INTRODUCTION TO FINANCE

Markets, Investments, and Financial Management
INTRODUCTION

Ask someone what he or she thinks “finance” is about. You’ll probably get a variety of responses: “It deals with money.” “It is what my bank does.” “The New York Stock Exchange has something to do with it.” “It’s how businesses and people get the money they need—you know, borrowing and stuff like that.” And they’d all be correct!

Finance is a broad field. It involves national and international systems of banking and financing business. It also deals with the process you go through to get a car loan and what a business does when planning for its future needs.

It is important to understand that while the U.S. financial system is complex, it generally operates efficiently. However, on occasion, imbalances can result in economic, real estate, and stock market “bubbles,” which when bursts cause havoc on the workings of the financial system. The decade of the 2000s began with the bursting of the “tech” or technology bubble and the “dot.com” bubble. Then in mid-2006, the real estate bubble in the form of excessive housing prices burst. This was followed by the peaking of stock prices in 2007 followed by a steep decline that continued into early 2009. Economic activity began slowing in 2007 and progressed into an economic recession beginning in mid-2008, which was accompanied by double-digit unemployment rates. The result was the 2007–2008 financial crisis and the 2008–2009 Great Recession that produced the most financial distress on the U.S. financial system since the Great Depression years of the 1930s.

Within the general field of finance, there are three areas of study: financial institutions and markets, investments, and financial management. These areas are illustrated in the accompanying diagram. Financial institutions collect funds from savers and lend them to or invest them in businesses or people that need cash. Examples of financial institutions are commercial banks, investment banks, insurance companies, and mutual funds. Financial institutions operate as part of the financial system. The financial system is the environment of finance. It includes the laws and regulations that affect financial transactions. The financial system encompasses the Federal Reserve System, which controls the supply of money in the U.S. economy. It also consists of the mechanisms that have been constructed to facilitate the flow of money and financial securities among countries. Financial markets represent ways for bringing together those that have money to invest with those that need funds. Financial markets, which include markets for mortgages, securities, and currencies, are necessary for a financial system to operate efficiently. Part 1 of this book examines the financial system and the role of financial institutions and financial markets in it.

Securities markets play important roles in helping businesses and governments raise new funds. Securities markets also facilitate the transfer of securities between investors. A securities market can be a central location for the trading of financial claims, such as the New York Stock Exchange. It may also take the form of a communications network, as with the over-the-counter market, which is another means by which stocks and bonds can be traded. When people invest funds, lend or borrow money, or buy or sell shares of a company’s stock, they are participating in the financial markets. Part 2 of this book examines the role of securities markets and the process of investing in bonds and stocks.

The third area of the field of finance is financial management. Financial management studies how a business should manage its assets, liabilities, and equity to produce a good or service. Whether or
not a firm offers a new product or expands production, or how it invests excess cash, are examples of decisions that financial managers are involved with. Financial managers are constantly working with financial institutions and watching financial market trends as they make investment and financing decisions. Part 3 discusses how financial concepts can help managers better manage their firms.

There are few clear distinctions or separations between the three areas of finance. The diagram intentionally shows institutions and markets, investments, and financial management overlapping one another. Financial institutions operate in the environment of the financial markets and work to meet the financial needs of individuals and businesses. Financial managers do analyses and make decisions based on information they obtain from the financial markets. They also work with financial institutions when they need to raise funds and when they have excess funds to invest. Participants investing in the financial markets use information from financial institutions and firms to evaluate different investments in securities such as stocks, bonds, and certificates of deposit. A person working in one field must be knowledgeable about all three. Thus, this book is designed to provide you with a survey of all three areas of finance.

Part 1, Institutions and Markets, presents an overview of the financial system and its important components of policy makers, a monetary system, financial institutions, and financial markets. Financial institutions operate within the financial system to facilitate the work of the financial markets. For example, you can put your savings in a bank and earn interest. But your money doesn’t just sit in the bank: The bank takes your deposit and the money from other depositors and lends it to Kathy, who needs a short-term loan for her business; to Ron for a college loan; and to Roger and Maria, who borrow the money to help buy a house. Banks bring together savers and those who need money, such as Kathy, Ron, Roger, and Maria. The interest rate the depositors earn and the interest rate that borrowers pay are determined by national and even international economic forces. Just what the bank does with depositors’ money and how it reviews loan applications is determined to some extent by bank regulators and financial market participants, such as the Federal Reserve Board. Decisions by the president and Congress relating to fiscal policies and regulatory laws may also directly influence financial institutions and markets and alter the financial system.

Chapter 2 presents an overview of the role of money in the operation of the U.S. monetary and financial systems, including discussion of how funds are transferred among individuals, firms, and countries. Depository institutions, such as banks and savings and loans, as well as other financial institutions, involved in the financial intermediation process are the topic of Chapter 3. The Federal Reserve System, the U.S. central bank that controls the money supply, is discussed in Chapter 4. Chapter 5 places the previous chapters in perspective, discussing the role of the Federal Reserve and the banking system in helping meet national economic goals for the United States, such as economic growth, low inflation, and stable exchange rates. Part 1 concludes with an explanation of international trade and the topic of international finance in Chapter 6.
CHAPTER 1

The Financial Environment

Chapter Learning Objectives...

AFTER STUDYING THIS CHAPTER, YOU SHOULD BE ABLE TO DO THE FOLLOWING:

• Define finance and explain why finance should be studied.
• Identify several major career opportunities in finance.
• Identify and describe the six principles of finance.
• Identify characteristics and components of an effective financial system.
• Describe the financial functions performed in an effective financial system.
• Briefly describe the four types of financial markets.

Where We Have Been...

As we progress through this book, we start each chapter with a brief review of previously covered materials. This will provide you with a reference base for understanding the transition from topic to topic. After completing the text, you will be at the beginning of what we hope is a successful business career.

Where We Are Going...

The financial environment within which we live and work is composed of a financial system, institutions, and markets. Part 1 of this text focuses on developing an understanding of the financial institutions and markets that operate to make the financial system work efficiently. Chapter 2 describes the U.S. monetary system, including how it is intertwined with the capital formation process and how it has evolved. Current types of money are described, and we discuss why it is important to control the growth of the money supply. In following chapters, we turn our attention to understanding how financial institutions, policy makers, and international developments influence how the financial system functions.

How This Chapter Applies to Me...

While it is impossible to predict what life has in store for each of us in terms of health, family, and career, everyone can be a productive member of society. Nearly all of us will take part in making social, political, and economic decisions. A basic understanding of the financial environment that encompasses economic and financial systems will help you in making informed economic choices.

