Chapter 1

Financial Management

LEARNING OBJECTIVES (Slides 1-1 to 1-3)

1.Describe the cycle of money, the participants in the cycle, and the common objective of borrowing and lending.

2. Distinguish the four main areas of finance and briefly explain the financial activities that each encompasses.

3. Explain the different ways of classifying financial markets.

4. Discuss the three main categories of financial management.

5. Identify the main objective of the financial manager and how he or she might meet that objective.

6. Explain how the finance manager interacts with both internal and external players.

7. Delineate the three main legal categories of business organizations and their respective advantages and disadvantages.

8. Illustrate agency theory and the principal-agent problem.

9. Define issues in corporate governance and business ethics.

10. Explain why studying finance improves your employability.

IN A NUTSHELL

Given that a large number of business students tend to be “terrified” of taking their first (and possibly, their only) course in finance, the topics, concepts, and issues presented in this chapter provide an excellent opportunity for the instructor to “break the ice” and dispel the premonitions and prejudices that cloud students’ interest in the subject. The chapter is organized into 10 sections beginning with the definition of finance and financial management. Next, the process known as the “cycle of money” is defined, and the role of financial intermediaries such as commercial and investment banks, in the smooth operation of this cycle, is discussed.

Following financial intermediation, the author presents an overview of the four inter-related areas of finance, i.e., corporate finance, investments, financial institutions and markets, and international finance. It is important to stress that finance majors should have a strong grasp of all four of these areas. Next, the various classifications of financial markets based on structure, participants, types of assets traded, and maturity are described.

After presenting the similarities, differences, advantages, and disadvantages of the various forms of business organizations (i.e., sole proprietorship, partnerships, and corporations), the author discusses the main responsibilities of a financial manager and the main goal of financial management, which is to maximize the value of the equity of the company.

The complexity of the responsibility of financial management is introduced by presenting the various stakeholders whose interests must be balanced by the financial manager. The author then explains the relationship of the officers of a company to the owners of the company through a model called agency theory and discusses the areas of conflict that often arise from this relationship as well as the mechanisms by which these conflicts can be minimized. Finally, he touches on some of the issues concerning how corporations govern their activities and how the government attempts to regulate and monitor these activities.

LECTURE OUTLINE

Definition of Finance: (Slide 1-4)

*Finance* is the art and science of managing wealth. It is about making decisions regarding what assets to buy/sell and when to buy/sell these assets. Its main objective is to make individuals and their businesses better off.

Definition of Financial Management: (Slide 1-5)

*Financial management* is generally defined as those activities that create or preserve the economic value of the assets of an individual, small business, or corporation. Financial management comes down to making sound financial decisions.

1.1 The Cycle of Money (Slide 1-6 to 1-8)

Financial intermediaries such as investment and commercial banks assist in the movement of money, from lenders to borrowers and back again. This process is termed the *cycle of money*and its main objective is to make all the participants better off (see Figure 1.1.).

Example

A mutual fund issues shares, which are bought by individuals who save and invest part of their paychecks. The pooled funds are invested by the mutual fund company in shares that are issued by firms that are trying to raise capital for growth. The firms pay dividends periodically, which are received by the mutual fund and passed through to their shareholders or reinvested in additional shares, and the cycle of money starts again. The mutual fund managers earn fees; the firms whose securities are bought are able to raise capital for growth and future returns; and the mutual fund shareholders earn dividends and capital gains. Thus, all participants are generally better off.

Completed learning objective 1: Describe the cycle of money, the participants in the cycle, and the common objective of borrowing and lending.

1.2 Overview of Finance Areas (Slide 1-9)

Finance is often partitioned into four main interconnected and interrelated areas:

**1. Corporate Finance** deals with the financial activities that support the acquisition, investment, and repayment of capital.

**2. Investments**involve the activities centered on the buying and selling of financial assets, such as stocks and bonds.

**3. Financial Institutions and Markets**is concerned with organization, functioning, and activities of financial intermediaries and forums that promote the cycle of money.

**4. International Finance**adds the element of multinational dealings, country risk, and exchange rate conversions to the other three areas listed.

It is important to stress the point that these four areas cover the main activities of finance and are interconnected to establish a well-organized network for the cycle of money.

Completed learning objective 2: Distinguish the four main areas of finance and briefly explain the financial activities that each encompasses.

