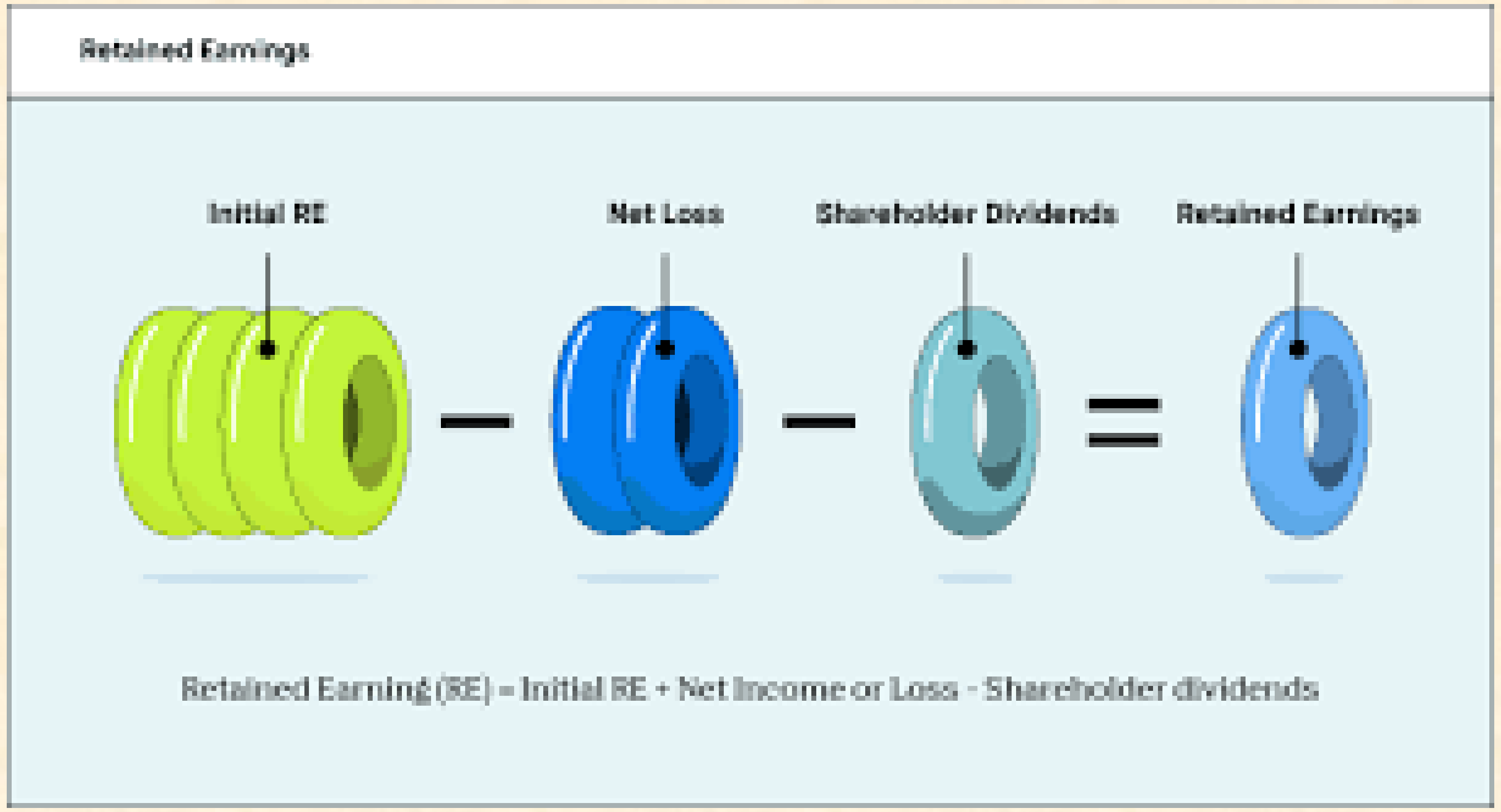
- Gradual decrease in the value of asset due to wear and tear and passage of time

- Depreciation is simply a book entry having the effect of reducing the book value of the asset and profits of same year for the same amount

Source : www.donaldcross.com

Retained Earnings

The percentage of net earnings not paid out as dividends



Source : www.slideshare.net

It is retained by the company to be reinvested in its core business or to pay debt

