Part One

1

2

## VALUE

## Chapter

#### FINANCE AND THE FINANCIAL MANAGER 2

- 1.1 What Is a Corporation? 3
- 1.2 The Role of the Financial Manager 4
- 1.3 Who Is the Financial Manager? 6
- 1.4 Separation of Ownership and Management 7
- 1.5 Topics Covered in this Book 9 Summary 10 Further Reading 10 Concept Review'Questions 11 Quiz 11

## \_Ch\_apter\_

## PRESENT VALUES, THE OBJECTIVES OF THE FIRM, AND CORPORATE GOVERNANCE 13

- 2.1 Introduction to Present Value 14 Calculating Future Value and Present Value /Net Present Value /Risk and Present Value /Present Values and Rates of Return /The Opportunity Cost of Capital / A Source of Confusion
- 2.2 Foundations of the Net Present Value Rule 19 Hozv Capital Markets Reconcile Preferences for Current vs. Future Consumption /A Fundamental Result / Other Corporate Goals
- 2.3 Corporate Goals and Corporate Governance 23 Should Managers Look After the Interests of Shareholders? /Should Firms Be Managed for Shareholders or All Stakeholders? /Enron, WorldCom, and SOX

Summary 29 Further Reading 31 Concept Review Questions 31 Quiz 31 Practice Questions 32 Challenge Question 34

## <u>Chapter'3</u>

#### HOW TO CALCULATE PRESENT VALUES 35

- 3.1 Valuing Long-Lived Assets 35 Valuing Cash Flozvs in Several Periods / Why the Discount Factor Declines as Futurity Increases—And a Digression on Money Machines /Calculating PVs and NPVs
- 3.2 Looking for Shortcuts—Perpetuities and Annuities 40 Hozv to Value Perpetuities /Hozv to Value Annuities / PV Annuities: An Example /PV Annuities: Another Example / PV Annuities Due / Calculating Ann ual Payments: An Example / Future Value of an Annuity: An Example
- 3.3 More Shortcuts—Growing Perpetuities and Annuities 46

Grozoing Perpetuities / Growing Annuities

3.4 Compound Interest and Present Values 48 A Mote on Compounding Intervals /Continuous Compounding

Summary 53

Web Projects 54

Concept Review Questions 54

Quiz 54

Practice Questions 55

Challenge Questions 58

### Chapter 4

#### VALUING BONDS 59

- 4.1 Using the Present Value Formula to Value Bonds 60
  A Short Trip to Germany to Value a Government Bond/Back to the United States: Semiannual Coupons and Bond Prices
- 4.2 How Bond Prices Vary with Interest Rates 63 Duration and Bond Volatility IA Cautionary Note
- 4.3 The Term Structure of Interest Rates 67 The Yield to Maturity and the Term Structure / Measuring the Term Structure
- 4.4 Explaining the Term Structure 69 The Expectations Theory /Introducing Risk /Inflation and Term Structure
- 4.5 Real and Nominal Rates of Interest 72 Indexed Bonds and the Real Rate of Interest /Inflation and Nominal Interest Rates /How Well Does Fisher's Theory Explain Interest Rates?

Summary 78

Further Reading 79 Web Project 79 Concept Review Questions 80 Quiz 80 Practice Questions 82 Challenge Questions 84

#### \_C h a p t e r

### THE VALUE OF COMMON STOCKS 85

5

- 5.1 How Common Stocks Are Traded 86
- 5.2 How Common Stocks Are Valued 88 Today's Price/But What Determines Next Year's Price?
- 5.3 Estimating the Cost of Equity Capital 92 Using the DCF Model to Set Gas and Electricity Prices / Dangers Lurk in Constant-Growth Formulas
- 5.4 The Link Between Stock Price and Earnings per Share 98

Calculating the Present Value of Growth Opportunities for Fledgling Electronics /Examples of Growth Opportunities

5.5 Valuing a Business by Discounted Cash Flow 102 Valuing the Concatenator Business I Valuation Format Estimating Horizon Value /A Further Reality Check

