

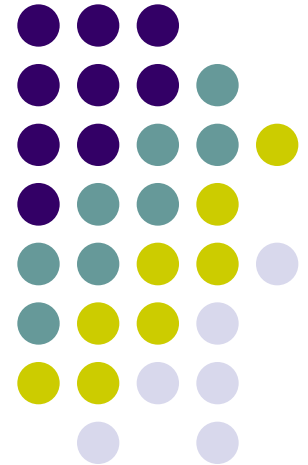
Corporate Finance

Lecture 0: Introduction

Yuan Shi ©

HSBC Business School

Peking University



Housekeeping



- Instructor: Yuan Shi
 - yuan.shi@phbs.pku.edu.cn
 - Lecture: Mon/Thur 15:30 – 17:20
 - Office Hours: Thur 10:30 – 11:00, 13:00 – 14:00
- Teaching Assistant: Shuyan Qin

Group: Corporate Finance
2024 M2



Valid until 11/18 and will update upon joining
group



Our Goals

- To give you the capacity to understand the theory and apply, in real world situations, the techniques that have been developed in corporate finance.
- To give the big picture of corporate finance so that you can understand how things fit together.
- To hopefully let you feel that corporate finance is fun.



Housekeeping

- **Lecture**
 - Your active participation is important
 - Asking questions is highly encouraged
- **Reading the reference book & exercise**
 - I won't follow the book
 - Pre-class reading will help you get better prepared
- **Case and project**
 - Analytical & presentation skill
 - Teamwork
- **Exams**
 - You can bring a double-sided A4 cheat sheet



Grade

- **Mid-term exam: 30%**
 - in class, **NO make-up**
 - Close book; A double-sided A4 cheat sheet is permitted
 - A calculator will be needed, but computer or smart phone are NOT allowed
- **Group project: 25%**
 - Start forming groups of four to six, task to be announced later
 - Presentation on last class
- **Class attendance: 5%**
 - Class attendance is mandatory in accordance with school regulations
 - According to facial scanning system records (no appeals)
- **Final exam 40%**
 - 4PM-6PM of Jan 16, 2025



Hardware and Software

- Websites: cms.phbs.pku.edu.cn
 - Search for: Corporate Finance - 2024F1R
 - Enrollment code: **CF2024_M2**
 - Lecture notes, case material...
 - Uploaded before classes & [possibly updated after classes](#)
- Reference book
 - *Corporate Finance*, by Ross, Westerfield, Jaffe, and Jordan. McGraw Hill, 11th ed. (RWJJ)
- Calculator
 - You will need one in exams.
 - You will NOT be allowed to borrow it from others during the exam.
- Microsoft Excel



How Challenging?

- **Mathematically**
 - **Not challenging at all!**
 - If you know discounting, correlation, etc., you will do just fine.
- **Conceptually**
 - **Intensive!**
 - It is NOT a course about doing calculations with accounting numbers.
 - It is all about **thinking** about corporate issues as a financial economist.



How fast we should go?

