

Introduction to Finance



Accounting & Finance



Accounting

Finance

Accounting keeps track of where money has come from and where it went over some period of time.

Today

Finance determines what to do with the money to maximize the return to the company's stakeholders.

Accounting & Finance

Accounting:

“...a set of rules that govern how a business records transactions, such as the sale of a product or the purchase of raw materials, what it owns, how much it is owed and how much it owes others.”

“These rules serve an important purpose: they force businesses to measure things in a relatively consistent manner.”

Adapted from
“If You’re Clueless about Accounting & Finance”,
Seth Godin & Paul Lim, Dearborn Press, 1998.

Accounting & Finance

Finance:

“The management of money, banking, investments, and credit.”

“A discipline concerned with determining value and making decisions. The finance function allocates resources, including the acquiring, investing, and managing of resources.”

The Free Dictionary

3 Pillars of Finance

Financial Management

Where and how to invest the company's money.

How best to manage day-to-day operations of the business.

*(also known as
Corporate or
Managerial
Finance)*

Capital Markets

Those “markets” and “institutions” where interest rates, stock prices and bond prices are determined.

Banks

Insurance Co's

Trading Co's

Mutual Fund Co's

Gov't: Federal Reserve

Investment Analysis

Security Analysis: determines what the price of a stock or bond “should” be.

Market Analysis: determines whether the actual price of a stock or bond is high, low, or just right.

Portfolio Theory: determines what combination of stocks and bonds to optimize the investor's return and risk.

Finance and the Business

Financial principles are used to drive business decision-making...

What investments should the company make?

Where will the money come from to pay for those investments?

How can the company determine the cost and price for its products and services?

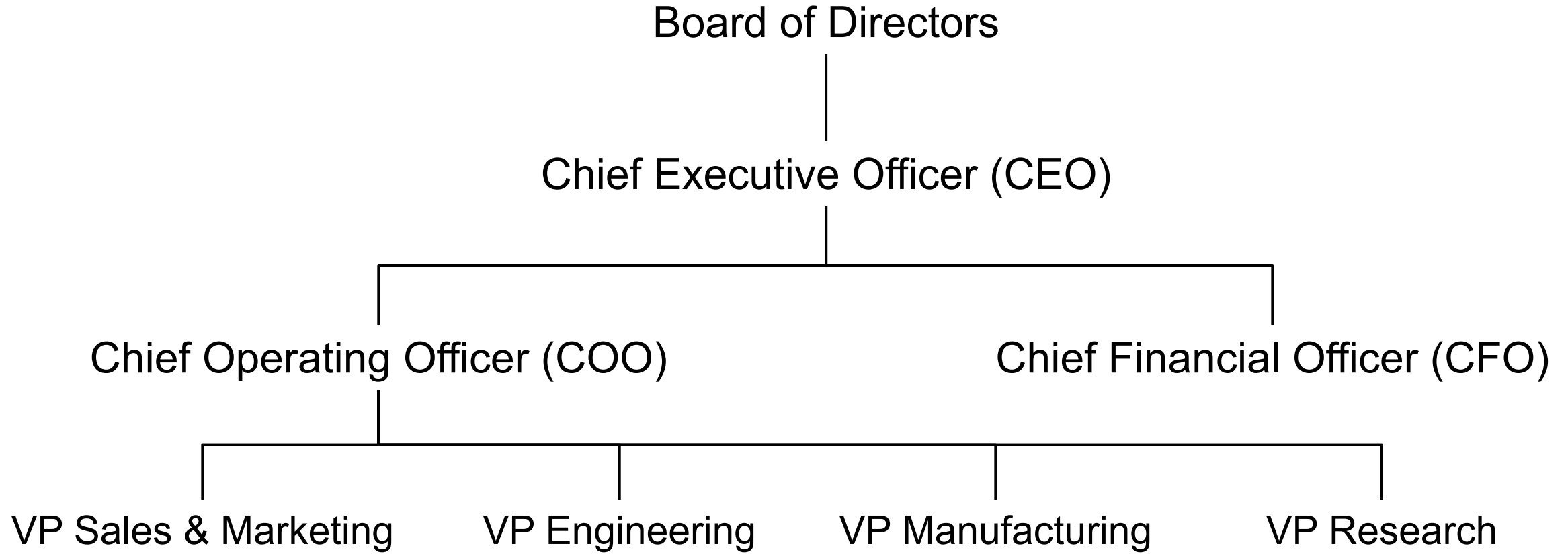
How does the company manage day-to-day financial activities, such as paying suppliers, collecting from customers, and making sure there is enough inventory on hand!

