TABLE 1.2 Career Opportunities in Financial Markets

Career	Career opportunities
Banking and related institutions	*Loan officers* evaluate and make recommendations on various types of loans. *Retail bank managers* run bank offices and supervise the programs offered by the bank. *Trust officers* administer trust funds for estates, foundations, and business firms.
Personal financial planning	*Financial planners* advise individuals on all aspects of their personal finances and help them develop comprehensive financial plans to meet their objectives.
Real estate	*Real estate agents/brokers* negotiate the sale or lease of residential and commercial property. *Appraisers* estimate the market values of all types of property. *Real estate lenders* analyze and make decisions with regard to loan applications. *Mortgage bankers* find and arrange financing for real estate projects. *Property managers* handle the day-to-day operations of properties to achieve maximum returns for their owners.
Insurance	*Insurance agents/brokers* sell insurance policies to meet clients' needs and assist in claims processing and settlement. *Underwriters* appraise and select the risks that their company will insure and set the associated premiums.
Investments	*Stockbrokers,* or account executives, assist clients in choosing, buying, and selling securities. *Securities analysts* study stocks and bonds and advise securities firms and insurance companies with regard to them. *Portfolio managers* build and manage portfolios of securities for firms and individuals. *Investment bankers* provide advice to security issuers and act as intermediaries between issuers and purchasers of newly issued stocks and bonds.

Integration of Components in the Financial Environment

The integration of components that exist within the financial environment will be explained throughout the text. Figure 1.3 offers a brief overview of that integration. When a firm's financial managers determine whether to use debt or equity financing, they rely on investors to supply those funds through the financial markets. For example, the investment decision by Dell Computer to expand its product line or by The Gap to establish additional stores that require external financing will result in the firm's obtaining funds from individual and institutional investors.

Financial managers and investors face similar types of investment decisions. They must decide what to invest in, how much to invest, and the length of the investment period. However, the typical types of investments made by financial managers are distinctly different from the types of investment decisions made by investors. The investment decisions of financial managers commonly focus on **real assets** such as buildings, machinery, and office equipment; the investment decisions of investors focus on **financial assets,** which include securities such as bonds and stocks.

real assets
Resources such as buildings, machinery, and office equipment.

financial assets
Resources such as bonds and stocks.

Note in Figure 1.3 that the investment decisions of financial managers and investors are related. The investment decisions made by the firm's financial managers dictate how much funds the firm needs to invest in its businesses. That is, the investment decisions determine the amount of funds that the firm will obtain from investors. The firm issues financial assets (securities) in order to obtain funds, which are used by the firm's financial managers to invest in real assets.

Example

Wilmington Inc. is a financial institution that presently holds 2 million shares of stock of Lexo Co. The portfolio managers of Wilmington Inc. believed that Lexo Co. had much potential when they purchased the stock 3 years ago, but Lexo has performed poorly over this period. Last year, the portfolio managers told Lexo's board of directors that unless Lexo's performance improved, Wilmington might sell all the Lexo stock it owns.

Lexo's board of directors responded by pressuring the executives of Lexo to implement changes that increased the firm's efficiency. These changes resulted in improved performance, and the stock price increased by $3 per share. Because Wilmington holds 2 million shares, it gained $6 million as a result of exerting its influence on Lexo Co. If Wilmington Inc. had held a much smaller number of shares (as most individual investors do), it would not have been able to influence Lexo's board of directors.

Threat of Takeover

If a firm's managers do not act to maximize the value of the firm, some investors may consider acquiring enough of the firm's stock to gain control of it. They then may restructure the firm in order to better achieve the shareholders' goal to maximize the share price. The incentive for such an effort is the potential reward from buying stock at a low price (when the firm is undervalued as a consequence of poor management) and then taking actions that cause the price to rise.

Example

Oregon Co. experienced poor performance in the last 3 years because of poor management, and its stock price declined from $40 to $15 per share over this period. Some institutional investors believed that the firm had excellent potential and that they could improve the firm if they could acquire enough shares to take control. These investors used some of their own money, along with borrowed funds, to acquire the needed shares. They then restructured the firm by firing the inefficient managers and replacing them. Once the better managers improve the firm's performance, the institutional investors could profit from selling some or all of their shares at a much higher price than the price they paid for them.

In many takeovers, some of the managers of the firm serve as the investors who take control of the firm. They have a vested interest in ensuring that the firm performs well once they become owners, because their investment is at stake. In other cases, managers may not be able to purchase underperforming firms, because the amount of funds needed to gain control of the firm is too large. Under these circumstances, another firm (perhaps a competitor) may serve as the investor and purchase a sufficient proportion of the firm's shares to gain control. Regardless of whether a firm might be acquired by some of its managers or by another firm, the threat of a takeover should give the firm's managers an incentive to perform well, because a takeover may result in the elimination of their jobs.

? Review Questions

1–9 Why do firms engage in direct foreign investment?
1–10 How is a firm’s cash flow exposed to exchange rate risk?

Using This Textbook

In this textbook we will focus on three key components of finance: financial managers, financial markets, and investors. As you’ve seen in this chapter, these components play critical roles in finance.

Financial managers: Obtain funds for their firms (arrange financing) and invest the firm’s funds.

Financial markets: Facilitate the flow of funds between investors and firms.

Investors: Provide debt financing and equity financing to firms in pursuit of their own personal financial goals.

The activities of financial managers and investors, and the role of financial markets in channeling funds from investors to firms, are described in this book, which is divided into five parts:

Part 1 The Financial Marketplace

Part 2 Financial Tools for Firms and Investors

Part 3 Financial Management

Part 4 Investment Management

Part 5 How Investors Monitor and Control a Firm’s Managers

Coverage of international events and topics is integrated into the discussions throughout the book.

As you study this book, you will observe that each chapter is organized and developed around a group of learning goals. The numbered learning goals listed at the beginning of each chapter are tied to text sections in the chapter and also to end-of-chapter materials (chapter summaries, questions, and problems). At periodic intervals in each chapter (usually before major section headings) review questions test your understanding of the material just presented. For best results in learning the text material, take a few moments to stop and consider the review questions. Think about what you’ve just read. (If you’re shaky on any of the topics, be honest enough with yourself to go back and reread the material.) If you’re able to answer the review questions, you’ll be well on your way toward mastering the chapter’s learning goals. Mastery of these goals will result in a broad understanding of the concepts, techniques, and practices of finance.