Depends on your background knowledge

So I need your feedbacks

- <https://wj.qq.com/s2/16258983/d2a6/>



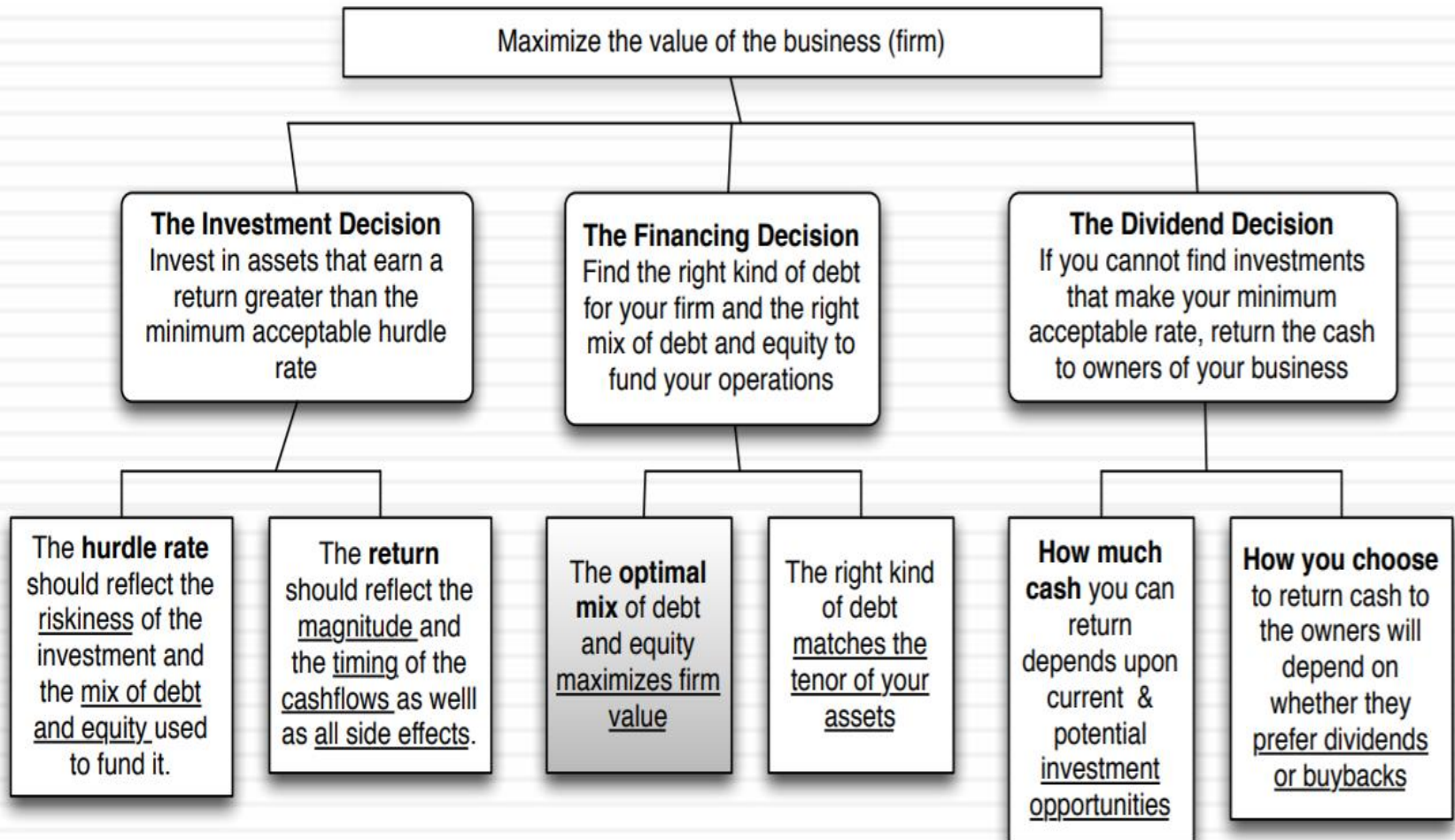


Corporate finance decisions

What are they and why do we care?



What is corporate finance decision?



An example from Tailored Brands:



- A retail holding company for various men's apparel stores
- In 2019 the stock has lost 77% of its value



TAILORED BRAND



TLRD Stock Price



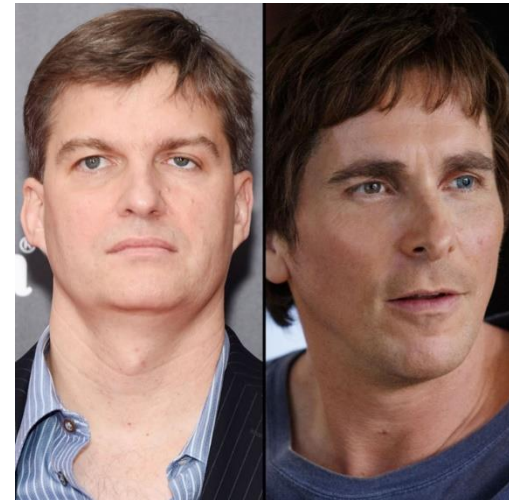
What is behind such performance?

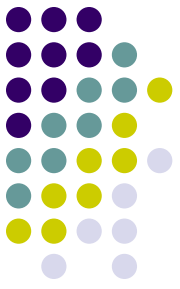


On August 19th, Scion Asset Management wrote a (second) letter to the Board of Tailored Brands

Scion owns 4.7% of TLRD's outstanding shares

In the letter Dr. Michael J. Burry writes:





“We acknowledge and appreciate the \$425 million in debt Tailored has paid down over the last two years out of free cash flow alone. However, the **terrible long-term performance of the stock is largely a consequence of poor capital allocation**, and those mistakes must not be made again.”

“If Tailored feels that it absolutely must use funds from the sale of Corporate Apparel to pay down debt, then **we wonder why Tailored continues to pay over \$36 million a year toward the dividend**.”

“We recommend the Board of Directors **prioritize a substantial buyback along with continued aggressive debt reduction**.”



Story develops:

On August 21st, Street Insider cited an anonymous source in reporting that Tailored Brand has **been approached several times by Sycamore Partners about an acquisition**

On August 30 Michael burry wrote a third letter:

We do not know if any of this is true. However, we believe you must know that **\$10 per share is not fair value and will not be acceptable to shareholders.**



Many interesting questions:

Which **investment** project should Tailored Brands pursue?

What is **the fair value** of Tailored Brands in a M&A market?

How much **debt** should Tailored Brands maintain?

Should it reduce its **dividends/share repurchase**?



What is Finance?



