Corporate Finance: IOE 452/MFG 455
University of Michigan
Winter 2026
Reza Kamaly

1/8/26

Contents

1 Introduction

1.1 Corporate Finance: Overview

• Corporate finance is a major field of finance explaining the connections related to the financial aspects of a company's operations.

• Corporate finance deals with all the financial and monetary events or phenomena linked with the activity of a company.

• Theories of corporate finance are theories of economics. In fact, many representatives of finance are among the recipients of the Nobel Memorial Prize in Economic Sciences.

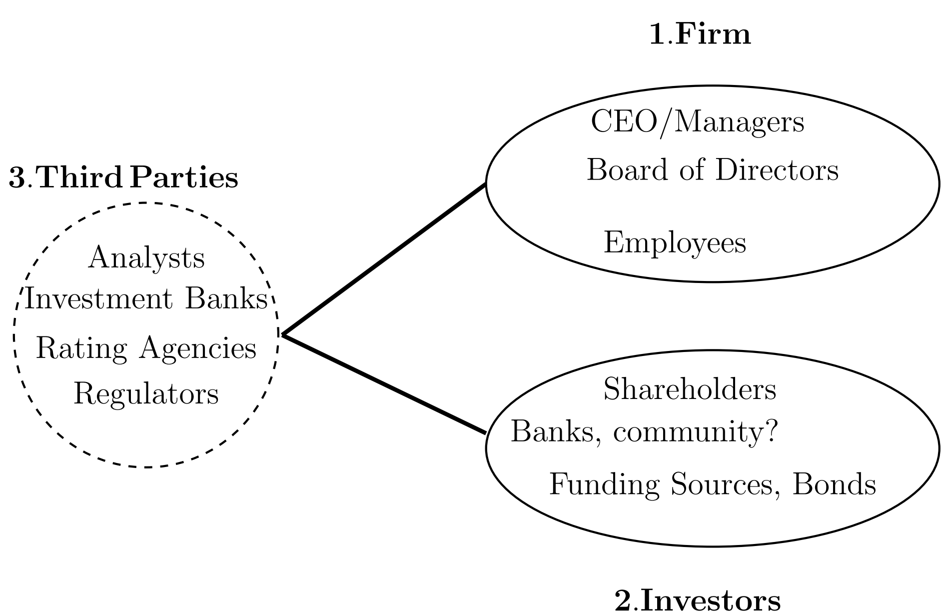
• Notable recurring names in this class are the following Nobel prize winners: Modigliani (1985); Markowitz, Miller, and Sharpe (1990); Merton & Scholes (1997); Akerlof, Spence, & Stiglitz (2001); Fama, Hansen, & Schiller (2013); Tirole (2014); Holmstrom & Hart (2016). Michael Jensen is not a recipient.

• What is Corporate Finance? Create value for investors. The objective in *conventional* corporate finance theory is to making decisions to maximize the value of the firm. In any type of business:

1. Which kind of investments to undertake. (Capital Budgeting)
2. How to raise funds to finance investments.
3. Sources of financing. (Capital Structure)
4. Working capital.

• Corporate finance is not immune to technological changes. *Fintech* (short for financial technology) is increasingly likely to revolutionize the finance industry. Similarly applications of AI.

• Participants?



1.2 Modern Corporation

• When beginning a business, you must decide what form of business entity to establish. Your form of business determines which income tax return form you have to file.

• A company can take many organizational forms, and there are several issues involved in proper financial management.

1. Sole Proprietorships:
   - Usually very small number of employees.
   - No separation between the firm and its sole owner. ($\approx$ 72%)
   - The owner has unlimited personal liability for any of the firm's debts. That is, if the firm defaults on any debt payment, the lender can (and will) require the owner to repay the loan from personal assets.
2. Partnership: Identical to sole proprietorship except it has more than one owner. ($\approx$ 3.5%)
   - All owners have unlimited personal liability for the firm's debt. Limited life. Issues with ownership transfer.
3. Limited Partnership. Two *kinds of owners:* ($\approx$ 7.3%). Example: Private Equity
   (a) General Partners
      - General partners have the same rights and privileges as partners in a (general) partnership.
      - They manage the operations.
      - Personally liable for the firm's debt obligations.

   (b) Limited Partners
      - Have limited liability. Their private property is off limit.
      - No management role. Not involved in managerial decision making.
      - Partnership is not dissolve upon their death.
4. Limited Liability Companies **LLC**
   - Similar to Limited Partnership without the limited partners.
   - Relatively newer form in the United States.
5. Corporation
   - Corporations must be legally formed.
   - Corporation has many of the legal powers that individuals have. Can make contracts, carry on business, borrow, lend, sue, and be sued.

- A limited liability corporation is a legal entity, incorporated in a physical location and owned by shareholders.[1]
- Many ways & locations to incorporate! Delaware attractive legal environment.
- There is a *separation* between ownership & and control.
- The owners are the shareholders. Control is exercised by the management.
- Shareholders have limited liability and *cannot* be held personally responsible for corporation's debts.

  (a) Public: shares are traded on stock exchanges and can be purchased by a wide range of investors.

  • Publicly traded companies are required to register with the U.S. Securities and Exchange Commission (**SEC**). The **SEC** is the federal agency responsible for overseeing securities markets and ensuring that companies follow regulations designed to protect investors, maintain fair and efficient markets, and facilitate capital formation.

  • The **Securities Act of 1933** requires companies to register their securities (stocks, bonds, etc.) with the **SEC** before offering them for sale to the public, unless an exemption applies. This applies to companies conducting an initial public offering (**IPO**) or other types of public offerings.