Let us begin with the following quote by George Santayana, a U.S. philosopher and poet:

Those who cannot remember the past are condemned to repeat it.¹

While this quotation refers to the need to know something about history so individuals can avoid repeating bad social, political, and economic decisions, it is equally important to the field of finance. All individuals have the responsibility to be able to make informed public choices involving the financial environment. By understanding the financial environment and studying the financial system, institutions and markets, investments, and financial management, individuals will be able to make informed economic and financial choices that will lead to better financial health and success. After studying the materials in this book, you will be better informed in making choices that affect the economy and the financial system, as well as be better prepared for a business career, possibly one in the field of finance.

HOW HAS THE FINANCIAL ENVIRONMENT CHANGED?

The first twelve years of the twenty-first century have been a difficult time in the United States and worldwide. Whereas the 1990s decade was a period of economic growth and prosperity, the early part of the twenty-first century has been characterized by economic and financial markets volatility along with many individuals “treading water” in trying to maintain the standards of living they had achieved.

A price bubble for technology stocks, including so-called dot.com start-ups, burst in the United States in 2000. An economic downturn followed and was exacerbated by the September 11, 2001 terrorist attack. Economic recovery occurred over several years until the housing price bubble burst in 2006 and housing values declined. Securities tied to housing prices declined causing concerns that “over-borrowed” financial institutions might fail because they held insufficient equity capital resources to cover the decline in values of the home mortgages and housing-related debt securities they held. This led to the 2007–2008 financial crisis. A major economic recession (sometimes called the Great Recession) began in early 2008 and continued through mid–2009 and turned out to be the deepest and longest recession since the Great Depression of the 1930s. Unemployment rates exceeded 10 percent in 2009 and remained above the 7 percent level as of the end of 2012.

The health of economies, financial institutions, and markets is linked throughout the world. European and other major foreign financial institutions were caught in the 2007–2008 financial crisis and most foreign economies suffered economic downturns near the end of the 2000s decade. Even China, which had been growing its economy at a double-digit rate during the decade of the 2000s, had a slowing economic activity during the past couple of years. This has worldwide implications since many developed and developing economies are tied to demand for natural resources and other products by Chinese firms.

We believe the analysis and understanding of past developments in economic activity and financial markets is useful to governments, businesses, and individuals in planning their futures. By learning from the past, we may be able to avoid, or mediate, similar pitfalls in the future.

WHAT IS FINANCE?

Finance is the study of how individuals, institutions, governments, and businesses acquire, spend, and manage money and other financial assets. Understanding finance is important to all students regardless of the discipline or area of study because nearly all business and economic decisions have financial implications. The decision to spend or consume (for new clothes or dinner at a fancy restaurant) rather than save or invest (for spending or consuming more in the future) is an everyday decision that we face.

The financial environment encompasses the financial system, institutions or intermediaries (we will use these terms interchangeably throughout this text), financial markets, business firms, individuals, and global interactions that contribute to an efficiently operating economy. Figure 1.1 depicts the three areas of finance within the financial environment: institutions and markets, investments, and financial management. Though we identify three distinct finance areas, these areas do not operate in isolation but rather interact or intersect with each other. Our focus in this book is to provide the reader with exposure to all three areas, as well as to show how they are integrated. Of course, students pursuing a major or area of emphasis in finance will take multiple courses in one or more of these areas.

Financial institutions are organizations or intermediaries that help the financial system operate efficiently and transfer funds from savers and investors to individuals, businesses, and governments that seek to spend or invest the funds in physical assets (inventories, buildings, and equipment). Financial markets are physical locations or electronic forums that facilitate the flow of funds among investors, businesses, and governments. Investments involve the sale or marketing of securities, the analysis of securities, and the management of investment risk through portfolio diversification. Financial management involves financial planning, asset management, and fund-raising decisions to enhance the value of businesses.

Finance has its origins in economics and accounting. Economists use a supply and demand framework to explain how the prices and quantities of goods and services are determined in a free-market economic system. Accountants provide the record-keeping mechanism for showing
ownership of the financial instruments used in the flow of financial funds between savers and borrowers. Accountants record revenues, expenses, and profitability of organizations that produce and exchange goods and services.

Efficient methods of production and specialization of labor can exist if there is an effective means of paying for raw materials and final products. Businesses can obtain the money needed to buy capital goods such as machinery and equipment only if a mechanism has been established for making savings available for investment. Similarly, federal and other governmental units, such as state and local governments and tax districts, can carry out their wide range of activities if efficient means exist for raising money, for making payments, and for borrowing.

Financial institutions, financial markets, and investment and financial management are crucial elements of the financial environment and well-developed financial systems. Financial institutions are intermediaries, such as banks, insurance companies, and investment companies that engage in financial activities to aid the flow of funds from savers to borrowers or investors.

Financial markets provide the mechanism for allocating financial resources or funds from savers to borrowers. Individuals make decisions as investors and financial managers. Investors include savers and lenders as well as equity investors.

While we are focusing on financial managers in this book, we recognize that individuals must be continuously involved in managing their personal finances. Investment management involves making decisions relating to issuing and investing in stocks and bonds. Financial management in business involves making decisions relating to the efficient use of financial resources in the production and sale of goods and services. The goal of the financial manager in a profit-seeking organization is to maximize the owners’ wealth. This is accomplished through effective financial planning and analysis, asset management, and the acquisition of financial capital. Financial managers in not-for-profit organizations aim to provide a desired level of services at acceptable costs and perform the same financial management functions as their for-profit counterparts.
TWO THEMES

As we progress through this book, we offer two themes within the financial institutions and markets, investments, and financial management topic areas. In each chapter, we provide boxed materials relating to small business practice and personal financial planning. Successful businesses typically progress through a series of life cycle stages from the idea stage to exiting the business. More specifically, the successful business typically moves through five stages: development stage, startup stage, survival stage, rapid growth stage, and maturity stage. Individuals who choose to become small business owners do so for a number of different reasons. Some small business owners focus on salary replacement opportunities where they seek income levels comparable to what they could have earned by working for much larger firms. Other individuals pursue lifestyle small business opportunities where they get paid for doing things they like to do. Entrepreneurs seek to own and run businesses that stress high growth rates in sales, profits, and cash flows.