Summary 106

Further Reading 108

Concept Review Questions 108

Quiz 108

Practice Questions 109

Challenge Questions 112 Mini-case: Reeby Sports 113

#### Chapter 6

## WHY NET PRESENT VALUE LEADS TO BETTER INVESTMENT DECISIONS THAN OTHER CRITERIA 115

- 6.1 A Review of the Basics 116 Net Present Value's Competitors / Three Points to Remember about NPV/NPV Depends on Cash Flow, Not on Book Returns
- 6.2 Payback 120 The Payback Rule
- 6.3 Internal (or Discounted-Cash-Flow) Rate of Return 121 Calculating the IRR/The 1RR Rule/Pitfall 1—Lending or Borrowing? /Pitfall 2—Multiple Rates of Return / Pitfall 3—Mutually Exclusive Projects / Pitfall 4— What Happens When We Can't Finesse the Term Structure of Interest Rates? /The Verdict on IRR
- 6.4 Choosing Capital Investments When Resources Are Limited 131 An Easy Problem in Capital Rationing /Uses of Capital Rationing Models Summary 134 Further Reading 135 Concept Review Questions 136 Quiz 136 Practice Questions 137 Challenge Questions 139 Mini-case: Vegetron's CFO Calls Again 140

#### Chapter 7

#### MAKING INVESTMENT DECISIONS WITH THE NET PRESENT VALUE RULE 142

- 7.1 · Applying the Net Present Value Rule 143 Only Cash Flow Is Relevant/Estimate Cash Floxvs on an Incremental Basis /Treat Inflation Consistently
- 7.2 Example—IM&C'S Fertilizer Project 147 Separating Investment and Financing Decisions / Investments in Working Capital/A Further Note on Depreciation /A Final Comment on Taxes /Project Analysis / Calculating NPV in Other Countries and Currencies
- 7.3 Equivalent Annual Costs 155 Investing to Produce Reformulated Gasoline at California Refineries / Choosing Between Long- and Short-Lived Equipment I Deciding Wlien to Replace an Existing Machine

Summary 160 Concept Review Questions 161 Quiz 161 Practice Questions 163 Challenge Questions 167 Mini-case: New Economy Transport (A) and (B) 168

# <u>Part Two</u> **RISK 171**

#### Chapter 8

# INTRODUCTION TO RISK, RETURN, AND THE OPPORTUNITY COST OF CAPITAL 172

8.1 Over a Century of Capital Market History in One Easy Lesson 172 Arithmetic Averages and Compound Annual Returns / Using Historical Evidence to Evaluate Today's Cost of Capital I dividend Yields and the Risk Premium

8.2 Measuring Portfolio Risk 180 Variance and Standard Deviation /Measuring Variability /How Diversification Reduces Risk

- 8.3 Calculating Portfolio Risk 189 General Formula for Computing Portfolio Risk/Limits to Diversification
- 8.4 How Individual Securities Affect
   Portfolio Risk 193
   Market Risk Is Measured by Beta / Why Security Betas
   Determine Portfolio Risk

8.5 Diversification and Value Additivity 197
Summary 198
Further Reading 199
Concept Review Questions 199
Quiz 200
Practice Questions 201
Challenge Questions 204

<u>Chapter</u>

#### RISK AND RETURN 206

9

- 9.1 Harry Markowitz and the Birth of Portfolio Theory 206 Combining Stocks into Portfolios / We Introduce Borrowing and Lending
- 9.2 The Relationship between Risk and Return 213 Some Estimates of Expected Returns I Review of the Capital Asset Pricing Model/What If a Stock Did Not Lie on the Security Market Line?

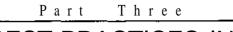
- 9.3 Validity and Role of the Capital Asset Pricing Model 217 Tests of the Capital Asset Pricing Model/Assumptions behind the Capital Asset Pricing Model
- 9.4 Some Alternative Theories 222 Consumption Betas versus Market Betas /Arbitrage Pricing Theory/A Comparison of the Capital Asset Pricing Model and Arbitrage Pricing Theory/The Three-Factor Model
  Summary 227
  Further Reading 228
  Concept Review Questions 229
  Quiz 229
  Practice Questions 231
  Challenge Questions 235
  Mini-case: John and Marsha on Portfolio Selection 236

