

Introduction to Finance

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MGM 237

**The Financial Environment and
Foundations of Finance**

Lecture 1



Chapter

1

The Financial Environment and Foundations of Finance

Learning Outcomes

Students will be able to:

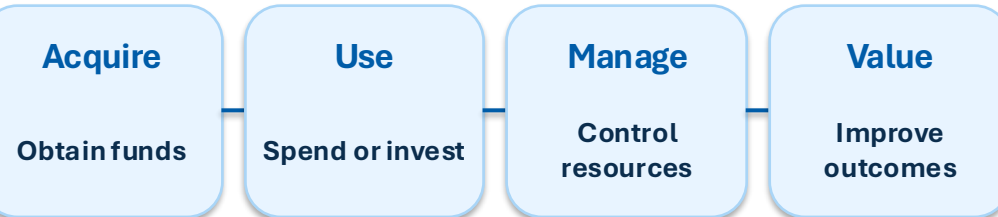
- Define finance and explain its three major areas.
- Explain why finance should be studied.
- Describe the six principles of finance.
- Identify the four components and key functions of the financial system.
- Classify financial markets and recognize major finance career paths.

What Is Finance?

Finance is about acquiring, spending, and managing financial resources.

Core explanation

- Finance studies how individuals, institutions, governments, and businesses acquire, spend, and manage financial resources.
- Finance connects saving, investing, financing, and business decision-making.
- The field is broader than corporate finance alone.
- The textbook organizes finance into three interacting areas.



Manager's Insight

Finance is the language that connects resources with decisions.

Quick Example

A business choosing how to fund new equipment is making a finance decision.

The Financial Environment

Finance operates inside a system of institutions, markets, participants, and rules.

Core explanation

- The financial environment includes the financial system, institutions, markets, businesses, individuals, and global interactions.
- These elements work together to help the economy operate efficiently.
- Finance decisions are influenced by laws, regulations, interest rates, and market conditions.
- A strong financial environment helps move funds from savers to productive uses.

System

Rules and structure

Institutions

Intermediaries

Markets

Fund transfer

Participants

Savers and users

Manager's Insight

Finance decisions never occur in isolation from the surrounding financial environment.

Quick Example

A loan decision depends on market interest rates and the rules that govern lenders.

Finance and Its Roots

Finance draws heavily on economics and accounting.

Core explanation

- Economics helps explain prices and quantities using supply and demand.
- Accounting provides the record-keeping system for financial transactions.
- Accounting records revenues, expenses, and profitability.
- Finance uses this information to make resource-allocation and value decisions.

Economics

- Prices and quantities
- Supply and demand

Accounting

- Records transactions
- Reports revenues and expenses

Manager's Insight

Accounting tells us what happened; finance uses information to decide what should happen next.

Quick Example

A manager uses accounting data on costs and profits to evaluate future financing or investment choices.

Three Major Areas of Finance

The textbook views finance through three overlapping areas.

Core explanation

- The three areas are financial institutions and markets, investments, and financial management.
- Each area has a distinct focus but they continuously interact.
- People working in one area need basic knowledge of the other two.
- The course follows this integrated view of finance.



Manager's Insight

Do not treat markets, investments, and financial management as separate worlds.

Quick Example

A corporation raises funds in markets, works with institutions, and must understand investor expectations.

Financial Institutions and Markets

Institutions and markets connect savers with those who need funds.

Core explanation

- Financial institutions collect funds from savers and lend or invest them.
- Examples include commercial banks, investment banks, insurance companies, and mutual funds.
- Financial markets bring investors together with businesses and governments that need funds.
- Securities markets help raise new funds and transfer existing securities.

Institutions

Collect and channel funds

Markets

Match funds with users

Securities

Raise and transfer capital

Outcome

Flow from savings to investment

Manager's Insight

Intermediation reduces the distance between saving and productive investment.

Quick Example

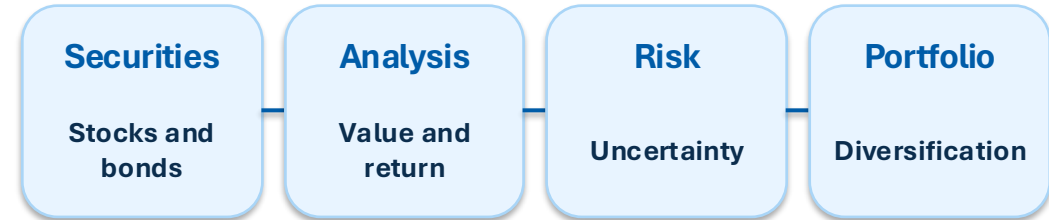
A bank pools many deposits and uses them to make larger loans.

