

# Warm up exercises

[Finance](#)



For financial institutions, the key suppliers of funds and the key demanders of funds are individuals, businesses, and governments. The savings that individual consumers place in financial institutions provide these institutions with a large portion of their funds. Individuals not only supply funds to financial institutions but also demand funds from them in the form of loans. However, individuals as a group are the net suppliers for financial institutions: They save more money than they borrow.

What do you think the consequences might be in financial markets if individuals consumed more of their incomes and thereby reduced the supply of funds available to financial institutions? If individuals consumed more financial institutions would have less to invest in the economy. Lack of investment in the economy could lead to loss of jobs and much needed investment into businesses and infrastructure. E2-2 You are the chief financial officer (CFO) of Gaga Enterprises, an edgy fashion design firm. Your firm needs \$10 million to expand production.

How do you think the process of raising this money will vary if you raise it with the help of a financial institution versus raising it directly in the financial markets? As a CFO if I raise the money with the help of a financial institution I will be in a better position to get loan rates that are lower and cheaper with possibly better terms than if I raised it in the financial markets. E2-3 For what kinds of needs do you think a firm would issue securities in the money market versus the capital market?

If a firm is investing in itself and would like to have a situation where they need money for a short period of time they will issue securities. Some of those needs could be any expense they may have that is considered short

term. Some of those needs could be short term inventory and long term equipment. If they need to finance an activity or an equipment for several years they may finance it with securities. E2-4 Your broker calls to offer you the investment opportunity of a lifetime, the chance to invest in mortgage-backed securities.

The broker explains that these securities are entitled to the principal and interest payments received from a pool of residential mortgages. List some of the questions you would ask your broker to assess the risk of this investment opportunity. What is the quality and the type of real estate that the investment would be in? What kind of mortgage backed securities? Or are these securities risky or are they mortgages were most customers have a good credit rating? How will the interest rate be affecting the market? E2-5 Reston, Inc. , has asked your corporation, Pruro, Inc. for financial assistance. As a long-time customer of Reston, your firm has decided to give that assistance. The question you are debating is whether Pruro should take Reston stock with a 5% annual dividend or a promissory note paying 5% annual interest. Assuming payment is guaranteed and the dollar amounts for annual interest and dividend income are identical, which option will result in greater after-tax income for the first year? Based on the data above Pruro should take the Reston Stock paying a 5% annual dividend rather than taking the 5% promissory note.

The reason is because the treatment of Pruro annual interest tax compared to the annual dividend is different for tax purposes. Pruro would have greater tax benefits from dividend income because of the 30% tax treatment. Write a one-paragraph analysis of where " you are" at this point. What have you

learned? Where do you see potential problems in your learning? I have learned so far the relationship between how money flows from the financial institutions to individuals, businesses, and governments.

I think that in order for a company to become successful it has to learn how their business is affected by how the individual and government behavior influences the flow of money. In addition I learned how the markets can be affected by the decisions that are made. My potential problems could possibly be the word problems when I have to figure out if a particular exercise has to be solved by using a particular formula. Also another problem is that since I look at things from an Accounting standpoint I have a bias toward seeing them from my perception of accounting rather than from the perception of others.