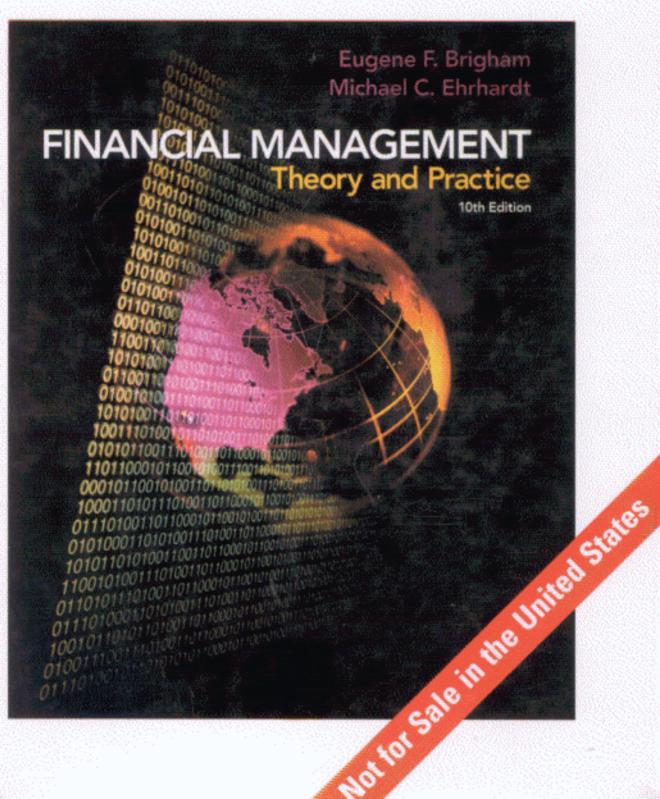
International Student Edition



Contents

Preface vii

Part One	Introduction to Financial Management		
1	An Overview of Financial Management 3		
	Finance and Your Career 4		
	How Are Companies Organized? 6		
	Finance in the Organizational Structure of the Firm 9		
	The Goals of the Corporation 10		
	Financial Management in the New Millennium 14		
	Box: Coke Rides the Global Economy Wave 15		
	Business Ethics and Social Responsibility 16		
	Agency Relationships 19		
	Box: Are CEOs Overpaid? 21 Organization of the Book 24		
	e-Resources 25		
	Summary 26		
	Summary 20		
2	Financial Statements, Cash Flow, and Taxes 30		
	A Brief History of Accounting and Financial Statements 31		
	Financial Statements and Reports 32		
	The Balance Sheet 33		
	The Income Statement 36		
	Statement of Retained Earnings 38		
	Net Cash Flow 38		
	Box: Financial Analysis on the Internet 39		
	Statement of Cash Flows 40		
	Modifying Accounting Data for Managerial Decisions 43		
	MVA and EVA 48 The Federal Income Tax System 51		
	Box: Tax Havens 60		
	Depreciation 60		
	Summary 61		
3	Analysis of Financial Statements 74		
	Ratio Analysis 75		
	Liquidity Ratios 75		
	Asset Management Ratios 77		
	Debt Management Ratios 80		

	Stand-Alone Risk 201	
6	Risk and Return: The Basics 199 Investment Returns 200	
Part Two	Fundamental Concepts in Financial Management	197
	The Financial Markets 154 Financial Institutions 158 Box: Mutual Fund Mania 162 Box: Online Trading Systems 164 The Stock Market 164 Box: Measuring the Market 166 The Cost of Money 167 Interest Rate Levels 168 The Determinants of Market Interest Rates 172 The Term Structure of Interest Rates 177 What Determines the Shape of the Yield Curve? 179 Using the Yield Curve to Estimate Future Interest Rates 181 Investing Overseas 183 Other Factors That Influence Interest Rate Levels 184 Interest Rates and Business Decisions 186 Summary 188	
5	The Financial Environment: Markets, Institutions, and Interest Rates 153	
	The AFN Formula 132 Forecasting Financial Requirements When the Balance Sheet Ratios Are Subject to Change 136 Other Techniques for Forecasting Financial Statements 138 Summary 141	
	Operating Plans 117 The Financial Plan 117 Box: Financial Planning in the New Millennium 118 Computerized Financial Planning Models 119 Sales Forecasts 119 Financial Statement Forecasting: The Percent of Sales Method 122	
4	Financial Planning and Forecasting Financial Statements Strategic Plans 114	113
	Box: International Accounting Differences Create Headaches for Investors Market Value Ratios 86 Trend Analysis, Common Size Analysis, and Percent Change Analysis 89 Tying the Ratios Together: The Du Pont Chart and Equation 92 Comparative Ratios and "Benchmarking" 95 Box: Ratio Analysis in the Internet Age 97 Uses and Limitations of Ratio Analysis 97 Problems with ROE 98 Looking Beyond the Numbers 99 Summary 100	85
	Profitability Ratios 84	