Investments

Investments focuses on securities, analysis, and risk management.

Core explanation

- The investments area includes selling or marketing securities.
- It includes analyzing debt and equity securities.
- Investment decisions involve balancing expected return and risk.
- Portfolio diversification is used to manage investment risk.



Manager's Insight

An investment decision is not only about return; it is also about risk.

Quick Example

An investor comparing a bond and a stock considers both expected payoff and uncertainty.

Financial Management

Financial management focuses on planning, assets, and financing.

Core explanation

- Financial management studies how a business manages assets, liabilities, and equity.
- Key functions include financial planning, asset management, and fund-raising.
- Managers evaluate choices such as new products, expansion, and investing excess cash.
- The textbook links good financial management to enhancing business value.

Plan

Financial
planning

Assets

Manage
resources

Funds

Raise capital

Value

Enhance
business value

Manager's Insight

Financial management converts business strategy into financial choices.

Quick Example

A firm deciding whether to expand production must estimate funding needs and expected benefits.

How the Three Areas Interact

The three areas of finance continuously exchange funds and information.

Core explanation

- Financial institutions operate within financial markets.
- Financial managers use market information when making investment and financing decisions.
- Businesses work with institutions when raising funds or investing excess cash.
- Investors use information from firms and institutions to evaluate securities.



Manager's Insight

A strong finance decision often depends on information from more than one area of finance.

Quick Example

A firm issuing bonds needs a financial institution, a securities market, and investor demand.

Why Study Finance?

Finance knowledge supports better economic, investment, and career decisions.

Core explanation

- The textbook identifies three broad reasons to study finance.
- Finance helps people make informed economic decisions.
- It supports personal and business investment decisions.
- It also helps people make informed career decisions.

Economic

Public choices

Investment

Personal and
business

Career

Work decisions



Manager's Insight

Finance is useful even for students who will not work in a finance department.

Quick Example

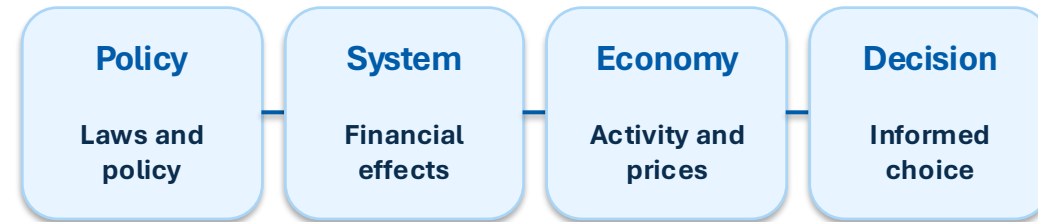
A marketing manager still needs to understand budgets, returns, and financing constraints.

Informed Economic Decisions

Understanding the financial system improves economic decision-making.

Core explanation

- Policy makers influence the financial system and economic activity.
- Laws and policy decisions can affect taxes, inflation, employment, and financial conditions.
- Individuals need basic financial understanding to evaluate economic choices.
- Part 1 of the textbook explains institutions, markets, and the financial system.



Manager's Insight

Economic choices are easier to evaluate when you understand how the financial system works.

Quick Example

A change in monetary policy can affect borrowing costs for households and firms.

Personal and Business Investment Decisions

Finance supports saving, investing, and financing choices.

Core explanation

- Individuals use finance to manage resources and accumulate wealth over time.
- Businesses use finance to understand how operations are funded.
- Investment decisions require knowledge of interest rates, security prices, and risk versus return.
- These concepts help users compare alternatives on a consistent basis.

Personal

Saving and wealth

Business

Funding operations

Markets

Rates and prices

Choice

Risk versus return

Manager's Insight

The same finance principles influence both personal and business decisions.

Quick Example

Both an individual and a firm may compare borrowing costs before taking a loan.

Career Decisions

Finance knowledge is useful across many professional roles.

Core explanation

- Non-finance professionals often work with finance specialists.
- Basic financial management knowledge improves cross-functional communication.
- Students may also pursue finance careers directly.
- The textbook highlights career opportunities throughout the course.

Non-finance

Work with finance

Finance roles

Direct careers

Skill

Interpret data

Benefit

Better decisions

Manager's Insight

Finance literacy improves communication across business functions.

Quick Example

A production manager may need to explain a capital request to the finance team.

