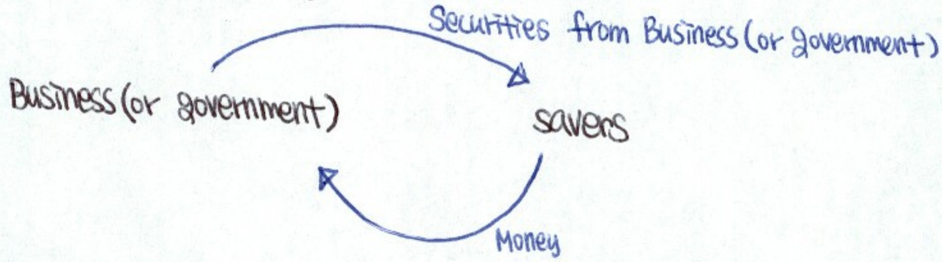
June 5, 2019

The Principles of Financial Management - Shin, Seungho

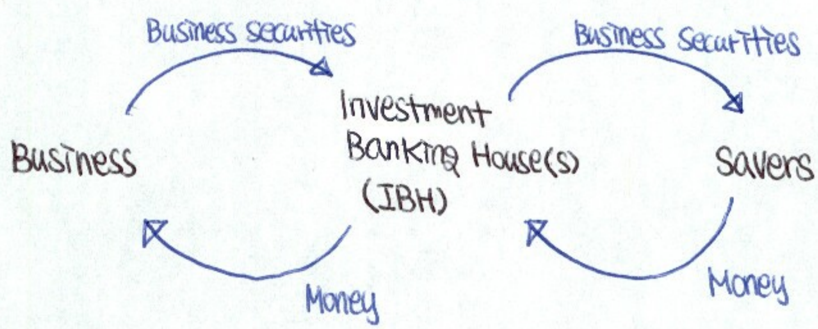
Part I

* • How is capital transferred between savers and borrowers? ① Direct transfer, ② Investment banks, and ③ Financial intermediaries

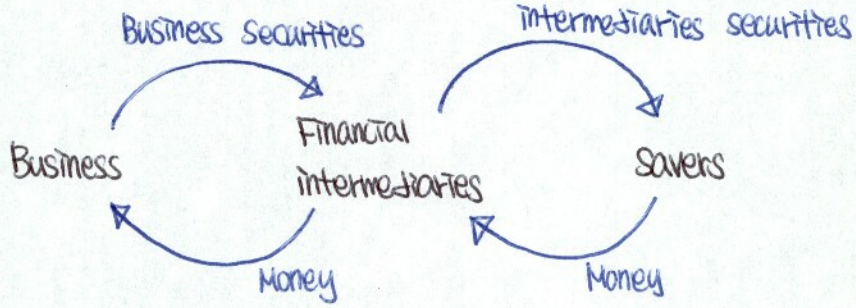
① Direct transfers ; a privately held company might sell shares of stock directly to a new shareholder, or the U.S. government might sell a treasury bond directly to an individual investor



② Investment banks ; investment banking house(s) (IBH) underwrites the issue; an underwriter facilitates the issuance of securities. The company sells its stocks or bonds to the investment bank, which in turn sells these same securities to savers.

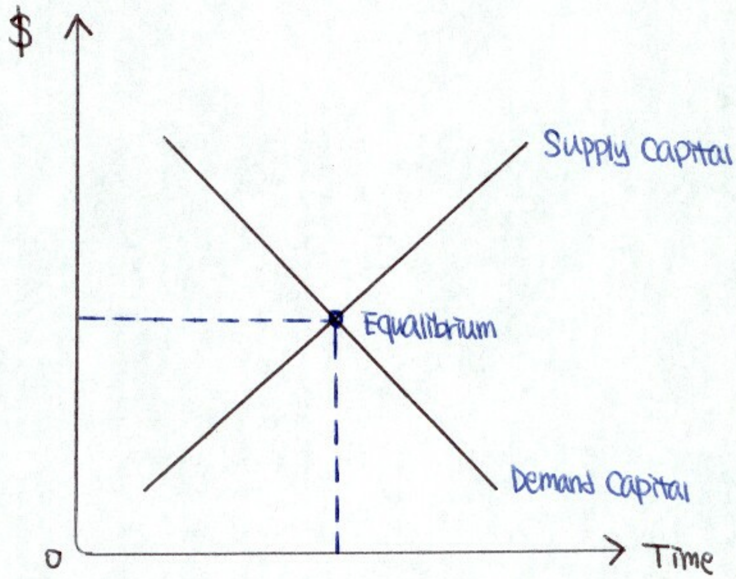


③ Financial intermediaries ; a saver might give dollars to a bank and receive a CD, and then the bank might lend the money to a small business, receiving in exchange a signed loan.



