Chapter 1 – Introduction to Financial Management

Finance: A Quick Look

The Four Basic Areas

- Corporate finance suggests business finance.
- Investments deal with financial assets and stockbrokers specialise in this career. Portfolio management is the management of money for investors. Security or share analysts research individual investments or shares to determine whether the price is right.
- Financial institutions are businesses that primarily deal in financial matters such as banks and insurance companies.

International Finance – International finance involves international aspects of corporate finance, investments or financial institutions.

Why Study Finance?

Marketing and Finance – Marketers need to work with budgets and financial analysts rely heavily on marketing analysts making them work together and evaluate profitability of proposed projects and products.

Accounting and Finance – Accountants sometimes need to make financial decisions and therefore need to understand the newer types of financial contracts and their impact on financial statements. Financial analysts make extensive use of accounting information.

Management and Finance – Businesses need to understand how their jobs affect profitability and how to improve profitability.

You and Finance – Personally people make financial decisions that impact their lives.

Business Finance and the Financial Manager

What is Business Finance? Business finance studies the way of what long-term investments to take, how to get long-term financing to pay for investments and manage everyday financial activities.

Financial Manager – The financial manager coordinates the activities of the treasurer and the accountant and is within a senior position within the firm.

Capital Budgeting – Capital budgeting is the process of planning and managing a firm's long-term assets with decisions about current liabilities, long-term liabilities and shareholders' equity (capital structure decisions).

Capital Structure – A firm's capital structure refers to long-term debt and equity the firm uses to finance equity. The manager has to decide how and where to raise money.

Working Capital Management – This refers to a firm's short-term assets and short-term liabilities. It is managing day-to-day activities that ensures the firm has sufficient resources to continue operations and avoid costly disruptions.

Forms of Business Organisations

Sole Proprietorship – A business owned by one person and is the simplest way to start a business. The sole owner keeps profit but has unlimited liability for debts which means creditors can look to proprietor's personal assets for payments. It is limited to the owner's lifespan and equity can be raised is limited to personal wealth. This makes it unable to exploit new opportunities with insufficient capital. It can be difficult to transfer.

Partnership – A partnership is similar to sole partnership but has two or more owners. They all have unlimited liability and share gains and losses.

Corporation – A corporation is a legal person, separate and distinct from its owners, has rights, duties and privileges of an actual person. They can borrow money and own property, can sue and be sued, and enter into contracts. To start a corporation, a constitution needs to be prepared that describes how the corporation regulates its own existence and includes the name, intended life, purpose, how directors are elected and the number of shares. In a large corporation, the shareholders and managers are separate groups.

A Corporation by Another Name – The corporate form has many variations around the world.

The Goal of Financial Management

Profit Maximisation

The Goal of Financial Management in a Corporation – Financial managers act in the shareholders' best interests by making decisions to increase the value and wealth of the shareholders.

A More General Financial Goal – Good financial decisions increase the market value of the owners' equity and poor financial decisions decrease it.

Corporate Governance – Corporate scandals called USA government to enact Sarbanes-Oxley Act in 2002 which intends to strengthen protection against corporate accounting fraud and financial malpractice.

The Agency Problem and Control of the Corporation

Agency Relationships – This is the relationship between shareholders and management where someone (principal) hires another (the agent) to represent their interest. In such relationships they are possibilities of conflict of interest between the principal and agent which is called an agency problem.

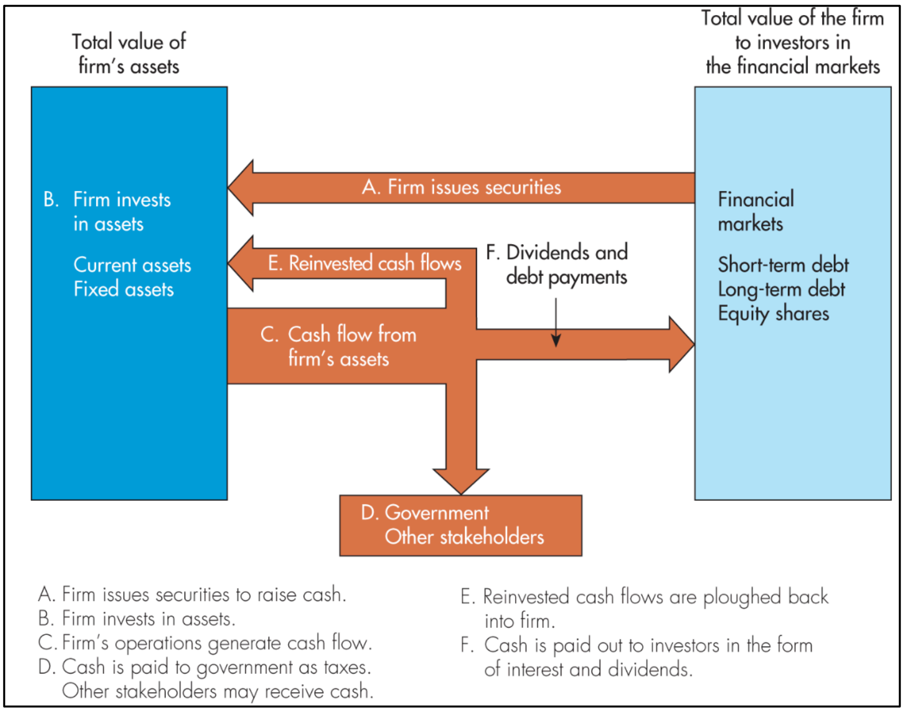
Management Goals – Management tends to overemphasise organisational survival to protect job security.

Do Managers Act in the Shareholders' Interests?

Managerial Compensation – Managers have incentive to increase share value as it is tied to financial performance since the higher the value of the share, the more valuable this option is to them. Managers also who are successful pursuing shareholder goals are in greater demand and commanding higher salaries.

Control of the Firm – Control of the firm rests with shareholders as unhappy shareholders can act to replace existing management in a proxy fight. A proxy is the authority to vote on behalf of another shareholder and a proxy fight develops when a group solicits proxies in order to replace the existing board. Management can be replaced by takeovers as poorly managed firms are attractive as acquisitions since greater profit potential exists.

Financial Markets and the Corporation



A financial market brings buyers and sellers together with debt and equity securities that are bought and sold. The type of securities trades, how trading is conducted and who buyers and sellers are, are the most important differences.

Primary Markets – The corporation is the seller and the transaction raises money for the corporation. This can be done through public offerings which involves selling securities to general public or private placement where a negotiated sale involves a specific buyer.

Secondary Markets – This involves transactions involving one creditor or owner selling to another. The types of secondary markets are dealer markets where they buy and sell for themselves at their own risk or action markets which has a physical location and the broker brings buyers and sellers together and charges a fee for the service. The equity shares of all large firms in Australia trade on organised auction markets called the ASX. Shares that trade on an organised exchange are called listed on that exchange. In order to be listed, firms meet certain criteria concerning asset size and number of shareholders.

The criteria differ for different exchanges.

Chapter 2 – Introduction to Financial Statements

The Balance Sheet

The balance sheet is a snapshot of the financial position of the firm at a particular time. It organises and summaries what a firm owns and what it owes and the difference between the two.

Liabilities – They are either current or long-term. A debt not due in the coming year is classified as long-term liability.