Entrepreneurial finance is the study of how growth-driven, performance-focused, early-stage (from development through early rapid growth) firms raise financial capital and manage their operations and assets. Our small business practice boxes focus on operational and financial issues faced by early-stage firms. Personal finance is the study of how individuals prepare for financial emergencies, protect against premature death and the loss of property, and accumulate wealth over time. Our personal finance planning boxes focus on planning decisions made by individuals in regards to saving and investing their financial resources.

WHY STUDY FINANCE?

There are several reasons to study finance. Knowledge of the basics of finance covered in this text should help you make informed: economic decisions, personal and business investment decisions, and career decisions.

1. To make informed economic decisions.

As we will see, the operation of the financial system and the performance of the economy are influenced by policy makers. Individuals elect many of these policy makers in the United States, such as the president and members of Congress. Since these elected officials have the power to alter the financial system by creating laws and since their decisions can influence economic activity, individuals must be informed when making political and economic choices. Do you want a balanced budget, lower taxes, free international trade, low inflation, and full employment? Whatever your financial and economic goals may be, you need to be an informed participant if you wish to make a difference. Every individual should attain a basic understanding of finance as it applies to the financial system. Part 1 of this book focuses on understanding the roles of financial institutions and markets and how the financial system works.

SMALL BUSINESS PRACTICE

Importance of Small Firms in the U.S. Economy

As the U.S. economy moved from the industrial age to the information age, dramatic changes occurred in the importance of small businesses. As large firms with five hundred or more employees continued to downsize and restructure throughout the 1990s and into the twenty-first century, small firms provided the impetus for economic growth.

During the mid-1970s through the 1980s period, firms with fewer than five hundred employees provided over half of total employment and nearly two-thirds of the net new jobs in the United States. Small firms provided most of the net new jobs during the 1990s. And, while the decade of the 2000s involved a housing price collapse, a major financial crisis, and economic recession, small firms continued to be the primary supplier of new jobs.

Why have small firms been so successful in creating new jobs? A U.S. Small Business Administration (SBA) white paper suggests two reasons. First, small firms provide a crucial role in technological change and productivity growth. Market economies change rapidly, and small firms can adjust quickly. Second, small firms provide the mechanism and incentive for millions of individuals to pursue the opportunity for economic success.

Others may argue that entrepreneurial spirit and activity account for the importance of small firms in the U.S. economy. Whatever the reasons, the ongoing growth of small businesses continues to be an important stimulus to the economy in the early years of the twenty-first century.

2. To make informed personal and business investment decisions.
An understanding of finance should help you better understand how the institution, government unit, or business that you work for finances its operations. At a personal level, the understanding of investments will enable you to better manage your financial resources and provide the basis for making sound decisions for accumulating wealth over time. Thus, in addition to understanding finance basics relating to the financial system and the economy, you need to develop an understanding of the factors that influence interest rates and security prices. Part 2 of this book focuses on understanding the characteristics of stocks and bonds and how they are valued, securities markets, and how to make risk-versus-return investment decisions.

3. To make informed career decisions based on a basic understanding of business finance.
Even if your business interest is in a nonfinance career or professional activity, you will likely need to interact with finance professionals within and outside your firm or organization. Doing so will require a basic knowledge of the concepts, tools, and applications of financial management. Part 3 of this book focuses on providing you with an understanding of how finance is applied within a firm by focusing on decision making by financial managers.

Of course, you may be interested in pursuing a career in finance or at least want to know what people who work in finance do. Throughout this text, you will find discussions of career opportunities in finance as well as a boxed feature entitled Career Opportunities in Finance.

CAREERS IN FINANCE

Career opportunities in finance are available in financial management, depository financial institutions, contractual savings and real property organizations, and securities markets and investment firms. While you may aspire to own your own business or to be a chief executive officer (CEO) or chief financial officer (CFO) in a major corporation, most of us must begin our careers in an entry-level position. Following are four ways to get started in a finance career.

1. Financial management
Larger businesses or corporations divide their finance activities into treasury and control functions, whereas smaller firms often combine these functions. The treasurer is responsible for managing the firm’s cash, acquiring and managing the firm’s assets, and selling stocks and bonds to raise the financial capital necessary to conduct business. The controller is responsible for cost accounting, financial accounting, and tax record-keeping activities. Entry-level career opportunities include the following:

- Cash management analyst involves monitoring and managing the firm’s day-to-day cash inflows and outflows
- Capital expenditures analyst involves estimating cash flows and evaluating asset investment opportunities
- Credit analyst involves evaluating credit applications and collecting amounts owed by credit customers
- Financial analyst involves evaluating financial performance and preparing financial plans
- Cost analyst involves comparing actual operations against budgeted operations
- Tax analyst involves preparing financial statements for tax purposes

2. Depository financial institutions
Banks and other depository institutions offer the opportunity to start a finance career in consumer or commercial lending. Banks hold and manage trust funds for individuals and other organizations. Entry-level career opportunities include the following:

- Loan analyst involves evaluating consumer and/or commercial loan applications
- Bank teller involves assisting customers with their day-to-day checking and banking transactions
- Investments research analyst involves conducting research on investment opportunities for a bank trust department
3. **Contractual savings and real property organizations**

Insurance companies, pension funds, and real estate firms provide opportunities for starting a career in finance. These institutions need various employees willing to blend marketing or selling efforts with financial expertise. Entry-level career opportunities include the following:

- **Insurance agent (broker)** involves selling insurance to individuals and businesses and participating in the processing of claims.
- **Research analyst** involves analyzing the investment potential of real property and securities for pension fund holdings.
- **Real estate agent (broker)** involves marketing and selling or leasing residential or commercial property.
- **Mortgage analyst** involves analyzing real estate loan applications and assisting in the arranging of mortgage financing.

4. **Securities markets and investment firms**

Securities firms and various investment-related businesses provide opportunities to start a finance career in the investments area. Opportunities include buying and selling seasoned securities, analyzing securities for investment potential, marketing new securities issues, and helping individuals plan and manage their personal financial resources. Entry-level career opportunities include the following:

- **Stockbroker (account executive)** involves assisting clients in purchasing stocks and bonds and building investment wealth.
- **Security analyst** involves analyzing and making recommendations on the investment potential of specific securities.
- **Investment banking analyst** involves conducting financial analysis and valuation of new securities being issued.
- **Financial planner assistant** involves analyzing individual client insurance needs and investment plans to meet retirement goals.

While we have focused on entry-level careers in profit-motivated businesses and financial organizations, careers in finance are available in government or not-for-profit organizations. Finance opportunities at the federal or state government levels include managing cash funds, making asset expenditure decisions, and issuing debt securities to raise funds. Hospitals and other not-for-profit organizations also need expert financial managers to manage assets, control costs, and obtain funds. Government units and not-for-profit organizations hire financial and other analysts to perform these tasks.

