EPTARC
Technology Solutions Private Limited

CORPORATE FINANCE

TOPICS COVERED

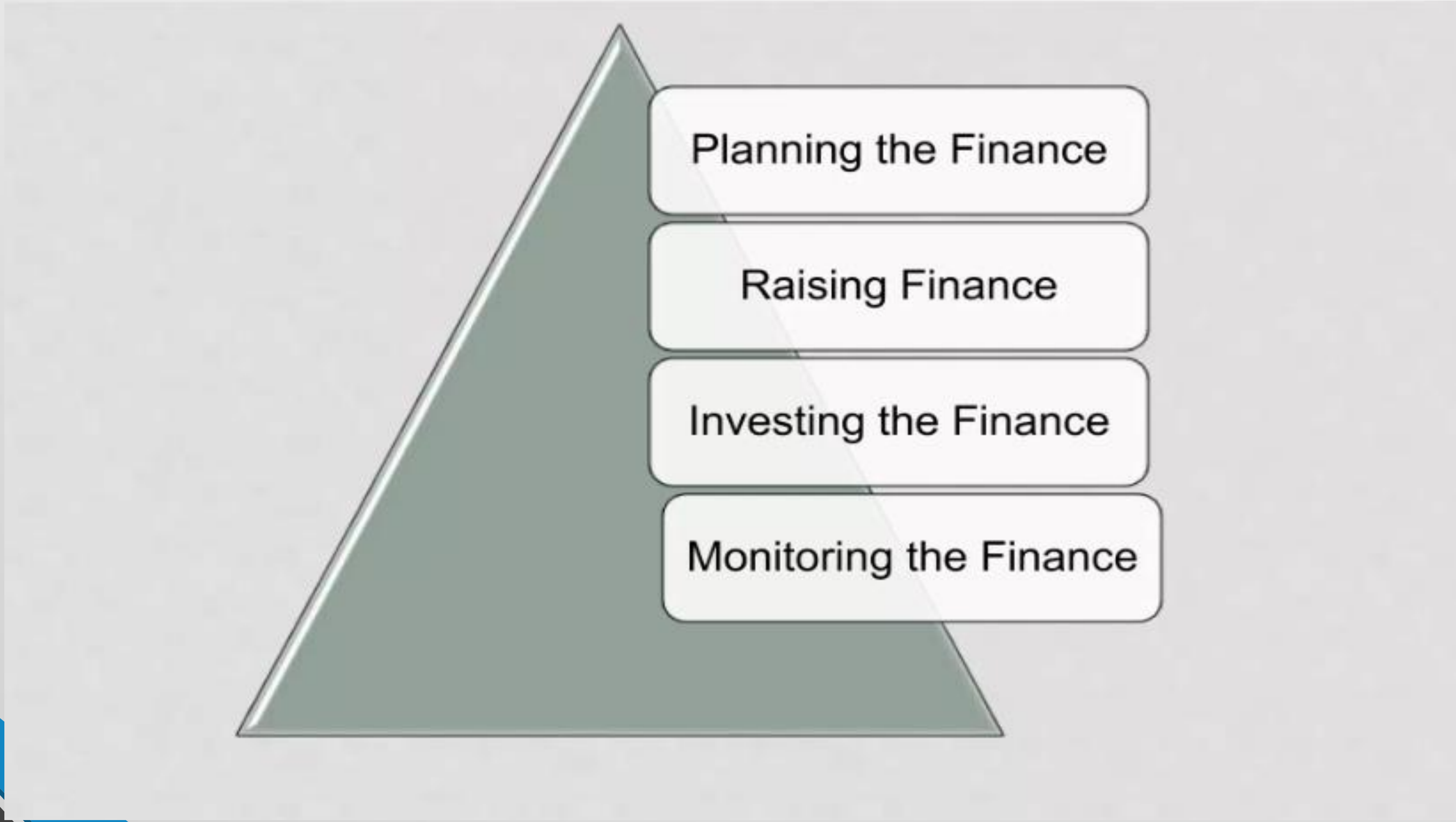
- INTRODUCTION
- PROCESS
- TASKS
- CHARACTERISTICS
- MODELS
- ROLE OF A FINANCE MANAGER
- CAPITAL STRUCTURE
- AGENCY PROBLEM
- FINANCIAL MARKETS
- KEY POINTS
- BIBLIOGRAPHIES

CORPORATE FINANCE: Corporate Finance is the area of finance dealing with the sources of funding and the Capital Structure of Corporations, the actions that managers take to increase the value of the firm to the shareholders, and the tools and resources used to allocate the financial resources.

