

FIN 2704/2704X

Week 1 Slides

Introduction to Financial Management

Learning objectives

- Know the definition of “Finance”
- Understand the scope of financial studies
- Understand the basic types of financial management decisions



A word cloud of financial terms. The central and largest word is "Finance". Other large words include "money", "debt", "interest", "investor", "risk", "banks", "loans", "corporate", "management", "equity", "control", "funds", "assets", "bonds", "forms", "general", "package", "individuals", "exchanges", "securities", "investors", "consumption", "funding", "includes", "business", "loans", "investments", "rates", "financially", "careful", "become", "market", "charge", "work", "although", "investor", "private", "sell", "decrease", "hold", "important", "personal", "budgeted", "act", "directly", "managed", "agent", "concepts", "investing", "basically", "although". Smaller words include "lends", "also", "general", "package", "individuals", "equity", "control", "funds", "loans", "securities", "investors", "consumption", "funding", "includes", "business", "loans", "investments", "rates", "financially", "careful", "become", "market", "charge", "work", "although", "investor", "private", "sell", "decrease", "hold", "important", "personal", "budgeted", "act", "directly", "managed", "agent", "concepts", "investing", "basically", "although".

Business finance

- A company wants to replace its current production line with a line of new more expensive and more efficient machines
 - Should it buy the new machines?
- A firm needs to purchase a piece of equipment
 - Should it buy a cheaper machine with a shorter lifespan or a more expensive machine that lasts longer?
- A company is deciding whether to develop a new product
 - But most of the development costs that will be incurred before any sale revenues have been realized
- How should businesses finance their operations:
 - Borrow or bring in new investors/shareholders?



Government finance

Singapore – KL high speed rail

S'pore to KL: Getting up to speed

The dream of zipping from Singapore to Kuala Lumpur in 90 minutes took another step towards being realised, with the announcement of Jurong East as the site for the Singapore terminus. We compare the high-speed rail option to other transportation modes.

A magnetic levitation train on an experimental track in Tsuru, 100km west of Tokyo.



COST OF HIGH-SPEED RAIL

■ Estimated: RM40 billion (\$14.8 billion). However, one railway expert said it could range from £15 million to £40 million (\$30 million to \$80 million) per km, depending on the complexity of construction. Going by a distance of 340km, this could mean a range of \$10.2 billion to \$27.2 billion.



COMPLETION DATE

■ Possibly 2025 to 2030.
■ While initially targeted for 2020, experts said some time between 2025 and 2030 would be more realistic.
■ Malaysian Prime Minister Najib Razak said the construction would take approximately five years, while the design and tender phases would take one year each.



Sources:

- <https://www.straitstimes.com/singapore/transport/financing-singapore-kl-high-speed-rail-a-complex-task-analysts>
- <https://www.channelnewsasia.com/news/asia/kl-singapore-hsr-high-speed-train-malaysia-mahathir-12191180>
- <https://www.iseas.edu.sg/?s=singapore+KL+HSR>

Personal finance

The principles behind making correct business finance decisions are the same as those used for individual finance decisions. So the good news is that the lessons of this course can benefit you in many areas of your personal life.

You can begin to theoretically and quantitatively address:

- When to start saving for retirement and how much to save?
- How to evaluate the terms for a home mortgage?
- Whether a car loan or a lease is more advantageous?
- Is a particular stock a good investment? Is a particular fund a good investment?
- How to finance a child's education?



Main areas of finance

1. Investments
2. Financial Markets and Intermediaries
3. Corporate Finance (or Business Finance)



Investments

The study of financial transactions from the perspective of **investors outside the firm**

Examples:

- How do we assess the risk of various financial securities?
- How do we manage a portfolio (a grouping) of financial securities to achieve a stated objective of the investor?
- How do we evaluate portfolio performance?



Financial markets and intermediaries

Financial markets

The study of **markets where financial securities** (such as stocks and bonds) **are bought and sold**

Financial intermediaries

The study of **financial institutions** (such as commercial banks, investment banks, and insurance companies) that facilitate **the flow of money** from savers to demanders of money



Corporate finance

Corporate Finance addresses the following:

- **Capital budgeting** decision: What long-term investments should the firm take on?
- **Capital structure** decision: Where will we get the long-term financing to pay for the investment?
- **Working capital management** decision: How will we manage the everyday financial activities of the firm?

Examples of Financial decisions affecting firms:

- Honda expands into amphibious vehicles.
- ShengSiong opens additional stores.
- Nike closes a production plant in Asia.
- Unilever borrows \$3 billion.
- Thai Bev issues stock valued at \$3 billion.



Capital budgeting example

Dyson to Make Electric Car by 2020

- <https://www.channelnewsasia.com/news/business/dyson-to-make-electric-cars-by-2020-9253136>
- Announced in September 2017
- £2 billion (\$3.4 billion) investment

But, in October 2019, the firm announced that it is putting a halt in this project

- <https://www.channelnewsasia.com/news/business/dyson-hits-brakes-electric-car-what-the-shift-means-singapore-11992980>

- From the article:

“Breaking the news in an email to employees, Mr Dyson wrote:

“Though we have tried very hard throughout the development process, we simply can no longer see a way to make it commercially viable.””

12



Capital structure example

Amazon sets record low rates for its new bond issuance

- <https://www.bloomberg.com/news/articles/2020-06-02/it-s-a-borrower-s-bond-market-as-amazon-gets-record-low-rates>
- US\$10 billion debt issuance; 40 basis points (1 basis point = 0.01%) coupon for 3 years



Working capital management example

Dell's lengthy payment terms to its suppliers

- <https://www.wsj.com/articles/will-emc-adopt-dells-lengthier-payment-terms-1468874149>

- From the article:

“Dell is one of the technology industry's most aggressive companies at delaying payments to help finance its operations. It took approximately 107 days to pay its bills in its most recent quarter, far more than the 42 average days in accounts payable at EMC, based on the companies' regulatory filings.”