All of these entry-level finance job opportunities can be found in the international setting. For example, many businesses engaged in producing and marketing products and services in foreign markets often offer employees opportunities for international job assignments. Large U.S. banks offer international job experiences through their foreign banking operations. Furthermore, since worldwide securities markets exist, securities analysts and financial planners often must analyze and visit foreign-based firms.

---

**CAREER OPPORTUNITIES IN FINANCE**

*You Are Likely to Have More than One Business Career*

Students are advised to prepare for several business careers during their working lifetimes. Corporate America continues to restructure and reinvent itself. At the same time, new industries associated with the information age are developing, and old industries are dropping by the wayside. These developments mean you will have more opportunities for multiple business careers.

Graduates of Harvard University are periodically surveyed concerning their work experiences and careers. Responses to one survey of individuals twenty-five years after graduation found that over half had worked for four or more employers, and one-fourth had been fired or, in kinder terms, “involuntarily terminated”. Over half of the men and women respondents had had at least two substantially different careers, and in many instances significant retraining was required.

Remember as you read this book that even if you do not plan on a career in finance, learning about finance might become important to you in your working lifetime. No matter where your business career takes you, you will always need to know and understand your personal finances.
Several detailed Career Opportunities in Finance boxes are presented in selected chapters. We hope these materials provide a better understanding of some of the many career opportunities that exist in the finance field. We are sure new finance job opportunities will occur as the field continues to develop and change. It is time to begin learning about finance.

SIX PRINCIPLES OF FINANCE

Finance is founded on six important principles. The first five relate to the economic behavior of individuals, and the sixth one focuses on ethical behavior. Knowing about these principles will help us understand how managers, investors, and others incorporate time and risk into their decisions, as well as why the desire to earn excess returns leads to information-efficient financial markets in which prices reflect available information. Unfortunately, sometimes greed associated with the desire to earn excess returns causes individuals to risk losing their reputations by engaging in questionable ethical behavior and unethical behavior in the form of fraud or other illegal activities. The bottom line is “Reputation matters.” The following are the six principles that serve as the foundation of finance:

1. Money has a time value.
2. Higher returns are expected for taking on more risk.
3. Diversification of investments can reduce risk.
4. Financial markets are efficient in pricing securities.
5. Manager and stockholder objectives may differ.
6. Reputation matters.

TIME VALUE OF MONEY

Let’s look at these principles one by one. Money in hand today is worth more than the promise of receiving the same amount in the future. The time value of money exists because a sum of money today could be invested and grow over time. For example, assume you have $1,000 and that it could earn $60 (6 percent) interest over the next year. Thus, $1,000 today would be worth $1,060 at the end of one year (i.e., $1,000 plus $60). As a result, a dollar today is worth more than a dollar received a year from now. The time value of money principle helps us understand the economic behavior of individuals and the economic decisions of the institutions and businesses they run. This finance principle pillar is apparent in many of our day-to-day activities, and knowledge of it will help us understand the implications of time-varying money decisions. We explore the details of the time value of money in Chapter 9, but this first principle of finance will be apparent throughout this book.

RISK VERSUS RETURN

A trade-off exists between risk and expected return in all types of investments, both assets and securities. Risk is the uncertainty about the outcome or payoff of an investment in the future. For example, you might invest $1,000 in a business venture today. After one year, the firm might be bankrupt, and you would lose your total investment. On the other hand, after one year your investment might be worth $2,400. This variability in possible outcomes is your risk. Instead, you might invest your $1,000 in a U.S. government security, where after one year the value may be $950 or $1,100. Rational investors would consider the business venture investment to be riskier and would choose this investment only if they feel the expected return is high enough to justify the greater risk. Investors make these trade-off decisions every day.

Business managers make similar trade-off decisions when they choose between different projects in which they could invest. Understanding the risk/return trade-off principle helps us understand how individuals make economic decisions. While we specifically explore the trade-off between risk and expected return in greater detail in Part 2, this second principle of finance is involved in many financial decisions throughout this text.

DIVERSIFICATION OF RISK

While higher returns are expected for taking on more risk, all investment risk is not the same. Some risk can be removed or diversified by investing in several different assets or securities. Let’s return to
the example involving a $1,000 investment in a business venture where after one year the investment we could provide a return of either zero dollars or $2,400. Let’s assume an opportunity exists to invest $1,000 in a second unrelated business venture in which the outcomes would be zero dollars or $2,400. Let’s further assume we will put half of our $1,000 investment funds in each investment opportunity such that the individual outcomes for each $500 investment would be zero dollars or $1,200.

Though both investments could lose everything (i.e., return zero dollars) or return $1,200 each (a total of $2,400), one investment could go broke and the other return $1,200. So, four outcomes are possible:

<table>
<thead>
<tr>
<th>POSSIBLE OUTCOMES</th>
<th>COMBINED INVESTMENT</th>
<th>POSSIBLE RETURNS</th>
<th>COMBINED RETURN</th>
</tr>
</thead>
<tbody>
<tr>
<td>Outcome 1:</td>
<td>$500 + $500</td>
<td>$0 + $0</td>
<td>$0</td>
</tr>
<tr>
<td>Outcome 2:</td>
<td>$500 + $500</td>
<td>$0 + $1,200</td>
<td>$1,200</td>
</tr>
<tr>
<td>Outcome 3:</td>
<td>$500 + $500</td>
<td>$1,200 + $0</td>
<td>$1,200</td>
</tr>
<tr>
<td>Outcome 4:</td>
<td>$500 + $500</td>
<td>$1,200 + $1,200</td>
<td>$2,400</td>
</tr>
</tbody>
</table>

If each outcome has an equal one-fourth (25 percent) chance of occurring, most of us would prefer this diversified investment. Though our combined investment of $1,000 ($500 in each investment) at the extremes could return zero dollars or $2,400, it is also true that we have a 50 percent chance of getting $1,200 back for our $1,000 investment. As a result, most of us would prefer investing in the combined or diversified investment rather than in either of the two investments separately. We will explore the benefits of investment diversification in Part 2 of this text.