  • Going public triggers ongoing **SEC** reporting requirements under the Securities Exchange Act of 1934 (e.g., **Form 10–K**, **Form 10–Q**).

  (b) Private: shares of closely held corporations are not publicly traded and are held by a small group of private investors.

- Corporate Bankruptcy

  If the corporation fails to repay its debts, the debt holders are entitled to seize the assets of the corporation in compensation for the default. [2]

  Some notable recent bankruptcies: Sears (2018, filed for Chapter 11 in 2018 and liquidated in 2019), Pacific Gas and Electric (PG&E)–2019, The Hertz Corporation–2020, TGI Fridays

• Corporations are the world's main wealth–producing institutions. In U.S. more than 80% of revenues are generated by corporations (**IRS**).

[1] The Supreme Court's decision in Citizens United v. Federal Election Commission (2010) had a profound impact on corporate finance, particularly in the realm of political spending. After Citizens United: Corporations were allowed to spend unlimited amounts on independent political activities, such as funding ads or supporting "super PACs" (political action committees), which could raise and spend unlimited amounts of money to advocate for or against political candidates.

[2] At least 686 US companies filed for bankruptcy in 2024, up about 8 per cent from 2023 and higher than any year since the 828 filings in 2010, according to data from S&P Global Market Intelligence.FT, 1/7/25.

1.3 Finance in Times of Disruption: The Dodd–Frank Act

• In response to the 2008 financial crisis, the U.S. federal government reevaluated its role in the control and management of financial institutions and private corporations.

• The Dodd–Frank Act aims to

1. Promote U.S. financial stability by "improving accountability and transparency in the financial system."
2. Put an end to the notion of "too big to fail."
3. "Protect the American taxpayer by ending bailouts."
4. "Protect consumers from abusive financial services practices."

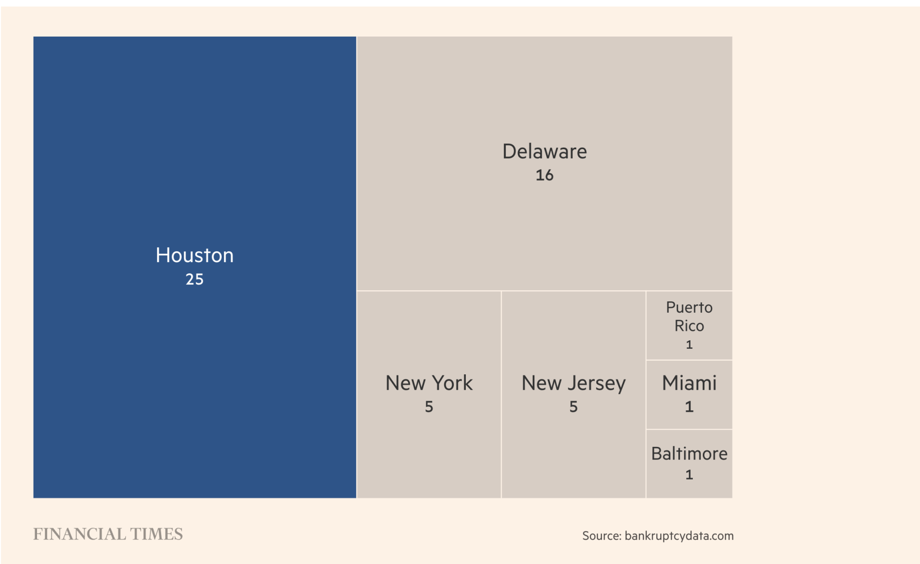


Figure 1: Nearly half of all large US bankruptcy cases in 2023 have landed in Houston! Source: FT, Nov. 21 2023

1.4 Corporate Objectives & Corporate Governance

• In general the goals of a corporation are defined by its owners. However, due to multiple ownership and the separation of ownership and control, the appropriate goal is not as clear.

• What about the interaction between the corporation and the society?

• If the objective is to maximize the value of the firm, then the main issue with the theory is that it is entirely built on that *one* objective.

1. Should the success of any firm be measured by increase in value for the *shareholders* of the firm?

2. In the United States and increasingly in other countries, most managers–and even more academics and business journalists–argue that firms seeking to maximize the return to shareholders best serve this end.

3. In this view, corporate purpose is tied directly to the capital markets.

4. Should the success of any firm be measured by increase in value for the *stakeholders* of the firm?

5. Corporate social responsibility (CSR), has emerged as a fundamental aspect of contemporary business practices, emphasizes integrating social and environmental considerations with decision–making processes.

6. The value a firm creates for society is not synonymous with its shareholder wealth creation. Most critical for society is the firm's sustained total value–generating ability, not the value created for shareholders alone, but also for customers, employees, and communities.

• Non–financial goals and Environmental, Social and Governance (**ESG**) considerations have been highlighted in recent high profile statements from large asset managers, such as Larry Fink (CEO of **Blackrock**), and by the **Business Roundtable**.

• **Business Roundtable** released a statement in August 2018 signed by 181 CEOs in which they pledged "a fundamental commitment" to "deliver value to all" stakeholders. No longer should decisions be based solely on whether they will yield higher profits for shareholders, the group said. Rather, corporate leaders should take into account "all stakeholders"—that is, employees, customers and society writ large.

• It is an ongoing debate! See the attached **WSJ**. What do you think?

