FIN 360: PRINCIPLES OF FINANCIAL MANAGEMENT
EQUITY SECURITIES
CRITICAL THINKING & CONCEPTUAL QUESTIONS

1. Describe the differences between debt and equity, and why a firm might issue each to pay for projects and investments.
2. Explain the tax benefit of debt to a firm. Explain double taxation in the context of dividends.
3. Creditors do not have voting rights like equity holders do, but how might they control some of the actions of the firm through protective covenants?
4. What does it mean for a firm to be financed entirely through equity? Explain with a simple example. Can such a firm go "bankrupt"?
5. What is "ownership dilution", and how do preemptive rights associated with common stock protect investors from the effects of dilution?
6. Describe how cumulative voting works, and how it may give more power to smaller voters when voting in corporate elections.
7. How do dual class share structures and staggered (or classified) boards protect existing managers and directors of a firm? All else equal, would you want a firm that you own stock in to have a dual class share structure or staggered board?
8. Does your vote really matter in corporate elections? Who controls the firm and has voting power?
9. Why specifically do banks and financial institutions find it useful to issue preferred stock?
10. Explain how preferred shares and common shares differ when it comes to dividends.
11. Preferred stock is an equity security, but is often called a "hybrid" of debt and equity. In what ways does preferred stock exhibit a mix of both debt and equity features?
12. Preferred stockholders *do not vote* in firm elections. What, then, makes them "preferred"?
13. Why would an investor purchase equity shares if the company doesn't pay dividends?
14. What's the difference between dealers and brokers? How are they generally compensated?
15. Explain the mechanism behind stock prices "moving". That is, what causes a stock's price to rise or fall throughout the course of the day?
16. Explain the process of trading on the floor of the NYSE and how this process differs from trading on the NASDAQ.
17. Dealers on the floor of the NYSE are known as "designated market makers". Describe their role. What does it mean to be a "market maker"?
18. What might explain why a company experiences trading volume in a day significantly above its normal trading volume?
19. What does the saying "stock prices *reflect* information" mean? What causes stock prices to reflect information?
20. A financial analyst tells you: "It is a waste of time to look at stock price charts. Everyone already has access to those charts and uses them to make trading decisions. What you should

do is conduct financial analysis, use ratios, and use forecasts to pick good stocks." What version of market efficiency do you think this analyst believes in?

21. You tell a friend, "My relative works for the US Department of Defense (DoD). They secretly told me that the DoD is announcing a $200 billion deal with Boeing to produce a new fleet of helicopters. Go buy some Boeing stock today!"
    a. Your friend responds: "It doesn't matter. The stock price already reflects this news even if it wasn't publicly announced yet." What type of market efficiency does your friend believe in?
    b. You purchased Boeing stock based on this information prior to the announcement. What are the potential consequences of your actions?
    c. You told your friend this information, and they bought Boeing stock, profiting when the stock price jumped 10% once the news became public. What is a potential consequence of your friend's actions? What is a potential consequence of *your* actions?
22. How feasible is strong form market efficiency? Do we think that stock prices reflect all private information?
23. Which version of market efficiency is most likely to explain how markets function in practice?
24. Assume that you believe markets are efficient. Is it possible for you to make money by investing in stocks?