FINANCIAL MARKETS ARE EFFICIENT

A fourth finance-related aspect of economic behavior is that individuals seek to find undervalued and overvalued investment opportunities involving real and financial assets. It is human nature, economically speaking, to search for investment opportunities that will provide returns higher than those expected for undertaking a specified risk level. This attempt by many to earn excess returns or to beat the market leads to financial markets being information efficient. However, at the same time, consistently earning returns higher than those expected in a risk/return trade-off framework becomes almost impossible. Rather than looking at this third pillar of finance as a negative consequence of human economic behavior, we prefer to couch it positively in that it leads to information-efficient financial markets.

A financial market is said to be information efficient if the prices of securities reflect all information available to the public. When new information becomes available, prices change to reflect that information. For example, let’s assume a firm’s stock is currently trading at $20 per share. If the market is efficient, potential buyers and sellers of the stock know that $20 per share is a fair price. Trades should be at $20, or near to it, if the demand (potential buyers) and supply (potential sellers) are in reasonable balance. Let’s assume the firm announces the production of a new product that is expected to increase sales and profits. Investors might react by bidding up the price to, say, $25 per share to reflect this new information. Assuming this new information is assessed properly, the new fair price becomes $25 per share. This informational efficiency of financial markets exists because a large number of professionals are continually searching for mispriced securities. As soon as new information is discovered, it becomes immediately reflected in the price of the associated security. Information-efficient financial markets play an important role in the marketing and transferring of financial assets between investors by providing liquidity and fair prices. The importance of information efficient financial markets is examined throughout this text and specifically in Chapter 12.

MANAGEMENT VERSUS OWNER OBJECTIVES

A fifth principle of finance is related to management objectives differing from owner objectives. Owners or equity investors want to maximize the returns on their investments but often hire professional managers to run their firms. However, managers may seek to emphasize the size of firm sales or assets, have company jets or helicopters available for their travel, and receive company-paid country club memberships. Owner returns may suffer as a result of manager
objectives. To bring manager objectives in line with owner objectives, the company must tie manager compensation to measures of performance beneficial to owners. Managers are often given a portion of the ownership positions in privately held firms and are provided stock options and bonuses tied to stock price performance in publicly traded firms.

The possible conflict between managers and owners is sometimes called the principal-agent problem. We will explore this problem in greater detail and describe how owners provide incentives to managers to manage in the best interests of equity investors or owners in Chapter 13.

**REPUTATION MATTERS**

The sixth principle of finance is “Reputation matters.” An individual’s reputation reflects his or her ethical standards or behavior. Ethical behavior is how an individual or organization treats others legally, fairly, and honestly. The ethical behavior of organizations reflects the ethical behaviors of their directors, officers, and managers. For institutions or businesses to be successful, they must have the trust and confidence of their customers, employees, and owners, as well as the community and society within which they operate. Firms have an ethical responsibility to provide safe products and services, to have safe working conditions for employees, and to not pollute or destroy the environment. Laws and regulations exist to ensure minimum levels of protection and the difference between unethical and ethical behavior. Examples of high ethical behavior include when firms establish product safety and working-condition standards well above the legal or regulatory standards.

Unfortunately, and possibly due in part to the greed for excess returns (such as higher salaries, bonuses, more valuable stock options, personal perquisites), directors, officers, managers, and other individuals sometimes are guilty of unethical behavior for engaging in fraudulent or other illegal activities. Reputations are destroyed, criminal activities are prosecuted, and involved individuals may receive jail sentences. The unethical behavior of directors, officers, and managers may lead to a loss of reputation and destruction of the institutions and businesses for which they work.

Many examples of fraudulent and illegal unethical behavior have been cited in the financial press over the past few decades, and most seem to be tied to greed for personal gain. In such cases, confidential information was used for personal benefit, illegal payments were made to gain business, accounting fraud was committed, business assets were converted to personal use, and so forth. In the early 1980s, a number of savings and loan association managers were found to have engaged in fraudulent and unethical practices, and some managers were prosecuted and sent to prison, and their institutions were dissolved or merged with other institutions.

In the late 1980s and early 1990s, fraudulent activities and unethical behavior by investment banking firms resulted in several high-profile financial wheeler-dealers going to prison. This resulted in the collapse of Drexel, Burnham, Lambert and the near collapse of Salomon Brothers. By the early part of the twenty-first century, such major firms as Enron, its auditor Arthur Andersen, and WorldCom ceased to exist because of fraudulent and unethical behavior on the part of their managers and officers. In addition, key officials of Tyco and Adelphia were charged with illegal actions and fraud. In 2009, Bernie Madoff was convicted and sent to prison for operating a Ponzi scheme that resulted in investors losing billions of dollars. Returns in a Ponzi scheme are fictitious and unearned. Early investors receive their returns from the contributions of subsequent investors. Ultimately, such a scheme collapses when new investors cannot be found and when existing investors want to sell their investments.

While the financial press chooses to highlight examples of unethical behavior, most individuals exhibit sound ethical behavior in their personal and business dealings and practices. In fact, the sixth principle of finance depends on most individuals practicing high-quality ethical behavior and believing that reputation matters. To be successful, an organization or business must have the trust and confidence of its various constituencies, including customers, employees, owners, and the community. High-quality ethical behavior involves treating others fairly and honestly and goes beyond meeting legal and regulatory requirements. High reputation value reflects high-quality ethical behavior, so employing high ethical standards is the right thing to do. Many organizations and businesses have developed and follow their own code of ethics. The importance of practicing sound ethical behavior is discussed throughout this text.
The financial system is a complex mix of financial intermediaries, markets, instruments, policy makers, and regulations that interact to expedite the flow of financial capital from savings into investment. We present a brief overview of the financial system in Chapter 1 and then follow with more detailed coverage in the remaining chapters of Part 1.

CHARACTERISTICS AND REQUIREMENTS

Figure 1.2 provides a graphic review of the U.S. financial system. First, an effective financial system must have several sets of policy makers who pass laws and make decisions relating to fiscal and monetary policies. These policy makers include the president, Congress, the U.S. Treasury, and the Federal Reserve Board. Since the United States operates within a global economy, political and economic actions of foreign policy makers influence, although indirectly, the U.S. financial system and its operations. Major economic goals are identified and policy maker actions designed to achieve those goals are discussed in Chapter 5.

Second, an effective financial system needs an efficient monetary system, which is composed of a central bank and a banking system able to create and transfer a stable medium of exchange called money. In the United States, the dollar is the medium of exchange, the central bank is the Federal Reserve System, and the banking system is commonly referred to as the commercial banking system. Characteristics of money and the monetary system are discussed in Chapter 2, and the Federal Reserve System is covered in Chapter 4.