1.5 Corporate Financial Decision Making

1. Financial managers set corporate strategy & goals.
    - Financial manager or chief financial officer (**CFO**) is responsible for financing the firm and acts as an intermediary between the financial system's institutions and markets.
    - The primary role of the financial manager is to ensure that his company has a sufficient supply of capital.

2. Investment Decisions & Their Valuation.
    - Tools needed to asses whether investments are worthwhile : **PV**, **CAPM** etc.
    - Capital Structure

3. Financing Decisions: Sources of Capital:
    (a) Issue shares (equity). Equity represents the capital injected into a company by an investor who bears the full risk of the company's undertakings in return for a share of the profits.[3]
    (b) A stock or share (an equity) gives you a portion, for better or worse, of earnings and realizations from the productive activities of a company.
    (c) In a limited liability corporation, the risk borne by the shareholders is limited to the amount contributed.
    (d) Issue bonds.[4] A bond is a negotiable debt security. It ties a lender (investor) to a borrower (company).
    (e) A secured loan—such as corporate bond—gives the lender the right to seize some or all of the borrower's assets if the borrower fails to pay agreed interest and the original money lent.
        - **Businesses globally raised** $4.9**tn through new bonds, loans and equity in the first half of 2022.** (down 25 per cent from the $6.6tn raised in the first half of 2021.)
        - U.S. Corporate debt is around $10tn (2020).
    (f) Financial engineering (hybrid) products.
        - Commercial paper, bank loans, hybrid securities, etc.
    (g) Manage short–term cash.

4. Separation of ownership/control, asymmetric information, etc. Managers may prefer to consume private perks or make other decisions for their private benefit—rather than maximize shareholder wealth. Agency theory.

5. How to deal with uncertainty & risk management?

6. What are the key Instruments?

7. Approach to Capital Markets.

[3] There is more to this simplistic and yet popular view!

[4] Bonds had traditionally been boring! But since late 1970s several distinct innovations turned the bond market into an exciting place.

1.6 Capital Markets

- Capital markets facilitate the transfer of capital from those seeking a return (investors) to those who need capital to grow their enterprises (issuers). [5]
- In the U.S., capital markets fuel the economy, providing 74.1% of equity and debt financing for non–financial corporations. Debt capital markets are more dominant in the U.S. at 74.9% of total financing, whereas bank lending is more dominant in other regions, at 80.7% on average.
- US Capital Markets Are the Largest in the World .
- As of 2024, the size of the U.S. fixed income market is estimated to be approximately \$55.3 trillion.
- As of 2024, the total market capitalization of the U.S. stock market is approximately \$49 trillion. This represents the combined value of all publicly traded companies listed on major U.S. exchanges, such as the New York Stock Exchange (**NYSE**) and the **NASDAQ**.

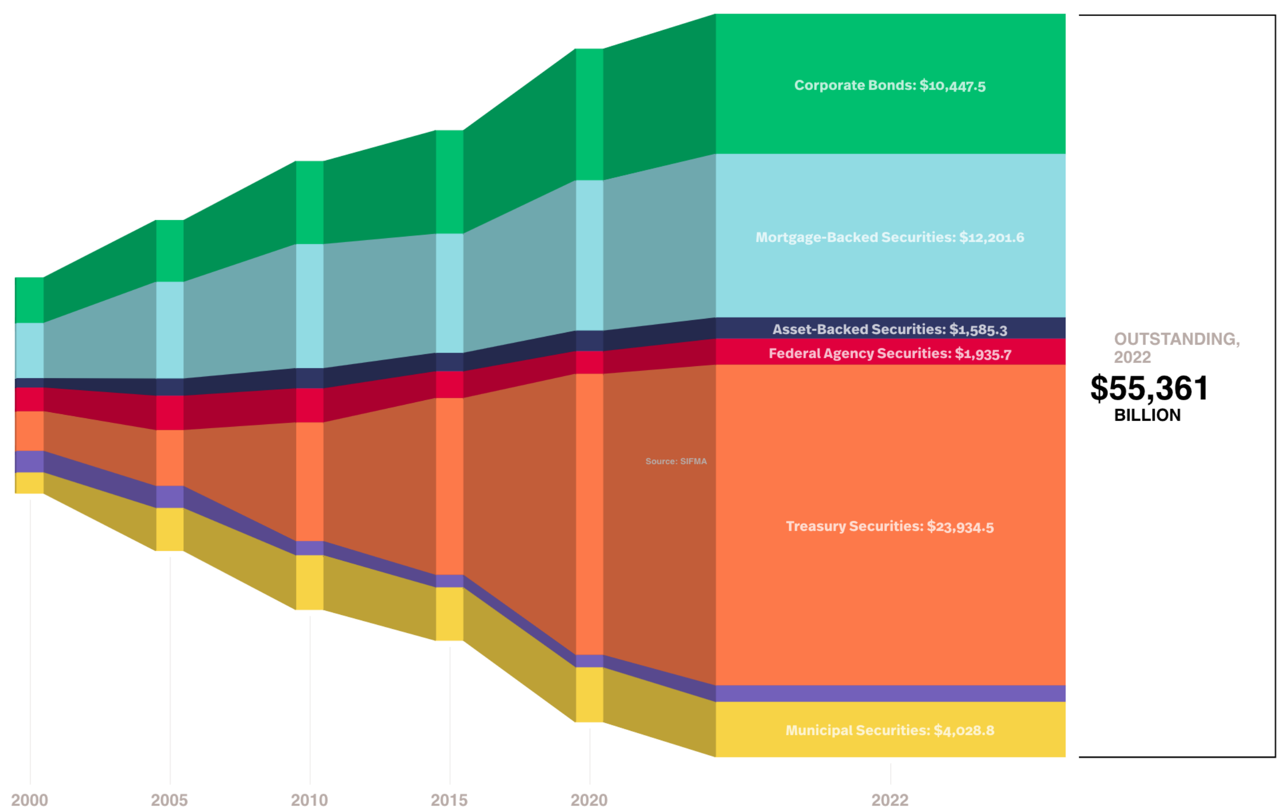


Figure 2: Fixed Income Outstanding Source: SIFMA

[5] A good source of basic information is Securities Industry and Financial Markets Association (**SIFMA**).