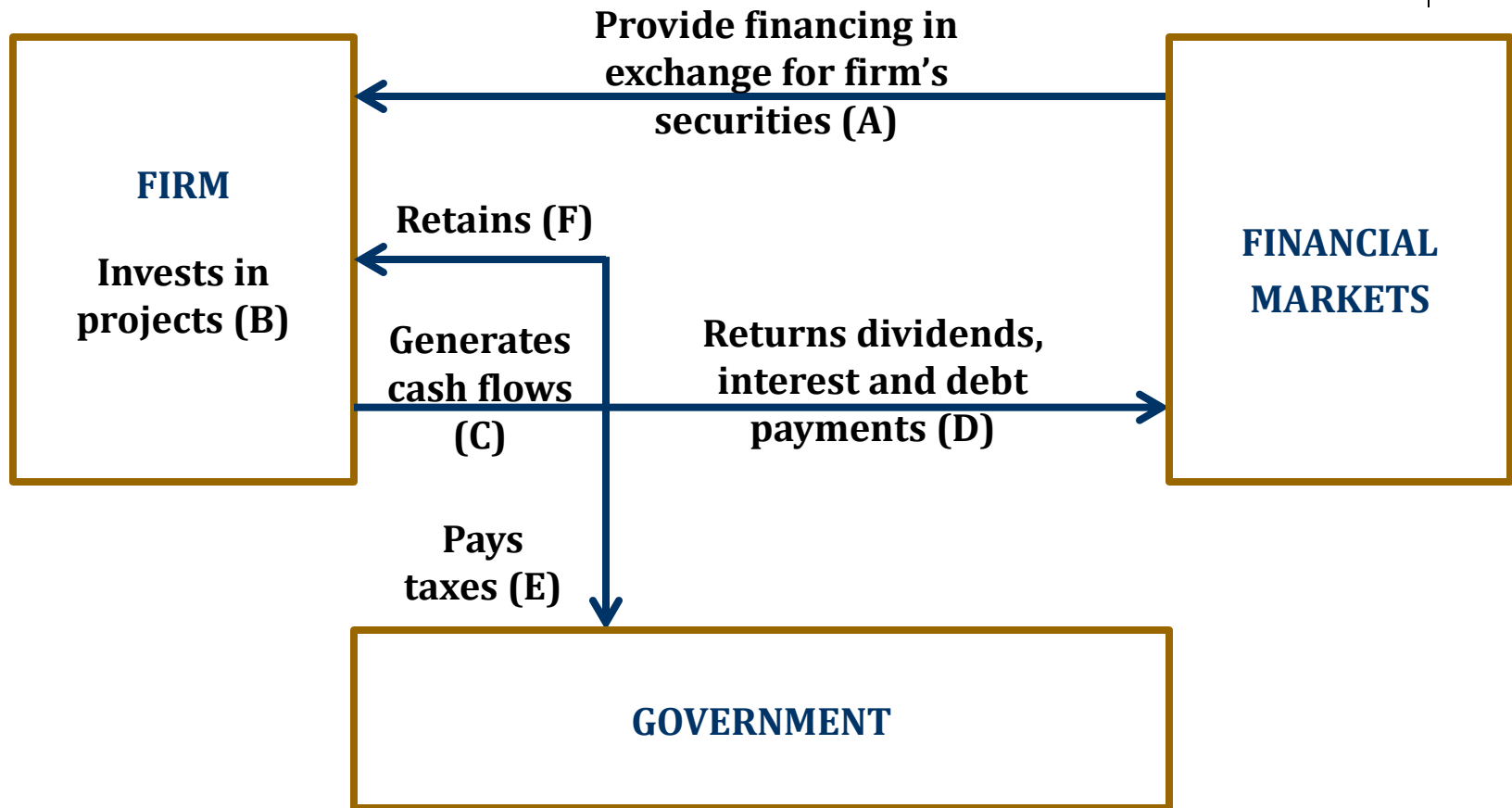
Finance is the process of transferring money from savers to borrowers through financial markets/ institutions



