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Principles of Financial Management Chapter 1 - 4

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Principles of Financial Management

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Introduction

Principles of Financial Management is a course that introduces you to key financial concepts and the application of financial analysis in making sound business decisions. Topics covered are time value of money, risk and rates of return, asset valuation, capital budgeting, and capital structure, and more. At the end of the course, you will gain an understanding of financial assets, financial markets, financial intermediaries, and the banking system. You will also be able to understand financial statements (i.e., balance sheet, income statement, and cash flow statement) published by corporations and the various ratios utilized by investors.

Upon completion of reading this book, you will understand and apply these concepts and skills in business decisions and meet the following objectives.

- Gather, interpret, and assess economic information from a variety of sources/viewpoints.
- Evaluate economic evidence and arguments critically or analytically.
- Produce well-reasoned written/oral arguments using evidence to support conclusions.
- Identify and apply the fundamental concepts and methods of economics exploring the U.S. experience in its diversity.
- Analyze/explain one or more major economic themes of U.S. history from more than one informed perspective.
- Explain/Evaluate the role of the United States in international relations.
- Identify the major economic systems and ways to measure economic performance.
- Describe the supply and demand model in numerous applications.
- Describe how prices are determined in markets.
- Interpret graphical economic data.
- Describe macroeconomic problems of unemployment and inflation & their measurements.
- Evaluate macroeconomic stabilization policies including fiscal and monetary policies.
- Analyze/evaluation the impact of the Federal Government's economic and foreign policies on the American economy.

Acknowledgements

This work has been supported by the CUNY OER Grant 2022-23.

Chapter 1 Overview of Financial Management, Firms v. Markets

Overview

In module 1, we will learn about finance and alternative ways of organizing economic activities, which is either through a firm or market. We will focus on firms, specifically:

- Goal of the firm
- Structure of the firm
- Size of the firm
- Forms of business organizations

We will see how firms ar eable to fund themselves, either through equity or debt, and then some problems that exists with corporations, such as the agency problem. The different interests of shareholders and managers conflict with each other, which leads to the agency problem. Hence, the question is how to lower this risk or balance these opposing interests of sharelders versus managers.

Topics in this section include the following:

- **What is Finance?**
  - *Comparing markets for goods and services to markets for money.*
  - *Market Efficiency.*
  - *Financial Markets.*

- **Firm vs. Markets**
  - *Organizing economic activities through markets.*
  - *Transactions costs and rise of the firms.*
  - *Mergeers and acquisitions and size of firms.*

- **Creating Value for Investors & Agency Problem**
  - *Creating value for investors.*
  - *What is the agency problem.*
  - *How to mitigate the agency problem.*

A. What is Finance?

Before we understand what finance is, we want to stop for a moment and remember what you learned in an economics course: supply and demand. Think about the market for books. Deamnd is known as the choice making behavior or buyers, while supply is the choice making behavior of sellers. In other words, the demand curve shows the quantity demanded that consumers are willing and able to buy at different prices. The demand curve is downward sloping and is shown in blue. The supply curve shows the quantity supplied that sellers are willing and able to sell at different prices. The supply curve is upward slowing and is shown in orange. Both curves meet in one point known as the equilibrium. Markets are efficient because they can reach equilibrium and allocate resources efficiently. So, the buyers who value the good the most will be the ones to

purchase the good, and the sellers who can produce it at the lowest cost will be selling the good to these buyers. So, trading through markets in this voluntary exchange of goods and services will make both buyers and sellers better off and will also provide the optimum and most efficient allocation of goods and services.

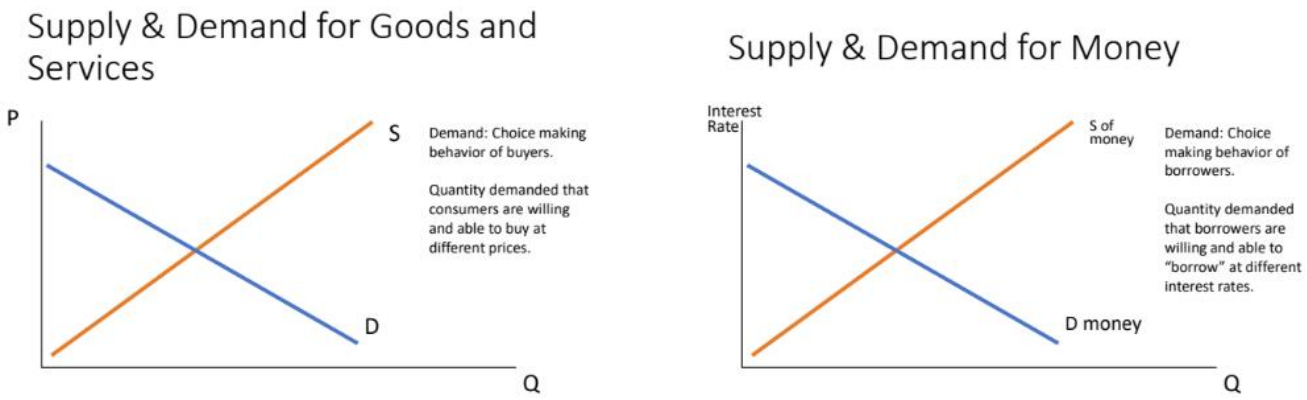


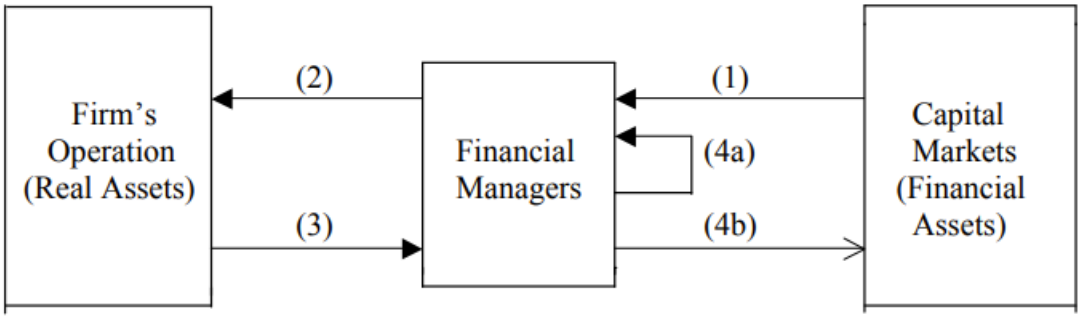
Figure 1: Markets for goods, services, or money.

