Summary Cap 1 y 2 Admin financiera

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Chapter 1: An Overview of managerial Finance

1. A managerial perspective

- Rational investors hope and expect to gain wealth.
- There was a problem with executives not "acting on the best interest of investors" this was problematic, they were paid a lot and represented huge costs to investors and in addition firing them was not a viable option because compensation plans were composed of large sums of money.
- Compensation plans that limit severance payments when contracts are terminated prematurely has been recently sought, the so-called golden parachute is no longer. **Definition of "Golden parachute":** *a package that provides executives with excessive payments when they are dismissed from their firms.*
- More companies are now limiting the severance payment due.
- Boards are redefining what it means to be fired for a "just cause", among these are poor performance and non-actions.

2. What is finance?

- Finance is concerned with decisions about money, or more appropriately, cash flows. They deal with how money is raised by businesses, governments, and individuals.
- Rational financial decisions, everything else equal:
  1. More value is preferred to less.
  2. The sooner the cash is received, the ore valuable it is.
  3. Less risky assets are more valuable and preferred to risky assets.

3. General areas of finance

Four interrelated areas:

1. Financial markets and institutions.
2. Investments.
3. Financial services.
4. Managerial finance.

3.1. Financial markets and institutions

- Financial institutions: banks, insurance companies, savings and loans, and credit unions.

3.2. Investments

- Focus: decisions made by businesses and individuals as they hose securities and investment portfolios.
- Major functions in investment: (1) determining the values, risks and returns associated with financial assets (2), determining the optimal mix of securities that should be held in a portfolio.

3.3. Financial services

- Financial services refers to functions provided by organizations that operate in the finance industry.
- Banks, insurance companies, brokerage firms, and other similar companies.
- Provide services that help individuals(and companies) determine how to invest money.

3.4. Managerial (business) finance

- Managerial finance deals with decisions that all firms make concerning their cash flows.

4. The importance of finance in non-finance areas

4.1. Management

- Managers concern themselves with personnel decisions and employee relations.
- Such personnel decisions as setting salaries, hiring new staff, and paying bonuses must be coordinated with financial decisions to ensure that any needed funds are available.

4.2. Marketing

- Allocation of funds to do the four p's in marketing (product, price, place, and promotion).
- People in marketing must understand how marketing decisions affect and are affected by such issues as funds availability, inventory levels, and excess plant capacity.

4.3. Accounting

- Financial managers rely heavily on accounting information.
- Accountants must understand how financial managers use accounting information in planning and decision-making so that it can be provided in an accurate and timely fashion.
- Accountants must understand how accounting data are viewed (used) by investors, creditors, and other outsiders.

4.4. Information systems

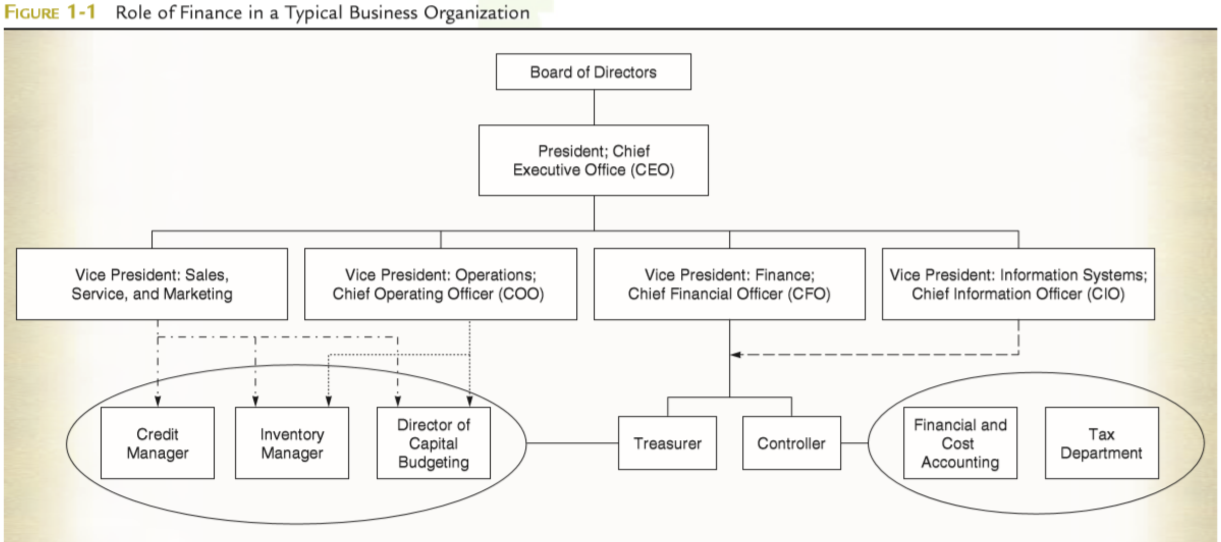
- Information system specialists work with financial managers to determine what information is needed, how it should be stored, how it should be delivered, and how information management will affect the profitability of the firm.