Six Principles of Finance

The textbook uses six principles as the foundation of finance.

Core explanation

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

1

Time value

2

Risk-return

3

Diversification

4

Efficiency

5

Agency

6

Reputation

Manager's Insight

These principles appear repeatedly throughout the course.

Quick Example

Valuation, investment choice, and financing all rely on one or more of these principles.

Time Value of Money

A dollar today is worth more than the same dollar received later.

Core explanation

- Money available today can be invested and earn a return.
- Waiting to receive money means giving up that investment opportunity.
- This makes timing important in financial decisions.
- The textbook develops the detailed mathematics later in Chapter 9.

Today

\$1,000 available

Invest

Earn return

Future

\$1,060 at 6%



Manager's Insight

Always ask when a cash flow occurs, not only how large it is.

Quick Example

\$1,000 invested at 6% for one year becomes \$1,060.

Risk versus Expected Return

Higher expected returns are normally required for greater risk.

Core explanation

- Risk is uncertainty about an investment's future payoff.
- Riskier opportunities have a wider range of possible outcomes.
- Rational investors require enough expected return to justify greater risk.
- Managers face similar trade-offs when choosing business projects.

Lower risk

More stable payoff

Trade-off

Risk vs return

Higher risk

Higher expected
return



Manager's Insight

Return should never be judged without considering the risk required to earn it.

Quick Example

A risky business venture must offer a higher expected return than a safer government security.

Diversification of Risk

Holding multiple investments can reduce some risk.

Core explanation

- Not all investment risks are the same.
- Combining unrelated investments can reduce the impact of a poor outcome in one investment.
- Diversification changes the distribution of possible portfolio outcomes.
- The textbook develops portfolio diversification later in the investments section.

Single asset

Concentrated risk

Diversify

Combine
investments

Portfolio

Lower some risk

Manager's Insight

Diversification is a risk-management principle, not a guarantee of profit.

Quick Example

Splitting funds across unrelated investments reduces dependence on a single outcome.

Efficient Financial Markets

Security prices respond quickly to available public information.

Core explanation

- Investors search for undervalued and overvalued securities.
- This search helps make markets information efficient.
- In an information-efficient market, prices reflect publicly available information.
- New information causes prices to adjust quickly.

Information

New public facts

Market

Investors react

Price

Adjusts quickly

Manager's Insight

Market prices are useful signals because many participants continuously process information.

Quick Example

A strong new-product announcement may quickly change a company's stock price.

Management versus Owner Objectives

Managers and owners may not always want the same things.

Core explanation

- Owners want returns on their investment to be maximized.
- Professional managers may sometimes prefer goals that benefit themselves.
- This difference can create a principal-agent problem.
- Compensation and ownership incentives can help align interests.

Owners

- Maximize investment returns
- Protect value

Managers

- May pursue different objectives
- Need aligned incentives

Manager's Insight

Good governance tries to align managerial decisions with owner interests.

Quick Example

Stock-based compensation can link managers' rewards to stockholder outcomes.

Reputation Matters

Ethical behavior is part of the foundation of finance.

Core explanation

- Reputation reflects ethical standards and behavior.
- High-quality ethical behavior means treating others legally, fairly, and honestly.
- Ethical behavior goes beyond simply meeting minimum legal requirements.
- Trust and confidence are important to customers, employees, owners, and communities.



Manager's Insight

Reputation has economic value because finance depends on trust.

Quick Example

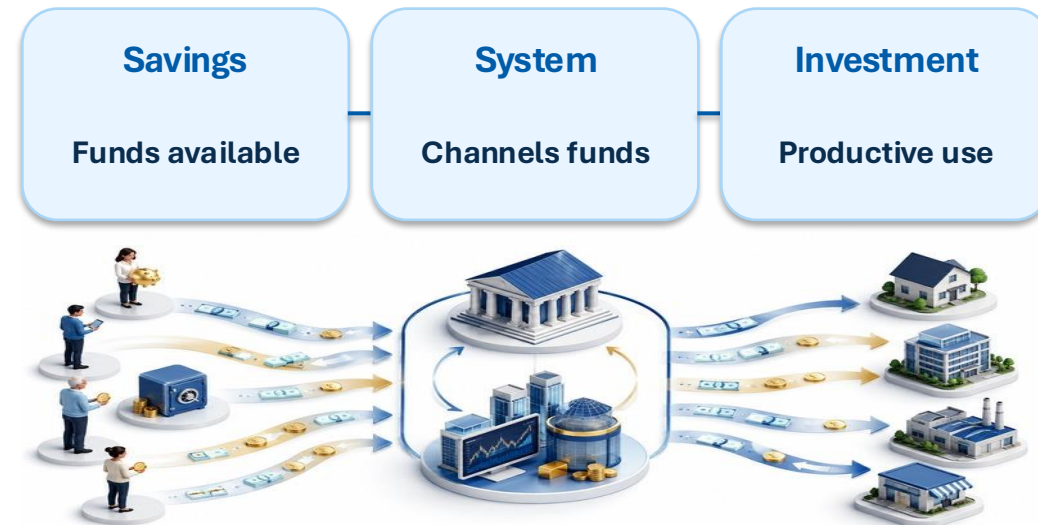
A firm can lose customers and financing opportunities when dishonest behavior damages trust.

