

LECTURE 1:

4 BASIC AREAS OF FINANCE:

1. Corporate finance
2. Investments
3. Financial institutions
4. International finance

PURPOSE OF FINANCIAL MANAGEMENT:

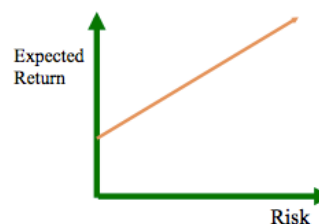
- Profit maximization = not an appropriate goal
- Profit is determined by accounting standards
 - Return on assets (ROA) = net profit/ total assets
 - Return on equity (ROE) = net profit/ total equity
 - Price earnings ration (P/E) = price per share/ earnings per share
 - Earnings per share = net profit/ # of shares
- AIM = to maximize shareholder wealth (measured in terms of cash flow)

FACTORS IN ANY FINANCIAL DECISION:

- Cash
- Time (when CF received or paid out)
- Risk

RISK RETURN TRADE OFF:

- Wealth maximization takes into account risk
- Higher returns = higher risk involved
- Trade off between risk and return = upward slope



FINANCIAL MANAGERS RESPONSIBILITIES:

1. Investment decision
 - What assets to buy/ sell?
 - What will create greatest shareholder wealth
 - Capital budgeting decision
 - MOST IMPORTANT DECISION – hard to reverse if wrong
2. Financing decision
 - How to fund the investment decision?
 - Can be altered if needed
 - Capital structure decision
 - Determine best mix between debt (loan funds/contractual claim) and equity (owner's funds/residual claim)
3. Working capital decision
 - Managing of ST assets and liabilities
 - Inventory management *e.g. optimal level*
 - Receivables management
 - Accounts payable management
 - Cash *e.g. how much should be held*

FORMS OF BUSINESS:

Sole trader/ proprietorship:

- Unlimited liability

- Success or failure relies on individual owner
- Life is limited
- Equity is directly linked to owner's wealth

Partnership:

- 2 or more sole traders combines
- All share in gains and losses
- If one wants to leave, partnership ends

Company:

- Separate legal entity
- Unlimited life
- Many formal and legal requirements
- Limited liability for shareholders
- Superior form when raising capital
- MOST IMPORTANT FORM

CORPORATE GOVERNANCE:

- Objectives of management may differ from shareholders
- Managers may be satisfiers rather than maximizers
- Management = agents for the owners
- Potential conflict (AGENCY PROBLEM)
 - Ethical concerns
 - Managers may focus on self interest e.g. *incentive payments, bonuses*

PRINCIPAL & AGENT LAW:

- Agency law = part of commercial law
- Contractual relationship between the agent, who is authorised to act on behalf of the principal
- Agent can create legal relationship with 3rd party = creation of agency

Employer/ employee relationships:

- Not all employees are agents for the employer
- Depends on type of work carried out e.g. *sales people = agents for the employer*

Types of agents:

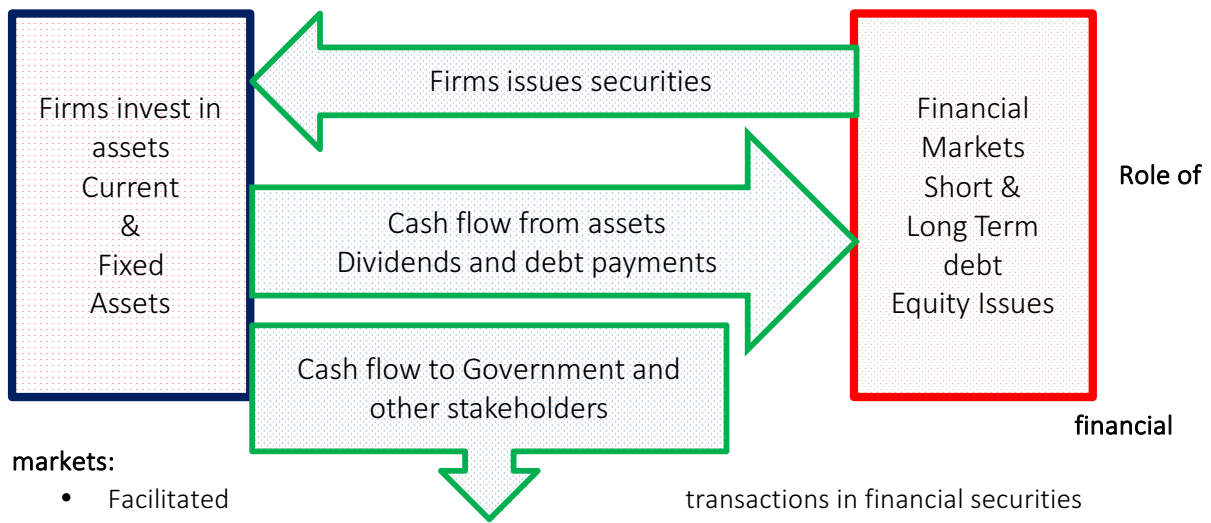
- Special
- General
- Universal

Duties of an agent:

- Follow principal's instructions
- Act personally (do NOT delegate)
- Act in principal's best interests
- Not to make secret profit
- Do not divulge confidential information
- Reasonable skill and diligence

FINANCIAL MARKETS:

Interaction between firms and financial markets:



markets:

- Facilitated transactions in financial securities
- Efficiently allocate funds for alternative uses
- Bring buyers and sellers together
- Laws cover the offering of securities to the public (ASIC)
- Most trade on ASX

Primary market:

- Issued to investor for the first time
- Funds are raised by the firm and flow to it
- Public offering or private placement
- Can be debt or equity funding
- Fund raising between investors and firm

Secondary market:

- Securities that are already issued are bought and sold
- Way of transferring ownership
- *e.g. securities exchange*
- Investor-to-investor trading
- No additional funds raised by the firm

FINANCIAL STATEMENTS:

- Balance sheet
- Income statement
- Cash flow statement

Balance sheet:

- At a point in time – concerned with current market value
- $A = L + E$
- Net working capital = current assets – current liabilities
- Real (productive) assets = produce CF over time