1.3 Financial Markets (Slide 1-10)

Financial markets are the forums where buyers and sellers of financial assets and commodities meet. Financial markets can be classified by the following:

* The type of asset traded, i.e., equity, debt, derivatives, foreign exchange, etc.
* The maturity of the financial asset, i.e., money market (1 year or less) and capital market (> 1 year maturity)
* The owner of the financial asset that is traded, i.e., primary market (the issuing company is one party to the trade) and secondary market (subsequent trading of securities between investors themselves)
* The nature of transaction, i.e., dealer markets (dealers buys and sell assets for profit) and auction markets (assets are sold to the highest bidders via an open outcry or auction process, and the auctioneers receive a commission for conducting the sale)

Completed learning objective 3: Explain the different ways of classifying financial markets.

1.4 The Finance Manager and Financial
Management (Slides 1-11 to 1-12)

Within businesses, it is the finance manager who is entrusted with the responsibility of determining the best repayment structure for borrowed funds so as to make sure that debt obligations are met on time and sufficient funds are available for carrying out daily operations.
It is important to stress the point that such responsibilities (i.e., budgeting and managing one’s finances), whether they are done within a business setting or within the purview of one’s personal life, are very similar.

Financial management can be divided into three main categories:

**1. Capital Budgeting**—the process of planning, evaluating, selecting and managing the long-term operating projects of the company.

**2. Capital Structure**—the means by which a company is financed; for public companies, usually a mix of stocks (equity) and bonds (debt) sold to investors and owners.

**3. Working Capital Management**—managing the day-to-day operating needs of the company through the current assets and current liabilities of the company; often referred to as the short-term financing activities of the company.

Completed learning objective 4:Discuss the three main categories of financial management.

1.5 Objective of the Finance Manager (Slide 1-13)

The main objective of the financial manager is to make investment and financing decisions that increase the cash flow of the firm, thereby, increasing the current stock price or the current market value of equity of the company.

Profit Maximization: There is often the misconception that maximizing stock price is best done by maximizing profits. However, students should be advised that although the pursuit of profits is a necessary step in shareholder wealth maximization, it is not the only step. In fact, often blind pursuit of short-term profit maximization by managers has resulted in negative long-term effects on the firm.

Maximizing Current Share Price: Although at first glance, it may seem that the goal of maximizing a firm’s stock price leads to trade-offs that could end up hurting the interests of the other stakeholders of the firm, such as employees, suppliers, or customers, in reality, the actions that must be taken to raise current stock prices often end up benefiting the other stakeholders as well. Raising stock prices requires actions and decisions that lead to higher future cash flows. Good employees, happy customers, and strong community ties all support a strong and vibrant company with better prospects for improved future cash flow. Thus by maintaining a safe and happy workplace, striving for customer satisfaction, and fostering good relations with the local community, managers can increase the future cash flow of the firm, which in turn will lead to higher stock prices.

Maximizing Equity Value: In the case of privately held firms, the goal of maximizing the current share price translates to the maximization of the firm’s equity value, i.e., the market value of its assets minus its liabilities or claims against it.

Completed learning objective 5: Identify the main goal of the financial manager and how he or she might meet that objective.

1.6 Internal and External Players (Slides 1-14 to 1-15)

Figure 1.2 shows how a typical company might be organized. Each functional area is headed by a manager or vice president, who must report to the CEO and interact with the other functional area managers to create and maintain the value of the assets of the company.

Figure 1.2: A Basic Organizational Chart for a Company



Besides the company officers, the employees, customers, suppliers, and business clients make up a much greater collection of players who are involved in the creating and maintaining the wealth of the company. So, financial managers have to interact with various internal as well as external stakeholders in their quest for shareholder wealth maximization.

Completed learning objective 6: Explain how the finance manager interacts with both internal and external players.

