**ADVANCE CORPORATE FINANCE**

**MBA-NB**

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**QUESTION 1:** Evaluate the following statement: Managers should not focus on the current stock value because doing so will lead to an overemphasis on short-term profits at the expense of long-term profits.?

**ANSWER**

1. **INTORDUCTION.**

 The main goal of the financial manager is to maximize the value of the firm to its owners. The value of a publicly owned corporation is measured by the share price of its stock. A private company’s value is the price at which it could be sold. To maximize the firm’s value, the financial manager has to consider both short- and long-term consequences of the firm’s actions. Maximizing profits in short-term gains over achieving long-term goals should not be the approach of a rational finance manager.

1. **STOCK VALUATION.**

 In finance, valuation is the process of estimating what something is worth. Valuation often relies on fundamental analysis (of financial statements) of the project, business, or firm, using tools such as discounted cash flow or net present value. Valuations can be done on assets (for example, investments in marketable securities such as stocks, options, business enterprises, or intangible assets such as patents and trademarks) or on liabilities

1. **WHY SHOULD THE MANAGR NOT FOCUS ON CURRENT STOCK VALUE .**

 The term ‘**SHORT-TERMISM’** used for managers who focus on short term and focus on current stock for gains at the expense of long term loss. For example measures such as stock **buy-backs**(buying back own shares), dividends, and increasing profitability by charging for services or increasing profit margins might harm such companies, while investing in R&D or logistics can help their long term growth, but may lower stock prices or earnings. Short-termist behaviour is particularly visible in the case of public companies,which are under pressure from their shareholders to deliver short-term outcomes.This leads to **agency problems**. The agency problem usually refers to a conflict of interest between a company's management and the company's stockholders. The manager, acting as the agent for the shareholders, or principals, is supposed to make decisions that will maximize shareholder wealth ,sometimes focusing to much on the current stock at the expense of the long term goals of the organisation.

**A Balance Between Short and Long Term Priorities:**The manager should adopt a balanced approach by not foregoing crucial short term priorities,and at the same time not be myopic in approach i-e avoiding the long term consequenses for short term gains.The manager should focus on the vision of the organisation.

1. **CONCLUSION:**

 It could be argued in the end that the manager should not focus on the current stock at the expense of long term goal because by focusing on the current stock the manager can lose get involved in practices that are harmful for organisation’s image in the market and can lead to loss in the earnings per share.Moreover the managers would keep investing in the stocks at the expense of investing in R & D which could increase the share value in the long run.

END OF QUESTION NO: 1

**QUESTION 2**:Why might the revenue and cost figures shown on a standard income statement not represent the actual cash inflows and outflows that occurred during a period? While Looking at the accounting statement of cash flows, what does the bottom line number mean? How useful is this number for analyzing a company??

**ANSWER:**

1. **CASH FLOW STATEMENT.**

 The cash flow statement (CFS) measures how well a company manages its cash position, meaning how well the company generates cash to pay its debt obligations and fund its operating expenses. The cash flow statement complements the balance sheet and income statement and is a mandatory part of a company's financial reports since 1987.

1. **INCOME STATEMENT.**

 The income statement is a financial statement that is used to help determine the past financial performance of the enterprise, predict future performance, and assess the capability of generating future cash flows. It is also known as the profit and loss statement (P&L), statement of operations, or statement of earnings.

1. **WHY DOES INCOME STATEMENT NOT SHOW NOT SHOW ACTUAL CASHFLOW.**

 The revenue and cost figures shown on a standard income statement not represent the actual cash inflows and outflows occurred during a specific period of time,due to following reasons;

* **Firstly**, takes into account non-cash items.. It takes into account accrued revenue and accrued expenses. These expenses are not included in the CFS but are shown in the income statement. when analyzing income statements to determine the true cash flow of a business, these items should be added back in because they do not contribute to inflow or outflow of cash like other gains and expenses
* **Secondly,** revenue and cashflow are different things. Revenue is often tracked as it’s earned (or accrued), regardless of whether or not you’ve received payment. Conversely, cash inflows aren’t counted until your customer pays for the products destined for retail centers across the country.
* **Thirdly**, in fact, a business undergoing a period of high growth might experience just that because they’re reinvesting or taking on financing in order to accommodate this growth. In this scenario, the revenue numbers look great, but the cash flow statement will show the deficit. Discrepancies between accounts receivable and accounts payable can also cause a business to be cash flow negative even when sales are stable or strong. Again, the income statement would show positive revenue. However, the cash flow statement would tell a completely different story.
1. **THE BOTTOM –LINE OF CASHFLOW.**

 The first item to note on the cash flow statement is the bottom line item. This is likely to be the "net increase/decrease in cash and cash equivalents." The bottom line reports the overall change in the company's cash and its equivalents (the assets that can be immediately converted into cash) over the last period. This amount is shown in the balance sheet as well it is of less importance to the to the financial manager. Important parts of the cash flow are the cash from operating activity, cash flow from investing activity and cash flow from financing activity, these parts provide information from which major ratios are calculated which are useful to the financial managers in evaluating the performance of the organization.

1. **CONCLUSION.**

 By using all three of a company's financial statement that is the Income Statement, Balance Sheet and the Cash Flow Statements, you can get a clear picture of how well a company is performing and derive useful metrics to use when analyzing a stock. For example, by taking the net income figure from the income statement and the shareholders' equity from the balance sheet, you can determine the company's return on equity, which is one of the best metrics to assess its profitability.

END OF QUESTION NO2

**QUESTION 3**: Financial ratio by itself tells us little about a company because financial ratios vary a great deal across industries. There are two basic methods for analyzing financial ratios for a company: time trend analysis and peer group analysis. Why might each of these analysis methods be useful? What does each tell you about the company’s financial health??

**ANSWER:**

1. **INTRODUCTION.**

 Ratio analysis is a quantitative method of gaining insight into a company's liquidity, operational efficiency, and profitability by studying its financial statements. There are two basic methods for analysing financial ratios for a company, which are explained as follow.

1. **RATIO ANALYSIS METHODS**.

 Two of the ratio analysis methods are as follow.

1. **Time Trend Analysis**:

Time trend analysis and peer group analysis. In time trend analysis, we find the ratios for the company over some period, say five years, and examine how each ratio has changed over this period. It helps in identifying the changes in company’s financial situation over time. It helps in identifying the areas where the firm has undergone any changes, if any. It helps management in identifying whether the areas of firm’s operations, finances, or investment activities have changed.

1. **Peer Group Analysis**:

In peer group analysis we compare a company’s financial ratios to those of its peers. Comparing a firm to its peers allows the financial manager to evaluate whether some aspects of the firm’s operations, finances, or investment activities are out of line with the norm, thereby providing some guidance on appropriate actions to take to adjust these ratios if appropriate.

1. **CRITICAL ANALYSIS.**

 Both methods allow an investigation into what is different about a company from a financial perspective, but neither method gives an indication of whether the difference is positive or negative. For example, suppose a company’s current ratio is increasing over time. It could mean that the company had been facing liquidity problems in the past and is rectifying those problems, or it could mean the company has been less efficient in managing its current accounts.

Similar arguments could be made for peer group comparison. A company with a current ratio lower than its peers could be more efficient at managing its current accounts, or it could be facing liquidity problems.

1. **CONCLUSION.**

 In conclusion it can be argued that neither analysis method tells us whether a ratio is good nor bad, both simply show that something is different, and tells us where to look.

 END OF QUESTION NO 3