11th EDITION

FINANCIAL MARKETS and INSTITUTIONS



JEFF MADURA

Financial Markets and Institutions

11th Editon

Jeff Madura

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Preface

Financial markets finance much of the expenditures by corporations, governments, and individuals. Financial institutions are the key intermediaries in financial markets because they transfer funds from savers to the individuals, firms, or government agencies that need funds. *Financial Markets and Institutions,* 11th Edition, describes financial markets and the financial institutions that serve those markets. It provides a conceptual framework that can be used to understand why markets exist. Each type of financial market is described with a focus on the securities that are traded and the participation by financial institutions.

Today, many financial institutions offer all types of financial services, such as banking, securities services, mutual fund services, and insurance services. Each type of financial service is unique, however. Therefore, the discussion of financial services in this book is organized by type of financial service that can be offered by financial institutions.

Since the credit crisis, regulatory actions have been taken to prevent another crisis in the future. Accordingly, this text gives special attention to the impact of financial reform on each type of financial market and financial institution.

Intended Market

This text is suitable for undergraduate and master's level courses in financial markets, or financial institutions. To maximize students' comprehension, some of the more difficult questions and problems should be assigned in addition to the special applications at the end of each chapter and the Comprehensive Project. A term paper on the credit crisis may also be a valuable exercise, and several possible topics for this paper are provided at the end of the first chapter.

Organization of the Text

Part 1 (Chapters 1 through 3) introduces the key financial markets and financial institutions, explains why interest rates change over time, and explains why yields vary among securities. Part 2 (Chapters 4 and 5) describes the functions of the Federal Reserve System (the Fed) and explains how its monetary policy influences interest rates and other economic conditions. Part 3 (Chapters 6 through 9) covers the major debt security markets, Part 4 (Chapters 10 through 12) describes equity securities markets, and Part 5 (Chapters 13 through 16) covers the derivative security markets. Each chapter in Parts 3 through 5 focuses on a particular market. The integration of each market with other markets is stressed throughout these chapters. Part 6 (Chapters 17 through 20) concentrates on commercial banking, and Part 7 (Chapters 21 through 25) covers all other types of financial services provided by financial institutions.

Courses that emphasize financial markets should focus on the first five parts (Chapters 1 through 16); however, some chapters in the section on commercial banking are also relevant. Courses that emphasize financial institutions and financial services should focus on Parts 1, 2, 6, and 7, although some background on securities markets (Parts 3, 4, and 5) may be helpful.

Professors may wish to focus on certain chapters of this book, and skip others, depending on the other courses available to their students. For example, if a course on derivative securities is commonly offered, Part 5 of this text may be ignored. Alternatively, if an investments course provides a thorough background on types of securities, Parts 3 and 4 can be given less attention.

Chapters can be rearranged without a loss in continuity. Regardless of the order in which chapters are studied, it is highly recommended that some questions and exercises from each chapter be assigned. These exercises may serve as a focal point for class discussion.

The credit crisis receives considerable emphasis in the mortgage markets chapter (Chapter 9) because it was primarily caused by activities in the mortgage market. The crisis has had an impact on every type of financial market and institution, however, so it is covered in each chapter as it applies to the contents of that chapter.

Coverage of Major Concepts and Events

Numerous concepts relating to recent events and current trends in financial markets are discussed throughout the chapters. These include the following:

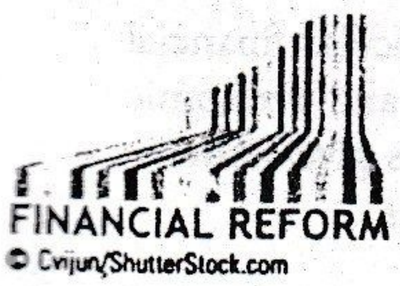
- New laws applied to bond rating agencies
- Increased exposure of municipal bonds to default
- Facebook's IPO
- Performance of venture capital and private equity funding
- Government rescues of financial institutions during the credit crisis
- Credit default swaps
- Behavioral finance
- Emergence of private stock exchanges, such as SecondMarket and SharesPost
- Dark pools used to trade stocks
- Recent developments in insider trading
- New restrictions on proprietary trading by banks
- Occupy Wall Street protests
- Backdating of options
- Governance in financial markets
- The Fed's increasing role in financial markets
- Role of analysts
- Value-at-risk applications
- Asymmetric information
- Valuation of financial institutions
- Regulatory reform in financial services

Each chapter is self-contained, so professors can use classroom time to focus on the more complex concepts and rely on the text to cover the other concepts.

Features of the Text

The features of the text are as follows:

- ***Part-Opening Diagram.*** A diagram is provided at the beginning of each part to illustrate generally how the key concepts in that part are related.
- ***Objectives.*** A bulleted list at the beginning of each chapter identifies the key concepts in that chapter.