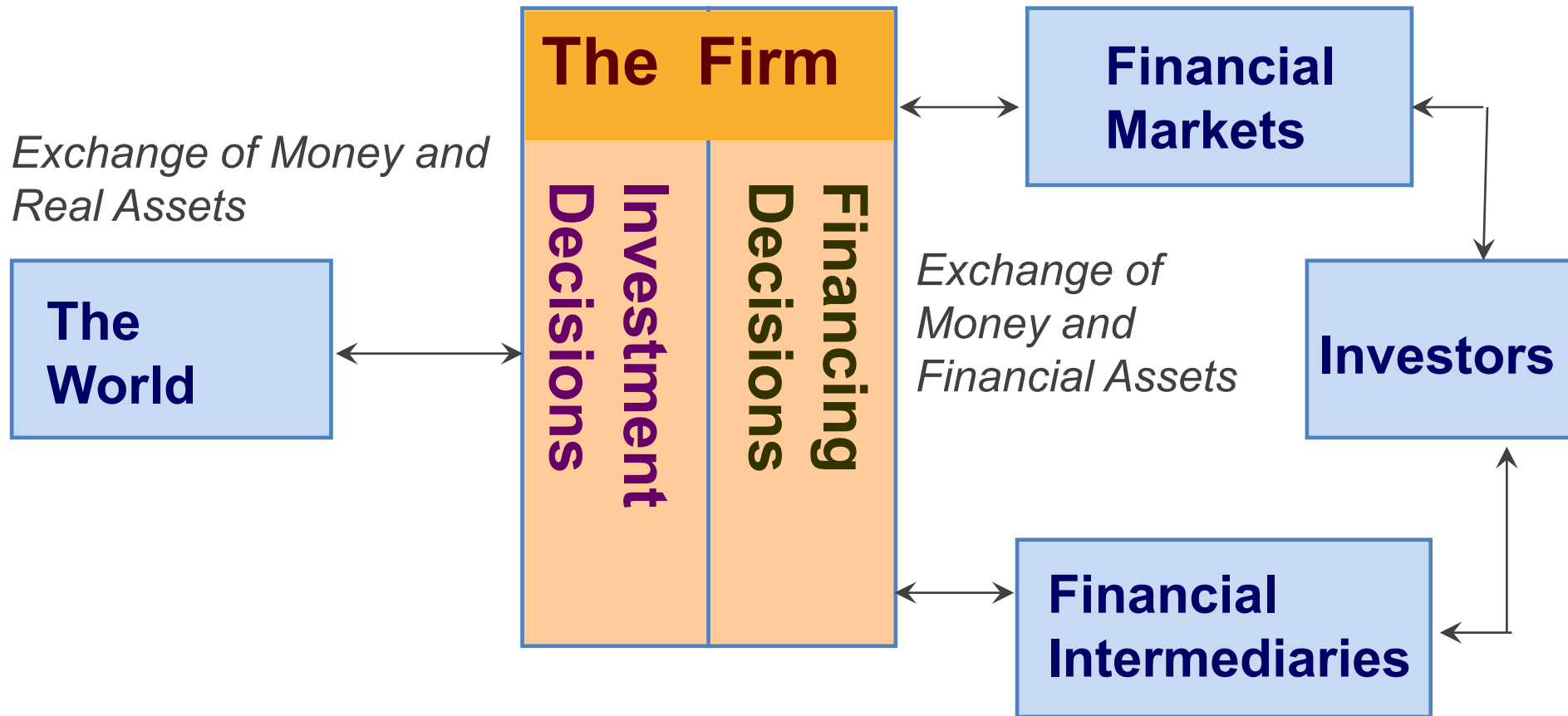


Firm as an investment vehicle

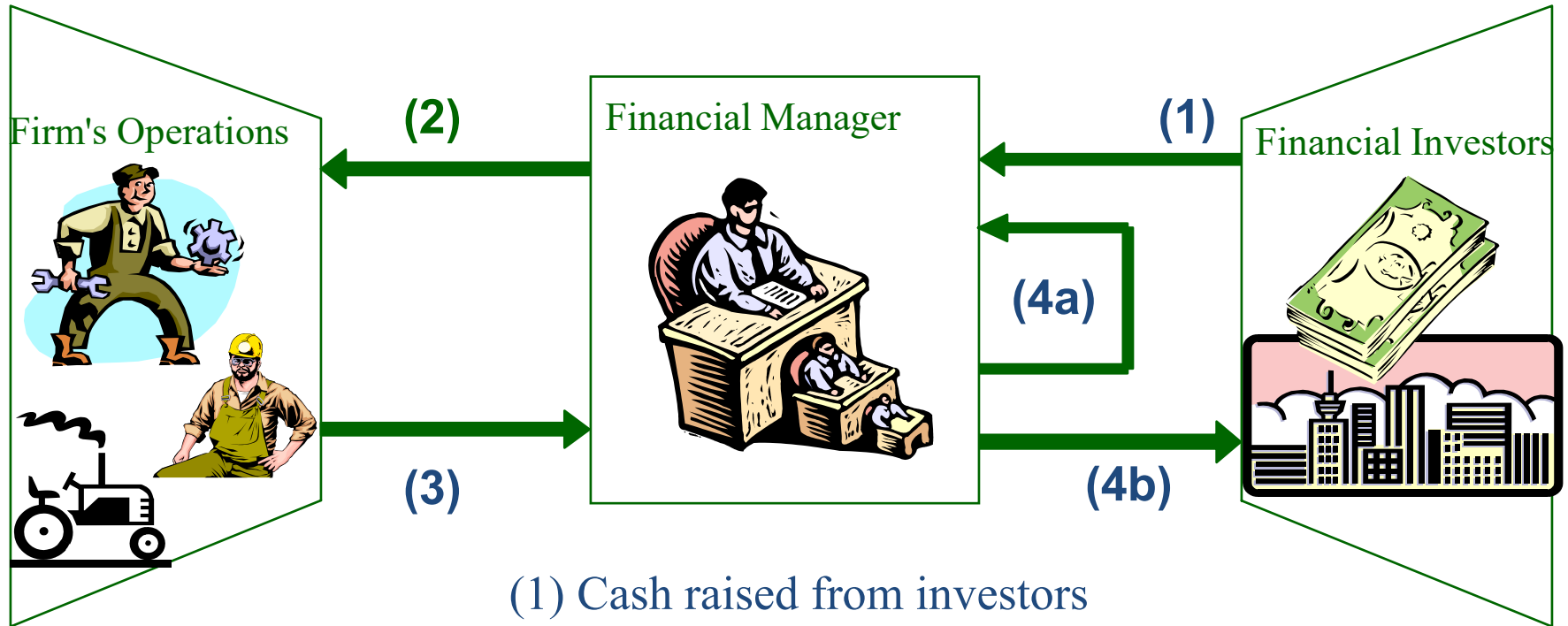
- Investors provide financing to the firm in exchange for financial securities (various claims on the firm's cash flows)
- The firm invests these funds in assets
- Income generated by the firm's assets is distributed to the investors (i.e., the holders of the firm's financial securities).



Investment vehicle model



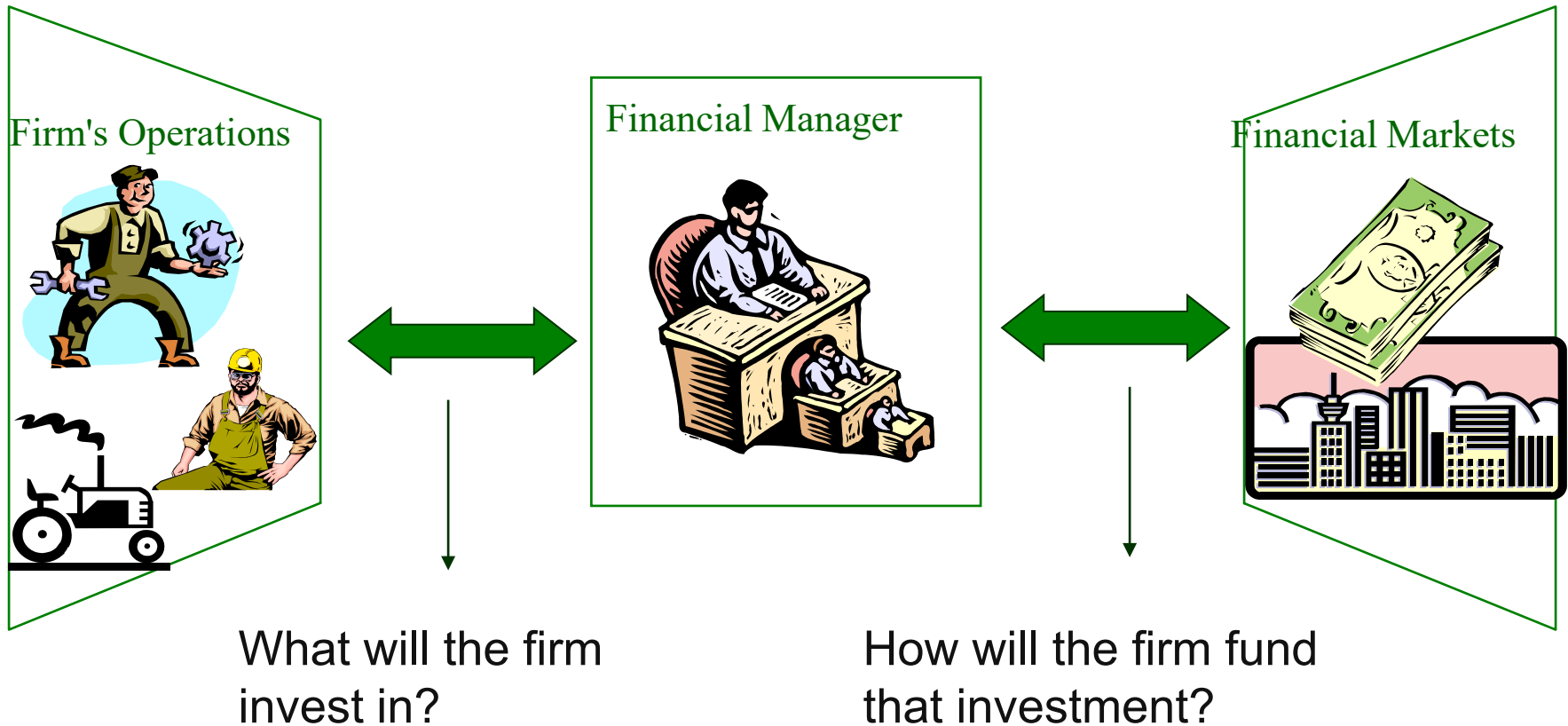
Investment vehicle model – cash flows



- (1) Cash raised from investors
- (2) Cash invested in firm
- (3) Cash generated by operations
- (4a) Cash reinvested
- (4b) Cash returned to investors



