



香港中文大學(深圳)  
The Chinese University of Hong Kong, Shenzhen



經管學院  
School of Management and Economics

# Chapter 1.

# The Role of Financial Management

# ***Roadmap of Finance Courses***

## **Financial Management**

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graph TD; FM[Financial Management] --> IC[Investments: Capital Markets]; FM --> CF[Corporate Finance];
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### ***Investments: Capital Markets***

- **Portfolio of assets**
- **Options and futures**
- **Fixed income securities**
- **International capital markets**

### ***Corporate Finance***

- **How to choose the right project**
- **How to evaluate a company**
- **Synergy of M&A**

# ***After studying Chapter 1, you should be able to:***

- 1. Explain why the role of the financial manager today is so important.**
- 2. Describe "financial management" in terms of the three major decision areas that confront the financial manager.**
- 3. Identify the goal of the firm and understand why shareholders' wealth maximization is preferred over other goals.**
- 4. Understand the potential problems arising when management of the corporation and ownership are separated (i.e., agency problems).**
- 5. Demonstrate an understanding of corporate governance.**
- 6. Discuss the issues underlying social responsibility of the firm.**
- 7. Understand the basic responsibilities of financial managers and the differences between a "treasurer" and a "controller."**

# ***Why should I care about Financial Management ?***

- **Prepare for the workplace of tomorrow.**
- **Broadening expectations of financial knowledge and skills.**
- **Use and understand financial terminology and concepts in team communication.**
- **Developing cross-functional capabilities.**
- **Critical thinking.**

# ***What is Financial Management?***

**Concerns the acquisition,  
financing, and  
management of assets  
with some overall goal in  
mind.**

# ***Investment Decisions***

**Most important of the three decisions.**

- **What is the optimal firm size?**
- **What specific assets should be acquired?**
- **What assets (if any) should be reduced or eliminated?**

# ***Financing Decisions***

**Determine how the assets (LHS of balance sheet) will be financed (RHS of balance sheet).**

- **What is the best type of financing?**
- **What is the best financing mix?**
- **What is the best dividend policy (e.g., dividend-payout ratio)?**
- **How will the funds be physically acquired?**

# ***Asset Management Decisions***

- **How do we manage existing assets *efficiently*?**
- **Financial Manager has varying degrees of operating responsibility over assets.**
- **Greater emphasis on **current asset management** than **fixed asset management**.**



# ***What is the Goal of the Firm?***

***Maximization of  
Shareholder Wealth!***

***Value creation occurs when  
we maximize the share price  
for current shareholders.***

# ***What Goals do some Firms have?***

- ***“Creating superior shareholder value is our top priority.”***  
Associated Banc-Corp 2006 Annual Report.
- ***“The desire to increase shareholder value is what drives our actions.”*** Phillips 2006 Annual Report.
- ***“FedEx’s main responsibility is to create shareholder value.”*** FedEx Corporation, SEC Form Def 14A for the period ending 9/25/2006.
- ***“... the Board of Directors plays a central role in the Company’s corporate governance system; it has the power (and the duty) to direct Company business, pursuing and fulfilling its primary and ultimate objective of creating shareholder value.”*** Pirelli & C. S.p.A. Milan Annual Report 2006.

# ***Corporate Social Responsibility Discussion***

***Class Discussion: What role should CSR and/or sustainability have on living the “goal of the firm”?***

***Corporate Social Responsibility (CSR): A business outlook that acknowledges a firm’s responsibilities to its stakeholders and the natural environment.***

***Sustainability: Meeting the needs of the present without compromising the ability of future generations to meet their own needs.***

# ***Shortcomings of Alternative Perspectives***

## ***Profit Maximization***

- Maximizing a firm's earnings after taxes.

## ***Problems***

- Could increase current profits while harming firm (e.g., defer maintenance).
- Ignores changes in the risk level of the firm.