	Box: The Trade-Off between Risk and Return 211 Risk in a Portfolio Context 212 Box: The Benefits of Diversifying Overseas 220 Calculating Beta Coefficients 225 The Relationship between Risk and Rates of Return 229 Physical Assets versus Securities 234 Some Concerns about Beta and the CAPM 235 Volatility versus Risk 236 Summary 236
7	Risk and Return: Portfolio Theory and Asset Pricing Models 247
	Measuring Portfolio Risk 248 Efficient Portfolios 251 Choosing the Optimal Portfolio 254 The Capital Asset Pricing Model 257 The Capital Market Line and the Security Market Line 258 Calculating Beta Coefficients 262 Empirical Tests of the CAPM 270 Arbitrage Pricing Theory 273 The Fama-French Three-Factor Model 275 An Alternative Theory of Risk and Return: Behavioral Finance 278 Summary 279
8	Time Value of Money 285 Time Lines 286 Future Value 287 Box: The Power of Compound Interest 294 Present Value 294 Solving for Interest Rate and Time 297
	Future Value of an Annuity 300 Present Value of an Annuity 304 Annuities: Solving for Interest Rate, Number of Periods, or Payment 300 Perpetuities 308 Uneven Cash Flow Streams 309 Growing Annuities 312 Semiannual and Other Compounding Periods 313 Box: Using the Internet for Personal Financial Planning 314
laut Thuas	Comparison of Different Types of Interest Rates 318 Fractional Time Periods 321 Amortized Loans 321 Summary 324
	Securities and Their Valuation 337
9	Who Issues Bonds? 340 Key Characteristics of Bonds 341 Bond Valuation 345 Bond Yields 352

