

BOSTON COLLEGE

S U M M E R S E S S I O N

MFIN102201, Fundamental of Finance
Boston College Summer Session 2018
Summer 1, 5/16/2018-6/20/2018
Monday and Wednesday 6:00 PM-9:15 PM

Problem Set 1.

You must read Chapter 1 and 2 before attempting to solve the problem set. The content from the class presentation will not be sufficient to answer the problem set.

- 1) What are the two major decisions made by financial managers? **Explain each decision in one or two sentences.**
- 2) Choose in each case the type of company that best fits the description. **Explain your choice briefly (1 sentence)**
 - a. The business is owned by a small group of investors. (private corporation / public corporation)
 - b. The business does not pay income tax. (private corporation / partnership)
 - c. The business has limited liability. (sole proprietorship / public corporation)
 - d. The business is owned by its shareholders. (partnership / public corporation)
- 3) What is limited liability, and who benefits from it?
- 4) Is limited liability always an advantage for a corporation and its shareholders?
- 5) We claim that the goal of the firm is to maximize current market value. Could the following actions be consistent with that goal? **Explain your choice briefly (1 sentence)**
 - a. The firm adds a cost-of-living adjustment to the pensions of its retired employees.
 - b. The firm reduces its dividend payment, choosing to reinvest more earnings in the business.
 - c. The firm buys a corporate jet for its executives.
 - d. The firm drills for oil in a remote jungle. The chance of finding oil is only 1 in 5.
- 6) What are agency costs? List some ways by which agency costs are mitigated.
- 7) Sometimes lawyers work on a contingency basis. They collect a percentage of their clients' settlements instead of receiving fixed fees. Why might clients prefer this arrangement? Would the arrangement mitigate an agency problem? Explain.

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- 8) What is a stock market? What is the difference of a primary market and a secondary market?
- 9) What is a fixed-income market? What is the difference of a capital market and a money market?
- 10) What is a mutual fund? What is a pension fund?
- 11) Individual investors can buy bonds and stocks directly, or they can put their money in a mutual fund. What are the advantages of the second strategy?
- 12) What are the functions of financial markets? What are the functions of financial institutions?
(Hint: 2.3)

Bonus question: If you answer this correctly, you get 10 additional points in your lowest score problem set. All problem sets are graded in a 0-100 point scale.

It is sometimes suggested that instead of seeking to maximize shareholder value and, in the process, pursuing profit, the firm should seek to maximize the welfare of all its stakeholders, such as its employees, its customers, and the community in which it operates. How far would this objective conflict with one of maximizing shareholder value? Do you think such an objective is feasible or desirable? **Explain in more than one sentence and less than half a page. Hint: we discussed this in class.**