

# Essay on finance management

[Finance](#)



**ASSIGN  
BUSTER**

Finance used to be in the same field as accounting, which focuses on the measurement of firms' economic activities. The study of finance, which focuses on the management of money, investment and assets, developed through the years due to the changing circumstances faced by firms. According to the July 8, 1907 edition of the New York Times, the U. S. Census Bureau reported that from 1900 to 1905, capital in the iron and steel industry rose to \$948, 689, 640 from \$500, 530, 184; tonnage produced increased 18%; while the number of establishments dropped to 606 from 669.

The rapid growth in the iron and steel industry and the decrease in the number of firms in the industry was a result of business combinations or mergers, which resulted to the remaining companies holding more assets, equity and debts. This required complex business decisions involving bigger capital outlays, thus the onset of finance. The innovations in the 1920s of various products, including the telephone, automobiles, and aviation, and the emergence of other industries resulted to an economic boom which led to a greater supply and demand for funds and capital.

However, in 1929, the infamous stock market crash in Wall Street occurred when the economy contracted, and firms suffered massive price declines of their stock. The easy, low-interest credit in the early 1920s was no longer available during and after the Great Depression in the 1930s, thus requiring firms to maximize the use of capital borrowed money. Hence the study of finance evolved to focus on not just maximizing shareholders' wealth or profits but also into helping companies maintain liquidity and survive competition and financial downturns. When the U.

S. economy boomed, firms, which were not directly involved in the production of goods and services, but had liquid assets, emerged. These were the investment funds, the hedge funds and the private equity firms. The entry of globalization in the 1980s and 1990s, through General Agreements on Tariffs and Trade, allowed firms to reach international markets but subjected them to more competition. This also resulted to industry consolidation, more competition and entry of firms to international markets. These factors were added to the concept of finance. Q. 12.

Compare and contrast the direct and indirect methods of cash flow. Which method is more widely used? Why? A statement of cash flow shows the movement of cash into (receipts) and cash out (disbursements) of a firm in a given period. The two methods used to calculate cash flow are: the direct and the indirect. Both methods have different starting points but produce identical results. Both methods require cash flows to be grouped according to operating, investing, and financing activities. The methods, however, differ in the process of computing cash flows from operating activities.

With the indirect method, the net income figure from the income statement is utilized as the starting point, followed by certain adjustments (i) first on non-cash transactions, and (ii) then on cash-based transactions. The method, in other words, converts net income or loss into cash flow by using additions and deductions, i. e. non-cash transactions are negated then changes in asset/liability accounts that relate to operations are then reconciled, The direct method reports receipts and disbursements of each major class of operating activities to calculate cash flow.

With this method, the movement of cash is recorded directly at its corresponding group. The indirect method has been more popular than the direct method because it resembles the statement of changes in financial position that was previously required to be submitted by the company's financial officers or managers. While some assert that the indirect method has been easier to use, others say that the direct method avoids the confusing adjustments to net income because movements of cash are measured directly.

The International Accounting Standards Committee, while it allows both methods, recommends that the direct method be used, because, among other things, it provides for a clearer method to users of financial statements. Regardless, the indirect method continues to be popular. Unit II Q. 11. Over the last two decades, the marketing profession has developed many sophisticated techniques for analyzing and projecting future sales. Why is it important that the financial manager look to the marketing staff for help in his/her financial forecasting?

In order to have effective financial forecasts, financial managers need to tap the assistance of his marketing staff. In order to make sales projections for a particular, the marketing staff needs to do "market research", i. e. checking the demographics reached by the product, the competition in the market place, and the percentage of the market that the product will gain. Market research helps in determining market demand. Aside from financial managers checking historical information of the company and its competitors, the marketing staff could do more homework by communicating with actual and potential customers to determine their needs.

With the help of a marketing team, the financial manager could set realistic sales projections using the four Ps – product, pricing, promotion and placement. Q. 12. Compare and contrast the three theories used to describe the shape of the yield curve. Explain how each theory might impact interest rates. The yield curve is a two-dimensional diagram showing interest or yield as a function of time to maturity of a given debt. This helps investors compare the yields offered by bonds or securities with different tenures or maturities. The yield curve can have these forms or shapes – upward sloping, downward sloping, and flat, among others.

An upward sloping (normal) curve means that short-term yields are lower than long-term yields. A downward sloping (inverted) curve provides that short-term yields are higher than long-term yields. A flat curve shows that there is no difference between short- and long-term yields. In order to assess the yield curve's shape, these theories are used: (i) the expectation theory, (ii) the liquidity preference theory, and (iii) the market segmentation theory. The expectation theory provides that the shape of the yield curve would depend on the expectation of the changes in the yield of future short-term bonds or notes.

