




Topic 1.

The essence and functions of finance



Plan

1. The essence of finance.
2. The functions of finance.
3. Relations between finance and other distribution categories.
4. Financial resources: essence and structure
5. The essence and role of financial reserves.
6. The essence and composition of the financial system.
7. Characteristics of the financial system.



The term of “finance” was introduced by Doctor Zhan Boden in 1577 y. in France He is named the “finance” a “**nerves of the state**”.

The aim of finance is to provide every subject of economic system (government, subject of management, physical persons) with money for their economic activities.



The finance appeared as a result objective reasons:

- due to influence economic laws on the development of society;
- the existence of the commodity-money relations in society;
- the existence of the different forms of property;
- the activity of the government and the need of its financial provision.



In foreign financial science:

Finance is study of financial institutions and markets and their operation within the financial system (macro level), financial planning, asset management, and fund raising (micro level) (american scholar Melisher, Ronald W.).

In Ukrainian financial science

Finance is combination of economic relations, related to division and redistribution of GDP or national wealth of a country with the purpose of formation of financial resources and money funds and also for providing social, economic development of society.



The objects of financial distribution and redistribution are:

- 1) gross domestic product, is a cost of goods and services made in society during a certain period of time (mainly during a year);
- 2) national wealth, is combination of the created and accumulated commodities of the society, and also natural resources, involved in economic process. National wealth are involved in distributive process only in exceptional cases (wars, catastrophes, natural calamities, and others).



Subjects of financial relations:

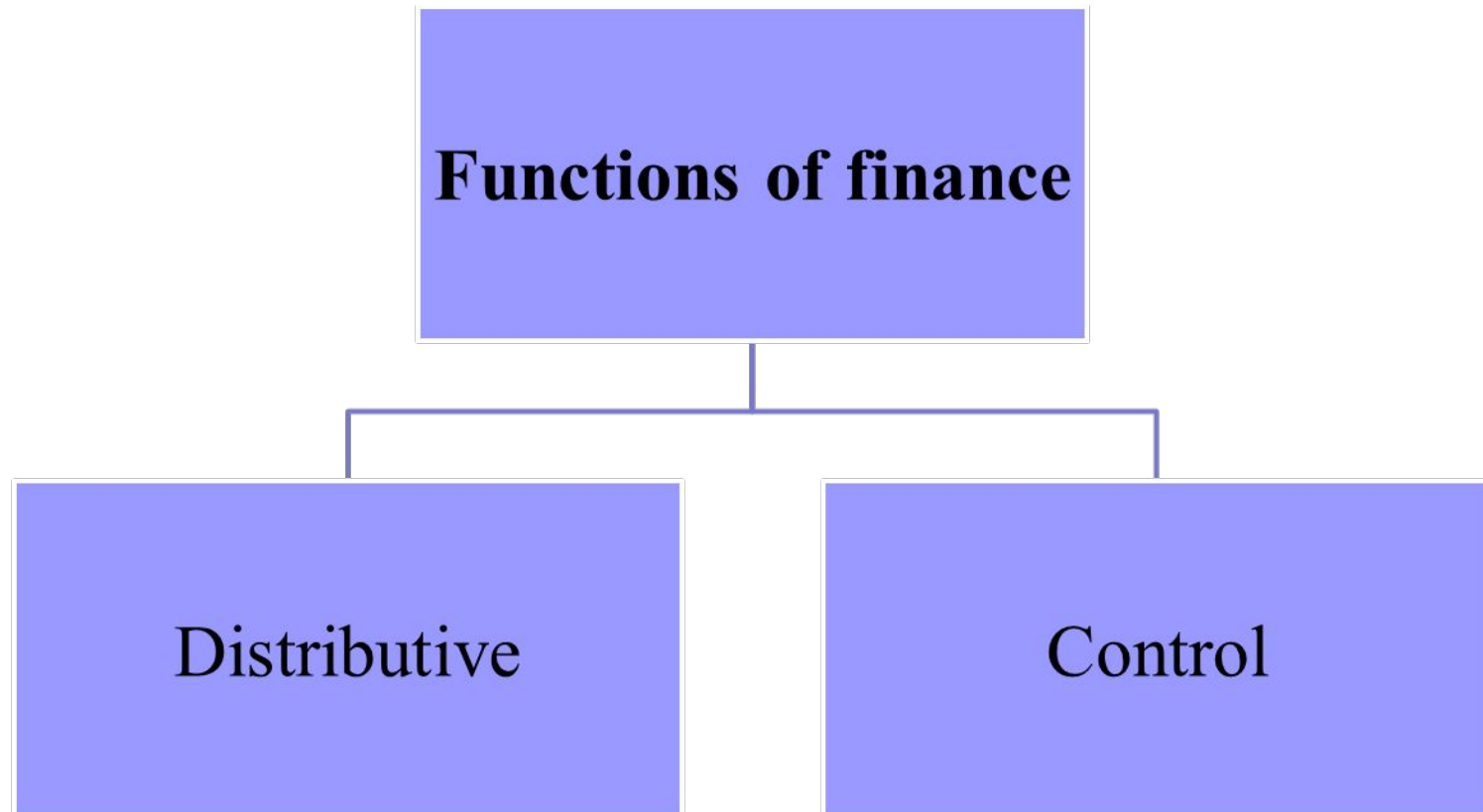
- government (local, state);
- legal entities (official bodies);
- physical persons and households;
- international organizations.