1.7 The Legal Forms of Business (Slides 1-16 to 1-19)

The three main forms of business organizations are sole proprietorships, partnerships, and corporations; the advantages and disadvantages of each form are shown in the following table:

| **Type of Business Organization** | **Advantages** | **Disadvantages** |
| --- | --- | --- |
| Sole Proprietorship | 1. Simplest and easiest form of business.2. Least amount of legal documentation.3. Least regulated.4. Owner keeps all profits | 1. Owner pays personal tax rate on profits.2. Obligations of the business are sole responsibility of owner, and personal assets may be necessary to pay obligations (personal and business assets commingled).3. Business entity limited to life of owner.4. Access to outside funding of business can be limited. |
| Partnership | 1. Agreements between partners may be easily formed.2. Involves more individuals as owners and therefore usually more expertise.3. Larger amount of capital usually available to the business (compared to proprietorship). | 1. Assets of general partners are commingled with assets of the business.2. Profits treated as personal income for tax purposes.3. Difficult to transfer ownership. |
| Corporation | 1. Business is legal separate entity from owners.2. Owners have limited liability to obligations of the business.3. Easy to transfer ownership.4. Usually greater access to capital for business.5. Profits may be taxed at capital gains rate for owners. | 1. Most difficult business operation to form due to charters and other legal documents.2. Double taxation of company profits, first at the company and then at the owners when distributed.3. Often the most regulated form of business. |

Hybrid Corporationssuch as Limited Liability Corporations (LLCs) and S Corporations, combine the limited liability advantage of a corporation with the personal taxation of business income feature of a partnership, thereby providing the owners (members) the best of both worlds!

Not-For-Profit Corporations are formed by businesses that engage in charitable, educational, or professional development work. Rather than maximizing shareholder wealth, they strive to promote the social good of a community or the development of a specific activity, profession, or affiliated group.

Completed learning objective 7:Delineate the three main legal categories of business organizations and their respective advantages and disadvantages.

1.8 The Financial Management Setting:
The Agency Model (Slide 1-20)

The relationship between the owners (principals) of a corporation and the managers (agents) who are appointed by the owners to run the corporation is termed an *agency relationship*. The very nature of such a relationship is fraught with opportunities for conflict *(agency conflict)* because owners want higher stock prices while managers, who are empowered to make the key operating decisions, can often stray away from their main goal of maximizing shareholder wealth and grant themselves excessive perks, or high salaries, or pad their offices with luxurious carpets, much to the dismay of the shareholders.

The problem of motivating managers to act in the best interest of the shareholders is known as the principal-agent problem. Some methods that can be used to minimize agency conflicts include supervision, outside audits, and performance-based compensation contracts, such as stock option plans and bonuses tied to earnings per share.

Agency theory is the name given to the processes surrounding recognition of the principal-agent problems and ways to align agents with the interests of the principals. Costs to align the agents above a straight effort contract or ensure performance at the contracted level are *agency costs*.

Completed learning objective 8: Illustrate agency theory and the principal-agent problem

1.9 Corporate Governance and Business Ethics (Slide 1-21)

*Corporate governance* deals with how a company conducts its business and implements controls to ensure proper procedures and ethical behavior. Most companies and managers go about the business in a fair and honest manner; however, occasionally some managers get involved in actions that fall outside the purview of ethical behavior while pursuing higher profits and lower costs. Laws concerning employee safety, truth in advertising, pollution control, illegal bribes, issuance and sale of securities, provision of financial information, and so on have been enacted by Congress to ensure fair competition and ethical behavior.

The *Sarbanes-Oxley Act*, enacted in 2002, requires among other things, that

* The CEO and CFO attest to the fairness of the financial reports.
* The company maintains an effective internal control structure around financial reporting.
* The company and its auditors assess the effectiveness of the controls over the most recent fiscal year.

Completed learning objective 9: Review issues in corporate governance and business ethics.

1.10 Why Study Finance? (Slide 1-22)

By studying finance one can understand how and why financial decisions are made in large and small companies. This knowledge can help individuals increase their own compensations as well as improve their contributions to the success of the companies that they work for. Studying finance can also help us understand the trade-offs we face in making personal financial choices and help us to select the most appropriate action.

The Putting Finance to Work box helps us gain some more insight into how studying finance can help our professional development.

Questions

1. What is the cycle of money? Who participates in the cycle of money? What is the objective of a financial transaction?

The cycle of money is the movement of funds from a lender to a borrower and back to the lender.

The participants are the original lenders (usually an individual (or household) through direct investment or through a financial institution), the financial institution that matches the lender with a borrower or bundles up a set of lenders for a single borrower, and the borrower (such as a company that is using the funds for operating the business or expanding the business).

The objective of every financial transaction is to make all parties in the transaction better off.

2.Construct an example of the cycle of money, identify all the players involved, and identify their individual benefits from participating in the cycle of money.

