

Chapter 1

Goals and Governance of the Corporation

Financial Management (MGCM10018)

Introduction

- This chapter introduces the **corporation**, its goals, and the roles of financial managers.

Outlines

- Investment and financing decisions
- What is a **corporation**?
- Who is the financial manager?
- Goals of the corporation
- **Agency problems** and corporate governance
- Ethics of maximizing value
- Careers in finance
- Topics covered in this book

Investment & Financing Decisions (1.1)

- The investment decision
 - Decision to invest in real assets
 - Real assets
 - Assets used to produce goods and services
 - Tangible assets vs. intangible assets
 - This involves spending money
 - Often called **capital budgeting** or **capital expenditure** decisions

✕ Luck-in coffee 瑞幸咖啡
做投资事件

Company (revenue in billions, 2010)	<u>錢花去哪裡</u> Recent Investment Decisions	<u>如何拿到錢</u> Recent Financing Decisions
GlaxoSmithKline (£28 billion)	Spent £3.7 billion in 2009 on research and development of new drugs.	Financed R&D expenditures with reinvested cash flow generated by sales of pharmaceutical products.
Boeing (\$64 billion)	Completed testing of its 787 Dreamliner aircraft, developed at a cost of more than \$10 billion.	Bolstered its cash position by borrowing nearly \$6 billion.
Walmart (\$405 billion)	Planned in 2011 to open more than 150 stores in the U.S. and more than 600 overseas.	Repaid over \$6 billion of long-term debt, bought back \$7 billion of its shares, and paid a dividend to shareholders of \$4 billion.
Union Pacific (\$17 billion)	Acquired 127 new locomotives in 2009 at a cost of \$287 million.	Financed many of the new locomotives by long-term leases.
Banco Santander (€42 billion)	Acquired Sovereign Bank for \$1.9 billion.	Financed the acquisition by an exchange of shares.
Ford Motor Company (\$121 billion)	Announced \$2.3 billion investment in U.K. manufacturing facilities over the next 5 years to support production of low-carbon emission vehicles.	Paid off \$7 billion in automotive debt in the second quarter of 2010.
LVMH (€20 billion)	Engaged in capital expenditures of €729 million, including new store openings for Louis Vuitton and new production facilities for Christian Dior, Hennessy, and Veuve Clicquot.	Issued a 3-year bond in 2008, raising 200 million Swiss francs.
Honda (¥10,011 billion)	Invested ¥90 billion to develop new motorcycle models and modernize production facilities.	Issued \$1 billion of debt maturing in 3 and 5 years.
Chevron (\$171 billion)	Announced plans to invest with its partners in the Gorgon liquefied natural gas project in western Australia. The total cost of the project is forecast at more than A\$40 billion.	Arranged credit facilities with various banks that would allow it to borrow \$5.1 billion.

Investment & Financing Decisions

- The financial decision
 - The form and amount of financing of a firm's investments
 - This involves raising money
 - For the firm's investments and operations
 - **Financial assets**
 - Financial claims to the income generated by the firm's real assets.
 - Examples: share of stock, bank loan, bonds

Investment and Financing Decisions

- Are the following ^①capital budgeting or ^②financing decisions?
 - Apple decides to spend \$500 million to develop a new iPhone. ①
 - GE borrows \$400 million from bond investors. ②
 - Microsoft issues 100 million shares to buy a small technology company. ① & ②

Investment and Financing Decisions

- Are the following ^① real assets or ^② financial assets?
用來從事生產製造 用來獲得資金
 - A patent ①
 - A share of stock issued by HSBC ②
 - A mortgage loan taken out to help pay for a new home ②
 - A new factory built by TSMC in Tainan ①
 - An IOU from your brother-in-law ②

What is a Corporation? (1.2)

- Corporation: A business organized as a separate legal entity owned by stockholders (shareholders).
 - The stockholders have **limited liability** of the corporation.
有限責任
 - Limited liability: the owners of a corporation are not personally liable for its obligations.
 - Shareholders can lose their entire investment in a corporation, but no more.

