Study Plan
Chapter 1

Learning Objectives

After studying this chapter you should be able to:

- Demonstrate an appreciation of how finance interacts with other functional areas of any business, see the diverse career opportunities available to finance majors and outline the main professional financial qualifications available in business
- Describe how modern companies obtain funding from financial intermediaries and markets, and discuss the five basic functions that modern financial managers must perform;
- Assess the costs and benefits of the three principal forms of business organization and explain why limited liability companies, with publicly traded shares, dominate economic life in most countries; and
- Define agency costs and explain how shareholders monitor and encourage corporate managers to maximize shareholder wealth by choosing business opportunities for which the marginal benefits (MB) outweigh the marginal cost (MC).

Summary and Conclusions

- When making financial decisions, managers should always ask whether the marginal benefits of the decision outweigh the marginal costs. Managers should take actions and accept projects only where the marginal benefits exceed or are equal to marginal costs.
- Finance graduates must interact with professionals trained in all other business disciplines. The five most important career paths for finance professionals are in corporate finance, commercial banking, investment banking, money management, or consulting.
- Corporations can obtain external funding either from financial intermediaries, such as commercial banks, or by issuing securities directly to investors through capital markets. Intermediaries have been steadily losing financial market share to capital markets for several decades.
- The practice of corporate finance involves five basic, related sets of activities: external financing, capital budgeting, financial management, corporate governance, and risk management.
- The three key legal forms of business organization in the United States are sole proprietorships, partnerships, and corporations. Sole proprietorships are most common, but corporations dominate economically. Limited partnerships and S corporations are hybrid forms, combining the limited

liability of corporations with the favorable tax treatment of partnerships. A new, fourth form, the limited liability company, has recently become popular because of its flexibility and favorable tax treatment.

- Limited liability companies exist in virtually every country, and those in developed countries share many of the same basic traits.
- The goal of firm managers should be to maximize shareholder wealth rather than maximize profits, because the latter focuses on the past, ignores the timing of profits, relies on accounting values rather than future cash flows, and ignores risk. Shareholder wealth maximization is socially optimal because shareholders are residual claimants who profit only after all other claims are paid in full.
- Agency costs that result from the separation of ownership and control must be addressed satisfactorily for companies to prosper. These costs can be overcome, or at least reduced, by relying on market incentives or threats for corporate control, by incurring monitoring and bonding costs, and by using executive compensation contracts that align the interests of shareholders and managers.
- Ethics, the standards of conduct in business dealings, are important in corporate finance. Ethical behavior is viewed as necessary for the achievement of firms' goal of maximizing owner wealth. The Sarbanes-Oxley Act of 2002 established rules and procedures aimed at eliminating the potential for unethical acts and conflicts of interest in public corporations.