There are **GROUPS OF FINANCIAL RELATIONS** between

- subjects of management and government;
- different subjects of management;
- subjects of management and their employees;
- subjects of management and shareholders, participants;
- subjects of management and financial and credit establishments;
- subjects of management and their associations.


2. What functions of finance?





Distributive function is primary, because finance take part in:

- Distribution and Redistribution GDP;
- Second redistribution of Government money funds.

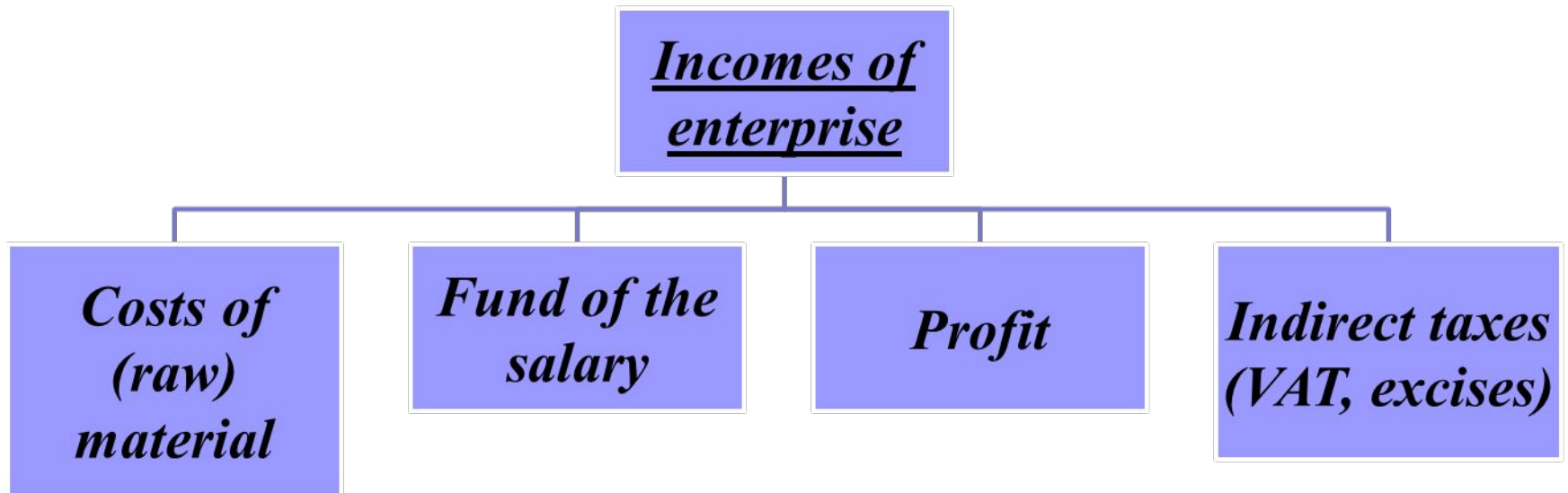



The finance distributes incomes, which enterprises or other economic subjects get after selling their products, work and services.

In this case, finance distributes of enterprise incomes on the:

- costs of (raw) material;
- fund of the salary;
- profit;
- indirect taxes and others

Distribution



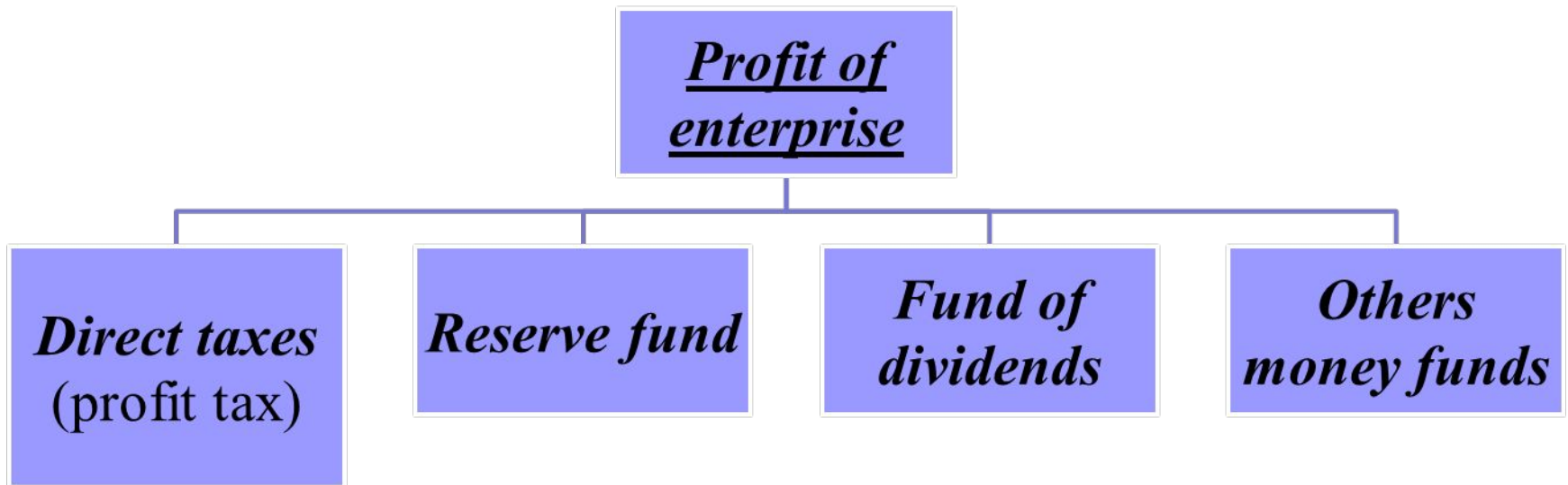



Redistribution begins, when enterprises or other economic subjects redistribute their own profit.

After paying profit tax, enterprise can create such corporate money funds:

- reserve fund;
- fund of dividends;
- others money funds.