Business Organization

- Sole proprietorship 獨資企業
- Partnership 合夥企業
 - Limited Liability Partnership (LLP)
 - Limited Liability Company (LLC)
- Professional Corporation (PC)
- Corporations
 - Public Corporations
 - Board of directors, Top managers
 - Private Corporations

Benefits of the Corporation

- Separation of ownership and control
- Limited liability
- Infinite lifespan
- Ease of raising capital
- Easy transferability of ownership interest

Drawbacks of the Corporation

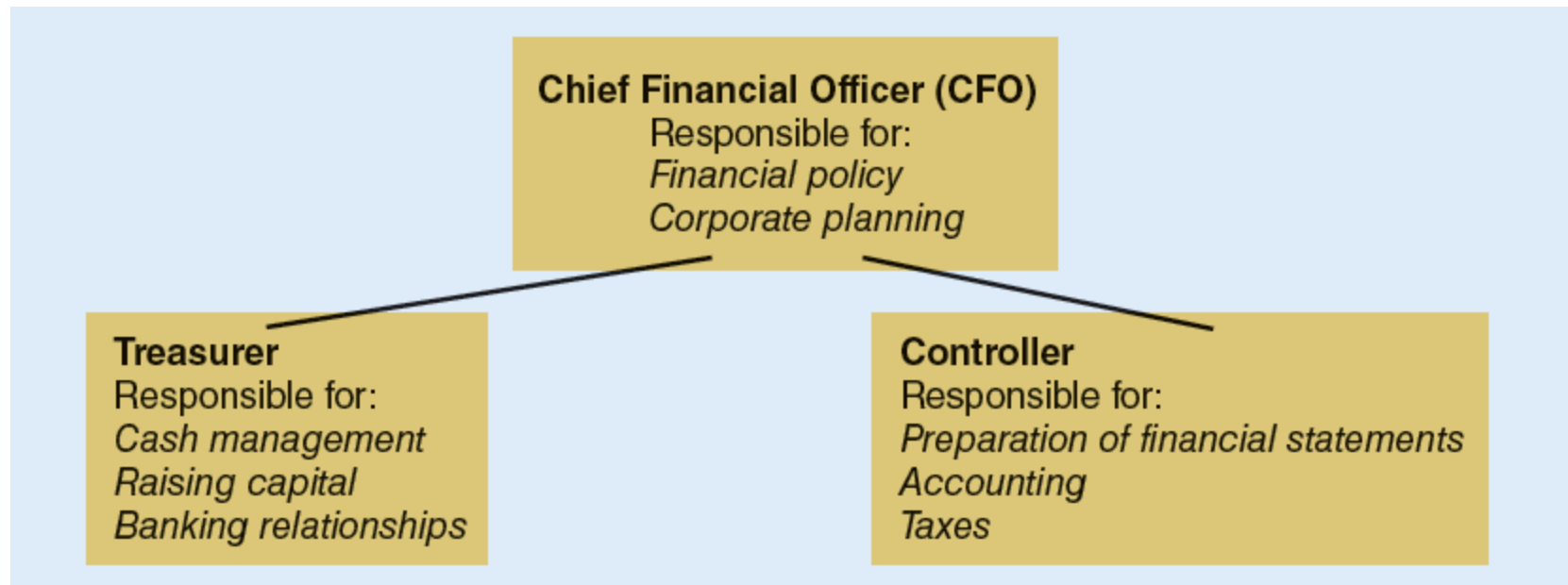
- Setting up a corporation is more complex and time-consuming
- Corporations face the problem of double taxation
- Improper corporate structures may lead to **agency problems**. 代理問題
 - Managers and directors may act in their own interests rather than in the stockholders' interests.

Financial Mangers (1.3)

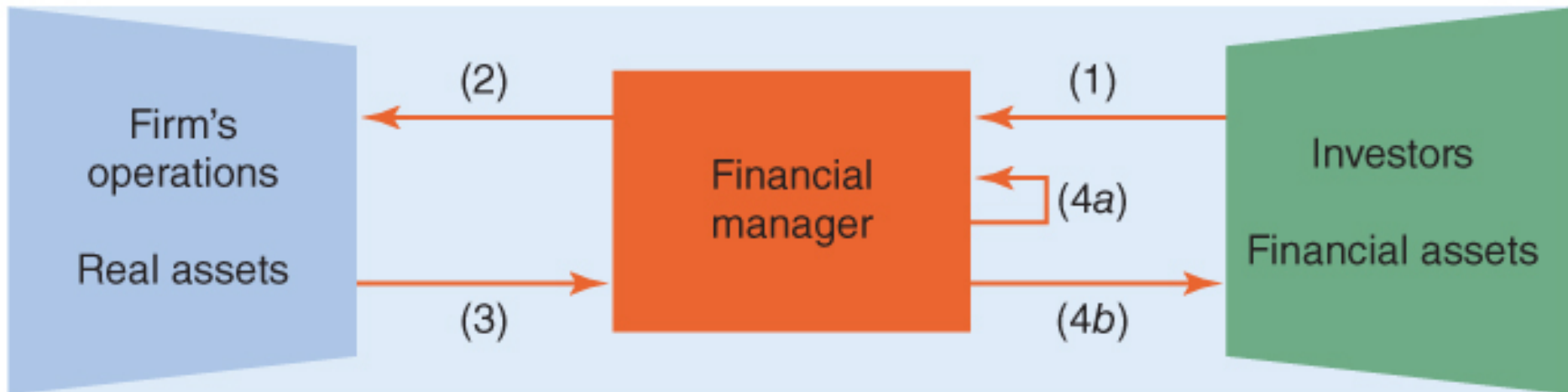
- Chief Financial Officer (CFO)
 - Overseas the work of all financial staff and make financial policy.
- Treasurer
 - To obtain and manage the firm's capitals
- Controller
 - To ensure that money is used efficiently

