Chapter Preview: Chapter 1

Answer the following questions briefly.

1. Explain the four types of firms:
   1. **Sole proprietorships**

One person owns and manages his/her business. Although this is the most common type of company, the share of the market’s overall revenue is much smaller than the other types.

Features:

1. Easy to establish.
2. One and only owner.
3. No separation between owner and business (financially, legally).
4. Dependence of business existence on the owner.
   1. **Partnership (law firms, groups of doctors, …)**

Except for multi-owners (i.e., partners), a partnership shares features with sole proprietorship.

Features:

1. The same responsibility of all partners (financially, legally).
2. The death or withdrawal of some partners leads to the end of the business. However, if the partnership agreement includes alternatives, the partnership can avoid liquidation.

Cf. **limited partnership (venture capitals as limited partners)**

Two types of partners exist: general partners (all authority and unlimited liability) & limited partners (limited liability for their investment).

* 1. **Limited liability companies**

LLC is a limited partnership without general partners. The partners have management rights unlike limited partners in limited partnership.

* 1. **Corporations**

Corporations are legally defined as artificial beings. They have legal rights and responsibilities for themselves. The law secures independence from their owner.

Formation of corporations requires the government’s consent. (more cost than establishing sole proprietorship). Also, the state recognizes corporations as a citizen for jurisdiction. Hired lawyers make corporate charters.

Corporations can have an unlimited number of owners, with no specific qualification required. Their stock and ownership are divided into shares and distributed. The equity of a corporation is represented by its total outstanding shares in the market. The company can pay dividends to its stockholders. Shareholders can freely trade stocks. Companies can attract external capital by selling their equity, which helps expand their business significantly.

1. Define or explain the following terms:
   1. **Double taxation**

Corporations pay taxes about their profit. However, the government also imposes taxes on shareholders’ earnings from corporate profits.

* 1. **Agency problems**

Members of the board of directors may face ethical and economic conflicts between their personal interests and those of the shareholders. In some cases, situations arise where both sides' interests cannot be fully satisfied, such as when board members prioritize their own compensation over long-term shareholder value, leading to an agency problem.

* 1. **Goal of the firm**

The main goal of the firm is to increase the value of its shares by making decisions that maximize shareholder value and align with the interests of the board of directors.

* 1. **Hostile takeover**

An individual or organization (corporate raider) purchases a lot of stock to get authority for replacement of current board members. It can be helpful to make more stakeholders’ profit because new directors make the value of the company higher.

* 1. **Public company**

Public companies are listed on stock exchange. They can acquire capital by issuing shares or bonds. Based on their stable capital foundation, they make large strategic investments. Also, companies are required to disclose their financial information to prove their transparency.

* 1. **IPO**

The process of selling stock to the public for the first time. Through the process, the value of stock is determined by market. After the company IPO, it can raise capital from the market and become a public company, subject to regulations and duties regarding financial transparency.

* 1. **Primary market**

Primary markets provide a platform where investors can purchase newly issued shares of stock directly from corporations.

* 1. **Liquidity**

Liquidity stands for how easily trade shares of stock. It is the ability to sell property quickly at a fair price. External investors can decide timing and period of investment flexibly. Also, the price chart of liquid stock price can give feedback to managers of the firm.