

Real Vs Financial Assets

April-16-12
6:54 PM

Finance: the study of how and under what terms savings are allocated between lenders and borrowers.

Balance Sheet: Snapshot of assets and liabilities at a particular time

- 1) Individuals
- 2) Businesses
- 3) Government

Real Assets: Tangible things that compose personal and business assets

Asset Acquisitions: Capital Expenditure decisions

Liability side is how we finance expenditures = ***Corporate Finance Decisions***

Financial Asset: What one individual has lent to another.

The Financial System

April-16-12
7:24 PM

Intermediaries

Intermediation: The transfer of funds from lenders to borrowers

Financial Intermediaries: Entities that invest funds on behalf of others and change the nature of the transactions

Market Intermediaries: Make market transactions better

Market Intermediary: An entity that facilitates the working of markets and helps provide direct intermediation but does not change the nature of the transaction; **also called a broker**

-Where Financial institutions intermediate.

The *Ultimate Lenders* have **Indirect claim from** *Ultimate Borrower* and **Direct Claim** from the institution

Crown Corporations: Government -owned companies that provide goods and services needed by Canadians

Review

3 Channels of Savings

- 1) *Direct Intermediation*
-**Ultimate Lender to Borrower**
- 2) *Market Intermediation*
- **Help find lender**
- 3) *Financial Intermediation*
-**Lender to Financial Institution to Ultimate Borrower**

Financial Instruments & Markets

April-16-12
7:30 PM

Financial Assets are formal legal documents that set out the rights and obligations of all the parties involved.

- **Debt Instruments:** Legal obligations to repay borrowed funds at specified maturity date and to provide interim interest payments
- **Equity Instruments:** Ownership stakes in a company
- **Common Share:** An equity instrument that represents part ownership in a company and usually gives voting rights on major decisions affecting the company
- **Preferred Shares:** Equity instruments that usually entitle the owner to fixed dividend payments that must be made before any dividends are paid to common shareholders
- **Non-marketable Financial Assets:** Invested funds that are available on demand in instruments that are not tradable
e.g.. savings accounts or demand deposits
- **Marketable Financial Assets:** Those assets that can be traded among market participants
e.g.. Traditional Bonds
- **Money Market Securities:** Short-term debt instruments
- **Capital Market Securities:** Debt securities with maturities greater than one year, and equity securities

Canadian Crap

Toronto Stock Exchange (TSX)

TSX Venture Exchange

TSX Group Inc. = Company

TSX Markets: Performs operations on TSX+TSX Venture

Market Capitalization: Total market value of the securities of an equity

Winnipeg Commodity Exchange

Ontario Securities Commission (OSC): Protect investors in transactions

CNQ= Alternate trading market for small companies

Third Market: The trading of securities that are listed on organized exchanges in the OTC market

Fourth Market: The trading of securities between investors without the involvement of brokers or dealers

Markets

- 1) **Primary Markets**
Markets that involve the issue of new securities by the borrower in return for cash from investors
- 2) **Secondary Markets**
Trading environments that permit investors to buy and sell existing securities
 - **Exchanges/Auction Markets**
Secondary Markets that involve a bidding process that takes place in specific location
 - **OTC(Over Counter)**
Do not have a physical location and consist of a network of dealers who trade directly with one another

Bootstrapping

April-16-12
7:30 PM

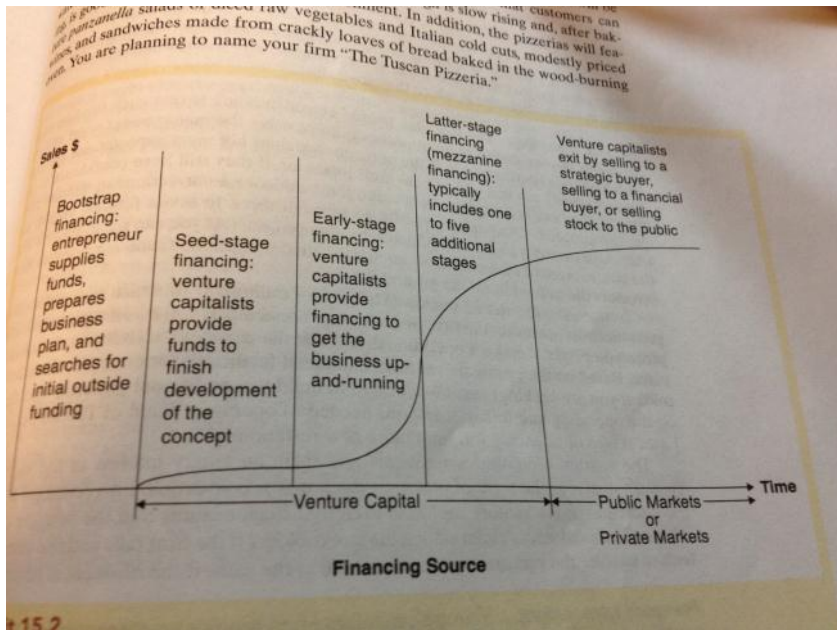
Bootstrapping: Process by which many entrepreneurs raise "Seed" money and obtain other resources necessary to start their businesses

