*Corporate Finance, 5e, Global Edition* (Berk)

Test BankChapter 1

The Corporation and Financial Markets

1. Chapter Outline

The following chapter outline is correlated to the PowerPoint Lecture Slides. The PowerPoint slides are referenced in **bold**. Alternative Examples to selected textbook examples are also available in the PowerPoint Lecture Slides and are also referenced in **bold**.

* 1. The Four Types of Firms **(Slide 6)**
* Sole Proprietorships **(Slide 8)**
* Figure 1.1: Types of U.S. Firms **(Slide 7)**
* Partnerships **(Slides 9–10)**
* Limited Liability Companies **(Slide 11)**
* Corporations **(Slides 12–14)**
* Formation of a Corporation
* Ownership of a Corporation
* Tax Implications for Corporate Entities **(Slide 15)**
* S Corporations
* Example 1.1: Taxation of Corporate Earnings **(Slides 16–17)**
* *PowerPoint* Alternative Example 1.1 **(Slides 18–19)**
* Example 1.2: Taxation of S Corporation Earnings **(Slides 20–21)**
* *PowerPoint* Alternative Example 1.2 **(Slides 22–23)**

**1.2** Ownership Versus Control of Corporations **(Slide 24)**

* The Corporate Management Team **(Slides 24–25)**
* Interview with David Viniar
* The Financial Manager **(Slide 26)**
* Investment Decisions
* Financing Decisions
* Figure 1.2: Organizational Chart of a Typical Corporation **(Slide 25)**
* Global Financial Crisis: The Dodd-Frank Act
* Cash Management
* The Goal of the Firm (**Slide 27**)
* The Firm and Society (**Slide 28)**
* Ethics and Incentives within Corporations (**Slides 29–31**)
* Agency Problems
* Global Financial Crisis: The Dodd-Frank Act on Corporate Compensation and Governance
* The CEO’s Performance **(Slide 30)**
* Corporate Bankruptcy **(Slide 31)**

**1.3** The Stock Market **(Slides 32–33)**

* Figure 1.3: Worldwide Stock Markets Ranked by Two Common Measures **(Slide 37)**
* Primary and Secondary Stock Markets **(Slide 34)**
* Traditional Trading Venues **(Slide 35)**
* Interview with Frank Hatheway
* Figure 1.4: Trading volumes for NYSE- and NASDAQ- listed shares (**Slide 38)**
* New Competition and Market Changes **(Slides 36, 39)**
* Dark Pools **(Slide 40)**
  1. Fintech: Finance and Technology **(Slide 41)**
* Telecommunications **(Slide 42)**
* Security and Verification **(Slide 43)**
* Automation of Banking Service **(Slide 44)**
* Big Data and Machine Learning **(Slide 45)**
* Competition **(Slide 46)**

1. Learning Objectives
   1. List and define the four major types of firms in the United States; describe major characteristics of each type, including the means for distributing income to owners.
   2. Distinguish between limited and unlimited liability, and list firm types that are subject to each type of liability.
   3. Describe the taxation consequences for C and S corporate forms.
   4. Discuss the division of corporate ownership into shares of stock; evaluate the implications of that division for corporate decision making.
   5. Explain how corporate bankruptcy can be viewed as a change in firm ownership.
   6. Compare and contrast the characteristics of shares that are publicly traded and those that are not.
   7. Describe the major changes that stock markets have gone through in the last decade.
   8. Differentiate between trading on an exchange and trading in a dark pool.
   9. Describe the impact of various types of Fintech, such as telecommunications, security, automation, and big data on the field of finance.
2. Chapter Overview

Chapter 1 begins by discussing the “birth” of the modern corporation. The chapter examines important characteristics of the four major types of firms in the United States; however, the focus is on the corporation. Section 1.2 defines the agency relationships that sometimes occur in a corporation. Section 1.3 focuses on the stock market and its advantages in raising capital.

1.1 The Four Types of Firms

The four major types of firm in the United States are the sole proprietorship, partnership, limited liability company, and corporation. The section begins by defining each type and then highlights the differences among them. Particular emphasis is placed on the following areas that distinguish the four types:

1. Ease of formation
2. Separation between the firm and the owner from the perspective of the owner’s personal liability
3. Lifespan of the firm
4. Ease of transference of ownership

The text emphasizes the corporate form. In this chapter, the authors focus on the fact that, although corporations take a great deal of effort to form, they have some distinct advantages. The life of the firm is not limited to the life of any particular individual. Ownership in the corporation is very easy to transfer through either purchase or sale of shares of stock. However, there are some disadvantages as well. Each shareholder is likely to own only a small percentage of the stock; agency problems can be pretty serious (see Section 1.3). There is extreme separation between the firm and its owner.