The same way we discuss about supply and demand and how their interactions create a market, which eventually is the voluntary transaction between buyers and sellers who are both better off from this voluntary trade, imagine instead we are talking about goods, we are talking about money. So, there are consumers or households who have excess money at the present, meaning that they want to save instead of spending. These households want to postpone their spending for the future. And then there are other households or individuals who demand money because they have some great ideas about starting a business or expanding their business or buying a house or investing in other areas. So, there is a a demand and there is a supply of money. Think of money as being another type of good or service. Where demand and supply meet will set the point of equilibirum. This point will set the quantity demand and supplied be the same and a price, which is called "interest rate." We will revisit this topic about interest rates and how they affect borrowing and lending in more detail in the future. But for now, we want to see that the same way that markets of goods ands ervices allow efficient allocation of those goods and services, these markets for borrowing and lending money allows an efficient allocation of money as well.

Stop and Think: You have $10,000. You could open an annual Certificate of Deposit (CD) with an interest rate of 4%, or you could start a business with $30,000, which you expect to have a return on investment of 10%. Woud you rather borrow $20,000 to start a business or open a CD? In other words, will you be lending $10,000 (in supply side) or borrowing 20,000 (in the demand side)?

What is finance? We talked about supply and demand of goods, services, and money as well. In a money market, there are individuals who want to lend money and others that want to borrow money. They come together in a market, and they transact. So that is what finance is, right? You have the firms who want to invest the money, and then you have the capital markets where these financial assets, such as money, are being borrowed by the firms. In addition, the financial managers are in between to make decisions for the firm. So, you can see that cash is going from

the capital markets where we find individuals who want to lend money, who are saving their money. They're lending it to others and this money is flowing to firms that have better ways of making use of this money. These firms are making a good investment and as a result they are earning a return and they're willing to pay an interest for borrowing the money.



(1) Cash raised by selling financial assets in financial markets
(2) Cash invested in firm's operations and used to purchase real assets
(3) Cash generated from firm's operations
(4a) Cash reinvested in firms' operations
(4b) Cash returned to investors

Financing decisions vs. investment decisions: raising money vs. allocating money
Activity (1) is a financing decision
Activity (2) is an investment decision
Activities (4a) and (4b) are financing decisions

Figure 2: Fincial Market Diagram
Source: https://www.csun.edu/~zz1802/Finance%20303/Web-New/Lecture-Notes-Mid1.pdf

That payment goes back into these capital markets when that debt matures. We will talk about capital markets in the future modules. So, the firms have different ways of funding their investments. One would be through borrowing money through debt. The other would be through selling equity.

B. Firm vs. Market

We discussed how firms borrow money in the capital markets to fund their investments. I want to stop here for a moment to identify the difference between firms and markets. So, production or transactions in general can occur either through markets, through demand and supply.

When production occurs through markets, there are independent agents who buy and sell from each other, but this increases transaction costs. So, in some cases, it makes it hard for individuals to transact with each other in order to produce. Under these circumstances of high transaction costs, it is cheaper to create firms than handle this production as a whole entity. This topic is covered in detail by the recommended source, an article by Ronald Coase in 1937. He explained that a firm is an alternative means of organizing economics to market.

Stop and Think: Please consider what has happened during the past decades has been mergers and acquisitions? What has been the cause for such mergers and acquisitions? Decreasing costs? This process is creating larger size firms that expect to decrease transaction costs and take advantage of economies of scale, etc.

The creation and expansion of firms has occurred due to high transactions have been high. Creating firms and these organized activities would take advantage of economies of scale and firms can be more efficient and can produce at a lower cost compared to smaller firms or market transactions.

Stop and Think: But what are we finding recently with what we call this GIG economy? In a GIG economy, the work is being done by freelancers or subcontracting and independent agents. Is production shifting from organazed transactions on a firm to market transactions? Or is this a different type of production, a third alternative?

Note that new apps, improved technology, and the internet may have been lowering transaction costs, which might now make markets a preferred option compared to firms. This might be an explanation of the emergence of the GIG economy.

So, we just mentioned before that firms and markets are alternative ways of transactions of production and organizing economic activities. When firms are small, the cost of doing business with other firms is high. But when firms start to increase in size, then the costs of doing business decrease. This reduction in transaction costs is because transactions are done internally rather than having competitive firms transacting with each other. But the problem is that you have also been monitoring the costs of its managers, which leads to the agency problem.

How will transactions occur either through firms or markets? When transaction costs are high, we move from markets into creation of the firms. When these firms start to increase in size, transaction costs might become even lower. That's why we see those mergers and acquisitions.

To clarify, a merger is a transaction in which the assets of one or more firms are combined in a new firm. There are different types of mergers, such as vertical mergers, horizontal mergers, and conglomerates. McDonald's is an example of vertical mergers. McDonald's is the supplier of meat and dairy and other resource products that it uses in the process of production.