**Example One:** An individual opens a savings account at a local commercial bank with a $200 deposit. The bank loans out the $200 with other funds from other savings accounts to a local business man who is expanding his business. The local business man pays back the loan over time with interest, and the bank credits the savings account with interest. The individual withdraws money from the savings account to buy a new bike.

**Example Two:** An individual deposits his monthly paycheck in a checking account. The bank accumulates the funds from many checking accounts and loans money to an individual buying a house. The new homeowner makes monthly mortgage payments to the bank. The bank uses the mortgage payments to cover the checks written by the person with the checking account.

**Example Three:** An individual buys a municipal bond for an airport improvement project. The individual usually buys a municipal bond from a bond dealer, or an investment banker marketing the bond, and the funds from the sale of the bond are delivered to the city minus a fee from the investment banker. The city uses the funds to build new facilities at the airport, such as a new parking lot. Once finished, the fees received from parking are used to payback the buyer of the bond with interest.

3. What are the four areas of finance? Give an example of a financial activity that would fall into each area.

Corporate finance—the financial activities that support the operations of a business. A typical financial activity in this area is borrowing funds to support a plant expansion or supplementing short term cash needs.

Investments— the activities around the buying and selling of financial assets. A typical activity is the selling of a bond issue such as a school bond for building a new school.

Financial Institutions— the organizations that promote and facilitate the cycle of money. A typical financial activity is issuing checking and savings accounts as well as selling securities such as certificates of deposit, stocks, and bonds.

International Finance—the financial activities performed in foreign countries for a domestic company. A typical financial activity is the changing of currency from one country to another country.

4.What is the difference between the primary market and the secondary market?

The primary market is the market of first sale of common stock by a company. The proceeds of the sale go to the company for the newly issued stock.

The secondary market is the sale of “used” stock in that the current owner sells it to a new owner and the proceeds go to the current owner, not the company.

5.What is the general definition of the financial management function? Give an example of a financial management function that an individual might perform.

The financial management function is generally defined as the activities that create or preserve the economic value of the assets of an individual or company.

An individual might set a monthly budget to ensure that incoming funds are sufficient to make payments on all personal obligations, such as rent payment, car payment, utilities, food, clothing, insurance, and still allow for entertainment.

6.List a capital budgeting decision, a capital structure decision, and a working capital management decision a business might make.

Here are three examples of financial decisions that a business might make:

1. The company chooses a new product to introduce into the market (capital budgeting).

2. The company chooses to sell a bond to finance the new product (capital structure).

3. The company sets production and inventory levels on the new product (working capital management).

7.List the advantages and disadvantages of the three different types of business organizations.

See Section 1.7.

8. What is the goal of the financial manager? How does the surrounding community where a business operates fit into this goal?

The goal of the financial manager is to maximize the current share price or equity value of the firm. This goal encompasses many good business practices, such as a good working relationship with the surrounding community.

If the firm pollutes local streams, abuses local facilities such as roads, and in general does not participate in the economic advancement of the local community, its share price or equity value will suffer.

The local community may sue the company for damages, and the best members of the local workforce may choose not to work for the company. Employees may not be loyal to the company, causing high turnover and increased personnel costs for recruiting and training. Finally, facilities such as roads and utilities may not be repaired or modernized by the local community, affecting the company’s ability to produce a profit. A good community relationship is embedded in the goal of maximizing current share price or the equity value of the company.

9.With what players in an organization does the finance manager work to ensure proper financial controls are in place? Can you give a real-world example of a situation in which this relationship was absent and ultimately brought down the company?

One of the key player(s) that the financial manager works with is the auditing firm of the company. Together with the controller, a financial manager works with the auditing company to ensure that proper controls are in place for the economic activities of the firm. Auditors review the process of checks and balances within the company to ensure that access to funds and information is appropriate and that financial transactions are recorded and reported in such a manner as to provide potential investors and current owners accurate information about the performance and condition of the company.

An example of a major failure in this area is Enron and Anderson Accounting. Here the lack of proper recording of financial transactions and the lack of appropriate reporting of financial transactions ultimately led to the failure of Enron and the loss of jobs and pensions for thousands of Enron employees.

10.Name a natural conflict between a principal and an agent. How could this conflict be reduced?