Expectations by investors of rising short-term interest rates create an upward sloping curve; while expectation of reduction in short-term interest rates produces a downward sloping curve. The liquidity preference hypothesis assumes that investors prefer short-term debt because it is readily available and would be subject to lesser risk. With this assumption, a positive yield curve is always expected and any changes to the shape are expected to be temporary. The segmented market hypothesis relies on the

assumption that the yield curve depends on the investment policies in the market.

If investors confined themselves to the short-term maturity segment, the yield curve is expected to be upward sloping, vice versa. For example, investors prefer to invest in long-term securities, during a robust economy; while they would prefer to invest in short-term debt during a financial downturn. Unit III. Q. 11. Relating your answer to the time value of money, explain the effect of inflation on the current average salary in the United States. On the average salary in the United States in 50 years? How would these differ if you were comparing these projections to a country such as Israel?

If I receive \$10, 000 payment this month and am able buy a used car, pay one-month rent for my condominium and buy a pack of cigarettes, would I be able to do the same 10 years from now with \$10, 000? Chances are that I won't be able to do that, because my \$10, 000 will not have the same purchasing power 10 years from now. This is because of inflation, i. e. the average annual price increase of basic commodities. On the average, average salary in the United States have been keeping up with inflation. In Israel, however, due to the political turmoil there, thus less demand for labor, salaries have not been able to keep up with inflation.

Q. 12. Explain why valuation might be described as a "fickle" process to a stockholder. What factors tend to make the process fickle, and what factors tend to make it more predictable? Valuation is considered a "fickle" process because value is often difficult to measure or predict. As such, different approaches could result to different valuations. Four methods are widely

used to perform valuations of assets (1) historical cost, basing from the amount of cash paid for an asset, subject to depreciation, (ii) current market value method, i. e.

the amount of cash that could be earned if an asset is sold in the market, (iii) net realizable value method, i. e. the cash amount an asset could be converted in the course of business, and (iv) discounted future cash flows method, which calculates the expected cash flows from those assets, subject to the discount rates. Factors that make the valuation predictable include the relevance and reliability of the projections and valuations. During the DOT-COM bubble for example, some Internet-based companies got high valuations because of marketing projections and opportunities, and not a healthy financial outlook.

However, after the Internet industry declined, some people realized that some valuations were actually inflated. Hence, any valuation not on actual value but on potential value should be substantiated. Unit IV. Q. 11. Explain how unexpected national and/or international events can create a higher standard deviation in cash flows and increase the risk associated with long-lived projects/ Give examples of events that produced such results. Unexpected events can create a higher standard deviation – i. e. high deviations from projected cash flows – in instances when the company has high exposure to these risks.

Northwest Airlines, after canceling bad contracts, firing employees, and clearing debts while under Chapter 11 protection from creditors, predicted rosy cash flows and profits within the next five years. However, due to the unexpected skyrocketing increase in fuel prices due to the crisis in the <https://assignbuster.com/essay-on-finance-management/>

Middle East, Northwest Airlines has incurred losses because of the increase since 40% of operating costs were attributed to fuel expenses. U. S. -based companies that have foreign operations have high deviations in cash flow projections because, among other things, they are subject to unexpected events.

These types of companies, for example, report gains or losses from foreign transactions due to fluctuating currency exchange rates. Q. 12. Describe the features of The Securities Act of 1933. What led to its passage? Why is it referred to as the “truth-in-securities” act? The Securities Act of 1933 was passed by Congress four years after the stock market crash of 1929. The demand for securities due to a booming economy in the 1920s resulted to the overvaluation of securities, and misrepresentations by financial managers in order to generate higher prices.

Due to expectations of higher yields due to faulty and fraudulent projections by financial managers and impressive historical results, people were actually buying stock at prices above actual value. When reality sank in, prices declined and most investors lost all their investments. The Securities Act was enacted in order to (i) require publicly traded companies to provide investors with material information concerning securities being offered for sale; and (ii) prohibit deceit, and misrepresentations in the sale of those securities. The Securities and Exchange Commission has been tasked to monitor implementation of those rules.

Visiting the Securities and Exchange Commission Web site, for example, you'll see (i) 10-Q filings, which provides for a company's quarterly financial results, (ii) 8-K filings, which provides disclosures on material events of a <https://assignbuster.com/essay-on-finance-management/>



company, and (iii) Form 4 filings, which provides disclosures on stock ownership and disposal of company officers. Those filings are aimed at helping investors make informed investment decisions. The law was also referred to as the “truth in securities act” because it tried to avoid lies and misrepresentations of firms’ securities by requiring them to make truthful disclosures to the public.

Unit V Q. 11. Discuss the significance of the Gramm-Leach-Bliley Act to investment banking. Are there any procedures in place to protect a bank’s capital? Explain. The Gramm-Leach-Bliley Act repealed the The Glass-Steagall Act, which prohibited a bank from offering investment, insurance and commercial banking services altogether. The rationale for this act was that people prefer risk-free transactions with their money when the economy is bad, while they submit their cash to risky and non-guaranteed investments when the economy is improving -- hence, banks assert they should be able to offer all those services.

