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Long-term Financial Decisions in the Business and how much it affects the Value of the Business

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Abstract
The article sheds light on the goal of the study. In the section "Theoretical basis", the author has fully presented the theory of finance, corporate finance, and long-term financial decisions in enterprises. In order to clarify the impact of financial decisions on business value, the author has provided evidence of each financial decision so that we can see the impact if the manager makes a wrong decision, causing a loss of business value. Therefore, before making financial decisions, we need to eliminate the sentiment of business administrators and need to rely on scientifically based calculation data on the current financial situation of the enterprise, consider whether the investment goal of raising capital is in line with the strategic business goals of the enterprise, Carefully consider whether the investment in raising capital or distributing profits affects and poses risks to corporate financial security, in addition, it is necessary to consider the suitability with the business environment and legal regulations in the place where the investment is intended to raise capital.

Keywords: Finance, Corporate Finance, Corporate Value

1. Introduction

In a business, Finance will deal with issues such as how to handle capital, investment decisions, and capital structure. The departments in charge of Corporate Finance will be responsible for managing and supervising investment decisions and financial activities. Of the company. Financial decisions can be understood as the intentions of corporate administrators on finance-related matters such as raising capital and allocating and using the financial resources that the company has. This use and allocation must be appropriate to the market context and conditions of the company to carry out business activities in order to maintain and grow the business. The making of financial decisions must depend on many different factors, based on each context and business conditions, that the manager will make an appropriate decision. The current situation of corporate financial management in enterprises has many wrong decisions. This is because many business executives use "mental calculation" to make long-term financial decisions. Every time they come across business projects, they estimate in their minds the cost of profits, so they run into a big problem in that they can easily round numbers and make mistakes. At first, these flaws may seem insignificant, but their accumulation can lead to a large financial loss for the business. Making emotional financial decisions and one mistake can lead to business bankruptcy.

The objective of this study is to clarify the theoretical basis of corporate finance, long-term decisions in corporate finance, and how long-term financial decisions affect corporate value.

2. Theoretical basis

2.1 Corporate finance

In the book The Theory of Finance by Fama & Miller (1972), "The theory of finance is concerned with how individuals and firms allocate resources through time. In particular, it seeks to explain how solutions to the problems faced in allocating resources through time are facilitated by the existence of capital markets (which provide a means for individual economic agents to exchange resources to be available at different points In time) and of firms (which, by their production-investment decisions, provide a means for individuals to transform current resources physically into resources to be available in the future)." [1]

Guthmann &; Dougall (1966) introduced the concept of "Finance is concerned with the raising and administering of funds and with the relationships between private profit-seeking enterprise on the one hand and the groups which supply the funds on the other. These groups, which include investors and speculators — that is, capitalists or property owners — as well as those who advance short-term capital, place their money in the field of commerce and industry and return expect a stream of income." [2]. Thus, referring to "Finance" refers to the management of "in money, currency, and capital assets".

According to Pamela & Frank (2009), "Corporate finance refers to the actions that managers take to increase the value of the company to shareholders, its funding sources and capital structure, as well as the tools and analysis used to allocate financial resources. Although corporate finance is fundamentally different from managerial finance, which studies the financial management of all companies rather than just companies, these concepts are applicable to the financial affairs of all companies. And this field was then often called "business". Finance" [3]. Typically, "corporate finance" relates to the long-term goal of maximizing the value of the entity's assets, stocks, and returns for shareholders, while balancing risk and return [4]. This requires three main areas: "Capital budgeting: Choosing which projects to invest in—here, Accurately determining value is crucial, as judgments about asset value can be "success or failure." Dividend policy: The use of "excess" funds - these funds will be reinvested in the business or returned to shareholders. Capital structure: Decides the combination of capital sources to be used – here try to find the optimal capital combination between debt commitments and capital costs" [5].

