**Mini Case Solutions**

**Chapter 1: The Desert Company**

1. By changing the company’s organizational form from a partnership to a corporation, the general partners are no longer personally liable for the company’s losses. Liability for all corporate shareholders is limited to their respective equity investment. As a corporation, the life of the company will be unrelated to the life of its shareholders as ownership can be easily transferred. The debt capacity of a company depends on its collateral. In case of a partnership this collateral is determined by the equity investment made by its partners plus the personal assets of the general partners. A corporation does not face these restrictions as its asset base can easily be expanded with the sale of ownership certificates (stocks), which is an important advantage for a company with significant funding needs. On the downside, a corporation is more expensive to organize, listing and publication requirements set by the stock exchange can be stringent, and control (voting rights) would have to be shared with investors outside the family.
2. A corporation is based on the notion of separation of ownership and control. With the retirement of Mohamad Abdelhamid and the resulting transfer of corporate control to a management team, potential agency conflicts can arise that may result in direct and indirect agency costs. Typical examples of direct agency costs involve corporate spending on non-operational items to the personal benefit of the manager. Indirect agency costs are opportunity costs that typically accrue from the manager’s inability to diversify his job risk. In other words, trying to keep his job, a manager may implement an investment policy that unnecessarily conservative thereby generating a return for the shareholders that is sub-optimal.
3. A cash flow between the company and the financial market occurs only during the IPO. Any subsequent trading activities generate cash flow solely between investors. However, a rising share price is in any company’s best interest as its ability to raise more debt and/or equity in the future depends on the sentiment of the financial markets, i.e., the level of investor’s optimism.
4. Ethical behavior and share price maximization does not have to be a tradeoff. Companies want to sell their products and services. Consumers, in turn, make consumption decision not just based on price and product quality criteria, but increasingly based on social and ethical values. Violating these values can be costly for companies as they may suffer from a consumer backlash. Outraged drivers boycotted Exxon’s gas station for years in the wake of the Alaskan oil spill in 1980 that was perceived to be the result of corporate negligence. Similarly, many customers turned away from Nike in 1999 when they learned about the company’s violation of child labor laws. Thus, it is in any company’s best interest to behave in the most ethical and socially accepted manner, so customers can not only feel good about the product itself but also the way it was produced and the impact its production had on society.