Financial Managers

Most large companies have 3 top-level financial managers:



Role of the Financial Managers



1. Cash raised from investors (how?)
2. Cash invested in firm
3. Cash generated by operations
- 4A. Cash reinvested in the firm
- 4B. Cash returned to investors

Shareholder = stockholder 股東 \neq stakeholder 利害關係人

Goals of the Corporation (1.4)

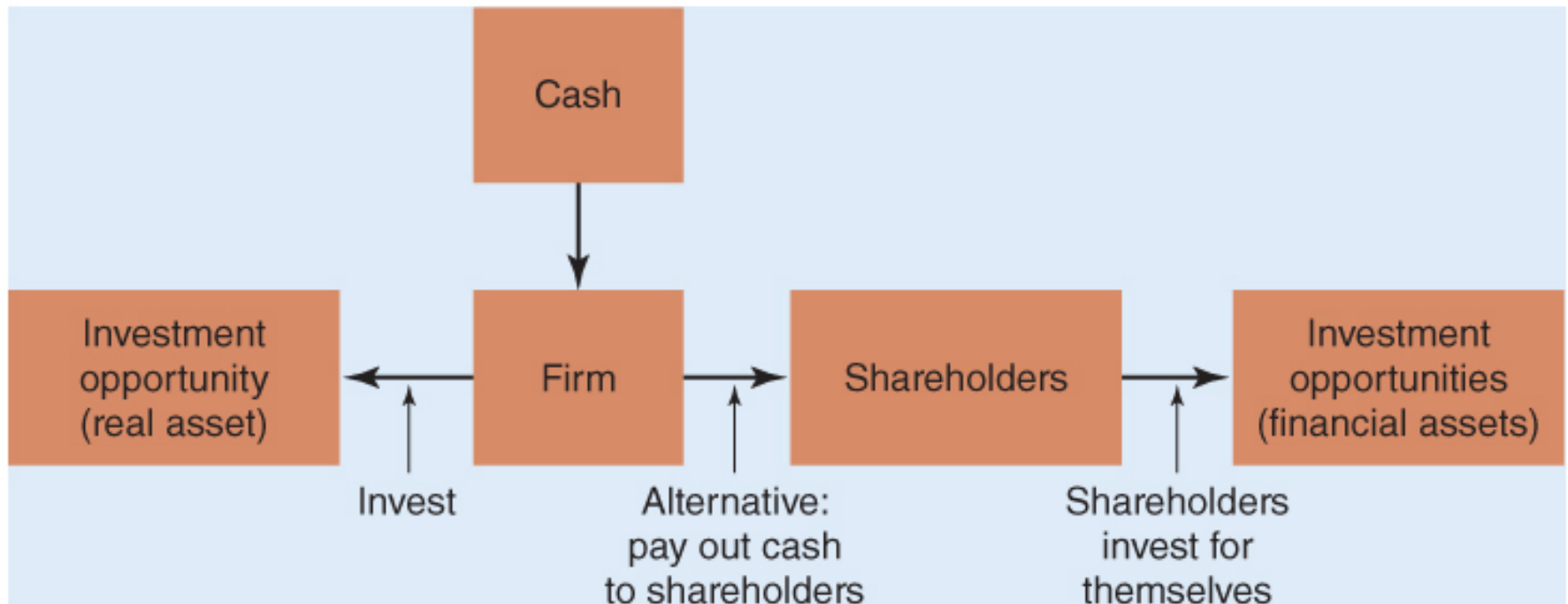
- Shareholders want **wealth maximization**
 - Large corporation can have thousands of shareholders
 - How can these shareholders delegate one common decision making to the managers?
 - **Maximize the current market value** of shareholders' investment in the firm.
 - This simple goal makes sense when the shareholders have access to well-functioning financial markets.

