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

经管學院
School of Management and Economics

# Chapter 1.

# The Role of Financial Management

# Roadmap of Finance Courses

**Financial Management**

***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?** IPO

# *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"?***

shareholder
↕
stakeholder

***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.

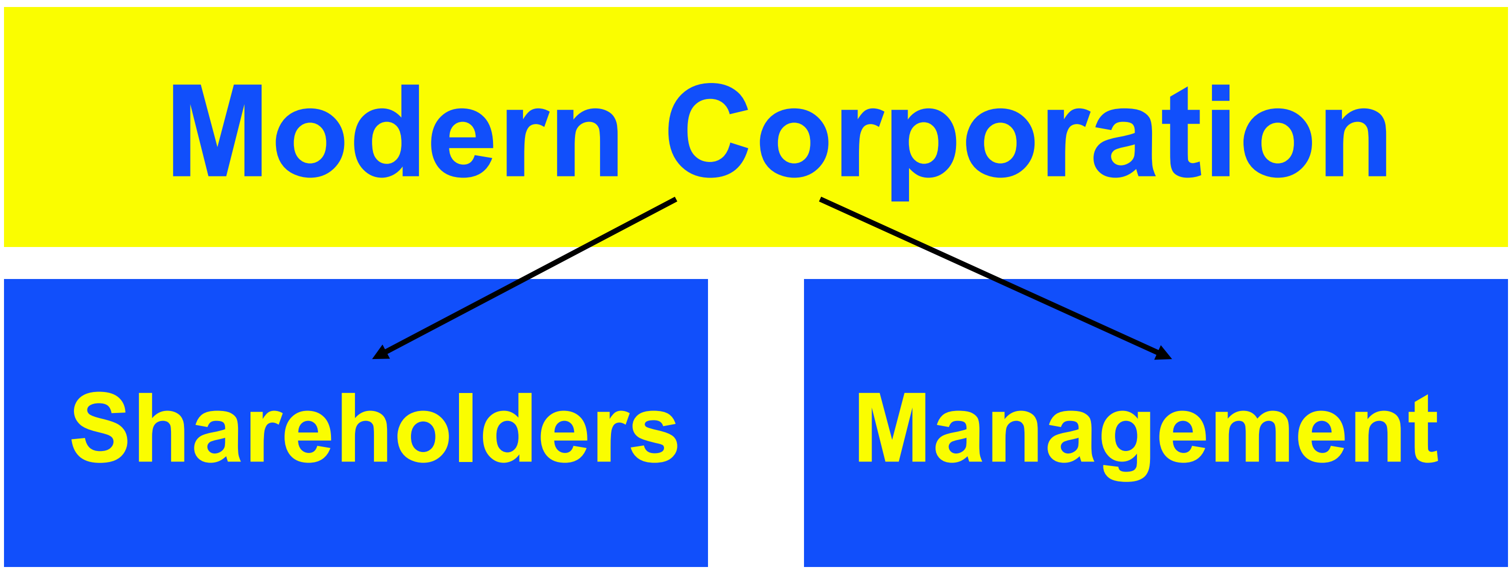
## Problems

- 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

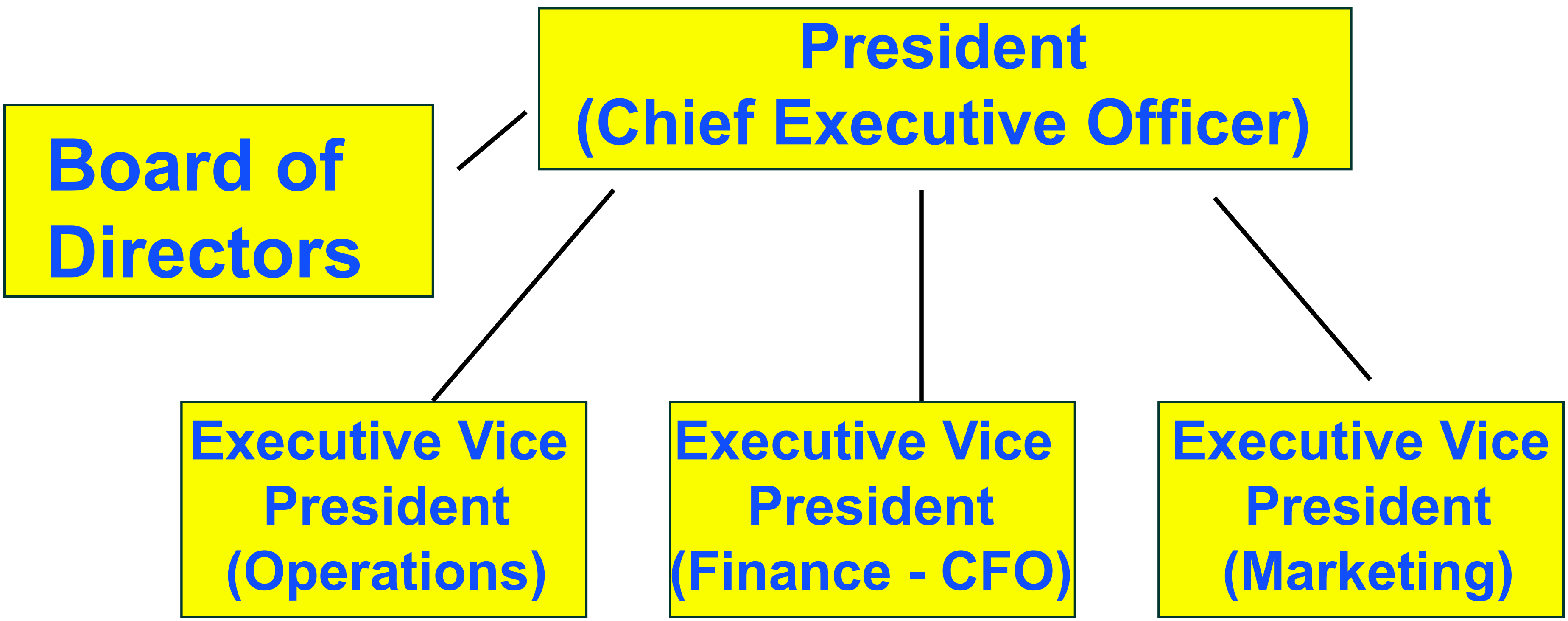
1.07 / Peter B. Henry
// BOARD OF DIRECTORS RECOMMENDED VOTE: FOR
FOR AGAINST ABSTAIN

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

### *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