

1.1: What is Finance?

There are many different definitions of finance, but for the purposes of this course, we are going to define it as follows:

Finance refers to the process of allocating capital in order to optimize the risk-adjusted expected return on that capital.

This can apply to corporate finance where firms are allocating capital across various operations within the firm, making decisions which long-term projects they should undertake, developing dividend policy, planning how to raise funding, etc. It can also apply to banking where financial institutions evaluate who to lend money to and how much to charge in interest rates. It can apply to personal finance where individuals develop budgets to manage their spending and make investments to meet future goals, such as retirement.

There are several primary areas of finance. These include:

Commercial Banking/Financial Institutions

- Commercial banks, credit unions, insurance companies and countless other financial institutions are an important part of the financial landscape. These institutions deal with financial concerns such as risk management, time value of money, financial intermediation, providing short-term and long-term financing to individuals and businesses, payment processing, and many other activities critical to the financial environment.
- Banks and other similar financial institutions are among the primary employers in the field of finance.
- While we will deal with some issues that are of concern to these financial institutions (time value of money, risk/return analysis, types of financial instruments, etc.), this class will not be primarily focused on banking-related issues.

Investments

- One of the common images associated with finance is the stock market. The field of investments deals with stocks, bonds, options, mutual funds, futures, and many other financial instruments.
- Some of the key considerations in the field of investments include valuation analysis, risk/return analysis, diversification, and fit (by fit we mean that what may be a good investment for one individual may be a poor investment for someone else due to each person's unique set of investment objectives.)
- There are many career paths related to investments including stock analyst, fixed-income analyst, portfolio manager, trader, etc. These careers tend to be very competitive, demanding, and offer the potential for high income.

Personal Finance

- Personal finance deals with a variety of financial decisions made on the personal level. This includes areas such as retirement planning, insurance, personal budgeting (e.g. can I afford a new house or new car?), and any other financial decision that a person makes.
- While personal finance is not the primary topic of this course, it is an important issue for everyone AND overlaps with many of the main themes (time value of money, diversification, valuation analysis, etc.) that we will talk about in this class. Due to its importance and overlap with our primary focus, we will spend a fair amount of time this semester discussing personal finance issues.
- The most common career path associated with personal finance is the financial advisor/planner. A financial advisor works with individuals to help them achieve their personal financial goals. Financial planning is an expanding field and is consistently rated very high in job ranking evaluations due to its combination of potential income and job satisfaction.

Corporate Finance

- The terms Corporate Finance, Business Finance, and Managerial Finance are often used interchangeably and refer to the field of finance dealing with financial decision making from a business perspective.
- Primary topics for corporate finance deal with raising capital (issuing stocks, bonds, or other forms of financing), paying dividends, maximizing value for shareholders, evaluating potential long-term investments that the firm will undertake (e.g. building a new warehouse), and managing the firm's cash flows.
- Students with a strong background in accounting are often among the top candidates for jobs in the field of corporate finance.

This textbook will touch on several of these topics (interested students may find more information about potential finance-related careers at the [Careers-in-Finance](https://biz.libretexts.org/@go/page/109430) site), but our primary focus is going to be on Corporate Finance. In order to do this, we must start by defining the concept of the corporation (firm).

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