

Chapter 16

Understanding Financial Management and Securities Markets

**THE FUTURE OF BUSINESS:
The Essentials
Gitman & McDaniel
2nd Edition**



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Learning Goals

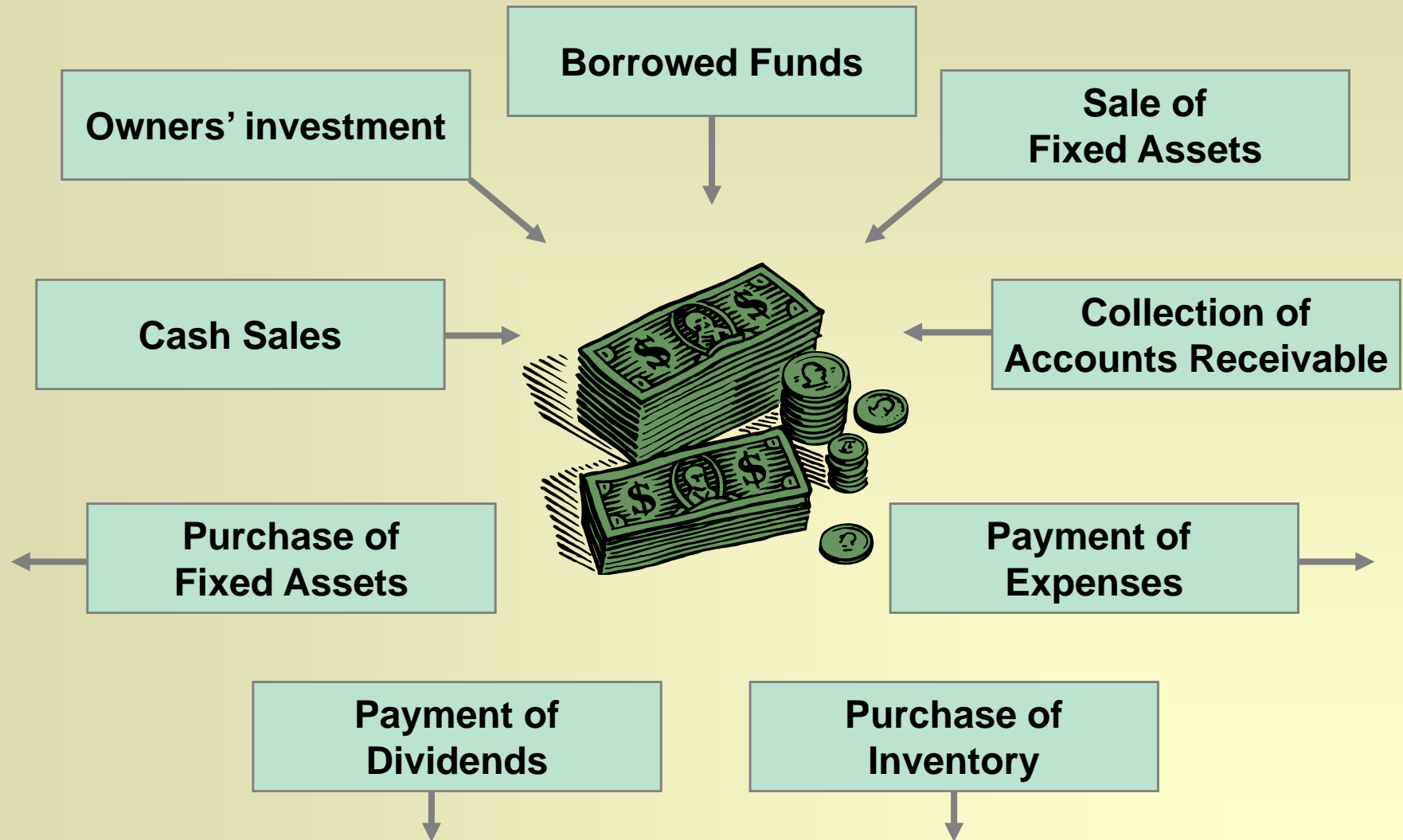
- 1 How do finance and the financial manager affect the firm's overall strategy?**
- 2 What types of short-term and long-term expenditures does a firm make?**
- 3 What are the main sources and costs of unsecured and secured short-term financing?**
- 4 What are the key differences between debt and equity, and what are the major types and features of long-term debt?**