Redistribution



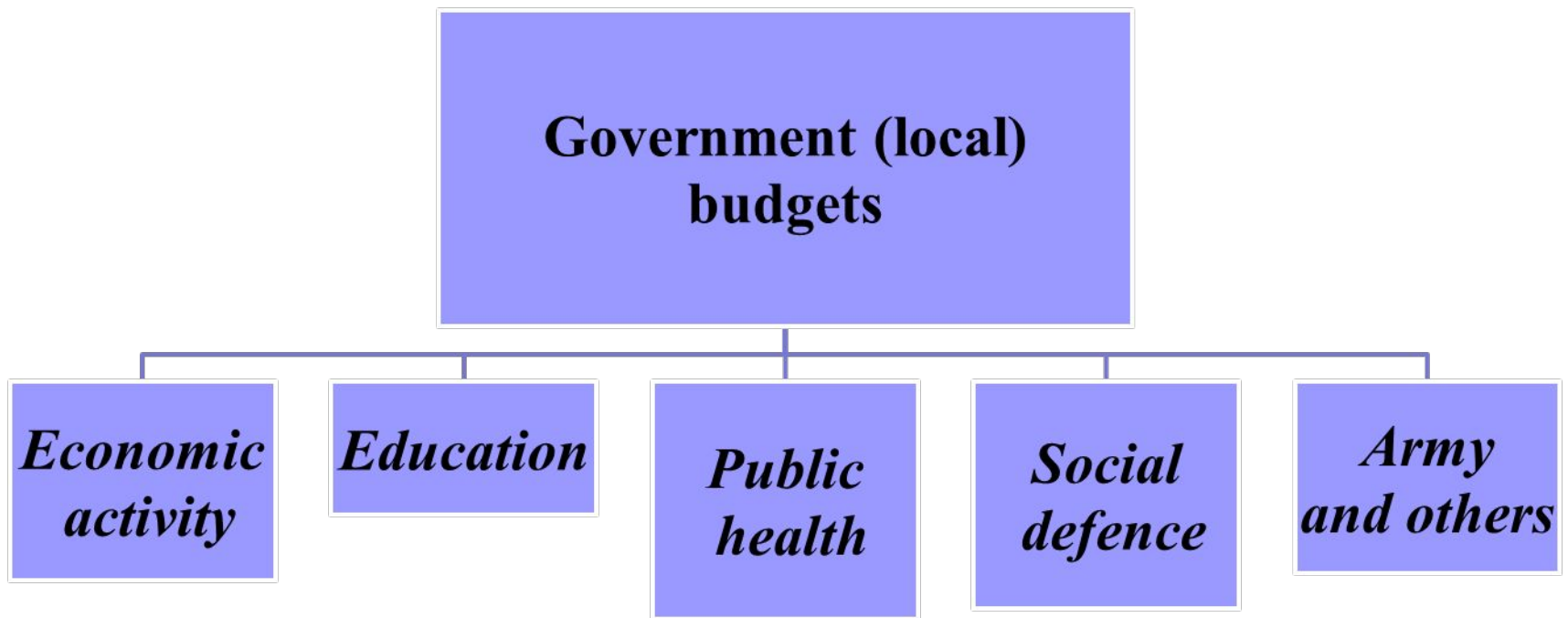



All enterprises pay taxes from their incomes and profits and it help government to create money funds such as:

- state budget;
- regional (local) budgets;
- state social insurance funds

The second redistribution is the final stage of distributive function of finance and it foresees usage of government money funds for different needs (development of economy priority industries, socio-cultural measures, social defence, army, management and other needs).

Second redistribution





Finance is instrument of control of the firm activities during exchange-distributive relations.

Finance provides effective and legal using of money.

In practice the control function is performed by bodies who conduct financial control.



The organization, which carry out financial control in Ukraine, are:

Ministry of finance;

State treasury;

Government audit service;

State fiscal service;

Government custom service;

Pension fund;

Account chamber other.



3. Relations between finance and others distribution categories

Finance interacts with such categories as money,
salary, price and credit.

These categories have a distributive character too.



Finance and money.

Categories of finance and money are very similar

But money is not finance.


Very often finance is determined as a certain sum of money. It's not correct, because a certain sum of money is yet not finance.



The functions performed by finance, differ from those performed by money.

