Telkom University

Introduction to Financial Management

Apple, Inc

Apple, Inc Sell thousands of iPhone, iPads, iPods, and Personal Computers

Apple, Inc must evaluate potential new products, make personal choices, and consider new locations for Apple retail stores

These decisions affects the risk and timing of Apple's operation as well as the cash they generate → financial decisions

You must think about financial decisions, evaluate alternatives in uncertain future conditions

Welcome to the World of Finance

- In personal Life, You will be both working and living in a world where you will be making choices that have financial consequences
- Corporations make money by introducing new sales outlets, hiring best people, improving productivity→ involve investing and spending money

COST & BENEFIT

NOW & FUTURE

Finance : An Overview

What is Finance ?

Finance is the study of how people and businesses evaluate investments and raise capital to fund them

Capital Budgeting

What is long term investments should the firm undertake

Capital Structure

How Should the firm raise money to fund these investments

Working Capital Management

How can the firm best manage its cash flows as they arise in its day-to-day operations

Telkom University

Finance: An Overview

Why Study Finance ?

All of major strategic decisions will give impacts to finance

If you can’t manage your finance You won’t be in business very long

Financial decisions are everywhere : personal life & your career

Your business and your personal lives will be spent in the world of finance

Operations is one on the three functions that every organization performs

Three Types of Business Organizations

01
Sole Proprietorship

02
Partnership

03
Corporation

Three Types of Business Organizations

01

Sole Proprietorship

- Owned by individual →responsible for profit and debt
- Easy forming → the founder of the business is the sole owner
- No difference between personal borrowing and business borrowing

Three Types of Business Organizations

02

Partnership

- An association of two or more persons who come together as co-owners for the purpose of operating a business for profit
- An important advantage of the partner- ship is that it provides access to **equity**, or ownership
- 2 Classes in partnership : General and Limited

Three Types of Business Organizations

03

Corporation

- The corporation is legally owned by its current set of stockholders, or owners, who elect a board of directors.
- The larger firms that need to raise large sums of money for investment and expansion that use this organizational form
- One of the drawbacks of the corporate form is the double taxation of earnings that are paid out in the form of dividends

Characteristics of Different Forms of Business

Business Form	Number of Owners	Are Owners Liable for the Firm's Debts?	Do Owners Manage the Firm?	Does an Ownership Change Dissolve the Firm?	Access to Capital	Taxation
Sole Proprietorship	One	Yes	Yes	Yes	Very limited	Personal Taxes
Partnership	Unlimited	Yes; each partner has unlimited liability	Yes	Yes	Very limited	Personal Taxes
Limited Partnership (with General Partners [GPs] and Limited Partners [LPs])	At least one GP, but no limit on LPs	GPs—unlimited liability LPs—limited liability	GPs—manage the firm LPs—no role in management	GPs—yes LPs—no, can change[1]	Limited	Personal Taxes
Limited Liability Company (LLC)	Unlimited	No	Yes	No	Dependent on size	Personal Taxes
Corporation	Unlimited	No	No—although managers generally have an ownership stake[2]	No	Very easy access	Double Taxation: Earnings taxed at corporate level Dividends taxed at personal level

How The Finance Area Fits Into a Corporation

Board of Director

Chief Executive Officer (CEO)

Vice President - Marketing

Vice President - Finance or Chief Financial Officer (CFO)

Duties :

- *Oversight of financial planning*
- *Corporate strategic planning*
- *Control of corporate cash flow*

Vice President - Production and Operation

Treasurer

Duties :

- *Cash management*
- *Credit management*
- *Capital expenditures*
- *Acqusition of capital*
- *Financial Planning*
- *Management of foreign currencies*

Controller

Duties :

- *Taxes*
- *Financial statements*
- *Cost accounting*
- *Data processing*

How The Finance Area Fits Into a Corporation

The Goal of the Financial Manager :

Maximizing Shareholder Wealth→ Maximizing the stock price

Financial Manager must concern about Ethical Consideration:

- Acting in an ethical manner morally correct
- It is a necessary ingredient of long-term business and personal success.

