IHT3318 Part 2
Pat Vivatpattanakul

- Class rules
  - Proper classroom etiquette
  - No Thai
  - Be responsible and honest
  - Take notes
  - Class assignment
  - No late assignment
  - Open to constructive suggestion
- Grading
- Office Hour – 401@ Wednesday 13:00-15:30

IHT3318: Accounting and Finance for Tour Business

Session 9: Introduction to Finance
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What is Finance?

- Financial institutions
  - Collect funds from savers and lend them to or invest them in business or people that need cash.
- Financial markets
  - Framework or mechanism for bringing together those that have money to invest with those that need funds
- Financial management
  - This field study how a business should manage its assets, liabilities, and equity to produce a good or service
  - Goals of financial management

finance is the study of how individuals, institutions, and businesses acquire, spend and manage money and other financial resource

- Area of business responsible for finding the best source of funds and the best way to use them
- Managing financial capital

Risk and Return

- Risk: degree of uncertainty about a decision
- Return: what you expect to receive in exchange for incurring risk

- Determining your investment (comparing)
  - The strength & weaknesses of the company need to be analyzed to devise financial plan
  - Accounting statement
  - Financial Ratio
    - Liquidity, ROA, leverage ratio, profitability ratio, ROE, D/E, EPS, average collection period and etc

Funding option

- Retain earning
- Debt
- Equity

  - Firm stage of development
    - Start up vs. mature
  - Purpose of funds
    - Short term vs. long term
    - Major investment vs. minor investment

Capital Structure

Debt Financing

inquire from lenders

- Pros
  - Interest payment are tax deductable
  - Avoid diluting ownerships
  - Avoid public disclosure of financials
- Cons
  - Legally binding: requirement to repay
  - fixed payment + interest
  - Lender may require collateral
  - Limitation on the amount of money that can be raised

Equity Financing

Acquire from owners

- Pros
  - More flexibility and less risk
  - No monthly payments
  - Money out of your pocket
- Cons
  - Dilution of ownership
  - No tax benefit
  - Forgoes financial leverage

Managing cash & Cash equivalent

- Cash is money in coins or notes, as distinct from checks, money orders, or credit
  - Need cash to pay employee, resource and etc
  - Cash can put you through turbulence
  - Cash doesn't give out earning
- Cash equivalent is a highly liquid investment having a maturity of three months or less. It should be at minimal risk of a change in value.

Managing account receivable & inventory

- A/R: money which is owed to a company by a customer for products and services provided on credit
  - Set credit terms
  - Establish credit standard
  - Design appropriate collection policy
- Inventory: finished goods, work in-progress, parts and materials
  - Customer are disappointed when they cannot find desired products on the shelves
  - The cost of storing, handling and insuring inventory is expensive

Capital Budgeting

Capital budgeting: a systematic evaluation of a firm's major long run capital investment opportunities

- Replace/ buy new machines and equipment
- Opening/buying a new plant
- Expanding resources/ production for growth

Evaluating capital budgeting proposal

- Cost and benefit over a project over a period of time
- Time value of money
- Present value & Future value
- Net present value

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Cash Flow

- Cash flow – movement of cash into or out of an account, a business or an investment
  - Operation cash flow
    - Cash received or spent as result of a company's business activities
  - Investment cash flow
    - Cash received or spent through investing activities
  - Financial cash flow
    - Cash received through debt or paid out as debt repayments
- Cash flow crunch

Rate of Return(RR)

- The earnings an asset generates in excess of its initial cost
- The amount is usually express as "X% per year"
- Calculate by the cash flows which generated by the asset
- Can be negative when it produces less income than its cost
- Rate of return is used to compare similar asset to find which project yield better return

Simple interest and compounding interest

- Simple interest is a quick method of calculating the interest charged on a loan.
- It is determined by multiplying the interest rate by the principal by the number of period
- Loan Fee

- Compounding interest will make a deposit or loan grow at a faster rate than simple interest
- Compound interest = interest on interest
- Compounding interest can be daily, monthly, annually or even continuously

Present value

- Present value tell us, how the future sum of money is worth today (giving a specified rate of return)
- This is an important financial concept based on the principle that money received in the future is not worth as much as an equal sum received today.
  - Investment opportunity
  - Interest
  - Inflation

Assignment

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Discounting

- An arithmetic process whereby a future value decrease at a compound interest rate over time to reach a present value
  - Example: We invest into building a new water factory which will generate cash flow in the upcoming years
- Discount Rate: The interest rate you need to earn on a given amount of money today, to end up with a given amount of money in the future