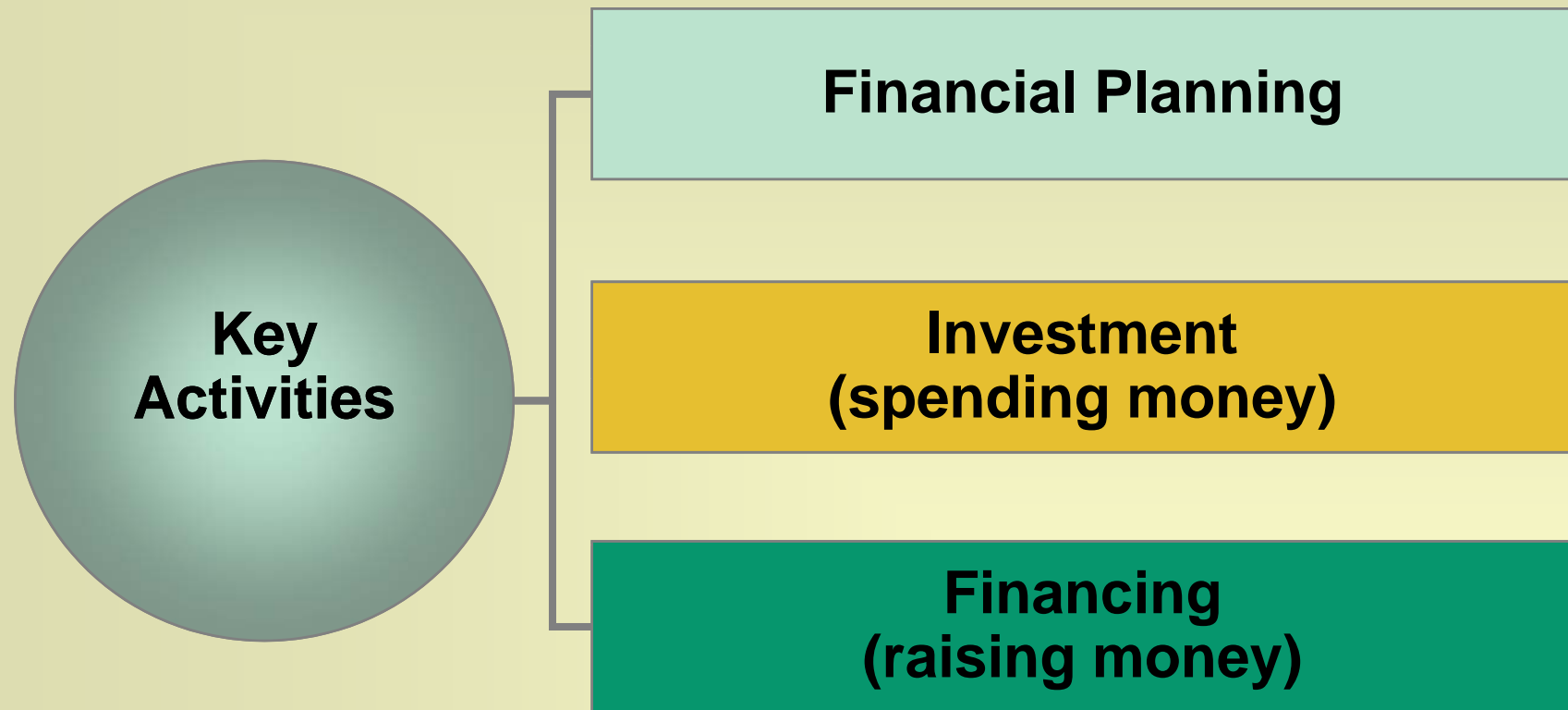
Learning Goals (continued)

- 5 When and how do firms issue equity, and what are the costs?**
- 6 How do securities markets help firms raise funding, and what securities trade in the capital markets?**
- 7 What are the major U.S. securities exchanges and how are they regulated?**
- 8 What are the current trends in financial management and the securities markets?**