5 Basic Principles of Financial Management

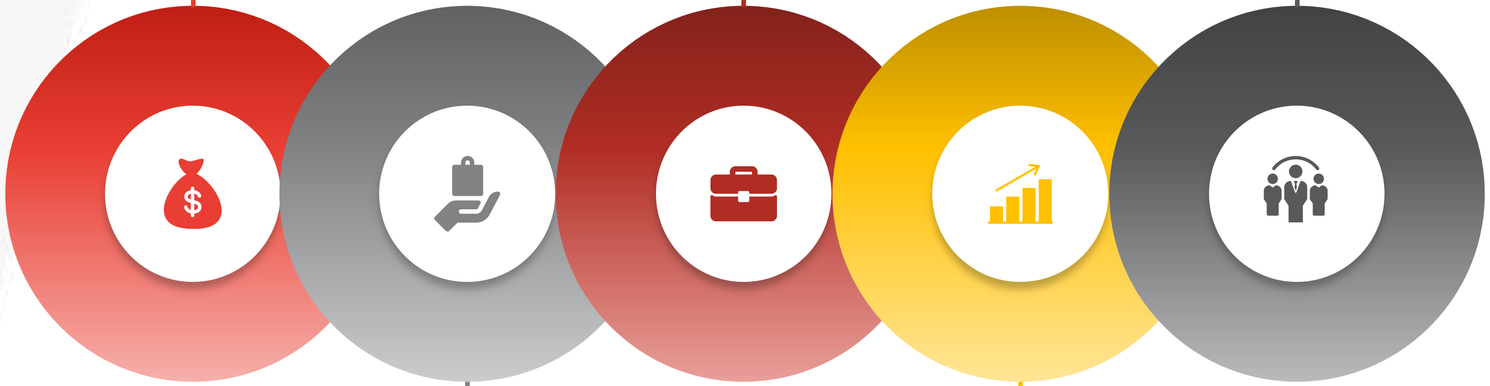
Principle 1
Money Has a Time Value

Principle 2
There is a Risk-Return Tradeoff

Principle 3
Cash Flows are The Source of Value

Principle 4
Market Prices Reflect Information

Principle 5
Individuals Respond to Incentives



Principle 1: Money Has a Time Value

A dollar **received today is worth** more than a dollar receiver in the future

A dollar **received in the future is worth less** than a dollar received today

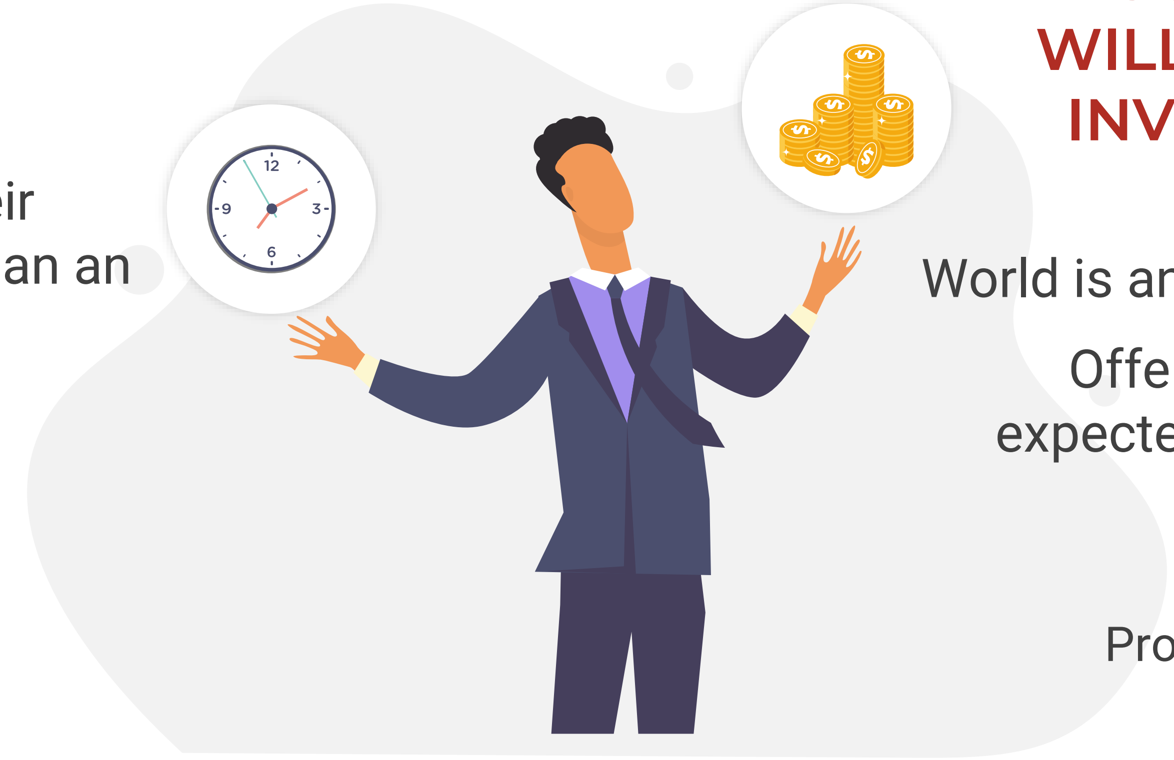
Opportunity Loss
vs
Opportunity Cost

We can invest the dollar we have today to earn interest, so that at the end of one year we will have more than one dollar