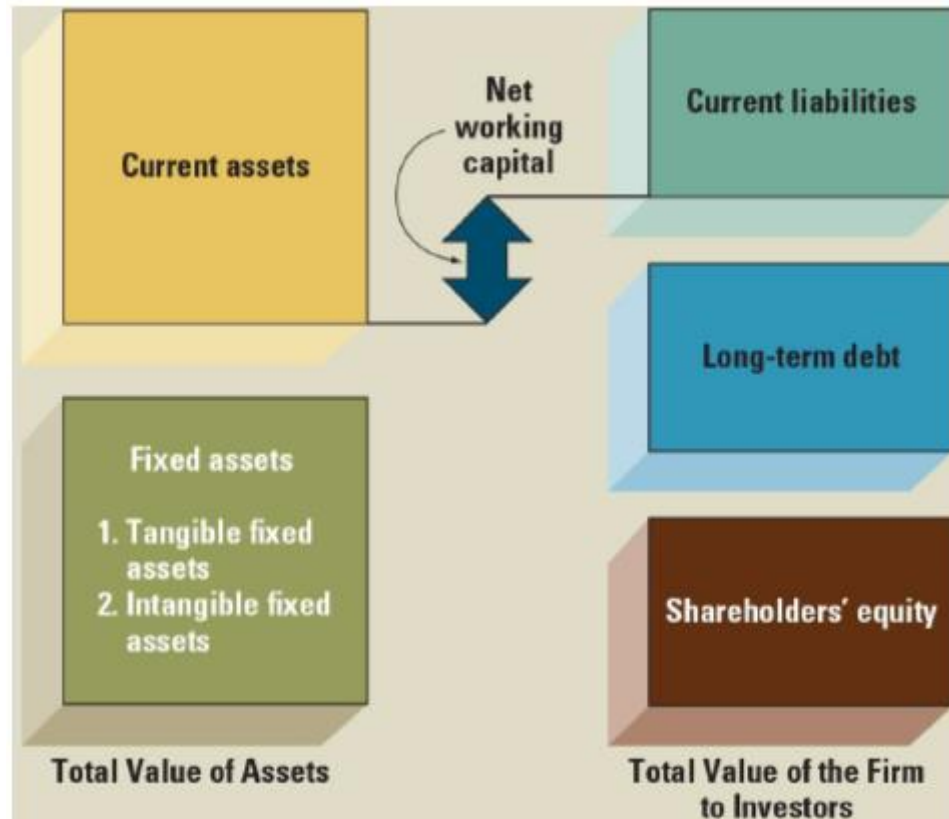
Finance Subjects

- Investment (Savers)
- Financial Markets & Institutions (Intermediaries / Banking)
- Corporate Finance (Borrowers)
 - Main decision maker: corporate managers
 - Estimate important parameters from security prices
 - So, also need to understand investors' logic
 - Usually assume a competitive & efficient financial market for simplicity

Cash Flows



Balance Sheet



Why called “corporate” finance?



- ❖ Corporation is the most popular form of business
- ❖ Almost all principles we learn under the name “corporate
●finance” apply to other forms of business
 - Sole proprietorship
 - Partnership

Sole proprietorship



- ❖ A business owned by a single person
 - No formal charter required, very few government regulations
 - Unlimited liability for business debt since no distinction between personal and business assets
 - Profit taxed as individual income (single taxation)
 - Equity is limited to the proprietor's personal wealth
 - Duration is limited to the life of the sole proprietor

Sole proprietorship without charter requirement



类型	定义	所需资料
小微	无营业执照、免办理工商注册登记的商户	需提供小微经营者的个人身份证
个人卖家	无营业执照，已持续从事电子商务经营活动满6个月，且期间经营收入累计超过20万元的个人商家（平台需核实已满足上述条件）	需提供个人卖家的个人身份证
个体工商户	营业执照上的主体类型一般为个体户、个体工商户、个体经营	需提供营业执照、经营者证件
企业	营业执照上的主体类型一般为有限公司、有限责任公司	需提供营业执照、法人证件、组织机构代码证（未三证合一提供）
党政、机关及事业单位	包括国内各级、各类政府机构、事业单位等。如：公安、党团、司法、交通、旅游、工商税务、市政、医疗、教育、学校等机构	需提供登记证书、法人证件、组织机构代码证（未三证合一提供）
其他组织	不属于企业、政府/事业单位的组织机构，如社会团体、民办非企业、基金会。要求机构已办理组织机构代码证。	需提供登记证书、法人证件、组织机构代码证（未三证合一提供）



Business forms: Partnership

- ❖ A business with two or more owners
 - General partnership:
 - All partners provide work and cash
 - All partners share the profit and losses
 - Each partner is liable for all the business debt

Business forms: Partnership

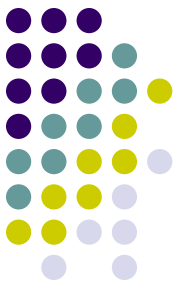


- ❖ A business with two or more owners
 - Limited partnership:
 - At least one general partner. Others are limited partners
 - Limited partners are liable for business debt up to the contributed equity
 - General partner(s) manage the business and have unlimited
 - liabilities for business debt
 - Limited partners do not participate in daily management