How Cash Flows Through a Business



The Financial Manager's Responsibilities



Risk and Return Factors

Changing Patterns of Market Demand

Interest Rates

General Economic Conditions

Market Conditions

Social Issues

How Organizations Use Funds

Short-Term Expenses

Operating expenses

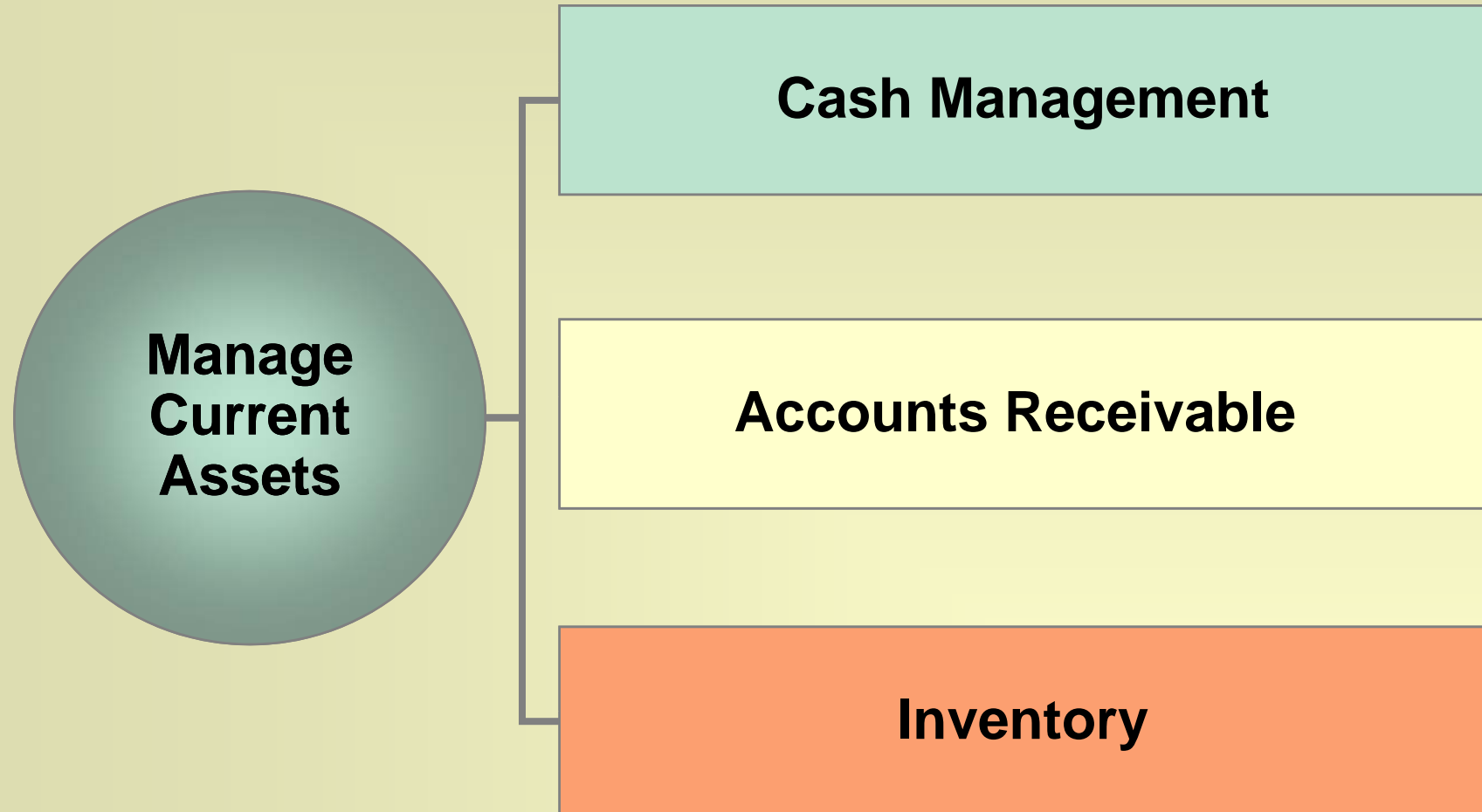
Support current selling and production activities