The financial calculations that go beyond raising and successfully organizing capital is what forms the basis of Corporate Finance.

Corporate Finance has a close relationship with other departments in the company because all departments need finance continuously.

PROCESS OF CORPORATE FINANCE



PLANNING THE FINANCE: The finance manager plans the finance of the company. He makes decisions on questions like:-

- How much finance is required by the company?
- What are the sources of finance?
- How to use the finance profitably?

RAISING THE FINANCE: The finance manager raises (collects) finance for the company. Finance can be collected from many sources, viz., shares, debentures, banks, financial institutions, creditors, etc.

INVESTING THE FINANCE: The finance manager uses finance to achieve the objectives of the company. There are two types of corporate finance:

FIXED CAPITAL: Used to purchase fixed assets like Land, Building, Machinery, etc.

WORKING CAPITAL: Used to purchase raw materials and meet day-to-day expenses like salaries, rent, taxes, electricity bills, etc.

MONITORING THE FINANCE: The finance manager monitors i.e. controls and manages) finance of the company. He has to minimize the cost of finance and minimize the wastage and misuse of finance. He also has to minimize the risk of investment of the finance and get maximum return on investment. Monitoring finance is an art and science and involves complex decision-making:

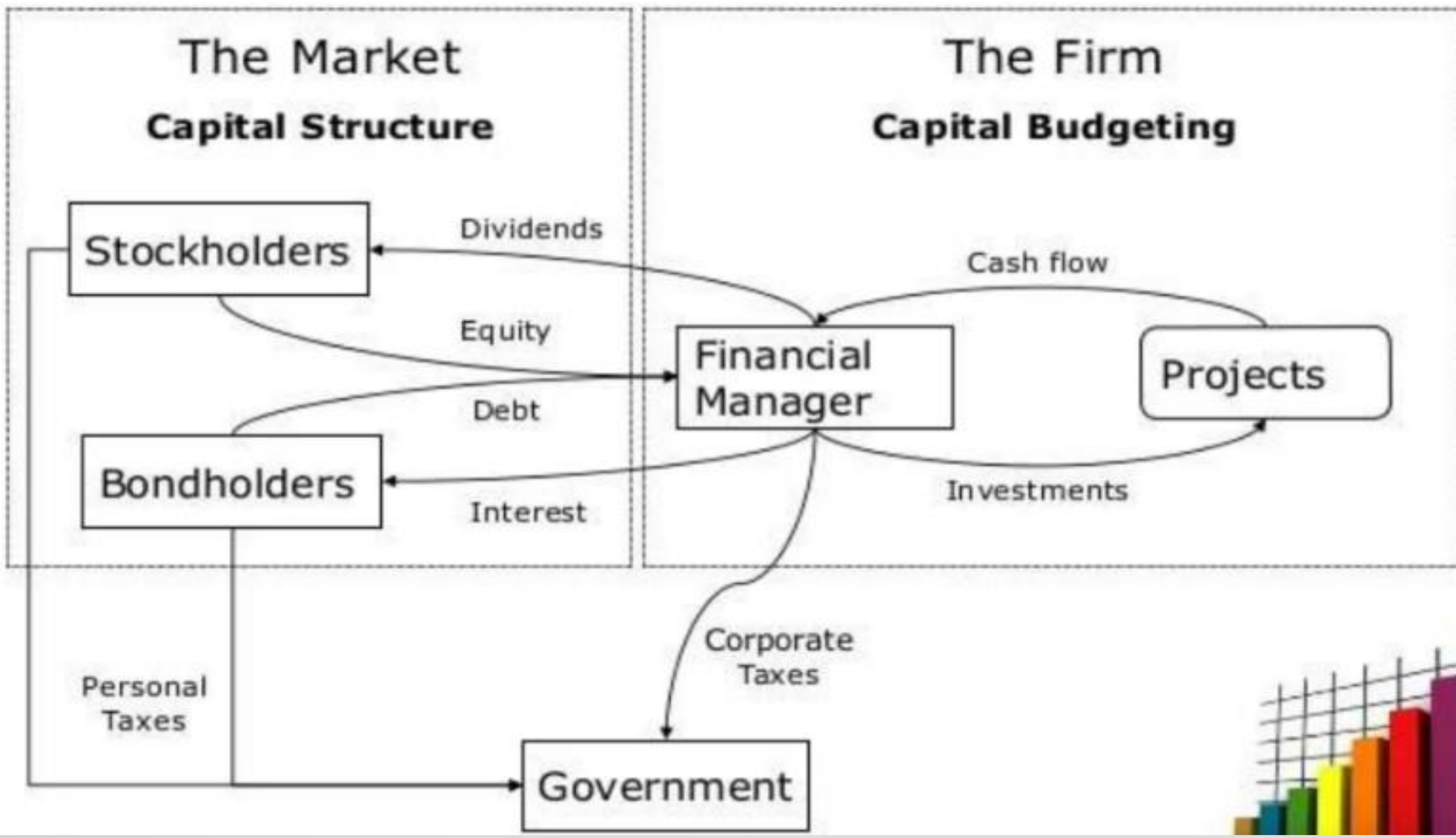
MAIN TASKS OF CORPORATE FINANCE

CAPITAL BUDGETING: The process of planning and managing a firm's investment in long-term assets

CAPITAL STRUCTURE: The mix of debt and equity maintained by a firm.

WORKING CAPITAL MANAGEMENT: Planning and managing the firm's current assets and liabilities.

