

# Overview of Financial Management

## The Main Point

## What is Corporate Finance?

Corporate finance focuses on 3 questions:

1. What should we invest in?
2. How do we finance those investments?
3. How do we manage the day-to-day operations of the firm?

## The Balance Sheet Model of the Firm

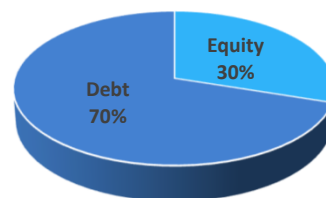
- Balance Sheet Identity:

## Capital Budgeting

- What is capital budgeting?
  - The process of \_\_\_\_\_ the firm's \_\_\_\_\_.
- How do we do it?
  1. Estimate cash flows.
  2. Estimate the cost of those cash flows.
  3. Discount the cash flows.

## Capital Structure

- What is capital structure?
  - The \_\_\_\_\_ describing how the firm is financed.
- Does capital structure matter?
- How do taxes affect this decision?
- How does this relate to the goal of the financial manager?



## Short-Term Cash Flow Management

- What does short-term cash flow management entail?
  - Net Working Capital =
  - Cash Management
  - Credit Management

## The Sole Proprietorship

### Advantages

1. Ease of formation
2. Subject to few regulations
3. No \_\_\_\_\_

### Disadvantages

1. Limited life
2. Difficult to raise capital to support growth
3. \_\_\_\_\_

## The Partnership

### Advantages

1. Ease of formation
2. Subject to few regulations
3. No \_\_\_\_\_

### Disadvantages

1. Limited life
  2. Difficult to raise capital to support growth
  3. \_\_\_\_\_
- **General versus \_\_\_\_\_ partnerships**
  - **General versus \_\_\_\_\_ partners**

## The Corporation

- A corporation is a legal entity separate from its owners and managers.
  - Charter
    - Name, activities, amount of stock, directors
  - Bylaws
    - How directors are elected

## The Corporation

### Advantages

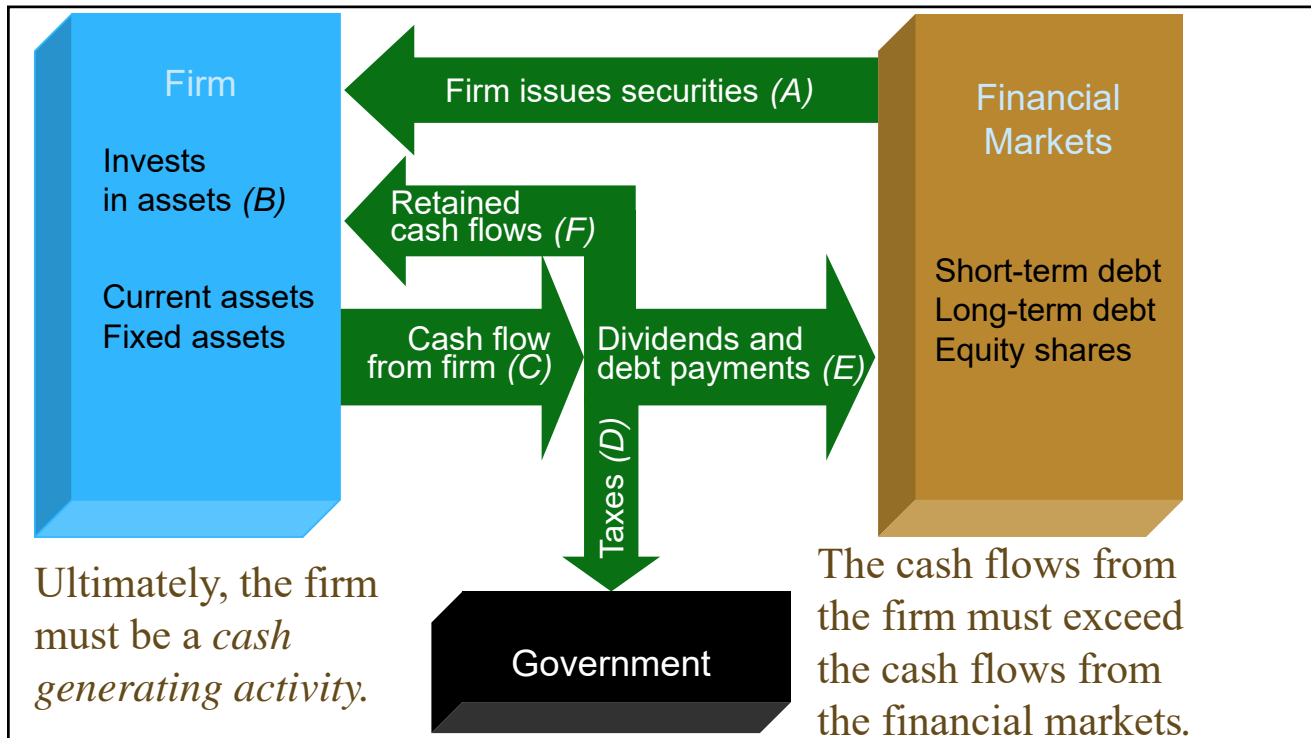
1. Unlimited life
2. Easy transfer of ownership
3. Ease of raising capital
4. \_\_\_\_\_

### Disadvantages

1. Cost of set-up and report filing
2. \_\_\_\_\_

## Other Types of Business Organization

- Limited liability partnership (LLP) or limited liability company (LLC)
- Professional corporation (PC) or professional association (PA)
- S corporation



## Agency Conflicts

- What is a principal-agent relationship?
- Agency Problem/Conflict: The possibility of \_\_\_\_\_ between the stockholders (the principal) and management (the agent) of a firm.

## Agency Conflicts

- Agency Costs: The costs of the conflict of interest between stockholders and management.
  - Direct agency costs:
    - Wasteful spending
    - Monitoring and auditing
  - Indirect agency costs
    - Missed opportunities

## How do we control agency conflicts?

- Managerial Compensation
- Control of the Firm



## Transparency

- Our financial system is dependent upon \_\_\_\_\_.

- This includes:

- GAAP
- Audits of financial statements
- Filing financial statements with the SEC
- Release of information to *ALL* investors
- Sarbanes-Oxley

## Chapter 1 Suggested Problems

- Concept Questions
  - 1, 3, 4, 6, and 8
- Questions and Problems
  - None for this chapter