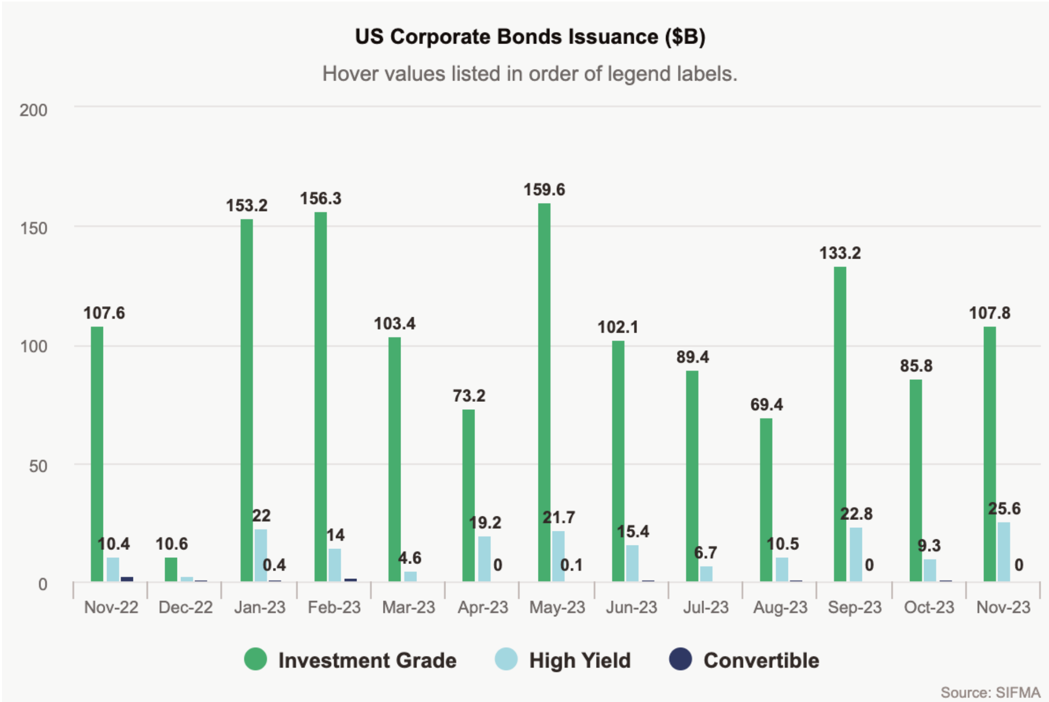


Figure 3: Corp. Bond Issuance Source: SIFMA