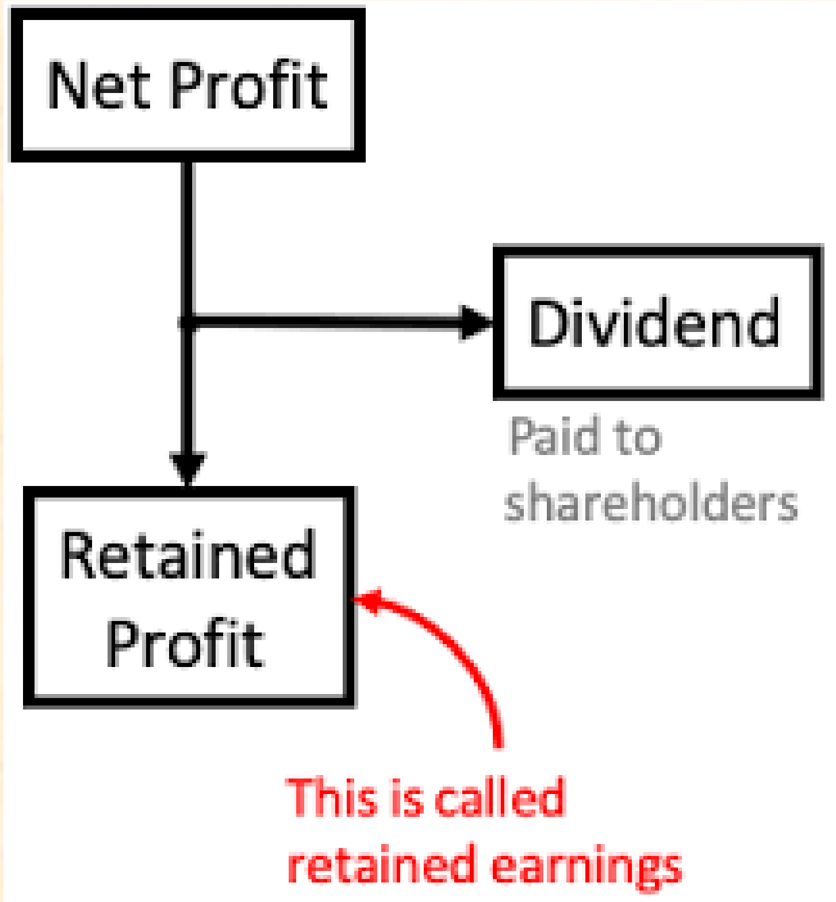
Also known as the "retention ratio" OR "retained surplus"

Retained Earnings (RE) = Beginning RE + Net Income - Dividends

Cost of Retained Earnings

- It is the cost for using the available internal funds accumulated for the shareholders
- It depends on the expectations of the investing shareholders.
- The cost of retained earnings is always less than the cost of external equity due to the existence of transaction and floatation cost
- Hence, Cost of Retained earnings (Kr) = Ke – F

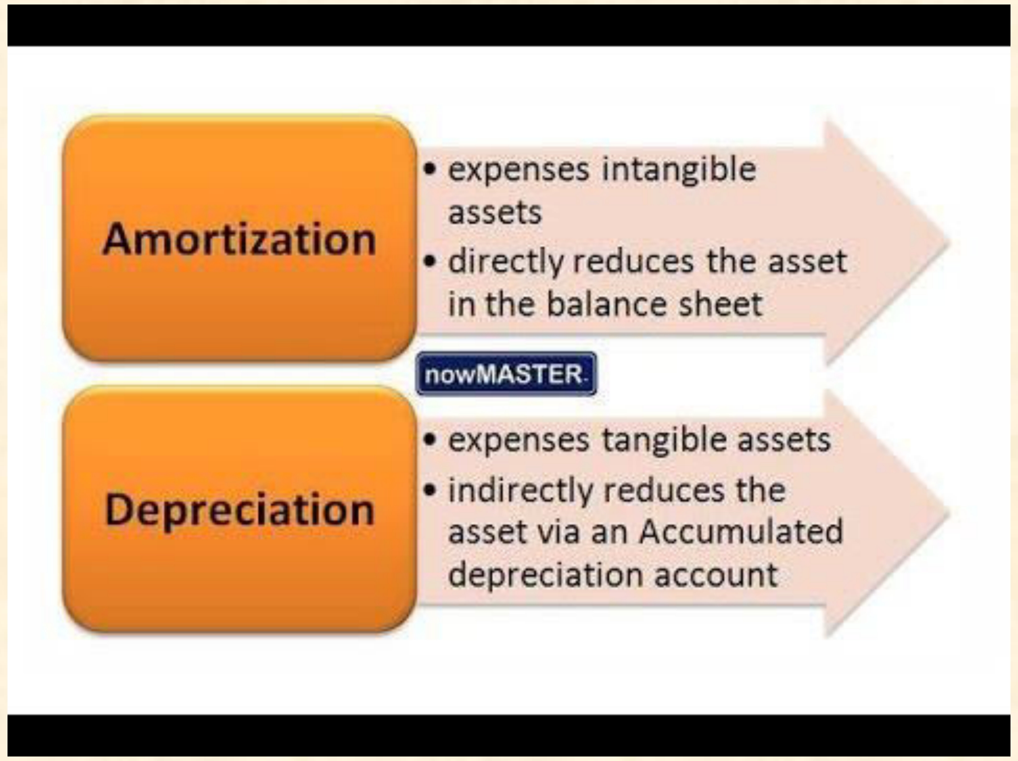
Where, ke = Cost of External Equity & F = Flotation Costs



