

# Introduction to Finance Concepts Part 1

BUAD 340

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# Overview

1.1 What is finance?

1.2 Areas of finance

1.3 Finance, accounting, and economics

1.4 Legal forms of business organizations

# 1.1 What is finance?

Finance is the study of how people and businesses evaluate investments and raise capital to fund them. (*how to get and use money*)

## Three Questions Addressed by the Study of Finance



What long-term investments should the firm undertake? (*capital budgeting decisions - how to spend the money*)



How should the firm fund these investments? (*capital structure decisions - how to get the money*)



How can the firm best manage its cash flows as they arise in its day-to-day operations? (*working capital management decisions*)

# What is finance?

- At the *macro level*, finance is the study of financial institutions and financial markets and how they operate within the financial system in both the American and global economies.
- At the *micro level*, finance is the study of financial planning, asset management, and fund raising for business and financial institutions

# What is finance? (con't)

- **Financial Services**
  - Design and delivery of advice and financial products to individuals, businesses, and government
- **Managerial Finance**
  - Duties of the financial manager

What is  
finance?  
(con't)

**Checkpoint**

**If you could use two words to describe  
finance, what would they be?**

## 1.2 The Four Basic Areas of Finance

- Corporate Finance
- Investments
- Financial Markets
- International Finance



## **Corporate Finance**

- Firm financial analysis
- Financial statement analysis, forecasting, cash flow analysis, current asset management, capital structure, and capital budgeting

# The Four Basic Areas of Finance (Con't)

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## **Investments**

- Investment opportunities evaluation
- Available investment instruments
- Ways capital markets currently work
- Consideration of ways for evaluating current investments and futures in the financial market

## Financial Markets

- Short Term: Money Markets
  - CD's
  - Treasuries
- Long Term: Capital Markets
  - Stocks
  - Bonds

# The Four Basic Areas of Finance (Con't)

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## **International Finance**

- May refer to financial between nations
- A nation's international financial transactions
- A firm's international financial transactions

## **Checkpoint**

Which of the four finance fields is the broadest?

# The Four Basic Areas of Finance (Con't)



# 1.3 Finance, Accounting, and Economics

# The Language of Finance

- Accounting is the language of finance
  - All finance professionals need some knowledge of accounting
    - Level depends on job
      - Financial analyst needs to know LOTS of accounting
      - Stockbrokers not as much

# Accounting and Finance Broad Portrayal vs. Cash Flow

- Accounting statements portray physical activity in numbers
    - Descriptive
    - Historical
  - E.g. Depreciation
- 
- The focus in Finance is on future cash flow
  - In finance:  
**Cash is King**




