Solutions Manual for Fundamentals of Corporate Finance 2026 Release 1st Edition by Brealey, Myers, Marcus, Racculia

ISBN: 9781266561849

Fundamentals of Corporate Finance, 2026 Release
Solutions for Chapter 1
Goals and Governance of the Corporation

1.
   a. Investment decision
   b. Financial asset
   c. Public corporation
   d. Corporation
   e. The opportunity cost of funds invested in the firm
   f. The cost resulting from conflicts of interest between managers and shareholders

Est time: 01–05
LO: 1-2 Cite the main financial decisions that corporations face.
Topic: Introduction to Corporate Finance

2. Investment decisions, typically called capital budgeting, relate to investments in tangible and intangible assets. Financing decisions relate to the raising of money through debt and equity. Repayment of that money as well as interest and dividends are also financing decisions.
   a. Investment decision
   b. Financing decision
   c. Investment decision
   d. Investment decision
   e. Financing decision
   f. Financing decision

Est time: 01–05
LO: 1-2 Cite the main financial decisions that corporations face.
Topic: Financial Management Decisions

3. Both capital budgeting decisions and capital structure decisions are long-term decisions. However, capital budgeting decisions are long-term investment decisions, while capital structure decisions are long-term financing decisions. Capital structure decisions essentially involve selecting between equity financing and long-term debt financing.

Est time: 01–05
LO: 1-2 Cite the main financial decisions that corporations face.
Topic: Introduction to Corporate Finance

4.

a.	A share of stock	financial
b.	A personal IOU	financial
c.	A trademark	real
d.	A truck	real

e.	Undeveloped land	real
f.	The balance in the firm's checking account	financial
g.	An experienced and hardworking sales force	real
h.	A bank loan agreement	financial

Est time: 01–05
LO: 1-2 Cite the main financial decisions that corporations face.
Topic: Introduction to Corporate Finance

5. "Companies usually buy real assets. These include both tangible assets such as executive airplanes and intangible assets such as brand names. To pay for these assets, they sell financial assets such as bonds. The decision about which assets to buy is usually termed the capital budgeting or investment decision. The decision about how to raise the money is usually termed the financing decision."

Est time: 01–05
LO: 1-2 Cite the main financial decisions that corporations face.
Topic: Financial Management Decisions

6.
   a. Private corporation
   b. Partnership
   c. Public corporation
   d. Public corporation

Est time: 01–05
LO: 1-1 Understand how businesses can organize as corporations.
Topic: Forms of Business Organization

7. *Double taxation* means that a corporation's income is taxed first at the corporate tax rate. When the income is distributed to shareholders as dividends, the income is taxed again at each shareholder's personal tax rate.

Est time: 01–05
LO: 1-1 Understand how businesses can organize as corporations.
Topic: Forms of Business Organization

8. C. Ownership can be transferred without affecting operations and
   D. Managers can be fired with no effect on ownership.

Est time: 01–05
LO: 1-1 Understand how businesses can organize as corporations.
Topic: Forms of Business Organization

9. The individual stockholders of a corporation (i.e., the owners) are legally distinct from the corporation itself, which is a separate legal entity. Consequently, the stockholders are not personally liable for the debts of the corporation; the

stockholders' liability for the debts of the corporation is limited to the investment each stockholder has made in the shares of the corporation.

Est time: 01–05
LO: 1-1 Understand how businesses can organize as corporations.
Topic: Forms of Business Organization

10. B. The corporation survives even if managers are dismissed and C. Shareholders can sell their holdings without disrupting the business.

Est time: 01–05
LO: 1-1 Understand how businesses can organize as corporations.
Topic: Forms of Business Organization

11. Limited liability is generally advantageous to large corporations. Large corporations would not be able to obtain financing from thousands or even millions of shareholders if those shareholders were not protected by the fact that the corporation is a distinct legal entity, conferring the benefit of limited liability on its shareholders.

    On the other hand, lenders do not view limited liability as advantageous to them. In some situations, lenders are not willing to lend to a corporation without personal guarantees from shareholders, promising repayment of a loan if the corporation does not have the financial resources to repay the loan. Typically, these situations involve small corporations, with only a few shareholders; often these corporations can obtain debt financing only if the shareholders provide these personal guarantees.