4.5. Economics

- It is important that financial managers understand economics and that economists understand finance—economic activity and policy impact financial decisions, and vice versa.

5. Finance in the organizational structure of the firm

FIGURE 1-1 Role of Finance in a Typical Business Organization



6. Alternative forms of business organization

3 main forms:

1. Proprietorships.
2. Partnerships.
3. Corporations.

6.1. Proprietorship 72 %-$4 %

- **Definition of "Proprietorship":** *is an unincorporated business owned by one individual.*
- 3 advantages:
  1. Easy and inexpensive to form.
  2. Fewer government regulations.
  3. Taxed like an individual (once).
- 4 Limitations:
  - Unlimited personal liability for business debts. Losses can far exceed the money invested.
  - Limited lifetime. New owner means a new proprietorship even if the same name is used.
  - Transferring ownership is difficult.
  - Difficult to obtain large sums of capital.

6.2. Partnership 8 %-$11 %

- **Definition of "Partnership":** *An unincorporated business owned by two or more people.*
- Formality is relative: ranging from informal, oral understandings to formal agreements filed with the secretary of the state in which the partnership does business.
- Advantages and disadvantages of a partnership are the same as a proprietorship.
- 3 advantages:
  1. Easy and inexpensive to form.
  2. Fewer government regulations.
  3. Taxed like an individual (once).
- 4 Disadvantages:
  1. Unlimited personal liability for business debts. Losses can far exceed the money invested.
  2. Limited lifetime. New owner means a new proprietorship even if the same name is used.
  3. Transferring ownership is difficult.
  4. Difficult to obtain large sums of capital.
- If any partner is unable to meet his or her pro rata claim in the event the partnership goes bankrupt, the remaining partners must make good on the unsatisfied claims, drawing on their personal assets if necessary.

6.3. Corporations 20 %-$85 %

- **Definition of "Corporation":** *A legal entity created by a state, separate and distinct from its owners and managers, having unlimited life, easy transferability of ownership, and limited liability.*
- 4 advantages:
  1. Unlimited lifetime, after original owners.
  2. Transferred more easily. Ownership interest divided into shares of stock.
  3. Limited liability. Limited to the amount invested.
  4. 3 previous advantages make it easy to obtain large sums of capital.
- 2 disadvantages:
  1. Setting up a corporation is difficult. Corporate charter (registration with the secretary of the state of the corporation) and bylaws (rules of the company).
  2. Corporate earnings are subject to double taxation.

7. Hybrid business forms: LLP, LLC, S Corporation

- **Definition of "Limited Liability Proprietorships (LLP)":** *A partnership wherein one (or more) partner is designated the general partner(s) with unlimited personal financial liability and the other partners are limited partners whose liability is limited to amounts they invest in the firm.*
- **Definition of "Limited Liability Company (LLC) ":** *Offers the limited personal liability associated with a corporation, but the company's income is taxed like a partnership.*
- **Definition of "S Corporation ":** *A domestic corporation with no more than 75 stockholders that elects to be taxed the same as proprietorships and partnerships so that business income is taxed only once.* Advantages:

1. Limited liability attracts investors.
2. Can attract funds more easily.
3. Ownership is easily transferable.

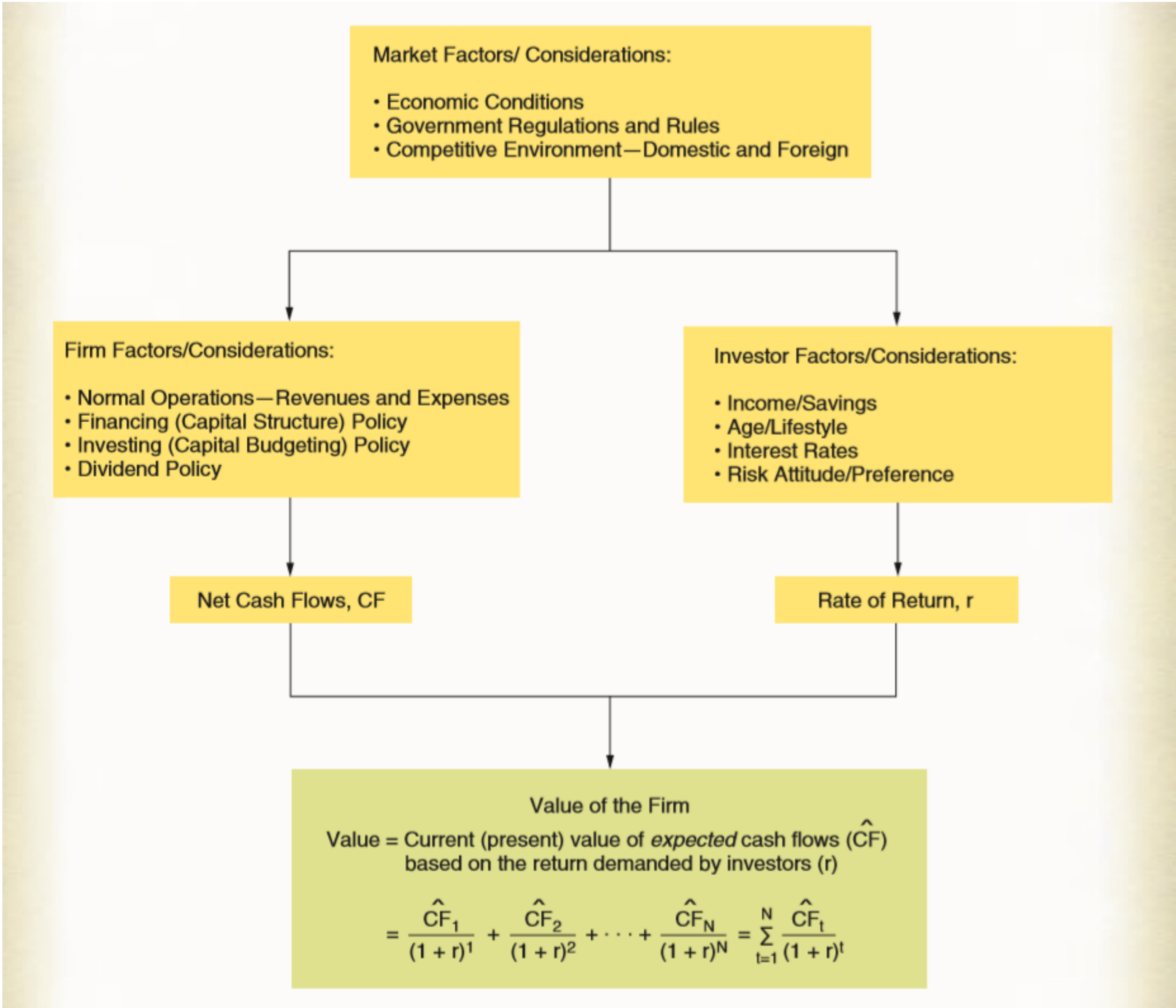
8. What goals should businesses pursue?