The Gramm act opened up competition among banks, insurance firms and securities companies. It also opened up various combinations and mergers by banks, insurers and investment firms. Various restrictions have been put in place in order to protect investors. These include (i) commercial banking operations, which provide for guaranteed but low yield to investors, and investment operations, which offers high-yield but non-guaranteed recovery to investors, are separated and (ii) banks are required to protect customer information. Q. 12.

Explain why Kirk Kerkorian is referred to as a “turnaround artist of the highest order.” Describe how his actions affected the bond rating for <https://assignbuster.com/essay-on-finance-management/>

General Motors. In May 2005, Standard & Poor's downgraded General Motors' credit rating to junk-bond status due to declining sales and high health-care costs. General Motors, while one of the largest U. S. companies, had total debts exceeding total assets, hence, was insolvent. Since 2005, Kirk Kerkorian, through Tracinda Corp. , bought shares of stock of GM and increased its stake to 9. 9% by January 2006, becoming the company's largest individual stakeholder.

Mr. Kerkorian acted as activist investor, pressuring CEO Rick Wagoner to make changes in order to stop further bleeding. Mr. Kerkorian proposed that GM enter into an alliance with France's Renault and Japan's Nissan in order to bail out U. S. 's largest auto-maker, which had lost \$10 billion in 2005. Mr. Kerkorian's entry into GM actually increased investor interest in GM, and caused its stock to increase. Rumors persisted that Mr. Kerkorian's motive for the combination was to push out Mr. Wagoner and replace him with Nissan CEO Carlos Ghosn, who made an effective turn around for Nissan.

Mr. Ghosn said that a combination of the three automakers will reduce research and development costs for each company, and would allow GM's underutilized factories to produce Nissan models. Mr. Kerkorian also named Jerry York with him as his partner in the GM board. Mr. York had impressive credentials, as the turnaround artist for Chrysler and International Business Machines Corp. The stock market and ratings agencies responded positively to Mr. Kerkorian's actions. Mr. Kerkorian, however, failed with his Nissan/Renault combination plans and Mr.

Wagoner retained the post as CEO, devising only plans to gain savings from reduction in healthcare costs, and employee buyouts and retirements.

Regardless, GM has recorded consecutive quarterly losses, but has averted Chapter 11 bankruptcy so far. Mr. Kerkorian, since then, has disposed of all his shares at GM. He is now betting on Ford as he has bought substantial shares in the company. Unit VI. Q. 11. What advantages might former Vice President Al Gore enjoy regarding his addition to the board of directors of Apple Computer? What advantage might Apple expect?

On the other hand, what would the disadvantages be for either party? Aside from enjoying the cash and stock incentives as a member of the board, Mr. Gore can also pursue his plans to push for the open source movement, in order to avoid the monopoly in Microsoft's operating systems. Apple was using a different operating system and more competition against Microsoft will reduce prices, and thus, will give people cheaper access to these technologies. As a government official and member of congress, Al Gore had excellent credentials and led initiatives in areas involving environmental policy, and information technology.

He, among other things, was instrumental in seeking funds to assist in building the Internet, and was known to have launched a great effort in hooking schools and libraries to the Internet. Gore's experience and his popularity will be beneficial to Apple and will improve Apple's reputation, especially in its plans to sell more environmentally-friendly computers. As a member of the U. S. Congress 25 years ago, he popularized the term "Information Superhighway," and was instrumental in fighting for federal funds to assist in building what later became the Internet.

He has remained an active leader in technology—launching a public/private effort to wire every classroom and library in America to the Internet. A <https://assignbuster.com/essay-on-finance-management/>

disadvantage for Apple is that the move may be taken as a political stunt, as it is appointing a former vice president of the United States. The appointment might also be controversial as some critics lambasted Mr. Gore for claiming undue credit for the Internet's invention. Mr. Gore's political affiliation may also reduce sales. A disadvantage for Mr.

Gore is that he might have to sacrifice his principles - in government, his policies were focused on general welfare, or the common good, but in Apple, his job's main function is to serve at the behest of shareholders, and to maximize shareholders' wealth (not necessarily the common good). Q. 12.

Explain why the effect of international mergers of the market value of the acquiring firm is often more positive returns than for domestic mergers. A China-based firm, for example, is already familiar with the Chinese's consumer tastes, preferences, labor market culture, and government regulations.

A United States-based firm is also familiar with consumer demand and preferences in its own country. The exchange and sharing of information between the two would entice the two companies to merge. Taiwan-based Acer, for example, stole the status as the world's third largest personal-computer manufacturer from Lenovo Group, after Acer acquired U. S. -based Gateway. The acquisition allowed Acer to use Gateway's existing distribution and sales channels in the U. S. , thus allowing its computers to penetrate the U. S. market. Works Cited Iron and Steel Industry. NYTimes. com. (1907-07-08). Retrieved on (2008-07-08)