Investment vehicle model – cash flows



Firm's decisions

1. Investment decisions

- Represented on the **assets** (i.e. left hand) side of the balance sheet

2. Financing decisions

- Represented on the **liabilities and equity** (i.e., right hand) side of the balance sheet

$$\text{Assets} = \text{Liabilities} + \text{Equity}$$

Known as the **Balance Sheet Model** or **Accounting Model** of the Firm



Relating value to the Balance Sheet

Total Value of Assets:

Current Assets

Fixed Assets

1. Tangible

2. Intangible

Total Firm Value to Investors:

Current
Liabilities

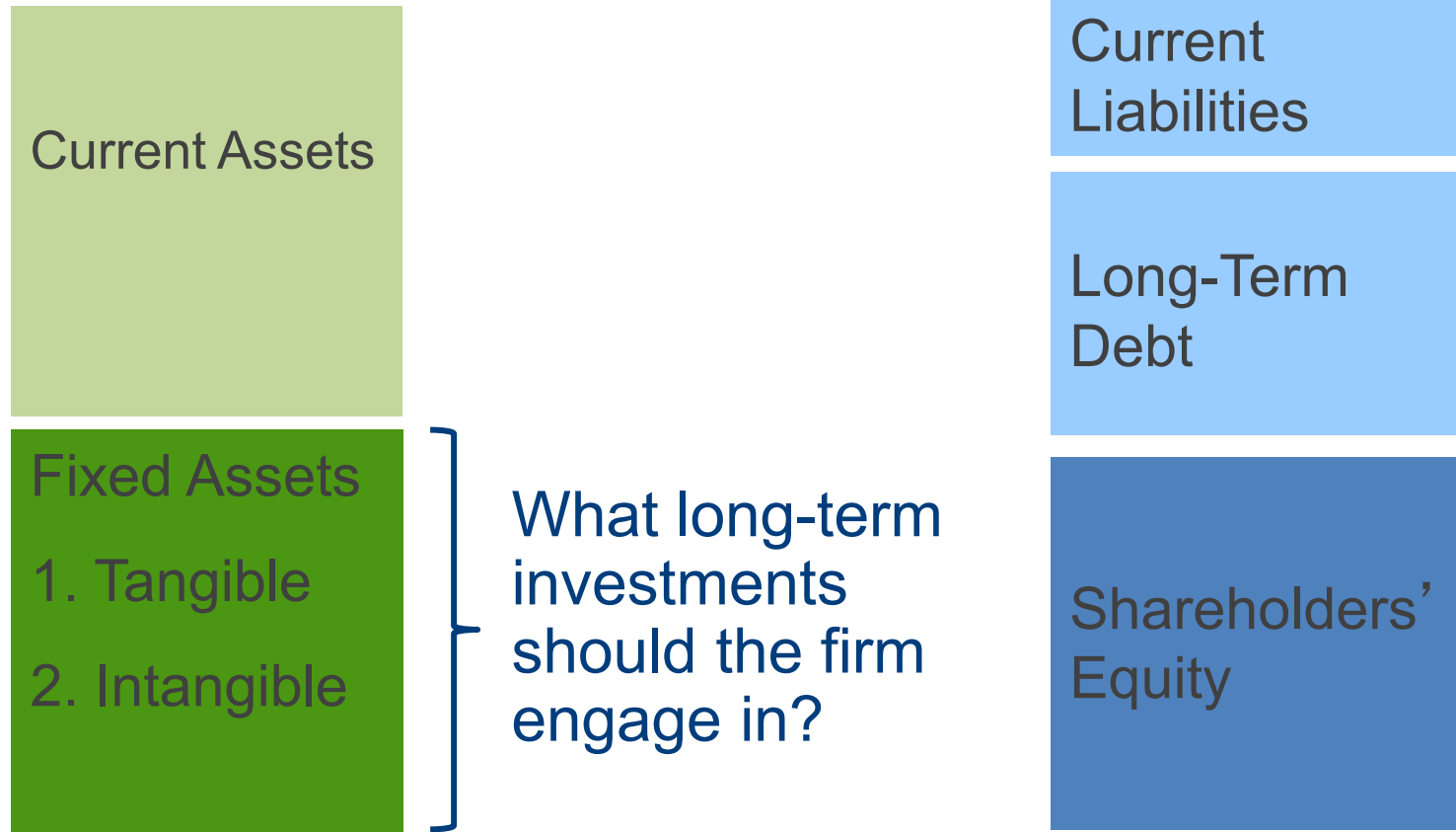
Long-Term
Debt

Shareholders'
Equity



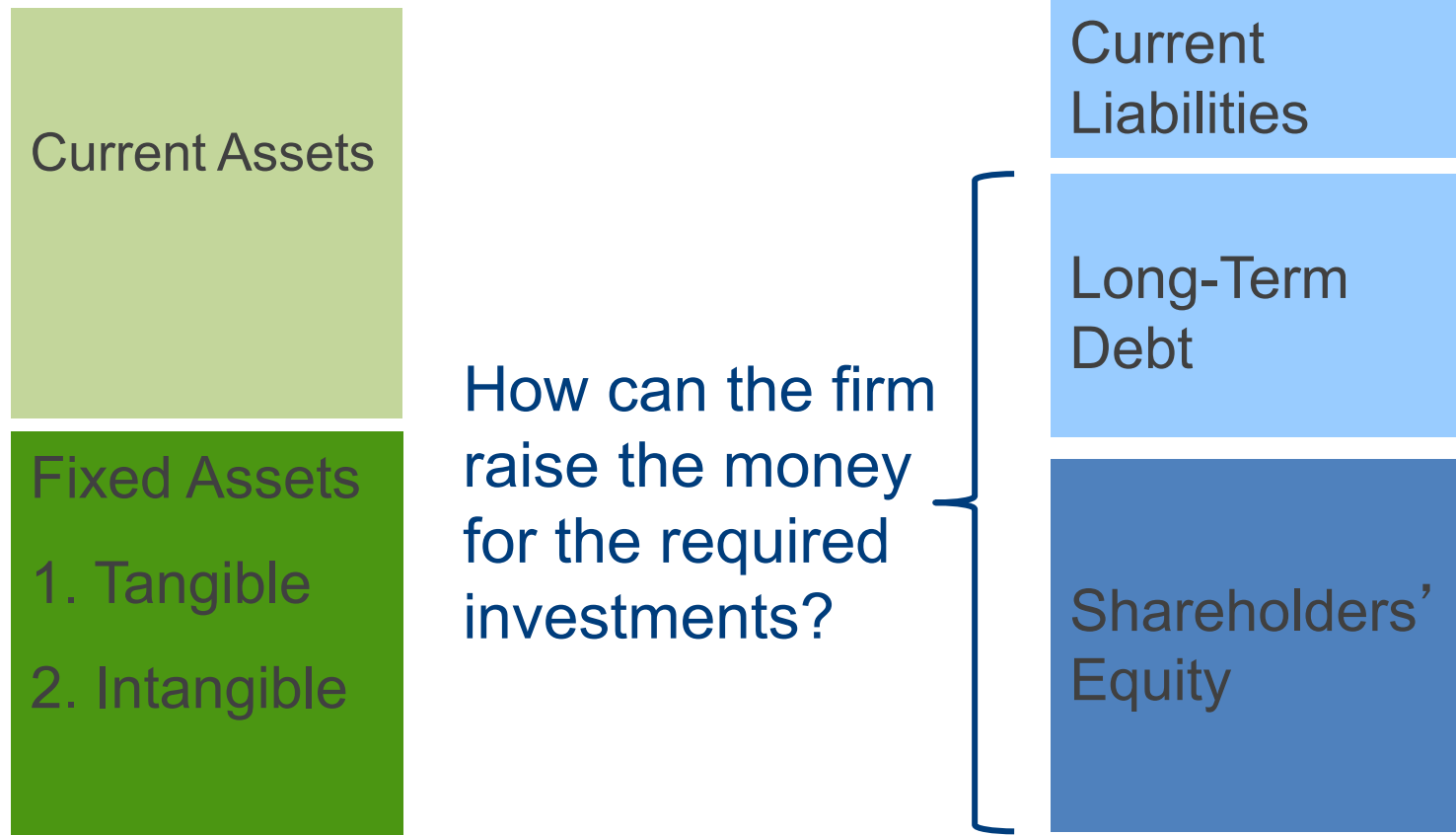
Relating value to the Balance Sheet

Capital budgeting decision:



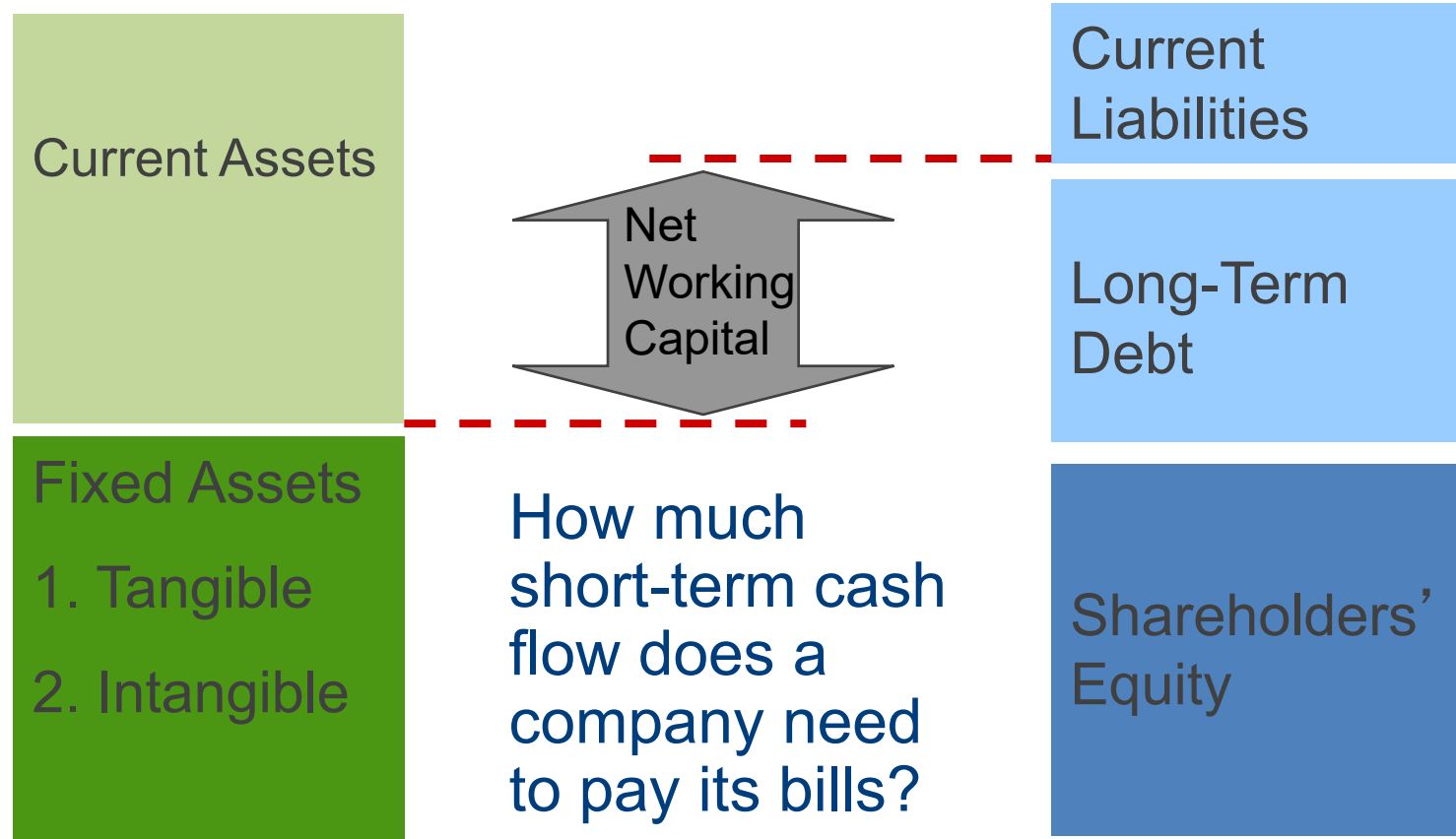
Relating value to the Balance Sheet

Capital structure decision:



Relating value to the Balance Sheet

Net Working Capital Investment Decision



Relating value to the Balance Sheet

Investment Decision:

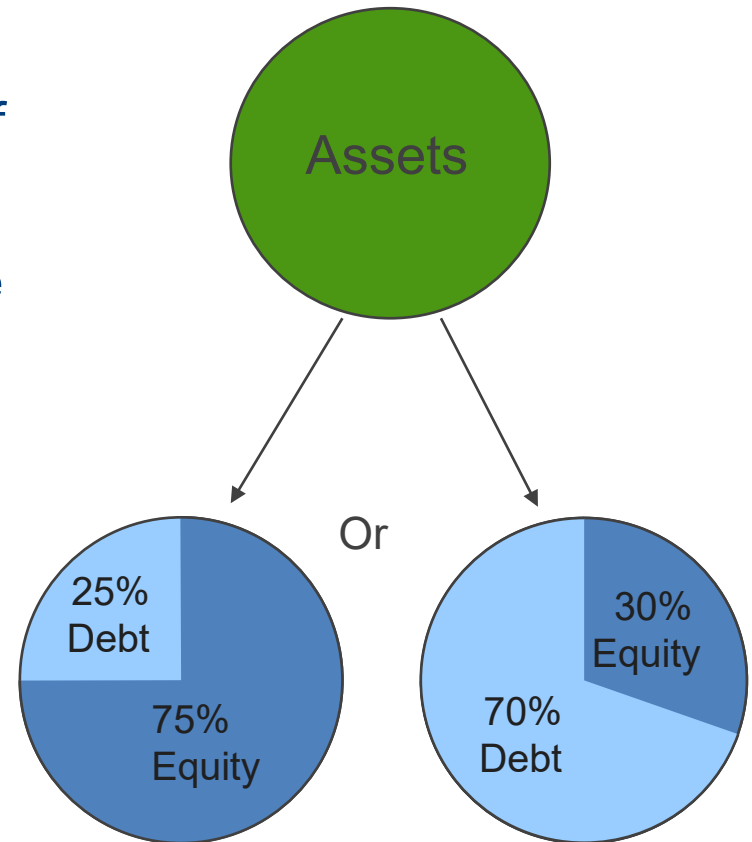
Goal: To maximize value

- The value of the firm can be thought of as a pie
- The goal of the manager is to increase the size of the pie via value maximization.