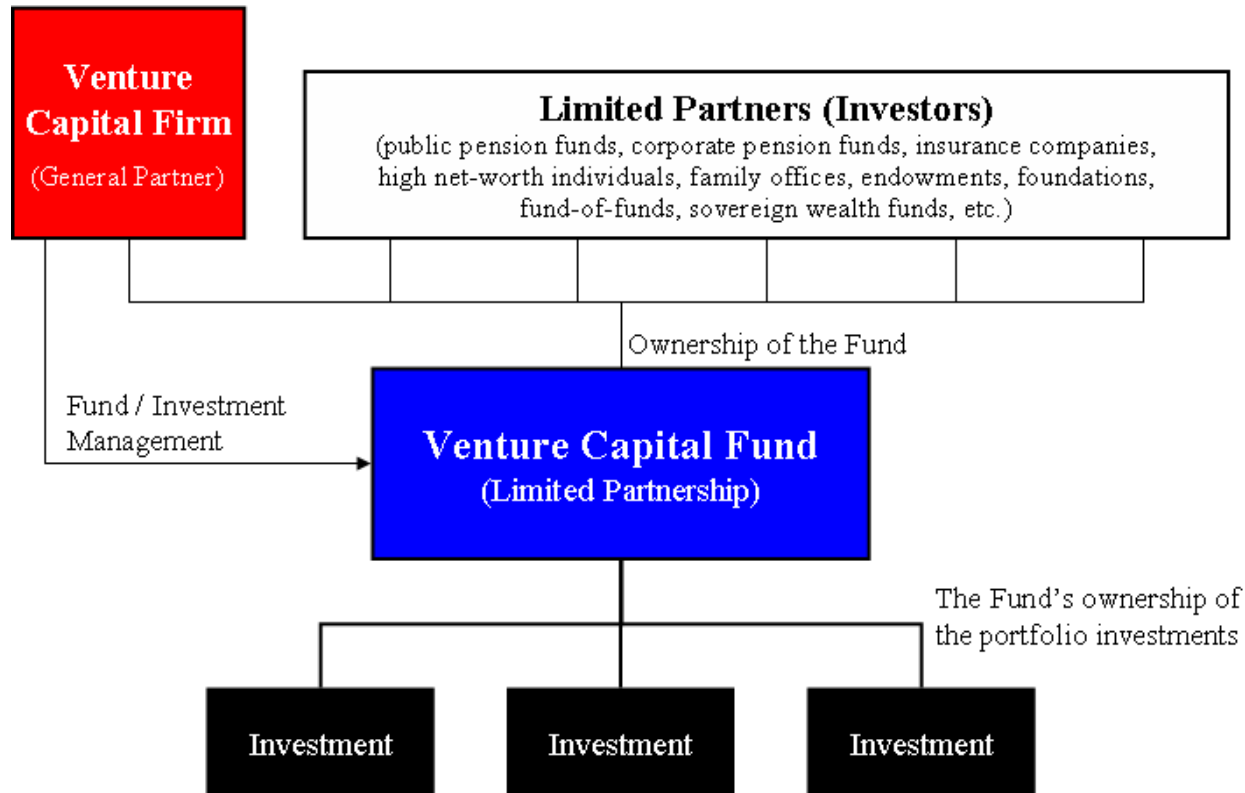
Business forms: Partnership



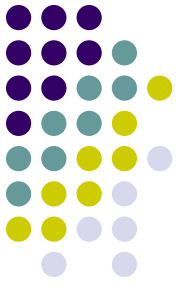
- ❖ Partnerships are inexpensive to form, subject to very few regulations
- ❖ General partners have unlimited liabilities for all debts
- ❖ Limited partners enjoy limited liabilities
- ❖ Difficulty in raising large amount of equity. Limited to partners'
 - capacity and desire to contribute
- ❖ Income taxed as individual income
- ❖ Duration of business is limited to life of partners
- ❖ Difficult to transfer ownership



Example: VCs partnership



Business forms: Corporation



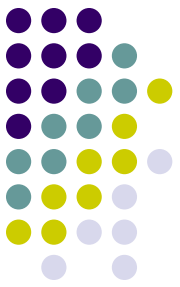
- ❖ A corporation is a distinct legal entity, separated from its owners
- ❖ For jurisdictional purposes, a corporation is a citizen (like a natural human being) of its state/nation of incorporation
- ❖ A corporation can have a name and enjoy many legal rights of natural persons
 - ❖ Corporations can acquire and exchange properties
 - ❖ Corporations can enter contracts and may sue and be sued

Business forms: Corporation



- ❖ Ownership in a corporation is represented by shares of stock
- ❖ Ownership is readily transferrable, no impact on existence of business
- ❖ Unlimited life, not subject to owners' life or exit/change
- ❖ Limited liabilities: Owners are liable up to the equity contribution
- ❖ Double taxation: Corporate income tax + individual income tax

