TINATIN GUGESHASHVILI

Associated professor

Akaki Tsereteli State University

Kutaisi, Georgia

INTERNATIONAL EXPERIENCES OF FINANCIAL MANAGEMENT IN CORPORATIONS

This paper is about financial decisions made by corporations. We should start by saying what these decisions are and why they are important. Corporations face two broad financial questions: What investments should the firm make? and How should it pay for those investments? The first question involves spending money; the second involves raising it.

The secret of success in financial management is to increase value. That is a simple statement, but not very helpful. It is like advising an investor in the stock market to "Buy low, sell high." The problem is how to do it. There may be a few activities in which one can read a textbook and then do it, but financial management is not one of them. Who wants to work in a field where there is no room for judgment, experience, creativity, and a pinch of luck? Although this paper cannot supply any of these items, it does present the concepts and information on which good financial decisions are based, and it shows how to use the tools of the trade of finance.

We start by explaining what a corporation is and introducing the responsibilities of its financial managers. We will distinguish real assets from financial assets and capital investment decisions from financing decisions. We stress the importance of financial markets, both national and international, to the financial manager.

Finance is about money and markets, but it is also about people. The success of a corporation depends on how well it harnesses everyone to work to a common end. The financial manager must appreciate the conflicting objectives often encountered in financial management. Resolving conflicts is particularly difficult when people have different information. This is an important theme.

We will start with some definitions and examples. Not all businesses are corporations. Small ventures can be owned and managed by a single individual. These are called sole proprietorships. In other cases several people may join to own and manage a partnership. However, our paper is about corporate finance. So we need to explain what a corporation is.

Almost all large and medium-sized businesses are organized as corporations. For example, General Motors, Bank of America, Microsoft, and General Electric, British Petroleum, Unilever, Nestlé, Volkswagen, and Sony are corporations. In each case the firm is owned by stockholders who hold shares in the business. When a corporation is first established, its shares may all be held by a small group of investors, perhaps the company's managers and a few backers. In this case the shares are not publicly traded and the company is closely held. Eventually, when the firm grows and new shares are issued to raise additional capital, its shares will be widely traded. Such corporations are known as *public companies.* Most well-known corporations in the United States are public companies. In many other countries, it's common for large companies to remain in private hands.

By organizing as a corporation, a business can attract a wide variety of investors. Some may hold only a single share worth a few dollars, cast only a single vote, and receive a tiny proportion of profits and dividends. Shareholders may also include giant pension funds and insurance companies whose investment may run to millions of shares and hundreds of millions of dollars, and who are entitled to a correspondingly large number of votes and proportion of profits and dividends.

Although the stockholders own the corporation, they do not manage it. Instead, they vote to elect a board of directors. Some of these directors may be drawn from top management, but others are non-executive directors, who are not employed by the firm. The board of directors represents the shareholders. It appoints top management and is supposed to ensure that managers act in the shareholders' best interests. This separation of ownership and management gives corporations permanence. Even if managers quit or are dismissed and replaced, the corporation can survive, and today's stockholders can sell all their shares to new investors without disrupting the operations of the business.

Unlike partnerships and sole proprietorships, corporations have limited liability, which means that stockholders cannot be held personally responsible for the firm's debts. If, say, General Motors were to fail, no one could demand that its shareholders put up more money to pay off its debts. The most a stockholder can lose is the amount he or she has invested. Although a corporation is owned by its stockholders, it is legally distinct from them. It is based on articles of incorporation that set out the purpose of the business, how many shares can be issued, the number of directors to be appointed, and so on. These article must conform to the laws of the state in which the business is incorporated. For many legal purposes, the corporation is considered as a resident of its state. As a legal "person," it can borrow or lend money, and it can sue or be sued. It pays its own taxes

Because the corporation is distinct from its shareholders, it can do things that partnerships and sole proprietorships cannot. For example, it can raise money by selling new shares to investors and it can buy those shares back. One corporation can make a takeover bid for another and then merge the two businesses. There are also some *disadvantages* to organizing as a corporation. Managing a corporation's legal machinery and communicating with shareholders can be time-consuming and costly. Furthermore, in the United States there is an important tax drawback. Because the corporation is a separate legal entity, it is taxed separately. So corporations pay tax on their profits, and, in addition, shareholders pay tax on any dividends that they receive from the company.

The United States is unusual in this respect. To avoid taxing the same income twice, most other countries give shareholders at least some credit for the tax that the company has already paid. To carry on business, corporations need an almost endless variety of real assets.