# ***Shortcomings of Alternative Perspectives***

## ***Earnings per Share Maximization***

- **Maximizing earnings after taxes divided by shares outstanding.**

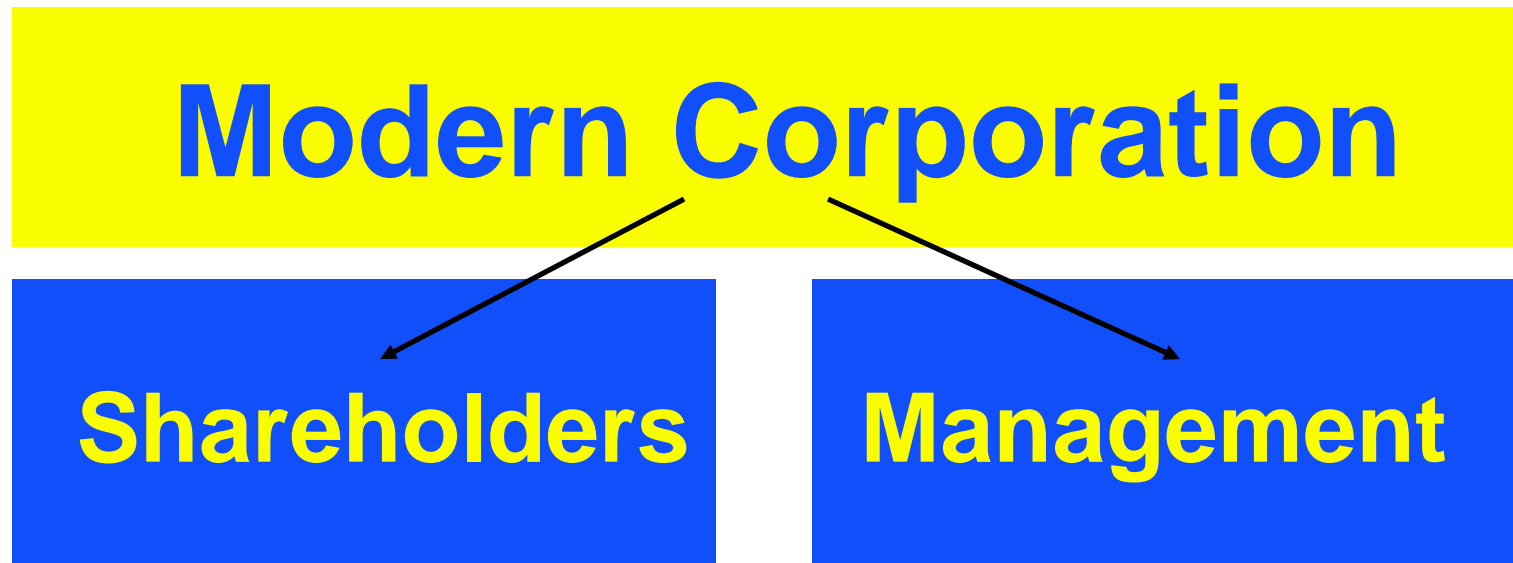
## ***Problems***

- **Does not specify timing or duration of expected returns.**
- **Ignores changes in the risk level of the firm.**
- **Calls for a zero payout dividend policy.**

# ***Strengths of Shareholder Wealth Maximization***

- Takes account of: **current and future profits and EPS**; **the timing, duration, and risk of profits and EPS**; **dividend policy**; and all other relevant factors.
- Thus, ***share price*** serves as a barometer for business performance.

# ***The Modern Corporation***



**There exists a SEPARATION  
between owners and managers.**

# ***Role of Management***

**Management acts as an *agent* for the owners (shareholders) of the firm.**

- **An *agent* is an individual authorized by another person, called the principal, to act in the latter's behalf.**



# ***Agency Theory***

- **Jensen and Meckling developed a theory of the firm based on *agency theory*.**
- ***Agency Theory* is a branch of economics relating to the behavior of principals and their agents.**

# *Agency Theory*

- Principals must provide ***incentives*** so that management acts in the principals' best interests and then ***monitor*** results.
- Incentives include ***stock options***, ***perquisites***, and ***bonuses***.

# ***Corporate Governance***

- ***Corporate governance: represents the system by which corporations are managed and controlled.***
  - Includes shareholders, board of directors, and senior management.
- Then ***shareholder wealth maximization*** remains the appropriate goal in governing the firm.

# ***Board of Directors***

- **Typical responsibilities:**
  - **Set company-wide policy;**
  - **Advise the CEO and other senior executives;**
  - **Hire, fire, and set the compensation of the CEO;**
  - **Review and approve strategy, significant investments, and acquisitions; and**
  - **Oversee operating plans, capital budgets, and financial reports to common shareholders.**
- **CEO/Chairman roles commonly same person in US, but separate in Britain (US moving in this direction).**

