

## I. THE CORPORATE FORM OF BUSINESS ORGANIZATION

Forming the corporation involves preparing *Articles of Incorporation & Bylaws*.

### Advantages:

1. Limited liability.
2. Transferable ownership.

### Disadvantages:

1. Double taxation.
2. Potential for agency conflicts between management and shareholders.

Separation of ownership and control:



## **II. GOALS OF FINANCIAL MANAGEMENT**

maximize stock price  
maximize firm value

### III. Example: Do managers act in shareholders' interest?

Time ↔ Warner  
↑  
Paramount

Date	Event	Time Inc. Stock Price
2/27/89		\$104.50
3/4/89	TIME INC & WARNER COMMUNICATIONS ANNOUNCE MERGER	107.25
6/7/89	PARAMOUNT BIDS \$175 FOR TIME INC STOCK	170.00
6/16/89	TIME INC MAKES REVISED BID FOR WARNER	156.875
6/21/89	PARAMOUNT FILES SUIT IN DELAWARE COURT TO BLOCK TIME'S ACQUISITION OF WARNER	152.50
6/23/89	PARAMOUNT RAISES OFFER TO \$200	165.875
7/24/89	SUPREME COURT REFUSES TO BLOCK TIME-WARNER MERGER	137.50

#### IV. MANAGERS' OBJECTIVES VS. STOCKHOLDERS' OBJECTIVES:

##### Management objectives

- |                                           |                                                                                  |
|-------------------------------------------|----------------------------------------------------------------------------------|
| 1. Job permanency                         | Golden parachutes<br>Greenmail<br>Unequal voting shares                          |
| 2. Max managers' wealth                   | Corporate perks; increase salary or bonuses at the expense of shareholder wealth |
| 3. Increase firm size at expense of value | Senseless takeovers<br>Fail to divest bad projects                               |

## V. CORPORATE GOVERNANCE:

### Evolution of Internal mechanisms

1. Management compensation.
2. Boards and institutional investors:

Sub-Period	Board composition	Board Size	Board Compensation	Institutional ownership	Institutional activism
1971-76	Fewer outsiders	Decreasing over time	Few incentives for outsider directors	Increasing over time	None
1977-82	Increasing number of outsiders				
1983-88	Increasing number of outsiders		Firms begin to pay stock-based compensation		Little
1989-98	More outsiders		Stock-based compensation becomes widespread		More

### External mechanisms

1. Proxy solicitations
2. Hostile takeovers