Corporate finance in a nutshell



CHARACTERISTICS OF CORPORATE FINANCE

FINANCIAL ACTIVITY: Corporate finance is a financial activity. It includes planning, raising, investing, and monitoring the finances of the company. In short, it includes all the financial aspects of the company. This work is done by the financial department headed by the finance manager.

RAISING THE FINANCE: Corporate finance includes raising (collecting) finance for the company. Finance can be collected through shares, debentures, bank, loans, etc. It is very difficult for new companies to collect finance because the investors do not have confidence in new companies. However, it is very easy for reputed companies to collect finance due to their well-established goodwill in the market.

INVESTING THE FINANCE: Corporate Finance also includes investing (using) the finance. The finance is used to achieve the objectives of the company. The finance must be used perfectly.

OBJECTIVES-ORIENTED: Corporate finance is objective oriented. This is, it is used to achieve the objectives of the company. The main objectives are :

i. To earn maximum profits.
ii. To give a proper dividend to the shareholders.
iii. To create a proper reserve for future growth and expansions, etc.

BALANCE SHEET MODEL

Total Value of Assets:

Current Assets

Fixed Assets

1 Tangible

2 Intangible

Total Firm Value to Investors:

Current Liabilities

Long-Term Debt

Shareholders' Equity

THE CAPITAL BUDGETING DECISION

Current Assets

Fixed Assets

1 Tangible

2 Intangible

What long-term investments should the firm choose?

Current Liabilities

Long-Term Debt

Shareholders' Equity

LONG TERM DECISION

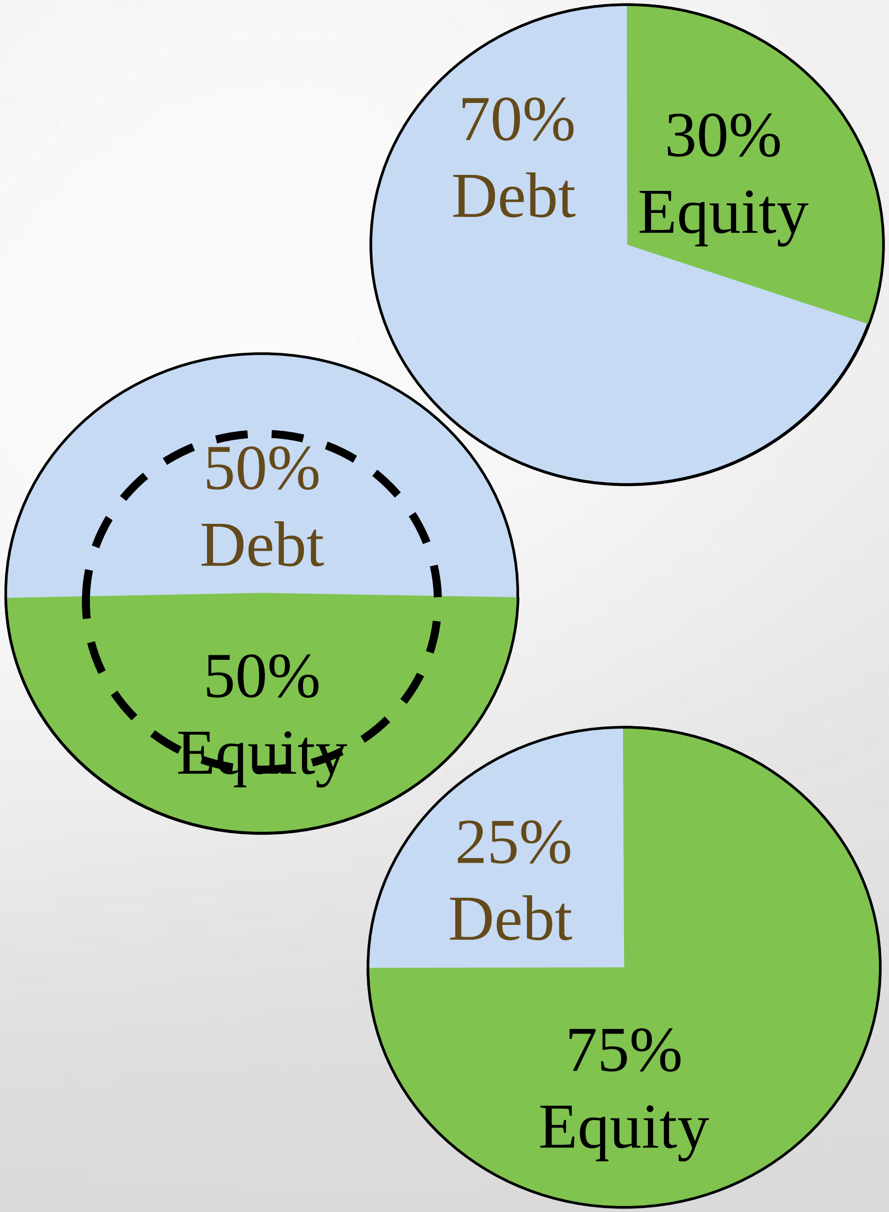
- Relates to Capital Budgeting Decisions
- Techniques:

i. Traditional- Payback Period, Accounting Rate of Return

ii. Modern- Net Present Value Method, Internal Rate of Return, Profitability Index, etc.

CAPITAL STRUCTURE

- The value of the firm can be thought of as a pie.
- The goal of the manager is to increase the size of the pie.
- The Capital Structure decision can be viewed as how best to slice the pie.
- If how you slice the pie affects the size of the pie, then the capital structure decision matters.



THE CAPITAL STRUCTURE DECISION

Current Assets

Fixed Assets

1 Tangible

2 Intangible

How should the firm raise funds for the selected investments?

Current Liabilities

Long-Term Debt

Shareholders' Equity

CAPITAL STRUCTURE DECISION

Decisions Related to Funding of the Projects

Sources

- **Short Term** (trade credit, bank overdraft, etc.)
- **Long Term**

(i) Owners Funds (Equity/Preference Share Capital, Retained Earnings)

(ii) External Funds(Debentures, Long Term Loans, etc.)

SHORT-TERM ASSET MANAGEMENT

Current Assets

Net Working Capital

Current Liabilities

Long-Term Debt

Fixed Assets

1 Tangible

2 Intangible

How should short-term assets be managed and financed?

Shareholders' Equity

THE FINANCIAL MANAGER

The Financial Manager's primary goal is to increase the value of the firm by:

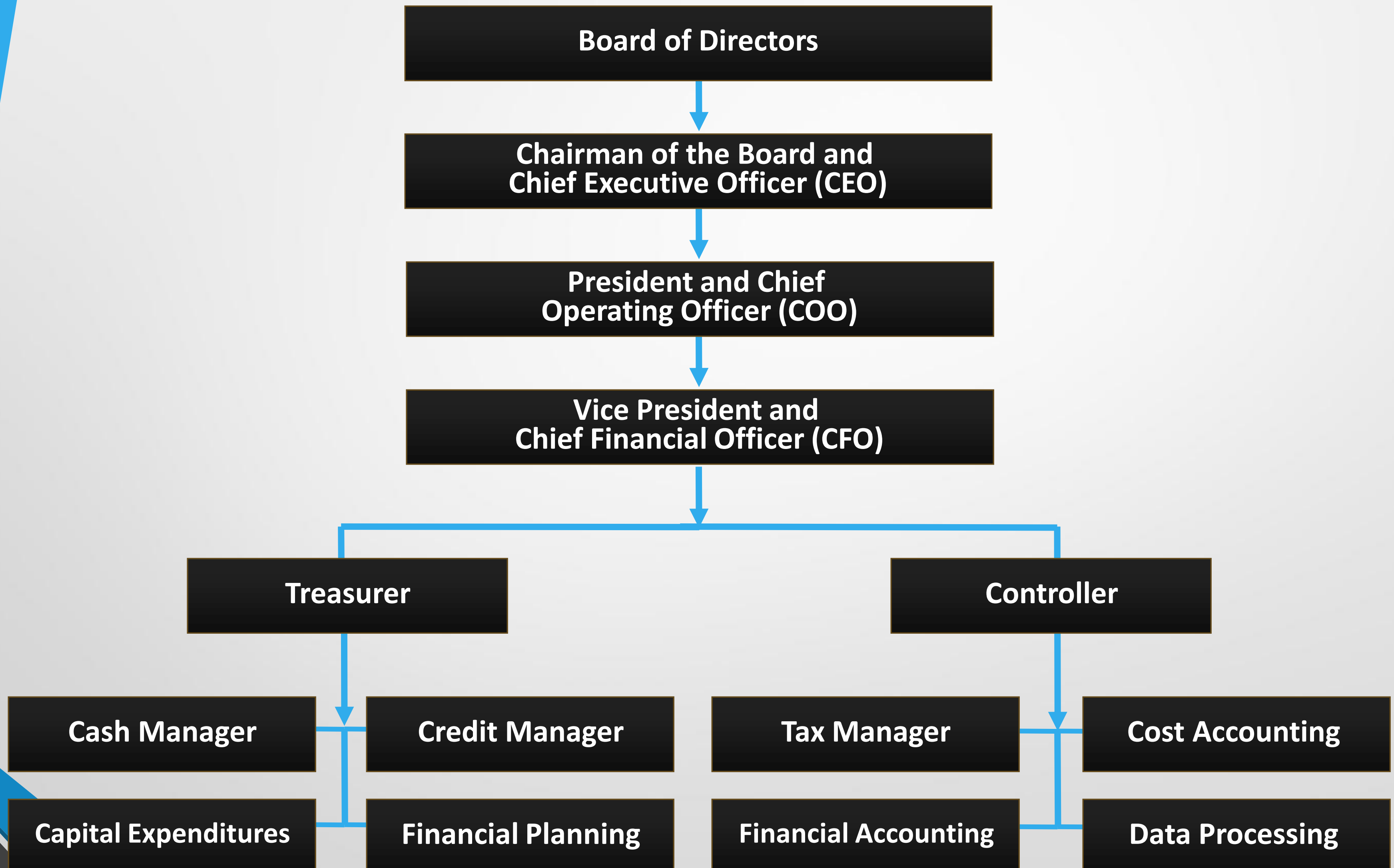
- Selecting value-creating projects
- Making smart financing decisions
  - Maximize profit
  - Minimize costs
  - Maximize market share
  - Maximize shareholder wealth