**Principal-Agent pair:** Shareholders and chief executive officer

Conflict can occur in the “perks,” such as if the CEO elects to take a personal jet for flying to and from business activities instead of flying commercial carriers. The cost of the jet outweighs the expense of commercial carriers, so it hurts the company’s profits. However, the CEO feels that the private jet allows for greater supervision of the operations and hence a more efficient operation.

**Solution:** This conflict could be reduced by the board of directors reviewing the CEO’s travel needs and frequency and the inconvenience of using commercial carriers. Once the pros and cons of the different travel options have been reviewed, a company policy can be issued so that shareholders understand the rationale if a private jet is elected for the CEO.

**Agent Pair:** Supervisor and Employee.

A conflict could involve an employee being required to work overtime. The employee wants sufficient lead time on overtime work while the supervisor assigns the work whenever the situation arises. The employee is disgruntled when working overtime and does not produce quality work. The cost of this is rework on some of the production items.

**Solution:** A policy on overtime and selection for overtime should be worked out between the supervisor and all employees subject to selection for overtime.

11.Employees at the Jackson Hole Corporation typically take forty-five minutes for lunch when the allocated time is only 30 minutes. Employees are encouraged to eat at the company cafeteria located in the middle of the company facilities. Most employees choose to eat their lunch in the cafeteria. Is there an agency cost here? If so, how can management eliminate or reduce this agency cost?

The first issue is why do employees take 45 minutes for lunch? The 45 minutes may be the natural time required to go through the line, purchase a lunch, and then eat the lunch at an appropriate pace. If this is the case, then it will be necessary to determine how to “speed” up the process to allow the employees to meet the 30 minute lunch time frame.

The agency cost here is the lost 15 minutes of employee production time each day. In order to eliminate this agency cost, it may be necessary to significantly modify the cafeteria or the serving procedure. If the management wants to maintain the 30 minute lunch period, it may have to look into the serving procedure in their cafeteria to see how to shorten lines and speed up purchasing meals. Any cost to redesign the cafeteria process is an agency cost. Any additional employees added to the cafeteria staff to speed up the process is an agency cost.

Another possibility is to extend the work day by 15 minutes. The cost to negotiate a new work day schedule is an agency cost. Any turnover caused by the new workday is also an agency cost.

It may be more costly to enforce the 30 minute lunch time than to accept the standard 45 minute break currently used by employees. Not all agency costs can be eliminated or reduced. The norms of the employees and the ability of current facilities to support a policy need to be considered when setting policies and in this case lunch time in the first place.

Then again, if the facilities are sufficient to handle a 30 minute lunch, it may be as simple as reaffirming the lunch break time with the employees.

Prepping for Exams

 1. c.

 2. b.

 3. a.

 4. b.

 5. c.

 6. b.

 7. c.

 8. b.

 9. c.

 10. d.

Solutions to Mini-Case Questions

**Richards’ Tree Farm Grows Up**

This case requires students to review the major financial decisions faced by any business and the advantages and disadvantages of various forms of business organization with emphasis on incorporation. It introduces the agency problem and ethical decisions, using examples that will be familiar to most students.

**1.Major financial management decisions involve capital budgeting, capital structure, and working capital management. Give an example of each that relates to Richards’ Tree Farm.**

**Capital Budgeting:** Whether they know it or not, when the Richards decide to purchase any asset with a significant cost and a useful life of more than a year, they are making a capital budgeting decision. Examples include the purchase of digging and packaging equipment, tractors, trucks, and buildings.

**Capital Structure:** The Richards had to decide whether to finance these purchases with their savings, by reinvesting profits, or with loans and leases. All of these financing decisions involved the overall capital structure decision of how much debt and how much of their personal equity they were willing to use.

**Working Capital:** The Richards always have inventories of trees at various stages of maturity and available for sale. They sell to commercial clients on credit and purchase supplies used in their operations on credit. They need cash to pay their suppliers and employees. In other words, the Richards need to decide on a day-to-day basis the proper levels of working capital accounts such as cash, inventory, accounts receivable, and accounts payable.