Venture Capital

April-16-12
7:52 PM

Venture capitalists: Individuals or firms that help new businesses get started and provide much of their early-stage financing

Individual venture capitalists are known as **Angel investors**



Why Venture Capital Funding Doesn't Work

- 1) **High Degree of Risk**
Most new businesses fail
Tend to lend to firms with tangible assets, not to firms with patents
- 2) **Types of Productive Assets**
Informational asymmetry problems
Inability to determine competent from incompetent entrepreneurs

How Venture Capitalists Reduce their Risk

- 1) **Staged Funding**
- 2) **Personal Statement**
- 3) **Syndication**
Originating venture capitalist sells percentage of a deal to other venture capitalists
- 4) **In-Depth Knowledge**
Comparative Advantage of venture Capitalist

Exit Strategies

- 1) **Strategic Buyer**
Sell firm's equity to a strategic buyer in the private market
- 2) **Financial Buyer**
Financial group (Often private equity firm) buys the new firm with the **intention of holding it for a period of time and selling it for a higher price**
- 3) **Initial Public Offering**
Taking the company public through IPO. Sell shares over time

Initial Public Offering

April-16-12
8:12 PM

Seasoned Public Offering: Sale of securities by a firm that already has similar publicly traded securities outstanding.
After IPO

Advantages of going Public

- 1) Larger equity capital
- 2) Easier for firms to reach investors
- 3) Seasoned public offerings at low cost
- 4) Entrepreneur doesn't have to sell all shares
- 5) Easier for firm to attract top management

Disadvantages of going Public

- 1) High cost of IPO
- 2) Cost of complying with SEC is high
- 3) Transparency can be costly to some firms
- 4) Managers have to focus on short term profits to show investors that they are worth investing in

Preliminary Prospectus:

The initial registration statement filed with SEC by a company preparing to issue securities in the public market; *contains detailed information about the issuer and the proposed issue*

Firm-commitment underwriting:

Underwriting agreement in which the underwriter purchases securities for a specified price and resells them

Best-effort underwriting:

Underwriting agreement in which the underwriter does not agree to purchase the securities at a particular price, but promises to make only best efforts to sell as much of the issue as possible above a certain price

Underwriting Syndicate

Group of underwriters that join forces to reduce underwriting risk

Dividends

April-16-12
8:22 PM

Dividends: Something of value distributed to firm stockholders

Special Dividend: One time payment to stockholders that is normally used to distribute large amount

Liquidating dividend: Final dividend paid when firm is liquidating

- 1) Board votes to pay dividend
- 2) Public announcement - Intent, amount and recorded date
- 3) Payable date- Date dividend is paid

Declaration Date: date dividend is announced

Ex-dividend date: First day on which a stock trades without rights to dividend

Record Date follows by 2 days of ex-dividend date

Stock Repurchases

April-17-12
1:08 AM

Stock Repurchase: Purchase of stock by a company from shareholders; Alternative way for company to distribute value to its stockholders

Open-market repurchase: Repurchase in open market

Tender Offer: Open offer by a company to purchase shares

Targeted Stock Repurchase: Stock repurchase that targets a specific stockholder

Stock Dividends and Stock Splits

April-17-12
1:10 AM

Stock Dividend: Distribution of new shares to existing stockholders

Stock Split: Distribution of new shares to existing stockholders that is not associated in any change in the assets held by firm; Larger increases in number of shares

Reasons

- 1) Make shares more attractive to investors

Setting a Dividend Policy

April-17-12

1:27 AM

- 1) Firms have long term payouts
- 2) Dividend changes follow shifts in long-term sustainable earnings
- 3) Managers focus more on dividend changes that on the level of the dividend
- 4) Managers are reluctant to make dividend changes that might have to be reversed

Introduction

April-17-12
1:29 AM

Equity- Derivatives Securities: Securities that derive their value in whole or in part by having claim on the underlying common stock

Options: Claims that give holder right to buy or sell a stated number of shares of stock within specified time and price

Call: Gives holder right to buy specified number of shares at stated price within specified time period

Put: Gives holder right to sell a specified number of shares at stated price within a time period

