An Overview of Financial Management

What is Finance?

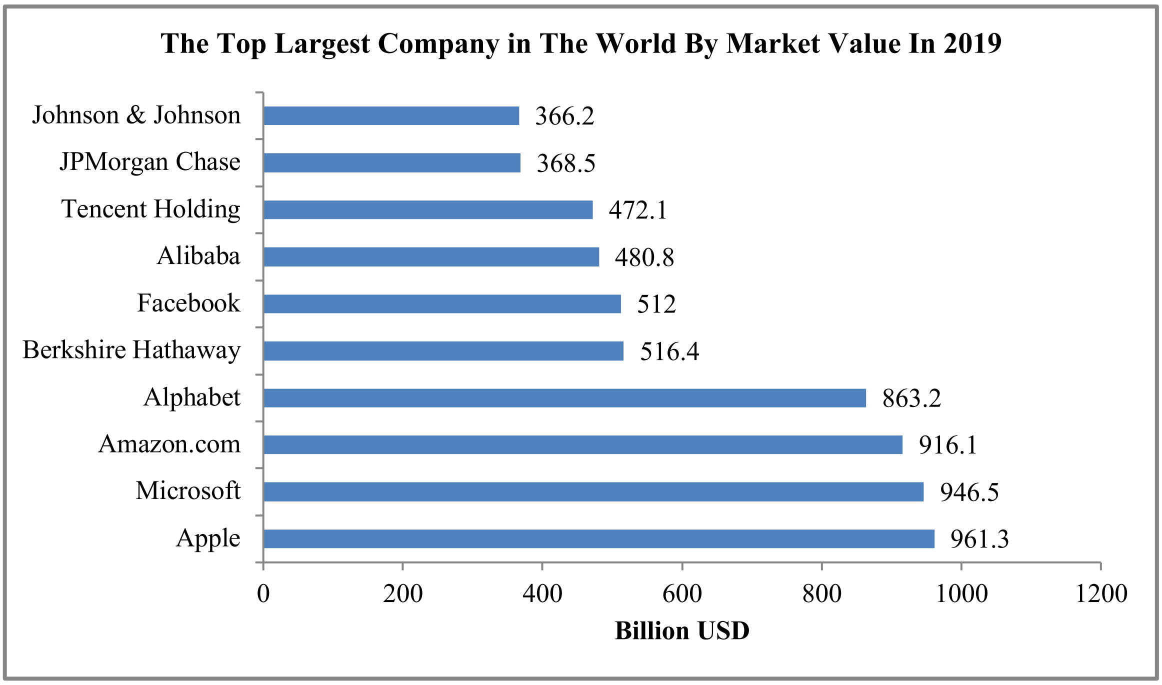
Finance is the study of how people and business evaluate investments and raise *Capital* to fund them (--*How to get and use money)*.

Responsibility of the Financial Staff

- Maximize value of shareholder's wealth by:
- Forecasting and planning
- Investment and financing decisions
- Coordination and control
- Transactions in the financial markets
- Managing risk

Financial Management Issues of the New Millennium

- The effect of changing technology
- The globalization of business



Alternative Forms of Business Organization

1. Sole Proprietorship

A sole proprietorship is a business that is owned and operated by one person. The enterprise has no existence apart from its owner.

2. Partnership

A partnership is an association of two or more persons acting as co-owners of a business for profit.

Advantage & Disadvantage of Sole proprietorships and Partnerships

Advantages

- Ease of formation
- Subject to few regulations
- No corporate income taxes

Disadvantages

- Difficult to raise capital
- Unlimited liability
- Limited life

3. Corporation

A corporation is "an artificial being, invisible, intangible, and existing only in contemplation of the law"*. As such, a corporation is a separate legal entity apart from the individuals who own it.

☐ Advantages

- Unlimited life
- Easy transfer of ownership
- Limited liability
- Ease of raising capital

☐ Disadvantages

- Double taxation
- Cost of set-up and report filing

Financial Goals of the Corporation

The primary financial goal is shareholder wealth maximization, which translates to maximizing stock price.

- Do firms have any responsibilities to society at large?
- Is stock price maximization good or bad for society?
- Should firms behave ethically?

Agency relationships

An agency relationship exists whenever a principal hires an agent to act on their behalf. Within a corporation, agency relationships exist between:

- Shareholders and managers
- Shareholders and creditors

1. Shareholders versus Managers

Managers are naturally inclined to act in their own best interests. But the following factors affect managerial behavior:

- Managerial compensation plans
- Direct intervention by shareholders
- The threat of firing
- The threat of takeover

2. Shareholders versus Creditors

Shareholders (through managers) could take actions to maximize stock price that are detrimental to creditors. In the long run, such actions will raise the cost of debt and ultimately lower stock price.

Factors that affect stock price

- Projected cash flows to shareholders
- Timing of the cash flow stream
- Riskiness of the cash flows

Factors that Affect the Level and Riskiness of Cash Flows

- Decisions made by financial managers:
    1. Investment decisions
    2. Financing decisions (the relative use of debt financing)
    3. Dividend policy decisions
- The external environment