

PRINCIPLES OF Finance



SCOTT BESLEY **6E** EUGENE F. BRIGHAM

Chapter 1

An Overview of Finance

Chapter 1 – Learning Objectives

- ✓ Explain what finance entails and why everyone should have an understanding of basic financial concepts.
- ✓ Describe how the finance discipline has changed during the past century.
- ✓ Explain in general how value is measured and what it means to maximize value.
- ✓ Explain what it means to be sustainable and how making appropriate financial decisions promotes sustainability.
- ✓ Explain what the terms lean manufacturing and lean finance mean.

What is Finance

- ✓ Finance is concerned with decisions about money
- ✓ To make sound financial decisions, remember:
 - ✓ More value is preferred to less
 - ✓ The sooner cash is received the more value it has
 - ✓ Less risky assets are more valuable than risky assets

Four Major Areas of Finance

- ✓ Financial markets and institutions
- ✓ Investments
- ✓ Financial services
- ✓ Managerial finance

Financial Institutions

- ✓ Banks
- ✓ Insurance companies
- ✓ Savings and loans
- ✓ Credit unions

Investments

- ✓ Major Functions
 - ✓ Determining the values, risks and returns of financial assets
 - ✓ Determining the optimal mix of securities that should be held in a portfolio

Financial Services

- ✓ Deal with the management of money
- ✓ Help individuals and companies determine how to invest money
- ✓ One of the largest industries in the world

Managerial Finance

- ✓ Important in all areas of business
- ✓ Decisions made by financial managers:
 1. The credit terms under which customers can buy
 2. How much inventory the firm should carry
 3. How much cash to keep on hand
 4. Whether to acquire other firms
 5. How much earnings to reinvest in business and how much to pay out in dividends

Evolution of Modern Finance

- ✓ Early 1900s - banks were full service financial organizations
- ✓ Crisis of 1907
- ✓ Bank failures during 1920s
- ✓ Great depression 1929 - 1933
- ✓ Legislative reform
- ✓ Deregulation since 1970s

History of Investments

- ✓ Early 1900s investments dominated by small group of wealthy investors
- ✓ Industrialization during WWI
- ✓ Growth of investment firms by 1920s
- ✓ Stock market crash 1929 – 1932; market value decreased > 80%

History of Investments

- ✓ Regulations of securities
- ✓ Prosperity after WWII
- ✓ Inflation and high interest in 1970s
- ✓ Increase in individual and institutional investors

History of Managerial Finance

- ✓ Emergence as a separate field of study—early 1900' s
- ✓ Wave of mergers during 1920s
- ✓ Bankruptcies in 1930s
- ✓ Liquidity stressed during 1940s & '50s
- ✓ Analysis and maximizing value in late 1950s and the 1960s
- ✓ **Innovative risk management in 1970s**

History of Managerial Finance

- ✓ Trends in the 1990s have continued into twenty-first century
 - ✓ Continued **globalization** of business
 - ✓ Further increase in **use of technology**
 - ✓ Regulatory attitude of government

Globalization of Business

- ✓ **Improvements in transportation** and communications
- ✓ Political clout of consumers
- ✓ Cost of developing new products has increased
- ✓ **Multinational firms** are able to shift production to wherever costs are lowest