Exercise (Strike) Price: Per Share price at which the common stock may be purchased from or sold to a writer

Expiration Date: Date option expires

Option Premium: Price paid by option buyer to seller of option

Long Term Options (LEAPs): Options greater than one year

Intrinsic Value: The value of an option if today was the expiration

$E - S$, Cannot be less than 0

Expectations:

- **Call writer** expects stocks to remain unchanged or move down
- **Call buyer** expects price to move upward and soon
- **Put writer** expects the price to remain steady or go up
- **Put Buyer** expects price to move down

In/Out the money

S= Price of Stock

E= Exercise Price

- $S > E \implies$ Call is in the money, Put is out the money
- $S < E \implies$ Call is out the money, Put is in the money
- $S = E$ Option is at the money

Introduction

April-17-12
1:42 AM

Current Futures Markets

- 1) Commodities
- 2) Financials
E.g. Foreign currencies

Futures Contract: Agreement providing for the future exchange of a particular asset between buyer and seller at a specified date for a specified amount

Short Position: Agreement to sell an asset at specified future date at specified price

Long Position: Agreement to purchase an asset at specified future date at specified price

Offset: Liquidation of futures position by offsetting a transaction; Buyers sell their position and sellers by their positions prior to settlement of contract

Futures Margin: The good faith deposit made by the buyer or seller to ensure completion of contract

Marked to the Market: All profits and losses on a contract are recorded to each investor's account

Short Hedge: Transaction involving the sale of futures while holding the asset

Long Hedge: Transaction where the asset is currently not held but futures are purchased to lock in current prices

Basis= Cash Price - Futures Price

Advantages of Speculating in Futures Market

- 1) Leverage: Magnification of gain
- 2) Ease of Transacting
- 3) Transaction costs: Smaller in futures markets

Types of Takeovers

April-17-12
1:49 AM

Takeover: Transfer of control from one ownership to another

Acquisition: The purchase of one firm by another

Merger: Combination of two firms into a legal entity

Going Private Transaction/ Issuer Bid: Special form of acquisition where the purchaser already owns a majority stake in the target company

Fairness Opinion: Opinion provided by independent expert regarding true value of a firm's shares based on an external evaluation

Cash Transaction: Receipt of cash for shares by shareholders of target company

Share Transaction: Offer by an acquiring company of shares or a combination of cash and shares to the target company's shareholders

Amalgamation: Genuine merger in which both sets of shareholders must approve the transaction

Securities Legislation

April-17-12

1:53 AM

- 1) 10%: Early Warning
- 2) 20%: Takeover Bid
- 3) 50.1% Control
- 4) 66.7% Amalgamation
- 5) 90%: Minority Squeeze-out

Tender: Signing an authorization accepting a takeover bid made to target company shareholders
Creeping Takeovers: Acquisition of a target company over time by the gradual accumulation of its shares

Friendly Versus Hostile Takeovers

April-17-12
1:57 AM

Friendly Acquisition: Acquisition of a target company that is willing to be taken over

Asset Purchase: Purchase of a Firm's asset rather than firm itself

Offer Memorandum: Document describing a target company's important features to potential buyers

Data Room: Place where a target company keeps confidential information about itself for serious potential buyers to consult

Confidentiality Agreement: Document signed by a potential buyer guaranteeing it will keep confidential any information it sees in data room about target company

Due Dilligence: Process of evaluating a target company by potential buyer

Letter of Intent: Letter signed by acquiring company scoping out the terms of agreement of its acquisition, including legal terms

No-Shop Clause: Clause in letter of intent stating that the target agrees not to find another buyer; demonstrating commitment

Break Fee: Fee paid to an acquirer or target should the other party terminate the acquisition (Often 2.5% of value of transaction)

Hostile

Hostile Takeover: Takeover where target firm has no desire to be acquired and refuses to provide confidential information

Arbs/ Arbitrageurs: Specialists who predict what happens in takeovers and buy and sell shares in the target companies, with the possibility of earning a premium

Tender Offer: Public offer in which the acquiring firms offer to purchase shares of the target firm from its existing shareholders

Defensive Tactic: Strategy used by a target company to stave off a takeover or to try to get the best deal for its shareholders

Shareholder's Rights Plan or Poison Pill: Target company allows its shareholders to buy 50 percent more shares at a discount price in the event of a takeover to make it less attractive

Selling Crown Jewels: Sale of a target company's key assets that the acquiring company is most interested in to make it less attractive

White Knight: Entity that rescues a target company from hostile company by offering a counter bid

Motivations for Mergers and Acquisition

April-17-12
2:08 AM

Horizontal Merger: Merger in which two firms in the same industry combine

Vertical Merger: Merger in which one firm acquires a supplier or another firm that is closer to its existing customers