What Is the Financial System?

The financial system moves financial capital from savings into investment.

Core explanation

- The financial system is a mix of intermediaries, markets, instruments, policy makers, and regulations.
- These elements interact to expedite the flow of financial capital.
- The system connects units with savings to units that can invest or spend funds.
- An effective system supports efficient economic activity.



Manager's Insight

The financial system is the infrastructure behind the movement of funds.

Quick Example

A household deposit can ultimately help finance a business investment.

Four Major Components

An effective financial system depends on four major components.

Core explanation

- Policy makers pass laws and set fiscal and monetary policies.
- The monetary system creates and transfers money.
- Financial institutions accumulate and lend or invest savings.
- Financial markets market and facilitate the transfer of financial assets.



Manager's Insight

Each component performs a different role, but the system works only when they interact.

Quick Example

A bank loan is influenced by institutions, markets, money conditions, and policy.

Policy Makers

Policy makers shape the rules and policies surrounding finance.

Core explanation

- In the U.S. example, policy makers include the president, Congress, the Treasury, and the Federal Reserve Board.
- Their role includes passing laws and setting fiscal and monetary policies.
- Foreign policy makers can also influence the domestic financial system in a global economy.
- Policy actions affect the environment in which institutions and markets operate.

Laws

Rules

Fiscal policy

Government actions

Monetary policy

Money and credit

Impact

Financial conditions

Manager's Insight

Policy is an external force that can change financial conditions quickly.

Quick Example

A policy action that changes interest rates affects borrowing and investment decisions.

The Monetary System

The monetary system provides a stable medium of exchange.

Core explanation

- An effective monetary system includes a central bank and a banking system.
- Its core functions are creating money and transferring money.
- A stable medium of exchange allows transactions to occur efficiently.
- The textbook develops the monetary system in later chapters of Part 1.

Central bank

System anchor

Banks

Create deposits

Money

Medium of exchange

Transfers

Payments

Manager's Insight

Money is financial infrastructure: without it, many transactions would not occur efficiently.

Quick Example

Electronic transfers allow payments to move between accounts without physical cash.

Financial Institutions

Financial institutions channel savings toward investment.

Core explanation

- Financial institutions act as intermediaries within the financial system.
- Four types highlighted in Chapter 1 are depository institutions, contractual savings organizations, securities firms, and finance firms.
- They accumulate savings and then lend or invest those funds.
- They can also facilitate direct financial investment by individuals.

Depository

Banks and thrifts

Contractual savings

Insurance/pensions

Securities firms

Market services

Finance firms

Credit

Manager's Insight

Pooling savings lets institutions finance amounts larger than most single savers could provide.

Quick Example

Many small deposits can support a large business loan.

Financial Markets

Financial markets facilitate the transfer of financial assets.

Core explanation

- Markets may be physical locations or electronic forums.
- They bring together investors, businesses, and governments.
- They help market and transfer securities and other financial claims.
- Efficient markets support the broader savings-investment process.



Manager's Insight

Markets create liquidity and access to capital by connecting buyers and sellers.

Quick Example

A corporation can issue securities to raise funds, while investors can trade existing securities.

Component–Function Map

Each financial-system component performs a specific financial function.

Core explanation

- The monetary system creates and transfers money.
- Financial institutions accumulate savings and lend or invest them.
- Financial markets market financial assets and facilitate their transfer.
- Policy makers provide the legal and policy framework around these functions.

Monetary system

Create / transfer
money

Institutions

Accumulate / lend
savings

Markets

Market / transfer
assets

Manager's Insight

Remember the system by matching each component to its financial function.

Quick Example

If the question says “accumulate savings,” think financial institutions.

Creating Money

Creating money supports exchange and economic activity.

