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Chapter 1: Overview of Financial Management

1. Real assets are assets that produce goods or help provide services, in order to function as a business. Financial assets are contracts that a firm provides to suppliers of cash.

2. The three cash-related activities are investing (in real assets), financing, (paying for the assets) and operating (generating cash).

3. A firm acquires cash through equity investors and through loans. The firm invests cash in fixed assets and acquires or creates inventory as needed. Cash outflows also occur through operations of the business, for example, related to expenses. The firm generates sales. If sales are on credit then the firm receives cash once customers pay. Cash is then used to pay interest, repay principal, and pay dividends to shareholders.

4. Accountants provide key financial information in an organized and systematic fashion. Financial managers use that financial information to make business decisions.

5. With a sole proprietorship an individual starts and owns a business. With a partnership two or more individuals jointly own a business. A corporation has a legal personality separate from its owners with limited liability, along with the benefit of a potentially unlimited lifespan.

6. A general partnership might be appropriate.

7. The primary goal of an enterprise is to create value for shareholders.

8. The two key value-drivers are growth and risk.

Chapter 2

1. We would require information related to interest rates, credit conditions, financial markets, and overall GDP growth.

2. The four stages are peak, recession, trough and expansion; comparing potential and actual output.

3. A recession is typically measured as two consecutive quarterly declines in real GDP.

4. The four components are consumption, business investment, government spending, and net exports.

5. The three goals are price stability, maximizing employment, and moderating long-term interest rates.

6. Low and steady inflation is important because it removes uncertainty related to costs and prices.

7. Deflation is a decrease in the level of prices.

8. The first hypothesis that explains the shape of the yield curve is the unbiased expectations hypothesis: long-term rates are the market's best guess of average expected short-term rates. The second hypothesis is the liquidity preference hypothesis: investors wish to be compensated for holding longer-term bonds.

9. An upward sloping yield curve is associated with an expansion. An upward sloping yield curve at lower yields is associated with a trough. An inverted yield curve is associated with a pre-recession stage.

10. In stage 2 of the life-cycle profits are becoming positive as revenues are growing rapidly. In stage 3 there are positive profits from improving efficiencies and cost controls but with squeezed margins due to increased competition.

11. The five key forces are: threat of new entrants, threat of substitutes, bargaining power of suppliers, bargaining power of customers, and intensity of rivalries.

12. Key success factors might include the efficiency of operations, investment in technology, labor management, relationships with customers, reliability, and delivery.

13. High supply risk is associated with: poor quality product, high costs and prices, out-of-date technology, insufficient production capacity or operability, ineffective inventory management system, and poor labor relations. High demand risk is associated with: poorly defined value proposition, ineffective targeting, and an inappropriate marketing mix.