One the other hand, when competing firms combine, that is a horizontal merger. We have seen throughout history that in telecommunication we have had competitors undertake horizontal mergers. Mergers of various airlines is an example of horizontal mergers. When these horizontal mergers continue, they may create new merged companies that become too large, instigating the antitrust laws. Then, a divestiture may occur. The conglomerate merger is a combination of both horizontal and vertical.

To summarize, we discussed how markets and firms are just alternative ways of organizing economic activities. After a review of how markets work, how supply and demand for goods ands services pressure and lead to equilibrium, and how markets create a voluntary institution

that led to efficient production and allocation of resources, we observed that transaction costs may lead to better and cheapter alternatives of such economic transactions. Economic transactions can be organized through firms.

There are different types of firms and different sizes of firms. We saw how mergers and acquisitions can lead to larger firms that decrease transaction costs. Now, we will observe the different types of these business organizations. The three main ones that we observe are sole proprietorship, partnership, and corporations. The first two are similar, but the first one is owned only by a single owner while the second is usually owned by multiple owners.

Proprietorship and partnerships have some advantages and of course some disadvantages. But the main advantage is that they're easy to form. They are passthrough entities for tax purposes, which means that there's no double taxation. In other words, $100 of income that you receive as the owner of a proprietorship will pass through into your personal income statement and will be taxed with your other income. So, it is taxed only once under your personal taxes. In addition to these advantages, proprietorships and partnerships also have some disadvantages, such as difficulty to raise capital, unlimited liability, and limited life. Once the owner or one of the owners dies, then that proprietorship or partnership is dissolved.

Corporations are different from partnerships and proprietorships because they have a not limited life. If any of the shareholders passes away, then the corporation continues. It's a legal entity continues. Corporations are easy to transfer ownership, in terms of percentage of interest, have a limited liability, and are easy to raise capital. In addition to these advantages, corporations have also disadvantaged, such as double taxation. If the corporation has a profit before taxes, this income will be taxed as a corporation. For example, if corporate tax rates is 20%, then you receive $80 as an owner of this corporation for every $100 Earning before Interest and Tax (EBIT). Then that $80 will be taxed again as your personal income using personal income tax rate.

Items	Proprietorship	Partnership	Corporation
Formation	Easier	Easier	More difficult
Liability	Unlimited	Unlimited	Limited*
Ownership	One	Two or more	One or more*
Ownership transfer	More difficult	More difficult	Easier*
Raise capital	More difficult	More difficult	Easier*
Life	Limited	Limited	Unlimited*
Corporate Income Tax	No	No	Yes

Figure 2: Summary of Business Organizations

This is a summary of what we discussed about the differences between different types of business organizations. Figure 2 lists the main advantages and disadvantages of different business organizations, including proprietorship, partnerships, and corporations.

The main difference between proprietorship and parthership is that the former has only one owner, while the latter has two or more. They are easier to form, and their income does not get taxed twice. Due to this they're passthrough entities. The advantages of corporations are that even though they're more difficult to form and there may be double taxation, they are limited liability, the ownership can be transferred easier, it's easier to raise capital, and can have an unlimited life.

As mentioned, corporations have an easier time raising money. There is two ways that corporations can raise money, either by issuing stocks or issuing debt. Issuing debt means that the corporation is selling a bond and making the bond holder a creditor or lender. Purchasing a bond means the buyer is entering into a contract of lending money. In the future, we will discuss the difference between primary and secondary markets.

In addition to issuing debt, meaning borrowing money from the public (individuals or institutions) and paying an interest for that, corporations can also issue new stocks. Buying stocks, meand that the buyer is owning equity. This stockholder will receive dividends, which will depend on how well the corporations will do. As you can see there is a higher risk, but also potentially higher payout for owning a stock rather than a bond. Future modules will focus in more detail on bonds and stocks, and their differences.

Stop and Think: If you intend to use $1,000, would you rather purchase bonds or stocks issued by the same company? Note that there is no right or wrong answer. Share your thoughts with a student in your class.

One thing we will talk about in the future, but we will stop here to briefly clarify are initial public offerings or known as IPOs. When a company becomes public, goes public for the first time, it will issue and sell stocks to the public. When these stocks are issued and sold, the issuing company will receive the money. When this same stock is sold from one stockholder to another one, then the proceeds are not received by the issueing company, but by the seller of the stock. The former is known as the primary market, while the latter is known as a secondary market. So, markets like the New York Stock Exchange and NASDAQ are secondary markets.

C. Creating Value for Investors & Agency Problem

Another advandage of corporations is that they usually tend to be larger. The larger they become, usually the average transaction costs go down. However, this advantage is coupled with a disadvantage. There is a separation of ownership and control. The limited liability is good for shareholders, because losses are limited to the price of the stock paid. But there is that separation of ownership and control, meaning that the ownership is held by the shareholders, but the operations and decisions are made by other parties: the managers and directors. So, imagine you may be owning stocks from Apple, but you are not really making decisions about Apple. The control of the company is not on you. It's managers who direct and make decisions in the operations of the company. Because managers and stock shareholders may have diverged or different interests, this may cause a conflict of interest. So, the Board of Directors is set up to

monitor managers and make sure that they're performing their job to the interest of the shareholders, not in their own interest.

To minimize this issue, stock packages are being given to managers to give managers the same incentives and interests as a shareholder. By making those managers part holders or part shareholders of the company, we're trying to make sure to align those interests.

So, to make sure that managers will follow those steps that will benefit the shareholders directly and not someone who is just doing daily operations on the company. The firm's organization may vary, but in general, at least large corporations, you have the Board of Directors that represent the shareholders and monitors the managers.

Stop and Think: If you started your own business, what type of business organization would you form? Share your reasoning with a student in your class.

