



Introduction to Financial Management

Chapter 1

Key Concepts and Skills

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

Chapter Outline



- Finance: A Quick Look
- Business 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

Basic Areas Of Finance

- Corporate finance
- Investments
- Financial institutions
- International finance

Investments

- Work with financial assets such as stocks and bonds
- Value of financial assets, risk versus return and asset allocation
- Job opportunities
 - Stockbroker or financial advisor
 - Portfolio manager
 - Security analyst



Financial Institutions

- Companies that specialize in financial matters
 - Banks – commercial and investment, credit unions, savings and loans
 - Insurance companies
 - Brokerage firms
- Job opportunities



International Finance

- This is an area of specialization among all of the areas discussed so far
- It may allow you to work in other countries or at least travel on a regular basis
- Need to be familiar with exchange rates and political risk
- Need to understand the customs of other countries and speaking a foreign language fluently is also helpful

Why Study Finance?

- Marketing
 - Budgets, marketing research, marketing financial products
- Accounting
 - Dual accounting and finance function, preparation of financial statements
- Management
 - Strategic thinking, job performance and profitability
- Personal finance
 - Budgeting, retirement planning, college planning, day-to-day cash flow issues

Business 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 Organization

- Three major forms in the united states
 - Sole proprietorship
 - Partnership
 - General
 - Limited
 - Corporation
 - S-Corp
 - 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

- Separation of ownership and management
- Double taxation (income taxed at the corporate rate and then dividends taxed at 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 their interest
 - 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

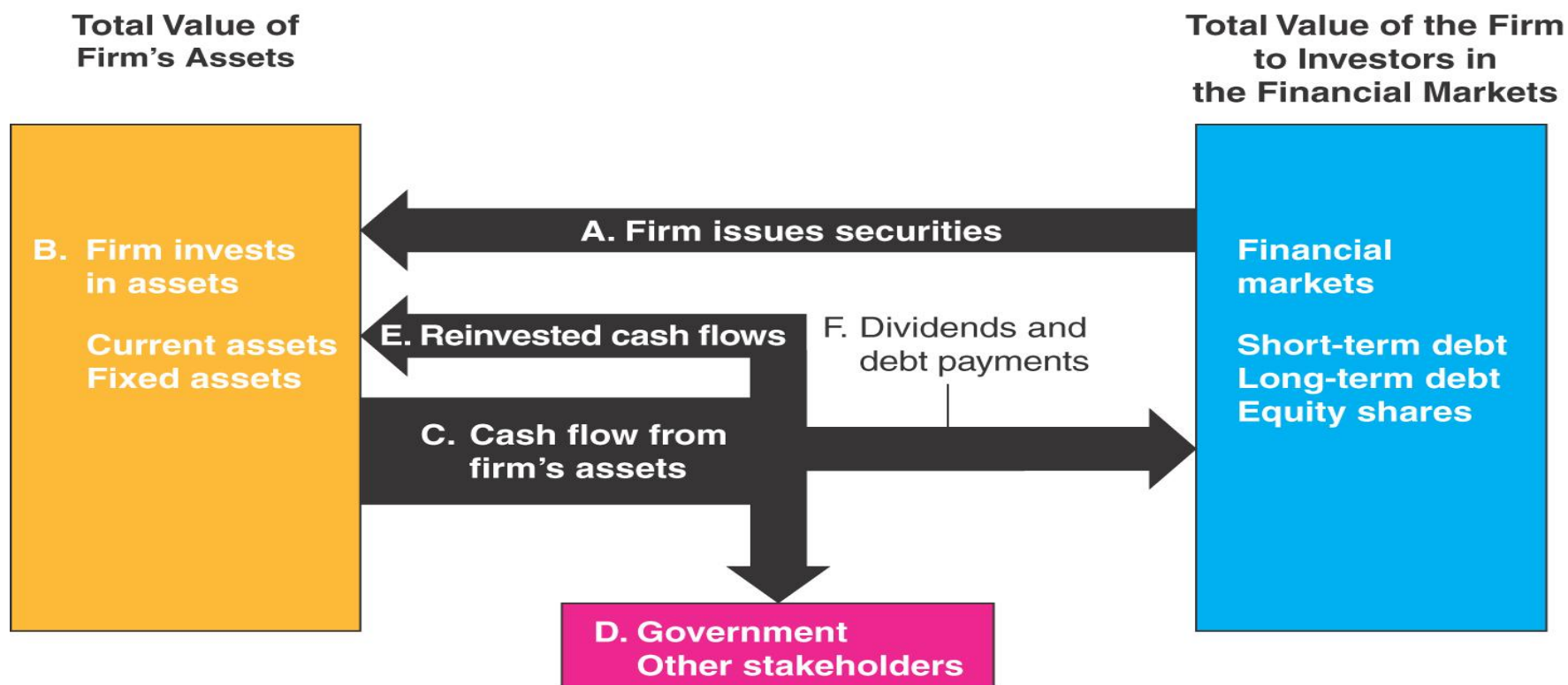
- Managerial compensation
 - Incentives can be used to align management and stockholder interests
 - The incentives need to be structured carefully to make sure that they achieve their goal
- Corporate control
 - The threat of a takeover may result in better management
- Other stakeholders

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!



Figure 1.2



- A. Firm issues securities to raise cash.
- B. Firm invests in assets.
- C. Firm's operations generate cash flow.
- D. Cash is paid to government as taxes. Other stakeholders may receive cash.

- E. Reinvested cash flows are plowed back into firm.
- F. Cash is paid out to investors in the form of interest and dividends.

Financial Markets

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

Quick Quiz

- What are the four basic areas of finance?
- 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?