



# Understanding Finance

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# Investment & Financing Decisions

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- Idea → conceptualization → Project → Implementation
- Project Cost – translates into Assets/resources
- Sources of Finance – translates into Liabilities
- Both put together → Balance Sheet
- What is the information content? **Financial Position**
- Proportion of borrowing/debt and equity – capital structure
- How much should we borrow? Decide at the time of evaluating financial viability before implementing the project



# Investment & Financing Decisions

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- The rate of return from the project (in present value terms) must be greater than cost of financing through debt and equity (weighted cost of capital).
- Debt has a long term impact on Profit & Loss statement (interest expense) and Cash Flow statement (both interest and repayment of principal).
- Long term assets should be financed through long term sources of finance (term loan, lease (Right of Use Asset), equity, etc.) and not through short term sources (like delaying payment to suppliers).



# Investment & Financing Decisions

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- Key Financial Metrics:
  - Debt to Equity Ratio ((long term debt + short term debt)/total equity)
  - Interest cover (profit before interest and tax/Interest exp)
  - Debt-service cover (Profit before interest and tax/(interest expense + loan repayment amount in next 12 months))
  - Asset turnover (Revenues or income/net fixed assets)



# Operations

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- Operating working capital requirements = inventories (if any) + Receivables (primarily cashless admissions) less (payables to suppliers + accrued expenses)
- Short term sources of financing – mainly cash credit facilities through banks
- Key Financial Metrics:
  - a) Working capital as % of revenues
  - b) No. of days inventories held
  - c) No. of days receivables outstanding
- Variable working capital needs – for example, inventories during pandemic.



# Operations (Contd.)

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## Challenges:

- Often conflicting goals of care delivery and financial viability
- Major shortages of qualified staff
- Increased demands from funding bodies for improved efficiencies at the same time as improved quality of care and patient outcomes
- Increasing expectations and knowledge of patients
- Balancing between increase in costs vs. increase in fees/revenues (competition)



# Operations (Contd.)

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## Indicative non-financial metrics:

- Patient level: Maintain competitive position, Maintain high levels of service, Create new mechanisms-products & services, Knowledge and improvement of patient satisfaction, “Life is worth-living” – involve patients and relatives
- Internal operations: Maintain/improve productivity, Development of protocols and procedures, Use of technology to the extent possible, Reduce surgical complications, Reduce hospital-level infection, provide safe work environment, legal/regulatory compliances



# Operations (Contd.)

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## Impact of operations on finance:

- Revenue growth – a) product/service mix b) asset utilization efficiency (improve capacity utilization)
- Cost efficiency – Consider two situations:
  - A radiologist wishes to set up the clinic for the first time in a town. What are the relevant costs to decide the charges for x-ray, sonography, etc.?
  - A surgeon has surplus capacity infrastructure (OT, # beds). Another surgeon wants to share these facilities if the charges are reasonable. What are the relevant costs to quote the prices – charges for using OT, charges per bed day for admission?





## Operations (Contd.)

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- A radiologist would consider all costs of operations in pricing decisions (no competition – benchmark prices with the prices charged by the radiologist in nearby city + patient's hardships). She/he would use "FULL COSTING SYSTEM".
- What about the surgeon with excess capacity infrastructure? Can she/he charge full costs?
- She/he would use "DIFFERENTIAL COSTING/RELEVANT COSTING SYSTEM". What are differential costs/relevant costs while allowing excess capacity to be used?
- Large hospitals can use Activity-based costing to determine the cost per patient-day or cost per procedure.



# Operations (Contd.)

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## Key Financial Metrics

- Profit before interest and tax
- Cost per procedure
- Cost per patient-day (support services)
- Return on capital employed = (Profit before interest and tax) divided by (all debt + equity)
- Cash flow from operations



**Thank You**

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