

Areas of Finance

Money & Capital Markets

Functions and regulation of markets and institutions

Interest rate determination

ECN 3210 The Financial System and the Economy

E/F 4260 Financial Markets and Institutions

Investments

Security valuation

Portfolio formation

FIN 3810 Investments

FIN 4810 Portfolio Theory and Management

Business/Corporate/Managerial Finance

raising/using new funds

managing existing assets

coordinating other managers

FIN 3010 Business Finance

FIN 3950 Intermediate Financial Management

FIN 4110 Managerial Finance

FIN 4860 International Financial Management

Major Corporate Financial Decisions

Issue(s)

Firms need (real) assets to operate and funds to acquire them
To raise funds, firms sell securities (financial assets) to investors

Importance

Implications for firm's survival, shareholders' wealth

Decisions

- ✓ Capital Budgeting Which assets to acquire?
- Capital Structure How to finance the assets (debt or stock)?
- Dividend Policy How to reward stockholders (dividend or capital gain)?
- Working Capital Policy How much to rely on current assets/liabilities?

Assets	Claims
Current Assets	Current Liabilities
Fixed Assets	Long-Term Debt
	Equity

Decisions ⇒ *Cash Flows* ⇒ *Stock Price* ⇒ *Shareholder Wealth*

Security Values and Firm Performance

Issue

Firms sell securities to investors

Investors buy securities for future cash flows (e.g., dividends, interest)

Investors' willingness to pay depends on their expectations about firm's *future* cash flows, which depend in part on firm's performance up to that point



Determinants of Security Values

Size of future cash flows

Timing of future cash flows

Risk of future cash flows

Current financial market conditions (e.g., general level of interest rates)

Financial Markets

Firms raise funds

Investors judge firm's *prospects*

Goals of the Firm

Maximize Shareholder Wealth

Shareholders own the firm, bear the risk

Share price reflects expectation of future performance

Why not Maximize Profits?

Not cash

Ignores opportunity costs (“normal” profit)

Ignores timing (today’s v. tomorrow’s profits)

Ignores risk (“quality of earnings”)

Capital structure

Dividend policy

What about Social Responsibility?

Competitive pressure

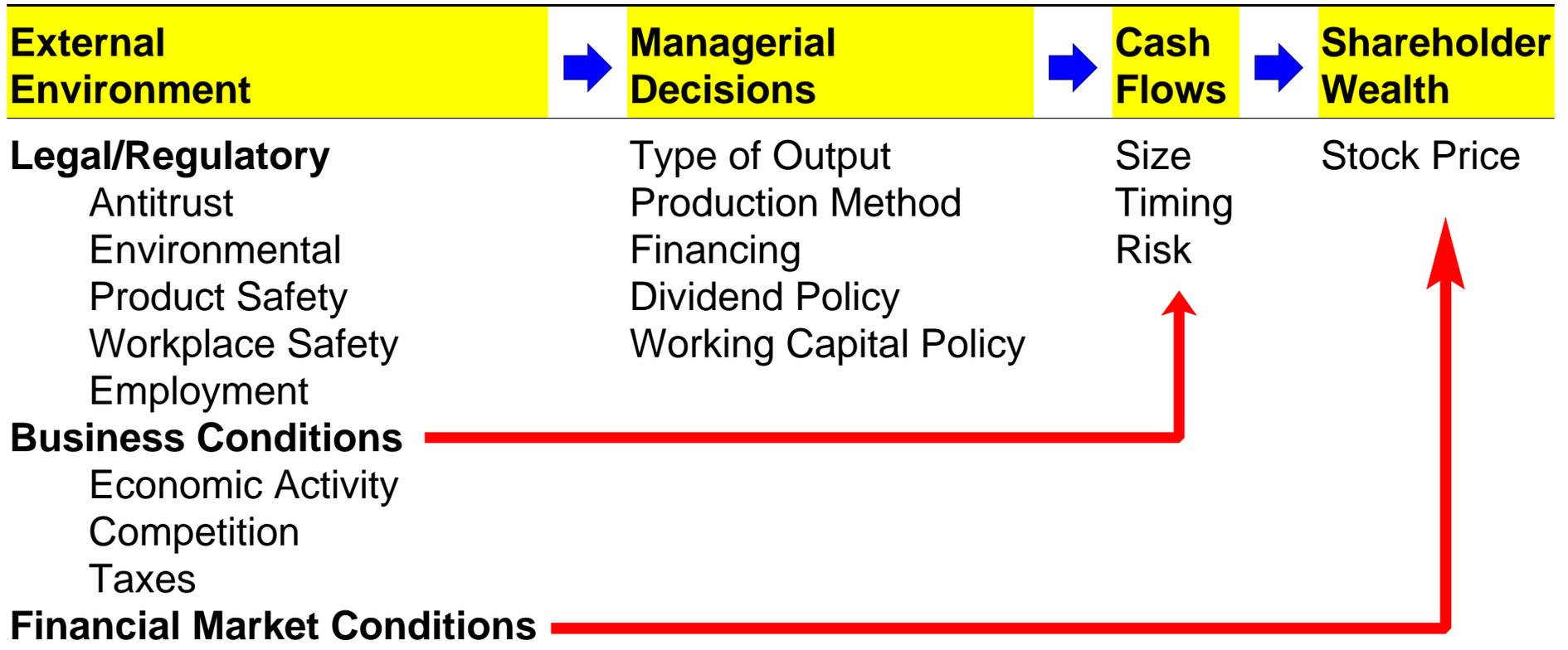
“Invisible Hand”: maximizing wealth maximizes social welfare

Efficiency: optimal output mix, in optimal quantity, produced in least-cost way

Other “Stakeholders”?

Management, employees, suppliers, creditors, customers, community

Context for Decision-Making



The external environment is given: managers must work within it. However, the environment also directly and independently affects cash flows and shareholder wealth.

Other Issues

Agency Relationships (Ethical Issues)

Conflicts of Interest Possible

Conflict: Shareholders (Owners) v. Managers

Problems: excessive compensation/perquisites, shirking, MBOs

Remedies: monitoring, firing, takeover, incentive compensation

Conflict: Shareholders (and Managers) v. Creditors

Problems: liquidating dividends, project switching

Remedies: monitoring, restrictive covenants

Advantages of Corporate Form of Organization

Limited Liability for shareholders

Transferability of shares

Longevity of firm

⇒ Investment Risk Reduced

⇒⇒ Capital Formation Enhanced