Est time: 01–05
LO: 1-1 Understand how businesses can organize as corporations.
Topic: Forms of Business Organization

12. *Answers will vary*. It should be noted that we only know about the PG&E example because of the courage of a whistleblower, which prompts the question, are there more companies out using carcinogens (or anything that might harm other stakeholders) there that just have yet to be caught? Increased whistleblower protection mitigates but does not eliminate that risk.

    Government regulation can regulate agent's action directly (e.g., Sarbanes Oxley's increased penalties for people convicted of white collar crimes as well as requiring the CFO to sign-off on the company's financials) or alter the governance (e.g., Sarbanes Oxley's independent auditor requirement which limits the non-audit services that an independent auditor can provide and the requirement that a majority of directors be independent[1])

    Students should consider how effective government regulation can be (is Congress reactive or proactive to Wall Street?). Also, students may want to consider agency problems built into the regulators themselves. For example, if there was significant

[1] Independence means neither they nor their spouse are part of the firm's management team.

career crossover between the pharmaceutical regulators and the pharmaceutical industry employees, that would give cause for alarm for drug testing and approval.

Est time: 06–10
LO: 1-3 Understand why maximizing market value is a natural financial goal of the corporation.
Topic: Goal of Financial Management

13. Answers will vary. One example of a firm that does well by doing good would be the societal benefits that accrue to corporate sponsored parks. Society benefits from the improved public space and the corporate benefits from the increased goodwill and elevated standing with the community.

    Donations of portions of profit to worthy causes is another example of doing good to do well. Examples include Patagonia's commitment to environmental protection and Cabela's support for wildlife and habitat conservation.

    An example of this approach claim being violated would be Wells Fargo, in 2016. Though it marketed itself as an organization committed to ethical banking, its internal aggressive sales targets incentivized many of its employees to open unauthorized bank accounts for customers. The customers were unknowingly charged fees on accounts (3.5 million!) they never approved. Once discovered, Wells Fargo faced damage to the very reputation is was promoting, $3 billion in settlements and fines, and the resignation of and subsequent civil action against CEO John Stumpf (though no criminal charges were ever filed).

Est time: 01–05
LO: 1-3 Understand why maximizing market value is a natural financial goal of the corporation.
Topic: Management Organization and Roles

14. Answers will vary. For example, a corporation might cut its labor force dramatically, which could reduce immediate expenses and increase profits in the short term. Over the long term, however, the firm might not be able to serve its customers properly, or it might alienate its remaining workers; if so, future profits will decrease, the stock price, and the market value of the firm, will decrease in anticipation of these problems.

    Similarly, a corporation can boost profits over the short term by using less costly materials even if this reduces the quality of the product. Once customers catch on, sales will decrease and profits will fall in the future. The stock price will fall.

    The moral of these examples is that, because stock prices reflect present *and future* profitability, the corporation should not necessarily sacrifice future prospects for short-term gains.

Est time: 01–05

LO: 1-3 Understand why maximizing market value is a natural financial goal of the corporation.
Topic: Goal of Financial Management

15. Financial managers refer to the opportunity cost of capital because corporations increase value for their shareholders only by accepting all investment projects that earn more than this rate. If the company earns below this rate, the market value of the company's stock falls as stockholders look for other places to invest.

    To find the opportunity cost of capital for a safe investment, managers and investors look at current interest rates on safe debt securities, such as U.S. Treasury debt.

Est time: 01–05
LO: 1-3 Understand why maximizing market value is a natural financial goal of the corporation.
Topic: Cost of Capital—General

16. The stock price reflects the value of both current and future dividends that the shareholders expect to receive. In contrast, profits reflect performance in the current year only. Profit maximizers may try to improve this year's profits at the expense of future profits. But stock-price maximizers will take account of the entire stream of cash flows that the firm can generate. They are more apt to be forward-looking.