2.2 Enterprise value

Trinh (2015) cited the concepts of Corporate Value by many authors whose work on corporate value is prominent such as Grossman and Stiglitz, (1977); and Sarma and Rao, (1969). Firm value is a measure of a firm's economic performance (Grossman and Stiglitz, 1977; Sarma and Rao, 1969). Enterprise value focuses on the capital structure of a business, allowing businesses to compare business value with many different capital structures (Quiry *et al*., 2011). Therefore, value maximization is the goal of many businesses (Sundaram and Inkpen, 2004), and it is natural for businesses to seek to maximize corporate value" [6].

Author Long (2017) said "Enterprise value: If you consider a business as an asset to invest, business value is a benefit to investors at the present time as well as in the future. Currently, there are many methods with different perspectives to determine business value such as: From the point of view based on absolute valuation, there is a discounted cash flow method or an asset method... but from a valuation-based point of view, there are indicators such as: ROA, ROE, EPS, EVA, P/E, or Tobin's Q… represents corporate value" [7]. In this author's follow-up study on "Capital Structure Thresholds and Enterprise Value" published in 2018, the author defines "Enterprise value is an economic measure that reflects the market value of a business. It reflects the opportunistic nature of business operations and may change over time due to external and internal conditions. However, financial analysts can use a variety of calculations to determine the value of the business." [8]. Author Hung (2022) makes a statement about business value in the study "Influence of the Appropriateness of Accounting Information on Financial Statements and Enterprise Value: Research in Vietnam" as follows: "If you consider an enterprise as an investment asset, the enterprise value depends on the income brought to investors. Therefore, enterprise value is the sum of the current prices of all income that is likely to be brought in the process of production and business activities. In other words, the business value is the tangible benefits and potential benefits a business can generate expressed in the form of value that we can calculate and determine through appropriate valuation methods and models" [9].

Thus, Enterprise value is the value of all assets of a business. The value of each asset constituting the total assets of the enterprise cannot be separated from each other and cannot be appraised on the basis of market value.

3. Long-term financial decisions in the business

In any business, making financial decisions is an extremely important task for managers. Financial decisions can be understood as the guidelines and intentions of managers on finance-related issues such as capital mobilization, allocation, and use of financial resources that the company has in accordance with the market context, and company conditions to carry out activities to maintain and develop the business. Financial decisions in the enterprise include short-term decisions and long-term decisions. Long-term financial decisions include Capital investment decisions, capital raising decisions, and profit distribution decisions. Here we will conduct an analysis of the impact of these long-term financial decisions in the business on the value of the business, and provide an illustrative example.

3.1 Capital investment decision

In finance, financial investment is putting money into an asset with the expectation of capital appreciation, usually in the long-term future. This may or may not be supported by research and analysis. Most or all forms of investing involve some form of risk, such as investments in equities, real estate, and even fixed-rate securities that can, inter alia, inflation. Invested capital is the amount of money or assets that a business invests in business activities in order to generate future profits. Investment capital includes financial resources such as cash, equipment, tools, workshops, and other types of assets necessary to operate the business.

Capital investment decisions are mainly decisions related to the preparation of capital budgets. Through monitoring capital budgets, businesses will determine the amount of capital spent and estimate future cash flows from proposed capital projects. In addition, the manager can also compare the planned investments with the potential amount of money that can be collected to make the final decision on which projects to include in their capital budget.

The author gives two examples to clearly see the impact of the decision to invest capital. First example: An enterprise considers two investment options using existing investment capital of VND 8 billion, assuming a bank deposit interest rate of 13%.

Option 1, invest VND 5 billion to produce item A, if the state levies a high tax on this item (the probability of being taxed is high is 30%), the rate of return on investment capital will be 18%. If the state were to tax at the normal rate, the rate of return on investment capital would be 32%.

Option 2, in addition to the existing VND 8 billion of investment capital, enterprises need to borrow an additional

VND 1.5 billion with an interest rate of 18% / year to invest in the production of item B. If the state levies a high tax on this item (the probability of being taxed is high is 70%), the rate of return on investment capital will be 21%. If the state charges taxes at the normal rate, the rate of return on investment capital will be 36%.