Core explanation

- Money is accepted in payment for goods, services, and debts.
- Its value lies in purchasing power and its role as a medium of exchange.
- A sufficient money supply helps economic activity occur efficiently.
- Too little money can constrain activity; too much can contribute to price increases.

Money

Medium of
exchange

Too little

Constrains activity

Too much

Price pressure

Manager's Insight

Money creation matters because economic activity depends on a workable medium of exchange.

Quick Example

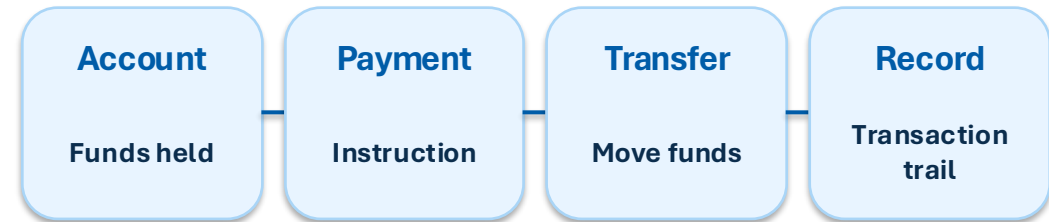
Businesses need an efficient payment system to buy inputs and sell output.

Transferring Money

The monetary system must move money efficiently between parties.

Core explanation

- Individuals and businesses hold money for near-term purchases and payments.
- Checkable deposits allow payments without transferring physical cash.
- Electronic systems transfer funds between accounts.
- The textbook notes channels such as checks, ATMs, telephone, and the Internet.



Manager's Insight

Payment systems are a practical part of finance because money must move as well as exist.

Quick Example

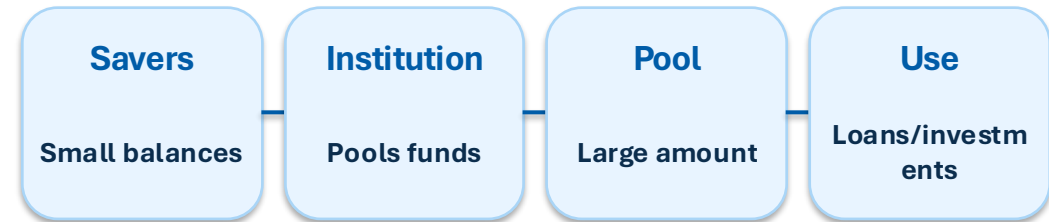
An electronic transfer moves funds from a buyer's account to a seller's account.

Accumulating Savings

Financial institutions gather many individual savings balances.

Core explanation

- Individuals and organizations often prefer safe deposit arrangements to holding cash.
- Depository institutions pool these deposits.
- Pooling allows institutions to make loans or investments larger than a single depositor could provide.
- Institutions compete to attract savings.



Manager's Insight

Pooling is a key economic benefit of financial intermediation.

Quick Example

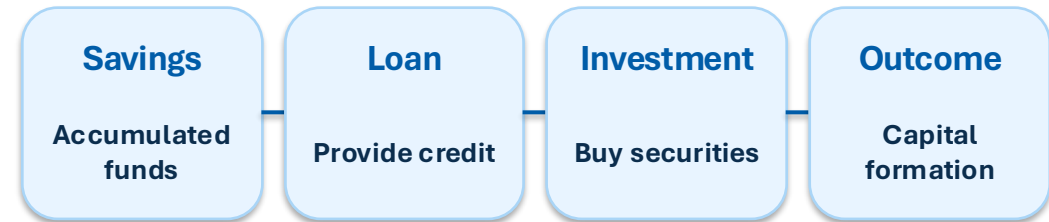
Thousands of small deposits can finance a major mortgage portfolio.

Lending and Investing Savings

Institutions put accumulated savings to work.

Core explanation

- Funds can be lent to businesses, consumers, farmers, institutions, and governments.
- Loans differ by purpose and maturity.
- Some institutions specialize in specific types of lending.
- Institutions may also invest in stocks or debt obligations.



Manager's Insight

Savings create economic value when they are channeled into lending and investment.