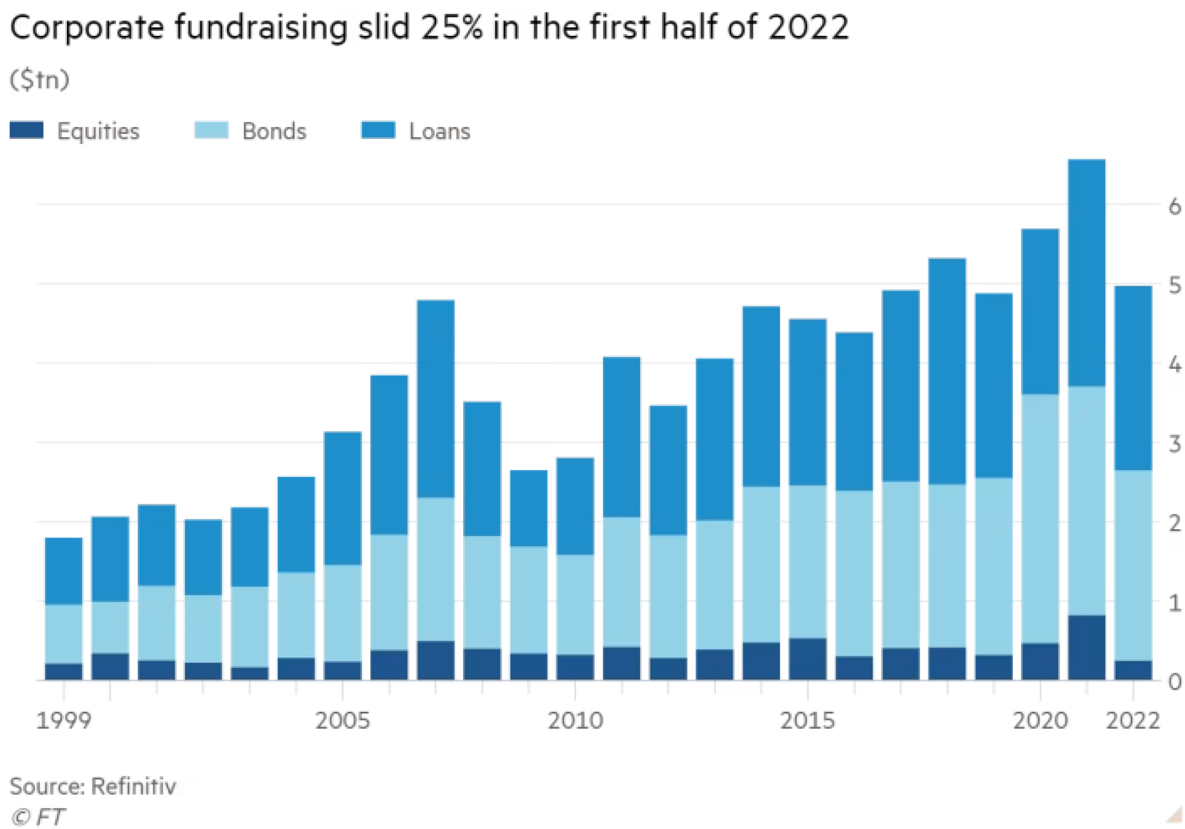
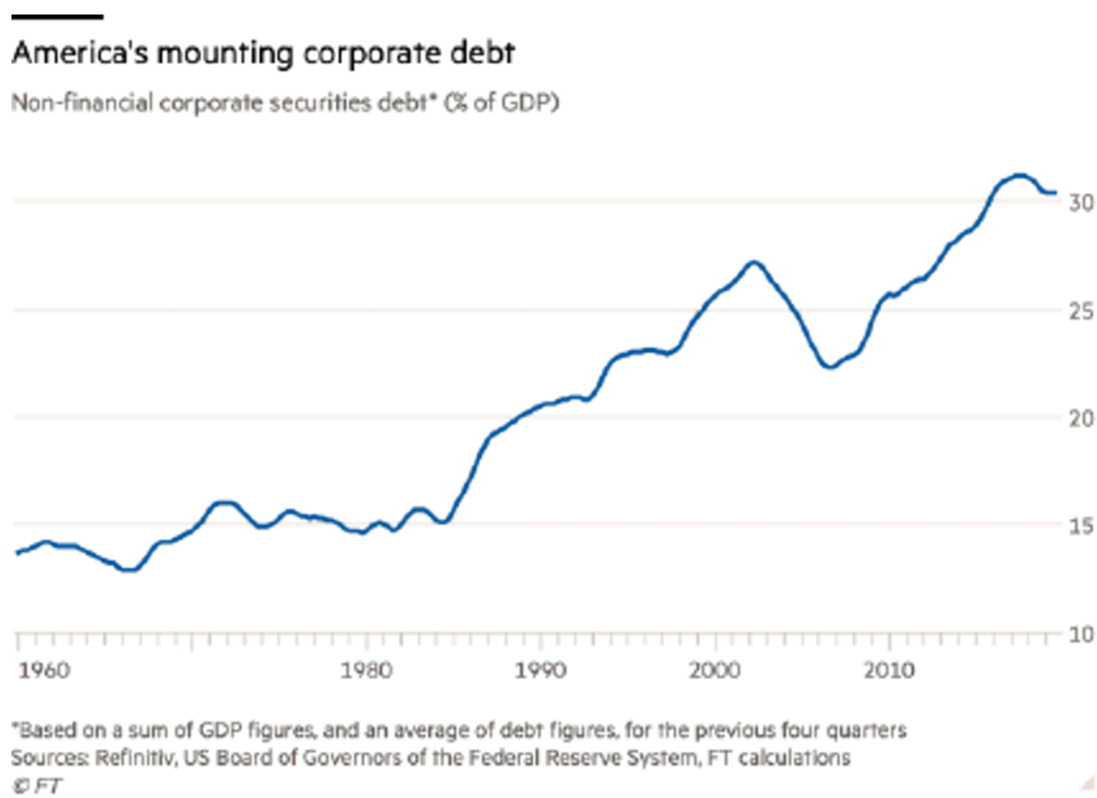
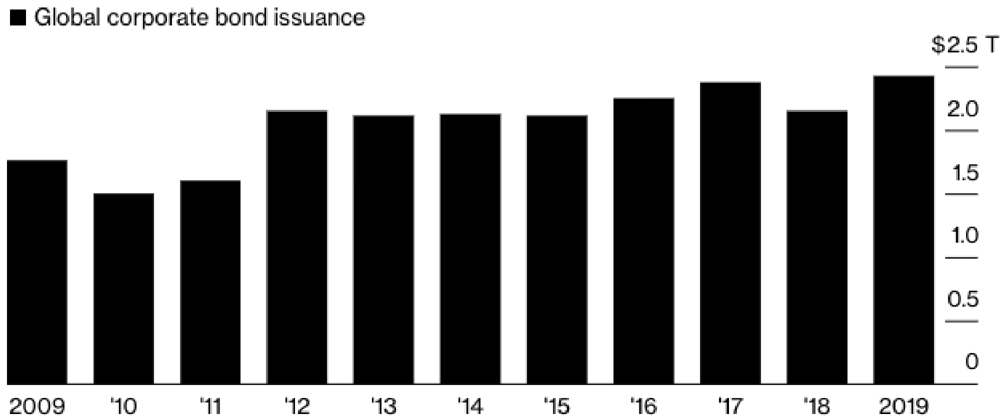


