

Wealth maximization concepts worksheet essay



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Wealth Maximization Concepts Worksheet University of Phoenix August 8, 2008 Maximizing Shareholder Wealth- MBA/540r4 Wealth Maximization Concepts Worksheet ConceptApplication of Concept in the ScenarioReference to Concept in Reading Definitions of Wealth Maximization Bernard Lester is CEO and founder of Lester Electronics the public Lester Electronics, Inc. which earns \$500 million annually. In 1984, Bernard took his company public, and it is now traded on the NASDAQ market and rated Baa by a nationally recognized rating agency. A corporation is owned by shareholders who share the privilege of limited liability and whose liability exposure is usually no greater than their initial investment. A corporation has a continued life and is not dependent on any one shareholder for maintaining its legal existence. A key feature of the corporation is the easy divisibility of the ownership interest by issuing shares of stock(Block & Hirt, 2005) Discuss definitions of wealth maximization (Ross Ch.

1) The corporate firm The Corporation “ Of the many forms of business enterprises, the corporation is by far the most important. It is a distinct legal entity. As such, a corporation can have a name and enjoy many of the legal powers of natural persons. For example, corporations can acquire and exchange property. Corporations can enter into contracts and may sue and be sued.

For jurisdictional purposes, the corporation is a citizen of its state of incorporation. (It cannot vote, however.). Starting a corporation is more complicated than starting a proprietorship or partnership. ” (Ross, et al, 2004 p. 13).

Definitions of Wealth Maximization John Lin, founder and CEO of Shang-wa Electronics at age 68, John looks forward to spending less time on business and more time with his grandchildren while they are still young. John has never groomed a successor and without one, the business cannot afford for him to slow down. With one son a doctor and the other a commercial architect, John has begun to explore other options that might afford him retirement. The sole proprietorship represents single person ownership and offers the advantages of simplicity of decision making and low organizational and operating costs(Block & Hirt, 2005). The Sole Proprietorship “ A sole proprietorship is a business owned by one person, and is the cheapest business to form. No formal charter is required, and few government regulations must be satisfied for most industries.

A sole proprietorship pays no corporate income taxes. All profits of the business are taxed as individual income. The sole proprietorship has unlimited liability for business debts and obligations. No distinction is made between personal and business assets.

The life of the sole proprietorship is limited by the life of the sole proprietor. Because the only money invested in the firm is the proprietor's, the equity money that can be raised by the sole proprietor is limited to the proprietor's personal wealth” (Ross, et al, 2004 p. 2). Evaluate the Metrics of Wealth Maximization Explain Corporate Valuation Methods CONFERENCE CALL AMONG LESTER BOARD OF DIRECTORS Lester's key manufacturer, Shang-wa, has received a hostile takeover bid from TEC. If John (CEO of Shang-wa) accepts it, LEI stands to lose upwards of 45 percent of expected revenues over the next five years. Fortunately, there are some options.

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Lester will have to run some numbers to see what the best course is. LEI is aware it will have to do something. Doing nothing will devastate them (Scenario, 2008). EMAILS TO: John Lin FROM: Bernard Lester LEI ran the numbers.

If Lester loses Shang-wa as a manufacturer, it loses 43 percent of its revenue over the next five years. Lester asked Shang-wa for a capital budget for the joint venture manufacturing facility and Shang-wa's recent financial statements? Bernard is ready to talk (Scenario, 2008). Bernard will need to know the relationship between today's dollar today and a possible uncertain dollar in the future before deciding on the merger or partnership. This relationship is called the time-value-of money concept. It is important in capital budgeting, financing arrangements and mergers(Block & Hirt, 2005).

Five years ago, Bernard invited John to sit on the LEI Board of Directors. During his past two visits to the United States for Lester's quarterly Board meetings, John has informally suggested that Shang-wa is open to growth opportunities that could position the company to meet growing demand (Scenario, 2008). TEC has been discussing global growth opportunities, and Shang-wa is one of the names that came up (Scenario, 2008). Corporate mergers considers external growth strategy and includes profit management, capital budgeting, portfolio considerations, and valuation concepts (Block & Hirt, 2005). Evaluate the metrics of wealth maximization (Ross Ch.