Box: Drinking Your Coupons 355 Bonds with Semiannual Coupons 355
Assessing the Risk of a Bond 356
Default Risk 359
Box: Santa Fe Bonds Finally Mature after 114 Years 367
Bond Markets 369
Summary 371
Stocks and Their Valuation 379
Legal Rights and Privileges of Common Stockholders 380
Types of Common Stock 381
The Market for Common Stock 382
Box: Martha Bodyslams WWF 384 Common Stock Valuation 385
Constant Growth Stocks 388
Expected Rate of Return on a Constant Growth Stock 392
Valuing Stocks That Have a Nonconstant Growth Rate 393
Stock Market Equilibrium 396
Box: A Nation of Traders 402
Actual Stock Prices and Returns 402
Preferred Stock 407
Summary 408
Corporate Valuation 417
Corporate Valuation 417
Corporate Valuation 417 The Cost of Capital 419
The Cost of Capital 419
The Cost of Capital 419
The Cost of Capital 419 The Weighted Average Cost of Capital 420
The Cost of Capital 419 The Weighted Average Cost of Capital 420 Cost of Debt, $k_d(1-T)$ 422
The Cost of Capital 419 The Weighted Average Cost of Capital 420 Cost of Debt, $k_d(1-T)$ 422 Cost of Preferred Stock, k_{ps} 423 Cost of Common Stock, k_s 424 The CAPM Approach 425
The Cost of Capital 419 The Weighted Average Cost of Capital 420 Cost of Debt, $k_d(1-T)$ 422 Cost of Preferred Stock, k_p 423 Cost of Common Stock, k_s 424 The CAPM Approach 425 Dividend-Yield-plus-Growth Rate, or Discounted Cash Flow (DCF), Approach 430
The Cost of Capital 419 The Weighted Average Cost of Capital 420 Cost of Debt, $k_d(1-T)$ 422 Cost of Preferred Stock, k_p 423 Cost of Common Stock, k_s 424 The CAPM Approach 425 Dividend-Yield-plus-Growth Rate, or Discounted Cash Flow (DCF), Approach 430 Bond-Yield-plus-Risk-Premium Approach 434
The Cost of Capital 419 The Weighted Average Cost of Capital 420 Cost of Debt, $k_d(1-T)$ 422 Cost of Preferred Stock, k_{ps} 423 Cost of Common Stock, k_s 424 The CAPM Approach 425 Dividend-Yield-plus-Growth Rate, or Discounted Cash Flow (DCF), Approach 80nd-Yield-plus-Risk-Premium Approach 434 Comparison of the CAPM, DCF, and Bond-Yield-plus-Risk-Premium Methods 434
The Cost of Capital 419 The Weighted Average Cost of Capital 420 Cost of Debt, k _d (1 - T) 422 Cost of Preferred Stock, k _{ps} 423 Cost of Common Stock, k _s 424 The CAPM Approach 425 Dividend-Yield-plus-Growth Rate, or Discounted Cash Flow (DCF), Approach 430 Bond-Yield-plus-Risk-Premium Approach 434 Comparison of the CAPM, DCF, and Bond-Yield-plus-Risk-Premium Methods 434 Composite, or Weighted Average, Cost of Capital, WACC 435
The Cost of Capital 419 The Weighted Average Cost of Capital 420 Cost of Debt, k _d (1 - T) 422 Cost of Preferred Stock, k _{ps} 423 Cost of Common Stock, k _s 424 The CAPM Approach 425 Dividend-Yield-plus-Growth Rate, or Discounted Cash Flow (DCF), Approach Bond-Yield-plus-Risk-Premium Approach 434 Comparison of the CAPM, DCF, and Bond-Yield-plus-Risk-Premium Methods Composite, or Weighted Average, Cost of Capital, WACC 435 Box: WACC Estimates for Some Large U.S. Corporations 436
The Cost of Capital 419 The Weighted Average Cost of Capital 420 Cost of Debt, k _d (1 - T) 422 Cost of Preferred Stock, k _{ps} 423 Cost of Common Stock, k _s 424 The CAPM Approach 425 Dividend-Yield-plus-Growth Rate, or Discounted Cash Flow (DCF), Approach 430 Bond-Yield-plus-Risk-Premium Approach 434 Comparison of the CAPM, DCF, and Bond-Yield-plus-Risk-Premium Methods Composite, or Weighted Average, Cost of Capital, WACC 435 Box: WACC Estimates for Some Large U.S. Corporations 436
The Cost of Capital 419 The Weighted Average Cost of Capital 420 Cost of Debt, k _d (1 - T) 422 Cost of Preferred Stock, k _{ps} 423 Cost of Common Stock, k _s 424 The CAPM Approach 425 Dividend-Yield-plus-Growth Rate, or Discounted Cash Flow (DCF), Approach 430 Bond-Yield-plus-Risk-Premium Approach 434 Comparison of the CAPM, DCF, and Bond-Yield-plus-Risk-Premium Methods Composite, or Weighted Average, Cost of Capital, WACC 435 Box: WACC Estimates for Some Large U.S. Corporations 436 Factors That Affect the Weighted Average Cost of Capital 436