Third, an effective financial system must have financial institutions or intermediaries that support capital formation either by channeling savings into investment in physical assets or by fostering

**FIGURE 1.2**
Graphic View of the U.S. Financial System

---

**Policy Makers**
President, Congress, and U.S. Treasury
Federal Reserve Board
Role: pass laws and set fiscal and monetary policies

**Monetary System**
Federal Reserve Central Bank
Commercial Banking System
Role: create and transfer money

**Financial Institutions**
Depository Institutions
Contractual Savings Organizations
Securities Firms
Finance Firms
Role: accumulate and lend/invest savings

**Financial Markets**
Debt Securities Markets
Equity Securities Markets
Derivative Securities Markets
Foreign Exchange Markets
Role: market and facilitate transfer of financial assets
direct financial investments by individuals in financial institutions and businesses. The process of accumulating and then lending and investing savings is referred to as the savings-investment process. Four types of financial intermediaries are listed in Figure 1.2. Depository institutions, contractual savings organizations, securities firms, and finance firms are discussed in Chapter 3.

Fourth, an effective financial system requires financial assets or instruments necessary for the savings-investment process to work efficiently. We cover the types of financial asset instruments and securities used in the United States throughout the text and cover how the savings-investment process works in Chapter 7.

Fifth, an effective financial system must also have financial markets that facilitate the transfer of financial assets among individuals, institutions, businesses, and governments. Figure 1.2 identifies three types of financial markets: debt securities markets, equity securities markets, and derivative securities markets. We briefly discuss these markets later in this chapter and then provide more detailed coverage of the various securities markets throughout the text.

FINANCIAL SYSTEM COMPONENTS AND FINANCIAL FUNCTIONS

We can express the roles of the monetary system, financial institutions, and financial markets as financial functions necessary in an effective financial system. Figure 1.3 indicates that the monetary system is responsible for creating and transferring money. Financial institutions efficiently accumulate savings and then lend or invest these savings. Financial institutions play important roles in the savings-investment process through financial intermediation activities and in facilitating direct investments by individuals. Financial markets, along with certain securities firms, are responsible for marketing and transferring financial assets or claims.

Creating Money

Since money is something accepted as payment for goods, services, and debts, its value lies in its purchasing power. Money is the most generalized claim to wealth since it can be exchanged for almost anything else. Most transactions in today’s economy involve money, and most would not take place if money were unavailable.

One of the most significant functions of the monetary system within the financial system is creating money, which serves as a medium of exchange. In the United States, the Federal Reserve System is primarily responsible for the amount of money created although most of the money is created by depository institutions. A sufficient amount of money is essential if economic activity is to take place at an efficient rate. Having too little money constrains economic growth. Having too much money often results in increases in the prices of goods and services.

**CONCEPT CHECK**

What five requirements are necessary for a financial system to be effective?
The main participant in the financial system is not the large institution or corporation. Instead, it’s you and others like you. Households, families, and individuals provide up to 80 percent of the savings flows in the U.S. economy in any year. Three main sources of savings exist: personal savings, business savings (that is, retained earnings), and government surpluses. Personal savings far outweigh the other two sources combined as a source of savings flows in the United States.

You can look at this is another way: Where do financial institutions get the funds they invest and loan? Banks get their funds mainly from individuals’ checking and savings accounts and from certificates of deposit (CDs). Pension funds obtain their cash from the savings of working people. Insurance firms accumulate funds to invest from policyholders’ payments of premiums for their life, health, car, and home insurance. Mutual funds obtain investable cash by selling their shares to investors like you who want to accumulate savings and returns on savings to fund a future goal such as retirement, a new car, a house down payment, or children’s college expenses.

Transferring Money

Individuals and businesses hold money for purchases or payments they expect to make in the future. One way to hold money is in checkable deposits at depository institutions. When money is held in this form, payments can be made easily by check. The check is an order to the depository institution to transfer money to the party who received the check. This is a great convenience since checks can be written for the exact amount of payments, can be safely sent in the mail, and can provide a record of payment. Institutions can also transfer funds between accounts electronically, making payments without paper checks. Funds transfers can be made by telephone, at automated teller machines (ATMs) connected to a bank’s computer, and via the Internet.

Accumulating Savings

A function performed by financial institutions is the accumulation or gathering of individual savings. Most individuals, businesses, and organizations do not want to take the risks involved in having cash on hand. Even if relatively small, cash amounts are put into a depository institution for safekeeping. When all the deposits are accumulated in one place, they can be used for loans and investments in amounts much larger than any individual depositor could supply. Depository institutions regularly conduct advertising campaigns and other promotional activities to attract deposits.

Lending and Investing Savings

Another basic function of financial institutions is lending and investing. The money that has been put into these intermediaries may be lent to businesses, farmers, consumers, institutions, and governmental units. It may be lent for varying periods and for different purposes, such as to buy equipment or to pay current bills. Some financial institutions make loans of almost all types. Others specialize in one or two types of lending. Other financial institutions invest all or part of their accumulated savings in the stock of a business or in debt obligations of businesses or other institutions.

Marketing Financial Assets

New financial instruments and securities are created and sold in the primary securities market. For example, a business may want to sell shares of ownership, called stock, to the general public. It can do so directly, but the process of finding individuals interested in investing funds in that business is likely to be difficult, costly, and time consuming. One particular financial intermediary, an investment banking firm, can handle the sale of shares of ownership. The function of the investment banking firm is one of merchandising. Brokerage firms market existing, or seasoned, instruments and securities.

Transferring Financial Assets

Several types of financial institutions facilitate or assist the processes of lending and selling securities. Brokerage firms market and facilitate the transferring of existing or seasoned instruments.
and securities. If shares of stock are to be sold to the general public, it is desirable to have a ready market in which such stocks can be resold when the investor desires. Organized stock exchanges and the over-the-counter market provide active secondary markets for existing securities. The ability to buy and sell securities quickly and at fair market values is important in an efficient financial system.

**FINANCIAL MARKETS CHARACTERISTICS**

Financial markets facilitate the raising of financial capital by government entities and business firms. Government entities can issue or sell debt securities to finance the building of roads and bridges or to provide added services to people. Business firms can issue debt securities, and corporations can sell equity securities or stocks to raise funds to invest in and grow their businesses. Financial markets facilitate the transferring of previously issued debt and equity securities from existing to new investors.

**MONEY AND CAPITAL MARKETS**

*Money markets* are where debt securities with maturities of one year or less are issued and traded. These markets are generally characterized by high liquidity whereby *money market securities* can be easily sold or traded with little loss of value. These short-lived securities generally have low returns and low risk. In Chapter 2, we will discuss money market securities.