Principle 2 : There is a Risk-Return Tradeoff

INDIVIDUALS ARE RISK AVERSE

They Prefer to get a certain return on their investment rather than an uncertain return



SOME INDIVIDUAL WILL HAVE TO MAKE INVESTMENTS THAT ARE RISKY

World is an inherently risky place

Offering investors a higher expected rate of return on the riskier investments

Value Assets

Propose Investment Project

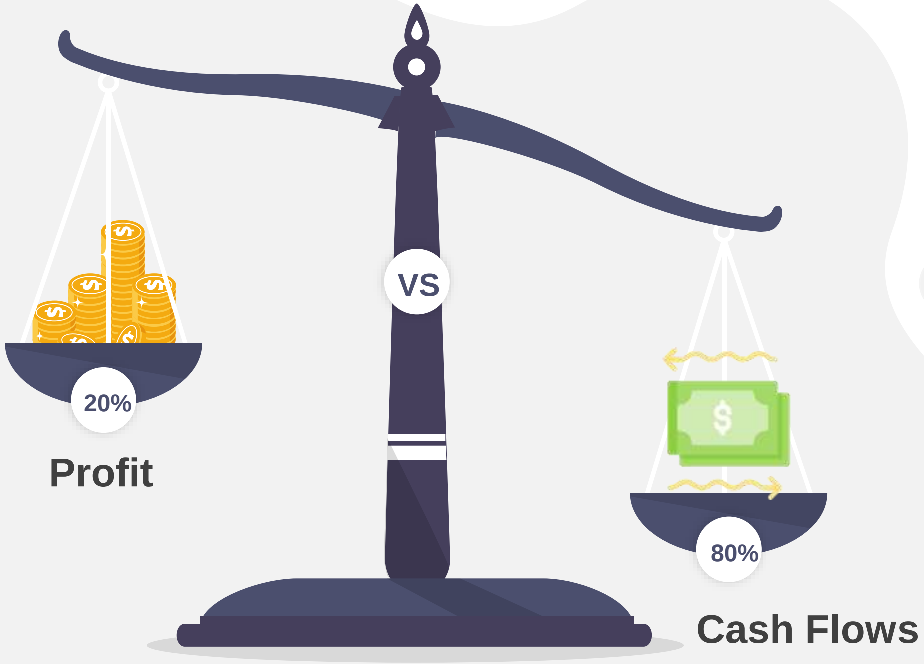
Measure Risk

Principle 3: Cash Flows Are The Source of Value

Profit is an accounting concept

Profit determines a company's accounting profit

(different judgment, different profit)