Est time: 01–05
LO: 1-3 Understand why maximizing market value is a natural financial goal of the corporation.
Topic: Goal of Financial Management

17. In this situation, a "superior" rate of return is a rate greater than the rate of return investors could earn elsewhere in the financial markets from alternative investments with risk equal to that of the "high-risk capital investment" described in the problem. Fritz (who is risk-averse) will likely sell the investment since he is risk averse. Frieda (who is risk-tolerant) will likely keep her shares since it matches her risk tolerance.

Est time: 01–05
LO: 1-4 Explain the fundamental trade-off firms must address when considering their investment decisions.
Topic: Goal of Financial Management

18.
    a. This action might appear, superficially, to be a grant to *former* employees and thus not consistent with value maximization. However, such "benevolent" actions might enhance the firm's reputation as a good place to work, might result in greater loyalty on the part of current employees, and might contribute to the firm's recruiting efforts. Therefore, from a broader perspective, the

action may be value-maximizing. Surely not doing so would damage the reputation of the firm and dissuade future potential employees.

b. The reduction in dividends, in order to allow increased reinvestment, can be consistent with maximization of current market value. If the firm has attractive investment opportunities, and wants to save the expenses associated with issuing new shares to the public, then it could make sense to reduce the dividend in order to free up capital for the additional investments.

c. The corporate jet would have to generate benefits in excess of its costs in order to be considered stock-price enhancing. Such benefits might include time savings for executives, greater convenience and flexibility in travel, and possibly cost savings if commercial flights become prohibitively expensive (particularly last-minute bookings)

d. Although the drilling appears to be a bad bet, with a low probability of success, the project may be value-maximizing if a successful outcome (although unlikely) is potentially sufficiently profitable. A one-in-five chance of success is acceptable if the payoff conditional on finding an oil field is more than five times the costs of exploration.

Est time: 06–10
LO: 1-4 Explain the fundamental trade-off firms must address when considering their investment decisions.
Topic: Goal of Financial Management

19. Shareholders want managers to maximize the market value of their investments. The firm faces a trade-off. It can either invest its cash in real assets or it can give the cash back to shareholders in the form of a dividend and they can invest it in financial assets. Shareholders want the company to invest in real assets only if the expected return is higher than they could earn for themselves. The return that shareholders could earn for themselves is therefore the opportunity cost of capital for the firm.

Est time: 06–10
LO: 1-3 Understand why maximizing market value is a natural financial goal of the corporation.
Topic: Goal of Financial Management

20.

a. Increased market share can be an inappropriate goal if it requires reducing prices to such an extent that the firm is harmed financially. Increasing market share *can* be part of a well-reasoned strategy, but one should always remember that market share is not a goal in itself. The owners of the firm want managers to maximize the value of their investment in the firm.

b. Minimizing costs can also conflict with the goal of value maximization. For example, suppose a firm receives a large order for a product. The firm should be willing to pay overtime wages and to incur other costs in order to fulfill the order, as long as it can sell the additional product at a price greater than those costs. Even though costs per unit of output increase, the firm still comes out ahead if it agrees to fill the order.

c. A policy of underpricing any competitor can lead the firm to sell goods at a price lower than the price that would maximize market value. In some situations, particularly the short term goal of increasing market share, this strategy might make sense, but it should not be the ultimate goal of the firm. It should be evaluated with respect to its effect on firm value.

d. Expanding profits is a poorly defined goal of the firm. The text gives three reasons:

   (i) There may be a trade-off between accounting profits in one year and accounting profits in another year. For example, writing off a bad investment may reduce this year's profits but increase profits in future years. Which year's profits should be maximized?

   (ii) Investing more in the firm can increase profits, even if the increase in profits is insufficient to justify the additional investment. In this case, the increased investment increases profits but can reduce shareholder wealth.

   (iii) Profits can be affected by accounting rules, so a decision that increases profits using one set of rules may reduce profits using another.