*Capital markets* are where debt instruments or securities with maturities longer than one year and corporate stocks or equity securities are issued and traded. *Capital market securities* are generally issued to finance the purchase of homes by individuals, buildings and equipment by businesses, and the providing of infrastructure (roads, bridges, buildings, etc.) by governments. Business firms and governments issue long-term debt securities, called bonds, to finance their assets and operations. Mortgages are issued to finance homes and buildings. Corporations also issue stocks to meet their financing needs. In Part 2, we will cover capital market securities.

**PRIMARY AND SECONDARY MARKETS**

Primary and secondary markets exist for debt (bonds and mortgages) and equity securities. The initial offering or origination of debt and equity securities takes place in *primary markets*. Proceeds from the sale of new securities after issuing costs go to the issuing business or government issuer. The primary market is the only “market” where the security issuer directly benefits (receives funds) from the sale of its securities. Mortgage loans provide financing for the purchase of homes and other real property.

*Secondary markets* are physical locations or electronic forums where debt (bonds and mortgages) and equity securities are traded. Secondary markets for securities facilitate the transfer of previously issued securities from existing investors to new investors. Security transactions or transfers typically take place on organized security exchanges or in the electronic over-the-counter market. Individuals and other investors can actively buy and sell existing securities in the secondary market. While these secondary market investors may make gains or losses on their securities investments, the issuer of the securities neither benefits nor loses from these activities. The secondary market for securities is typically divided into short-term (money) and long-term (capital) market categories. We discuss primary and secondary securities markets in detail in Chapter 11. In addition, an active secondary market for real estate mortgages exists. We will discuss the basics of secondary markets for mortgages in Chapter 7.

**MAJOR TYPES OF FINANCIAL MARKETS**

Four main types of financial markets exist: debt securities markets, equity securities markets, derivative securities markets, and foreign exchange markets. *Debt securities* are obligations to repay borrowed funds. *Debt securities markets* are markets where money market securities, bonds (corporate, financial institution, and government), and mortgages are originated and
traded. **Bond markets** are where debt securities with longer-term maturities are originated and traded. Government entities (federal, state, and local), financial institutions, and business firms can issue bonds. While bonds and bond markets are discussed throughout this text, we will focus on them in Chapter 10. **Mortgage markets** are where loans to purchase real estate (buildings and houses) are originated and traded. Mortgage markets are discussed in Chapter 7.

**Common stocks** are ownership shares in corporations. **Equity securities markets** are markets where ownership rights in corporations are initially sold and traded. Corporations can raise funds either through a *private placement*, which involves issuing new securities directly to specific investors, or through a *public offering*, which involves selling new securities to the general public. Financial institutions can also raise equity capital by selling stocks in their firms. Equity securities and markets are discussed in detail in Chapter 11.

In addition to money and capital markets, **derivative securities markets** are markets where financial contracts or instruments that derive their values from underlying debt and equity securities are originated and traded. A familiar form of *derivative security* is the opportunity to buy or sell a corporation’s equity securities for a specified price and within a certain amount of time. Derivative securities may be used to speculate on the future price direction of the underlying financial assets or to reduce price risk associated with holding the underlying financial assets. Organized exchanges handle standardized derivative security contracts, and negotiated contracts are handled in electronic markets often involving commercial banks or other financial institutions. We discuss derivative securities in the Learning Extension to Chapter 11.

**Foreign exchange markets** (FOREX markets) are electronic markets in which banks and institutional traders buy and sell various currencies on behalf of businesses and other clients. In the global economy, consumers may want to purchase goods produced or services provided in other countries. Likewise, an investor residing in one country may wish to hold securities issued in another country. For example, a U.S. consumer may wish to purchase a product in a foreign country. If the product is priced in the foreign country’s currency, it may be necessary to exchange U.S. dollars for the foreign currency to complete the transaction. Businesses that sell their products in foreign countries usually receive payment in the foreign currencies. However, because the relative values of currencies may change, firms often use the currency exchange markets to reduce the risk of holding too much of certain currencies. We discuss currency exchange rates and foreign exchange markets in Chapter 6.

**THE PLAN OF STUDY**

The subject matter of this book includes the entire scope of the financial environment from the perspective of the financial system and the three areas of finance: institutions and markets, investments, and financial management. You will learn about the markets in which funds are traded and the institutions that participate in and assist these flows of funds. You will learn about the investment area of finance, including the characteristics of issued debt and equity securities, securities markets, and investment risk-return concepts. You will study the financial management principles and concepts that guide financial managers to make sound financial planning, asset acquisition, and financing decisions. International finance applications are integrated throughout the text.

Part 1 focuses on the financial institutions, markets, and other participants that make the U.S. financial system operate effectively domestically and globally. Chapter 2 introduces the role of money within the overall financial system and its monetary system component. Chapter 3 focuses on the financial intermediation roles of depository and other financial institutions, as well as how they operate within the financial system. Chapter 4 discusses the Federal Reserve System. Chapter 5 discusses economic objectives, the role and actions of policy makers, and how money and credit are provided to meet the needs of the economy. We conclude Part 1 with Chapter 6 on international finance and trade because of its importance in understanding market economies worldwide.

Part 2 is concerned with the investments area of finance. Chapter 7 discusses the savings and investment process and its major role in the U.S. market economy. This is followed by Chapter 8,
which describes the structure of interest rates. Time value of money concepts are covered in Chapter 9, and Chapter 10 covers the characteristics and valuations of bonds and stocks. Chapter 11 discusses the characteristics and workings of the securities markets. Part 2 concludes with Chapter 12, which describes financial return and risk concepts for a single asset or security, and for portfolios of securities.

Part 3 focuses on the financial management of businesses. We begin Chapter 13 with an introduction and overview of the types of business organizations and follow with a review of basic financial statements and financial data important to the financial manager. Chapter 14 discusses the need for, and the way in which to conduct, financial analysis of past performance and concludes with a section on long-term financial planning. Chapter 15 covers the management of working capital, while Chapter 16 focuses on sources of short-term business financing. We then turn our attention in Chapter 17 to the process and methods for conducting capital budgeting analysis. We conclude Part 3 with Chapter 18, which provides a discussion of capital structure and cost of capital concepts.

As we illustrated in Figure 1.1, the three areas of finance are dependent and continue to interact or overlap. For example, financial institutions provide an important financial intermediation role by getting individual savings into the hands of businesses so financial managers can use and invest those funds. Financial managers rely on the investments area of finance when carrying out their financial management activities. Corporations often need to raise funds in the primary securities markets, and secondary securities markets, in turn, provide investors with the liquidity to buy and sell previously issued securities. Our approach in this book is to survey all three areas of finance.

