INTRODUCTION TO CORPORATE FINANCE

Chapter 1

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Course Roadmap

Chapter	Topic	Focus	Exam
1	Introduction to Corporate Finance	1.1, 1.2 & 1.3.	
2	Financial Statements, Taxes, and Cash Flow.	All	Quiz 1
3	Working with Financial Statements.	All	
5	Introduction to Valuation: The Time Value of Money.	All	Quiz 2 +Mid-Term
6	Discounting Cash Flow Valuation	All	
8	Stock Valuation	Only 8.1 & 8.2	Quiz 3
9	Net Present Value and Other Investment Criteria	Until "Problems with the IRR"	
13	Risk and Return	13.1 & 13.2	Quiz 4 + Final exam

Key Concepts

- 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

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?

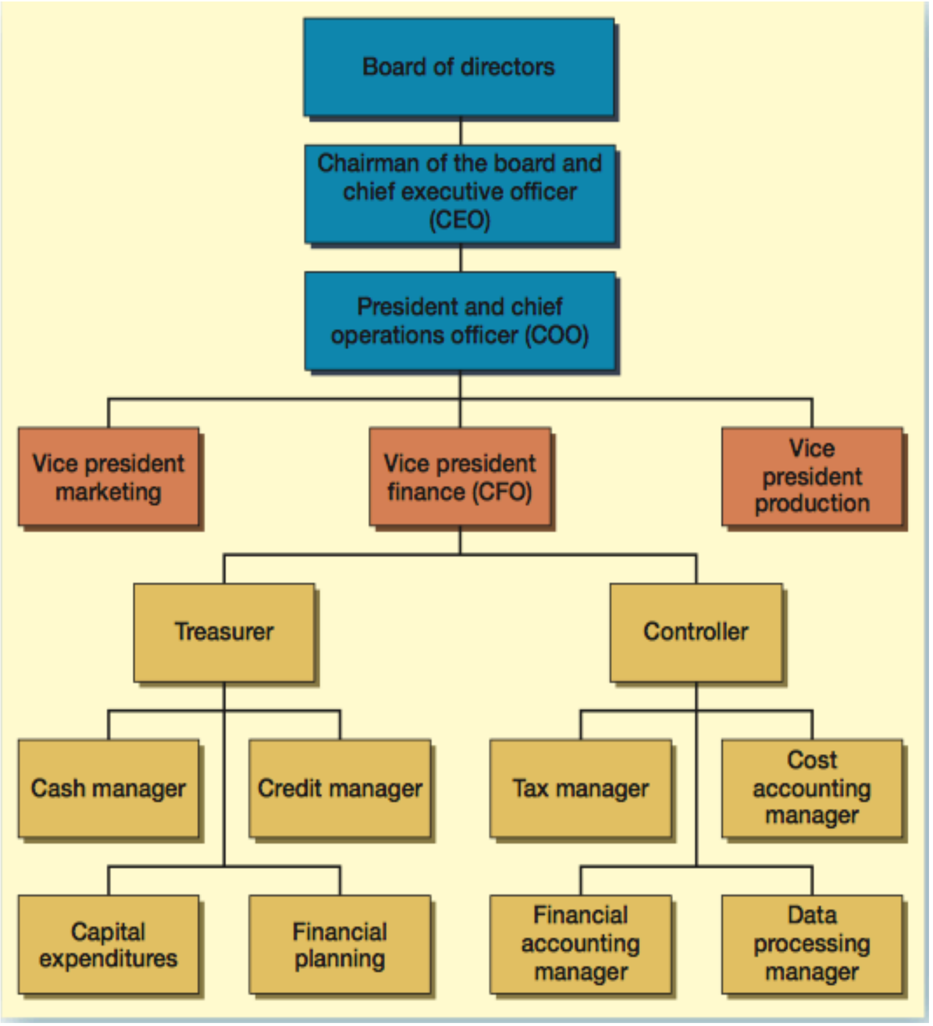
Financial Manager

- 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

A Sample Simplified Organizational Chart



Financial Manager

- A striking feature of large corporations is that the owners (the stockholders) are usually not directly involved in making business decisions.

- The corporation employs managers represent the owners' interests and make decisions on their behalf. In a large corporation, the financial manager would be in charge of answering the three questions.

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

1. Sole Proprietorship

- A **sole proprietorship** A business owned by a single individual "one person".

- This is the simplest type of business to start and is the least regulated form of organization.

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

2. PARTNERSHIP

- A business formed by two or more individuals or entities.
- is similar to a proprietorship except that there are two or more owners (partners).
- A. a general partnership: all the partners share in gains or losses, and all have unlimited liability for *all* partnership debts, not just some particular share.
- The way partnership gains (and losses) are divided is described in the *partnership agreement*.

- B. a limited partnership, one or more *general partners* will run the business and have unlimited liability, but there will be one or more *limited partners* who will not actively participate in the business.
- A limited partner's liability for business debts is limited to the amount that partner contributes to the partnership.

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

3. Corporation

- The **corporation** is the most important form (in terms of size) of business organization in the United States.
- A corporation is a legal “person” separate and distinct from its ,and it has many of the rights, duties, and privileges of an actual person.
- A business created as a distinct legal entity composed of one or more individuals or entities.

Corporation

- Corporations can :
- Borrow money
- Own property
- Can sue and be sued
- Can enter into contracts
- Can even be a general partner or a limited partner in a partnership
- Can own stock in another corporation

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 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 GOAL OF FINANCIAL MANAGEMENT

The goal of financial management is to maximize the current value per share of the existing stock.