Many of these assets are tangible, such as machinery, factories, and offices; others are intangible, such as technical expertise, trademarks, and patents. All of them need to be paid for. To obtain the necessary money, the corporation sells claims on its real assets and on the cash those assets will generate. These claims are called financial assets or securities. For example, if the company borrows money from the bank, the bank gets a written promise that the money will be repaid with interest. Thus the bank trades cash for a financial asset. Financial assets include not only bank loans but also shares of stock, bonds, and a dizzying variety of specialized securities. The financial manager stands between the firm's operations and the financial (or capital) markets, where investors hold the financial assets issued by the firm.

Capital investment and financing decisions are typically separated, that is, analyzed independently. When an investment opportunity or "project" is identified, the financial manager first asks whether the project is worth more than the capital required to undertake it. If the answer is yes, he or she then considers how the project should be financed. But the separation of investment and financing decisions does not mean that the financial manager can forget about investors and financial markets when analyzing capital investment projects. The fundamental financial objective of the firm is to maximize the value of the cash invested in the firm by its stockholders. "Adequate" means returns at least equal to the returns available to investors outside the firm in financial markets. If your firm's projects consistently generate *in*adequate returns, your shareholders will want their money back.

Financial managers of large corporations also need to be men and women of the world. They must decide not only which assets their firm should invest in but also where those assets should be located. Take Nestlé, for example. It is a Swiss company, but only a small proportion of its production takes place in Switzerland. Its 520 or sofactories are located in 82 countries. Nestlé's managers must therefore know how to evaluate investments in countries with different currencies, interest rates, inflation rates, and tax systems.

The financial markets in which the firm raises money are likewise international. The stockholders of large corporations are scattered around the globe. Shares are traded around the clock in New York, London, Tokyo, and other financial centers. Bonds and bank loans move easily across national borders. A corporation that needs to raise cash doesn't have to borrow from its hometown bank. Day-to-day cash management also becomes a complex task for firms that produce or sell in different countries. For example, think of the problems that Nestlé's financial managers face in keeping track of the cash receipts and payments in 82 countries. We admit that Nestlé is unusual, but few financial managers can close their eyes to international financial issues. The term financial manager refers to anyone responsible for a significant investment or financing decision. But only in the smallest firms is a single person responsible for all the decisions discussed.. In most cases, responsibility is dispersed. Top management is of course continuously involved in financial decisions. But the engineer who designs a new production facility is also involved: The design determines the kind of real assets the firm will hold. The marketing manager who commits to a major advertising campaign is also making an important investment decision. The campaign is an investment in an intangible asset that is expected to pay off in future sales and earnings. Nevertheless there are some managers who specialize in finance. The treasurer is responsible for looking after the firm's cash, raising new capital, and maintaining relationships with banks, stockholders, and other investors who hold the firm's securities.

For small firms, the treasurer is likely to be the only financial executive. Larger corporations also have a controller, who prepares the financial statements, manages the firm's internal accounting, and looks after its tax obligations. You can see that the treasurer and controller have different functions: The treasurer's main responsibility is to obtain and manage the firm's capital, whereas the controller ensures that the money is used efficiently.

Still larger firms usually appoint a chief financial officer (CFO) to oversee both the treasurer's and the controller's work. The CFO is deeply involved in financial policy and corporate planning. Often he or she will have general managerial responsibilities beyond strictly financial issues and may also be a member of the board of directors. The controller or CFO is responsible for organizing and supervising the capital budgeting process. However, major capital investment projects are so closely tied to plans for product development, production, and marketing that managers from these areas are inevitably drawn into planning and analyzing the projects. If the firm has staff members specializing in corporate planning, they too are naturally involved in capital budgeting.

Because of the importance of many financial issues, ultimate decisions often rest by law or by custom with the board of directors. Boards usually delegate decisions for small or medium-sized investment outlays, but the authority to approve large investments is almost never delegated.

References

1. Aswath Damodaran, New York University's Stern School of Business **"Corporate Finance: First Principles"** p.12.
2. Katz, Jeffrey; Zimmerman, Scott. "Recent Developments in Acquisition Finance". Transaction Advisors. ISSN 2329-913 p.45.
3. Campbell R. Harvey "Investment Decisions and Capital Budgeting, Prof.
4. Don M. Chance, "The Investment Decision of the Corporation".
5. Lawrence J. Gitman; Michael D. Joehnk; George E. Pinches (1985). Managerial finance. p.67.