Conglomerate Merger: Merger in which two firms in unrelated business combine

Cross Border M&A: Merger or acquisition involving a Canadian and a foreign firm as either the acquirer or target company

Synergy: Value created from economies of integrating a target and acquiring company; Amount by which the value of the combined firm exceeds the sum value of the two individual firms

Over Capacity M&A: M&A resulting when an industry has too many firms operating in it

Geographic Roll-Up: Creation of national firm from a series of regional ones

Extension M&A: Merger or acquisition that extends a firm's expertise

Value Creation Motivations for M&As

- 1) Economies of Scale (Growth)
- 2) Economies of Scope (reducing costs)
- 3) Complementary Strengths (Extensions)
- 4) Efficiency Increases
- 5) Financing Strategy
- 6) Tax Benefits
- 7) Strategic Realignment

Managerial Motivations for M&A

- 1) Increased Size Firm
- 2) Reduced firm risk through diversification

Introduction to International Finance Management

April-17-12
2:37 AM

Globalization: Removal of barriers to free trade and the integration of national companies

Multinational Corporation: Business that operate in more than one country (HQ in one country)

Transnational Corporation: Multinational firm that has widely dispersed ownership and that is managed from global perspective

- 1) Currency Differences
- 2) Differences in legal systems and tax codes
- 3) Language Differences
- 4) Cultural Differences
- 5) Differences in Economic Systems
- 6) Differences in Country Risk

Country Risk: Political uncertainty associated with a particular country

Basic Principles Remain the Same

Introduction

April-17-12
2:40 AM

Corporate Governance: The way a company is managed, monitored, and held accountable
Primary Goal: Is to create right balance of power between all corporate governance participants & reducing agency costs

Shareholder's Aspect

Board of directors is elected and executives are hired to make business decisions on behalf of shareholders

Principle - Agent Problem: Shareholders and Corporations are separate entities

Two-Factors: 1) Separation of ownership and control & agency costs (incomplete or forcible contracts)

Corporate Governance exists to align behaviour of *Agents* and *Shareholders*

This is done using **Internal** and **External Mechanisms**.

Designed to reduce *Agency Costs*.

- 1) Provide incentives and opportunities for management to carry out its function effectively
- 2) Strengthening *Shareholder* rights to monitor, control, and discipline management
- 3) Promoting *shareholder* democracy
- 4) Improving the vigilance of the board's oversight function
- 5) Holding directors accountable and liable for the fulfillment of their fiduciary duties
- 6) Improving the effectiveness of both **Internal** and **External** corporate governance mechanisms

Integrated Aspect

Shareholders exercise right by electing directors, who then appoint management to run the company.

Directors and officers act as trustees on behalf of Shareholders

- 1) Directors should pay attention to interests of various stakeholders
- 2) Interest of stakeholders have intrinsic value of company
- 3) Stakeholders contribute to and have some claim to company's success
- 4) Directors and officers have many non-fiduciary duties to stakeholders under contract and tort laws
- 5) Shareholder-management relationship, is not different than that with other stakeholders. Though legally the relationship may be different

3 Aspects of Corporate Governance

- 1) Shareholder Aspect
- 2) Stakeholder Aspect
- 3) Integrated Aspect

Stakeholder Aspect

Includes: Creditors, Shareholders, Customers, and employees

Also includes the community

This requires the company to be **Socially Responsible**

Governance Structure should be based on following premises

- 1) Create and enhance sustainable and enduring shareholder value
- 2) Board of Directors are accountable to investors for company's performance
- 3) Board of Directors hold senior executives responsible
- 4) Chairperson is accountable for Board, not CEO
- 5) CEO responsible for managing company and accountable to board
- 6) Corporate Governance participants' roles should be considered value added
- 7) Should promote and facilitate shareholder democracy
- 8) Proper communication should assist shareholders in investment decisions
- 9) Good governance results in more capital flow in long run
- 10) Should reward good ethical performance while punishing poor performance and misconduct
- 11) Executive compensation should be linked to performance
- 12) Board of Directors should have proper executive succession plan and appropriate strategies to deal with potential crisis management

Corporate Governance Structure

- 1) Mechanisms
- 2) Principles
- 3) Functions

Principles

- 1) Fairness
- 2) Transparency
- 3) Accountability
- 4) Responsibility

Principles

- 1) Honesty
- 2) Resilience (Easily recuperate from setbacks and abuses)
- 3) Responsiveness (Timely and appropriate responses to requests of all stakeholders)
- 4) Transparency (Openness and understandability of the company's disclosures to both internal and external audiences can result in trust in its corporate governance)