Figure 4: Financial Times, July 2022



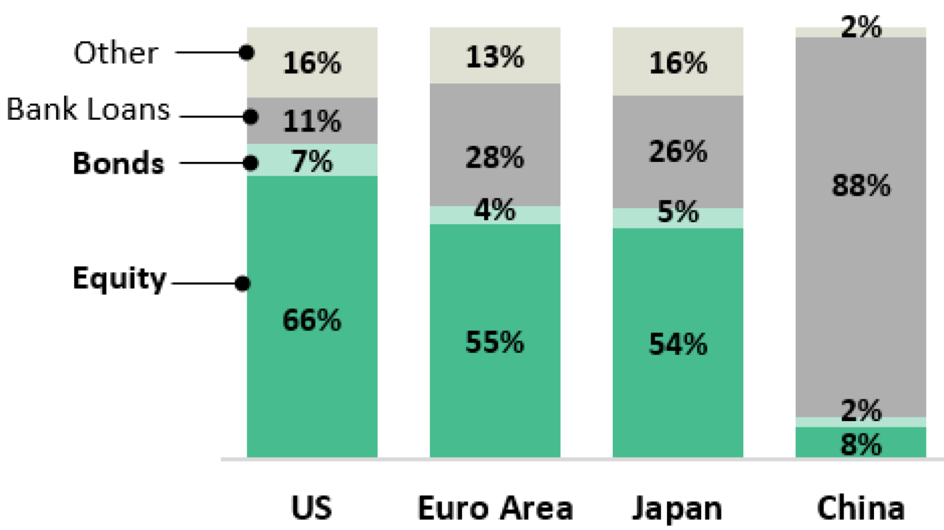
Corporate Debt Bonanza

Companies in 2019 rushed to sell debt across currencies as rates fell



Source: Blomberg
Note: Data for 2019 are year to date, while other periods are for full year

Figure 1. Capital Markets Financing Compared with Bank Loans for Nonfinancial Firms



Source: CRS, using data from SIFMA.

Notes: Data as of 2020, except for China, which is as of 2017.

Figure 5: Congressional Research Service, Jan. 2022

1.7 Financial Corporate Goals

- Stockholders want:
  1. To maximize current wealth?
  2. Control of decision & structure?
  3. To transform wealth into most desirable time pattern of consumption.
  4. To manage risk characteristics of chosen consumption plan.
- *Hurdle Rate*/Cost of Capital: Minimum acceptable rate of return on investment.
- Opportunity Cost of Capital: Investing in a project eliminates other opportunities to use invested cash.

1.8 Tax Implications: Corporations

- A corporation's profits are subject to taxation separate from its owners' tax obligations.
- Shareholders of a corporation pay taxes twice:
  1. When the corporation pays taxs on its profits.
  2. When the remaining profits are distributed to the shareholders, the shareholders pay their own personal income tax on this income.

1.9 Agency Problems and Corporate Governance

- The separation of ownership and management.
- Ideally, managers will make decisions without worrying about owners' preferences.
- Managers, acting as *agents* for stockholders, may act in their own interests rather than maximizing value.
- Objectives as well as the information available to owners and managers may differ.
- Information asymmetries are major barriers to resolving *principal–agent* problems facing corporations.
- Tools to ensure Management pays attention to the values of the firm.

https://www.wsj.com/articles/stakeholder-capitalism-seems-mostly-for-show-11596755220

OPINION | COMMENTARY

'Stakeholder' Capitalism Seems Mostly for Show

If CEOs really intended to amend their companies' purpose, they'd at least consult their boards first.

By Lucian Bebchuk and Roberto Tallarita
Aug. 6, 2020 7:07 pm ET

JPMorgan Chase CEO Jamie Dimon, left, at a meeting of the Business Roundtable in Washington, Dec. 4, 2014.

PHOTO: LARRY DOWNING/REUTERS

By putting American workers through months of turmoil, the Covid-19 crisis has heightened expectations that large companies will serve the interests of all "stakeholders," not only shareholders. The Business Roundtable raised such expectations last summer by issuing a statement on corporate purpose, in which the CEOs of more than 180 major companies committed to "deliver value to all stakeholders." Although the Roundtable described the statement as a radical departure from shareholder primacy, observers have been debating whether it signaled a significant shift in how business operates or was a mere public-relations move. We have set out to obtain evidence to resolve this question.

To probe what corporate leaders have in mind, we sought to examine whether they treated joining the Business Roundtable statement as an important corporate decision. Major decisions are typically made by boards of directors. If the commitment expressed in the statement was supposed to produce major changes in how companies treat stakeholders, the boards of the companies should have been expected to approve or at least ratify it.

We contacted the companies whose CEOs signed the Business Roundtable statement and asked who was the highest-level decision maker to approve the decision. Of the 48 companies that responded, only one said the decision was approved by the board of directors. The other 47 indicated that the decision to sign the statement, supposedly adopting a major change in corporate purpose, was not approved by the board of directors.

We received responses from only about three-tenths of the signatories. Yet there is no reason to expect that these companies are less likely than companies electing not to respond to have obtained board approval for joining the statement.

What can explain a CEO's decision to join the Business Roundtable statement without board approval? Even "imperial" CEOs tend to push major decisions through the board rather than disregard it. Similarly, it is implausible that CEOs didn't seek board approval because they viewed the statement as reflecting a personal belief rather than a commitment made in their "official" capacity. In fact, the Business Roundtable presented the statement as a commitment by CEOs "to lead their companies for the benefit of all stakeholders," thus reflecting a pledge regarding the goals of the companies led by these CEOs.

The most plausible explanation for the lack of board approval is that CEOs didn't regard the statement as a commitment to make a major change in how their companies treat stakeholders. That may be because they believe their companies are already meeting the standard for taking care of stakeholders. But it still implies that they believed signing the statement wasn't a major step for their businesses.

