

PowerPoint Presentation
Financial Management And
Policy

Twelfth Edition

by

James C. Van Horne

Stanford University

Prepared by

Memphis Viveros

Chapter 1

Goals and Functions

of

Finance

Financial Goal

Maximize Shareholder
Wealth

Objective of a Company

- Create value for its shareholders
 - Market price of common stock (C/S)
 - Function of finance
 - Investment
 - Financing
 - Dividend/share repurchase

Value Creation

- Niche in an attractive industry
- Imperfections in the financial markets

Maximization of EPS

- Does not consider
 - Timing
 - Duration
 - Risk or uncertainty
 - Dividends
- Usually is not the same as maximizing market price per share

Agency Problems

- Management/stockholders
- Creditors/equityholders

Dealing With Agency Problems

- Incentives
 - Stock options
 - Bonuses
 - Perquisites
- Monitoring
 - Bonding
 - Reviewing
 - Auditing
 - Limiting management decisions

Principle of Maximization of Shareholder Wealth

- Rational guide for running a business
- Efficient allocation of resources in society
- Objective in making financial decisions

Allocation of Savings in an Economy

- Occurs on the basis of expected risk and return
- Market value of common stock reflects the market's trade-off between risk and return

Social Responsibility

- Protecting consumers
- Paying fair wages
- Maintaining fair hiring practices
- Maintaining safe working conditions
- Supporting education
- Involved in environmental issues
- Impact on stakeholders

Functions of Finance

- Investment decisions
- Financing decisions
- Dividend/share repurchase decision

New Investment Decision

- Most important of three functions
- Allocation/reallocation of capital
- Determines
 - The total amount of assets
 - Composition of assets
 - Business-risk complexion of the firm
- Appropriate acceptance criterion
(or required rate of return)

Existing Investment Decision

- Efficient management of current assets
- Proper level of liquidity
- Allocating capital to fixed assets

External Investment Opportunities

- Mergers and acquisitions
- Domestic and international
- Globalization of finance

Financing Decision

- Determining the best financing mix
 - Optimal capital structure
 - Maximize market price per share
- Variation in capital structure can impact firm value
- Interface with capital markets
 - Ever-changing environment
 - Manage financial risk with hedging devices
- Corporate restructuring
 - New financing sources
 - Existing financing sources

Dividend/Share Repurchase Decision

- Amount of cash to distribute to stockholders
- Dividend policy
 - % of earnings paid
 - Stability of dividends
 - Stock dividend
 - Splits
- Share repurchase
- Determines the amount of earnings retained
- Financial signals to the market

Making Optimal Decisions

- Interrelated decisions
- Effect on the value of the firm
- Financial analysis