**2. Should the Richards form a regular corporation or choose one of the hybrid forms? Whichever form they use, they intend to distribute ownership equally among Jake, his wife, and their two children so that each party will own 25% of the shares. Consider the tax consequences of their decision.**

The major advantage to incorporating is the separation of personal income and assets from business income and assets. Either a regular corporation or one of the alternative forms (LLC or Subchapter S) will accomplish this goal. The distribution of shares more or less assures that Jake Richards and his wife will maintain a controlling interest in the business, but they might have kept a small majority just to be sure. The Richards want to share some of their wealth with their children now, and probably hope that they will remain involved in the business, but there is no guarantee of that. As their children marry, their spouses may also become part owners of significant shares of the business. Disharmony anywhere in the immediate family has the potential to create a difficult situation potentially requiring the sale of the business or some its assets. The distribution of shares could make the business more difficult to sell because potential buyers will have to deal with several parties who may each have a different agenda.

In theory, basic incorporation subjects the Richards to double taxation because income could be taxed once at the corporate level, and again when it is distributed as dividends. By taking appropriate salaries from the business, however, they might be able to have lower marginal rates on both personal and business income. If they use dividends as a means of sharing wealth with their children, double taxation could be an issue.

Smaller businesses often choose hybrid forms of organization, such as a Subchapter S Corporation or a Limited Liability Company. These are so-called “pass through” organizations that are taxed like partnerships. These organizations avoid the “double taxation” problem but could require principals to pay taxes on money that has not been withdrawn from the business.

**3. How does incorporating affect the family’s overall risk exposure?**

In theory, at least, any problems with the business will leave the Richards liable only for the value of their investment. The worst that could happen would be a forced liquidation of the business, which would be unfortunate, but would leave any personal wealth intact. However, in smaller businesses like this one, loans often require personal guarantees from the principal owners.

**4. How does incorporating affect the ability of the business to expand?**

Although incorporating a relatively small business would not automatically give it easy access to the capital markets, the Richards might be able to obtain additional equity by selling shares to outside investors. Additional equity would make it easier to borrow larger amounts. Because of limited liability protection, the Richards also may be more willing to take on additional debt.

**5. Jake is concerned that if the business gets much bigger or if he should just decide to slow down and enjoy life a little more, he will need to hire professional management and possibly lose control over key business decisions. Are his concerns justified?**

Corporations do create the possibility of separating ownership and management, but as long as the Richards retain a clear majority of the shares, hired managers will serve at their discretion. The Richards would have to decide how much money and effort they would be willing to spend to detect and prevent agency problems.

**6. Jake occasionally hires day workers, who may or may not be in the United States legally. What are his legal and ethical obligations with respect to this decision?**

Jake has a clear legal and ethical responsibility to verify the immigration status of all employees, even temporary ones. Such a choice could lead to serious penalties that would jeopardize the business. By doing so, Jake is also unwittingly exerting downward pressure on the wages and employment benefits of legal agricultural workers.

**7. The Richards are deeply concerned with environmental issues and know that the best practices for pesticide and fertilizer usage increase production costs. Will incorporating affect their ability to give up a small amount of profit in exchange for protecting the environment?**

Again, as long as the Richards maintain a controlling interest in the firm, they can establish and enforce whatever policies they wish regarding the use of fertilizers and pesticides. If they become minority shareholders or simply stop playing an active role in the management of the business, profit pressures could make it difficult to follow best environmental practices. At times, best practices, such as avoiding unnecessary pesticide applications, can actually lower costs. Some customers may also be willing to pay a higher price for responsibly farmed crops.

**8. How does incorporating affect the Richards’ ability to transfer ownership of the tree farm to their children?**

Incorporating creates many convenient options for transferring ownership of the business. The Richards can gradually sell or give their children increasing numbers of shares as they see fit. If they hold shares at the time of their deaths, their will can arrange to distribute them according to their wishes. Inherited shares are not subject to capital gains taxes at the time they are received. Shares could also be sold to outside parties. If they choose the LLC form of organization, which retains more features of partnerships, provisions for transferring ownership will need to be carefully spelled out in the original agreement.

**9. Suppose this business has an opportunity to become much larger at some point in the future. How might it obtain more equity funding and perhaps create considerable wealth for the Richards family in the process?**

A handful of similar businesses are publicly traded on NASDAQ (which will be discussed in more detail in Chapter 7 on stocks), so it is possible to imagine that by acquiring other properties and employing professional managers, the business could eventually become big enough to warrant an initial public offering (which will be discussed in more detail in Chapter 15 on raising capital). Such an event could raise large amounts of capital for the business and allow the Richards to sell their shares at the market price. At present, however, such an event seems rather unlikely. If the Richards have any such ambitions, they would be better off organizing as a regular corporation rather than choosing one of the hybrid forms.