Additional Resources

- Test 1
- Discussion 1:
- PowerPoint 1: https://www.dropbox.com/s/hqefjrcbkjao8lr/Finance%20-%20Module%201%20-%20PDF.pdf?dl=0
- Video: https://www.dropbox.com/s/vakxwp1fby83rmp/Finance%20-%20Module%201.1%20Recorded%20mp4.mp4?dl=0

References

- Coase, R.H. (1937). The Nature of the Firm. Economica, 4(16), p. 386-405. http://kbcc.ezproxy.cuny.edu:2048/login?url=https://www.jstor.org/stable/2626876

- Coase, R. (1988). The Nature of the Firm: Meaning. *Journal of Law, Economics, & Organization, 4*(1), 19-32. http://kbcc.ezproxy.cuny.edu:2048/login?url=https://www.jstor.org/stable/765012

Chapter 2 Firms and Fincial Institutions

Overview

This module will discuss capital allocation process, the use, importance, and efficiency of financial markets. We will learn about primary and secondary markets; difference between NASDAQ and NYSE, what is IPO, etc. We will discuss the market efficiency theory and pave the way for other topics such as insider trading, etc.

Topics in this section include the following:

- **Capital Allocation Process**
  - *Direct and Indirect Finance*
  - *Financial Markets*
- **Types of Financial Markets and Importance**
  - *Physical v. Financial Markets*
  - *Spots v. Futures*
  - *Money v. Capital*
- **Market Efficiency Theory**
  - *Market Efficiency*
  - *Price and information*

A. Capital Allocation Process

Goods and services flow from those who produce them to the ones who demand them. The same way, capital flows from those who supply capital to those who demand it. The suppliers of capital are agents (individuals or institutions) with "excess funds," lenders of money, or the ones who save money. Demanders of capital are agends (individuals or institutions) who need to raise funds to finance their investment opportunities. These groups are willing to pay a rate of return on capital that they borrow. This rate of return is usually referred to as the interest rate.

As shown in Figure 3, in Indirect Finance, borrowers borrow indirectly from lenders via finanial intermediairies that issue financial instruments which are claims on the borrrowers' future income or aassets. In Direct Finance, borrowers borrow directly from lenders in financial markets by selling financial instruments (securities) which are claims on the borrowers' future income or assets.

Financial markets are of great importance because they allow capital to flow from savers to investors. Saers lend money, or postpone their consumption from present to future, and receive a return, usually known as interest. Demanders of capital are able to receive and use funds to finance their investment projects. They are willing to pay a rate of return (e.g., interest) to borrow and use someone else's capital.

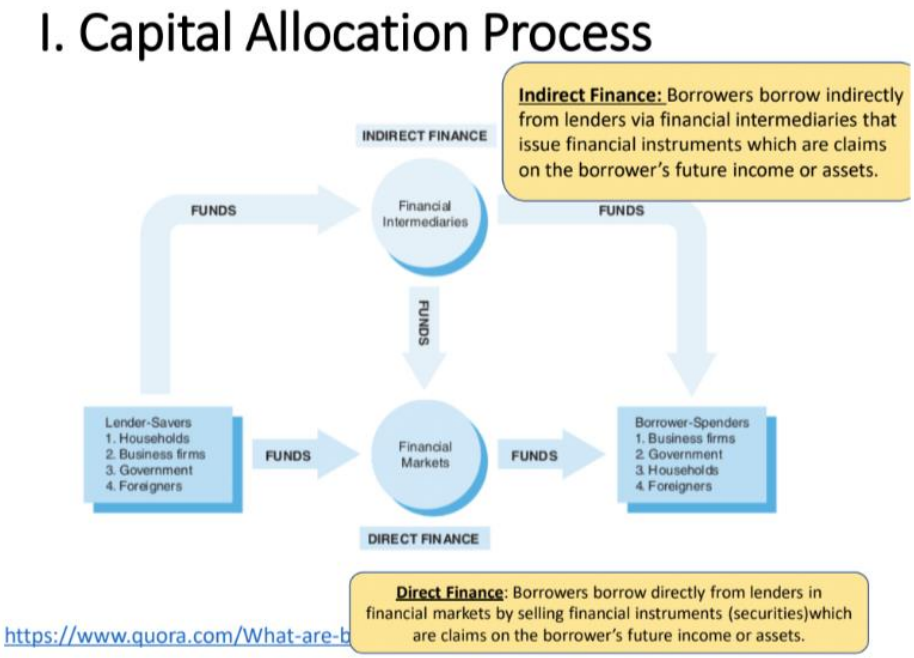


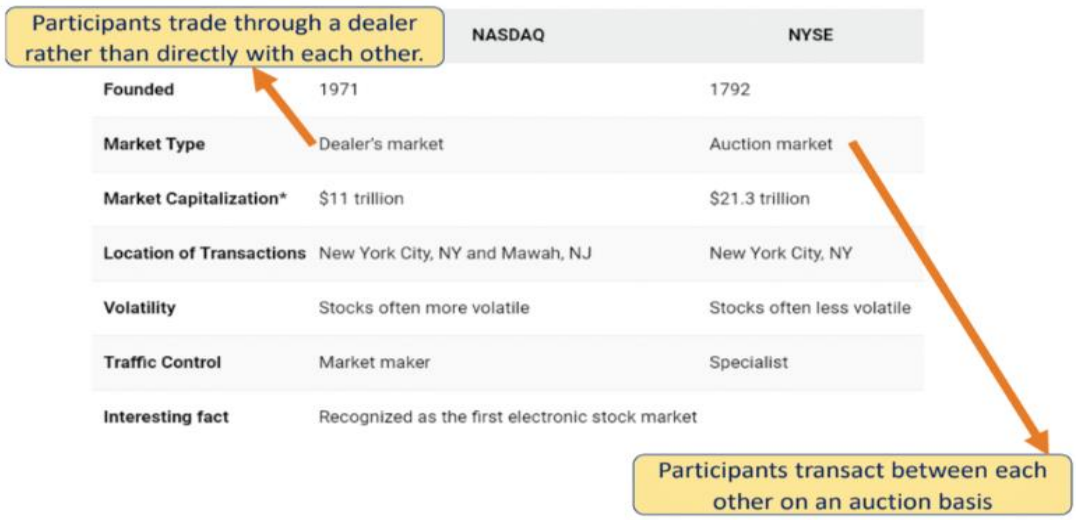
Figure 3: Capital Allocation Process
Source: https://www.quora.com/What-are-bonds-financial-term