The Cost of Capital 419 The Weighted Average Cost of Capital 420 Cost of Debt, k _d (1 - T) 422 Cost of Preferred Stock, k _{ps} 423 Cost of Common Stock, k _s 424 The CAPM Approach 425 Dividend-Yield-plus-Growth Rate, or Discounted Cash Flow (DCF), Approach 80nd-Yield-plus-Risk-Premium Approach 434 Comparison of the CAPM, DCF, and Bond-Yield-plus-Risk-Premium Methods Composite, or Weighted Average, Cost of Capital, WACC 435 Box: WACC Estimates for Some Large U.S. Corporations 436 Factors That Affect the Weighted Average Cost of Capital 436 Box: Global Variations in the Cost of Capital 438 Adjusting the Cost of Capital for Risk 438 Estimating Project Risk 440
The Cost of Capital 419 The Weighted Average Cost of Capital 420 Cost of Debt, k _d (1 - T) 422 Cost of Preferred Stock, k _{ps} 423 Cost of Common Stock, k _s 424 The CAPM Approach 425 Dividend-Yield-plus-Growth Rate, or Discounted Cash Flow (DCF), Approach Bond-Yield-plus-Risk-Premium Approach 434 Comparison of the CAPM, DCF, and Bond-Yield-plus-Risk-Premium Methods Composite, or Weighted Average, Cost of Capital, WACC 435 Box: WACC Estimates for Some Large U.S. Corporations 436 Factors That Affect the Weighted Average Cost of Capital 436 Box: Global Variations in the Cost of Capital 438 Adjusting the Cost of Capital for Risk 438 Estimating Project Risk 440 Using the CAPM to Estimate a Project's Risk-Adjusted Cost of Capital 441
The Cost of Capital 419 The Weighted Average Cost of Capital 420 Cost of Debt, k _d (1 - T) 422 Cost of Preferred Stock, k _{ps} 423 Cost of Common Stock, k _s 424 The CAPM Approach 425 Dividend-Yield-plus-Growth Rate, or Discounted Cash Flow (DCF), Approach 800d-Yield-plus-Risk-Premium Approach 434 Comparison of the CAPM, DCF, and Bond-Yield-plus-Risk-Premium Methods Composite, or Weighted Average, Cost of Capital, WACC 435 Box: WACC Estimates for Some Large U.S. Corporations 436 Factors That Affect the Weighted Average Cost of Capital 436 Box: Global Variations in the Cost of Capital 438 Adjusting the Cost of Capital for Risk 438 Estimating Project Risk 440 Using the CAPM to Estimate a Project's Risk-Adjusted Cost of Capital 441 Techniques for Measuring Beta Risk 444
The Cost of Capital 419 The Weighted Average Cost of Capital 420 Cost of Debt, k _d (1 – T) 422 Cost of Preferred Stock, k _{ps} 423 Cost of Common Stock, k _s 424 The CAPM Approach 425 Dividend-Yield-plus-Growth Rate, or Discounted Cash Flow (DCF), Approach 8000-Yield-plus-Risk-Premium Approach 434 Comparison of the CAPM, DCF, and Bond-Yield-plus-Risk-Premium Methods Composite, or Weighted Average, Cost of Capital, WACC 435 Box: WACC Estimates for Some Large U.S. Corporations 436 Factors That Affect the Weighted Average Cost of Capital 436 Box: Global Variations in the Cost of Capital 438 Adjusting the Cost of Capital for Risk 438 Estimating Project Risk 440 Using the CAPM to Estimate a Project's Risk-Adjusted Cost of Capital 441 Techniques for Measuring Beta Risk 444 Adjusting the Cost of Capital for Flotation Costs 445
The Cost of Capital 419 The Weighted Average Cost of Capital 420 Cost of Debt, k _d (1 - T) 422 Cost of Preferred Stock, k _{ps} 423 Cost of Common Stock, k _s 424 The CAPM Approach 425 Dividend-Yield-plus-Growth Rate, or Discounted Cash Flow (DCF), Approach 800d-Yield-plus-Risk-Premium Approach 434 Comparison of the CAPM, DCF, and Bond-Yield-plus-Risk-Premium Methods Composite, or Weighted Average, Cost of Capital, WACC 435 Box: WACC Estimates for Some Large U.S. Corporations 436 Factors That Affect the Weighted Average Cost of Capital 436 Box: Global Variations in the Cost of Capital 438 Adjusting the Cost of Capital for Risk 438 Estimating Project Risk 440 Using the CAPM to Estimate a Project's Risk-Adjusted Cost of Capital 441 Techniques for Measuring Beta Risk 444