Source : www.slideshare.net

Amortization

- The spreading out of capital expenses for intangible assets over a specific period of time ie the useful life of an asset
- Is similar to depreciation
- Includes the write off of intangible assets like Trademark, Patent, Goodwill etc
- It decreases the profit of the business and facilitates in tax saving
- No real cash flow occurs



Source : www.s-cool.uk.com

Provisions

- Amount put aside in your accounts to cover up a future liability
- It is treated as an expense in the books of account and is shown in the liability side
- of the balance sheet
- Includes loan loss provisions, bad debts provisions etc
- It is used up when the future liability occurs
- Corresponding liability doesn’t occur a huge amount of money

Source : www.neckmilton.com

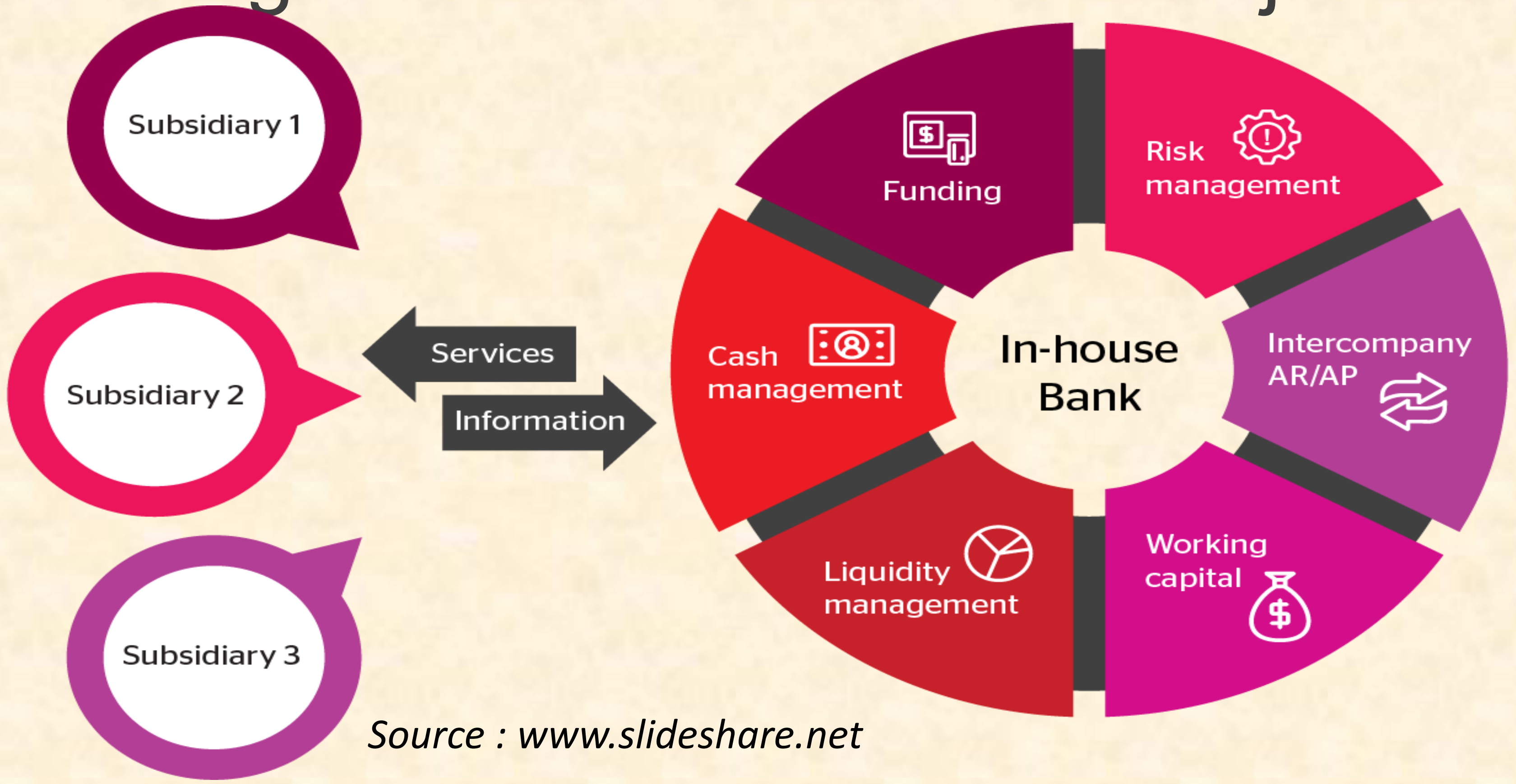
Inter-Company Funding

To shift cash to a business unit that would otherwise experience a cash shortfall

