An Introduction to Corporate Finance

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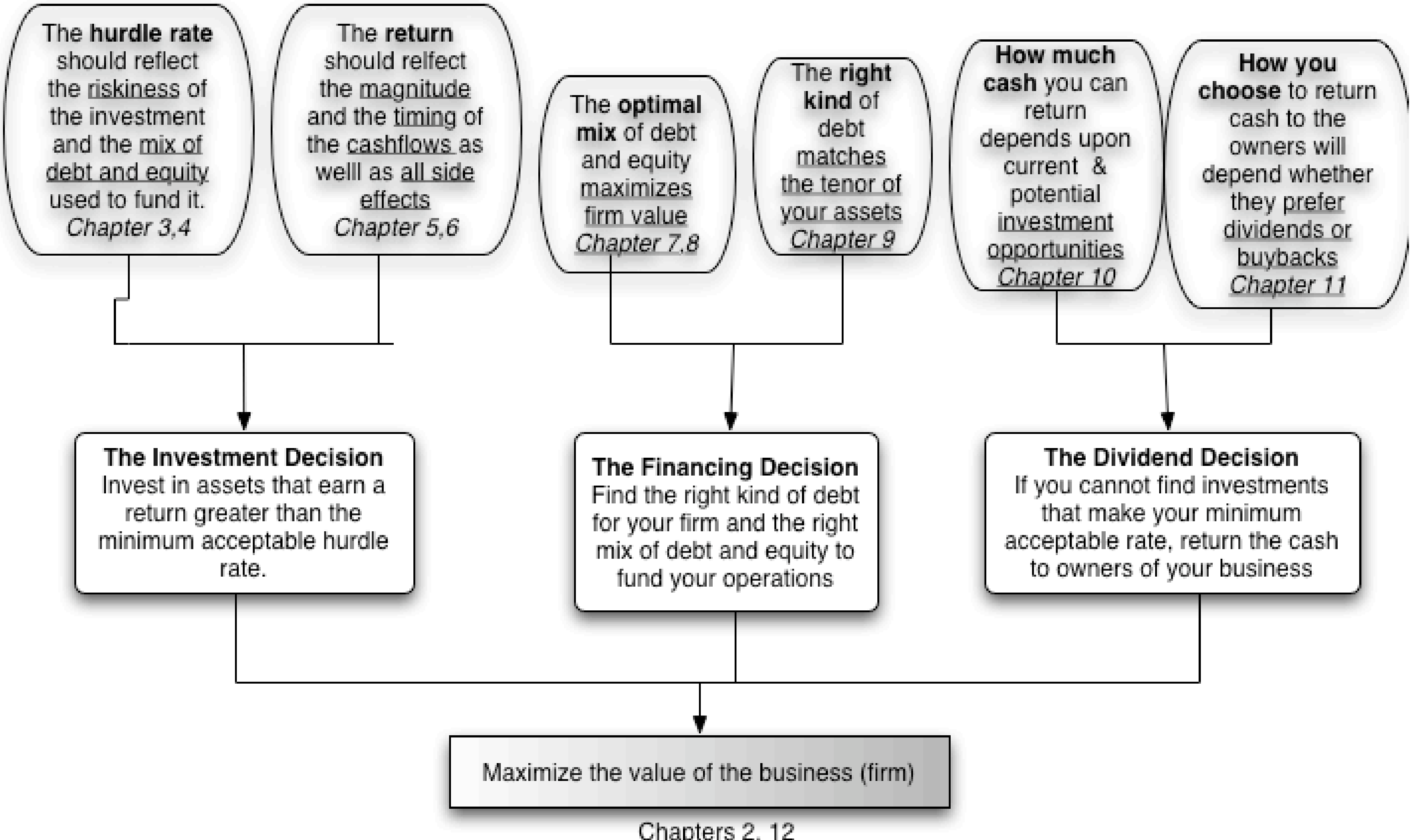
The Traditional Accounting Balance Sheet

The Balance Sheet

	Assets	Liabilities	
Long Lived Real Assets	Fixed Assets	Current Liabilties	Short-term liabilities of the firm
Short-lived Assets	Current Assets	Debt	Debt obligations of firm
Investments in securities & assets of other firms	Financial Investments	Other Liabilities	Other long-term obligations
Assets which are not physical, like patents & trademarks	Intangible Assets	Equity	Equity investment in firm

The Financial View of the Firm

Assets		Liabilities	
Existing Investments Generate cashflows today Includes long lived (fixed) and short-lived(working capital) assets	Assets in Place	Debt	Fixed Claim on cash flows Little or No role in management *Fixed Maturity* *Tax Deductible*
Expected Value that will be created by future investments	Growth Assets	Equity	Residual Claim on cash flows Significant Role in management *Perpetual Lives*


The **hurdle rate** should reflect the riskiness of the investment and the mix of debt and equity used to fund it. *Chapter 3,4*
The **return** should relfect the magnitude and the timing of the cashflows as welll as all side effects *Chapter 5,6*
The **optimal mix** of debt and equity maximizes firm value *Chapter 7,8*
The **right kind** of debt matches the tenor of your assets *Chapter 9*
How much cash you can return depends upon current & potential investment opportunities *Chapter 10*
How you choose to return cash to the owners will depend whether they prefer dividends or buybacks *Chapter 11*
The Investment Decision Invest in assets that earn a return greater than the minimum acceptable hurdle rate.
The Financing Decision Find the right kind of debt for your firm and the right mix of debt and equity to fund your operations
The Dividend Decision If you cannot find investments that make your minimum acceptable rate, return the cash to owners of your business
Maximize the value of the business (firm)
Chapters 2, 12

The Investment Decision

- Every business has to decide where to allocate scarce resources. Put more prosaically, every business has to look at its available investment opportunities and decide whether to make the investment or not.
- In making this decision, firms have to grapple with two basic issues.
  - The first is the rate of return that they need to make on an investment, given its risk, for it to be a good investment.
  - The second is how to measure returns on investments, especially when the cashflows on these investments are different from accounting earnings and vary over time.

The financing decision

- There are two ways in which any business can raise financing. It can use the owner's funds (equity) or it can borrow money (debt).
- Every business has to consider whether the mix of debt and equity that it uses to fund investments is in fact the right one. The financing decision examines whether the firm's existing mix of debt and equity is the right one.
- Firms also have to pick from a variety of different financing choices - short term versus long term debt, fixed rate versus floating rate debt- and determine what type of financing is best suited for them.

The dividend decision

- After firms make investments with their chosen financing mix, the investments generate cashflows. When the cashflows come in, firms will have to make decisions on how much of these cashflows will be invested back into the business and how much returned to the owners of the business.
- In a publicly traded firm, cashflows can be returned either as dividends or by buying back stock.

It all ties back to value…

- Investment, financing and dividend decisions made by businesses affect the values of these businesses.
- In valuation, we attempt to tie inputs into valuation models into basic corporate finance decisions. If the objective in corporate finance is to maximize firm value, good investment, financing and dividend decisions should increase value. Bad decisions should decrease value.