Finance and Business Decision-Making

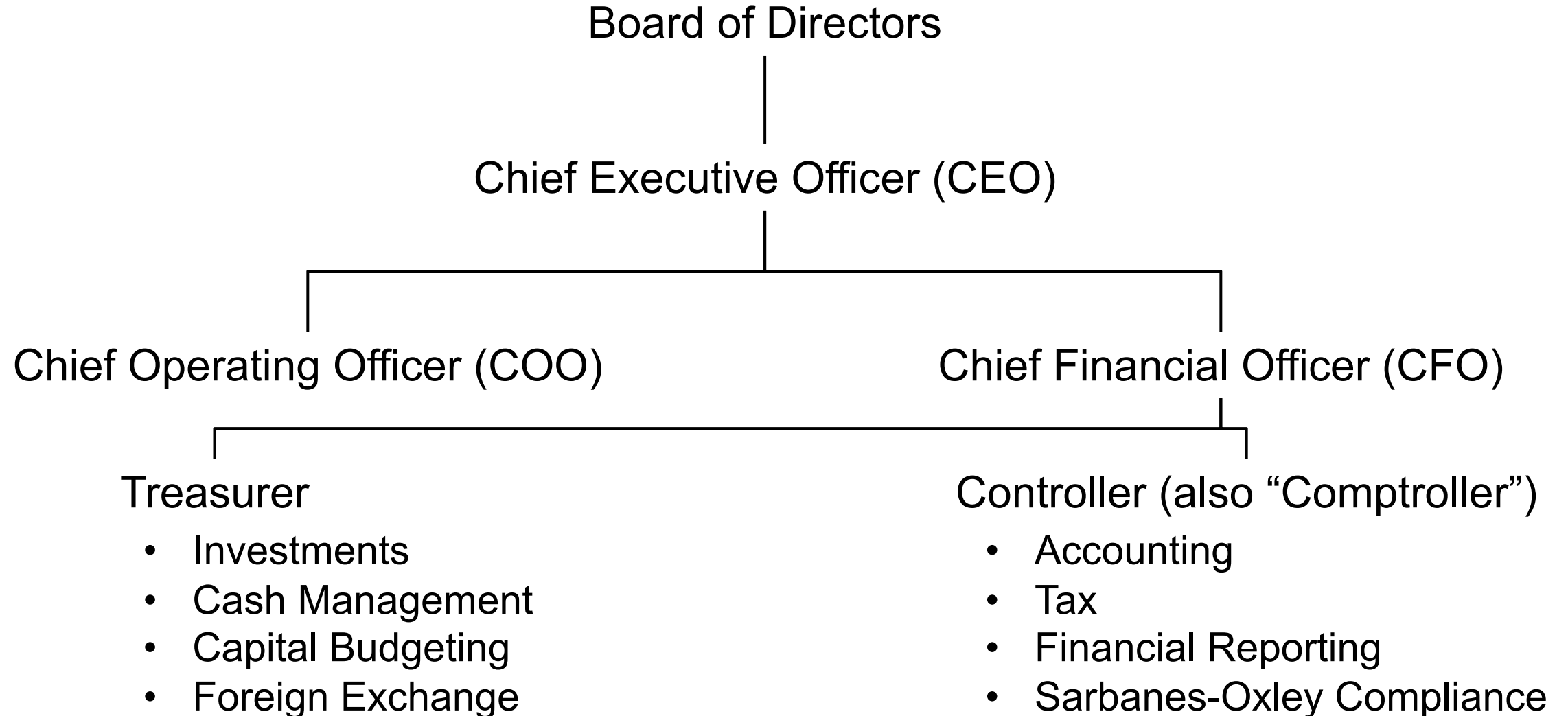
Who is ultimately responsible for managing a company's finances?



The Players...



The Players...



Financial Statements

The CFO and their team generate periodic financial reports...

Internal Financial Statements: often monthly reports that help management make day-to-day decisions throughout the year.

External Financial Statements: quarterly and annual reports that provide the investing public a detailed view of the financial health of the company:

- Income Statement
- Balance Sheet
- Statement of Cash Flows

Public companies are held to a very strict standards and rules when issuing financial statements – to be financially transparent.

When things aren't all that transparent...

Throughout the 1990s, Enron (among others, notably Tyco International and Worldcomm) published financial statements that suggested the company was doing exceptionally well.

Investors were enthusiastic about such profit growth, and aggressively bought Enron stock, driving up the stock price.

Until one day, an Enron accountant noticed things were not adding up correctly.

It became public that Enron's financial statements were falsified to mislead investors.

Enron soon collapsed, and investors holding Enron stock lost everything.



