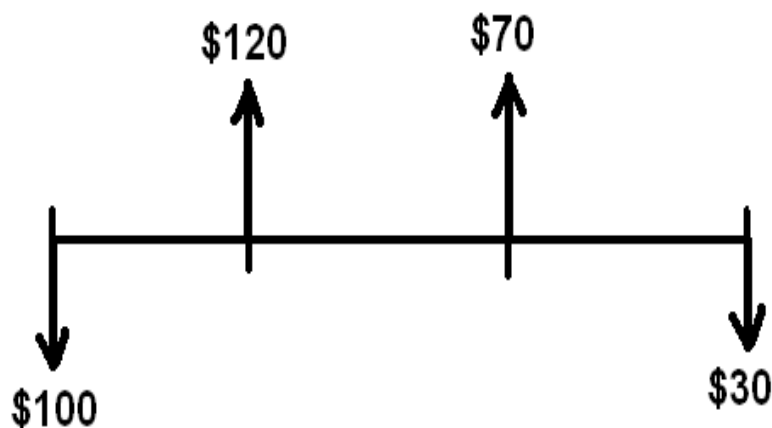


## *Econ 134A—Introduction to Finance*

- Finance is the interaction of time, money, and uncertainty (risk).
- Cash flows (with certainty):



# *Types of Business Organizations*

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## 1. Sole Proprietorship

- No Corporate income tax
- Unlimited liability
- Limited by initial owner

## 2. Partnership

- Most partners' liability limited
- Still difficult to raise cash
- Income taxed as personal income

# *Types of Business Organizations II*

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## 3. Corporation

- Easy transfer of ownership
- Unlimited life
- Limited liability
- Separation of ownership and management
- Double taxation

# Financing the Firm

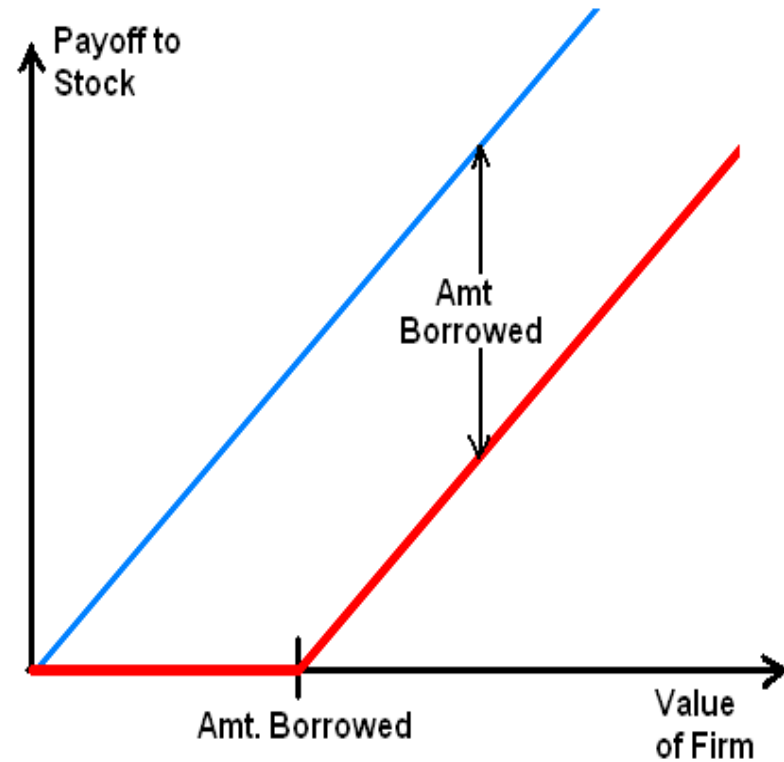
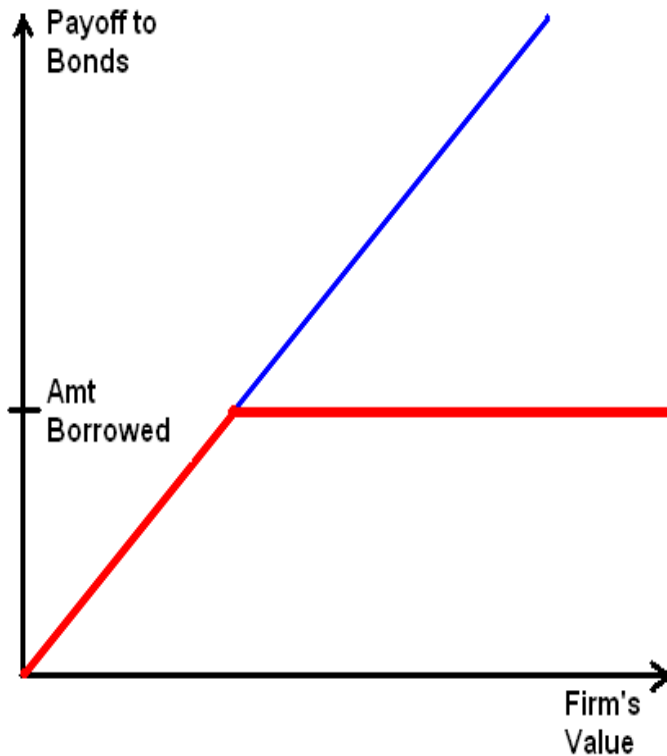
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Two ways for firms to obtain capital

- Issue debt (bonds)
- Issue ownership shares (stocks)

The firm has to pay off the bondholders first. The residuals go to the stockholders

## Graphically, the payoffs are:



# Financial Decisions facing the firm

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Capital Budgeting decision:

- What projects in which to invest.

Financing decision:

- How to raise the money.

# *Content of the course*

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## The Capital Budgeting decision

- Net Present Value
- Stock Markets

## The Financing Decision

- Market Efficiency/Modigliani-Miller Theorems

# The financial manager controls the cash flows.

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1. Initial issue of securities
2. Investment in Assets
3. Cash flows from operations
4. Cash to the government for taxes
5. Cash reinvested in the firm
6. Interest and dividends to investors

# What is the goal of a corporate firm?

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Shareholders want the value of the firm maximized.

But the managers may have other goals.

How to synchronize the goals?

- Shareholders vote on the Board of Directors
- Incentives in contracts
- Market Rationality

# Assumptions

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The following assumptions will be made throughout the class.

- Markets are:
  - Perfect
  - Efficient, and
  - Complete.