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- ***Examples.*** Examples are provided to reinforce key concepts.
- ***Financial Reform.*** A Financial Reform icon in the margin indicates a discussion of financial reform as it applies to the topics covered in the chapter.
- ***Global Aspects.*** A Global Aspects icon in the margin indicates international coverage of the topic being discussed.
- ***Summary.*** A bulleted list at the end of each chapter summarizes the key concepts. This list corresponds to the list of objectives at the beginning of the chapter.
- ***Point Counter-Point.*** A controversial issue is introduced along with opposing arguments, and students are asked to determine which argument is correct and to explain why.
- ***Questions and Applications.*** The Questions and Applications section at the end of each chapter tests students' understanding of the key concepts and may serve as homework assignments or study aids in preparation for exams.
- ***Interpreting Financial News.*** At the end of each chapter, students are challenged to interpret comments made in the media about the chapter's key concepts. This gives students practice in interpreting announcements by the financial media.
- ***Managing in Financial Markets.*** At the end of each chapter, students are placed in the position of financial managers and must make decisions about specific situations related to the key concepts in that chapter.
- ***Flow of Funds Exercise.*** A running exercise is provided at the end of each chapter to illustrate how a manufacturing company relies on all types of financial markets and financial services provided by financial institutions.
- ***Internet/Excel Exercises.*** At the end of each chapter, there are exercises that introduce students to applicable information available on various websites, enable the application of Excel to related topics, or a combination of these. For example, the exercises allow students to assess yield curves, risk premiums, and stock volatility.
- ***Problems.*** Selected chapters include problems to test students' computational skills.
- ***WSJ Exercise.*** This exercise appears at the end of selected chapters and gives students an opportunity to apply information provided in the *Wall Street Journal* to specific concepts explained in that chapter.
- ***Integrative Problems.*** An integrative problem at the end of each part integrates the key concepts of chapters within that part.
- ***Term Paper on the Credit Crisis.*** Several topics for term papers on the credit crisis are suggested at the end of Chapter 1.
- ***Comprehensive Project.*** This project, found in Appendix A, requires students to apply real data to several key concepts described throughout the book.
- ***Midterm and Final Self-Examinations.*** At the end of Chapter 16, a midterm self-exam is offered to test students' knowledge of financial markets. At the end of Chapter 25, a final self-exam is offered to test students' knowledge of financial institutions. An answer key is provided so that students can evaluate their answers after they take the exam.

The concepts in each chapter can be reinforced by using one or more of the features just listed. Professors' use of the features will vary depending on the level of their students and the course focus. A course that focuses mostly on financial markets may emphasize tools such as the WSJ Exercises and Part 1 of the Comprehensive Project (on taking positions in securities and derivative instruments). In contrast, a course that focuses on financial institutions may assign an exercise in which students must review recent annual

reports (see Part 2 of the Comprehensive Project) to determine how a particular financial institution's performance is affected by its policies, industry regulations, and economic conditions. In addition, the Internet/Excel Exercises on financial institutions give students practice in assessing the operations and performance of financial institutions.

Supplements to the Text

To access the instructor resources, go to **www.cengage.com/login**, log in with your faculty account username and password, and use **ISBN 9781133947875** to search for and add instructor resources to your account Bookshelf.

- ***Instructor's Manual.*** Revised by the author, the instructor's manual contains the chapter outline for each chapter and a summary of key concepts for discussion as well as answers to the end-of-chapter Questions and Problems.
- ***Test Bank.*** The expanded test bank, which has also been revised by the author, contains a large set of questions in multiple choice or true/false format, including content questions as well as problems.
- ***Cognero™* Test Bank.** Cengage Learning Testing Powered by Cognero™ is a flexible, online system that allows you to author, edit, and manage test bank content from multiple Cengage Learning solutions; create multiple test versions in an instant; and deliver tests from your LMS, your classroom, or wherever you want. The Cognero™ Test Bank contains the same questions that are in the Microsoft® Word Test Bank. All question content is now tagged according to Tier I (Business Program Interdisciplinary Learning Outcomes) and Tier II (Finance-specific) standards topic, Bloom's Taxonomy, and difficulty level.
- ***PowerPoint Slides.*** The PowerPoint slides clarify content and provide a solid guide for student note-taking. In addition to the regular notes slides, a separate set of exhibit-only PPTs are also available.

Additional Course Tools

Cengage Learning Custom Solutions

Whether you need print, digital, or hybrid course materials, Cengage Learning Custom Solutions can help you create your perfect learning solution. Draw from Cengage Learning's extensive library of texts and collections, add or create your own original work, and create customized media and technology to match your learning and course objectives. Our editorial team will work with you through each step, allowing you to concentrate on the most important thing—your students. Learn more about all our services at **www.cengage.com/custom**.

Cengage Learning's Global Economic Watch

This online portal houses the most current and up-to-date content concerning the economic crisis and is your source for turning today's challenges into tomorrow's solutions. Organized by discipline, the GEW Resource Center offers the solutions instructors and students need in an easy-to-use format. Included are an overview and timeline of the historical events leading up to the crisis, links to the latest news and resources, discussion and testing content, an instructor feedback forum, and a Global Issues Database. Visit **www.cengage.com/thewatch** for more information.

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