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COLLEGE OF BUSINESS & ECONOMICS  
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# Chapter 1

Finance 300  
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# Key Concepts

1. Financial Management Decisions
2. Business Organizations
3. Goal of Financial Management
4. Agency costs
5. Financial Markets

# Corporate Finance

Answers three main questions:

1. Decision

What long-term investments should the firm choose?

2. Financing

How should the firm raise funds for the selected investments?

3. Day-to-day

How should current assets be managed and financed?

# Financial Manager

Answers those questions.

- V.P. or Chief Financial Officer (CFO)
  - Strategist, coordinator, authority
- Treasurer
  - Cash flow, capital expenditure, capital structure
- Controller
  - Accounting, information systems, taxes

# Financial Management Decisions

## 1. Capital budgeting

**The process of managing a firm's long term investments.**

## 2. Capital structure

**The mixture of debt and equity maintained by the firm.**

## 3. Working capital management

**A firm's short term assets and liabilities.**

# Choosing a Business Form

Factors to consider:

1. Risks and liabilities
2. Formalities and expenses of business form
3. Income tax situation
4. Investment needs

# Forms of Business Organization

## 1. Sole proprietorship

A business owned by a single individual

## 2. Partnership

A business formed by two or more individuals entities.

## 3. Corporation

A business create as a distinct legal entity.

# (Un)Limited Liability

- Lester is the owner of a small manufacturing business. When business prospects look good, he orders \$50,000 worth of supplies and uses them in creating merchandise. Unfortunately, there's a sudden drop in demand for his products, and Lester can't sell the items he has produced. When the company that sold Lester the supplies demands payment, he can't pay the bill.



# (Un)Limited Liability

- Shirley and Sue are the owners of a flower shop. One day Roger, one of the employees, is delivering flowers using a truck owned by the business. Roger strikes and seriously injures a pedestrian. The injured pedestrian sues Roger, claiming that he drove carelessly and caused the accident. The lawsuit names Shirley and Sue as co-defendants. After a trial, the jury returns a large verdict against Shirley and Sue as owners of the business.

What is the goal of financial management?

**Maximize the current value per share of existing stock.**

# Agency problem

**Principal hires agent to represent his/her interests.**

**Problem comes from conflicts of interest.**

Real estate example

**The possible conflict of interest between the stockholders(principal) and management (agent) of the firm.**

# Agency costs

The manager is considering a new investment. This investment will add to firm value(positive NPV) but is relatively risky. Shareholders would benefit from this project.

What is the agency cost here?

# Aligning interests

- Managerial compensation



- Control of the firm



"This is us."

# Financial Markets

Primary vs secondary

Dealer vs auction

# Takeaways

- Three main areas of concern for financial manager
- Goal is to maximize shareholder wealth
- Corporate forms come with advantages and disadvantages
- Agency problems arise due to conflicts of interest.
- Need to align interests
- Financial markets and flow of cash