

Nanyang Business School

BU8201 Business Finance

Tutorial 1: Introduction

(Common Questions)

1) Which type of stock – under, over, or equal to its intrinsic value – is preferred by investors? For a CEO who is preparing to retire and plan to exercise all his stock options, is the answer still the same? Explain.

Note to students: Do some research about what stock option is.

2) Suppose three honest individuals gave you their estimates of Stock X's intrinsic value. One person is your current roommate, the second person is a professional security analyst with an excellent reputation on Wall Street, and the third person is Company X's CFO. If the three estimates differed, in which one would you have the most confidence? Why?

3) The president of Southern Semiconductor Corporation (SSC) made this statement in the company's annual report: "SSC's primary goal is to increase the value of our common stockholders' equity." The newspapers also reported the following news on SSC.

a) The company contributed \$1.5 million to the symphony orchestra in Birmingham, Alabama, its headquarters city.

b) In an effort to reduce cost, SSC's plant released untreated industrial waste into the nearby river.

Discuss how SSC's stockholders might view each of these actions, and how they might affect the stock price.

4) True or False. Evaluate whether the below statements are true or false. Explain.

a) If management maximizes the firm's expected profits for the current year, this will also maximize the stockholders' wealth as of the current year.

b) The goal of financial management is to minimize the firm's risks because most stockholders dislike risk. In turn, this will maximize the firm's stock price.

c) Managers should not focus on the current stock value because doing so will lead to an overemphasis on short-term profits at the expense of long-term profits.

5) If a company's board of directors wants management to maximize shareholder wealth, should the CEO's compensation be set as a fixed dollar amount, or should the compensation depend on how well the firm performs? If it is to be based on performance, how should performance be measured?