

INTRODUCTION TO FINANCIAL MANAGEMENT



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Key Concepts and Skills

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- 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

Chapter Outline

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- 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

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- Corporate finance
- Investments
- Financial institutions
- International finance

Investments

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- 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

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

International Finance

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- This is an area of specialization within each 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; speaking a foreign language fluently is also helpful

Why Study Finance?

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

Business Finance

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- 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 investments?
 - How will we manage the everyday financial activities of the firm?

Financial Manager

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- 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

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- 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

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- Three major forms in the United States
 - Sole proprietorship
 - Partnership
 - ✦ General
 - ✦ Limited
 - Corporation
 - ✦ S-Corp
 - ✦ Limited liability company

Sole Proprietorship

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- **Advantages**

- Easiest to start
- Least regulated
- Single owner keeps all of 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

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- **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

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- **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 (agency problem)
- Double taxation (income taxed at the corporate rate and then dividends taxed at personal rate, while dividends paid are not tax deductible)

Goal Of Financial Management

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- 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?
- Sarbanes-Oxley Act

The Agency Problem

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- Agency relationship
 - Principal hires an agent to represent its 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

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- **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**

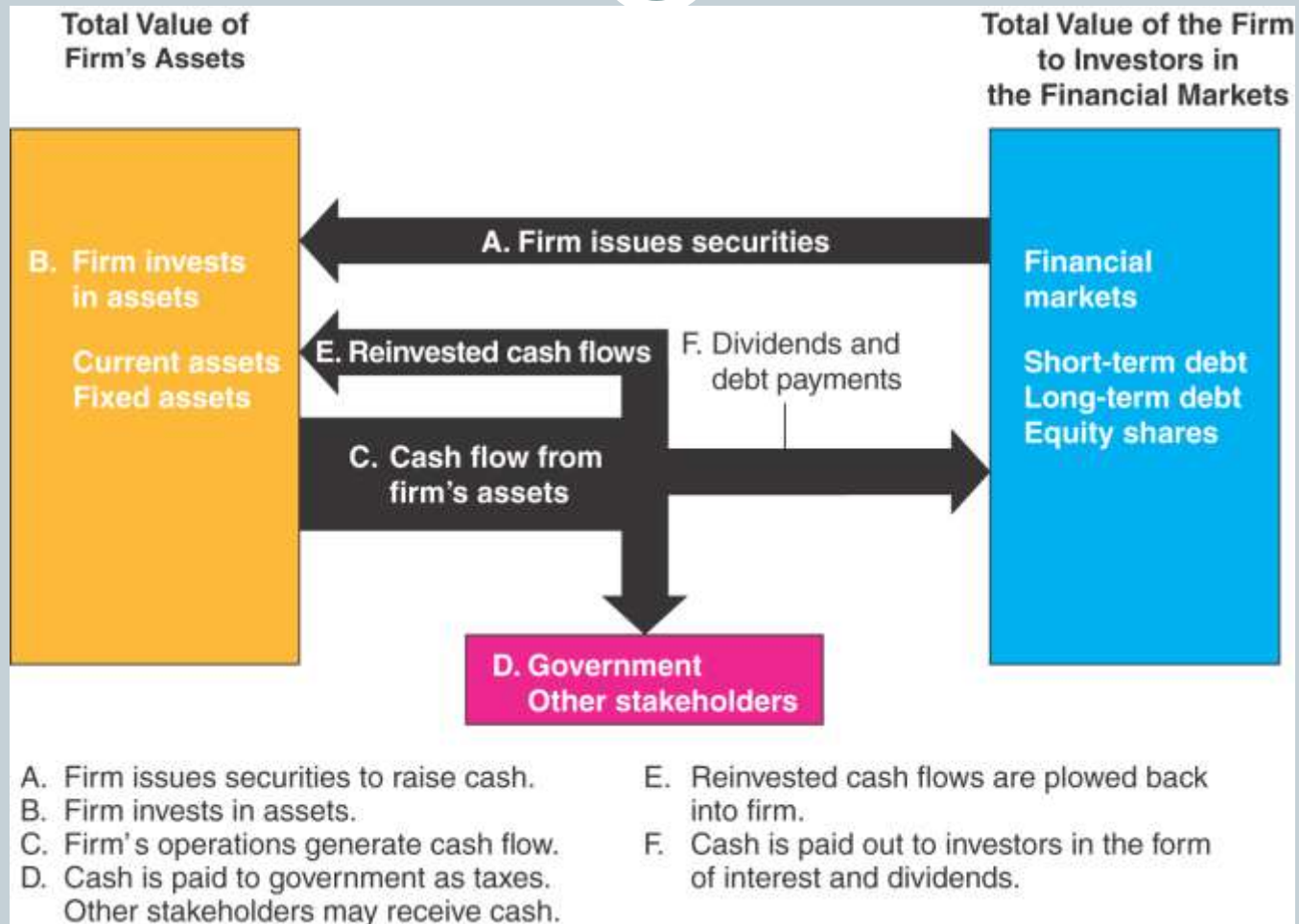
Example: Work the Web

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- 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

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Financial Markets

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

Quick Quiz

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- 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?



THANK YOU