



CHAPTER 1

INTRODUCTION TO CORPORATE FINANCE



KEY CONCEPTS AND SKILLS

- Know the basic types of financial management decisions and the role of the financial manager
- Know the financial implications of the different forms of business organization
- Know the goal of financial management
- Understand the conflicts of interest that can arise between owners and managers
- Understand the various types of financial markets

CHAPTER OUTLINE

- Corporate Finance and the Financial Manager
- Forms of Business Organization
- The Goal of Financial Management
- The Agency Problem and Control of the Corporation
- Financial Markets and the Corporation





CORPORATE FINANCE

- Some important questions that are answered using finance:
 - What long-term investments should the firm take on?
 - Where will we get the long-term financing to pay for the investment?
 - How will we manage the everyday financial activities of the firm?



FINANCIAL MANAGER

- Financial managers try to answer some or all of these questions
- The top financial manager within a firm is usually the Chief Financial Officer (CFO)
 - Treasurer – oversees cash management, credit management, capital expenditures, and financial planning
 - Controller – oversees taxes, cost accounting, financial accounting and data processing



FINANCIAL MANAGEMENT DECISIONS

- Capital budgeting
 - What long-term investments or projects should the business take on?
- Capital structure
 - How should we pay for our assets?
 - Should we use debt or equity?
- Working capital management
 - How do we manage the day-to-day finances of the firm?

FORMS OF BUSINESS ORGANIZATION

- Three major forms in the United States
 - Sole Proprietorship
 - Partnership
 - General
 - Limited
 - Corporation
 - Limited Liability Company



SOLE PROPRIETORSHIP

- Advantages

- Easiest to start
- Least regulated
- Single owner keeps all the profits
- Taxed once as personal income

- Disadvantages

- Limited to life of owner
- Equity capital limited to owner's personal wealth
- Unlimited liability
- Difficult to sell ownership interest



PARTNERSHIP

- Advantages

- Two or more owners
- More capital available
- Relatively easy to start
- Income taxed once as personal income

- Disadvantages

- Unlimited liability
 - General partnership
 - Limited partnership
- Partnership dissolves when one partner dies or wishes to sell
- Difficult to transfer ownership



CORPORATION

- Advantages

- Limited liability
- Unlimited life
- Separation of ownership and management
- Transfer of ownership is easy
- Easier to raise capital

- Disadvantages

- Double taxation (income taxed at the corporate rate and then dividends taxed at the personal rate)





GOAL OF FINANCIAL MANAGEMENT

- What should be the goal of a corporation?
 - Maximize profit?
 - Minimize costs?
 - Maximize market share?
 - Maximize the current value of the company's stock?
- Does this mean we should do anything and everything to maximize owner wealth?



THE AGENCY PROBLEM

- Agency relationship
 - Principal hires an agent to represent his/her interests
 - Stockholders (principals) hire managers (agents) to run the company
- Agency problem
 - Conflict of interest between principal and agent
- Management goals and agency costs



MANAGING MANAGERS

- Managerial compensation
 - Incentives can be used to align management and stockholder interests
 - The incentives need to be structured carefully to make sure that they achieve their goal
- Corporate control
 - The threat of a takeover may result in better management
- Other stakeholders

WORK THE WEB EXAMPLE

- The Internet provides a wealth of information about individual companies
- One excellent site is finance.yahoo.com
- Click on the web surfer to go to the site, choose a company and see what information you can find!





FINANCIAL MARKETS

- Cash flows to and from the firm
- Primary vs. secondary markets
 - Dealer vs. auction markets
 - Listed vs. over-the-counter securities
 - NYSE
 - NASDAQ



QUICK QUIZ

- What are the three types of financial management decisions and what questions are they designed to answer?
- What are the three major forms of business organization?
- What is the goal of financial management?
- What are agency problems and why do they exist within a corporation?
- What is the difference between a primary market and a secondary market?



ETHICS ISSUES

- Is it ethical for tobacco companies to sell a product that is known to be addictive and a danger to the health of the user? Is it relevant that the product is legal?
- Should boards of directors consider only price when faced with a buyout offer?
- Is it ethical to concentrate only on shareholder wealth, or should stakeholders as a whole be considered?
- Should firms be penalized for attempting to improve returns by stifling competition (e.g., Microsoft)?

END OF CHAPTER

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