Est time: 06–10
LO: 1-4 Explain the fundamental trade-off firms must address when considering their investment decisions.
Topic: Goal of Financial Management

21. A. Make shareholders as wealthy as possible by investing in real assets.

Est time: 01–05
LO: 1-4 Explain the fundamental trade-off firms must address when considering their investment decisions.
Topic: Goal of Financial Management

22. The director is mistaken. The risk of the project is not determined by the borrowing rate from the bank. The opportunity cost of capital is the rate of return from investments in the financial markets at the same level of risk as Quince's average-risk investments. The opportunity cost of capital is the minimum acceptable rate of return for a firm's capital investments. The rate of return on the average-risk investment project must be compared to the firm's cost of capital to determine whether to move ahead with the project.

Est time: 01–05
LO: 1-4 Explain the fundamental trade-off firms must address when considering their investment decisions.
Topic: Cost of Capital—General

23. The opportunity cost of capital for this investment is the rate of return that investors can earn in the financial markets from safe investments, such as U.S. Treasury securities. The best estimate of the opportunity cost of capital would rely on interest rates on U.S. Treasuries with the same maturity as that of the proposed investment, for example, 1-year Treasury bills. However, that it is considered "guaranteed" should be met with skepticism.

Est time: 01–05
LO: 1-4 Explain the fundamental trade-off firms must address when considering their investment decisions.
Topic: Cost of Capital—General

24.

a. Because the government guarantees the payoff for the investment, the project is essentially riskless, so opportunity cost of capital is the rate of return on U.S. Treasuries with 1 year to maturity (i.e., 1-year Treasury bills).
b. Because the average rate of return from an investment in carbon is expected to be about 20%, this is the opportunity cost of capital for the investment under consideration by Pollution Busters, Inc.
c. Purchase of the additional sequesters would not be a worthwhile capital investment if the expected rate of return remains 15%. This *expected* return (which is no longer a guaranteed risk-free return) would be less than the opportunity cost of capital given the risk of the project.

Est time: 06–10
LO: 1-4 Explain the fundamental trade-off firms must address when considering their investment decisions.
Topic: Cost of Capital—General

25. While these other objectives are important, only by having Shareholder Value maximized do we have a clear, unambiguous goal. The risks and liability from ambiguity of multiple "Primary" goals would in the end mean little would be accomplished. Instead, we set one goal as the legal obligation of the board and officers of the company, and if they are prudent they will accomplish that in part through working productively with all stakeholders, including employees, the larger community, and so on. Failure to act ethically might occasionally provide short-term gains, but in the long term is likely to damage the firm's reputation, alienate employees and customers, and reduce shareholder value (even aside from the intrinsic rewards of ethical behavior). Shareholder value is the one measure that is legally paramount, is measurable, and in the end is most productive overall for all stakeholders.

Est time: 01-05
LO: 1-4 Explain the fundamental trade-off firms must address when considering their investment decisions.
Topic: Cost of Capital—General

26. Takeover defenses increase the target firm's agency problems. One of the mechanisms that stockholders rely on to mitigate agency problems is the threat that an underperforming company (with an underperforming management) will be taken over by another company, and the new owners will replace the management team. If management is protected against takeovers by takeover defenses, it is more likely that managers will act in their own best interest, rather than in the interests of the firm and its stockholders.

Est time: 01–05
LO: 1-5 Understand what is meant by "agency problems."
Topic: Agency Costs and Problems

27. The contingency arrangement aligns the interests of the lawyer with those of the client. Neither makes any money unless the case is won. If a client is unsure about the skill or integrity of the lawyer, this arrangement can make sense. First, the lawyer has an incentive to work hard. Second, if the lawyer turns out to be incompetent and loses the case, the client will not have to pay a bill. Third, the lawyer will not be tempted to accept a very weak case simply to generate bills. Fourth, there is no incentive for the lawyer to charge for hours not really worked. Once a client is more comfortable with the lawyer, and is less concerned with potential agency problems, a fee-for-service arrangement might make more sense.

Est time: 06–10
LO: 1-5 Understand what is meant by "agency problems."
Topic: Agency Costs and Problems

28. Traders can earn huge bonuses when their trades are very profitable, but if the trades lose large sums, as in the case of Barings Bank, the trader's exposure is limited. This asymmetry can create an incentive to take big risks with the firm's (i.e., the shareholders') money. This is an agency problem.