Long-Term Expenditures

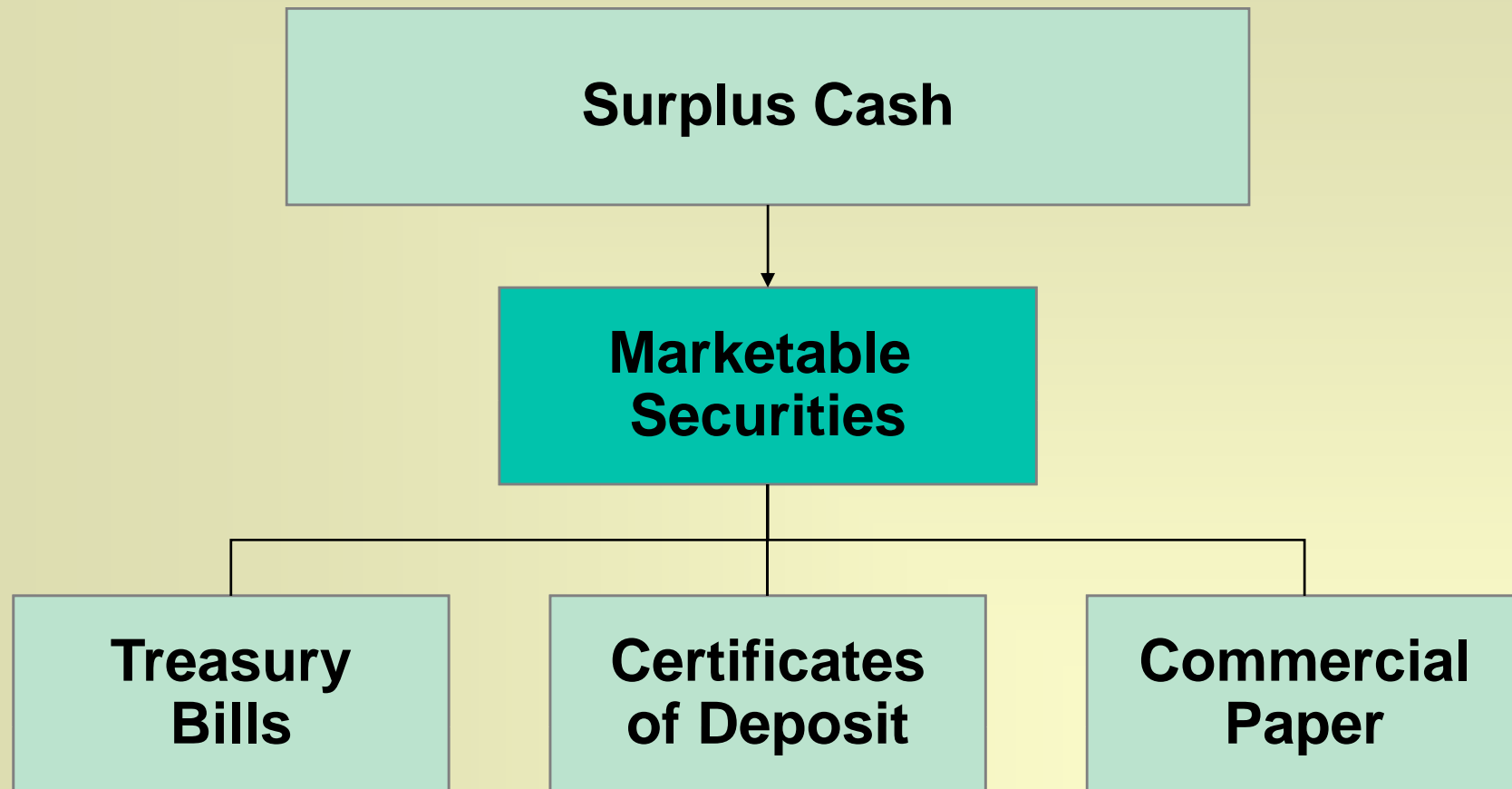
Investment in long-lived assets

Expansion, asset replacement, new product development

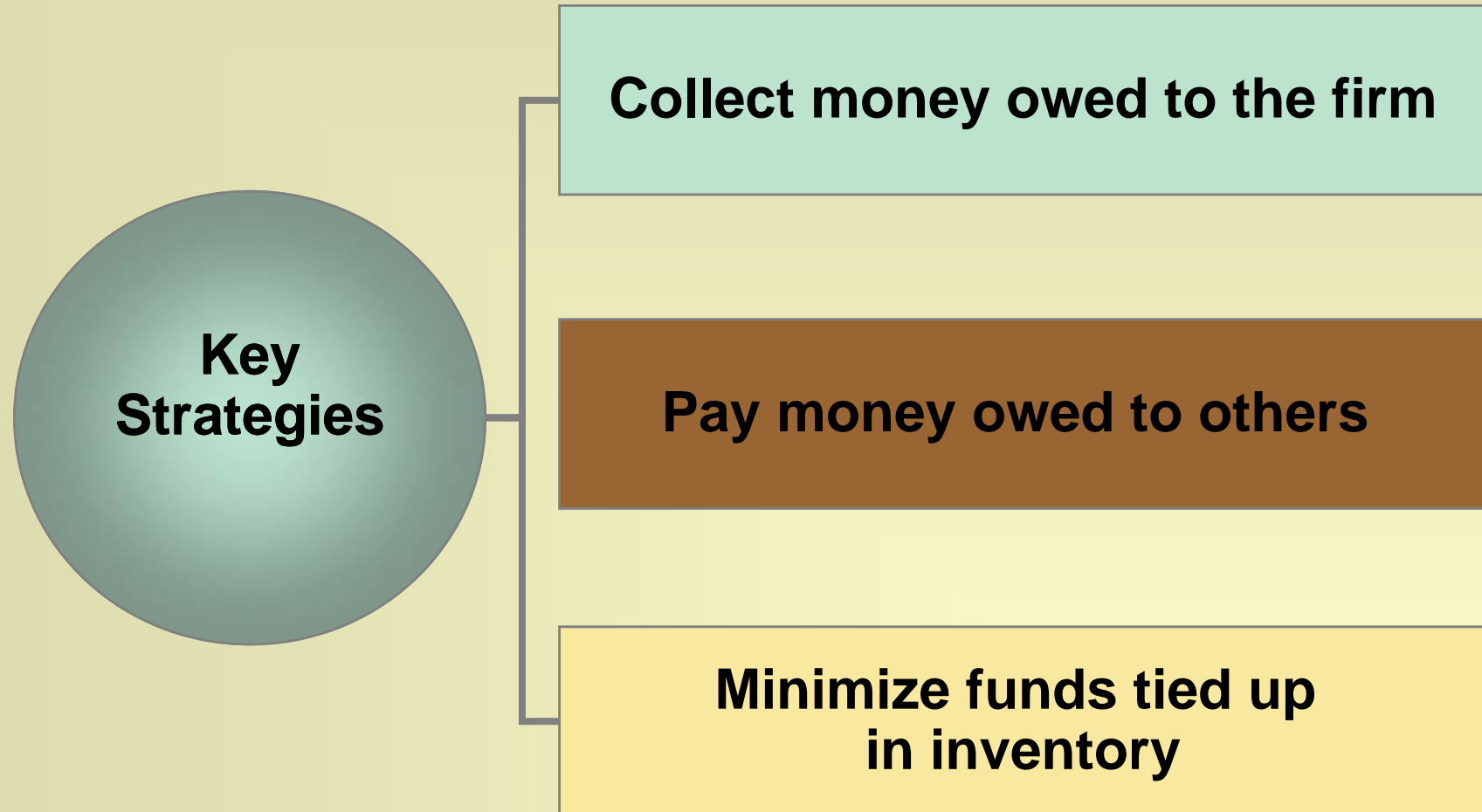
Short-Term Expenses



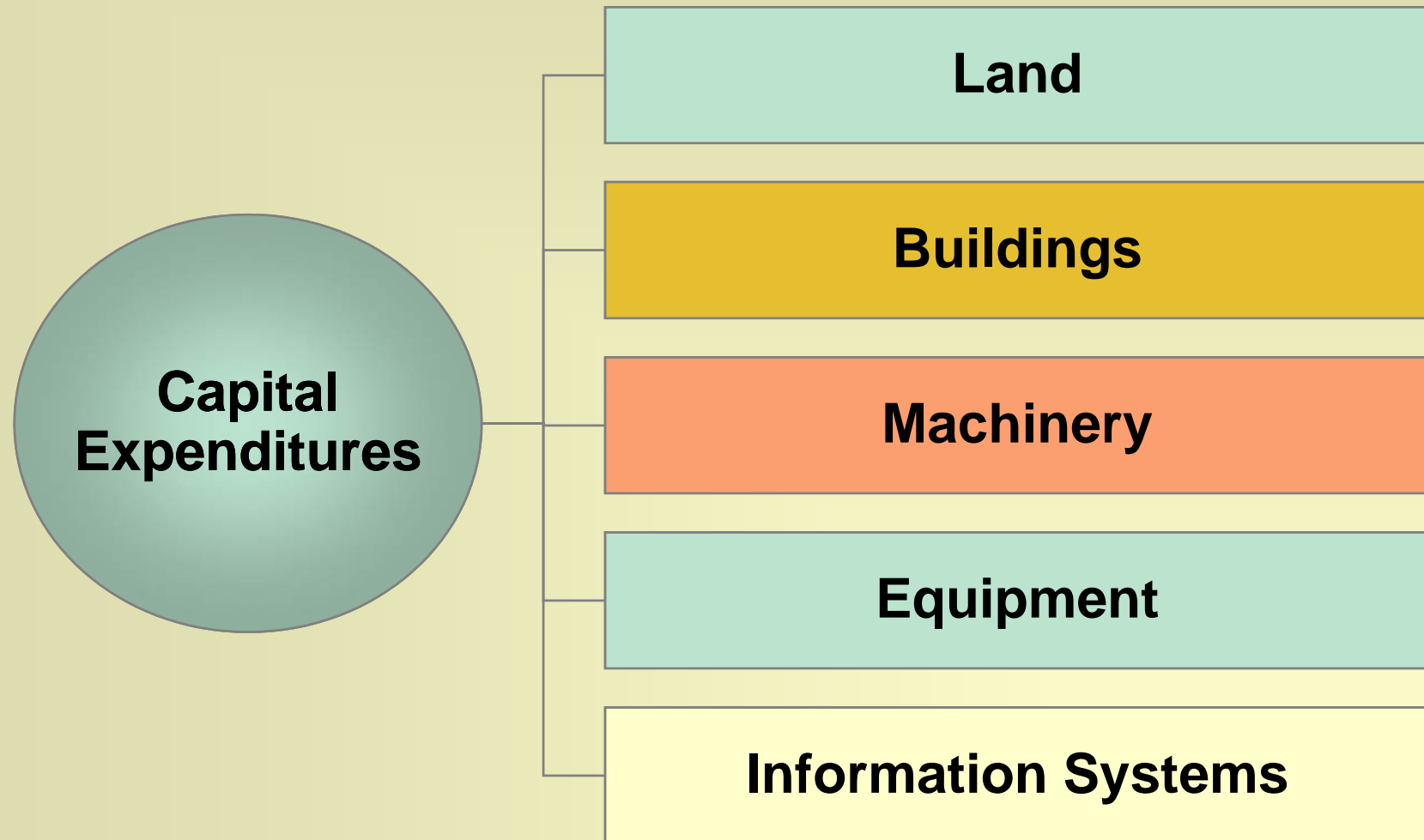
Cash Management



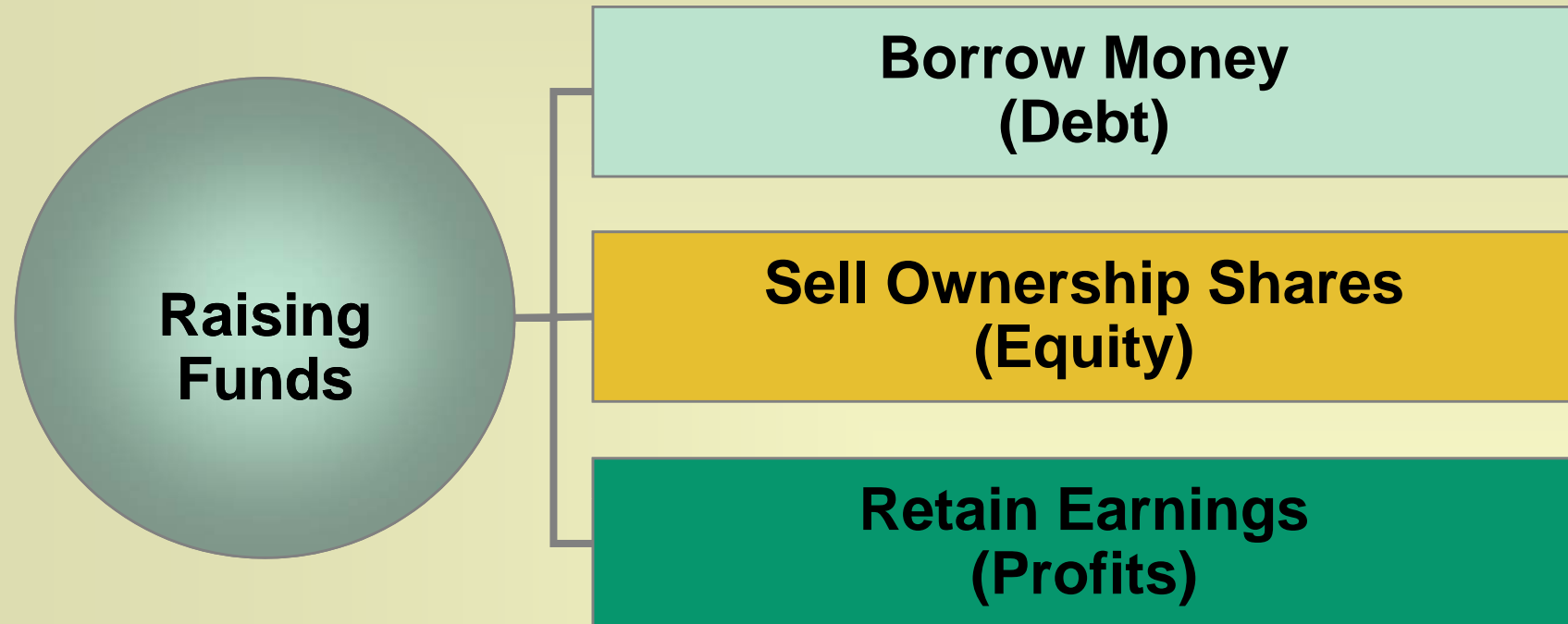
Cash Management



Long-Term Expenditures



Obtaining Short-Term Financing



Unsecured Short-Term Loans

Trade Credit

Seller extends credit to the buyer

Bank Loans

- Lines of credit
- Revolving credit agreement

Commercial Paper

Unsecured short-term debt issued by a financially strong corporation

Secured Short-Term Loans

Secured Loans

Borrower pledges specific assets as *collateral*, such as accounts receivable or inventory.

Factoring

Firm sells its accounts receivable to a *factor*, such as a commercial bank or commercial finance company.

Debt versus Equity Financing

	Debt Financing	Equity Financing
Voice in management	Creditors typically have none, unless borrower defaults on payments. Creditors may be able to place restraints on management in event of default.	Common stockholders have voting rights.
Claim on income and assets	Debt holders rank ahead of equity holders. Payment of interest and principal is a contractual obligation of the firm.	Equity owners have a residual claim on income (dividends are paid only after interest and any scheduled principal payments are paid) and assets. The firm has no obligation to pay dividends.
Maturity	Debt has a stated maturity and requires repayment of principal by a specified maturity date.	The company is not required to repay equity, which has no maturity date.
Tax treatment	Interest is a tax-deductible expense.	Dividends are not tax-deductible and are paid from after-tax income.

Debt Financing

Term Loans

A business loan with a maturity of more than one year.

Bonds

Long-term debt obligations issued by corporations and governments.

Mortgage Loans

A long-term loan made against real estate as collateral.