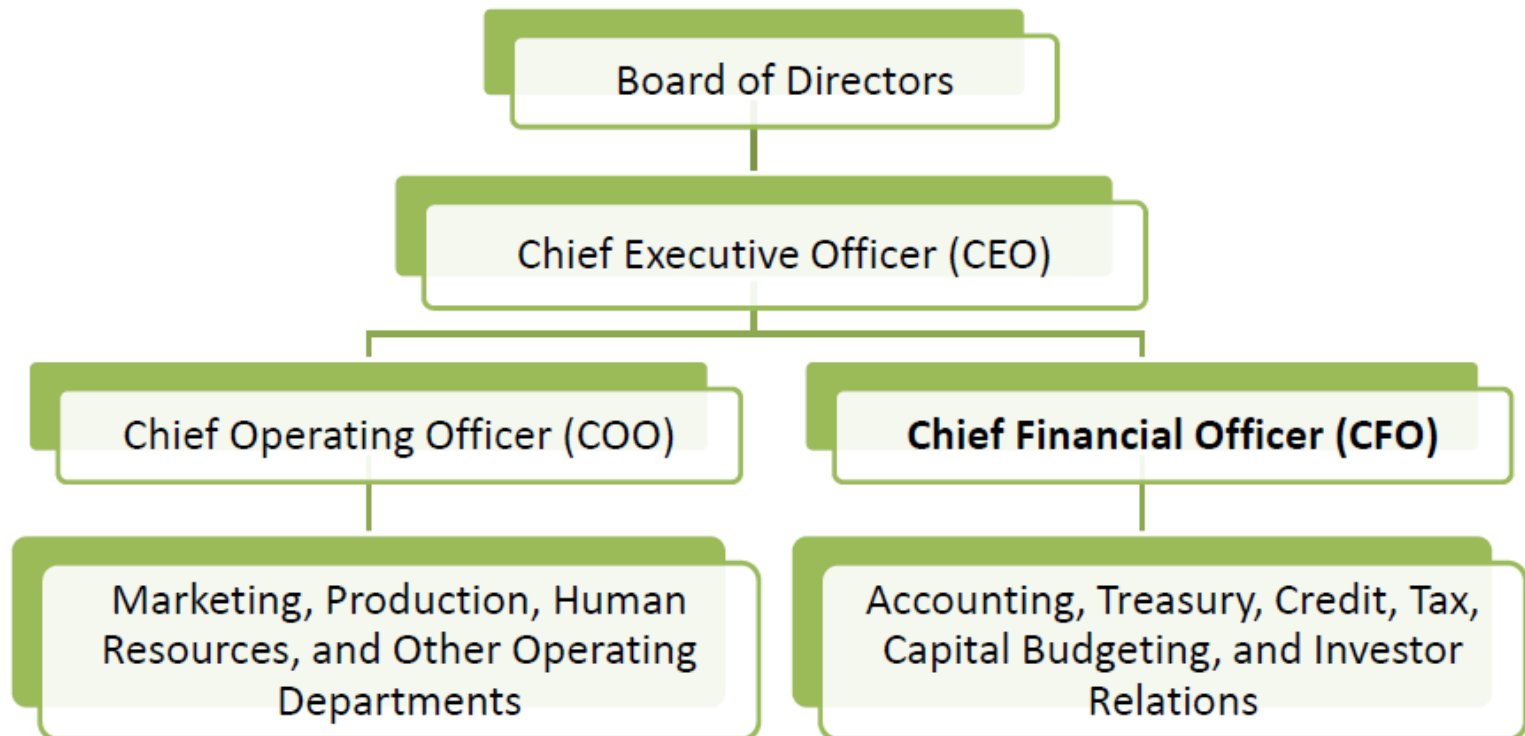
Comparing Corporation vs Partnership



	Corporation	Partnership
Liquidity and marketability	Shares can be exchanged without termination of the corporation. Common stock can be listed on a stock exchange.	Units are subject to substantial restrictions on transferability. There is usually no established trading market for partnership units.
Voting rights	Usually each share of common stock entitles the holder to one vote per share on matters requiring a vote and on the election of the directors. Directors determine top management.	Some voting rights by limited partners. However, general partners have exclusive control and management of operations.
Taxation	Corporations have double taxation: Corporate income is taxable, and dividends to shareholders are also taxable.	Partnerships are not taxable. Partners pay personal taxes on partnership profits.
Reinvestment and dividend payout	Corporations have broad latitude on dividend payout decisions.	Partnerships are generally prohibited from reinvesting partnership profits. All profits are distributed to partners.
Liability	Shareholders are not personally liable for obligations of the corporation.	Limited partners are not liable for obligations of partnerships. General partners may have unlimited liability.
Continuity of existence	Corporations may have a perpetual life.	Partnerships have limited life.



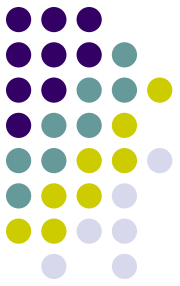
Organization Chart





Financial Management Decisions

- **Capital Budgeting**
 - What long-term investments and projects should be taken?
- **Capital Structure**
 - How should we raise finance for our investments?
 - Should we use debt or equity? What percent?
- **Working Capital Management**
 - How do we manage the day-to-day finances of the company?
- **Acquisition, IPO, Raising Capital, etc.**



Who care about Corporate Finance?

- *Corporate managers*
 - Capital budgeting (long-term asset investment decisions)
 - Financing decisions (debt vs. equity)
 - Acquisition, Going Public, Going Private, etc.
 - **The basic rules of making good decisions**
- *Investors/ fund managers/ investment bankers*
 - Offer cash in exchange for future cash flows
 - As investor, **how to judge a good deal**
 - Underwriter, security analysts, fund managers, etc.

What is the Goal of a Corporation?



General Motors is not in the business of making automobiles.

*General Motors is in the **business of making money***

-- Alfred P. Sloan





What is the Goal of Corporation?

- **Maximize Shareholders' Value**
 - Why not market share, profit, growth, survival, risk management... ?
 - “Value” encompasses all above
 - Why not creditors', employees', customers', community's...?
 - Chief decision makers (executives) are hired by shareholders!

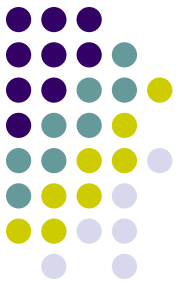


True or False?

- The goal of financial management for a public firm is to maximize the current value per share of the existing stocks.
- The goal of financial management is to maximize the value of existing owners' equity.
- We evaluate financial managers' decisions on the basis of whether they add value to the business owners.
- Maximizing shareholders' value is equivalent with maximizing firm value.
- Maximizing shareholders' value is equivalent with maximizing the value of all the stakeholders (i.e., creditors, suppliers, customers, government, community, etc.)
 - Corporate social responsibility debate (video)

Does this mean social responsibility does not matter?