Quick Example

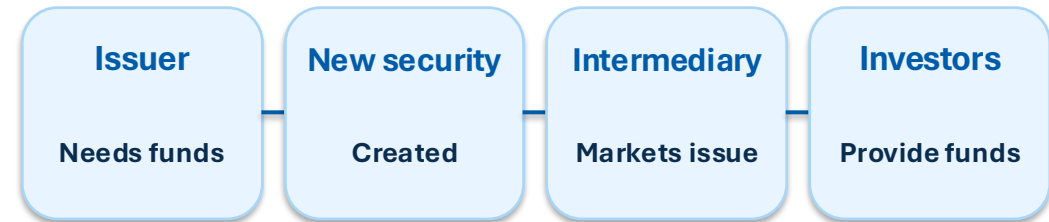
Deposits can finance equipment purchases for a business.

Marketing Financial Assets

Primary markets help create and sell new financial instruments.

Core explanation

- New securities are created and sold in the primary securities market.
- A business may issue ownership shares to the public.
- Investment banking firms can help market new securities.
- This process allows issuers to raise new financial capital.



Manager's Insight

Primary-market activity is about raising new funds for the issuer.

Quick Example

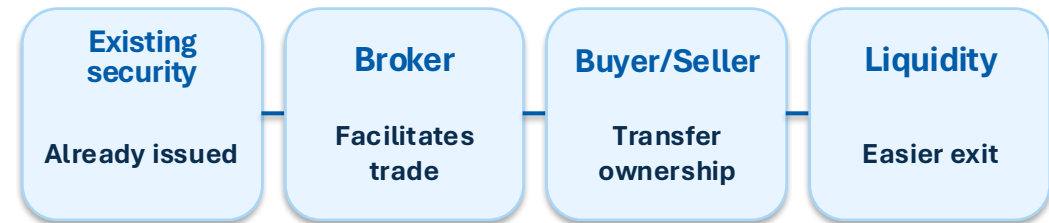
A company selling new shares uses the primary market to raise capital.

Transferring Financial Assets

Secondary-market activity transfers existing financial claims.

Core explanation

- Brokerage firms facilitate the transfer of existing securities.
- These are previously issued, or seasoned, instruments.
- Transfer markets help investors buy and sell ownership or debt claims.
- This supports liquidity for investors.



Manager's Insight

Secondary markets do not create the original security; they transfer ownership of it.

Quick Example

An investor selling shares to another investor is using a secondary market.

Financial Market Characteristics

Financial markets can be classified in more than one way.

Core explanation

- The textbook classifies markets as money versus capital markets.
- It also distinguishes primary versus secondary markets.
- In addition, it identifies major market types based on the securities traded.
- These classifications describe maturity, issuance status, and security type.

Maturity

Money vs capital

Issue status

Primary vs
secondary

Security type

Debt/equity/etc.

Manager's Insight

One market can fit more than one classification at the same time.

Quick Example

A newly issued long-term bond belongs to a capital market and a primary market.

Money Markets versus Capital Markets

The maturity of financial claims separates money and capital markets.

Core explanation

- Money markets focus on short-term financial instruments.
- Capital markets focus on longer-term financial instruments.
- Both markets help transfer funds between savers and users.
- The distinction helps describe the time horizon of financing.

Money Markets

- Short-term instruments
- Shorter financing horizon

Capital Markets

- Longer-term instruments
- Longer financing horizon

Manager's Insight

Think maturity first when distinguishing money markets from capital markets.

Quick Example

Short-term debt belongs to the money market; longer-term bonds belong to the capital market.

Primary versus Secondary Markets

The key distinction is whether the security is newly issued or already exists.

Core explanation

- Primary markets facilitate the issuance of new debt and equity securities.
- Funds raised in a primary issue go to the issuer.
- Secondary markets transfer ownership of existing securities among investors.
- Secondary markets provide liquidity after the original issue.

Primary Market

- New securities
- Issuer raises funds

Secondary Market

- Existing securities
- Investors trade ownership

Manager's Insight

Primary raises capital; secondary transfers ownership.

Quick Example

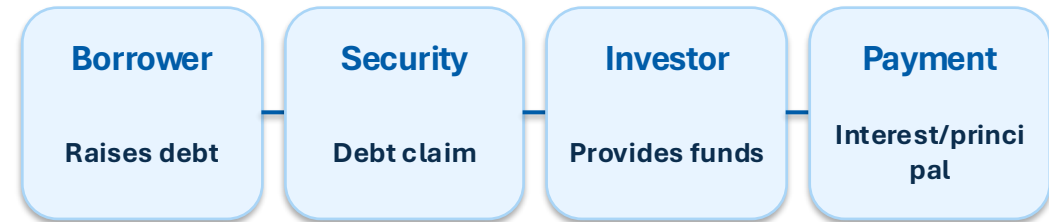
An IPO is a primary-market transaction; later trading of the same shares is secondary.