① 減少資訊不對稱 ② 有市場效率

Goals of The Corporation

- Why not profit maximization?
 - Wealth maximization vs. profit maximization
 - Profits from which period?
 - Increase profit by cutting back staff training
 - Cutting this year's dividends to increase cash reserves for future projects
 - Investment trade-off

Investment Trade-Off



- The return of shareholders' investment is often called hurdle rate or opportunity cost of capital.

- Minimum acceptable rate of return on capital investment

得利率高於機會成本
才會投資

Agency Problems (1.5)

- Do managers really maximize value?
 - Managers are agents for stockholders, but the managers may act in their own interests rather than maximizing the firms' value
- Shareholders vs. Stakeholders
 - Stakeholders
 - Anyone with a financial interest in the firm
 - Examples: managers, employees, shareholders, lenders, government...etc.

Agency Problems

solution

- ① internal control
- ② compensation schemes
- ③ system of corporate governance (external)

Different Information

- Stock prices vs. Returns
- Dividend Policy
- Financing Decisions

Different Objectives

- Managers vs. Shareholders
- Top Managers vs. lower Managers
- Stockholders vs. Banks and Lenders

Solutions to Agency Problem

- Legal and Regulatory Requirements
- Board of Directors
 - Sarbanes-Oxley Act 沙賓法案
- Blockholders 大股東(持有>5%的股份)
- Specialist Monitoring
- Compensation plans
- Takeovers 併購(非善意/敵意併購) → 經理人會有壓力
- Shareholder Pressure

✕ ExxonMobil 解決碳排放問題
(石油公司)

Corporate Governance

- Well-designed incentives for managers
- Standards for accounting
- Disclosure to investors
- Requirements for boards of directors
- Legal sanctions for fraud or self-dealing by management

ESG (environmental, social, corporate governance) is a popular evaluation for companies.

The Ethics of Maximizing Value (1.6)

- Does value maximization justify unethical behavior?

- Examples:

- Enron (財報作假 - 左手進右手出)
- WorldCom (謊報成本)
- Bernard Madoff (龐氏騙局)

- It is not always easy to know what is ethical behavior, and there can be many gray areas

Volkswagen cut back carbon pollution in test by modifying the program in 2015
(謊報低碳排放量)

The Ethics of Maximizing Value

- Does value maximization justify unethical behavior?
 - In most instances, there is little conflict between doing well and doing good
把事作好 做好事
 - Good managers know that their firm's reputation is one of its most important assets,
 - And playing fair and keeping one's word are simply good business practices.

-X: Aspen consensus said that most business and their decision makers are willing to do more goods rather than do less harms. (ex. 寶子水庫供半導體用水 但傷害環境)
亞斯潘共識

Careers in Finance (1.7)

Career	Annual Compensation
Commercial Banking	
Loan officer	\$100,000
Financial analyst	\$58,000
Corporate Finance	
Financial analyst	\$63–81,000
Assistant treasurer	\$88–113,000
Chief financial officer	\$260–390,000
Major Investment Banks	
First-year analyst	\$90,000
Vice president	\$500,000
Managing director/partner	\$800,000
Department head	\$2 million
Money Management	
Portfolio manager	\$500,000+
Bank trust department	\$90–180,000
Hedge fund head	\$1.3 million

Preview of Coming Attractions (1.8)

- How do I calculate the value of a stream of future **cash flows**?
- How do I measure **risk**?
- Where does **financing** come from?
- How do I ensure that the firm's financial decisions add up to a sensible whole?
- What about some of those other responsibilities of the financial manager that you mentioned earlier?

Snippets of Financial History (1.9)

Date	Activity
Unknown	Compound growth
1800 b.c.	Interest rates
1000 b.c.	Options
15th C	International banking
1650	Futures
17th C	Stock corporations
17th C	Currency
1720	New issue speculation
1792	NYSE formed
1929	Stock market crash
1960	Eurodollar market
1971	Corporate bankruptcies
1972	Financial futures
1986	Capital investment decisions
1988	Mergers
1993	Inflation
1780 & 1997	Inflation securities
1993	Controlling risk
1999	The Euro
2002	Financial scandals
2007-2009	Subprime mortgages
2011	Sovereign debt defaults