Chapter Preview: Chapter1

1. Explain the four types of firms

Sole Proprietorships

a business owned an run by one person.

They have few employes and don’t account for much sales reveneue in the economy. They are most common type of firm in the word.

Sole proprietorships are easy to set up amd there is no separation between firm and owner. The owner has unlitimited personal libaility for any of the firm’s debts. This business ends with the owner’s life.

Partnerships

It is like a sole proprietorship but has more than one owner.

All partners are personally libale for the firm’s debts. And the partenership ends if a partner dies or withdraws, unless an agreement allows alternatives like a buyout. It is often used in professional services firms.

A limited partnership includes general partners and limited partners. General parteners have full control but unlimited liability. Limited partners have limited liability and can transfer ownership but have no management authority.

Limited Liability Companies

a limited partnership but without a general partner.

It has limited liability for all owners and owners can manage the business. It is relatively new in US but it is common in worldwide.

Corporation

a legally separate entity from its owners, meaning it can enter contracts, own assets, and incur obligations independently. Owners are not personally liable for corporate debts, and the corporation is not liable for their personal obligations.

Corporations must be legally formed by registering with a state, often choosing Delaware due to its favorable legal environment. Most firms hire lawyers to create a corporate charter outlining governance rules.

There is no limit on the number of owners, and ownership is divided into shares (stocks). Shareholders receive dividends proportional to their shares. Stocks can be freely traded, allowing corporations to raise large amounts of capital from investors.

2. Define or explain the following terms:

Double Taxation

Corporations face **double taxation**, meaning their profits are taxed at the corporate level, and shareholders pay taxes again on dividends they receive. This does not apply to partnerships or sole proprietorships.

Agency Problems

Since ownership and control are separate in corporations, agency problems arise when managers prioritize personal interests over shareholders' interests. This issue is addressed through performance-based compensation, shareholder voting rights, and the threat of takeovers.

Goal of the Firm

The primary goal of a corporation is to maximize shareholder value, usually by increasing the stock price. However, firms must also consider ethical responsibilities, regulatory constraints, and societal impact.

Hostile Takeover

A hostile takeover occurs when an outside party acquires a large portion of a company's stock against the management's wishes, aiming to replace the board and executives to improve performance.

Public Company

A public company is a corporation whose shares are traded on stock exchanges, allowing the general public to invest. It must comply with financial disclosure and regulatory requirements.

IPO (Initial Public Offering)

An IPO is when a private company sells shares to the public for the first time, raising capital for growth. This process transforms a private company into a public company.

Primary Market

The primary market is where new stocks and bonds are sold directly by the company to investors, such as during an IPO.

Liquidity

Liquidity refers to how quickly an asset can be bought or sold without affecting its price. Stocks traded on major exchanges are highly liquid, while real estate and private equity are less liquid.