- The ESG evolution



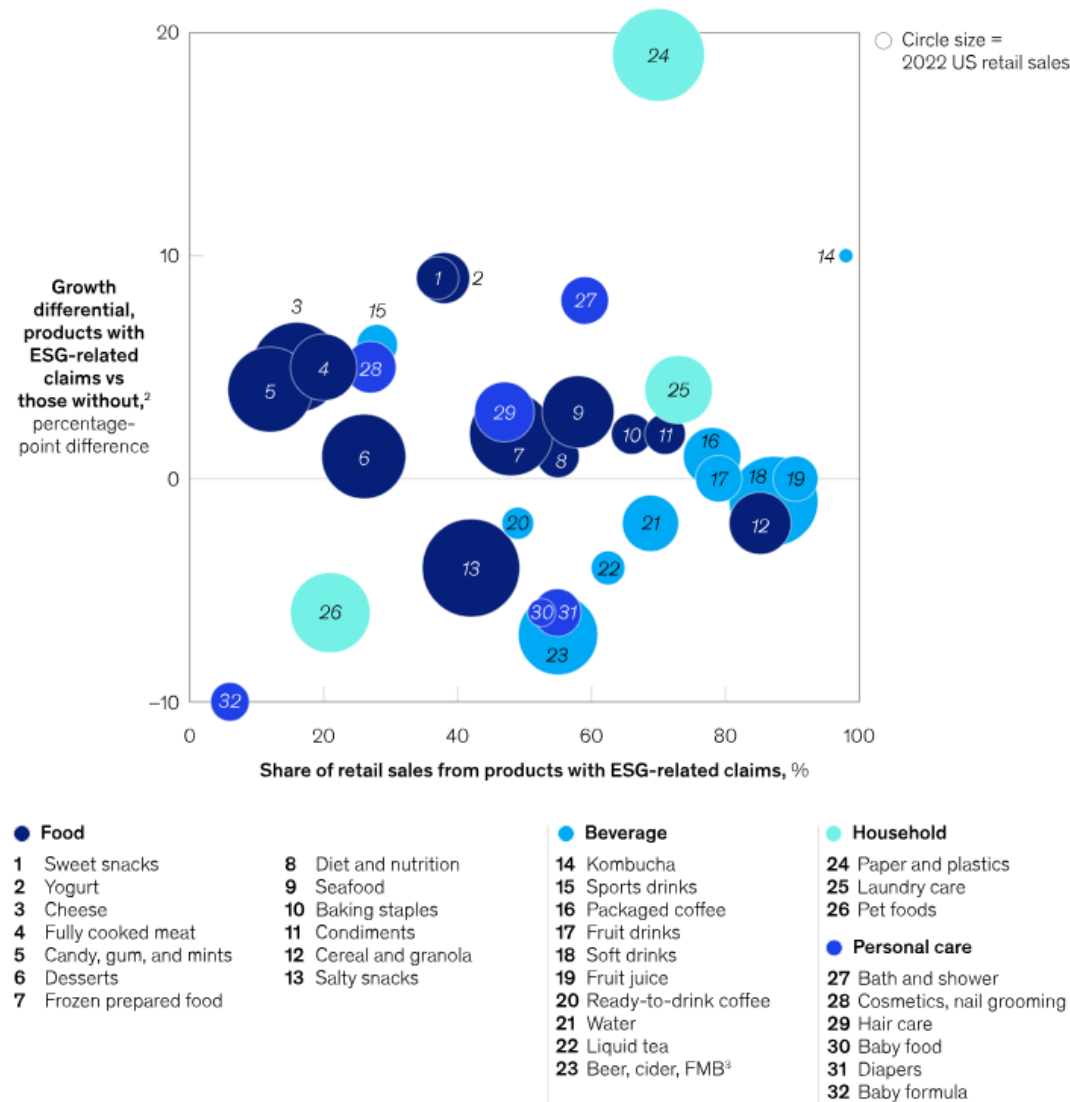
Through what ways can ESG affect firm value?



- ESG affects long term cash flow:
 - Government intervention
 - Emission allowances and carbon allowances auctions
 - Customer preferences & brand value

Prevalence and performance of environmental, social, and governance-related claims vary by product category.

Growth differential vs prevalence of ESG¹-related claims by product category



¹Environmental, social, and governance.

²Difference between June 2018–June 2022 CAGR growth for products with ESG-related claims vs those without.

³Flavored malt beverages.

Source: NielsenIQ

Through what ways can ESG affect firm value?



- ESG affects long term cash flow:
 - Government intervention
 - Emission allowances and carbon allowances auctions
 - Customer preferences
 - Brand value
 - Employee disruption of business
 - Union
 - OpenAI's mass exodus

Through what ways can ESG affect firm value?



- ESG affects long term cash flow:
 - Government intervention
 - Emission allowances and carbon allowances auctions
 - Customer preferences
 - Brand value
 - Employee disruption of business

Altman to return after OpenAI employees threaten mass exodus

OpenAI employees have some of the most in-demand skills in tech. When a majority threatened to resign over Sam Altman's firing, they had and used that leverage.



By **Patrick Thibodeau**, Editor at Large

Published: 22 Nov 2023

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Through what ways can ESG affect firm value?



- ESG affects discount rate:
 - Non-ESG imposes risk factors
 - Climate change: physical damage to facilities, increased insurance costs, or operational disruptions due to natural disasters.
 - Resource scarcity: water, energy, raw materials
 - Investor preferences
 - Green equity (firm based)
 - Green bond (project-based)

What is the Goal of a Corporation?