B. Types of Financial Markets and Importance

Marekts are venues where goods and services are exchanged. This voluntary exchange of goods and services occurs between buyers and sellers, which are represented through supply and demand. Financial markets are markets where instead of trading goods and services, you trade "money" or financial instruments, such as bonds and stocks. A financial market is a place where individulas and organizations wanting to borrow funds are brought together with those having a surplus of funds.

Stop and Think: Who would perform better: economies with efficient capital markets or economices with poorly functioning markets? Would efficient markets promote economic growth?

There are various types of financial markets, such as public v. private, primary v. secondary, etc. A publicly owned corporation is a company whose shares are held by the intesting pulic, which may include other corporations as well as institutional investors.



	NASDAQ	NYSE
Founded	1971	1792
Market Type	Dealer's market	Auction market
Market Capitalization*	$11 trillion	$21.3 trillion
Location of Transactions	New York City, NY and Mawah, NJ	New York City, NY
Volatility	Stocks often more volatile	Stocks often less volatile
Traffic Control	Market maker	Specialist
Interesting fact	Recognized as the first electronic stock market	

Figure 4: Dealer v. Auction Markets
Source: https://www.dailyfx.com/nas-100/NASDAQ-vs-NYSE.html

C. Efficiency Market Theory

Securities Efficient Markets mean that equilibrium is reached, and securities are priced "fairly" or close to their intrinsic value. Information is absorbed by the market and reflected in the price changes. According to efficient market theory, all publicly available information about a stock's value is already reflected in its share price. Hence, you cannot predict them at all.

Stop and Think: What about publicly unknown information or known as inside information? Can you see why insider trading is not allowed?

Additional Resources

- Test 2
- Discussion 2:
- PowerPoint 2:

References

- A Random Walk Down Wall Street: The Time-Tested Strategy for Successful Investing. http://kbcc.ezproxy.cuny.edu:2048/login?url=https://www.jstor.org/stable/2626876
- The 15 Largest Exchange Traded Funds. https://etfdb.com/compare/market-cap/
- Bitcoin stock quote. https://finance.yahoo.com/quote/BTC-USD?p=BTC-USD

Chapter 3 Time Value of Money

Overview

Time Value of Money is an important concept in finance and economics because it explains why $1 today is not the same as $1 tomorrow. In addition to other factors, such as inflation rate, which leads to a higher purchasing power of $1 today compared to the future, is that money can be used to generate value and more earnings. There is an opportunity cost of using money. Money is made by using money, so when you sacrifice the present use of money by lending it others, you are expected to be compensated (what we call interest rate). In this module, we will continue to look at more examples of calculating future values. For example, how much would this $1 be in 20 years if we lend it (or invest it) and earn an interest rate of 10%? While in prior module we focused on calculating future values, module 4 will focus compounding and the different types of interest rates (e.g., annual, periodic, and effective interest rates). This will pave the way for the calculation of present values in module 5.
Topics in this section include the following:

Topics in this section include the following:

- **Interest Rates**
  - *Why do interest rates exist?*
  - *Types of interest rates.*
  - *Amortization*
- **Future Value**
  - *What is future value?*
  - *Calculating future value.*
  - *Compounding.*
- **Present Value**
  - *What is present value?*
  - *Calculating present value.*
  - *Discounting.*

A. Interest Rates

In this introductin of interest rates, it will make a reference to chapter 1. Similarly, to buyers paying a price for goods ands services, borrowers pay a price for borrowing money, which is referred to as interest rate. If interest rates did not exist, then lenders would have no incentive to lend money. If an individual is an entrepreneur who expects to invest money in a project that would provide a return on interest higher than the prevailing interst rates, the entrepreneur will have the incentive to borrow money and invest. However, the entrepreneur will have no incentive to undertake projects that pay a return on investment lower than the interest rates.

Recall the term opportunity cost in an economics course. Even if the entrepreneur has the money to invest in a project with a return on investment of 2%, he will not undertake such project if

interest rates are 5%. He will have the incentive of becoming a lender and receive 5% on this deposit, rather than invest it to earn 2% and sacrifice the opportunity of earning 5%.

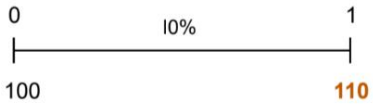
Stop and Think: You have $10,000. You could open an annual Certificate of Deposit (CD) with an interest rate of 4%, or you could start a business with $30,000, which you expect to have a return on investment of 10%. Woud you rather borrow $20,000 to start a business or open a CD? In other words, will you be lending $10,000 (in supply side) or borrowing 20,000 (in the demand side)?

B. Future Value

Future Value (FV) means the nominal value that you would receive at the end of the period based on your principal and terms of the loan. Future value is expected to be higher than the initial investment or prinicipal. This is due to the time value for money.

