




Introduction

Gestão Financeira II
Undergraduate Course
2010-2011

Instituto Superior de Economia e Gestão

Gestão Financeira II Licenciatura
Clara Raposo 2010-2011 1




Details of the Course

- Material available in ISEG's website (aquila):
 - Course Syllabus;
 - Powerpoint Presentations;
 - Problem Sets to solve in class/home.
- Two 1-hour Lectures + One 2-hour Class;
- Bibliography: Berk and DeMarzo's "Corporate Finance", 2nd edition
 - With access to MyFinance Lab;
- Assessment:
 - 1 Mid-Term Test (20%);
 - 1 Group Work Assignment (25%);
 - Final Exam (55%).

Instituto Superior de Economia e Gestão

Gestão Financeira II Licenciatura
Clara Raposo 2010-2011 2



Syllabus

- What is corporate finance?
- Investment Decision (Capital Budgeting):
 - Assuming a given cost of capital /discount rate.
- Financing Decision:
 - Debt (Loans, Bonds) – cost of debt;
 - Equity – cost of equity;
 - Choice of Capital Structure.
- Payout Policy:
 - Retain or Distribute?
 - Cash Dividends or Stock Repurchases?

Instituto Superior de Economia e Gestão

Gestão Financeira II Licenciatura
Clara Raposo 2010-2011 3

Balance Sheet

Invested Capital:

Net Working Capital

Current assets – Current liabilities

Fixed Assets

Tangible

Intangible

Equity and Debt:

Long-Term Debt

Shareholders' Equity

Capital Budgeting Decision:
which investments maximize value?

Capital Structure Decision:
which financing mix maximizes value?

Universitat Superior de Economia i Dretes
Geòmetria Financera II | Llicenciatura Clara Raposo | 2010-2011 | 4

The Four Types of Firms

- Sole Proprietorship
 - Business is owned and run by one person, with Unlimited personal liability;
- Partnership
 - Similar, but with more than one owner. Each and every partner is personally liable for all of the firm's debts. The partnership ends with the death or withdrawal of any single partner.
 - Limited Partnership has two types of owners: General Partners and Limited Partners. The latter have limited liability and cannot lose more than their initial investment. Cannot legally be involved in decision making.
- Limited Liability Company (LLC)
 - All owners have limited liability but they can also run the business.
- Corporation
 - A legal entity separate from its owners. The corporation is solely responsible for its own obligations. Its owners are not liable for any obligation the corporation enters into.

Universitat Superior de Economia i Dretes
Geòmetria Financera II | Llicenciatura Clara Raposo | 2010-2011 | 5

The Objective of the Firm: Classical view

SHAREHOLDERS

Problem: Have little control
- Hire and fire
- General Assembly
- Board of Directors

Maximize shareholder wealth

MANAGERS
* Choose projects
* Choose Financing
* Choose Dividends

Problem: Managers have their own agendas

Problem: Not effective

CREDITORS
Lend Money
Protect creditors interests

Supervises the Corporation

SOCIETY
Avoids Social Costs

Problem: Abuses

Problem: Prices too volatile, or speculation driven, or erroneous valuation

Information

Market Value = True Value

FINANCIAL MARKETS

in Damodaran (1997)

AGENCY PROBLEMS

Universitat Superior de Economia i Dretes
Geòmetria Financera II | Llicenciatura Clara Raposo | 2010-2011 | 6

The role of the Stock Market

- Provides **Liquidity** to shareholders: The ability to easily sell an asset for close to the price you can currently buy it for;
- **Public Company**: Stock is traded by the public on a stock exchange.
 - **Private Company**: Stock may be traded privately.
- **Primary Markets**
 - When a corporation itself issues new shares of stock and sells them to investors, they do so on the primary market.
- **Secondary Markets**
 - After the initial transaction in the primary market, the shares continue to trade in a secondary market between investors.

Instituto Superior de Economia e Gestão
Título Financeira II - Licenciatura
Clara Raposo 2010-2011 7

Stock Markets

- **Largest Stock Markets**
 - New York Stock Exchange (NYSE)
 - Market Makers/Specialists
 - Each stock has only one market maker
 - NASDAQ
 - Does not meet in a physical location
 - May have many market makers for a single stock
 - Bid Price versus Ask Price
 - Bid-Ask Spread
 - Transaction cost

Instituto Superior de Economia e Gestão
Título Financeira II - Licenciatura
Clara Raposo 2010-2011 8

Worldwide Stock Markets Ranked by Two Common Measures

(a) Total Volume (\$ trillions)

(b) Total Value (\$ trillions)

Source: www.world-exchanges.org

Instituto Superior de Economia e Gestão
Título Financeira II - Licenciatura
Clara Raposo 2010-2011 9

Banking System

- As an alternative to issuing securities , corporations can raise funds in the banking system through loans
 - More common in Continental Europe and among small firms
- Money Market (interbank – LIBOR, EURIBOR)
- Foreign Exchange Market (spot)