Corporations are taxed in a very different way than other types of firms. Example 1.1 shows the double taxation of corporate earnings when dividends are paid. Example 1.2 shows how taxation of S corporations differs from that of C corporations.

1.2 Ownership Versus Control of Corporations.

Section 1.2 highlights the separation of ownership and control in the corporation, with particular emphasis on principal-agent problems and the firm’s relationship with society. The chapter emphasizes the market for corporate control as the primary means for encouraging managers and boards of directors to act in the best interest of shareholders.

Further stakeholders in a corporation are debt holders. A corporation that fails to repay its debt holders will be forced into bankruptcy.

1.3 The Stock Market

An important feature of equity investment is its liquidity. Stock markets improve liquidity for investors by enabling investors to trade shares of public corporations. The NYSE is the world’s largest stock market. It has a physical location, where market makers match buyers to sellers. The Nasdaq is an electronic network, where prices are posted so that they can be viewed by all participants.

Stock markets have undergone tremendous change over the last decade. Fully electronic exchanges handle more than half of all trades (Figure 1.4). Dark pools offer investors the ability to trade at a better price, but there is no guarantee that the trade will be made. Including dark pools, researchers estimate that as many as 50 venues are available for trading stock in the United States alone. They compete mainly on liquidity. Stock markets remain in a state of flux.

1.4 Fintech: Finance and Technology

The relation between financial innovation and technological innovation is known as Fintech. The field of finance has been very important in technological advancement, and the converse is also true. In the 1840s the telegraph connected distant markets and enabled the first stock ticker system. Today, some trades use microwave technology to transmit orders at the highest possible speeds. Security and verification are very important in the financial world, and blockchain technology is a form of advanced cryptography that allows transactions to be recorded in a verifiable way without the intervention of a trusted third party.

Another advance in fintech is automated transactions, such as ATMs and smartphone apps. One new development is the recent growth in robo-advisors, which provide investment recommendations and other financial advice via computer programs.

One of the first examples of “big data” was financial information, which is now stored electronically by companies such as Bloomberg, which collects and disseminates data all over the world. Computer investing algorithms use big data in an attempt to find patterns that will allow them to predict future prices. This strategy has been successful for short periods of time, but as computer algorithms compete with one another and traders adjust their strategies to make them less predictable, a technological arms race has ensued. Fintech has also enabled financial services firms to improve their product offerings and make improved lending decisions. Finally, nonfinancial organizations, such as Google, Apple, and Paypal, provide payment services that had typically been provided by banks.

1. Spreadsheet Solutions in Excel

The following problems for Chapter 1 are available as Excel Project problems in MyLab Finance at [www.pearson.com/mylab/finance](https://na01.safelinks.protection.outlook.com/?url=https%3A%2F%2Furldefense.proofpoint.com%2Fv2%2Furl%3Fu%3Dhttps-3A__na01.safelinks.protection.outlook.com_-3Furl-3Dhttp-253A-252F-252Fwww.pearson.com-252Fmylab-252Ffinance-26data-3D02-257C01-257Cjpayne-2540txstate.edu-257C1decec92fba244f001ad08d660348540-257Cb19c134a14c94d4caf65c420f94c8cbb-257C0-257C0-257C636802176038258861-26sdata-3DpByJfMbQZ2Jmo2pnZOuVWq-252FUNABcT5WgIL70dCahL98-253D-26reserved-3D0%26d%3DDwMGaQ%26c%3D0YLnzTkWOdJlub_y7qAx8Q%26r%3DLfEeFCuhEus31oTQqhWojVChF96tp6pvTtSORnqwEbA%26m%3D18rjYgxGOQoFKa9IU9ewD1OCS07COSzJUQNqKiqj-gg%26s%3DFgBFDCyeOWQRIlYUAyxqDf5D7ta9-P86z9yJGcT2moo%26e%3D&data=02%7C01%7Cjpayne%40txstate.edu%7Ce1ea6fe8132544651cc208d6603ca55d%7Cb19c134a14c94d4caf65c420f94c8cbb%7C0%7C0%7C636802210931928567&sdata=%2FVMYarRIDN6sfh%2F3CKE5TUsz84ohPNyDLXHA1KZBIUw%3D&reserved=0): 6 and 7.