

Introduction to Corporate Finance

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Key Concepts, Objectives, and Tools for Managing a Firm's Financial Resources

1. What Is Corporate Finance?

Aspect	Description
Definition	The area of finance that deals with how corporations raise, allocate, and manage capital to achieve their strategic goals.
Core Activities	- Capital budgeting (investment decisions) - Capital structure (financing decisions) - Working?capital management (short?term liquidity)
Stakeholders	Shareholders, creditors, employees, customers, regulators, and the broader community.

2. Primary Objectives

Objective	Goal	Typical Metrics
Maximize Shareholder Value	Increase the market value of equity.	Stock price, total shareholder return (TSR)
Profitability & Growth	Generate sustainable earnings and expand operations.	Return on Equity (ROE), Earnings per Share (EPS), Revenue growth
Financial Stability	Ensure the firm can meet its obligations.	Debt?to?Equity ratio, interest coverage, current ratio
Risk Management	Balance risk and return across projects and financing.	Value?at?Risk (VaR), beta, scenario analysis

3. The Decision-Making Framework

1. **Identify Opportunities** – Market analysis, strategic fit, and resource availability.
2. **Evaluate Alternatives** – Use quantitative tools (NPV, IRR, payback) and qualitative considerations (strategic alignment, regulatory impact).

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3. **Select the Best Option** – Choose the project/financing mix that maximizes the firm's objective function (usually shareholder value).
 4. **Implement & Monitor** – Execute the plan, track performance, and adjust as needed.
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4. Capital Budgeting (Investment) Decisions

Tool	How It Works	When to Use
Net Present Value (NPV)	? (Cash flow? / (1+r)?) – Initial outlay. Positive NPV ? accept.	Standard for most projects; accounts for cost of capital.
Internal Rate of Return (IRR)	Discount rate that makes NPV = 0. Compare to required return.	Helpful for ranking projects, but beware of multiple IRRs.
Payback Period	Time needed to recover the initial investment.	Quick screening, especially for liquidity?sensitive firms.
Profitability Index (PI)	NPV / Initial investment.	Useful when capital is constrained.
Real Options Analysis	Values managerial flexibility (e.g., defer, expand, abandon).	Projects with high uncertainty and strategic options.

Key Input: Weighted Average Cost of Capital (WACC) – the discount rate reflecting the firm's blended cost of debt and equity.

5. Capital Structure (Financing) Decisions

5.1 Debt vs. Equity

Feature	Debt	Equity
Cost	Interest (tax?deductible)	Dividends (non?tax?deductible) & required return
Risk	Increases financial leverage ? higher default risk	Dilutes ownership, but no mandatory payments
Control	No voting rights	Shares confer voting rights
Flexibility	Covenants may restrict actions	More flexible cash?flow wise

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5.2 Theories of Capital Structure

Theory

Core Idea

**Modigliani?Miller