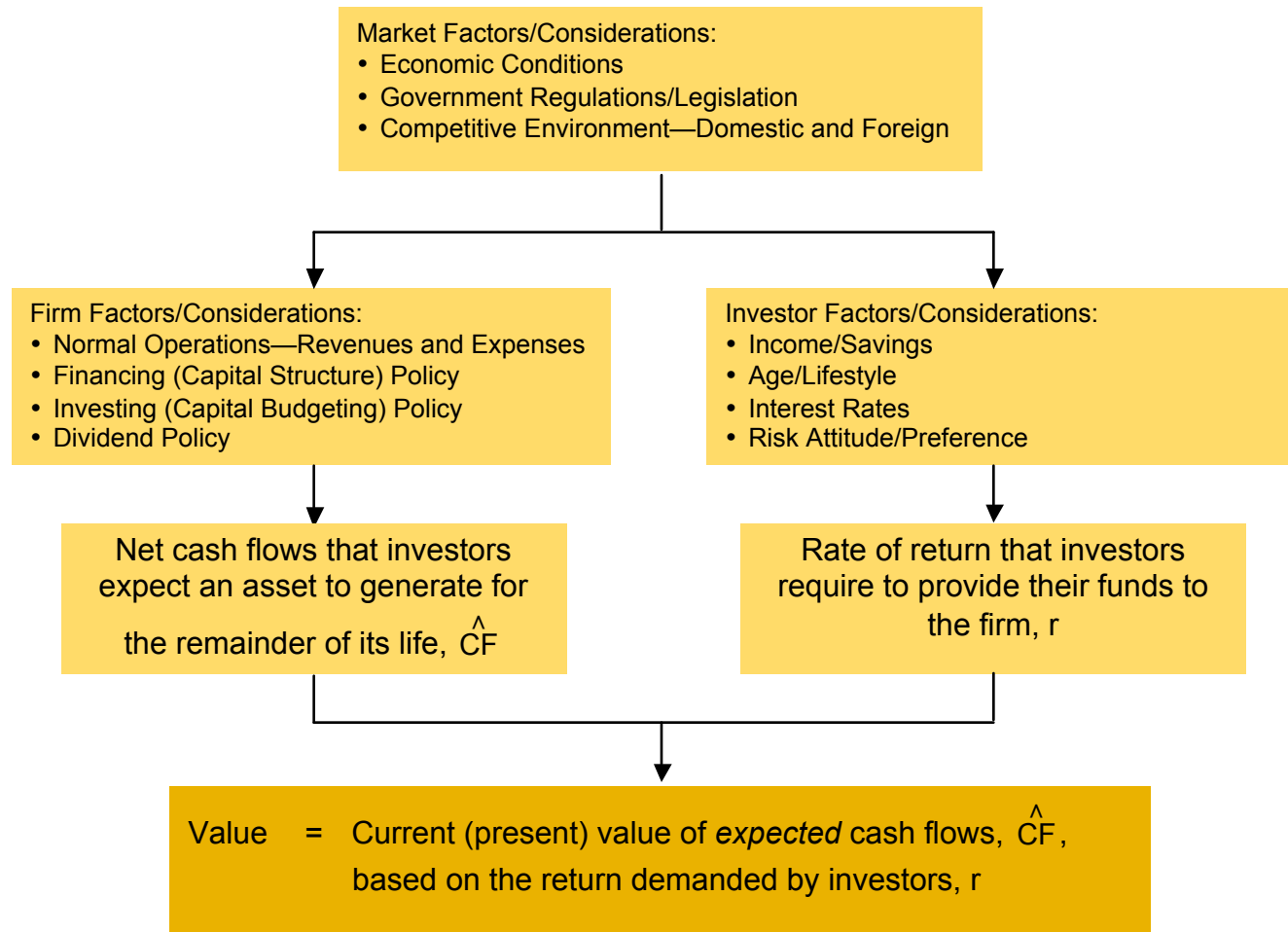
Importance of Managerial Finance

- ✓ Financial managers no longer merely fund the business needs
- ✓ Financial managers coordinate decisions
- ✓ People in marketing, accounting, production, and personnel need to understand finance to do their job well

Financial Manager's Responsibilities

- ✓ **Obtain** and **use** funds in a way that will **maximize** the value of the firm
- ✓ **Value** = the present, or current, value of the cash flows an asset is expected to generate in the future

Value of the Firm



Recent Developments in Finance

✓ Sustainability

- ✓ A long-run process that focuses on improving the quality of life of all stakeholders for all generations both current and future

✓ Lean Manufacturing

- ✓ A system that integrates the entire production process so that the least amount of resources is used

Chapter Principles

Key Overview of Finance Concepts

- ✓ What is finance, and why should everyone understand the basic financial concepts?
 - ✓ Finance deals with decisions about money
 - ✓ Everyone deals with financial decisions and there are financial implications in nearly every business-related decision
- ✓ How has the finance discipline changed during the past 100 years?
 - ✓ Finance evolved from a descriptive discipline using rules-of-thumb to a more technical discipline using quantitative models

Chapter Principles

Key Overview of Finance Concepts

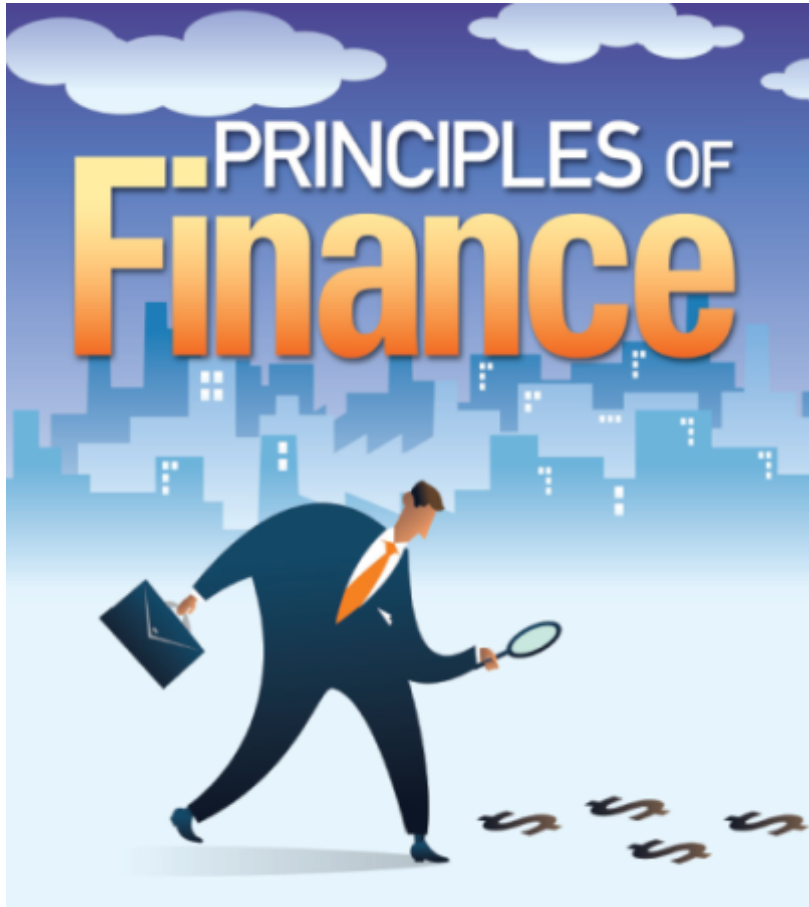
- ✓ What is value, and what does it mean to maximize value?
 - ✓ An assets value is based on the cash flows that it is expected to generate during its useful life
 - ✓ To maximize value, you should attempt to invest low-cost funds to generate the highest return possible

Chapter Principles

Key Overview of Finance Concepts

- ✓ What is sustainability?
 - ✓ Sustainability recognizes the effects that the practices we pursue in the current period have on future generations
- ✓ What is lean manufacturing? What is lean finance?
 - ✓ The concept that products should be produced using the least amount of resources
 - ✓ To maximize value, a firm must invest at the highest returns possible or have a goal to be “financially lean”

End of Chapter 1



An Overview of Finance