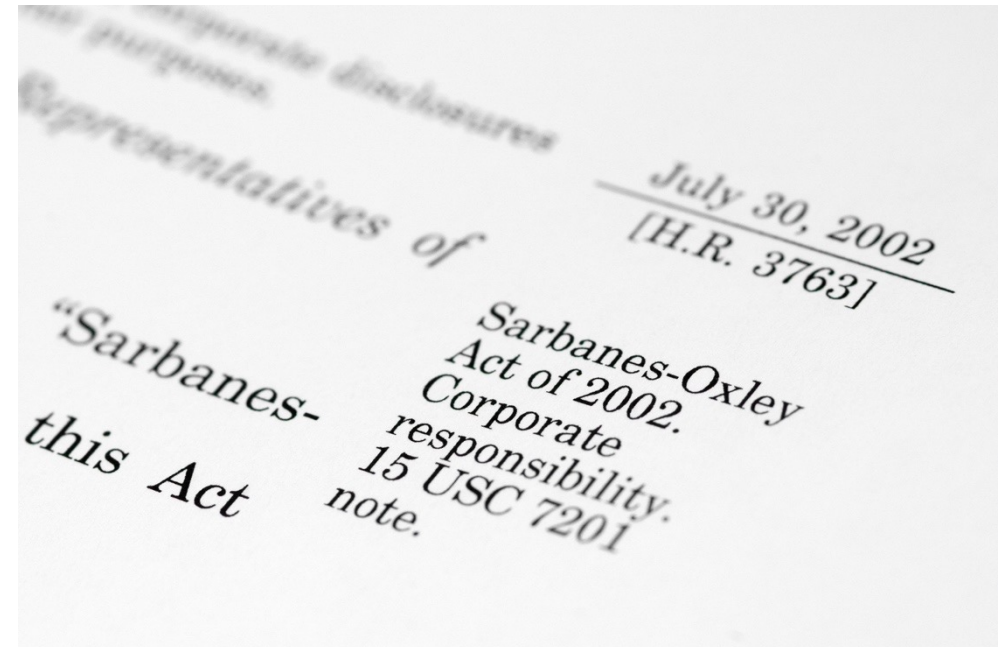
Sarbanes-Oxley...

After the collapse of Enron (and in turn Tyco International, Worldcomm and others) there was great concern in the investor community, and Congress stepped in.

In 2002, Senator Paul Sarbanes (D-MD) and Representative Michael Oxley (R-OH) co-sponsored the “Sarbanes-Oxley Act” (SOX).

Under SOX, the CFO and CEO of a public company must sign formal documents attesting the veracity of the company’s financial statements.

Failure to comply may lead to personal fines or jail time for the CEO & CFO.



Main Takeaways...

Financial management is about making investments for the future health of the business.

The CFO and their team are responsible for determining how the company will pay for those investments: debt, the company's profits, or outside investment (equity).

Yet financial management is also about deciding how to govern day-to-day operations.

A significant goal of financial management is to accurately reflect the financial state of the company, through its series of quarterly and annual financial statements. Sarbanes-Oxley ensures this is the case!

While major financial decisions are often made by the C-Suite, lower and mid-level managers are very involved in implementing corporate strategies and managing day-to-day operations.

Therefore, we need to understand the financial implications of our decisions!

Next Time...

The Goal of Financial Management



Credits & References

Slide 1: Business composition. Financial analysis - income statement, business plan by Leonid, Adobe Stock (284925719.jpeg)

Slide 2: Rear view mirror by itsallgood, Adobe Stock (3073418.jpeg). Businesswoman looking ahead by ChenPG, Adobe Stock (58445523.jpeg).

Slide 3: Source: "If you're clueless about accounting and finance", by Seth Godin and Paul Lim. Dearborn Publishing, Chicago (1998).

Slide 4: Source: The Free Dictionary, <https://www.thefreedictionary.com/finance> (accessed April 6, 2022).

Slide 7: Hand touching for select CFO interface button by hin255, Adobe Stock (89602382.jpeg).

Slide 11: Enron logo image source Wikipedia https://en.wikipedia.org/wiki/Enron#/media/File:Logo_de_Enron.svg (accessed April 6, 2022).

Slide 11: Enron Stock image source: Nehrams2020 (original), User:0xF8E8 (SVG) - Derived from Image:EnronStockPriceAug00Jan02.jpg, CC BY-SA 3.0, <https://commons.wikimedia.org/w/index.php?curid=41544334> <https://en.wikipedia.org/wiki/Enron#/media/File:EnronStockPriceAugust2000toJanuary2001.svg> (accessed April 6, 2022).

Slide 12: Sarbanes-Oxley Act by ellenmck, Adobe Stock (206608114.jpeg).

Slide 14: Business growth concept. Financial report with graphs and arrow by Vitalii Vodolazskyi, Adobe Stock (255882298.jpeg)