Part Four

12	Putting the Pieces Together: Corporate Valuation and Value-Based Management 461
	Overview of Corporate Valuation 462 The Corporate Valuation Model 463 Value-Based Management 470 Box: Who Is Creating Wealth? 476 Box: Value-Based Management in Practice 478 Corporate Governance and Shareholder Wealth 479 Box: International Corporate Governance 485 Summary 488
Part Five	Strategic Investment Decisions 499
13	The Basics of Capital Budgeting: Evaluating Cash Flows Importance of Capital Budgeting 502 Generating Ideas for Capital Projects 503 Project Classifications 504 Similarities between Capital Budgeting and Security Valuation 505 Capital Budgeting Decision Rules 506 Comparison of the NPV and IRR Methods 514 Modified Internal Rate of Return (MIRR) 520 Profitability Index 522 Conclusions on Capital Budgeting Methods 523 Business Practices 524 The Post-Audit 525 Box: Techniques Firms Use to Evaluate Corporate Projects 526 Using Capital Budgeting Techniques in Other Contexts 527 Special Applications of Cash Flow Evaluation 528 The Optimal Capital Budget 531 Summary 533
14	Cash Flow Estimation and Risk Analysis 546 Estimating Cash Flows 547 Identifying the Relevant Cash Flows 548 Tax Effects 551 Evaluating Capital Budgeting Projects 555 Adjusting for Inflation 561 Introduction to Project Risk Analysis 563 Techniques for Measuring Stand-Alone Risk 564 Box: Capital Budgeting Practices in the Asia/Pacific Region 568 Box: High-Tech CFOs 569 Project Risk Conclusions 572 Incorporating Project Risk and Capital Structure into Capital Budgeting 573 Summary 573
15	Option Pricing with Applications to Real Options 583 Financial Options 584 Introduction to Option Pricing Models 589

	The Black-Scholes Option Pricing Model (OPM) Introduction to Real Options 596 Types of Real Options 596 Valuing Real Options 598 The Investment Timing Option: An Illustration 599 Box: Growth Options at Dot-com Companies 608 Concluding Thoughts on Real Options 609 Summary 610
Part Six	Strategic Financing Decisions 617
16	Capital Structure Decisions: The Basics 619 The Target Capital Structure 620 Business and Financial Risk 621 Determining the Optimal Capital Structure 632 Advanced Issues in Determining the Optimal Capital Structure 639 Capital Structure Theory 642 Box: Yogi Berra on the M&M Proposition 643 Checklist for Capital Structure Decisions 648 Variations in Capital Structures 650 Box: Taking a Look at Global Capital Structures 651 Summary 652
17	Capital Structure Decisions: Extensions Capital Structure Theory: The Modigliani-Miller Models The Hamada Model: Introducing Market Risk 671 Capital Structure Theory: The Miller Model 673 Criticisms of the MM and Miller Models 676 Capital Structure Theory: The Trade-Off Models 678 Capital Structure Theory: The Signaling Model 683 Capital Structure Theory: Our View 686 Book Weights versus Market Weights 688 Summary 690
18	Distributions to Shareholders: Dividends and Repurchases 698 Dividends versus Capital Gains: What Do Investors Prefer? 699 Other Dividend Policy Issues 703 Box: Dividend Yields Around the World 704 Dividend Stability 706 Establishing the Dividend Policy in Practice 707 Dividend Reinvestment Plans 715 Summary of Factors Influencing Dividend Policy 716 Overview of the Dividend Policy Decision 718 Stock Dividends and Stock Splits 719 Stock Repurchases 721 Box: Buybacks Have Lowered Dividend Yields 724 Box: Stock Repurchases: An Easy Way to Boost Stock Prices? 725 Summary 726

art Seven	Tactical Financing Decisions 735
19	Initial Public Offerings, Investment Banking, and Financial Restructuring 737
	The Financial Life Cycle of a Startup Company 738 The Decision to Go Public: Initial Public Offerings 739 The Process of Going Public 741 Equity Carve-Outs: A Special Type of IPO 748 Non-IPO Investment Banking Activities 749 The Decision to Go Private 758 Managing the Maturity Structure of Debt 760 Zero (or Very Low) Coupon Bonds 763 Refunding Operations 766 Box: TVA Ratchets Down Its Interest Expenses 772 Managing the Risk Structure of Debt 773 Box: Bowie Bonds Ch-Ch-Change Asset Securitization 776 Summary 776
20	Lease Financing 784
	The Two Parties to Leasing 785 Types of Leases 785 Tax Effects 787 Financial Statement Effects 788 Evaluation by the Lessee 790 Box: Leasing Comes to the Internet 794 Evaluation by the Lessor 795 Other Issues in Lease Analysis 797 Box: Lease Securitization 799 Other Reasons for Leasing 800 Summary 802
21	Hybrid Financing: Preferred Stock, Warrants, and Convertibles 809
	Preferred Stock 810 Box: Where's the Dividend? 812 Box: A Rose by Any Other Name: MIPS, QUIPS, TOPrS, and QUIDS 813 Warrants 814 Convertibles 819 A Final Comparison of Warrants and Convertibles 826 Reporting Earnings When Warrants or Convertibles Are Outstanding 827 Summary 828
Part Eight	Working Capital Management 835
22	Current Asset Management 837
	Working Capital Terminology 838 Alternative Current Asset Investment Policies 830