Part II.

- Capital Allocation Process



① efficient economy ; Supply Capital = demand Capital

- ✓ Supply Capital from individuals or institutions with exceed funds; individuals or institutions are saving money and looking for excess return on their investment.
- ✓ Demand Capital from individuals or institutions who need to raise funds for their investment opportunities. These individuals or institutions are willing to pay a rate of return on the capital they borrow.

② *** Thee important charavteristics of the capital allocation process?
"new financial securities are created", "financial institutions are often

involved", "allocation between providers and users of funds occurs in financial markets."

Part III

• Market? "Financial Market"! → Type of financial markets
→ Type of financial institutions

✓ there are many financial markets in a developed economy, and financial markets are all different with certain characteristics.

✓ each market deals with a somewhat different type of instrument, customer, or geographic location.

✓ a financial market is a place where individuals or organizations trade securities including stocks, bonds, futures, options, currencies, and so on.

• "Types of financial markets"

① "Physical asset markets" are for tangible/real assets such as wheat, autos, real estates, and machines.

② "Financial asset markets" deal with financial securities such as stocks, bonds, mortgage, and cetain financial instruments.

③ "Spot" market is a market where assets are being bought or sold for "on-the-spot" delivery.

④ "Future" market is a market where assets are being bought or sold for delivery at some future date.

⑤ "Money" markets are the markets for short-term

⑥ capital markets are the markets for corporate stocks and debt maturing more than a year in the future.

※ debt markets

- short-term □ < 1 year (less than 1 year)
- intermediate 1 < □ < 5 years (between 1 and 5 years)
- long-term □ > 5 years (more than 5 years)

⑦"Primary" markets are the markets in which corporations raise new capital(IPO?).

⑧"Secondary" markets are the markets in which existing, already outstanding securities are traded among investors.

⑨"Private" markets, where transactions are worked out directly between two parties, are differenciated from "public" markets, where standardized contracts are traded on organized exchanges.

• "Type of financial institutions"

① "Investment banks" underwrite and distribute new investment securities and help businesses obtain financing (Bear Stearns, Merrill Lynch...)

② "Commercial banks" are department stores of finance (BOA, Chase, ...)

③ "Financial services corporations" are large conglomerates that combine many different financial institutions within a single corporation.

④ "Pension funds" are retirement plans funded by corporations or government agencies. They usually invest in stocks, bonds, and real-estate.

⑤ "Mutual funds" are pool investor funds to purchase financial instruments and thus reduce risks through diversification.

⑥ "ETFs" (or mutual funds) buy a portfolio of stocks such as S&P500, foreign companies, and so on. These regulated by SEC.

⑦ "Hedge funds" accept money from savers and use to buy various securities. These are not regulated.

• NYSE and NASDAQ

① The NYSE is an auction market. At NYSE, individual investors are typically buying and selling between one another and there is an auction occuring. That is, the highest bidding price will be matched with the lowest asking price. (Exxon, Berkshire Hathaway...)

② The NASDAQ is a dealer's market. Market participants are not buying from and selling to one another directly, but instead through a dealer. Matching of buyers and sellers happens in split seconds, electronically. (Apple, Microsoft. Facebook, ...)

	NYSE	NASDAQ
Founded	1792	1971
Market Type	Auction	Dealer
Listing Fee	up to $500,000	$50,000~75,000
# of firms	about 2400	about 3,800
Market Cap.	$22 trillion	$11 trillion

※ A secondary market can be either a physical location exchange or a Computer/telephone network (electronic dealer-based)

Part IV

- Initial Public Offering (IPO) occurs when firm issues stock in the Public market for the first time. *** IPO allows a firm's owners to raise capital from a wide variety of outside investors. Once issued, the stock trades in the secondary market.
- * IPO Process?

STEP1 Select an investment bank (underwriter) ⇒ STEP2 Due Diligence and regulatory filings ⇒ STEP3 Pricing ⇒ STEP4 Stabilization ⇒ STEP5 Transition to Market Competition