INTRODUCTION TO FINANCE
Lecture 1

Aim

- This course aims to introduce students to the fundamental principles underlying finance and financial decision making by individuals and firms.
- To provide a broad understanding of financial theory, particularly in relation to the valuation of investments, and explains financial markets & institutions.

Introduction: Financial economics

- Financial economics is divided into two parts. The first part revolves around asset pricing theory and its application to the valuation of securities that are traded in financial markets (e.g., stocks, bonds, and derivatives).
  - Part 1: Asset Markets Topics will include discounting and present value, risk and return, arbitrage, financial markets and securities, banks, mutual and hedge funds.
- The second part introduces corporate finance, which is concerned with how businesses make financial decisions.
  - Part 2: Corporate Finance Topics will include financial statement analysis, the cost of capital, capital structure, venture capital and private equity, initial public offerings, and the valuation of firms and projects.

Types of Business Entity/ Firms

- There are four types of business entities/firms (in India)
  - Sole Proprietorships
  - Partnership
  - Limited Liability Partnership
  - Companies
    - Private Limited Companies
    - Public Limited Companies
    - One Person Company

Sole Proprietorship

- Owned and run by one person
- Few or no employees
- Most common business entity
- No separate legal entity status for the firm
- Owner has unlimited personal liability for any of the firms debt
- This implies repayment of loans has to be met from personal assets in the case of default
- If not then owner must declare personal bankruptcy (legal declaration of one’s insolvency/ inability to pay-off his/her debt)

Partnership

- More than one owner
- No separate legal entity
- Agreement assigns rights , responsibilities and liabilities
- All partners are liable for firms debt-unlimited liability as directed by the agreement
- Personal properties can be used for debt repayment
- Limited Liability Partner- no managerial power but limited liability on firms outstanding debt

Limited Liability Partnership (LLP)

- ➢Limited Liability Partnership is a hybrid structure that combines the advantages of a partnership and a company.
- ➢It offers limited liability protection to its partners, meaning personal assets are protected in case of any legal or financial disputes.
- ➢Their responsibility towards losses or debts is limited to investments made by them
- ➢LLP is a separate legal entity, meaning it can own property, enter into contracts, and sue or be sued in its own name.
- ➢LLP is governed by the Limited Liability Partnership Act, 2008, and requires compliance with certain statutory requirements

Company

- Legally defined entity
- Many legal powers- enter into contracts , acquire assets, incur obligations
- Owners are not liable for companies debt. i.e. personal properties cannot be used for debt obligations
- In India three forms of comapines- Private Limited, Public Limited Companies and one-person companies

Private Limited Company

- Private Limited Company is the most popular form of business entity in India.
- It is a separate legal entity, meaning it can own property, enter into contracts, and sue or be sued in its own name.
- It offers limited liability protection to its shareholders, meaning personal assets are protected in case of any legal or financial disputes.
- A private limited company can have a minimum of two and a maximum of 200 shareholders.
- It is governed by the Companies Act, 2013, and requires compliance with various statutory requirements.

Public Limited Company

- Public Limited Company is a company whose shares are publicly traded on a stock exchange.
- It offers limited liability protection to its shareholders, meaning personal assets are protected in case of any legal or financial disputes.
- A public limited company can have a minimum of seven shareholders, and there is no upper limit on the number of shareholders.
- It is governed by the Companies Act, 2013, and requires compliance with various statutory requirements.

One –Person Company

- As per Section 2(62) of the Companies Act 2013, "*one person company*" *means a company that has only one person as a member*. This is a recent invention to facilitate entrepreneurs to own and manage companies alone.
- All the shares can be owned by one person but there must be a nominee for the sole member to register this form of business.

Syllabus

- **Module-1:** Introduction: Firm structure, financial markets, financial statement analysis, financial decision making, Time value of Money, interest rates, valuing Bonds
- **Module-2:** Investment Decision Rules, Fundamentals of capital Budgeting; Valuing Stocks
- **Module 3**: Capital markets and the pricing of risk; Optimal Portfolio Choice
- **Module-4**: Capital Asset Pricing Model
- **Module-5:** Estimating the cost of Capital; Investor Behaviour and Capital Market Efficiency

References

- Corporate Finance
  - John Hull
  - Berk and DeMarzo