Financing Decision:

Goal: How best to slice up the pie

This can take on an infinite range of possibilities



Summary

The scope of financial studies involves:

- Business finance
- Financial markets
- Investments

Business finance involves:

- Investment decisions
- Financing decisions
- Working capital management



Business Organizations

Learning objectives

Know the different forms of business organization



Forms of business organization

1. Sole proprietorship

2. Partnership

3. Corporation



Increasing
in
complexity
and costs



Sole proprietorship

An individual owns and manages the business

Advantages

- Easiest to start
- Least regulated
- Single owner keeps all the profits
- **Taxed once as personal income**

Disadvantages

- Limited to life of owner
- Equity capital limited to owner's personal wealth
- **Unlimited liability**
- Difficult to sell ownership interest



Partnership

A *group* of individuals collectively own and manage the business

Advantages

- Two or more owners
- More capital available
- Relatively easy to start
- **Income taxed once as personal income**

Disadvantages

- **General partnership: unlimited liability**
- **Limited partnership: general partner(s) & limited partners**
- Partnership dissolves when one partner dies or wishes to sell
- Difficult to transfer ownership

Roughly the same advantages and disadvantages as a sole proprietorship



Corporation

Advantages

- **Limited liability**
- Unlimited life
- Separation of ownership and management
- Transfer of ownership is easy
- Easier to raise capital

Disadvantages

- Separation of ownership and management (and the resulting potential for agency costs)
- **Double taxation**
 - **Income taxed at the corporate rate**
 - **Dividends taxed at personal rate***

* Not for Singapore



Corporation

Created via *Articles of Incorporation*, which

- Set out the purpose of the business
- Establish the number of shares that can be issued
- Set the number of directors to be appointed

Ownership and management are separated

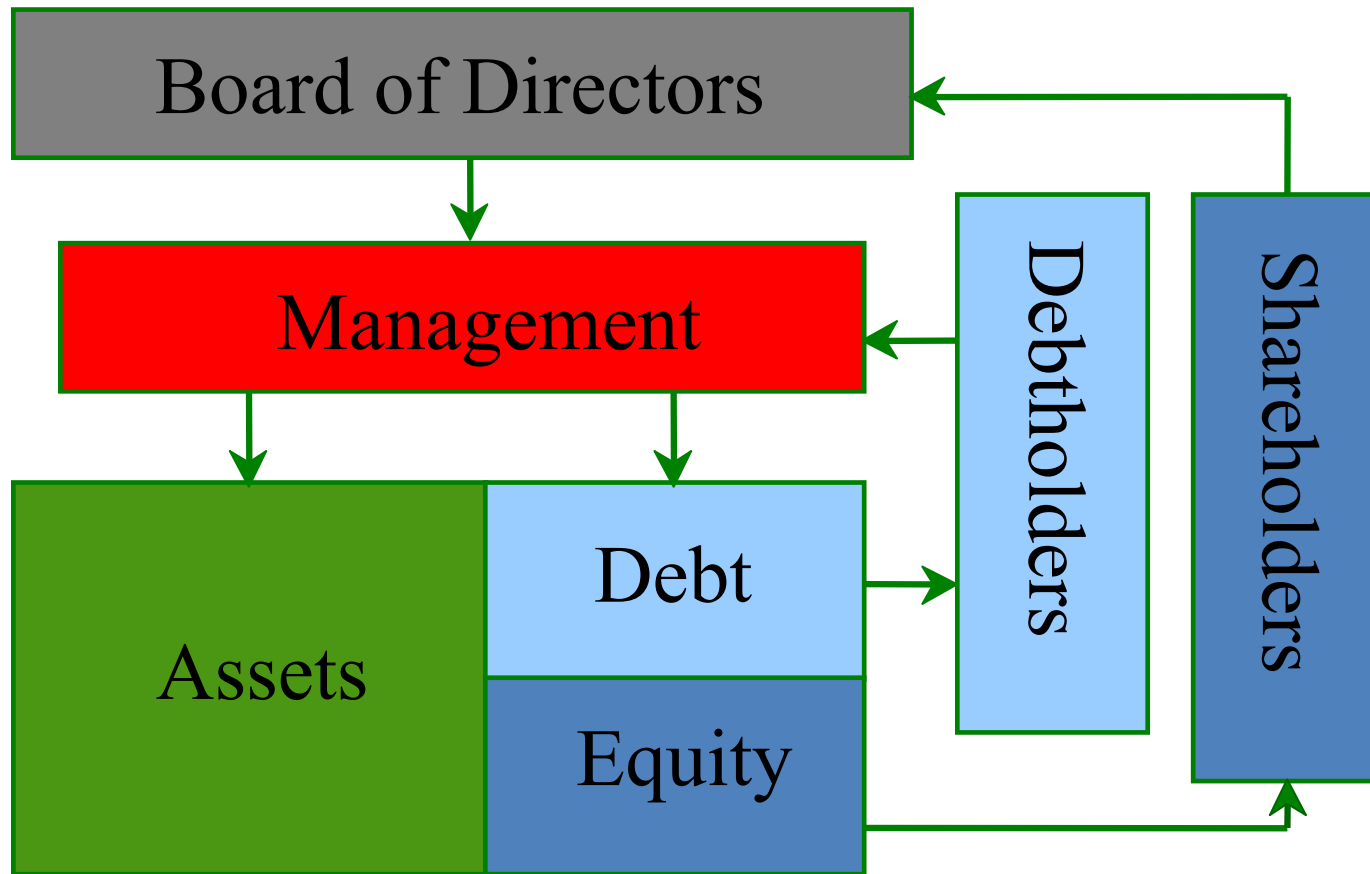
A corporation issues equity shares

- The **holders of these shares** are the **owners** of the firm
- **Although stockholders own the corporation, they do not necessarily manage it.** Instead they vote to elect a Board of Directors (BOD). The BOD represents the shareholders and in this vein, (i) selects the management team, (ii) appoints the auditors and (iii) is responsible for checking/monitoring management's actions.



Corporate structure

Separation of Ownership and Control



Corporation

- Private Companies
 - Firm's shares are usually closely held, i.e., ownership is closely held by a relatively small number of shareholders and shareholders often include the companies' original founders, some financial backers (e.g., venture capitalists) and others
 - Shares are **not traded on any exchange**
- Public Companies
 - Firm's shares are **listed on a stock exchange**, whereby the company's shares are widely dispersed and traded in the secondary markets



Corporations:

Two main sources of external financing

1. Debt

- **Lenders** – By lending money to the corporation, debt holders become the corporation's creditors and lenders.
- **Relationship Determined by Contract** - A debt contract is a legally binding agreement. It specifies principal, **interest**, maturity date, and specific protective covenants.
- **Security and Seniority** – In case of bankruptcy, debt holders collect before equity holders. However, different debt holders have different priority claim to the cash flows and assets of a bankrupt firm, according to their respective debt contracts.



Corporations:

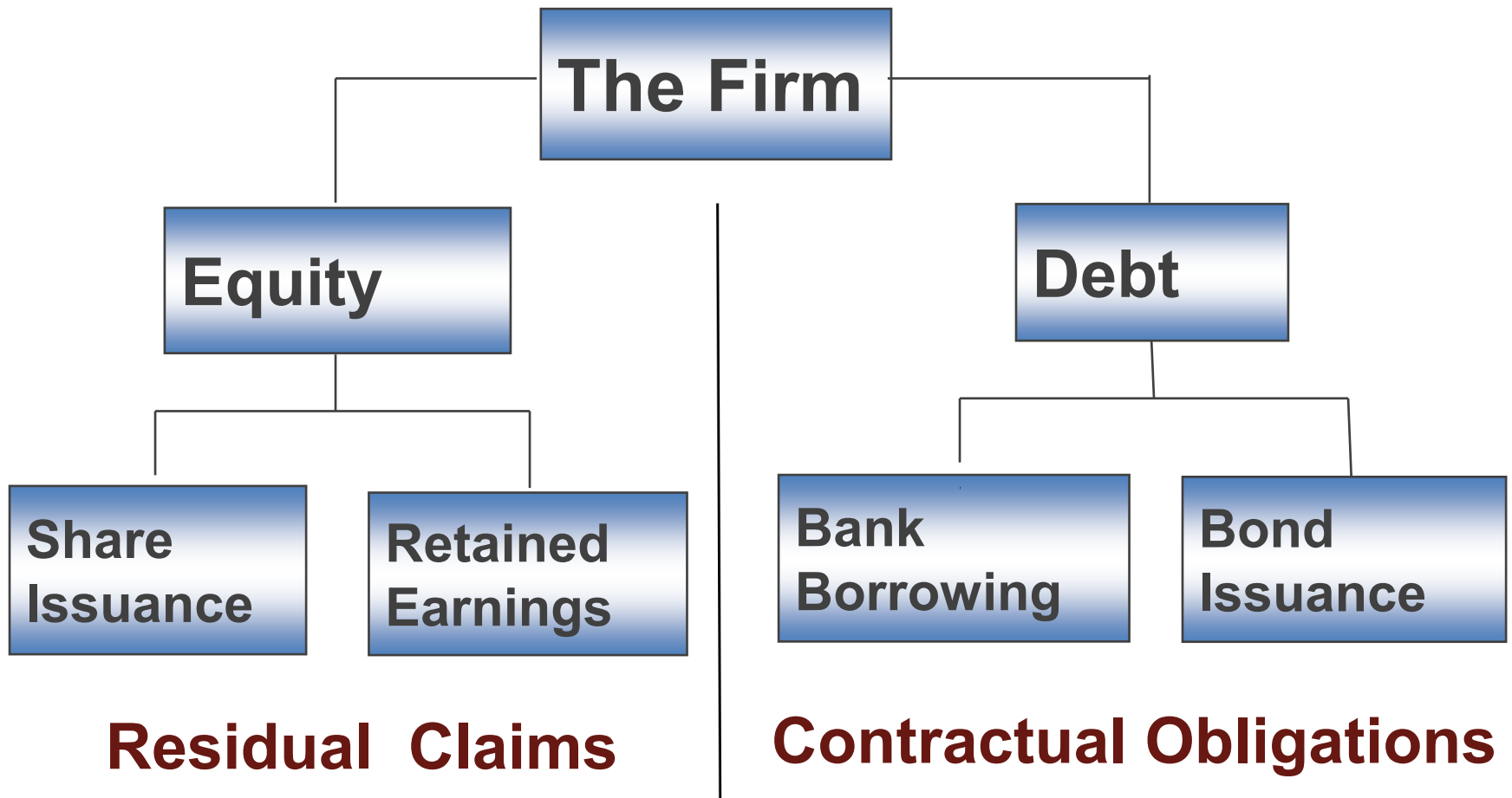
Two main sources of external financing

2. Equity

- **Shareholders' Ownership Rights** – by buying shares in the corporation, shareholders become the owners of the firm
 - Shareholders are the **residual** claimants of the firm
- **Shareholders' Payoffs** – shareholders receive monetary returns in the following ways:
 - **Dividend** per share, paid to investors from the corporation's after-tax dollars
 - **Capital gain** from the sale of shares (ownership rights) at a price higher than they were purchased for



Firm's Sources Of Funds



Summary

Forms of business organization:

- Sole proprietorship
- Partnership
- Corporation



Appendix



COMPARISON OF THE FORMS OF BUSINESS ORGANISATIONS

	Sole-Proprietorship	Partnership	Limited Partnership (LP)	Limited Liability Partnership (LLP)	Company
Definition	A business owned by one person	An association of two or more persons carrying on business in common with a view to profit	A partnership consisting of two or more persons, with at least one general partner and one limited partner	A partnership where the individual partner's own liability is generally limited	A business form which is a legal entity separate and distinct from its shareholders and directors
Owned by	One person	Generally between 2 and 20 partners. A partnership of more than 20 partners must incorporate as a company under the Companies Act, Chapter 50 (except for professional partnerships)	At least 2 partners; one general partner and one limited partner. No maximum limit.	At least 2 partners, no maximum limit.	Exempt Private Company – 20 members or less and no corporation holds beneficial interest in the company's shares Private Company – 50 members or less Public Company – can have more than 50 members
Legal Status	<p>Not a separate legal entity</p> <p>Owner has unlimited liability</p> <p>Can sue or be sued in individual's own name</p> <p>Can also be sued in business name</p> <p>Can own property in individual's name</p> <p>Owner personally liable for debts and losses of business</p>	<p>Not a separate legal entity</p> <p>Partners have unlimited liability</p> <p>Can sue or be sued in firm's name</p> <p>Cannot own property in firm's name</p> <p>Partners personally liable for partnership's debts and losses incurred by other partners</p>	<p>Not a separate legal entity</p> <p>General partner has unlimited liability</p> <p>Limited partner has limited liability</p> <p>Can probably sue or be sued in firm's name</p> <p>Cannot own property in firm's name</p> <p>General partner personally liable for debts and losses of the LP</p> <p>Limited partner not personally liable for the debts or obligations of LP beyond amount of his agreed contribution</p>	<p>A separate legal entity from its partners</p> <p>Partners have limited liability</p> <p>Can sue or be sued in LLP's name</p> <p>Can own property in LLP's name</p> <p>Partners personally liable for debts and losses resulting from their own wrongful actions</p> <p>Partners not personally liable for debts and losses of LLP incurred by other partners</p>	<p>A separate legal entity from its members and directors</p> <p>Members have limited liability</p> <p>Can sue or be sued in company's name</p> <p>Can own property in company's name</p> <p>Members not personally liable for debts and losses of company</p>



Registration Requirements	Age 18 years or above. Singapore citizen/ Singapore permanent resident/ EntrePass holder.	Age 18 years or above. Singapore citizen/ Singapore permanent resident/ EntrePass holder.	At least one general partner and limited partner. Both can be individuals (at least 18 years old) or body corporate (company or LLP).	At least two partners, who can be individuals (at least 18 years old) or body corporate (company or LLP)	At least one shareholder
	If owner not resident in Singapore, he must appoint an authorized representative who is ordinarily resident in Singapore	If owners not resident in Singapore, they must appoint an authorized representative who is ordinarily resident in Singapore	If all general partners are ordinarily resident outside Singapore, they must appoint a local manager who is ordinarily resident in Singapore	At least one manager ordinarily resident in Singapore and at least 18 years old	At least one director ordinarily resident in Singapore, at least 18 years old
	Self-employed persons must top up their Medisave account with the CPF Board before they register a new business name, become a registrant of an existing business name, or renew their business name registration	Self-employed persons must top up their Medisave account with the CPF Board before they register a new business name, become a registrant of an existing business name, or renew their business name registration	Self-employed persons must top up their Medisave account with the CPF Board before they register as a partner of a new LP, become a registered partner of an existing LP, or renew their LP registration		If a foreigner wishes to act as a local director of the company, he can apply for an EntrePass from the Ministry of Manpower
	Undischarged bankrupts cannot manage the business without approval from the Court or the Official Assignee	Undischarged bankrupts cannot manage the business without approval from the Court or the Official Assignee	Undischarged bankrupts cannot manage the business without approval from the Court or the Official Assignee	Undischarged bankrupts cannot manage the business without approval from the Court or the Official Assignee	Undischarged bankrupts cannot be a director and cannot manage a company without approval from the Court or the Official Assignee.
Formalities and Expenses	Quick and easy to set up	Quick and easy to set up	Quick and easy to set up	Quick and easy to set up	More costly to set up and maintain
	Easy to administer and manage	Easy to administer and manage	Easy to administer and manage	Fewer formalities and procedures to comply with than a company	More formalities and procedures to comply with
	Registration cost is minimal.	Registration cost is minimal.	Registration cost is minimal	Registration cost is relatively minimal and fewer regulatory duties to adhere to than a company	Must appoint a company secretary within 6 months of incorporation
	Less administrative duties to adhere to	Less administrative duties to adhere to	Less administrative duties to adhere to	No statutory requirement for general meetings, directors, company secretary, share allotments, etc.	Must appoint an auditor within 3 months after incorporation unless the company is exempt from audit requirements
	Can renew business registration for one year or three years.	Can renew business registration for one year or three years.	Can renew business registration for one year or three years.	Only an annual declaration of solvency/insolvency must be lodged by one of the managers stating whether the LLP is able or not able to pay its debts during the normal course of business	Annual Returns must be filed. Statutory requirements for general meetings, directors, company secretary, share allotments, etc. must be complied with.