2) Net working capital " Net working capital is current assets minus current liabilities. Net working capital is positive when current assets are greater

than current liabilities. This means the cash that will become available over the next 12 months will be greater than the cash that must be paid out” (Ross et al, 2004 p. 26).

“ Financial plans are compiled from the capital-budgeting analyses of each of a firm’s projects” (Ross, et al, 2004 p. 45) “ Costs are not always proportional to sales, assets need not be a fixed percentage of sales, and apital-budgeting involves a sequence of decisions over time” (Ross et al, 2004, p54) Explain corporate valuation methods (Ross Ch. 4 & 5) Growth opportunities “ While the introduction of future growth opportunities increases firm value, it does not increase the current level of debt needed to shield today’s income from today’s taxes. Since equity is the difference between firm value and debt, growth increases the value of equity” (Ross et al, 2004, p.

455) Describe the impact of Financial, Economic, and Global Environments on Wealth Maximization E-MAIL To: Bernard Lester-LIE From: John Lin-SHANG-WARe: David Antone of TEC David Antone from TEC approached CEO, John Lin of Shang-wa and was told outright told me that TEC is interested in acquiring Shang-wa. It is known that TEC is large enough to go from “ asking” to takeover rather quickly. If TEC decides it wants Shang-wa, Shang-wa currently has nothing in place to prevent Antone from taking it(Scenario, 2008) TELEPHONE CALL FROM PETER ZACK TO BERNARD LESTER Peter Zack tells Bernard Lester, he is calling on behalf of a client who has expressed interest in acquiring Lester Electronics(Scenario, 2008) E-MAILS TO: BERNARD LESTERFROM: JOHN LIN Re: TEC’s term sheet John sent this to Bernard so the CFO, Anne would “ know what she was up against” Attached <https://assignbuster.com/wealth-maximization-concepts-worksheet-essay/>

is TEC's term sheet for their proposed acquisition of Shang-wa(Scenario, 2008) TO: ANNE LORALE FROM: BERNARD LESTER Re: Our options Bernard sent over the joint venture capital budget from John as well as the term sheets for both the TEC/Shang-wa and Avral/Lester proposed acquisitions. He asked Anne to complete the analyses for all options and create a recommendation that can be given to Board(Scenario, 2008) Managing operating exposure is not a short-term tactical issue.

Both LEI and Shang-wa can use the following strategies for managing operating exposure: 1. Selecting low-cost production sites. 2. Flexible sourcing policy. 3. Diversification of the market.

4. Product differentiation and R&D efforts. 5. Financial hedging.

(Eun & Resnick, 2004 p. 293) Describing the impact of financial, economic, and global environments on wealth maximization (Eun Ch. 12) Determinants of operating exposure “ Unlike contractual exposure, which can readily be determined from the firm's accounting statements, operating exposure cannot be determined in the same manner. A firm's operating exposure is determined by (1) the structure of the markets in which the firm sources its inputs, such as labor and materials, and sells its products, (2) the firm's ability to mitigate the effect of exchange rate changes by adjusting its markets, product mix, and sourcing) (Eun, 2004 p. 288).

Managing operating exposure “ As the economy becomes increasingly globalized, many firms are engaged in international activities such as exports, cross-border sourcing, joint ventures with foreign partners, and establishing production and sales affiliates abroad. The cash flows of such

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firms can be quite sensitive to exchange rate changes. The objective of managing operating exposure is to stabilize cash flows in the face of fluctuating exchange rates. Since a firm is exposed to exchange risk mainly through the effect of exchange rate changes on its competitive position, it is important to consider exchange exposure management in the context of the firm's long-term strategic planning. In making such strategic decisions as choosing where to locate production facilities, where to purchase materials and components, and where to sell products, the firm should consider the currency effect on its overall future cash flows. Eun & Resnick 2004 p.

293) References Block, S. B. ; Hirt, G. A.

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New York: McGraw- Hill Scenario One: Lester Electronics (2008) MBA540, Week 1, University of Phoenix, retrieved from <https://ecampus.phoenix.edu/secure/resource/resource.asp>