Est time: 01–05
LO: 1-6 Cite some of the ways that good corporate governance helps mitigate agency problems.
Topic: Agency Costs and Problems

29. Even if a shareholder could monitor and improve managers' performance, and thereby increase the value of the firm, the payoff would be small, since the ownership share in a large corporation is very small. For example, if you own $10,000 of Ford Motor stock and can increase the value of the firm by 5%, a very ambitious goal, you benefit by only: 0.05 × $10,000 = $500.

In contrast, a bank that has a multimillion-dollar loan outstanding to the firm has a large stake in making sure that the loan can be repaid. It is clearly worthwhile for the bank to spend considerable resources on monitoring the firm.

Est time: 01–05

LO: 1-6 Cite some of the ways that good corporate governance helps mitigate agency problems.
Topic: Agency Costs and Problems

30. Company B: Paying managers according to the performance of the firm's stock aligns their interest with those of the owners. Since managers are likely to seek to maximize their own income, linking their compensation to share price, effectively turning them into shareholders, is likely to cause them to focus on increasing firm value. Long-term decisions may not produce short-term profits, thus managers may shy away from making good long-term decisions. Therefore, stock compensation plans may induce better long-term decisions if share grants are restricted stock, which the manager is required to hold onto while employed by the corporation.

Est time: 01–05
LO: 1-6 Cite some of the ways that good corporate governance helps mitigate agency problems.
Topic: Agency Costs and Problems

31. Clear and comprehensive financial reports provide essential information to the numerous shareholders of large corporations, allowing the shareholders to monitor the performance of the corporation and its board of directors and management. The debacles at WorldCom and Enron were directly related to a lack of clear and comprehensive financial reports.

Est time: 01–05
LO: 1-6 Cite some of the ways that good corporate governance helps mitigate agency problems.
Topic: Ethics, Governance, and Regulation

32. While the answer to this question is largely a matter of opinion, and there are significant numbers of commentators on each side of the issue, the perspective of the authors is that failures of corporate governance are a matter of a few "bad apples" rather than a symptom of systematic failure. The mechanisms discussed in the text (such as takeovers, compensation plans, and legal and regulatory requirements) for ameliorating agency problems generally contribute to effective corporate governance. Commentators on both sides of the issue would likely welcome improvements in these mechanisms.

Est time: 06–10
LO: 1-6 Cite some of the ways that good corporate governance helps mitigate agency problems.
Topic: Ethics, Governance, and Regulation

33.

a. A fixed salary means that compensation is (at least in the short run) independent of the firm's success.

b. A salary linked to profits ties the employee's compensation to this measure of the success of the firm. However, profits are not a wholly reliable way to measure the success of the firm. The text points out that profits are subject to differing accounting rules and reflect only the current year's situation rather than the long-run prospects of the firm.

c. A salary that is paid partly in the form of the company's shares means that the manager earns the most when the shareholders' wealth is maximized. This is therefore most likely to align the interests of managers and shareholders.

Est time: 01–05
LO: 1-6 Cite some of the ways that good corporate governance helps mitigate agency problems.
Topic: Agency Costs and Problems

34. Agency costs are caused by conflicts of interest between managers and shareholders, who are the owners of the firm. In most large corporations, the principals (i.e., the stockholders) hire the agents (i.e., managers) to act on behalf of the principals in making many of the major decisions affecting the corporation and its owners. However, it is unrealistic to believe that the agents' actions will always be consistent with the objectives that the stockholders would like to achieve. Managers may choose not to work hard enough, to overcompensate themselves, to engage in empire building, to overconsume perquisites, and so on.

    Corporations use numerous arrangements to ensure that managers' actions are consistent with stockholders' objectives. Agency costs can be mitigated by "carrots," linking the manager's compensation to the firm's success, or by "sticks," creating an environment in which poorly performing managers can be removed.