Finance provides distribution and redistribution of money, formation of money funds and control for them.

But the functions of money are: measure of value; mean of circulation; mean of payment; mean of accumulation.



There are exists a *mutual relation between finance and money*

It's impossible to achieve the improvement of state financial situation, when the normal money circulation is absent.

And vice versa, if the state doesn't expenditures in accordance with incomes, it result in disorder of money circulation.

Finance and price

A price is the cost of any commodity in term of money. Price as well as finance takes part in creation and distribution of GDP.

Price can influence the finance The level of the prices influences the GDP and it distribution and redistribution. Sometimes sharp fluctuations of prices can influence the financial situation in the state.

Finance by means of taxes or subsidies can influence the price too. So, introduction of new taxes or the change of tax rates can diminish or increase of price.

Finance and salary.

Finance and salary interact too. For example, when state regulates the amount of salary and uses taxes (income tax) or insurance payments to the state insurance social funds (Pension Fund, Unemployment Fund) and other.

A difference between finance and salary is that finance takes part in distribution of GDP, but a salary is a category which is only a part of GDP, namely the fund of labour payment.

Finance and credit.

The common feature of these two categories is that they are used in the circulation of financial resources.

Finance and credit complement each other. When there is a lack of financial resources an enterprise can take credit, and when there is a surplus of financial resources – an enterprise can give free money as a credit (to bank or enterprise for example).

The difference between finance and credit is that finance is movement of cost in one direction and credit it is movement of cost in two directions. Besides, finance take part in distribution and redistribution of GDP, but credit operates of free resources on redistribution stage.

