

Chapter 1: An Overview of Financial Management and the Financial Environment Mini Case  
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Printed By: Belinda Smith (bsmith255@my.gcu.edu)  
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Chapter 1

## Chapter Review

### Mini Case

Assume that you recently graduated and have just reported to work as an investment advisor at the brokerage firm of Balik and Kiefer Inc. One of the firm's clients is Michelle DellaTorre, a professional tennis player who has just come to the United States from Chile. DellaTorre is a highly ranked tennis player who would like to start a company to produce and market apparel she designs. She also expects to invest substantial amounts of money through Balik and Kiefer. DellaTorre is very bright, and she would like to understand in general terms what will happen to her money. Your boss has developed the following set of questions you must answer to explain the U.S. financial system to DellaTorre.

- a. Why is corporate finance important to all managers?
- b. Describe the organizational forms a company might have as it evolves from a start-up to a major corporation. List the advantages and disadvantages of each form.
- c. How do corporations go public and continue to grow? What are agency problems? What is corporate governance?
- d. What should be the primary objective of managers?
  1. Do firms have any responsibilities to society at large?
  2. Is stock price maximization good or bad for society?
  3. Should firms behave ethically?
- e. What three aspects of cash flows affect the value of any investment?
- f. What are free cash flows?
- g. What is the weighted average cost of capital?
- h. How do free cash flows and the weighted average cost of capital interact to determine a firm's value?
- i. Who are the providers (savers) and users (borrowers) of capital? How is capital transferred between savers and borrowers?

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## Chapter Review

### Mini Case

Suppose you decide (as did Steve Jobs and Mark Zuckerberg) to start a company. Your product is a software platform that integrates a wide range of media devices, including laptop computers, desktop computers, digital video recorders, and cell phones. Your initial market is the student body at your university. Once you have established your company and set up procedures for operating it, you plan to expand to other colleges in the area and eventually to go nationwide. At some point, hopefully sooner rather than later, you plan to go public with an IPO and then to buy a yacht and take off for the South Pacific to indulge in your passion for underwater photography. With these issues in mind, you need to answer for yourself, and potential investors, the following questions.

- a. What is an agency relationship? When you first begin operations, assuming you are the only employee and only your money is invested in the business, would any agency conflicts exist? Explain your answer.
- b. If you expanded and hired additional people to help you, might that give rise to agency problems?
- c. Suppose you need additional capital to expand and you sell some stock to outside investors. If you maintain enough stock to control the company, what type of agency conflict might occur?
- d. Suppose your company raises funds from outside lenders. What type of agency costs might occur? How might lenders mitigate the agency costs?
- e. Suppose your company is very successful and you cash out most of your stock and turn the company over to an elected board of directors. Neither you nor any other stockholders own a controlling interest (this is the situation at most public companies). List six potential managerial behaviors that can harm a firm's value.
- f. What is corporate governance? List five corporate governance provisions that are internal to a firm and are under its control.
- g. What characteristics of the board of directors usually lead to effective corporate governance?
- h. List three provisions in the corporate charter that affect takeovers.