Est time: 01–05
LO: 1-6 Cite some of the ways that good corporate governance helps mitigate agency problems.
Topic: Agency Costs and Problems

35. The national chain has a great incentive to impose quality control on all of its outlets. If one store serves its customers poorly, that can result in lost future sales. The reputation of each restaurant in the chain depends on the quality in all the other stores. If Joe's serves mostly passing travelers who are unlikely to show up again, unsatisfied customers pose a lower cost. They are unlikely to be seen again anyway, so reputation is not a valuable asset. The important distinction is *not* that Joe has one outlet while the national chain has many. Instead, it is the likelihood of repeat relations with customers and the value of reputation. If Joe's were located in the center of town instead of on the highway, one would expect his clientele to be repeat

customers from town. He would then have the same incentive to establish a good reputation as the chain has.

Est time: 01–05

LO: 1-6 Cite some of the ways that good corporate governance helps mitigate agency problems.

Topic: Agency Costs and Problems

36. Long-term relationships can encourage ethical behavior. If you know that you will engage in business with another party on a repeated basis, you will be less likely to take advantage of your business partner if an opportunity to do so arises. When people say "What goes around comes around," they recognize that the way they deal with their associates will influence the way their associates treat them. When relationships are short-lived, however, the temptation to be unfair is greater since they provide less reason to fear reprisal and less opportunity for fair dealing to be reciprocated.

Est time: 01–05

LO: 1-6 Cite some of the ways that good corporate governance helps mitigate agency problems.

Topic: Ethics, Governance, and Regulation

37. *Answers will vary.* As the text notes, the first step in doing well is doing good by your customers. Businesses cannot prosper for long if they do not provide to their customers the products and services they desire. In addition, reputation effects often make it in the firm's own interest to act ethically toward its business partners and employees since the firm's ability to make deals and to hire skilled labor depends on its reputation for dealing fairly.

    In some circumstances, when firms have incentives to act in a manner inconsistent with the public interest, taxes or fees can align private and public interests. For example, taxes or fees charged on pollution make it more costly for firms to pollute, thereby affecting the firm's decisions regarding activities that cause pollution. Other "incentives" used by governments to align private interests with public interests include legislation providing for worker safety and product, or consumer, safety; building code requirements enforced by local governments; and pollution and gasoline mileage requirements imposed on automobile manufacturers.

Est time: 06–10

LO: 1-6 Cite some of the ways that good corporate governance helps mitigate agency problems.

Topic: Ethics, Governance, and Regulation

38. *Answers will vary.* The arguments for ESG-focused mutual funds are based on the broader arguments for stakeholder capitalism. Firms' incentives can do real harm to people and communities (like a chemical plant disposing of waste in a damaging matter because the fines are cheaper than proper disposal). Businesses who do not act ethically towards the wider base of stakeholders could suffer (in reputation and in profit) in the long run.

Some arguments against ESG-focused mutual funds include the inevitable conflict between competing stakeholders. Which stakeholder(s) has primacy and which stakeholders(s) are ranked lower? Another argument against is the potential for companies that are ESG focused to fall to leaner, more efficient competitors. Consider, also, that there are changing and differing opinions on what constitutes socially and environmentally responsible companies.

Est time: 06–10
Agency Costs and Problems
LO: 1-6 Cite some of the ways that good corporate governance helps mitigate agency problems.
Topic:

Instructors Manual Introduction

For most instructors using this manual, it will add value by providing guidance towards building a successful Corporate Finance course. A secondary value-add for this Instructor's Manual is to provide a guidebook of the many new features in the 2026 release of the *Fundamentals of Corporate Finance.*

Power New Features: The authors have taken meaningful significant steps to provide significant online content to complement the textbooks. Significant improvements, presented throughout this manual included a fully updated, fully algorithmic Integrated Excel experience. *Fundamentals of Corporate Finance* is also the first undergraduate finance textbook to feature multiple chapters dedicated to understand the logic and flow of coding (Python) to solve complex finance problems easily. A series of Application Based Activities is tied directly to the content of the textbook and provide an interactive experience for students.

Chapter 1
Goals and Governance of the Corporation

The Instructor's Manual is divided into two parts. The first is an overview of the chapter, including a description of the material covered and a perspective on how the chapter content relates to the balance of the textbook. The second part reviews the learning objectives of the chapter and includes a list of challenges encountered by students when learning the material. Where appropriate, pedagogical ideas and tips are provided to improve student learning.