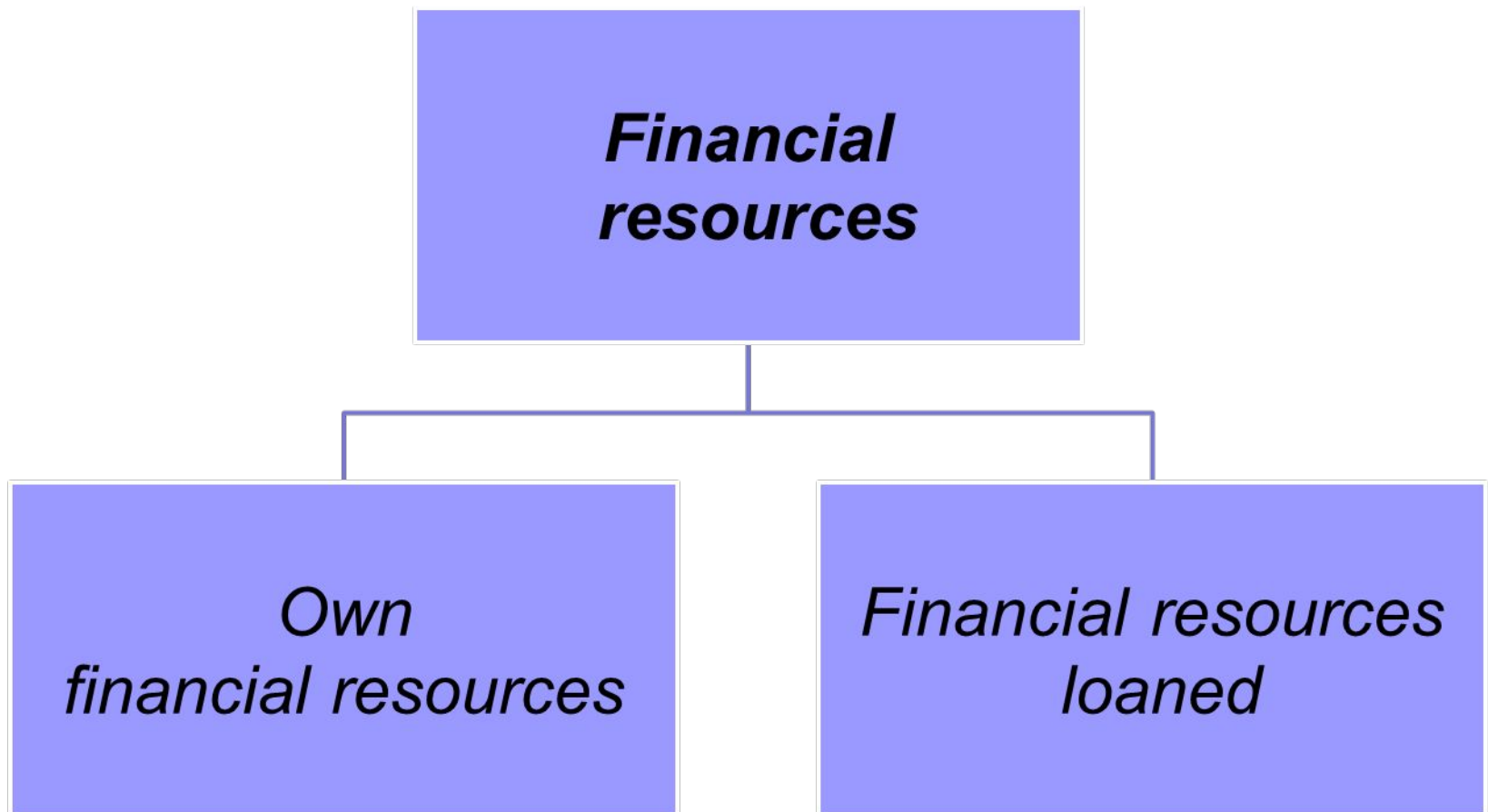
4. Financial resources


Financial resources are money funds, which are created in process of distribution and redistribution of GDP and used to provide of public and private needs.

Depending on the level of formation, financial resources are subdivided into:

- *centralized*, those which are created at the state level: state budget; local budgets; Pension fund;
- *decentralized* - funds of enterprises and organizations (fund of the salary, fund of dividends payment, reserve fund and others).

Depending on the sources of formation,
financial resources are subdivided into:





The own financial resources, its resources which are created from financial activity of government and private firms:

- own financial resources **of an enterprise** are: *profit, reserve fund, other funds of enterprises and*
- own financial resources **of a state** are: *profit of state enterprises; taxes; budget reserve fund and other.*

The financial resources loaned are money received as a result of credits and loans: bank credits; financial resources, attracted as securities; leasing credits; public credit.



Basic directions of the state financial resources usage:

- 1) development of economic activity;
- 2) financing of establishments of social sphere;
- 3) social defence of population;
- 4) foreign economic activity;
- 5) environmental protection;
- 6) management;
- 7) army;
- 8) accumulation of financial reserves.



Directions of the enterprise financial resources usage:

1. development of an enterprise;
2. of social sphere problems solving;
3. financial stimulation;
4. accumulation of financial reserves;
5. other necessities.


5. The essence and role of financial reserves.

Financial reserves are money taken from economic circulation and intended for the usage in case of failures of the economic process.

Financial reserves are formed on the national level and on the level of an enterprise.

Basic methods of formation of financial reserves are:


- 1. budgetary;**
- 2. self-supporting;**
- 3. insurance**



1. Budgetary method of the formation of financial reserves *foresees the creation of reserve fund in the state budget.*


One type of budgetary reserves is Reserve fund of the Ukraine State budget. Its creation is obligatory.

Reserve fund of the Ukraine State budget formed for extraordinary expenses which could not be foreseen in State budget for the current year. This fund is equals to 1% of expenditures of State budget general fund.




Main directions of the expenditures of reserve fund of the State budget of Ukraine:

- **financing of expenditures in the extraordinary situations;**
- **financing of works** for liquidation of consequences of the nature catastrophes;
- **extraordinary expenses**, related to introduction of new laws;
- **other measures** which could not be foreseen current in the State budget.



The law requires that reserve fund of State budget of Ukraine should not be used for the payment of the governments debts and financing of budgetary deficit.