To shift cash into a business unit (usually corporate)

To shift cash within business units that use a common currency

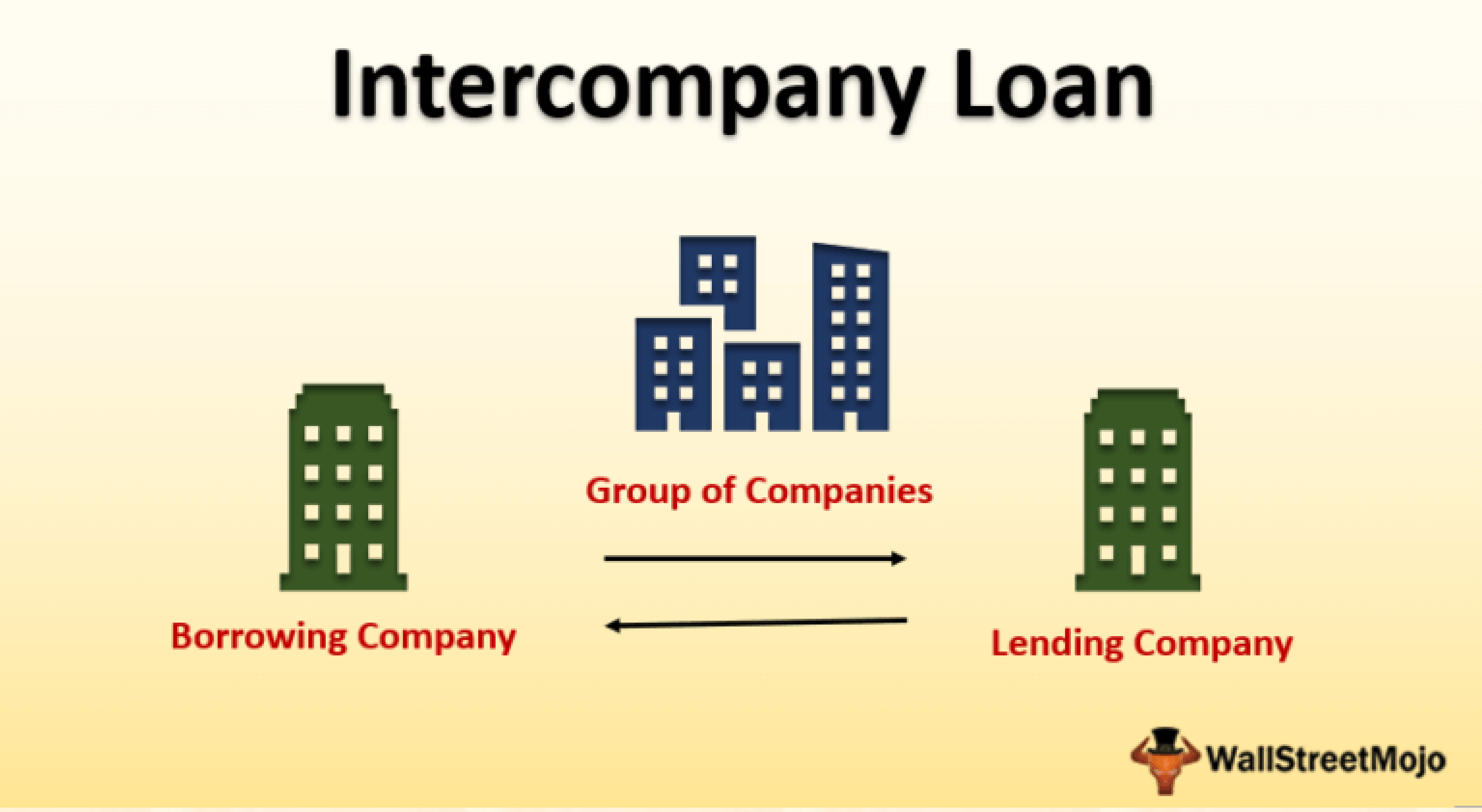
Funds from a foreign location that will be subject to exchange rate fluctuations



Source : www.slideshare.net

Inter company Loans

- It solves the problem of cash surplus in one unit
- No credit application is required
- The cash can be made available on short notice
- May be cheaper than the external financing
- These loans are not on strictly commercial terms
- Perhaps they bear low or zero interest
- The use of intercompany loans can cause tax problems



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THANK YOU