Taxes	Profits taxed at owner's personal income tax rates	Profits taxed at partners' personal income tax rates	Profits taxed at partners' personal income tax rates (if individual)/ corporate tax rate (if corporation)	Profits taxed at partners' personal income tax rates (if individual)/ corporate tax rate (if corporation)	Profits taxed at corporate tax rates
Continuity in Law	Exists as long as the owner is alive and desires to continue the business	Exists subject to partnership agreement	Exists subject to partnership agreement If there is no limited partner, the LP registration will be suspended and general partners are deemed registered under the Business Names Registration Act Once a new limited partner is appointed, the registration of the LP will be restored to "live" and general partners' registration under the Business Names Registration Act ceases	The LLP has perpetual succession until wound up or struck off	A company has perpetual succession until wound up or struck off
Closing the Business	By Owner – Cessation of business Registrar can cancel registration if not renewed or where Registrar is satisfied business is defunct	By the partners – Cessation of business. Registrar can cancel registration if not renewed or where Registrar is satisfied business is defunct	By general partner – cessation of business or dissolution of LP Registrar can cancel registration if not renewed or where Registrar is satisfied LP is defunct	Winding Up – Voluntarily by members or creditors, compulsorily by the High Court Striking off	Winding Up – Voluntarily by members or creditors, compulsorily by the High Court Striking off



Financial Managers

Learning objectives

- Understand the goals of the different stakeholders in a corporation
- Roles and decisions of financial managers
- Agency problem & agency costs
- Corporate governance



What should the goal of a corporation be?

Commonly cited goals:

- Maximize sales/market share?
 - Lowering price or relaxing credit terms
- Minimize costs?
 - Lowering quality or R&D
- Maximize profits?
 - Short-term nature
 - Definition of profits: accounting or economic
 - Risk is not addressed



Goal of Financial Management

The primary goal is shareholder **wealth maximization**

- The same as maximizing stock price

The goal of the firm is to **maximize its value**

- Maximize the value of the firm
- Maximize the wealth of its owners
- Maximize the price of its stock
- Maximize its contribution to the economy

As per finance theory, the above four objectives are all best realized when the firm uses finance's **systematic** value maximizing investment and financing **decision criteria**



How Can Managers Maximize Stock Price?

What determines stock prices?

- The underlying firm's **ability to generate cash flows**

Three aspects of cash flows that affect asset value and thus stock prices

- **Amount** of cash flows expected by shareholders
- **Timing** of the cash flow stream
- **Riskiness** of the cash flow stream

⇒ All three determine the stock's **Intrinsic Value**



Intrinsic Value vs. Market Price

Intrinsic value: an **estimate** of a stock's “true” value based on accurate risk and return data (amount, timing and riskiness of cash flows)

- An “estimated” value, not a precise objectively known measure
- Often referred to as estimates of ‘**fundamental value**’

Market price: the **actual selling price** of a stock. It is based on perceived information as seen by the marginal investor in the market.

Market value is sometimes used to refer to intrinsic value, but that may not be correct

- Market values are observable
- Intrinsic values are unobservable and can only be estimated



Organization chart



Financial Manager

The top financial manager within a firm is usually the **Chief Financial Officer (CFO)**

- **Treasurer:** oversees cash management, credit management, capital expenditures and financial planning
- **Controller:** oversees taxes, cost accounting, financial accounting and data processing



The Role & Decisions of the Financial Manager

Maximise Value (stock price) of the Firm

Capital Budgeting

What long-term investments or projects should the business take on?

Capital Structure

How should we pay for our assets?
Should we use debt or equity?

Working Capital Management

How do we manage the day-to-day finances of the firm?



Agency Problem

Agency relationship:

- Principal hires an agent to represent their interest
- Stockholders (principals) hire managers (agents), via the Board of Directors, to run the company

Agency problem:

- **Conflict of interest** between principal and agent
- Potential conflict of interests:
 - Shareholders and managers
 - Shareholders and creditors



Agency Costs

Direct agency costs:

- Expenditures that benefit management: car and accommodation, big office, high pay
- Monitoring costs: auditors, audit committee, corporate governance

Indirect agency costs:

- Lost opportunities which would increase firm value in the long run, if accepted



Example of agency cost



HSBC Faces Investor Anger Over Proposed Pay Rise For Top Team

by Katherine Griffiths, Miles Costello, 16/2/2010

<https://www.thetimes.co.uk/article/hsbc-faces-investor-anger-over-proposed-pay-rise-for-top-team-fw69tzb27ms>

- Investors are understood to be particularly unhappy with the sum that HSBC wants to pay Michael Geoghegan, its chief executive, who relocated his office to Hong Kong on February 1.
- HSBC will pay Michael Geoghegan, chief executive, an extra £800,000 a year in "allowances" and "benefits in kind" for moving his family from London to Hong Kong
(<https://www.telegraph.co.uk/finance/newsbysector/banksandfinance/7370366/HSBC-boss-Michael-Geoghegan-paid-800000-a-year-to-move-to-Hong-Kong.html>)



Shareholders vs. Managers

Managers are naturally inclined to act in their own best interests

Factors that could affect managerial behavior:

- Compensation plans tied to share value
- Direct intervention by shareholders
- The threat of firing
- The threat of takeover



CEO compensation example 1

Disney's Former CEO Compensation Package

Michael Eisner's compensation package's 3 main components:



1. A base annual salary of \$750,000
2. An annual bonus of 2% of Disney's net income above a threshold of "normal" profitability
3. A 10-year option that allowed him to purchase 2 million shares of Disney stock at the 1984 price when he was hired as the CEO.



CEO compensation example 2

DBS CEO Compensation Package



Piyush Gupta's 2014 compensation package's 3 main components:

1. A Base Salary of S\$1.2m
2. A Cash Bonus tied to performance and meeting of KPIs set on Balanced Scorecard (Short Term Incentive) of \$3.8m
3. A Share Plan with staggered vesting period between 2-4 years (Long Term Incentive) of \$5.1m

His compensation in 2019:

<https://www.straitstimes.com/business/banking/dbs-ceo-piyush-gupta-sees-2-rise-in-pay-to-121m-for-2019-down-from-155-hike-in-2018>



Addressing the agency problem

- Compensation plans that tie the fortunes of the managers to the fortunes of the firm
- Monitoring by lenders, stock market analysts and investors
- The threat that poorly performing managers will be fired
- The growing awareness of the importance of good **Corporate Governance**



What is Corporate Governance?

*“Term that refers broadly to the **rules, processes, or laws by which businesses are operated, regulated, and controlled.** The term can refer to internal factors defined by the officers, stockholders or constitution of a corporation, as well as to external forces such as consumer groups, clients, and government regulations.”*

*“...exists to **serve corporate purposes by providing a structure** within which stockholders, directors and management can pursue most effectively the objectives of the corporation”*

- US Business Round Table White Paper on Corporate Governance September 1997

Good corporate governance requires you to view organizations as **a web of relationships between and among various stakeholders and to manage their interests in a responsible manner**

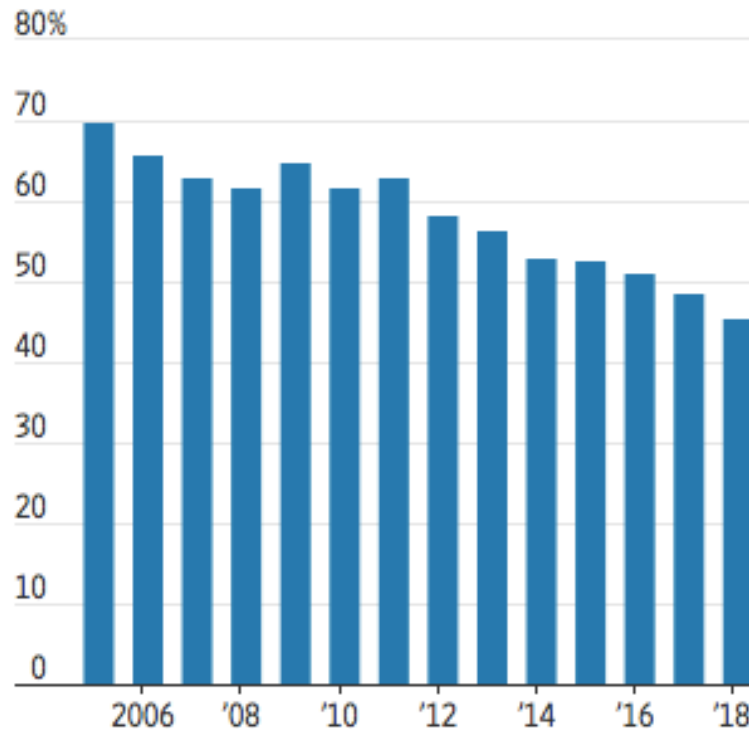
59



Splitting up CEO and Chairman Roles

Breaking Up

Percentage of S&P 500 companies with combined CEO-chairman roles



Source: ISS Analytics



Corporate governance example 1 (2013)

May 21, 2013, 11:49am EDT

Why Jamie Dimon Won Today

After much uncertainty, JPMorgan Chase the majority of shareholders have voted against a proposal that would split the chairman CEO roles at the bank.