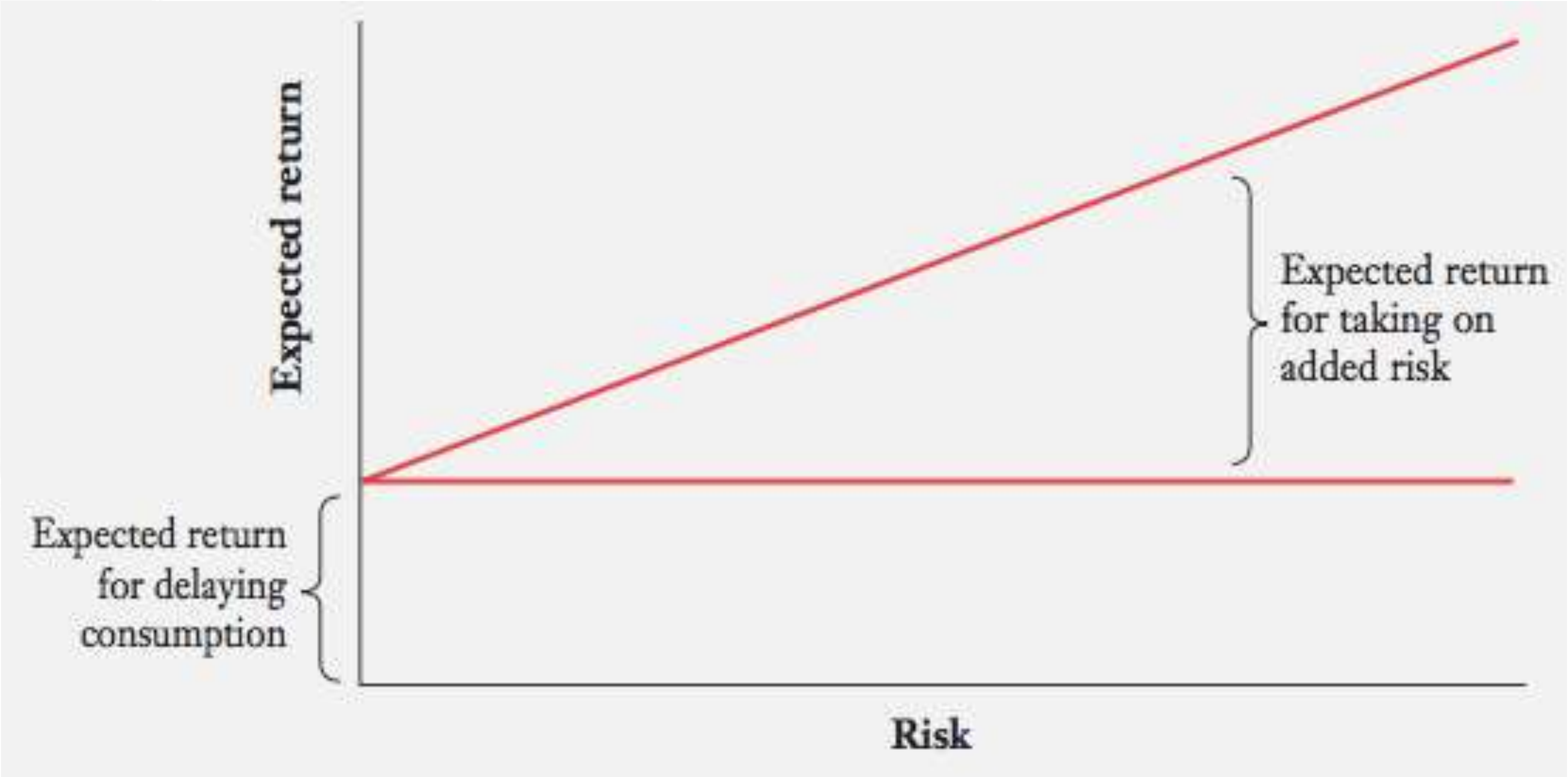


Cash flows are the source of value

Cash flow represent actual money that can be spent

Cash flow determines an investment's value

There is a Risk-Return Tradeoff



Principle 4: Market Prices Reflect Information

New Information

BUYING INVESTMENT

SELLING INVESTMENT

The Prices Respond to the information determine the efficiency of the market

1. When earnings reports come out→ Prices adjust immediately to the new information
2. Quickly Stock Prices can react to the information
3. Good decision in the company will result in higher stock prices

Principle 5: Individuals Respond to Incentives

01

Managers are often motivated by self-interest

02

Managers Incentives
vs
Stakeholders Value

03

Agency Problem

Agent
vs
Stock holders

04

Goal of Maximizing

Agency Cost

OWNERSHIP IN THE COMPANY

Mitigate The Agency Problem:

1. Compensation plans can be put in place that reward managers when they act to maximize shareholder wealth.
2. The board of directors can actively monitor the actions of managers and keep pressure on them to act in the best interests of shareholders.
3. The financial markets can (and do) play a role in monitoring management by having auditors, bankers, and credit agencies monitor the firm's performance, while security analysts provide and disseminate information on how well the firm is doing, thereby helping shareholders monitor the firm.
4. Firms that underperform will see their stock prices fall and may be taken over and have their management teams replaced.

Telkom University

Thank you