# Board of Directors - Example

VOTE BY

**04/26**

2021 / 5:00PM ET

## ACCOUNT & MEETING

### Details

#### DOCUMENTS ⓘ

- Meeting Materials
- Virtual Meeting Notice

#### RECORD DATE ⓘ

March 1, 2021

#### ACCOUNT INFO

ACCOUNT #: \*\*\*\*\*9176  
CONTROL #: 809741883285  
CUSIP ⓘ: 172967424  
SHARES HELD: 5.000

#### MEETING LOCATION ⓘ

Live Via Webcast:  
www.virtualshareholdermeeting.com/CITI2021

## 1. Proposal to elect 16 Directors:

Vote All Directors: **FOR**

**1.01 /** Ellen M. Costello

// BOARD OF DIRECTORS RECOMMENDED VOTE: **FOR**

FOR AGAINST ABSTAIN

**1.02 /** Grace E. Dailey

// BOARD OF DIRECTORS RECOMMENDED VOTE: **FOR**

FOR AGAINST ABSTAIN

**1.03 /** Barbara J. Desoer

// BOARD OF DIRECTORS RECOMMENDED VOTE: **FOR**

FOR AGAINST ABSTAIN

**1.04 /** John C. Dugan

// BOARD OF DIRECTORS RECOMMENDED VOTE: **FOR**

FOR AGAINST ABSTAIN

**1.05 /** Jane N. Fraser

// BOARD OF DIRECTORS RECOMMENDED VOTE: **FOR**

FOR AGAINST ABSTAIN

**1.06 /** Duncan P. Hennes

// BOARD OF DIRECTORS RECOMMENDED VOTE: **FOR**

FOR AGAINST ABSTAIN

**1.07 /** Peter B. Henry

// BOARD OF DIRECTORS RECOMMENDED VOTE: **FOR**

FOR AGAINST ABSTAIN

**1.08 /** S. Leslie Ireland

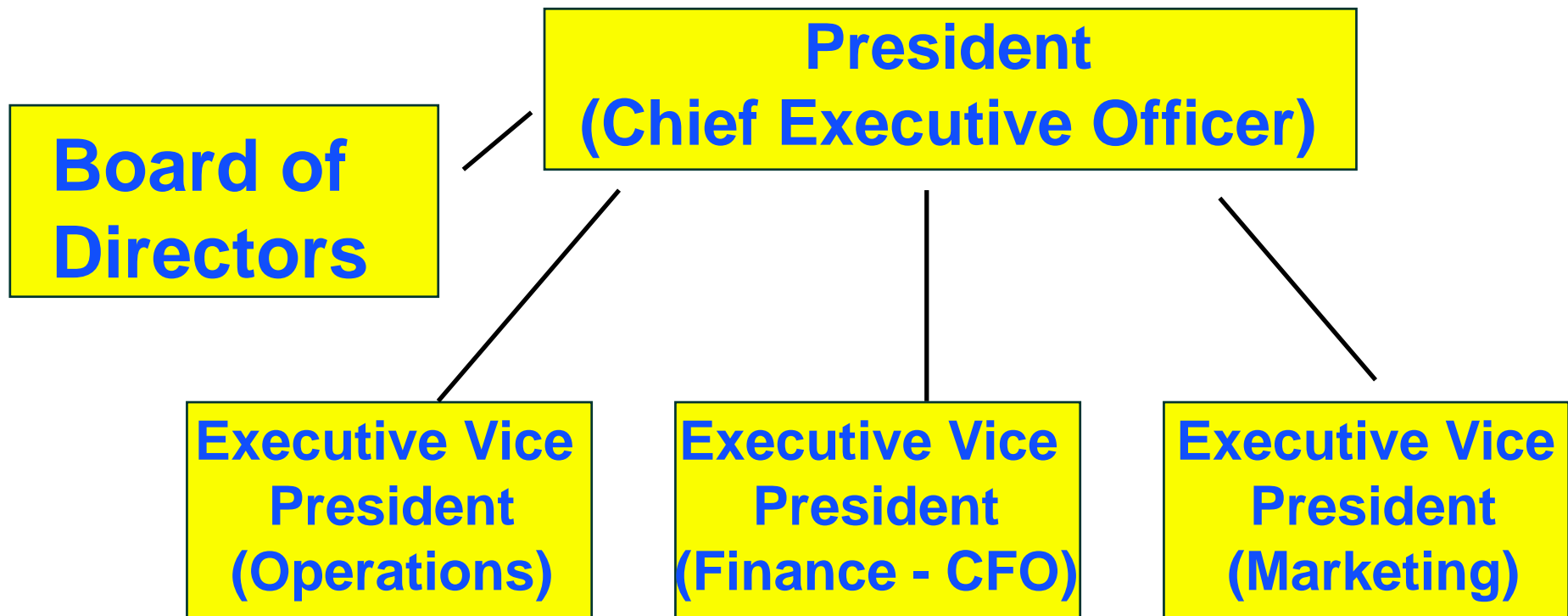
// BOARD OF DIRECTORS RECOMMENDED VOTE: **FOR**

FOR AGAINST ABSTAIN

# ***Sarbanes-Oxley Act of 2002***

- ***Sarbanes-Oxley Act of 2002*** (SOX): addresses corporate governance, auditing and accounting, executive compensation, and enhanced and timely disclosure of corporate information.
  - Imposes new penalties for violations of securities laws.
  - Established the Public Company Accounting Oversight Board (PCAOB) to adopt auditing, quality control, ethics, disclosure standards for public companies and their auditors, and policing authority.
  - Generally increasing the standards for corporate governance.

# ***Organization of the Financial Management Function***



# ***Organization of the Financial Management Function***

## **EVP of Finance**



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graph TD; EVP[EVP of Finance] --> VP[Vice President (Treasurer)]; EVP --> C[Controller];
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### ***Vice President (Treasurer)***

- Capital Investment
- Cash Management
- Commercial/investment banking relationships
- Credit Management
- Dividend Disbursement
- Financial Analysis/Planning
- Investor Relations
- Mergers and Acquisitions
- Pension Management
- Insurance/Risk Management
- Tax Analysis/Planning

### ***Controller***

- Cost Accounting
- Cost Management
- Data Processing
- General Ledger
- Government Reporting
- Internal Control
- Preparing Financial Statements
- Preparing Budgets
- Preparing Forecasts