Jamie Dimon, chairman of the board, president and CEO of JPMorgan Chase & Co.

That means Jamie Dimon will remain chairman and CEO, roles he's held since 2006 bringing an end to speculation about the future of the bank under Dimon. The proposal to split the roles received 32.2% of votes.

Over the last few months shareholders who wished to bring in an independent chairman argued the split would make for better corporate governance at the bank.

Source:

<https://www.forbes.com/sites/halahtouryala/2013/05/21/why-jamie-dimon-won-today/#3304e71f4c94>



Corporate governance example 2 (2016)

Wells Fargo splits chairman and CEO roles after investor pressure

Wells Fargo has changed its boardroom rules to require the roles of chief executive and chairman be kept separate, adding to pressure on other US banks to end the contentious practice of combining the top jobs.

The bank, which has been in the spotlight for months over sales malpractice in its branches, had prised apart the two positions when John Stumpf quit suddenly in October. He was replaced by Tim Sloan as chief executive and Stephen Sanger as chairman.

On Thursday, however, Wells went further — saying it had with immediate effect amended the company's bylaws to mandate the split. The move comes after pressure from shareholders, including state treasurers in Illinois and Connecticut.

Wells' decision is noteworthy in a sector that has largely resisted such demands — and some corporate governance experts said it should encourage other banks to do the same.

Source:

<https://www.ft.com/content/d32b1a1a-b813-11e6-961e-a1acd97f622d>



Summary

- The goal of financial managers are to maximize the value of the firm
- Shareholders hire managers (via BOD) to run the company.
 - However, there may be conflict of interest
 - Corporate governance



Introductions to Financial Markets

Learning objectives

- Understand what a financial market is
- Understand the different types of financial markets



Financial Markets

What are financial markets?

- Markets where “financial instruments” are traded
- Act as intermediaries between savers and borrowers

Money Markets vs. Capital Markets

Short-term debt vs. long-term assets

Primary Market vs Secondary Market

New stocks/bonds vs. existing stocks/bonds



Money Markets vs. Capital Markets

Money markets

- where debt securities of **less than one year** are traded: treasury securities, commercial paper, bills, inter-bank loans
- loosely connected **dealer markets**
- banks are major players

Capital markets

- where **equity and long-term debt** claims are traded
- Equity is usually traded in **auction markets** (e.g., SGX)
 - Nasdaq is a dealer market



Money market example

YES BANK IMPLEMENTS ASIA'S FIRST COMMERCIAL PAPER ISSUANCE ON BLOCKCHAIN

Blockchain technology leveraged for the first time in Asia to digitally issue Commercial Paper worth INR 100 CRORES for Vedanta Limited

Issuance completed using the capabilities of R3 Corda enterprise platform and MonetaGo's enterprise solution

Mumbai, July 11, 2019: YES BANK, India's fourth largest private sector bank, as an issuing and paying agent (IPA), facilitated the issuance of a Commercial Paper (CP) of **INR 100 Crores** using Blockchain technology for Vedanta Limited, a natural resources conglomerate. This is the first time in Asia that a CP has been digitally issued using Blockchain technology.

The digital solution ensures an efficient, transparent and secure mechanism for CP issuance and redemption. This transaction was completed in partnership with MonetaGo, a leading provider of financial technology headquartered in New York, USA.

MonetaGo built the solution using Corda Enterprise, technology provided by R3, a leading enterprise Blockchain software firm.

As part of the business solutioning, the stakeholders in the CP issuance and redemption benefit from

- ✓ Reduction in Turnaround Time (TAT) for issuance and redemption
- ✓ Immutable digital records of the entire transaction documents thereby reducing operational risk
- ✓ Real-time Visibility of the CP issuance and redemption
- ✓ Common Network for all participants in the CP issuance and redemption process



Source: <https://www.yesbank.in/media/press-releases/yes-bank-implements-asias-first-commercial-paper-issuance-on-blockchain#:~:text=Mumbai%2C%20July%2011%2C%202019%3A,Limited%2C%20a%20natural%20resources%20conglomerate.>

68



Capital market example

Alibaba IPO hits record \$25bn

19 September 2014 on the NYSE

Shares were sold to investors during the IPO process at \$68 each, but briefly reached \$99 during the opening minutes of trading. Alibaba's shares, trading under the ticker BABA, finished the day at \$93.89, up 38 per cent.

Shares slipped on Monday, falling about 2 per cent to \$92.

Based on Friday's closing share price, the company had a market capitalisation of more than \$230bn – larger than fellow tech giants Facebook and Amazon, and big US companies such as JPMorgan and Procter & Gamble. Had it listed on the Hong Kong exchange, as once planned, 15-year-old Alibaba would have become the city's third-largest company by market cap, behind only China Mobile and PetroChina.

Source: <https://www.ft.com/content/0f97cc70-4208-11e4-a7b3-00144feabdc0>

69



Primary Market vs. Secondary Market

Primary market

- for government and corporations **initially issued** securities
- **public offering** - where securities are offered to public at large; needs underwriting, more regulatory requirements, costly
- **private offering** - where securities are offered to large financial institutions or wealthy individuals etc.; less costly

Secondary market

- where **existing** financial claims are traded
- where getting market value of securities is easier
- **dealer market** (e.g. OTC markets, NASDAQ)
- **auction market** (e.g. SGX, NYSE)



Primary market example

Alibaba IPO hits record \$25bn

19 September 2014 on the NYSE

Shares were sold to investors during the IPO process at \$68 each, but briefly reached \$99 during the opening minutes of trading. Alibaba's shares, trading under the ticker BABA, finished the day at \$93.89, up 38 per cent.

Shares slipped on Monday, falling about 2 per cent to \$92.

Based on Friday's closing share price, the company had a market capitalisation of more than \$230bn – larger than fellow tech giants Facebook and Amazon, and big US companies such as JPMorgan and Procter & Gamble. Had it listed on the Hong Kong exchange, as once planned, 15-year-old Alibaba would have become the city's third-largest company by market cap, behind only China Mobile and PetroChina.

Source: <https://www.ft.com/content/0f97cc70-4208-11e4-a7b3-00144feabdc0>

71



Secondary market example

STI falls 3.44% as Asia sees a sea of red

The dismal showing by the regional bourses came after the US central bank gave a dour economic outlook the night before.

A reality check to the euphoria on share markets came in the form of the Fed's forecast that the US economy would contract 6.5 per cent this year and unemployment would still be at 9.3 per cent by the end of the year.



Source:

<https://www.straitstimes.com/business/companies-markets/sti-falls-344-as-asia-sees-a-sea-of-red>



Dealer vs. Auction Markets

- In a **dealer market**, buyers and sellers are not buying from and selling to one another directly. Transactions are occurring through dealers.
- In an **auction market**, there is an auction occurring where the highest bidding price is matched with the lowest asking price



Summary

Financial markets

- Money market vs. capital market
- Primary market vs. secondary market



Information on the Web

The Internet provides a wealth of information about individual companies

One excellent site is finance.yahoo.com

For locally listed companies, visit the Singapore Exchange website at www.sgx.com.