OVERVIEW

Part One of the book covers background information students will need while navigating the rest of the material. This section is divided into 4 chapters, each with content needed to fully comprehend the material in the balance of the book.

The first chapter addresses the goals of the corporation and the various organizational structures a company may adopt. Once established, students learn about the functions a company performs in order to achieve its goals. This includes the role of the financial manager, specifically as it relates to financing and investment decisions.

The latter part of the chapter address qualitative issues related to governance / agency theory and the ethics of maximizing market value. Students learn that maximizing value and ethical behavior are not mutually exclusive.

The content covered in Chapter 1 provides a "big picture" look at the scope, concerns, and issues of corporate finance. It sets the stage for later material and shows how it fits into the overall scheme of corporate finance. Several themes are introduced, which will be reemphasized throughout the book.

As future topics are covered, it is important to link the material back to the themes contained in this first chapter. Students often lose perspective and need to be reminded of the purpose of finance, rather than merely learning skills with no context. When the student has a sense of where and how a chapter fits into the whole, they can begin to tie chapters and concepts together, instead of staying mired in terms, computations, and specific topics.

REVIEW OF LEARNING OBJECTIVES (with teaching tips and notes)

The **first learning objective** is an understanding of the two major decisions made by financial managers. The primary functions of the financial manager or financial decision maker are to raise cash in financial markets (the financing decision) and to invest cash (capital budgeting decision). The chapter illustrates these decisions with the example FedEx.

> **Teaching Note: Investment and Financing Decisions—**Much of the material in later chapters can be tied back to the two fundamental decisions of the financial manager. Figure 1.2 can be used when discussing later material to show the student where the topic fits in the "big picture." For example, bring up Figure 1.2 again before discussing Net Present Value and how this decision rule is used to make investment decisions in the firm, and bring up the graph again when discussing dividend policy to remind students that this policy is part of the financing decisions.
>
> Learning facilitators should consider discussion some of the examples in Table 1.1 to help bring to light examples students can relate to.

The **second learning objective** is an understanding of the difference between real and financial assets. Financial managers raise funds in financial markets by selling financial assets, or securities, to investors as part of the financing decision, and invest this cash in real assets. The decision as to the amount and which tangible or intangible assets to acquire is an investment (capital budgeting) decision.

The **third learning objective** is an understanding of the corporate form of business organization. The choice of business organization affects the risk and the potential return in the form of after-tax cash flow and thus, the value of the business. Not all businesses are organized as corporations because of the time and cost of managing and maintaining a corporate entity, and the double-taxation of corporate earnings in the United States.

> **Teaching Note: Types of Business Organization:** Faculty should consider how the decision to incorporate is as much a function of legal implications as it is a function of long-run vision for the company.

The **fourth learning objective** is an understanding of the principal financial managers in the corporation. The classic financial manager titles are the treasurer and the controller, with the former being more associated with financing, cash management, and financial market relationships, and the latter being associated with more traditional accounting functions of financial statements, budgeting, and auditing. The chief financial officer, in larger firms, oversees the treasurer and controller and is involved in formulating corporate strategy and financial policy.

> **Teaching Note: Career Planning—**This first chapter is a good opportunity to get students thinking about careers in finance. The Finance in Practice, *Working in Finance*, section describing the work of four finance professionals can help students match their interests with a career in finance.

The **fifth learning objective** is an understanding of the goal of the firm. Shareholders want managers to make decisions based upon which alternative will maximize the market value of the shareholders' investment. Other decision criteria, such as profit maximization or market share maximization, do not achieve value maximization.

> **Teaching Note: Shareholder and Stakeholder Capitalism—**The Finance in Practice, *Stakeholder Capitalism*, section defines stakeholders and their interests and how they

may conflict with the interests of the shareholders. This is a great opportunity for students to think about incentives and motivation and to introduce agency problems.