I. Future Value (n=1)

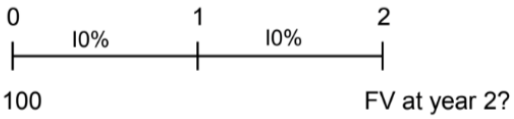
$100 deposited at the bank



- Would you lend $100 today if you receive 10% interest rate?
- What is the amount you receive at the end of the year?
- Future Value of $100 @ interest =10% is $110

I. Future value (n=2)

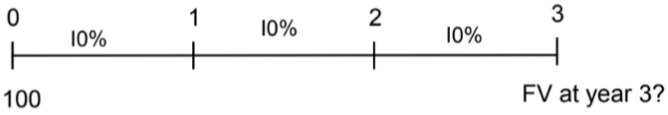
$100 deposited at the bank



- What is Future Value at the end of year 2?
- Year 1: 100 + 10%*100 = $110
- Year 2: 110 + 10%*110 = $121

I. Future Value (n=3)

$100 deposited at the bank



- What is Future Value at the end of year 3?
- Year 1: 100 + 10%*100 = $110
- Year 2: 110 + 10%*110 = $121
- Year 3: 121 + 10%*121 = $133

Stop and Think: In these examples did you earn interest on the interest? In other words, did you earn interest on $10 (interest earned during year 1) during year 2? This is called compound.

C. Present Value

A prior study of Team as Support is shared in this session. This type of intervension seemed to improve the sense of belonging and work with others.

Additional Resources

- Test 3
- Discussion 3
- Test 4
- Discussion 4
- Test 5
- Discussion 5

References

- Future Value Excel Example: https://www.youtube.com/watch?v=4jeJhkg2Q18
- Compounding Interest Rate Excel Example: https://www.youtube.com/watch?v=4jeJhkg2Q18

Chapter 4 Bonds

Overview

In this module we will learn about bonds, their key features, and the various types, as well as their valuation. We will make use of discounting future values to the present to calculate the present value or today's price of a bond. The lecture will also discuss in general the components of interest rates that help us understand why higher risks are associated with higher interest rates.

- **Bonds**
  - *What is a Bond?*
  - *Types of Bonds.*
  - *Examples*
- **Bond Evaluations**
  - *Price of a bond.*
  - *Coupon rate.*
  - *Yield to Maturity.*
- **Bonds and Interest Rates**
  - *Annual v. semi-annual bonds.*
  - *Bonds effective rates and preference*
  - *Risks and interest rates*

A. Bonds

A bond is a standard contract of borrowing. It is a long-term debt instrument in which the borrower is the bond issuer, and the lender is the bond holder. The bond issuer receives the principal when the bond is issued and sold, and it pays it back at maturity. During the term of the bond, the issuer makes payment of interest rates at specific dates.

The bond as a few important features:

1) Par Value: The face amount of the bond.
2) Coupon interest rates: Par Value * Coupon interest rate = interest payment.
3) Maturity Date: Date when bond must be repaid by the issuer.
4) Issue Date: Date the bond is issued.
5) Yield to Maturity (YTM): Rate of return earned on a bond held until maturity.

There are different types of bonds, such as:

1) Convertible bond
2) Warrant
3) Putable bond
4) Income bond
5) Indexed bond

B. Bond Evaluation

Price of a bond is calculated as the present value of all future streams of income related to it, which includes the interest payment and the par value paid at maturity. Below is an example.

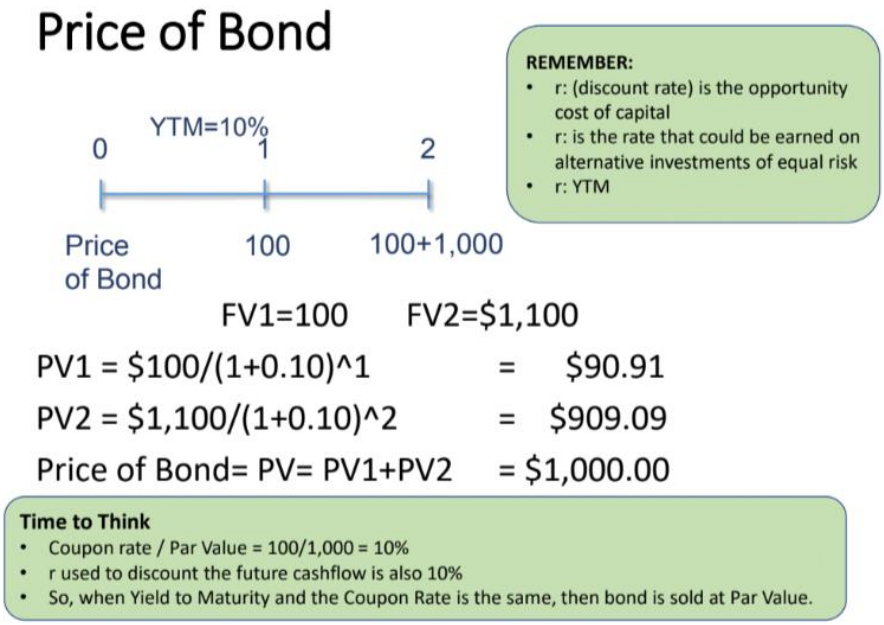


Figure 5: Price of a Bond

C. Bonds and Interest Rates

Yield to Maturity (YTM) is the rate of return earned on a bond held until maturity. When coupon rate is lower than YTM, then the bond will be sold at a discount, meaning at a lower price than its Par Value. Why?

If the bond is for sale at its par value of $1,000, no buyer would buy it because they could earn 10% investing in other alternative investments of equal risk, instead of 6% earnings that the bond provides. So, the bond holder is willing to drop the price from $1,000 to $754, which is exactly the discounted price that would make the YTM equal to the coupon rate of 6%.

Additional Resources

- Test 6
- Discussion 6:
- PowerPoint 6:

References

Discussion 1: Introduction

Welcome to Principles of Financial Management and greetings all! In this discussion forum, please introduce yourself to others. You are free to share pictures, hobbies, etc. Please try to include the following information in your introduction:

- What do you want to share with us (e.g., interest in future occupation, etc.)?
- Share ideas that come to your mind when you think of finance.

