CORPORATE ENTITIES AND BUSINESS DECISIONS

Every business organisation takes number of decisions in their day-to-day activities. The business decisions taken by a corporate entity can be broadly classified into following categories:

Financing decisions

Every company requires money to start and run the business. Money is required to acquire the assets and meet the day-to-day expenses. Such funds can be raised through capital, loans, bonds, debentures. Raising money and all the related decisions are called the financing decisions.

Every business requires finance to start its activities. Infosys requires money to buy a software unit or to pay salaries to its employees; Tata Steel requires money to set up a new unit in the state of Orissa; and Sat yam computers requires money for distributing dividend. Such money can be raised by selling shares or selling bonds and debentures, or borrowing from the financial institutions.

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Sources of the money can be broadly divided into the following three categories:

- Capital : Money contributed by the owners
- Loan/Debt: Money contributed by the outsiders
- Profit: Money generated by the business

Owners of a company are called shareholders and the money contributed by the shareholders is called share capital. Profit generated by the company also belongs to the shareholders. However, the management of the company may decide to distribute the profit among the shareholders as dividend or retain in the business. Capital and profit is called the owners-fund or net-worth or the equity of a company.

- Shareholders fund = Capital + Profit
- Capital is the money contributed by the owners
- Profit is the money generated by the business and not distributed as dividend.

Money contributed by the outsiders is called loan or borrowings or debt. The company has to make a periodic payment of interest and return the principal at a predetermined date. Most of the companies use a combination of equity and debt to finance its business: to meet the day to day expenses or the acquisition of assets. The mix of debt and equity is called the debt-equity ratio (DER). Table 1.7 shows the financing decisions as reflected by capital structure of some of the well known companies of India.

Table: 1.7

Debt and Equity of Selected Indian Companies as on 31st March 2006

	Debt	Capital	Profit	DER
Tata Steel				
Infosys				
TCS				
NALCO				

Investing decisions

Investment activities are the acquisition and disposal of assets owned by a company. Such activities are the results of investment decisions. The investment decisions of a company can divided into two broad categories:

- Investment with the company : Acquiring plant and machinery or furniture or building or stock of raw materials are the examples of investment within the company.
- Investment outside the company: Acquiring shares and bonds of another company are examples of investment outside the company.

Once a company collects money (from stockholders/liabilities)it makes plans to invest to earn profits. The investment in operating activities are called the operating activities. The investment activities include the following:

- Purchase and sale of fixed assets
- Purchase and sale of shares/bonds/debentures/other securities of other companies
- Dividend and interest received on the investments.

The outcome of the investment activities may be an acquisition of an asset or disposal of an asset or receiving regular incomes from such investments. When a company acquires an asset it is said to be acquiring the future cash flows. Therefore, one can say that the assets are the present value of the future cash flow. The value of the assets that is shown in the books of accounts can be one of the following:

- Accounting's Perspective: Money paid for acquiring the asset less the decrease in the value till that date. or
- Finance Perspective: Money that is expected from the income generating ability of the asset. According to this concept, asset is present value of future cash flows.

Relationship between financing and investment decisions will be discussed later chapters, some of the preliminary observations are as follows:

- Investment activities shows how the money collected or raised has been used.
- Financing activities shows how the investment has been financed.
- Investment activities show the future income generating capacity of the business.
- Investment activities show the ability of the business to return the borrowings and capital at the time of the maturity of the borrowings and closure of the business respectively.
- The liability side of the balance sheet shows the financing decisions and the assets side of the balance sheet shows the investment decisions of a company.

Operating decisions

Operating activities are the main activities through which a company generate revenue and in the process earn profit. After raising the money (for stockholders and loan givers) and investing the same in the productive assets, the business is ready to start its operations. The operating activities depend on the core competence of the company. For example: Tata Steel is in the business of making and selling of steel. Dr. Reddy's Lab is in the business of making and selling drugs. NALCO is in the business of making and selling aluminium. Infosys has been set up to provide IT solutions to various industries. All activities directly affecting the main operations are called the operating activities of a company. The net operating result of a company shows the profit generating ability of the business. Revenue is outcome of the operating activities and if all expenses required to generate the revenue are deducted from the revenue it will show the profit or loss of the business. Such profit is called the operating profit.

- Activities of a company = Financing Activities + Investment Activities + Operating Activities
- Profit of a company = Profit from Financing Activities + Profit from Investment Activities + Profit from Operating Activities
- Cash in hand of a company = Cash from Financing Activities + Cash from Investment Activities + Cash from Operating Activities

Take a business organisation that you are interacting with and make a list of important decisions taken by it and classify them on the basis of financing, investment, and operating activities.