Introduction to Corporate Finance

Basic Areas of Finance

- Corporate Finance
- Investments
- Financial Institutions
- International Finance

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

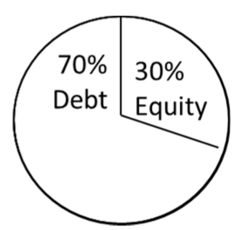
- Balance Sheet Identity:

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.

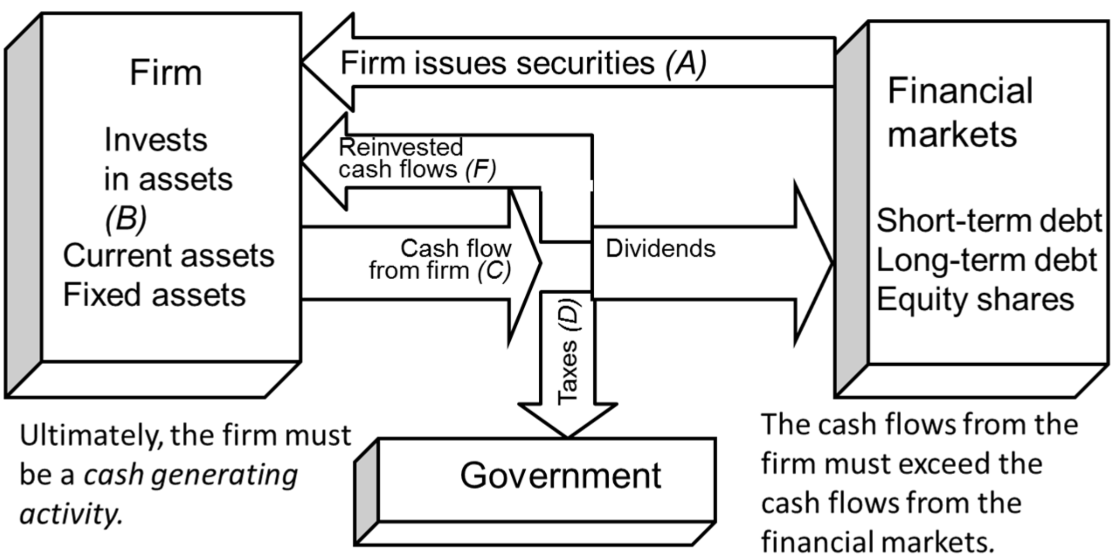


- Does capital structure matter?
- How do taxes affect this decision?
- How does this relate to the goal of the financial manager?

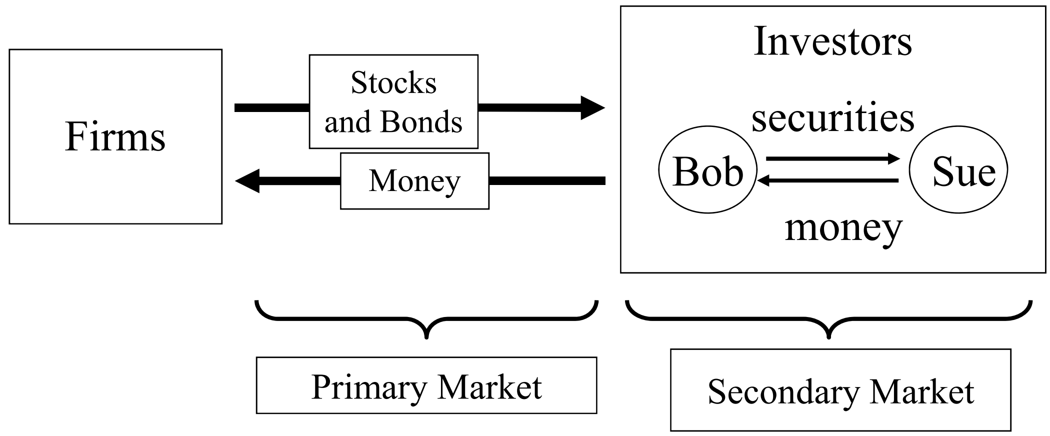
Short-Term Cash Flow Management

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

The Firm and the Financial Markets



Financial Markets



Debt and Equity as Contingent Claims

- Debt is ______________________________.
- Equity gets ________________________.

A corporation has $100 in debt.

If the value of the firm's assets is…

- $75, debtholders get _____ and stockholders get _____.
- $100, debtholders get _____ and stockholders get _____.
- $200, debtholders get _____ and stockholders get _____.
- $1,000,000, debtholders get _____ and stockholders get _________.

Sole Proprietorship

- Pros
  - Easy startup.
  - Taxed as personal income.
- Cons
  - ________________________.
  - Life limited to that of owner.
  - Equity limited to owner's wealth.
  - Difficulty in transferring ownership.

Partnership

- General vs. Limited Partners
- Pros
  - Easy startup.
  - Taxed as personal income.
- Cons
  - ________________________.
  - Life limited to that of the owners.
  - Equity limited to owners' combined wealth.
  - Difficulty in transferring ownership.

Corporation

- Corporation: *A business created as a distinct legal entity composed of one or more individuals or entities.*
- Separation of Ownership and Control
  - Shareholders
  - Directors
  - Managers

Corporation

- Pros
  - ________________________.
  - Easy transfer of ownership.
  - Unlimited life.
  - Equity is not limited.
- Cons
  - Difficult to startup.
  - ________________________.

The Goal of the Firm

What does that mean?

Agency Conflicts

- What is a principal-agent relationship?
- *Agency Problem/Conflict*: The possibility of conflict of interest 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:
    -
    -
  - Indirect agency costs
    -

How do we control agency conflicts?

- Managerial Compensation
- Control of the Firm
  -
  -

Chapter 1 Suggested Problems

- Concepts Review and Critical Thinking Questions:
  - 3, 6, 7, and 8