## Chapter 10

#### CAPITAL BUDGETING AND RISK 238

- 10.1 Company and Project Costs of Capital 239 Perfect Pitch and the Cost of Capital / Debt and the Company Cost of Capital
- 10.2 Measuring the Cost of Equity 242 Estimating Beta/The Expected Return on Union Pacific Corporation's Common Stock
- 10.3 Setting Discount Rates When You Don't Have a Beta 246 Avoid Fudge Factors in Discount Rates / What Determines Asset Betas?
- 10.4 Certainty Equivalents—Another Way to Adjust for Risk 250 Valuation by Certainty Equivalents I When to Use a Single Risk-Adjusted Discount Rate for Long-Lived Assets IA Common Mistake / When You Cannot Use a Single Risk-Adjusted Discount Rate for Long-Lived Assets
- 10.5 Discount Rates for International Projects 255 Foreign Investments Are Not Always Riskier /Foreign Investment in the United States /Do Some Countries Have a Lower Cost of Capital?
  Summary 258 Further Reading 259 Concept Review Questions 259 Quiz 260 Practice Questions 260 Challenge Questions 264

Mini-case: The Jones Family, Incorporated 264



## BEST PRACTICES IN CAPITAL BUDGETING 267

#### Chapter 11

## PROJECT ANALYSIS 268

- 11.1 The Capital Investment Process 269 Project Authorizations—and the Problem of Biased Forecasts /Postaudits
- U.2 Sensitivity Analysis 271 Value of Information /Limits to Sensitivity Analysis / Scenario Analysis / Break-Even Analysis / Operating Leverage and Break-Even Points
- 11.3 Monte Carlo Simulation 278 Simulating the Electric Scooter Project/Simulation of Pharmaceutical Research and Development
- 11.4 Real Options and Decision Trees 283 The Option to Expand / The Option to Abandon / Production Options / Timing Options /More on Decision Trees /An Example: Magna Charter /Pro and Con Decision Trees / Decision Trees and Monte Carlo Simulation

Summary 294

Further Reading 295

Concept Review Questions 295

Quiz 295

Practice Questions 296

Challenge Questions 299

Mini-case: Waldo County 299

## Chapter 12

#### INVESTMENT, STRATEGY, AND ECONOMIC RENTS 302

- 12.1 Look First to Market Values 303 The Cadillac and the Movie Star / Example: Investing in a New Department Store / Another Example: Opening a Cold Mine
- 12.2 Economic Rents and Competitive Advantage 308 Hoiv One Company Avoided a \$100 Million Mistake
- 12.3 Example: Marvin Enterprises Decides to Exploit a New Technology 311

Forecasting Prices of Gargle Blasters/The Value of Marvin's New Expansion /Alternative Expansion Plans/The Value of Marvin Stock/The Lessons of Marvin Enterprises

Summary 319

Further Reading 319

Concept Review Questions 320

Quiz 320

Practice Questions321Challenge Questions323Mini-case: Ecsy-Cola325

## Chapter 13

## AGENCY PROBLEMS, MANAGEMENT COMPENSATION, AND THE MEASUREMENT OF PERFORMANCE 327

- 13.1 Incentives and Compensation 328 Agency Problems in Capital Budgeting /Monitoring / Management Compensation
- 13.2 Measuring and Rewarding Performance: Residual Income and EVA 333 Pros and Cons of EVA
- 13.3 Biases in Accounting Measures of Performance 337 Example: Measuring the Profitability of the Nodhead Supermarket /Measuring Economic Profitability / Do the Biases Wash Out in the Long Run? / What Can We Do about Biases in Accounti?ig Profitability Measures? / Earnings and Earnings Targets Summary 345 Further Reading 346 Concept Review Questions 347 Quiz 347

Practice Questions 348 Challenge Questions 350

Part Four

## FINANCING DECISIONS AND MARKET EFFICIENCY 351

## <u>Chapter 14</u>

## EFFICIENT MARKETS AND BEHAVIORAL FINANCE 352

- 14.1 We Always Come Back to NPV 353 Differences between Investment and Financing Decisions
- 14.2 What Is an Efficient Market? 355 A Startling Discovery: Pric^Changes Are Random / Three Forms of Market Efficiency /Efficient Markets: The Evidence
- 14.3 The Evidence against Market Efficiency 363 Do Investors Respond Slowly to New Information? /Are Stock Prices Determined by Fundamentals? /The Dot.com Boom and Relative Efficiency
- 14.4 Behavioral Finance 369 Limits to Arbitrage / Behavioral Finance and Market Efficiency

