

Basic Areas Of Finance

Finance examines how the firm can best manage its scarce resources and assets. It is usual to divide finance into four basic areas:

Corporate finance deals with how the firm raises funds and utilises them.

Investments Work with financial assets such as stocks and bonds
Value of financial assets, risk versus return, and asset allocation

Financial institutions bring together people, companies or the government who need funds with people, firms or the government that have excess funds to invest. Companies that specialize in financial matters

- Banks: commercial and investment, credit unions, savings and loans

- Insurance companies

- Brokerage firms

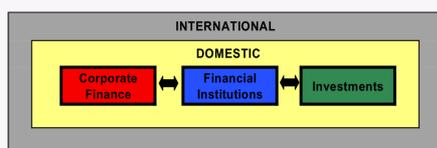
International finance An area of specialisation within each of the areas discussed so far

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

Basic Areas Of Finance



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

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, profitability

Personal finance Budgeting, retirement planning, college planning, day- to-day cash flow issues

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

Sole proprietorship Business owned by one person

Partnership General Business owned by two or more persons

Limited consists of general partner(s) and limited partner(s). There is no limit on the number of the partner

Limited Liability LLPs give owners the flexibility of operating as a partnership whilst giving them limited liability



Forms of Business Organization (cont)

- Private Limited Company (Pte. Ltd.)

- Public Limited Company

- Public Company Limited by Guarantee

Companies Privately held companies that can be used for a variety of purposes. These companies have fewer than fifty shareholders.

Sole Proprietorship

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

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

Limited liability

Unlimited life

Disadvantages

Separation of ownership and management (agency problem)

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

Separation of ownership and management

Corporation (cont)

Transfer of ownership is easy

Easier to raise capital

Goal Of Financial Management

What should be the goal of a corporation?

- Maximize profit?

- Minimize costs?

- Maximize market share?

- Maximize the current value per share of the company's existing stock

- Maximize the market value of the existing owners' equity

Does this mean we should do anything and everything to maximize owner wealth?

- Outsourcing?

- Off-shoring?

- Enron?

- Corporate support of charities?

The Agency Problem

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

Do Managers Act in the Shareholders' Interests?

Managerial compensation: Incentives can be used to align management and stockholder interests

Incentives need to be carefully structured to ensure that they achieve their goal

Corporate control: Threat of a takeover may result in better management

Other stakeholders