- A proprietor runs the bussiness directly and is involved in decisions made day by day.
- A stockholder does not have a say and is not directly involved in the day-to-day decisions, these decisions are made by managers. Thus managers have to have the objective of **stockholder wealth maximization** and **stock price maximization**.
- *The same actions that maximize stock prices also benefit society.*

9. Managerial actions to maximize shareholder wealth

- The financial manager makes decisions about the expected cash flows of the firm, among these decisions are **capital structure decisions**, **capital budgeting decisions**, **dividend policy decisions**.
  - **Definition of "Capital structure decisions about how much and what types of debt and equity should be used to finance the firm. ":**

    Definition of "Capital budgeting decisions": *decisions as to what types of assets should be purchased to help generate future cash flows.*
  - **Definition of "Dividend policy decisions":** *decisions concerning how much of current earnings to pay out as dividends rather than retain for reinvestment in the firm.*
- Although managerial actions affect the value of a firm's stock, external factors also influence stock prices, such as:
  - Legal constraints, the general level of economic activity, tax laws, and conditions in the financial markets.
- **Definition of "Value ":** *The present, or current, value of the cash flows an asset is expected to generate in the future.*



10. Should earnings per share (EPS) be maximized?

- Earnings Per Shares (EPS): EPS receives so much attention is the belief that net income, and thus EPS, can be used as a barometer for measuring the firm's potential for generating future cash flows.

$$\text{EPS} = \frac{\text{Net income}}{\text{Shares}}$$

- Although current earnings and cash flows are generally highly correlated, as we mentioned earlier, a firm's value is determined by the cash flows it is expected to generate in the future as well as the risk associated with these expected cash flows.

- Maximize earnings might not maximize value because earnings maximization is a short-sighted goal.

- Firm's stock price, and thus its value, is dependent on, everything else equal:

  1. The cash flows the firm is expected to provide in the future
  2. When these cash flows are expected to occur
  3. The risk associated with these cash flows.

11. Manager's roles as agents of stockholders

- **Definition of "Agency problem":** *A potential conflict of interest between outside shareholders (owners) and managers who make decisions about how to operate the firm.*
  - **Definition of "Agency relationship":** *when one or more individuals, who are called the principals, hire another person, the agent to perform a service and delegate decision-making authority to that agent.*
- Mechanisms to ensure managements don't fall in agency problems:
  1. Managerial compensation (incentives): provide compensation based on a target in sales or other metric. Accomplish 2 things:
     a) Motivate management to act in the best interest of stockholders and maximize stock price.
     b) Attract and retain top-level executives.
  2. Shareholder intervention: shareholders intervene and drive out management teams they consider are doing poor performance.
  3. Threat of takeover, Hostile takeovers: The acquisition of a company over the opposition of its management.
- Management must pursue to maximize the price of the firm's stock in the long term.

12. Business ethics

- **Definition of "Business ethics":** *A company's attitude and conduct toward its stakeholders—employees, customers, stockholders, and so forth; ethical behavior requires fair and honest treatment of all parties.*
- Executives believe that there is a positive correlation between ethics and long-run profitability because ethical behavior:
  1. Prevents fines and legal expenses,
  2. Builds public trust,
  3. Attracts business from customers who appreciate and support ethical policies,
  4. Attracts and keeps employees of the highest caliber, and
  5. Supports the economic viability of the communities where these firms operate.

13. Corporate governance

- The "set of rules" that a firm follows when conducting business; these rules identify who is accountable for major financial decisions.

14. Forms of businesses in other countries

- Non-US firms tend to be more closed than US firms.
- **Definition of "Industrial group":** *Organizations composed of companies in different industries with common ownership interests, which include firms necessary to manufacture and sell products—a network of manufacturers, suppliers, marketing organizations, distributors, retailers, and creditors.*

15. Multinational corporations

- **Definition of "Multinational corporation":** *a firm that operates in two or more countries.*

Corporation go international because they:

1. Seek new markets.
2. Seek raw materials.
3. Seek new technology.
4. Seek production efficiency.
5. Avoid political and regulatory hurdles.

16. Multinational versus domestic managerial finance

In theory there is no difference except for the following:

- Different currency denominations and exchange rates.
- Economic and legal ramifications.
- Language differences.
- Cultural differences.
- Role of government.
- Political risk (expropriation, terrorism, etc).

Chapter 2: Analysis of Financial Statements