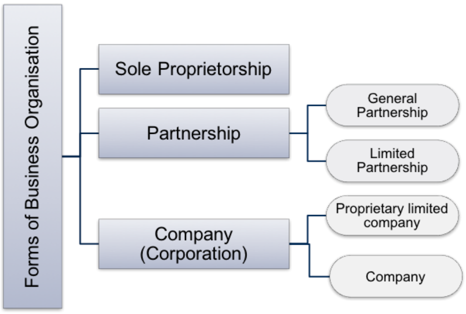
1. Introduction to Corporate Finance

- Corporate finance – concerned with the financial decisions of corporations.
    - Corporation = a legal entity, owned by shareholders.
        - Can make contracts, carry on business, borrow, lend, sue and be sued.

Forms of business organisations

- Sole proprietorship – no distinction between business and person.
    - Easy to set up and operate; taxed as personal income.
    - Limited life, limited access to capital, unlimited liability.
- General partnership – 2+ business owners.
    - Each partner liable for every partner's actions.
- Limited partnership – 1+ general partners with unlimited liability & many limited partners who are passive investors with limited liability.
    - Limited liability of corporation, tax benefits of partnership.
- Private company – separate legal entity with all the economic rights and responsibilities of a person.
    - Regulated under the Corporations Law 2001.
    - Not listed on ASX.
- Company – legal entity with all the economic rights and responsibilities of a person.
    - Owned by shareholders.
    - Limited liability for investors, unlimited business life (perpetual succession).



Corporate Investment and Financing Decisions

- Key decisions:
    - *Investment decisions*
    - *Financing decisions*
    - *Dividend decisions*
- Corporations invest in real assets. This needs to be financed (paid for) by borrowing, retaining and reinvesting cash flow, and by selling shares of stock in the corporation.

Investment decisions

- What 'real assets' should the firm acquire or invest in to operate its business and generate cash flows and income?
- Real assets – assets that can be put to productive use to generate a return.
    - Tangible – machinery, equipment etc.
    - Intangible – advertising, R&D, marketing etc.
- Often referred to as *capital budgeting decisions*.
    - Capital budgeting evaluation = development of a process to evaluate the desirability of alternative real asset purchases.

Financing decisions

- How to finance the acquisition of assets? Sell 'financial assets'.
    - Issue shares in capital/equity markets.
    - Reinvest profits in new assets (internal equity).
- Financial assets – assets that represent a claim to a series of cash flows against an economic unit.
- What should be the desired *capital structure*?

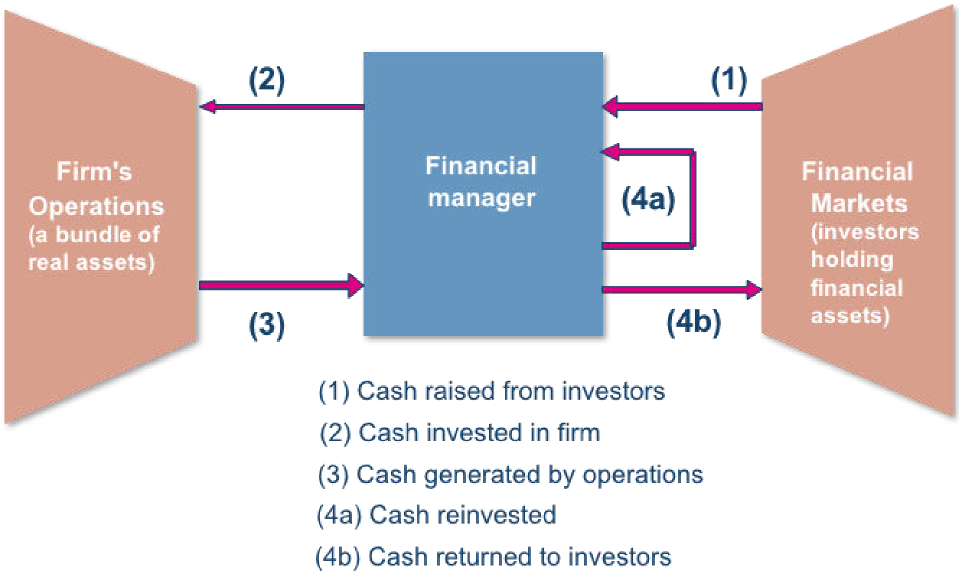
- Should owners use their own funds (equity) or borrow money (debt)?

Dividend decisions

- Retain earnings for organic growth OR *payout decision* (pay dividends or repurchase shares).

The Financial Manager or CFO

- The individual responsible for major corporate financial decisions; oversees the work of all financial staff.
- Involved in financial policy, financial planning.
- Stands between firm's operations and financial markets.



- **<u>The Investment Trade-Off</u>**
  - Financial manager adds value for the firm and its shareholders by choosing investments that offer rates of return higher than the opportunity cost of capital.
  - Hurdle rate/cost of capital – minimum acceptable rate of return on investment.
  - Opportunity cost of capital – expected return foregone by investing in a project rather than a financial security.
  - Corporations increase value when they accept all investment projects that earn more than the opportunity cost of capital.

The Financial Goal of the Corporation

Corporate Objective

- **Maximise company value (L/T).**
- **Maximise shareholder wealth.**
- Each shareholder wants to:
  1. Maximize their current wealth.
  2. Transform wealth into the most desirable time pattern of consumption.
  3. Manage the risk characteristics of that consumption plan.
- Financial managers can help with (1) only, by increasing the market value of the firm and the current price of its shares.
- Value of firm – the present value of a firm's expected future cash flows.