

Learning Outcome

Upon completion of this subject, students will be able to:

- 1] Understand the basic principles related to finance and financial management.
- 2] Familiarize with the role and functions of financial institutions.
- 3] Appreciate how finance and its management helps business to prosper Malaysia.
- 4] Apply basic capital investment tools



Week 1 - The Corporate Goal

What is accounting?

Accounting is a system where records are to respond to managing finance of the firm. It is like a mirror. It involves a lot of processes such as identifying, measuring, and reporting for the purposes below.



(a) **Financial Performance**

Income statement tells us the gain or loss of the result.

(b) **Financial Position**

Balance Sheet tells us position or relation of asset and liability of the firm.

Week 1 - The Corporate Goal

What is finance?

Knowledge is concerned with the maintenance and creation of economic value or financial wealth of company. This is related to the decision making.



1] Financing decision

How much financial resources are enough to put in projects?

2] Investing decision

Where should the finance be put in projects?

Week 1 - The Corporate Goal

What is finance? (cont')

3] Dividend decision

What is the optimal dividend to be declared in order to satisfy shareholder's expectation?



Week 1 - The Corporate Goal

What is financial management?

It is extension of accounting knowledge whereby the objective is to maximize the value of the firm by

- 1] the use of investment (long-term source), and
- 2] working capital planning (short term source).

Therefore, the primary objective of finance manager is to use various methods of employing capital so as to maximize wealth of firm and improve benefits of employees and satisfy various stakeholders.

Week 1 - The Corporate Goal

What is the prime objective of a firm?

It is to maximize the market value of the firm. Specifically, the main objective of a company should be to **maximize the wealth of its ordinary shareholders.**



It must be noted that the wealth of the shareholders in a firm comes from dividends received

and

the market value of the shares.

Week 1 - The Corporate Goal

What is the prime objective of a firm? (cont'd)

Again, the preferred goal of the firm is **maximizing shareholders' wealth.**

That is, maximization of the market value of ordinary share of existing shareholders because the effects of all financial management decisions are thereby included in the value.



Week 1 - The Corporate Goal

What is prime objective of a firm? (cont'd)

However, there is another goal for firm - **profit maximization**.

In economic theory, firm's objective is to maximize the profit. It stressed the efficient use of the capital resources (such as fixed assets).

But in microeconomics context, it ignores uncertainty and risk because they ignore the real world complexities.

Week 1 - The Corporate Goal

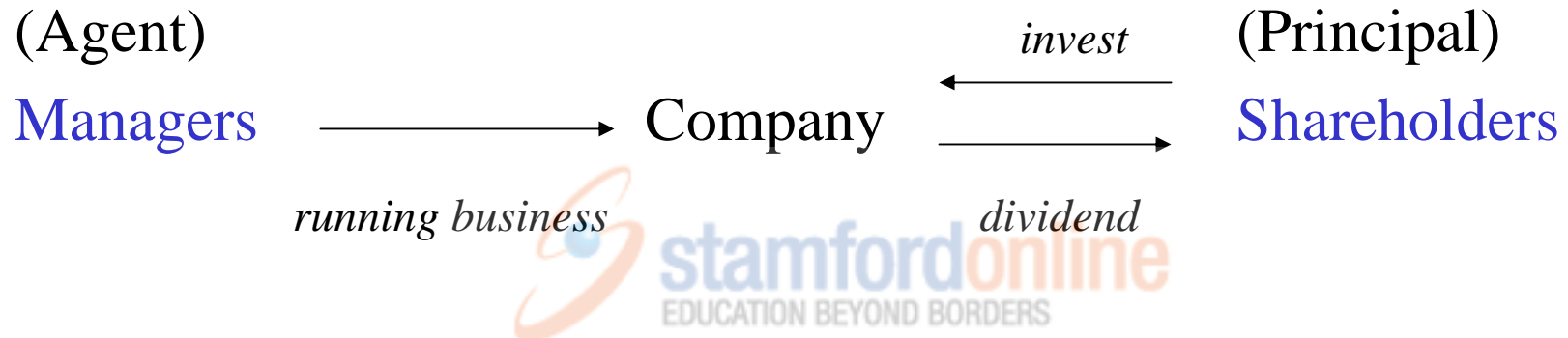
What is the prime objective of a firm? (cont'd)

Accounting profits fail to recognize one of the most important cost of doing business.

When we calculate accounting profits, we consider interest expense as a cost of borrowing money, but we ignore the cost of the funds provided by the firm's shareholders (Owners).

Week 1 - The Corporate Goal

What is agency problem?



The managers may have personal goals that compete with shareholder wealth maximization.

Managers are empowered by the shareholders to make decisions, and that creates a potential conflict of interest known as agency theory.

Week 1- The Corporate Goal

What is agency problem? (cont'd)

If the owner-manager incorporates and then sells some shares to outsiders, conflicts may arise, that is the owner-manager may decide to lead a more relaxed lifestyle and not work as strenuously to maximize shareholder wealth, because less of this wealth will accrue to him or her.

Also, the owner-manager may decide to consume more prerequisites, because some of those costs will be borne by outside shareholders.

Week 1 - The Corporate Goal

What is agency problem? (cont'd)

Managers can be encouraged to act in stockholders' best interests through incentives rewarded to them for good performance but punish them for poor performance. There are some specific mechanism to motivate managers as given below:

- (a) **Managerial compensation** (give some shares to sustain the good manager).
- (b) **Direct intervention by shareholders**
- (c) **Threat of firing**
- (d) **Threat of takeovers**