**SUMMARY**

Finance is the study of how businesses and others acquire, spend, and manage money and other financial resources. More specifically, finance is composed of three areas: financial institutions and markets, investments, and financial management. However, these three areas intersect and overlap. A survey approach to the study of finance covers all three areas.

An effective financial system requires policy makers, a monetary system, and financial institutions and financial markets to facilitate the flow of financial capital from savings into investments. Policy makers pass laws and set fiscal and monetary policies designed to manage the economy. A monetary system creates and transfers money. Financial institutions accumulate and lend/invest individual savings. Financial markets facilitate the transfer of securities and other financial assets. Four types of financial markets exist: debt securities markets, equity securities markets, derivative securities markets, and foreign exchange markets. These activities operate together to create a smooth and efficient financial system.
**KEY TERMS**

<table>
<thead>
<tr>
<th>Term</th>
<th>Definition</th>
</tr>
</thead>
<tbody>
<tr>
<td>bond markets</td>
<td>金融产品，包括股票、债券和衍生品。</td>
</tr>
<tr>
<td>capital markets</td>
<td>金融产品，包括股票、债券和衍生品。</td>
</tr>
<tr>
<td>common stocks</td>
<td>金融产品，包括股票、债券和衍生品。</td>
</tr>
<tr>
<td>debt securities</td>
<td>金融产品，包括股票、债券和衍生品。</td>
</tr>
<tr>
<td>debt securities markets</td>
<td>金融产品，包括股票、债券和衍生品。</td>
</tr>
<tr>
<td>derivative securities markets</td>
<td>金融产品，包括股票、债券和衍生品。</td>
</tr>
<tr>
<td>entrepreneurial finance</td>
<td>金融产品，包括股票、债券和衍生品。</td>
</tr>
<tr>
<td>equity securities markets</td>
<td>金融产品，包括股票、债券和衍生品。</td>
</tr>
<tr>
<td>ethical behavior</td>
<td>道德行为。</td>
</tr>
<tr>
<td>finance</td>
<td>金融产品，包括股票、债券和衍生品。</td>
</tr>
<tr>
<td>financial environment</td>
<td>金融产品，包括股票、债券和衍生品。</td>
</tr>
<tr>
<td>financial institutions</td>
<td>金融产品，包括股票、债券和衍生品。</td>
</tr>
<tr>
<td>financial management</td>
<td>金融产品，包括股票、债券和衍生品。</td>
</tr>
<tr>
<td>financial markets</td>
<td>金融产品，包括股票、债券和衍生品。</td>
</tr>
<tr>
<td>foreign exchange markets</td>
<td>金融产品，包括股票、债券和衍生品。</td>
</tr>
<tr>
<td>investments</td>
<td>金融产品，包括股票、债券和衍生品。</td>
</tr>
<tr>
<td>money markets</td>
<td>金融产品，包括股票、债券和衍生品。</td>
</tr>
<tr>
<td>mortgage markets</td>
<td>金融产品，包括股票、债券和衍生品。</td>
</tr>
<tr>
<td>personal finance</td>
<td>金融产品，包括股票、债券和衍生品。</td>
</tr>
<tr>
<td>primary markets</td>
<td>金融产品，包括股票、债券和衍生品。</td>
</tr>
<tr>
<td>secondary markets</td>
<td>金融产品，包括股票、债券和衍生品。</td>
</tr>
</tbody>
</table>

**DISCUSSION QUESTIONS**

1. Briefly describe how the financial environment has changed during the past few years.
2. What is finance?
3. What is meant by the term financial environment?
4. What are the three areas of finance?
5. Briefly describe the terms entrepreneurial finance and personal finance.
6. Identify and briefly describe several reasons for studying finance.
7. Indicate some of the career opportunities in finance available to business graduates.
8. What are the six principles of finance?
9. Describe what is meant by ethical behavior.
10. What are the basic requirements of an effective financial system?
11. Identify and briefly describe the financial functions in the financial system.
12. Briefly describe the differences between money and capital markets.
13. What are the differences between primary and secondary markets?
14. How do debt securities and common stocks differ?
15. Identify the four types of major financial markets.

**EXERCISES**

1. Match the following dates with the associated events:
   - Year: 2000, Event: (1) great recession
   - Year: 2001, Event: (2) U.S. terrorist attack
   - Year: 2006, Event: (3) financial crisis
   - Year: 2007–08, Event: (4) technology stock bubble
   - Year: 2008–09, Event: (5) housing price bubble

2. The U.S. financial system is composed of (1) policy makers, (2) a monetary system, (3) financial institutions, and (4) financial markets. Indicate which of these components is associated with each of the following roles:
   - a. accumulate and lend/invest savings
   - b. create and transfer money
   - c. pass laws and set fiscal and monetary policies
   - d. market and facilitate transfer of financial assets

3. Financial markets may be categorized as (1) debt securities markets, (2) equity securities markets, (3) derivative securities markets, and (4) foreign exchange markets. Indicate in which of these markets the following securities trade:
   - a. mortgages
   - b. bonds
   - c. common stocks
   - d. currencies

4. In business, ethical dilemmas or situations occur frequently. Laws and regulations exist to define unethical behavior. However, the practicing of high-quality ethical behavior often goes beyond meeting laws and regulations. Indicate how you would respond to the following situations.
   - a. Your boss has told you that tomorrow the Federal Drug Administration (FDA) will announce its approval of your firm’s marketing of a new breakthrough drug. As a result of this information, you are considering purchasing shares of stock in your firm this afternoon. What would you do?
   - b. In the past, your firm has complied with regulatory standards relating to product safety. However, you have heard through the company grapevine that some of your firm’s products have failed resulting in injuries to customers. You are considering quitting your job due to personal moral concerns. What would you do?

5. Obtain several recent issues of the The Wall Street Journal or Bloomberg Businessweek. Identify, read, and be prepared to discuss at least one article relating to one of the six principles of finance.

6. Obtain several recent issues of the The Wall Street Journal or Bloomberg Businessweek. Identify, read, and be prepared to discuss at least one article relating to one of the four types of financial markets identified in this chapter.

7. Obtain several recent issues of the The Wall Street Journal or Bloomberg Businessweek. Identify, read, and be prepared to discuss at least one article relating specifically to recent changes in the financial environment.