Post your introduction by the first week of the semester. Please return by Saturday to review your classmates' posts and respond to at least two (peer responses).

Discussion 2: Financial Markets

Please explain the difference between primary and secondary financial markets. Please provide an example.

Post your initial post (about 200 words) by the middle of the module/week. Please return by Saturday to review your classmates' posts and respond to at least two (peer responses).

Discussion 3: Time Value of Money

How would be best describe the time value of money? Please be thorough explanation in your own words. Providing examples may be helpful and add clarity.

Post your initial post (about 200 words) by the middle of the module/week. Please return by Saturday to review your classmates' posts and respond to at least two (peer responses).

Discussion 4: Time Value of Money | Compounding

Please explain what compounding is and how it can affect return on investment (or interest rate). Providing a numerical example (you can create your own) would be helpful.

Post your initial post (about 200 words) by the middle of the module/week. Please return by Saturday to review your classmates' posts and respond to at least two (peer responses).

Discussion 5: – Work in Progress

TBD. Post your initial post (about 200 words) by the middle of the module/week. Please return by Saturday to review your classmates' posts and respond to at least two (peer responses).

Discussion 6: Bonds

Please explain what a bond and its characteristics is. (Start thinking about how it differs from stocks... you will be asked next week).

Post your initial post (about 200 words) by the middle of the module/week. Please return by Saturday to review your classmates' posts and respond to at least two (peer responses).

Discussion 7: Stocks

Please explain the main differences between bonds and stocks. How would you choose to invest $1,000: bonds, stocks, or combination and why?

Post your initial post (about 200 words) by the middle of the module/week. Please return by Saturday to review your classmates' posts and respond to at least two (peer responses).

Discussion 9: Cost of Capital

In prior discussion, you were asked how you would choose to invest $1,000. In this discussion, assume that you are a financial manager and will decide how your firm will invest its projects: issue stocks (equity) or issue bonds (debt) and why?

Post your initial post (about 200 words) by the middle of the module/week. Please return by Saturday to review your classmates' posts and respond to at least two (peer responses).

Discussion 10: – Work in Progress

TBD. Post your initial post (about 200 words) by the middle of the module/week. Please return by Saturday to review your classmates' posts and respond to at least two (peer responses).

Discussion 11: Final Thoughts

Please explain what the most interesting thing is you learned so far. This could include topics covered in class, books, lectures, videos, or your independent research on regarding this material. Please be thorough and use at least 200 words.

Post your initial post (about 200 words) by the middle of the module/week. Please return by Saturday to review your classmates' posts and respond to at least two (peer responses).

Discussion 12: Firms vs. Markets

Please explain why firms and markets are alternative means of organizing economic activity. If transactions costs are high (e.g., need for a physical office or store, marketing, etc.) would production occur through the forming of a firm? If transactions costs are low (e.g., Internet platform that brings buyers and sellers together like amazon, ebay, etc.) production would occur through markets.

Post your initial post (about 200 words) by the middle of the module/week. Please return by Saturday to review your classmates' posts and respond to at least two (peer responses).

Multiple Choice Test 1: Business Organizations, Firms, Markets.

Based on Ronald Coase (1937) arguments about firms and markets, which statement could be correct?

a. He explained that a firm and a market are alternative means of organizing economic activity.
b. When transactions costs are too high, firms will tend to integrate.
c. Saving on high transaction costs would incentivize mergers & acquisitions.
d. All the above.

What are possible ways of expanding a firm?

a. Through investment such as building new factories.
b. Through vertical integration, meaning the firm combines with its supplier.
c. Through horizontal integration, meaning firms that compete within the same market combine.
d. Through conglomerates, meaning firms in unrelated lines of businesses combine.
e. All the above.

What is a merger?

a. A transaction in which the assets of one or more firms are combined in a new firm.
b. An investment such as building new factories.
c. Opening a new factory.
d. Starting a new business.
e. All the above.

How might a corporation raise money?

a. Increase transaction of old stocks.
b. Purchasing back old stocks.
c. Issuing debt and/or issuing new stocks.
d. Paying off a loan.
e. All the above.

What is a disadvantage of corporations resulting from separation of ownership and control?

a. Managers and shareholders have different interests.
b. Managers and shareholders have always the same interests.
c. Shareholders' losses are limited to the price of stock paid.
d. All the above.
e. None of the above.

What are the advantages of forming a corporation?

a. Unlimited life.
b. Easy transfer of ownership and ease of raising capital.
c. Limited liability.
d. All the above.
e. None of the above.

What is a disadvantage of corporations resulting from separation of ownership and control?

a. Managers and shareholders have different interests.
b. Managers and shareholders have always the same interests.
c. Shareholders' losses are limited to the price of stock paid.
d. All the above.
e. None of the above.

Which statement is correct?

a. One of the disadvantages of the corporate form of organization is that it leads to double taxation.
b. It is easier to transfer one's ownership interest in a corporation than in a partnership.
c. One of the dis-advantages of a proprietorship is that the proprietor is exposed to unlimited liability.
d. All the above.
e. None of the above.

Albi Inc. operates as a partnership. The partners have converted this business into a corporation. Which of the following statements is CORRECT?

a. Albi's shareholders (and previously known as partners) will now be exposed to less liability.
b. The company will probably be subject to more regulations and required disclosures.
c. The company's income will probably be subject to federal income taxes, leading to double taxation.
d. All the above.
e. None of the above.

Which entities would generally have a tax advantage?

a. Proprietorships and partnerships.
b. Corporations.
c. Conglomerates
d. All the above.
e. None of the above.

