Principles of corporate finance: goals and governance assignment

Business

Financing means raising the cash for this investment. C. The shares of public corporations are traded on stock exchanges and can be purchased by a wide range of investors. The shares of closely held corporations are not traded and are not generally available to investors. D. Unlimited liability: investors are responsible for all the firm’s debts. A sole proprietor has unlimited liability. Investors In corporations have limited liability. They can lose their Investment, but no more. Shares in the business. A partnership is a limited-life agreement to establish and run a business.

Separation of ownership and management typically leads to agency problems, 6. Where managers prefer to consume private perks or make other decisions for their private benefit rather than maximize shareholder wealth. 7. A. Assuming that the nomenclature market is risky, an 8% expected return on the F nomenclature investments may be inferior to a 4% return on U. S. Government securities. B. Unless their financial assets are as safe as U. S. Government securities, their cost of capital would be higher. The SCOFF could consider what the expected return is on assets with similar risk. 8.

Shareholders will only vote for (a) maximize shareholder wealth. Shareholders can modify their pattern of consumption through borrowing and lending, match risk preferences, and hopefully balance their own checkbooks (or hire a qualified professional to help them with these tasks). 9. If the investment increases the firm’s wealth, it will increase the value of the firm’s shares. Ms. Espanola could then sell some or all of these more valuable shares in order to provide for her retirement income. 10. As the

Putnam example illustrates, the firm’s value typically falls by significantly ore than the amount of any fines and settlements.

The firm’s reputation suffers in a financial scandal, and this can have a much larger effect than the fines levied. Investors may also wonder whether all of the misdeeds have been contained. 1 1 . Managers would act in shareholders’ interests because they have a legal duty to act in their interests. Managers may also receive compensation, either bonuses or Managers may fear personal reputation damage that would result from not acting in shareholders’ interests. And managers can be fired by the board of directors, which in turn is elected by shareholders.

If managers still fail to act in shareholders’ interests, shareholders may sell their shares, lowering the stock price, and potentially creating the possibility of a takeover, which can again lead to changes in the board of directors and senior management. 12. Managers that are insulated from takeovers may be more prone to agency problems and therefore more likely to act in their own interests rather than in shareholders’. If a firm instituted a new takeover defense, we might expect to see the value of its shares decline as agency problems increase and less shareholder value minimization occurs.