Management (the value creation orientation)

– agent of owners of the firm (common stockholders in a corporation):

– make investment decisions (employment of financial, physical and human capital) that are in the owners’ interest:

  extending credit to customers is an investment decision (investment in working capital)

  • Which customers?
  • What terms?

– make financing decisions (what capital to raise and how much) that are in owners’ interest.
Owners’ Interest

– common dimension

⇒ wealth invested in the firm

– wealth invested in the firm

⇐ value of ownership claims
   (market value of common stock in a corporation)
Managers should make investment and financing decisions that increase the value of ownership claims in the firm.
Value creation is the concern of all of management.

Good investment decisions are those that create value.

But why do we study capital budgeting in finance?
Finance is the art and science of valuation – valuing cash flow streams.

Strategy – find value creating opportunities:

value is created when *economic profits* are made.

Sources of economic profits:

1. exploiting *comparative advantage*
2. exploiting *competitive advantage*.

**Comparative and Competitive Advantages**

- A *comparative advantage* is an edge one firm has over other firms in terms of its operations, such as a superior distribution system (some form of productive or distributive efficiency).
- A *competitive advantage* is an edge one firm has over other firms in terms of the
structure of its input or output markets (some form of monopoly power).