Multiple Choice Test 2: Financial Markets

At a family dinner, you sold 20 shares of Apple stock to your cousin. You gave your cousin the stock certificates and received a check. How could this transaction be described?

a. This is an example of an indirect transfer of capital.
b. This is an example of a direct transfer of capital.
c. This is an example of a primary market transaction.
d. This is an example of a derivative market transaction.
e. All the above

Which of these transactions occurs in the primary market?

a. Santander issues 1,000 shares of new stock and sells them to the public through an investment banker.
b. Tesla issues 100 shares of new stock and sells them to the public through an investment banker.
c. FiaCo is going through an initial public offering.
d. All the above
e. None of the above

Which statement is correct?

a. The NYSE is defined as a "primary" market because it is one of the largest and most important stock markets in the world.
b. The NYSE operates as a dealer market, whereas NASDAQ is an auction market.
c. The New York Stock Exchange is an auction market, and it has a physical location.
d. All the above
e. None of the above

Which of the following is a financial instrument?

a. $100 Bill
b. $100 EUR
c. Preferred stock
d. All the abovee.
e. None of the above

Which statement is correct?

a. As they are generally defined, money market transactions involve debt securities with maturities of less than one year.b.
b. The NYSE operates as an auction market, whereas NASDAQ is an example of a dealer market.c.
c. The New York Stock Exchange is an auction market, and it has a physical location.
d. All the above
e. None of the above

Which statement is correct?

a. A publicly owned corporation is a company whose shares are held by the investing public, which may include other corporations as well as institutional investors.

b. "Going public" establishes a firm's true intrinsic value and ensures that a liquid market will always exist for the firm's shares.
c. A financial intermediary is a corporation that takes funds from investors and then provides those funds to those who need capital.
d. All the above
e. None of the above

Which of these transactions occur in the secondary market?
a. One financial institution buys 1,000 shares of Amazon (AMZN) stock from another institution. This transaction was arranged by an investment banker.
b. You sell 1,000 shares of IBM stock on the NYSE through your broker.
c. You buy 1,000 shares of Netflix stock from your brother. The trade is not made through a broker; you just give him cash and he gives you the stock.
d. All the above
e. None of the above

Which one is an example of a secondary market?
a. If you decide to buy 100 shares of Netflix and you decide to call your broker and ask her to execute the trade for you.
b. Apple issues 100 shares of new stock and sells them to the public through an investment banker.
c. You spend $100 to purchase the latest I-phone launched by Apple, Inc.
d. All the above
e. None of the above

Which statement is correct?
a. The "over the counter" market received its name years ago because brokerage firms would hold inventories of stocks and then sell them by literally passing them over the counter to the buyer.
b. In indirect finance, borrowers borrow indirectly from lenders via financial intermediaries that issue financial instruments which are claims on the borrower's future income or assets.
c. In direct finance, borrowers borrow directly from lenders in financial markets by selling financial instruments (securities)which are claims on the borrower's future income or assets.
d. All the above
e. None of the above

According to Efficient Market Theory, what is likely to be correct?
a. Markets are efficient and information is readily included in the company's stock price.
b. You cannot predict because all publicly available information about a stock's value is already reflected in its share price.
c. You "cannot beat the market."
d. All the above
e. None of the above

Multiple Choice Test 3 | Future Value

Suppose you have $1,000 and plan to purchase a 1-year certificate of deposit (CD) that pays 0% interest, compounded annually. How much will you have when the CD matures?

a. $1,000
b. $1,100
c. $1,200
d. $1,210
e. $1,300

Suppose you have $1,000 and plan to purchase a 1-year certificate of deposit (CD) that pays 10% interest, compounded annually. How much will you have when the CD matures?

a. $1,000
b. $1,100
c. $1,200
d. $1,210
e. $1,300

Suppose you have $1,000 and plan to purchase a 2-year certificate of deposit (CD) that pays 10% interest, compounded annually. How much will you have when the CD matures?

a. $1,000
b. $1,100
c. $1,200
d. $1,210
e. $1,300

How much would $1, growing at 3.0% per year, be worth after 50 years?

a. $1.00
b. $1.30
c. $4.38
d. $19.22
e. $100.00

How much would $1, growing at 3.0% per year, be worth after 100 years?

a. $1.00
b. $1.30
c. $4.38
d. $19.22
e. $100.00

How much would $1, growing at 0% per year, be worth after 100 years?

a. $1.00
b. $1.30
c. $4.38
d. $19.22
e. $100.00

How much would $1, growing at 0% per year, be worth after 6 years?

a. $1.00
b. $1.30
c. $4.38
d. $19.22
e. $100.00

Suppose you have $1,000 and plan to purchase a 10-year certificate of deposit (CD) that pays 15% interest, compounded annually. How much will you have when the CD matures?

a. $1,045.56
b. $1,150.00
c. $4,045.56
d. $4,480.31
e. $1,000.00

Suppose you have $1,000 and plan to purchase a 10-year certificate of deposit (CD) that pays 15% interest, compounded daily (365 days). How much will you have when the CD matures?

a. $1,045.56
b. $1,150.00
c. $4,045.56
d. $4,480.31
e. $1,000.00

Suppose you have $1,000 and plan to purchase a 10-year certificate of deposit (CD) that pays 0% interest, compounded daily (365 days). How much will you have when the CD matures?

a. $1,045.56
b. $1,150.00
c. $4,045.56
d. $4,480.31
e. $1,000.00

Multiple Choice Test 4 – Work in Progress

Multiple Choice Test 5 – Work in Progress

Multiple Choice Test 6 – Work in Progress

Multiple Choice Test 7 – Work in Progress

Multiple Choice Test 8 – Work in Progress

Multiple Choice Test 9 – Work in Progress

Multiple Choice Test 10 – Work in Progress

Multiple Choice Test 11 – Work in Progress

Multiple Choice Test 12 – Work in Progress