*We will still follow the principle of
customers first, employees second
and **investors third***

-- Jack Ma



*If you want me to do things only for
R.O.I. reasons, you should **get out of
this stock***

-- Tim Cook



Topics

- **Value** measure: NPV (discounted cash flows)
 - Topic 1 & 2
- What **cash flows**?
 - Topic 3 & 4
- What **discount rate**?
 - Topic 5, 6, & 7
- Does **capital structure** affect value?
 - Topic 8, 9, & 10

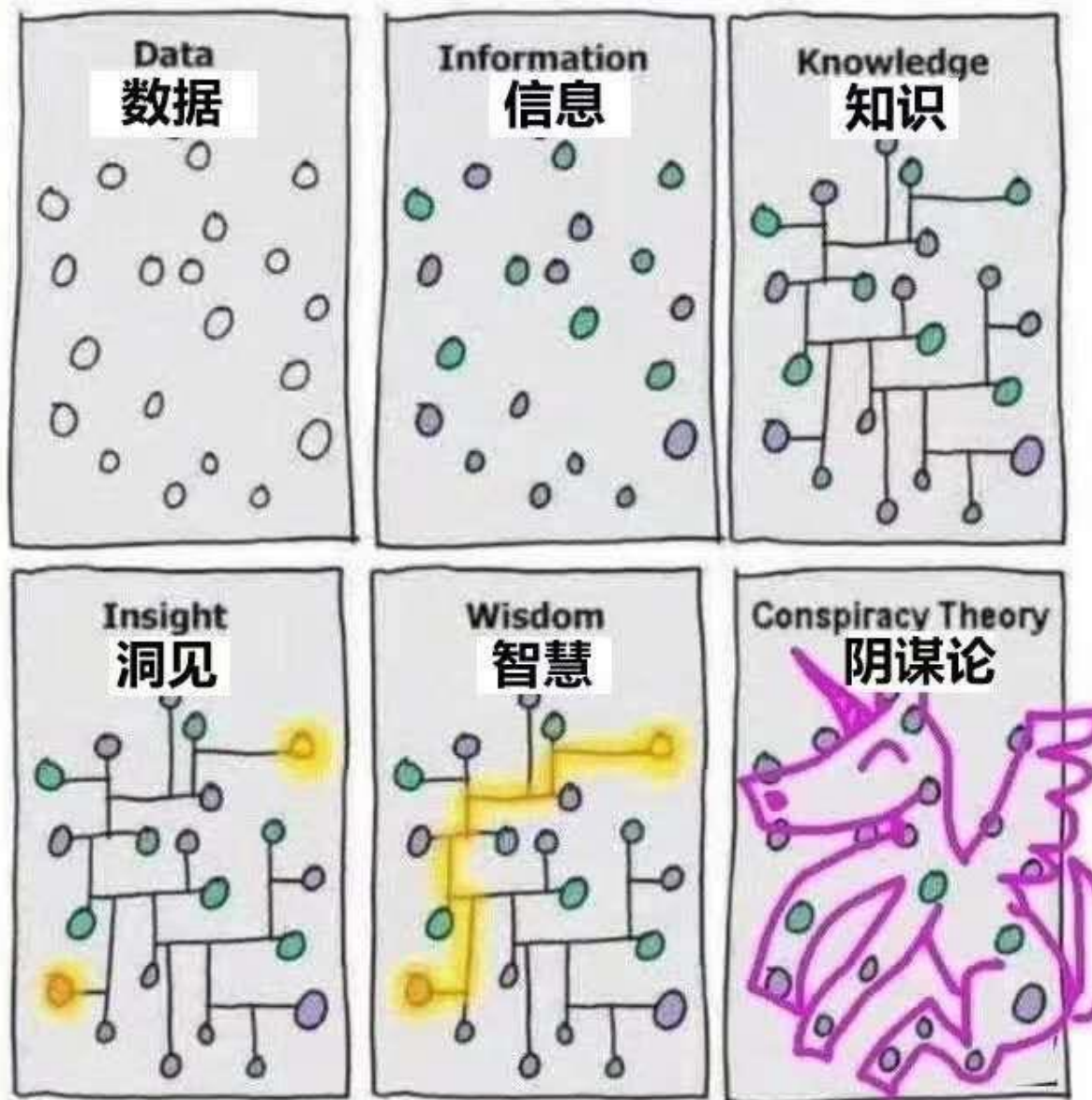
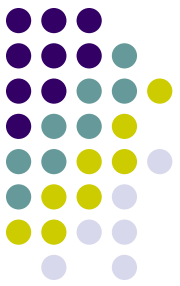
Capital Budgeting

Capital Structure



How to excel?

- Read the relevant book chapters and preview lecture notes before arriving in the classroom.
- Be concentrated and actively participate in activities (e.g., problem solving, discussion, and presentations) in class, and ask questions whenever they arise.
- Do the in-class examples and practice questions, and try to do some end-of-chapter questions after classes. You learn little until you do it.
- DO NOT FREERIDE others. A great portion of the course grade comes from team works. If a student is complained about and deemed free riding, his/her grades for team works will be adjusted in accordance with the severity of the problem.





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