We supplemented the evidence above with a review of the board-approved corporate governance guidelines of the companies whose CEOs joined the statement. We found that these guidelines, including the many that have been updated since the issuance of the Business Roundtable statement, mostly reflect a clear "shareholder primacy" approach.

Take the corporate governance guidelines of JPMorgan Chase, whose CEO, Jamie Dimon, chaired the Business Roundtable at the time the statement was issued. These guidelines state that “the Board as a whole is responsible for the oversight of management on behalf of the Firm’s shareholders.”

The corporate governance guidelines of Johnson & Johnson —whose CEO, Alex Gorsky, served as chairman of the Business Roundtable Corporate Governance Committee—indicate in clear terms that “the business judgment of the Board must be exercised . . . in the long-term interests of our shareholders.”

Further, about 70% of the U.S. companies that joined the statement are incorporated in Delaware, which is widely viewed as a state with shareholder-centric corporate laws. In a 2015 law-review article, Delaware Chief Justice Leo Strine stated that “a clear-eyed look” at Delaware law “reveals that . . . directors must make stockholder welfare their sole end.”

Nonetheless, the Business Roundtable, and the numerous Delaware companies endorsing its statement, didn’t address the potential constraints imposed by Delaware law. This disregard of the issue is consistent with the view that corporate leaders don’t contemplate a significant change in corporate strategy.

The evidence is clear: Notwithstanding statements to the contrary, corporate leaders are generally still focused on shareholder value. They can be expected to protect other stakeholders only to the extent that doing so would not hurt share value. That conclusion will be greatly disappointing to some and welcome to others. But all should be clear-eyed about what corporate leaders are focused on and what they intend to deliver.

Messrs. Bebchuk and Tallarita are director and associate director, respectively, of the Harvard Law School Program on Corporate Governance. Their co-written study that details their research, “The Illusory Promise of Stakeholder Governance,” is scheduled for publication in the autumn.

Congressional Research Service
Informing the legislative debate since 1914

IN FOCUS

Updated January 13, 2022

Introduction to Financial Services: Capital Markets

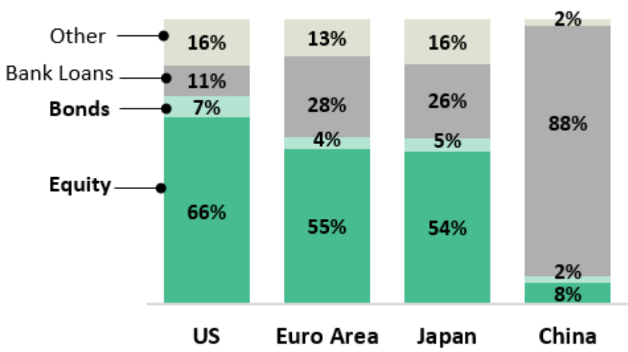
This In Focus provides an overview of U.S. capital markets, Securities and Exchange Commission (SEC) regulation, and related policy issues.

Market Composition

Capital markets are where securities such as stocks and bonds are issued and traded. U.S. capital markets instruments include (1) stocks, also called equity or shares, referring to ownership of a firm; (2) bonds, also called fixed income or debt securities, referring to the indebtedness or creditorship of a firm or a government entity; (3) digital asset securities, referring to digital representations of value in securities form; and (4) shares of investment funds, which are pooled investment vehicles that consolidate money from investors.

As a main segment of the financial system, capital markets provide the largest sources of financing for U.S. nonfinancial companies. U.S. capital markets provided 73% of the financing for nonfinancial firms in 2020 (**Figure 1**). By contrast, capital markets play a less prominent role in other major economies.

Figure 1. Capital Markets Financing Compared with Bank Loans for Nonfinancial Firms



Source: CRS, using data from SIFMA.

Notes: Data as of 2020, except for China, which is as of 2017.

Key Players

Participants in U.S. capital markets include companies and municipalities that issue securities, broker-dealers, investment companies (i.e., mutual funds and private equity), investment advisers, securities exchanges, institutional investors, and retail investors. The SEC and various self-regulatory organizations are the principal regulators of the markets.

Fundamental Concepts

Regulatory Philosophy. The SEC's regulatory philosophy for capital markets is different than that of banking regulators. The SEC is principally concerned with disclosure, on the theory that investors should have sufficient access to information from companies issuing stocks and bonds to enable investors to make informed decisions on whether to invest and at what price level to compensate for their risks. Banking regulators, by contrast, focus more on safety and soundness to avoid bank failure. This is largely because bank deposits are often ultimately guaranteed by the taxpayers, whereas in capital markets, investors generally assume all the risk of loss.

Public and Private Securities Offerings. The SEC requires that offers and sales of securities, such as stocks and bonds, be either registered with the SEC or undertaken pursuant to a specific exemption. The goal of registration is to ensure that investors receive key information on the securities being offered. Registered offerings, often called public offerings, are available to all types of investors. By contrast, securities offerings that are exempt from certain registration requirements are referred to as "private offerings" or "private placements." Private offerings are available to institutions or individual investors who meet certain net worth, income, or technical expertise thresholds.

Retail and Institutional Investors. Investors are often divided into retail investors (individuals and households) and institutional investors. Retail and institutional investors are generally perceived as having different capabilities to process information, comprehend investment risks, and sustain financial losses. In general, retail investors are thought to warrant more protection from inadequate disclosure and education than institutional investors.