Equity Financing

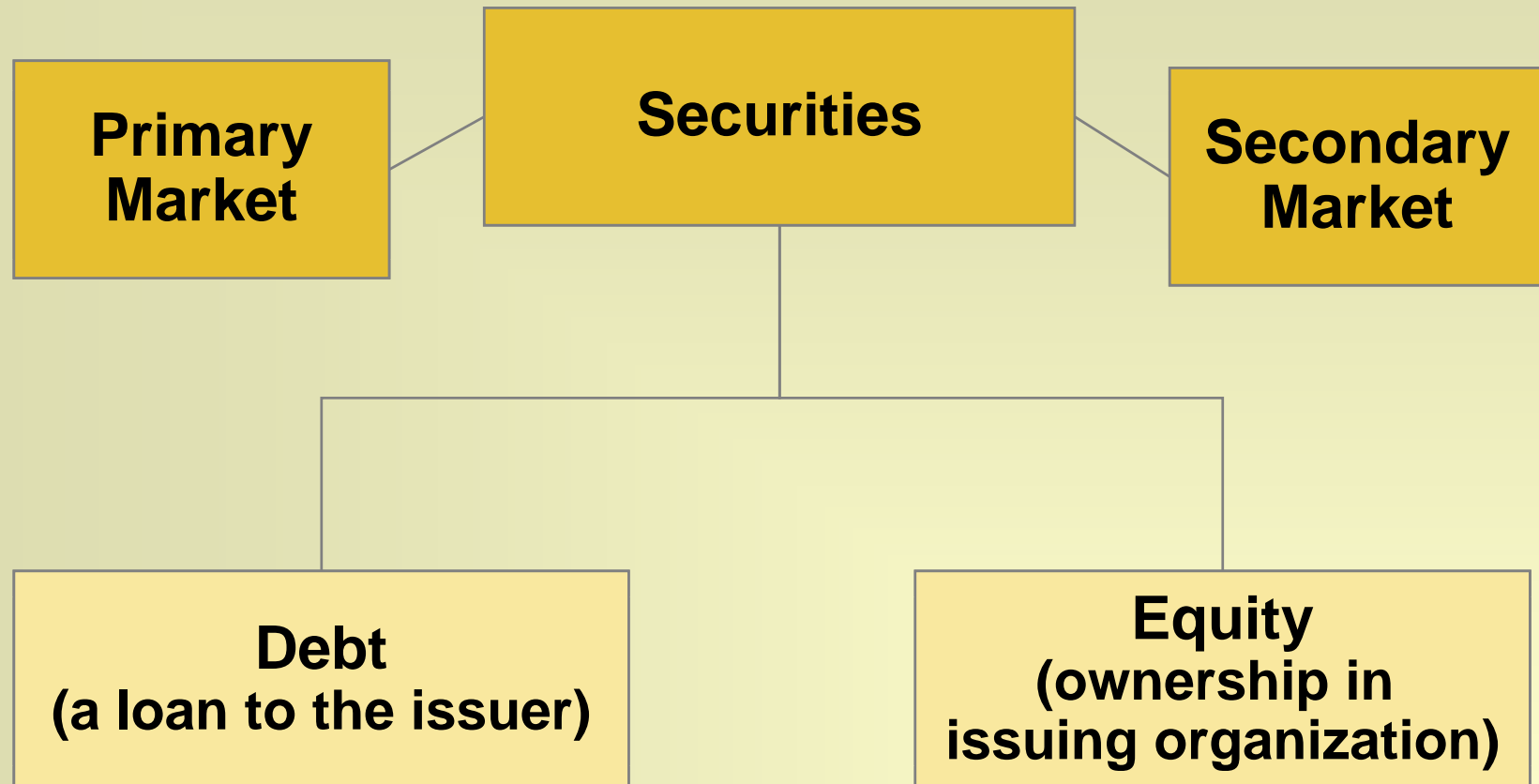
Selling Common Stock

Dividends & Retained Earnings

Preferred Stock

Venture Capital

Securities Markets



Securities Markets

**Investment
Bankers**

**Help companies raise
long-term financing,
a process called
*underwriting***

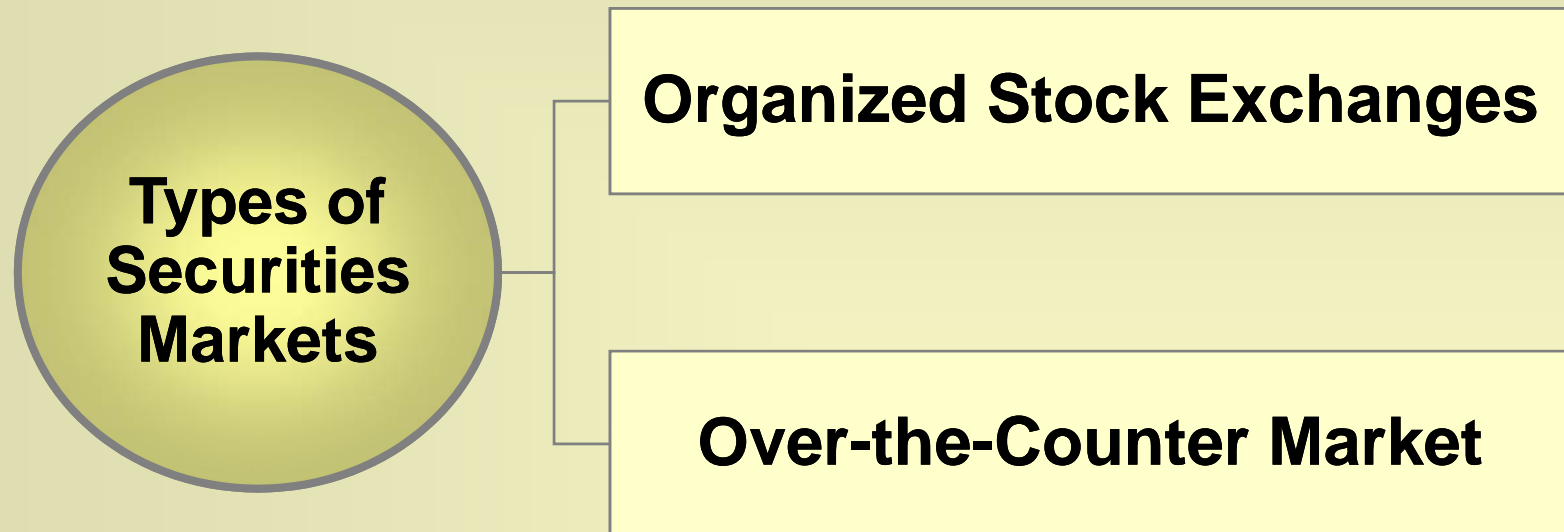
Stockbroker

**A person
(*account executive*)
licensed to buy
and sell securities on
behalf of clients**

Moody's and Standard & Poor's Bond Ratings

Moody's Ratings	S & P Ratings	Description
Aaa	AAA	Prime-quality investment bonds: Highest rating assigned; indicates extremely strong capacity to pay.
Aa	AA	High-grade investment bonds: Also considered very safe bonds, although not quite as safe as Aaa/AAA issues; Aa/AA bonds are safer (have less risk of default) than single As.
A	A	
Baa	BBB	Medium-grade investment bonds: Lowest of investment-grade issues; seen as lacking protection against adverse economic conditions.
Ba	BB	Junk bonds: Provide little protection against default; viewed as highly speculative.
B	B	
Caa	CCC	Poor-quality bonds: Either in default or very close to it.
Ca	CC	
C	C	
	D	