Debt Securities Markets

Debt markets trade financial claims that require repayment.

Core explanation

- Debt securities represent borrowing rather than ownership.
- Bonds and mortgage-related debt are examples of debt claims.
- Debt markets channel funds to borrowers.
- Investors expect contractual payments according to the security terms.



Manager's Insight

Debt financing creates a creditor claim, not an ownership claim.

Quick Example

A corporate bond represents funds borrowed from investors.

Equity Securities Markets

Equity markets trade ownership claims in businesses.

Core explanation

- Equity securities represent ownership interests.
- Common stock is the central example.
- Businesses can raise equity capital by issuing shares.
- Investors participate in the firm's ownership and potential returns.



Manager's Insight

Equity financing gives investors an ownership claim rather than a repayment promise.

Quick Example

Buying common stock means buying a share of ownership in the issuing company.

Derivative Securities Markets

Derivative markets trade claims whose value depends on another asset or variable.

Core explanation

- Derivative securities are identified by the textbook as a major financial-market type.
- Their values are linked to other financial assets or market variables.
- They are part of the broader securities-market environment.
- Detailed derivative coverage appears later in the text.

Underlying

Reference value

Derivative

Linked claim

Market

Trades derivative

Manager's Insight

For Lecture 1, know derivatives as a major market category; detailed mechanics come later.

Quick Example

A derivative's value is connected to an underlying financial asset or market factor.

Foreign Exchange Markets

Foreign exchange markets support transactions involving currencies.

Core explanation

- Foreign exchange markets are one of the four major financial-market types.
- They facilitate currency-related financial transactions.
- They matter because modern financial systems interact globally.
- The textbook provides detailed coverage later in the international finance chapter.



Manager's Insight

Currency markets connect domestic finance with global financial activity.

Quick Example

A business paying a foreign supplier may need to exchange one currency for another.

Owner Wealth as the Financial Goal

For a profit-seeking organization, financial management should aim to maximize owners' wealth.

Core explanation

- The textbook states that the financial manager's goal in a profit-seeking organization should be to maximize owners' wealth.
- This goal is supported through financial planning and analysis, asset management, and acquisition of financial capital.
- The goal links day-to-day financial choices to the value of the business.
- Not-for-profit organizations use similar financial functions while pursuing service objectives at acceptable cost.

Planning

Analyze
choices

Assets

Use resources
well

Capital

Acquire funds

Goal

Owners'
wealth

Manager's Insight

Financial decisions should be evaluated by how well they support the organization's financial objective.

Quick Example

A financing choice that lowers unnecessary cost can help protect owners' wealth.

Careers in Finance

Finance offers career paths across firms, institutions, and markets.

Core explanation

- Career opportunities exist in financial management.
- They also exist in depository financial institutions.
- The textbook identifies contractual savings and real-property organizations.
- Securities markets and investment firms provide additional career opportunities.

Financial management

Corporate roles

Depository institutions

Banking

Savings/real property

Insurance & related

Securities/investment

Markets

Manager's Insight

Finance careers span both internal company roles and external financial-system roles.

Quick Example

A graduate might work in corporate treasury, banking, insurance, or investments.

How the Textbook Is Organized

The course moves from the financial system to investments and then financial management.

Core explanation

- Part 1 covers financial institutions, markets, and participants in the financial system.
- Part 2 covers investments, including savings, interest rates, valuation, markets, risk, and return.
- Part 3 focuses on financial management of businesses.
- The structure reinforces the interaction among the three areas of finance.

Part 1

Institutions &
markets

Part 2

Investments

Part 3

Financial
management

Manager's Insight

The sequence moves from the external financial environment to investment analysis and then firm decisions.

Quick Example

Understanding markets first makes later valuation and financing decisions easier to interpret.

Applying Finance

The three finance areas meet in real business decisions.

Core explanation

- Institutions gather savings and channel them toward businesses.
- Primary securities markets help firms raise new debt and equity.
- Secondary markets let investors trade existing securities.
- Businesses interact with institutions and markets to finance inventories, equipment, buildings, and growth.



Manager's Insight

A financing decision links the firm to institutions, markets, and investors at the same time.

Quick Example

A growing firm may combine a bank loan with a new bond or stock issue.

Lecture Summary and Practice

Finance links the financial environment, markets, institutions, investments, and financial management.

Key message

An effective financial system moves savings toward productive investment through policy makers, money, institutions, and markets.