Future value

- Value of a savings amount or investment at a specified time in the future
  - Simple interest
  - Compounding interest
- The compounding formula always generate the higher amount than the simple interest calculation, this is because with compounding each period earned interest is added to the original amount and thus increase the amount(principal) again, which interest is calculate in subsequence years

TABLE 9.1*
Future Value Interest Factor (*FVIF*) of $1

YEAR	5%	6%	7%	8%	9%	10%
1	1.050	1.060	1.070	1.080	1.090	1.100
2	1.102	1.124	1.145	1.166	1.188	1.210
3	1.158	1.191	1.225	1.260	1.295	1.331
4	1.216	1.262	1.311	1.360	1.412	1.464
5	1.276	1.338	1.403	1.469	1.539	1.611
6	1.340	1.419	1.501	1.587	1.677	1.772
7	1.407	1.504	1.606	1.714	1.828	1.949
8	1.477	1.594	1.718	1.851	1.993	2.144
9	1.551	1.689	1.838	1.999	2.172	2.358
10	1.629	1.791	1.967	2.159	2.367	2.594

TABLE 9.2
Present Value Interest Factor (*PVIF*) of $1

YEAR	5%	6%	7%	8%	9%	10%
1	.952	.943	.935	.926	.917	.909
2	.907	.890	.873	.857	.842	.826
3	.864	.840	.816	.794	.772	.751
4	.823	.792	.763	.735	.708	.683
5	.784	.747	.713	.681	.650	.621
6	.746	.705	.666	.630	.596	.564
7	.711	.665	.623	.583	.547	.513
8	.677	.627	.582	.540	.502	.467
9	.645	.592	.544	.500	.460	.424
10	.614	.558	.508	.463	.422	.386

Finding interest rate and time requirement

- If you know three of the following: Present value, future value, interest rate, time periods, you can solve for the fourth unknown variable.
  - Solving for interest rate
  - Solving for time periods
- Rule of 72: Approximate the time required for an investment to double in value. This method is applied by dividing the interest rate into the number 72 to determine the number of years it will take for an investment to double in value

Annuity

- Annuity: a series of equal payments that occur over a number of time periods
- Ordinary annuity: exists when the equal payments occur at the end of each time period (deferred annuity)
  - Future value of annuity
  - Present value of annuity
  - Interest rate and time requirements for annuities
  - Determining annual annuity payments

Annuity (cont)

- Before there were four variable in the equation(PV, FV, interest, time period). Now we will add the fifth one onto the equation, that is PMT or annuity payment
  - Solving for interest rate
  - Solving for time period
- Determining annual annuity
  - There are many instances for which we would want to determine the periodic equal payment required for an annuity

TABLE 9.3
Future Value Interest Factor (*FVIFA*) for a $1 Ordinary Annuity

YEAR	5%	6%	7%	8%	9%	10%
1	1.000	1.000	1.000	1.000	1.000	1.000
2	2.050	2.060	2.070	2.080	2.090	2.100
3	3.152	3.184	3.215	3.246	3.278	3.310
4	4.310	4.375	4.440	4.506	4.573	4.641
5	5.526	5.637	5.751	5.867	5.985	6.105
6	6.802	6.975	7.153	7.336	7.523	7.716
7	8.142	8.394	8.654	8.923	9.200	9.487
8	9.549	9.897	10.260	10.637	11.028	11.436
9	11.027	11.491	11.978	12.488	13.021	13.579
10	12.578	13.181	13.816	14.487	15.193	15.937

TABLE 9.4
Present Value Interest Factor (*PVIFA*) for a $1 Ordinary Annuity

YEAR	5%	6%	7%	8%	9%	10%
1	0.952	0.943	0.935	0.926	0.917	0.909
2	1.859	1.833	1.808	1.783	1.759	1.736
3	2.273	2.673	2.624	2.577	2.531	2.487
4	3.546	3.465	3.387	3.312	3.240	3.170
5	4.329	4.212	4.100	3.993	3.890	3.791
6	5.076	4.917	4.767	4.623	4.486	4.355
7	5.786	5.582	5.389	5.206	5.033	4.868
8	6.463	6.210	5.971	5.747	5.535	5.335
9	7.108	6.802	6.515	6.247	5.995	5.759
10	7.722	7.360	7.024	6.710	6.418	6.145

Assignment

- Discounting
- FV – compound interest
- Solving time period (FV)
- Present value of annuity
- Solving for interest (PVA)
- Determining annual annuity payments (FVA)