Box: Free Cash Flow, EVA, and Working Capital

The Cash Conversion Cycle

23	Short-Term Financing 883 Alternative Current Asset Financing Policies 884
	Advantages and Disadvantages of Short-Term Financing 886 Sources of Short-Term Financing 888 Accruals 888 Accounts Payable (Trade Credit) 888 Box: The Internet Threatens to Transform the Banking Industry 893 Short-Term Bank Loans 894 The Cost of Bank Loans 896 Choosing a Bank 901 Commercial Paper 903
	Use of Security in Short-Term Financing 904 Summary 905
Part Nine	·
Part Nine 24	Summary 905 Special Topics 913

942

944

945

Financial Distress and Its Consequences

Federal Bankruptcy Law 9 Reorganization in Bankruptcy

Issues Facing a Firm in Financial Distress

Settlements without Going through Formal Bankruptcy

948

Box: The Best at Managing Working Capital

846

Box: The Great Debate: How Much Cash Is Enough?

852

848

The Concept of Zero Working Capital

Cash Management Techniques

Cash Management

The Cash Budget

844

855

Liquidation in Bankruptcy	957	
Other Motivations for Bankru	ptcy	960
Some Criticisms of Bankruptc	y Laws	961
Other Topics in Bankruptcy	962	
Summary 962		
•		

Mergers, LBOs, Divestitures, and Holding Companies 969

974

997

988

987

970 Rationale for Mergers Types of Mergers

Level of Merger Activity 973 Hostile versus Friendly Takeovers

Merger Regulation 977

Merger Analysis

Box: When You Merge You Combine More Than Just Financial Statements Taxes and the Structure of the Takeover Bid

Financial Reporting for Mergers Analysis for a "True Consolidation" 993

The Role of Investment Bankers 994

Corporate Alliances 999

Who Wins: The Empirical Evidence

Leveraged Buyouts 1000

Divestitures

Box: Governments Are Divesting State-Owned Businesses to Spur Economic Efficiency 1003

Holding Companies 1005 1007 Summary

27 Multinational Financial Management 1015

Multinational, or Global, Corporations

Multinational versus Domestic Financial Management 1018 Box: The Euro: What You Need to Know

Exchange Rates 1020

The International Monetary System 1024

Trading in Foreign Exchange 1026

Interest Rate Parity

Purchasing Power Parity 1029

Box: Hungry for a Big Mac? Go to Malaysia! 1030 Inflation, Interest Rates, and Exchange Rates 1032

International Money and Capital Markets 1033

Multinational Capital Budgeting

Box: Stock Market Indices Around the World 1036

International Capital Structures

Multinational Working Capital Management 1041 1044 Summary

Appendixes

Solutions to Self-Test Problems A-1

Answers to End-of-Chapter Problems A-31

С	Selected Equations and Data A-38	
D	Mathematical Table A-47	
	Index I-1	
Web/CD Chapters	s (http://www.harcourtcollege.com/finance/theory10e/)	
28	Working Capital Management: Extensions	
29	Pension Plan Management	
30	Financial Management in Not-for-Profit Businesses	
Web/CD Extensions (http://www.harcourtcollege.com/finance/theory10e/)		
6	Continuous Probability Distributions	
8	The Tabular Approach and Continuous Compounding and Discounting	
13.	The Marginal Cost of Capital and the Optimal Capital Budget	
14	Replacement Project Analysis	
15	Illustration of Valuation for Various Real Options	
16	Degree of Leverage	
20	Percentage Cost Analysis, Feedback Effect on Capital Budgeting, and Leveraged Leases	
21	Calling Convertible Issues	
23	Secured Short-Term Financing	
24	Risk Management with Insurance and Bond Portfolio Immunization	
25	Case Histories and Multiple Discriminant Analysis	