Securities Exchanges

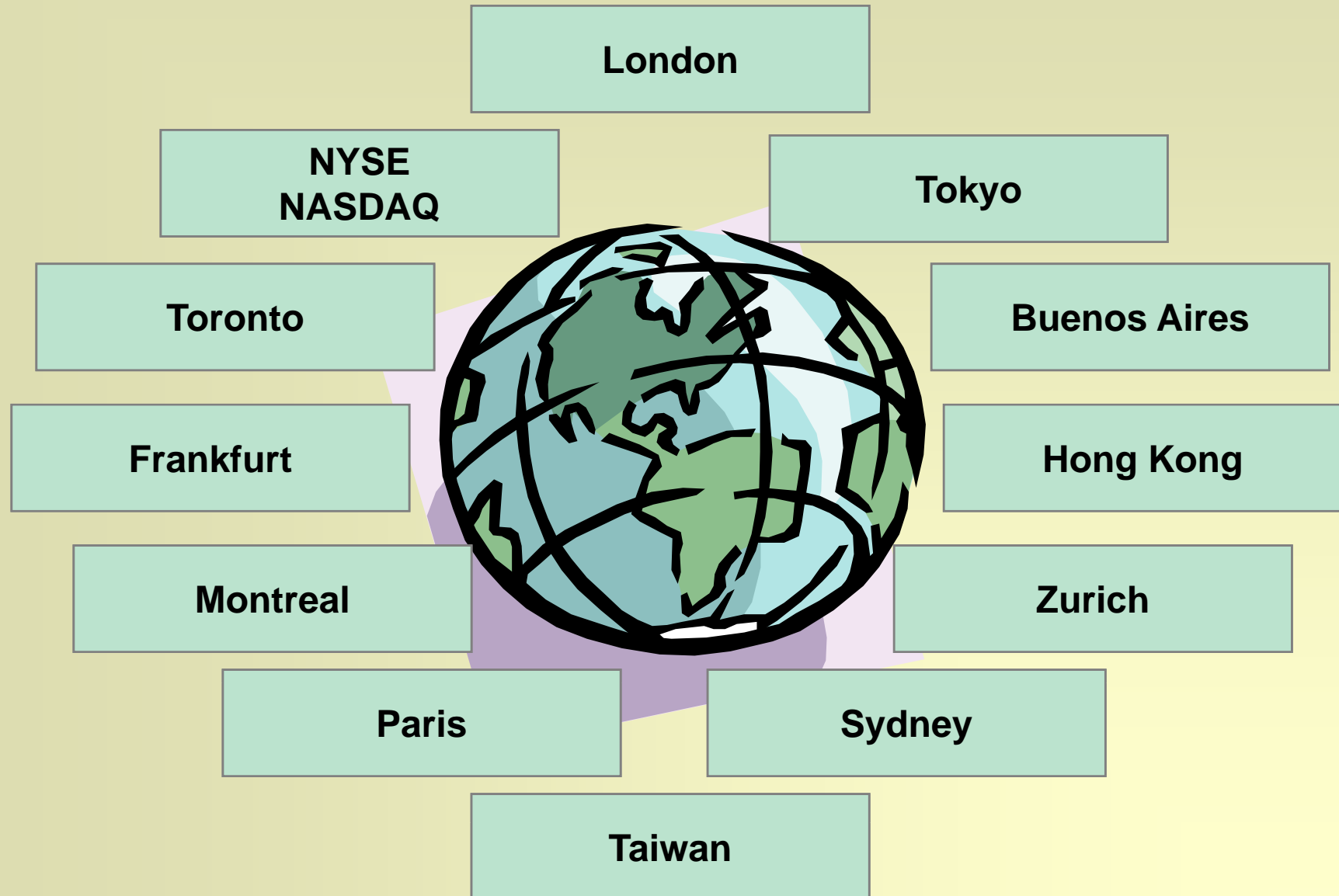


U.S. Stock Exchanges

**New York Stock Exchanges
(NYSE)**

**American Stock Exchange
(AMEX)**

Global Trading and Foreign Exchanges



Regulation of Securities Markets

Securities and Exchange Commission

The main federal government agency responsible for regulating the U.S. securities industry.

Insider Trading

The use of information that is not available to the general public to make profits on securities transactions.

Circuit Breakers

Measures that, under certain conditions, stop trading in the securities markets to limit the amount the market can drop in one day.