After calculating the IRR and NPV profit ratio, the enterprise will decide to choose Option 2 to proceed with the investment.

The second example is a business that intends to invest in mining and has two investment options to choose from.

Option 1. Mining A. Mining A, the likelihood of good ore is 65%. If the ore is good, the likelihood of high demand is 78%, this gives the business an NPV of 35 million USD, and if the demand is low, the NPV will be 20 million USD. Conversely, if the ore is bad, the NPV will only reach 14 million USD.

Option 2. Choose mining B. Mining B, the probability of good ore is 67%, at which time NPV reaches 53 million USD. If crocodile ore, enterprises must equip new smelting equipment, the probability of an event is 42%, then NPV only reaches 10 million USD. In the absence of new cooking equipment, NPV would reach $34 million.

In this example, the total investment capital of the two options is the same, but we have mining NPV A < mining NPV B. Thus, the enterprise will decide to invest capital in option 2, mining B.

3.2 Decision to raise capital

Capital mobilization is the activity of creating capital for business activities of enterprises in many different forms. Some popular forms of capital mobilization of enterprises today, include: Raising equity from: Initial contributed capital, Undivided profit, and Issuing shares.

Capital raising decisions are those that involve choosing which sources of capital to provide for investment decisions. The decision on capital mobilization in the enterprise will include tasks for the provision of capital in the form of equity or corporate debt, which can conduct unsecured loans, financial intermediaries, and commercial banks. It is also possible through Investment banks to issue debt securities, besides, enterprises can also choose to resell shares to investors.

Before deciding to invest, business administrators need to make a decision to raise capital. What long-term capital sources can be used for investment, and what is the size of capital mobilization to maximize profits and minimize costs through the evaluation of the cost of capital use of such capital sources? Evaluate the advantages and disadvantages of using each source of capital.

Example: A liquor business needs bottles to store alcohol. Instead of buying at a cost of 18 billion a year, they plan to build a workshop to make bottles. It is estimated that the number of bottles produced annually is worth 1.8 billion. The initial investment capital is VND 5 billion from bank loans with a constant interest rate of 7%. The operational life of the project is estimated to be 20 years. The estimated annual operating cost is VND 1 billion.

At this time, the management board will calculate the cost of using borrowed capital and profit if investing in the project to decide. At that time, the plan to mobilize loans to build factories will bring higher profits to investors.

Another example is: A business is planning to borrow 15 billion VND from the bank to operate a hotel. The annual revenue collected is VND 3.8 billion and kept at such a stable level until the end of the project. Annual expenses, excluding depreciation, are equal to 30% of revenue. It is expected that the hotel will operate for 15 years. Know that the bank interest rate is 12% per annum. Should enterprises borrow capital from banks to put into hotel investment activities?

In this embodiment, we have the profitability of NPV>0 and IRR> r projects. Thus, enterprises should borrow capital to conduct investment.

3.3 Profit distribution decision

Profit distribution is a form of profit distribution that enterprises get after a certain period to meet the interests of stakeholders.

The decision to distribute profits is a decision associated with the dividend distribution or dividend policy of the enterprise. Managers choose the after-tax profit ratio to distribute dividends and reinvest to maximize business value. With regard to dividends and capital gains, managers in the business will have to make a decision whether to retain excess earnings of the company to set aside for future investments or choose to distribute income to shareholders in the form of dividend share buybacks. Managers can also make decisions to use undistributed retained income to shareholders to fund business expansion. This is generally considered the most optimal source of capital because it will not reduce the value of the owner's capital through issuing shares or incurring debt for the business.

Illustrative example: To expand its business, a business acquires 1 hotel with undistributed profits worth VND 30 billion. The project will be in the mining business for 20 years. Annual revenue can be around VND 10 billion (assuming regularity). The annual operating cost to generate the above revenue is VND 3 billion. The residual value of the equipment after the liquidation at the end of the project life is about 5 billion. The price of land is considered to be constant. Assuming the bank interest rate is 13% / year, the business has the choice to invest or redistribute the profits.