The Cabinet of Ministers of Ukraine reports to Parliament about the expenses of the reserve fund of State budget of Ukraine monthly.



2. Self-supporting method of the formation of financial reserves *is the formation of financial reserves of enterprises, firms and organizations*

The need of reserve fund of the enterprise is tied up with existence of the business risk. Most reserve funds are established in agriculture.

The joint-stock companies in Ukraine obligatory deducts from its profit (5%) in to reserve fund. The recommended amount of reserve fund must equals to 15% from statute capital of joint-stock company.



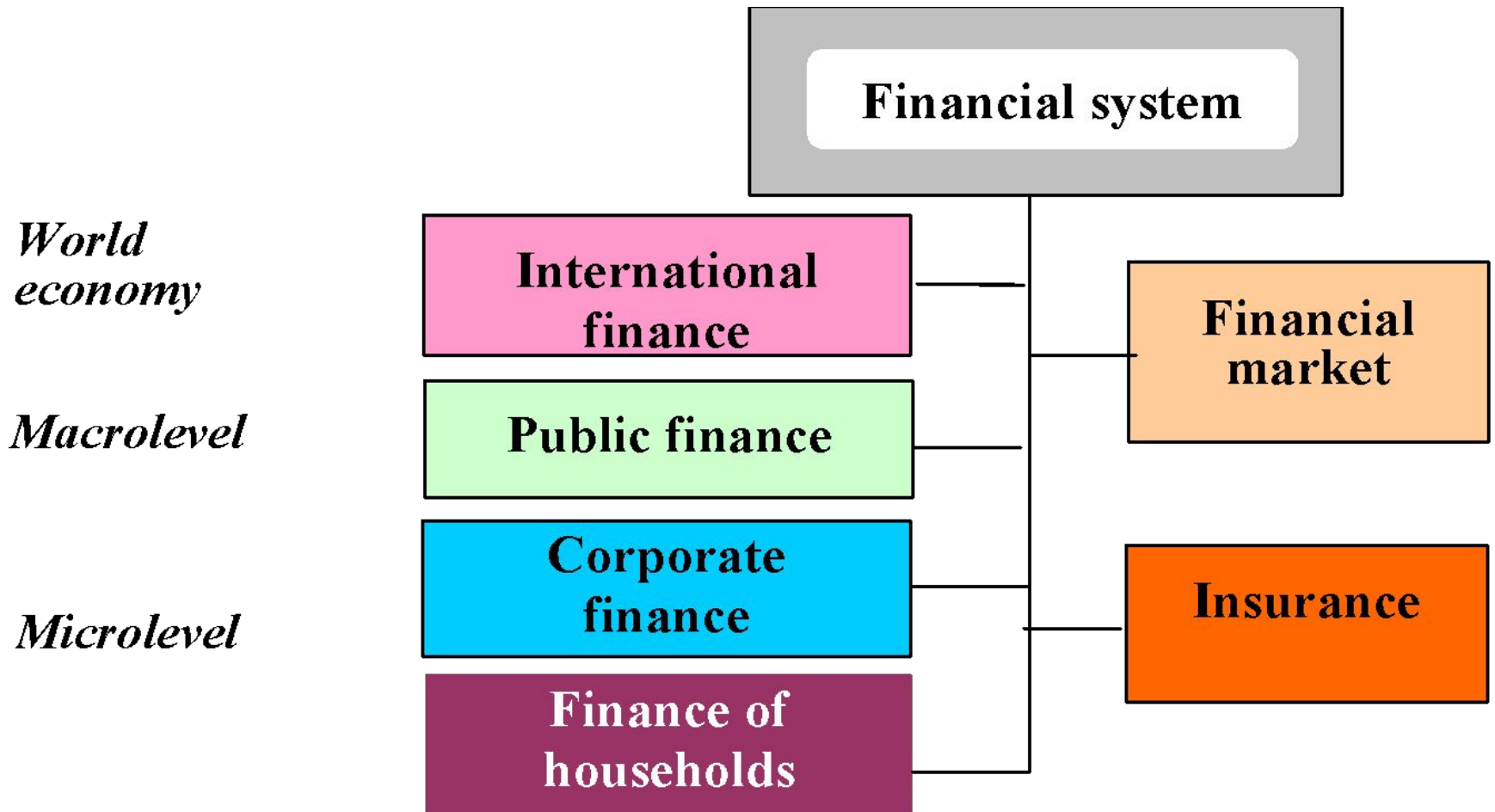
3. The insurance method of the formation of financial reserves is used *for the insurance organizations*.

