THE OBJECTIVE IN CORPORATE FINANCE

If you don’t know where you are going, it does not matter how you get there!
Set Up and Objective
1: What is corporate finance
2: The Objective: Utopia and Let Down
3: The Objective: Reality and Reaction

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

Hurdle Rate
4. Define & Measure Risk
5. The Risk free Rate
6. Equity Risk Premiums
7. Country Risk Premiums
8. Regression Betas
9. Beta Fundamentals
10. Bottom-up Betas
11. The "Right" Beta
12. Debt: Measure & Cost
13. Financing Weights

Investment Return
14. Earnings and Cash flows
15. Time Weighting Cash flows
16. Loose Ends

Financing Mix
17. The Trade off
18. Cost of Capital Approach
19. Cost of Capital: Follow up
20. Cost of Capital: Wrap up
21. Alternative Approaches
22. Moving to the optimal

Financing Type
23. The Right Financing

Dividend Policy
24. Trends & Measures
25. The trade off
26. Assessment
27. Action & Follow up
28. The End Game

Valuation
29. First steps
30. Cash flows
31. Growth
32. Terminal Value
33. To value per share
34. The value of control
35. Relative Valuation

36. Closing Thoughts
First Principles

Maximize the value of the business (firm)

The Investment Decision
Invest in assets that earn a return greater than the minimum acceptable hurdle rate

The hurdle rate should reflect the riskiness of the investment and the mix of debt and equity used to fund it.

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 return should reflect the magnitude and the timing of the cashflows as well as all side effects.

The Dividend Decision
If you cannot find investments that make your minimum acceptable rate, return the cash to owners of your business

The optimal mix of debt and equity maximizes firm value

The right kind of debt matches the tenor of your assets

How much cash you can return depends upon current & potential investment opportunities

How you choose to return cash to the owners will depend on whether they prefer dividends or buybacks

Maximize the value of the business (firm)
In traditional corporate finance, the objective in decision making is to maximize the value of the firm.

A narrower objective is to maximize stockholder wealth. When the stock is traded and markets are viewed to be efficient, the objective is to maximize the stock price.
The Classical Objective
What can go wrong?

Diagram:

- **STOCKHOLDERS**
  - Put managerial interests over stockholder interests
  - Have little control over firm

- **MANAGERS**
  - Lend Money
  - Hurt by stockholder actions
  - Delayed or Misleading Information

- **BONDHOLDERS**
  - Large Social Costs
  - Cannot trace social costs to firm

- **SOCIETY**
  - Markets that are volatile, short term and make mistakes

- **FINANCIAL MARKETS**
Who’s on Board? The Disney Experience - 1997

Revera F. Bowers 1,5
Head of School
Center for Early Education

Roy E. Disney 3
Vice Chairman
The Walt Disney Company

Michael D. Eisner 3
Chairman and Chief Executive Officer
The Walt Disney Company

Stanley P. Gold 4,5
President and Chief Executive Officer
Sherwood Holdings, Inc.

Sanford M. Litvack
Senior Executive Vice President
and Chief of Corporate Operations
The Walt Disney Company

Ignacio E. Lozano, Jr. 1,2,4
Editor-in-Chief, LA OPINION

George J. Mitchell 5
Special Counsel
Yager, Lipford, Bernael, McPherson and Hoard

Thomas S. Murphy
Former Chairman
Capital Cities/ABC, Inc.

Richard A. Nunnis
Chairman
Walt Disney Attractions

Leo J. O’Donovan, S.J.
President
Georgetown University

Michael S. Orzel 3
President
The Walt Disney Company

Sidney Poitier 2,4
Chief Executive Officer
Veston-Celsius Productions

Irwin E. Russell 2,4
Attorney at Law

Robert A.M. Stern
Senior Partner
Stern

E. Cardon Walker 1
Former Chairman and Chief Executive Officer
The Walt Disney Company

Raymond L. Watson 1,2,3
Vice Chairman
The Irvine Company

Gary L. Wilson 5
Co-Chairman
Northwest Airlines Corporation

1 Member of Audit Review Committee
2 Member of Compensation Committee
3 Member of Executive Committee
4 Member of Executive Performance Plan Committee
5 Member of Nominating Committee
So, what next? When the cat is idle, the mice will play ....

- When managers do not fear stockholders, they will often put their interests over stockholder interests
  - Greenmail: The (managers of ) target of a hostile takeover buy out the potential acquirer's existing stake, at a price much greater than the price paid by the raider, in return for the signing of a 'standstill' agreement.
  - Golden Parachutes: Provisions in employment contracts, that allows for the payment of a lump-sum or cash flows over a period, if managers covered by these contracts lose their jobs in a takeover.
  - Poison Pills: A security, the rights or cashflows on which are triggered by an outside event, generally a hostile takeover, is called a poison pill.
  - Shark Repellents: Anti-takeover amendments are also aimed at dissuading hostile takeovers, but differ on one very important count. They require the assent of stockholders to be instituted.
  - Overpaying on takeovers: Acquisitions often are driven by management interests rather than stockholder interests.
Application Test: Who owns/runs your firm?

- Look at: Bloomberg printout HDS for your firm
- Who are the top stockholders in your firm?
- What are the potential conflicts of interests that you see emerging from this stockholding structure?
Case 1: Splintering of Stockholders
Disney’s top stockholders in 2003
Case 2: Voting versus Non-voting Shares & Golden Shares: Vale

Vale has eleven members on its board of directors, ten of whom were nominated by Valepar and the board was chaired by Don Conrado, the CEO of Valepar.
Case 3: Cross and Pyramid Holdings
Tata Motor’s top stockholders in 2013

[Image showing a table of stockholders]

Australia 81 2 9777 8500 Brazil 1511 3040 4500 Europe 44 20 7330 7500 Germany 49 69 9204 1210 Hong Kong 852 2977 6000 Japan 81 3 3201 8900 Singapore 65 6212 1000 U.S. 1 212 318 2000 Copyright 2013 Bloomberg Finance L.P. SN 636136 EST GMT-5/00 GEDP=2030-0 04/Nov-2013 12:31:34
Case 4: Legal rights and Corporate Structures: Baidu

- **The Board**: The company has six directors, one of whom is Robin Li, who is the founder/CEO of Baidu. Mr. Li also owns a majority stake of Class B shares, which have ten times the voting rights of Class A shares, granting him effective control of the company.

- **The structure**: Baidu is a Chinese company, but it is incorporated in the Cayman Islands, its primary stock listing is on the NASDAQ and the listed company is structured as a shell company, to get around Chinese government restrictions of foreign investors holding shares in Chinese corporations.

- **The legal system**: Baidu’s operating counterpart in China is structured as a Variable Interest Entity (VIE), and it is unclear how much legal power the shareholders in the shell company have to enforce changes at the VIE.
Things change.. Disney’s top stockholders in 2009

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Task
Assess corporate governance at your company