The **sixth learning objective** is an understanding of different mechanisms that can be used to align the interest of managers with those of shareholders. Agency problems exist when managers, as agents of shareholders, have a conflict of interest with shareholders. *Compensation plans* can motivate managers to work for the best interest of the shareholders, the *board of directors*, can monitor managers on behalf of shareholders, managers not performing in the best interest of shareholders are candidates for a *takeover*, and *legal and regulatory requirements* for financial managers require responsible actions in the interests of investors.

The **seventh learning objective** is an understanding of why maximizing market value does not justify behaving unethically. Fair and ethical relationships build and maintain long-run value. There is positive relation between maximizing value and doing business ethically.

Teaching Note: Ethical Issues—This first chapter provides a good opportunity to discuss ethical issues with the class that can be reinforced when covering material later in the course. The *Finance Through the Ages* section provides not only a good historical perspective on the financial practices and theories that are constantly evolving, but also a reminder that financial scandals arise regularly.

INTEGRATED EXCEL

Topics Covered:

Market Capitalization, Mean and Median

Integrated Excel Problems introduces the following Functions:

SUM

AVERAGE

MEDIAN

APPLICATION BASED ACTIVITIES

Students can immerse themselves in Application Based Activities (ABA), which are interactive learning. As with Integrated Excel and Integrated Python, ABAs are fully algo and grading is fully automated, with Learning Objective level feedback.

In this introductory Application Based Activity (ABA), the student has recently started a new position at a publicly traded corporation. An older employee who happens to be an alumnus from the student's university acts as a guide through the first day, reviewing the basics of the corporation, the role of financial managers, and the difference between real and financial assets.

POWERPOINT GUIDE

What Is a Corporation? (Slides 3–6)
These slides introduce the corporation and other forms of business organization. Students should understand the strengths and weaknesses of each. Consider talking about the relative size of the corporations versus other business entities.

Investment and Financing Decisions (Slides 7–12)
Key takeaways in this section include: Investment vs. Financing decisions and Real vs. Financial

assets. Productive capacity differentiates real assets from financial assets. Students should intuit the symmetry: Investment decisions center around real assets and financing decisions center around financial assets.

Who Is the Financial Manager (Slides 13–14)
Differentiate the roles of CFO, Treasurer, and Controller. The CFO focuses on big picture and strategic thinking. The Controller will likely have a background in accounting while the Treasurer is likely from a finance background.

Goals of the Corporation and Agency Problems (Slides 15–23)
These slides offer an opportunity for discussion on the proper roles and responsibilities of financial managers. What constituency are financial managers ultimately beholden to—shareholders, stakeholders, a combination of both? Students should recognize the very different approaches. This can naturally lead to a conversation on agency problems and solutions. Faculty may wish to become conversant on some of the more egregious examples of agency problems as they offer interesting ways to illuminate these very real problems in finance

Preview of Coming Attractions (Slides 24–26)
The chapter ends with previews of what students will expect to learn over the course of the textbook. Material is presented as questions and themes with the intent of igniting curiosity.

LECTURE EXERCISE

To help students understand the link between corporate structures and agency theory a simple illustration may help. Ask for a volunteer who has the desire to start a business. Explain how they may begin as a sole proprietor and how they are accountable only to themselves. Next, ask for another volunteer to be a passive investor in the now successful company. Tell the class how the ownership and management has now changed in the partnership structure. Finally, tell the two owners they are so successful, the company will conduct an IPO, whereby the two owners will leave the company and a new CEO will be hired. This final step can lead to a detailed discussion of governance and agency theory.

This exercise can also be used to explain how the new business must finance operations and conduct capital budgeting. Many teaching avenues are available in a discussion format such as this.

eBOOK GUIDED LEARNING

Embedded learning in the eBook creates real-time feedback for students. Most Figures in the eBook have embedded *Learn It!*, *Try it!*, and *Check it!* links. *Learn it!* links to an animated sequence explaining the construction of the Figure. *Try It!* allows students to build the Figure with new inputs. *Check It!* shows a correct and complete Figure built from the new inputs.

A second new e-Book feature provides multiple solutions to important examples. Embedded links allow students to see the same example simultaneously solved with equations, on a financial calculator, and using Excel.