Decision toolkit

Principles

6 foundations

System

4 components

Markets

Key classifications

Careers

Multiple paths

Practice assignment

Prepare for Lecture 2 by reviewing the three areas of finance, the six finance principles, the four financial-system components, and the difference between primary and secondary markets.

Manager's Insight: The best finance answers combine correct numbers with a clear interpretation.

Assessment Practice 1

Solved questions: concepts, calculations, and applications.

QUESTION 01/10

Which statement best defines finance?

A Recording only past transactions

B Acquiring, spending, and managing financial resources

C Producing goods and services only

D Setting tax law only

ANSWER

B

Acquiring, spending, and managing financial resources

EXPLANATION

Finance studies how individuals and organizations acquire, spend, and manage financial resources.

EXAM TECHNIQUE: Look for the broad resource-management definition.

Assessment Practice 2

Solved questions: concepts, calculations, and applications.

QUESTION 02/10

Which is one of the three major areas of finance?

A Production management

B Financial institutions and markets

C Human resources

D Operations research

ANSWER

B Financial institutions and markets

EXPLANATION

The three areas are institutions and markets, investments, and financial management.

EXAM TECHNIQUE: Memorize the three-area framework.

Assessment Practice 3

Solved questions: concepts, calculations, and applications.

QUESTION 03/10

Which principle states that a dollar today is worth more than the same dollar received later?

A Diversification

B Reputation matters

C Time value of money

D Market efficiency

ANSWER

C Time value of money

EXPLANATION

Money today can be invested and earn a return, giving it a time value.

EXAM TECHNIQUE: Match timing language with time value of money.

Assessment Practice 4

Solved questions: concepts, calculations, and applications.

QUESTION 04/10

Which financial-system component accumulates savings and lends or invests them?

A Policy makers

B Financial institutions

C Financial markets

D Monetary policy only

ANSWER

B Financial institutions

EXPLANATION

Financial institutions pool savings and channel them into loans and investments.

EXAM TECHNIQUE: Match the function to the correct system component.

Assessment Practice 5

Solved questions: concepts, calculations, and applications.

QUESTION 05/10

What is the main role of the monetary system in Chapter 1?

A Set product prices

B Create and transfer money

C Issue common stock only

D Calculate profits

ANSWER

B Create and transfer money

EXPLANATION

The monetary system is responsible for creating and transferring money.

EXAM TECHNIQUE: Remember the component-function map.

Assessment Practice 6

Solved questions: concepts, calculations, and applications.

QUESTION 06/10

Which market is used when a firm sells newly issued securities to raise funds?

A Secondary market

B Primary market

C Foreign exchange market only

D Used-goods market

ANSWER

B Primary market

EXPLANATION

Primary markets facilitate the issuance and sale of new securities.

EXAM TECHNIQUE: New issue = primary market.

Assessment Practice 7

Solved questions: concepts, calculations, and applications.

QUESTION 07/10

Which market mainly transfers ownership of existing securities among investors?

A Primary market

B Secondary market

C Money-creation system

D Fiscal-policy market

ANSWER

B Secondary market

EXPLANATION

Secondary markets facilitate trading of previously issued securities.

EXAM TECHNIQUE: Existing security = secondary market.

Assessment Practice 8

Solved questions: concepts, calculations, and applications.

QUESTION 08/10

Which finance principle addresses possible differences between managers and owners?

A Time value of money

B Diversification

C Management versus owner objectives

D Money creation

ANSWER

C Management versus owner objectives

EXPLANATION

Manager and stockholder objectives may differ, creating an agency issue.

EXAM TECHNIQUE: Look for conflicts of interest between owners and managers.

Assessment Practice 9

Solved questions: concepts, calculations, and applications.

QUESTION 09/10

Which of the following is a major type of financial market identified in Chapter 1?

A Debt securities market

B Labor market only

C Product market only

D Real-estate construction market only

ANSWER

A Debt securities market

EXPLANATION

Debt, equity, derivative, and foreign exchange markets are the four major types identified.

EXAM TECHNIQUE: Focus on the four financial-market categories.

Assessment Practice 10

Solved questions: concepts, calculations, and applications.

QUESTION 10/10

Why should non-finance students study finance?

A Only to become accountants

B To make informed economic, investment, and career decisions

C Only to predict stock prices

D Only to prepare tax returns

ANSWER

B To make informed economic, investment, and career decisions

EXPLANATION

The textbook emphasizes informed economic, personal/business investment, and career decisions.

EXAM TECHNIQUE: Choose the answer that covers several decision areas.



The Financial Environment and Foundations of Finance

Thank You