EMERGING ROLE OF FINANCIAL MANAGER IN INDIA

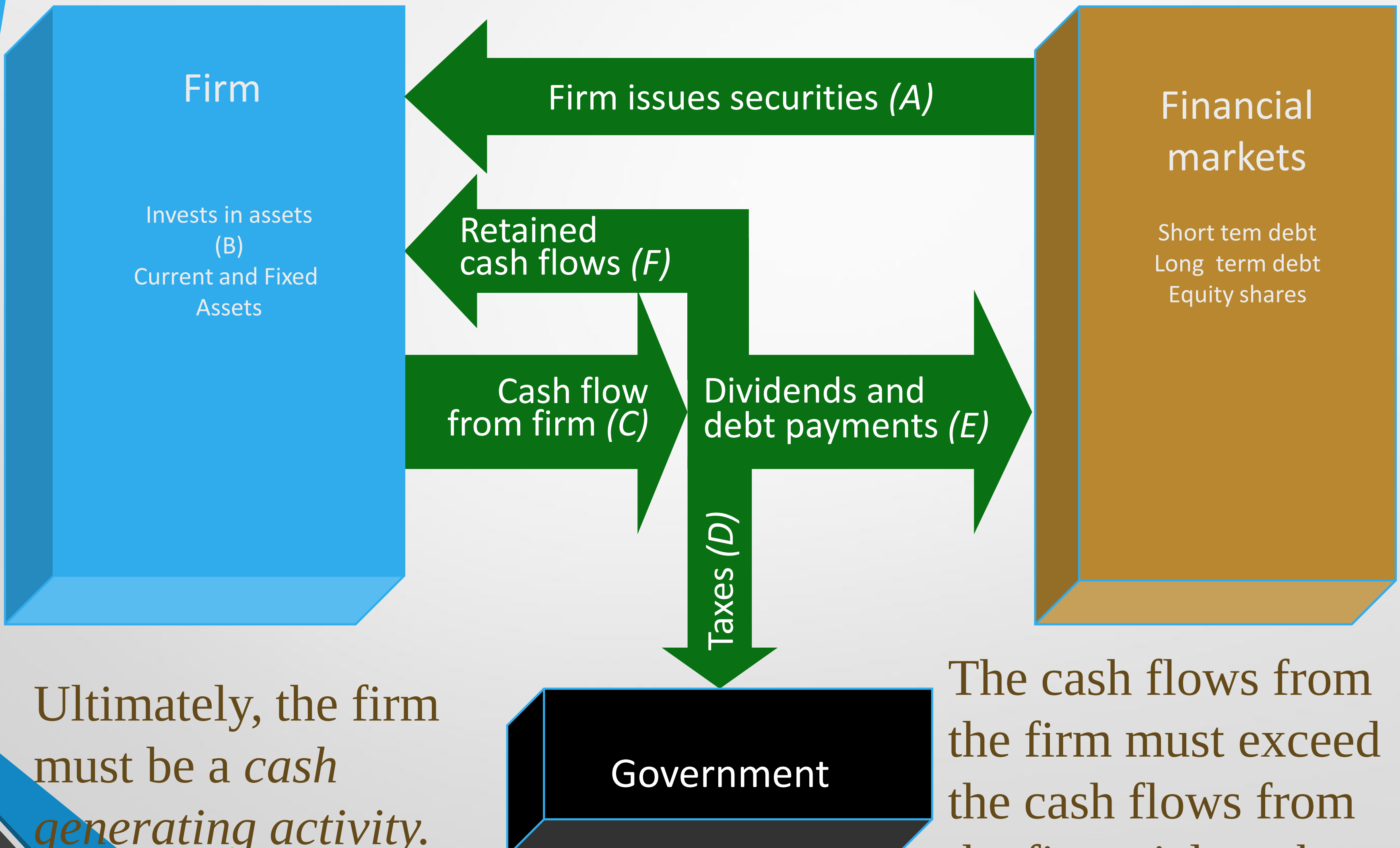
The key challenges for the financial manager appear to be in the following areas:

- Investment planning and resource allocation
- Financial structure
- Mergers, acquisitions, and restructuring
- Working capital management
- Risk management
- Corporate governance
- Investor relations

HYPOTHETICAL ORGANIZATION CHART



THE FIRM AND THE FINANCIAL MARKETS



Ultimately, the firm must be a *cash generating activity.*

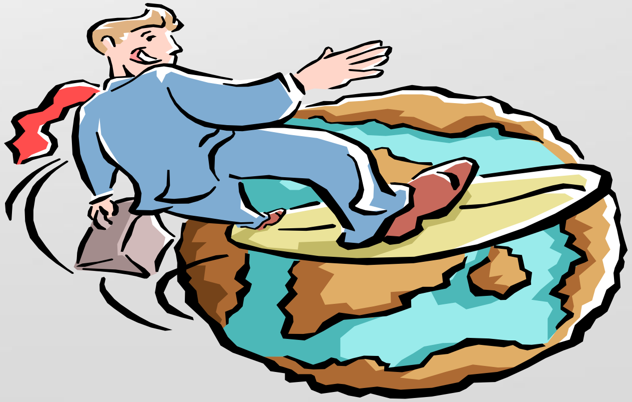
The cash flows from the firm must exceed the cash flows from the financial markets.

THE CORPORATE FIRM

- The corporate form of business is the standard method for solving the problems encountered in raising large amounts of cash.
- However, businesses can take other forms.

FORMS OF BUSINESS ORGANIZATION

- The Sole Proprietorship
- The Partnership
- The Corporation



THE AGENCY PROBLEM

- **<u>AGENCY RELATIONSHIP</u>**
  - Principal hires an agent to represent his/her interest
  - Stockholders (principals) hire managers (agents) to run the company
- **<u>AGENCY PROBLEM</u>**
  - Conflict of interest between principal and agent

FINANCIAL MARKETS

- **PRIMARY MARKET**
  - Issuance of a security for the first time
- **SECONDARY MARKETS**
  - Buying and selling of previously issued securities
  - Securities may be traded in either a dealer or auction market

KEY TAKEAWAYS

- Corporate finance is concerned with how businesses fund their operations in order to maximize profits and minimize costs.
- It deals with the day-to-day demands on business cash flows as well as with long-term financing goals (e.g., issuing bonds).
- Corporate finance also deals with monitoring cash flows, accounting, preparing financial statements, and taxation.

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