Primary and Secondary Markets. The primary markets are where securities are created through public and private securities offerings. The secondary markets are where securities are traded, through buying and selling activities, to provide "liquidity" for existing securities. *Liquidity* is a common term that measures how quickly and easily transactions can occur without affecting the price. Certain market structures—for example, national securities exchanges, broker-dealers, and service firms—are essential enablers of secondary market trading and liquidity, which are important to the markets' overall health and efficiency.

Policy Issues

COVID-19 has had profound effects on U.S. capital markets, which have in turn attracted attention from Congress and federal regulators. Although some policy focus may have changed since the pandemic, Congress continues to consider a broad range of issues.

COVID-19, Federal Government Capital Market Interventions, and Capital Market Conditions. The spread of COVID-19 induced heavy capital market selloffs and rebounds in 2020. The crisis-induced stress was broadly felt in all corners of capital markets—stocks, bonds, investment funds, and other segments all experienced heightened volatility. In response, the Federal Reserve, sometimes with support from the Department of the Treasury, established several emergency facilities to provide support for key capital market segments. Changes in the course of the pandemic, other economic factors, and other government responses, such as the CARES Act (P.L. 116-136), also likely had significant effects. Following the rapid selloff and rebound during the early stages of the pandemic, U.S. capital markets experienced record price appreciation across many asset classes, including stocks, bonds, and digital assets. Some observers are concerned about the sustainability of such market performance and whether the conditions could quickly deteriorate if triggering events (e.g., unexpected changes in public health, government programs, and economic growth) were to occur.

Capital Formation versus Investor Protection. Policy debates involving the capital markets often revolve around a perceived tradeoff between capital formation and investor protection (through disclosure and other compliance requirements), two of the SEC's core missions. Expanded capital formation allows businesses to more easily obtain funding for new projects, which in turn spurs economic growth. But lax regulations could also leave investors unprotected against risks such as fraud and market manipulation. In general, the SEC and lawmakers try to focus protections on less-sophisticated retail investors. However, expanding capital formation and investor protection need not always be in conflict. Investor protection could contribute to the health and efficiency of capital markets, because investors may be more willing to provide capital, and even at a lower cost, if they have faith in the integrity and transparency of the markets.

Public versus Private Securities Offerings. The number of U.S.-listed domestic public companies has declined by close to half since the mid-1990s. At the same time, private capital markets have surpassed public markets as the preferred way to raise money. This phenomenon has shaped policy discussions around the capital markets and led to proposals to encourage public offerings, facilitate both public and private market efficiency, and enable proper investor access to private securities market investment opportunities. In November 2020, the SEC adopted changes to the regulatory framework for private securities offerings. The new framework expands the size limit on multiple types of private offerings and makes it easier for certain companies to communicate with investors and transition from different offering types.

Asset Management. The asset management industry collectively manages money for nearly half of all U.S. households. The industry has experienced periods of high growth largely attributable to retail investors' increased reliance on asset managers to invest their money for them rather than investing the money themselves. This growth in the industry has generated financial stability and other concerns. For example, commentators have raised concerns about certain exchange-traded funds' risk structures (including leveraged and inverse structures) and passive investment strategies, business practices at some private equity funds, and money market mutual funds (MMFs). The pandemic prompted special attention to MMFs, as the Fed responded to the prospect of a run on the industry by lending to institutions that purchased certain assets from MMFs facing redemption requests. The Fed took this step despite post-financial crisis reforms aimed at strengthening the MMF industry's resilience. In the wake of these disruptions, some commentators flagged the MMF industry as a problem area in need of further reform.

Market Structure. Market structure issues often relate to the SEC's mission to maintain fair and orderly markets. Multiple discussions of structural vulnerabilities surfaced during recent episodes of stock price volatility at companies such as GameStop. These events have prompted growing support for a holistic examination of the capital markets structure to identify potential changes to enhance overall market operations. The GameStop event drew policymaker attention to a broker-dealer revenue model, referred to as *payment for order flow*. Other market-driven discussions that triggered policy inquiries include settlement cycles, short selling, and game-like digital engagement practices. In addition, broader market structure issues include the increased frequency of Treasury securities market disruptions and corporate bond market efficiency.

Digital Assets and Financial Innovation. In recent years, financial innovation in capital markets has generated new forms of fundraising—such as initial coin offerings and crowdfunding—as well as a new and emerging asset class, digital assets. Digital assets have a growing presence in the financial services industry, and in cases where they qualify as securities, securities regulation generally applies. Their increasing use in capital markets raises policy questions regarding whether changes to existing laws and regulations are warranted and, if so, when such changes should happen, what form they should take, and which agencies should take the lead. Examples of issue areas include stablecoins, digital asset securities exchanges and trading, and questions of the SEC's jurisdiction (in relation to proposals to change the definition of *security*). In addressing innovation, policymakers and regulators often walk a fine line between fostering innovation and protecting investors.

CRS Resources

CRS Report R46424, *Capital Markets Volatility and COVID-19: Background and Policy Responses*, by Eva Su

CRS Report R45957, *Capital Markets: Asset Management and Related Policy Issues*, by Eva Su

CRS Report R45221, *Capital Markets, Securities Offerings, and Related Policy Issues*, by Eva Su

CRS Report R46208, *Digital Assets and SEC Regulation*, by Eva Su

CRS In Focus IF11714, *Introduction to Financial Services: The Securities and Exchange Commission (SEC)*, by Gary Shorter

CRS In Focus IF11256, *SEC Securities Disclosure: Background and Policy Issues*, by Eva Su

Eva Su, Analyst in Financial Economics