At this time, the management board will calculate the profit achieved by the investment project and compare it with the bank interest rate, they will decide to retain the profit to proceed with the investment.

Another example of profit distribution is: The business of manufacturing your products is growing well, so the business intends to use 10 billion after-tax profits to innovate a technological line. The bank interest rate is expected to be 15% per year. The revenue of the new technology line reached VND 3.2 billion per year (lasting steadily for 8 years and incurring no other costs). The question is, should businesses use undistributed profits to reinvest?

In this example, the enterprise will calculate the interest rate target of the project and compare it with the bank's interest rate. The results show the r> IRR of the project. Thus, enterprises should consider paying dividends to shareholders of the enterprise.

4. The degree of impact of financial decisions on enterprise value

What should managers keep in mind to make successful financial decisions for their businesses? As mentioned above, financial decisions in an organization are formed by many different factors, based on specific business contexts and conditions. Administrators must make financial decisions appropriate to the current situation. Here are some important factors that administrators need to consider: First: "Current financial position: Financial decisions should be based on the organization's current financial position, including profitability, cash flow, assets, and liabilities. Managers must evaluate financial capacity and business performance to make rational decisions.

Second, business goals and strategies: Financial decisions must be consistent with the organization's business goals and strategy. For example, if the goal is rapid growth, it may be necessary to invest in new projects. Conversely, if the goal is to optimize short-term profitability, it may be necessary to reduce costs or increase debt collection.

Third, risk and financial security: Financial decisions require risk assessment and management. Managers must consider financial risk tolerance and seek to mitigate risks through effective risk assessment, analysis, and management.

Fourth, business and legal environment: Financial decisions also depend on the business and legal environment.

Administrators need to master regulations and laws related to finance and accounting to ensure compliance and make appropriate decisions.

Finally, other factors: In addition, other factors such as competition in the industry, market trends, economic situation, and political factors can also influence financial decisions. Administrators need to analyze and evaluate these factors to make smart and timely decisions."

4.1 Impact of capital investment decisions on enterprise value

The influence of capital investment decisions on enterprise value is in two completely different directions. If the capital investment decision is correct, it will help the business: Create the infrastructure and assets needed for the business to operate; Enhance the production and competitiveness of enterprises; Generate profits, and increase value for shareholders in the future; Plays an important role in attracting new investment and scaling up business operations. On the contrary, if the investment decision is incorrect, it will cause damage to the business such as capital loss; reduce the returns of shareholders and investors; corporate value to be affected and low; It is difficult to attract investment capital after an enterprise makes an unsuccessful investment.

4.2 Impact of capital mobilization decision on enterprise value

The influence of the decision to raise capital in the enterprise on the value of the enterprise. The decision to raise capital is a balancing act with the aim of determining the relative amount between equity and debt. If raising capital depends entirely on borrowed capital, it makes too much debt. At that time, the risk of default of the enterprise is very high and can dilute profit income. At this time, the value of the enterprise's shares and the value of the enterprise decrease.

4.3 Impact of profit distribution decisions on enterprise value

The influence of the decision to distribute profits in the enterprise on the value of the enterprise. When managers can be quite sure that they can earn a higher profit/investment rate than the cost of capital spent by the business, they will aim to retain after-tax profits to invest and increase business value. Conversely, if they are uncertain about this ratio, they need to consider paying dividends to shareholders.

5. Discussion

Financial decisions are always demanding in terms of time: Must be speed; Save time; and Cost. The more these factors save, the better for the business. In response to that requirement, many business executives have lacked calculation when making financial decisions, especially long-term financial decisions. These subjective and hasty decisions cause the assets and capital of the enterprise to decrease, indirectly causing the value of the enterprise to be affected. Therefore, before making a financial decision, business managers need to consider the current financial situation, strategic business objectives of the business, financial risks and security, business environment, legal and other factors to make long-term financial decisions such as Investment decisions; Decide on capital mobilization; The decision to distribute profits does not diminish the value of the business.

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