Insurance funds are created due to payments of participants of insurance, and only these participants can get benefits from insurance funds.

6. Financial system

- *The aim of the national financial system is to provide maximum mobilization of financial resources in the society; their effective usage for economic and social development.*
- *Financial system has internal and organizational structure.*

Internal structure of financial system *is combination of spheres and links which have a features in formation and using of financial resources*



Organizational structure of the financial system *is combination of financial organs and institutions which manage financial resources.*

Organizational structure of the financial system of Ukraine belong:

- Organs of management:*** Ministry of Finance; State fiscal Service; Government Audit Service; State Treasury; State Commission of Securities and Fund Market; Account chamber; Public Accountant Chamber; Pension fund;
- Financial institutions:*** National bank; Commercial banks; Insurance companies; Credit institutions (credit unions, lombard and others); Stock exchange; Investment funds.

7. Characteristics of the financial system.

The corporate finance *is a basis sphere of all financial system*, because it creates the biggest part of GDP in country.

The sphere of finance of enterprises represents *motion, creation, distribution, and disposal of financial resources and general principles of organization their financial activity*.

The financial activity of an enterprise depends on the form of ownership and peculiarities of branch. It is an important feature of finance of enterprises.

The sphere of public finance is a basic sphere of GDP redistribution, which influences social and economic development of country.

The aim of sphere of public finance to balance interests of all financial relations subjects

- Public finance is the field of economics that studies government activities and the alternative means of financing government expenditures (David N. Hyman. Public Finance).
- Public finance is a system of financial relations between the state and other economic subjects, which provides the forming and using of state financial resources and management of public and municipal property.



The sphere *of public finance* is divided into such links:

- budgetary system (state and local budgets in Ukraine);
- state credit;
- state social insurance funds (Pension fund);
- finance of state enterprises.



The finance of households (personal finance) is an important sphere of the financial system.


Citizens are taxpayers and recipients of public benefits. Finance of population influence the level of economy of a country and the government incomes and expenditures.

The basic income of population are:

- *salary;*
- *income in natural form (goods, products, harvest) from subsidiary economy;*
- *income from private business;*
- *income from the operations with securities and real estate and ets*


The basic expenditures of population are:

- expenditures on food;
- things of everyday consumption;
- on payment of public services;
- education;
- savings and ets.



The sphere of international finance represents financial relations at the level of world economy and characterizes relations of national subjects of management and states with international organizations and international financial institutions.

- *International financial relations* are formed for the usage of two currencies and fixed exchange rate. The process of purchase and sale of currencies is take place on the currency market.
- *The international finance* includes - finance of international organizations and finance of international financial institutions.



The *insurance* and *financial market* are a specific links of the financial system. They did not belong to particular sphere and occupy an intermediate position between micro- and macro- levels.



***The financial market** is provides the movement of financial resources as specific goods.*

Financial market is divided into the money market and capitals market. The financial market functions due to financial institutions: banks, investment company, stock exchange.



Insurance is represents relations of formation and usage of insurance funds.

For one hand, insurance is provided through insurance companies which are ordinary business entities, their activity belongs to the level of microeconomics.

For the other hand, the created funds represent the redistribution of financial resources between the separate subjects of insurance and thus have features of macro level.



Thank you!