# Finance and Accounting

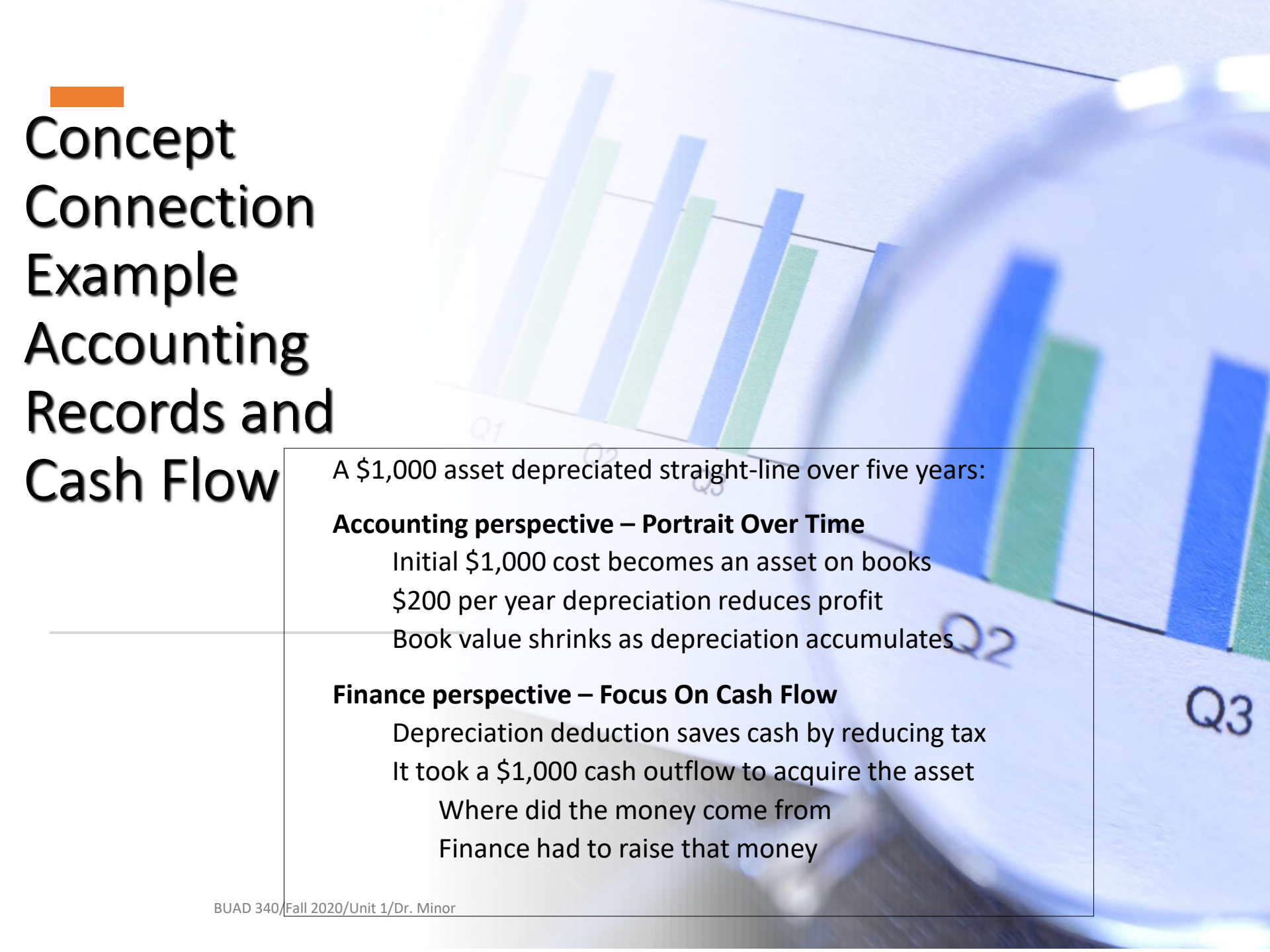
Finance department generally consists of both the accounting and treasury departments

- Controller is in charge of the accounting department
- Treasury department deals with other financial activities





# Concept Connection Example Accounting Records and Cash Flow



A \$1,000 asset depreciated straight-line over five years:

## **Accounting perspective – Portrait Over Time**

Initial \$1,000 cost becomes an asset on books

\$200 per year depreciation reduces profit

Book value shrinks as depreciation accumulates


## **Finance perspective – Focus On Cash Flow**

Depreciation deduction saves cash by reducing tax

It took a \$1,000 cash outflow to acquire the asset

Where did the money come from

Finance had to raise that money

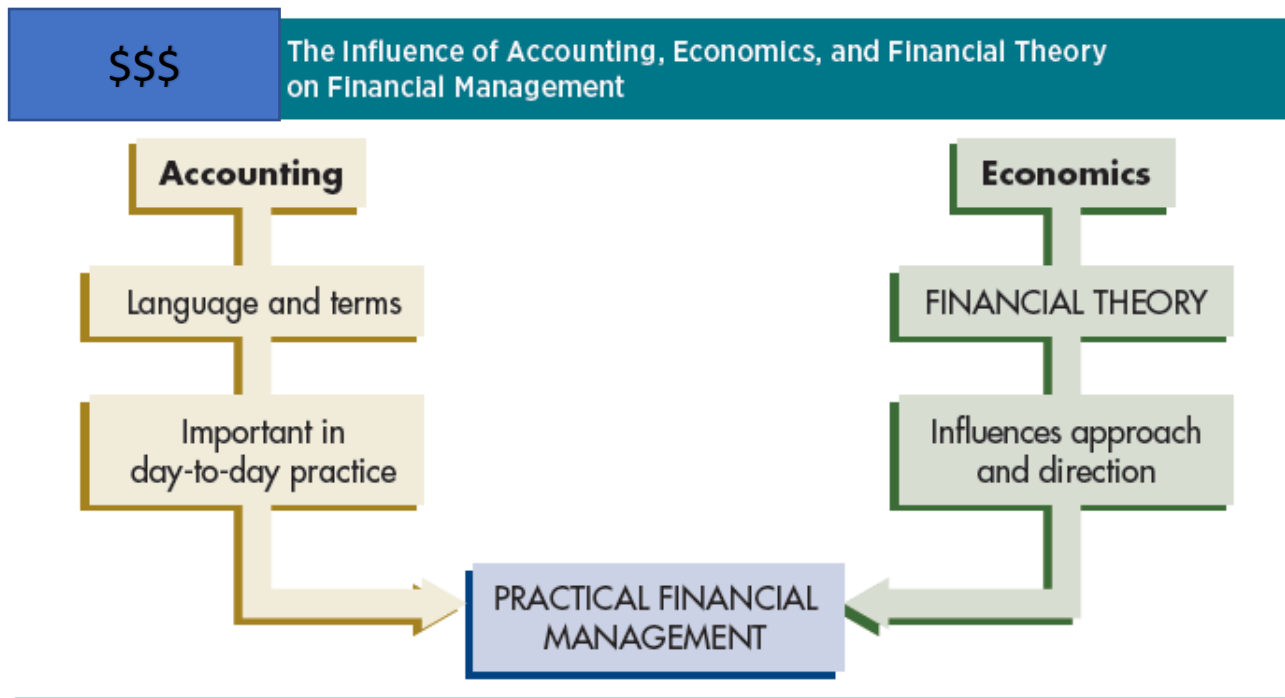
The background of the slide is a close-up, shallow depth-of-field photograph of a document. A silver pen is visible in the upper right corner, resting on the paper. A blue line graph is drawn on the document, showing an upward trend with some fluctuations. The overall color palette is light blue and white, with a dark blue geometric shape on the left side containing the text.

Economics, especially  
macroeconomics,  
provides analysis of  
the overall economy  
crucial in decision  
making

# Financial Theory—The Relationship with Economics

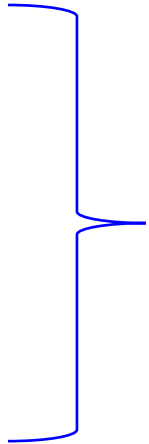
- Modern financial theory began as a branch of economics in the 1950s
  - Originally called “financial economics”
  - Theoretical tools are very similar
- Finance is a separate but still related field

# The Influence of Accounting, Economics and Financial Theory on Financial Management



# 1.4 Three types of business organizations

# Three types of business organizations

1. Sole proprietorships
  2. Partnerships
  3. Corporations
- 
- Hybrids

# Sole Proprietorship

- It is a business owned by a single individual that is entitled to all the firm's profits and is responsible for all the firm's debt.
- There is no separation between the business and the owner when it comes to debts or being sued.
- Sole proprietorships are generally financed by personal loans from family and friends and business loans from banks.



# Sole Proprietorship

- Advantages:
  - Easy to start
  - No need to consult others while making decisions
  - Taxed at the personal tax rate
- Disadvantages:
  - Personally liable for the business debts
  - Ceases on the death of the proprietor

- A *general partnership* is an association of two or more persons who come together as co-owners for the purpose of operating a business for profit.
- There is no separation between the partnership and the owners with respect to debts or being sued.

# Partnership

- Advantages:
  - Relatively easy to start
  - Taxed at the personal tax rate
  - Access to funds from multiple sources or partners
- Disadvantages:
  - Partners jointly share unlimited liability

# Partnership

# Limited Partnership

- In limited partnerships, there are two classes of partners: general and limited.
- The general partners runs the business and face liability for the firm's debts, while the limited partners are only liable on the amount invested.
- One of the drawback of this form is that it is difficult to transfer the ownership of the general partner.

# Corporation



Corporation is “an artificial being, invisible, intangible, and existing only in the contemplation of the law.”



Corporation can individually sue and be sued, purchase, sell or own property, and its personnel are subject to criminal punishment for crimes committed in the name of the corporation.



Corporation is legally owned by its current stockholders.



The Board of directors are elected by the firm’s shareholders. One responsibility of the board of directors is to appoint the senior management of the firm.