14.5 The Six Lessons of Market Efficiency 372 Lesson 1; Markets Have No Memory ILesson 2: Trust Market Prices I Lesson 3: Read the Entrails / Lesson 4: Tliere Are No Financial Illusions /Lesson 5: The Do-It-Yourseif'Alternative/'Lesson 6: Seen One Stock, Seen Them All / What if Markets Are Not Efficient? Implications for the Financial Manager Summary 378 Further Reading 379 Concept Review Questions 380 Quiz 380 Practice Questions 381 Challenge Questions 383

#### Chapter 15

#### AN OVERVIEW OF CORPORATE FINANCING 385

- 15.1 Patterns of Corporate Financing 386 Do Firms Rely Too Much on Internal Funds? /How Much Do Firms Borrow?
- 15.2 Common Stock 390 Ownership of the Corporation / Voting Procedures and the Value of Votes / Equity in Disguise/'Preferred Stock
- 15.3 Debt 396 Debt Comes in Many Forms IA Debt by Any Other Name I Variety's the Very Spice of Life
- 15.4 Financial Markets and Institutions 400 Financial Institutions
  Summary 402
  Further Reading 403
  Web Projects 404
  - Concept Review Questions 404

Quiz 404

Practice Questions 405

Challenge Question 406

#### Chapter 16

#### HOW CORPORATIONS ISSUE SECURITIES 407

- 16.1 Venture Capital 408 The Venture Capital Market
- 16.2 The Initial Public Offering 412 Arranging an Initial Public Offering / The Sale of Marvin Stock / The Underwriters I Costs of a New Issue I Underpricing of IPOs /Hot New-Issue Periods
- 16.3 Other New-Issue Procedures 422 *Types of Auction*

- 16.4 Security Sales by Public Companies 424 General Cash Offers /International Security Issues / The Costs of a General Cash Offer /Market Reaction to Stock Issues I Rights Issues
- 16.5 Private Placements and Public Issues 430
  Summary 430
  Further Reading 431
  Web Project 432
  Concept Review Questions 432
  Quiz 432
  Practice Questions 434
  Challenge Questions 435
  - Appendix: Marvin's New-Issue Prospectus 436

#### Part Five

## PAYOUT POLICY AND CAPITAL STRUCTURE 441

## Chapter 17 PAYOUT POLICY 442

- 17.1 The Choice of Payout Policy 443
- 17.2 How Firms Pay Dividends and Repurchase Stock 444
   How Firms Repurchase Stock
- 17.3 How Do Companies Decide on the Payout? 446
- 17.4 The Information in Dividends and Stock Repurchases 447 The Information Content of Share Repurchase
- 17.5 The Payout Controversy 450 Dividend Policy Is Irrelevant in Perfect Capital Markets / Dividend Irrelevance—An Illustration / Calculating Share Price / Stock Repurchase / Stock Repurchase and Valuation
- 17.6 The Rightists 455 Payout Policy, Investment Policy, and Management Incentives
- 17.7 Taxes and the Radical Left 457 Why Pay Any Dividends at All? I Empirical Evidence on Dividends and Taxes /The Taxation of Dividends and Capital Gains
- 17.8 The Middle-of-the-Roaders 461
  Alternative Tax Systems
  Summary 464
  Further Reading 465
  Concept Review Questions 466

Quiz 466

Practice Questions 467

Challenge Questions 470

## Chapter 18

## DOES DEBT POLICY MATTER? 472

- 18.1 The Effect of Financial Leverage in a Competitive Tax-free Economy 473 Enter Modigliani and Miller / The Law of Conservation of Value/ An Example of Proposition 1
- 18.2 Financial Risk and Expected Returns 479 Proposition 2/How Changing Capital Structure Affects Beta
- 18.3 The Weighted-Average Cost of Capital 483 *Tivo Warnings / Rates of Return on Levered Equity—The Traditional Position / Todat/s Unsatisfied Clienteles Are Probably Interested in Exotic Securities /Imperfections and Opportunities*
- 18.4 A Final Word on the After-Tax Weighted-Average Cost of Capital 488 Union Pacific's WACC Summary 489 Further Reading 490 Concept Review Questions 491 Quiz 491 Practice Questions 493

Challenge Questions 495

## Chapter 19

### HOW MUCH SHOULD A FIRM BORROW? 496

- 19.1 Corporate Taxes 497 How Do Interest Tax Shields Contribute to the Value of Stockholders' Equity? /Recasting Merck's Capital Structure /MM and Taxes
- 19.2 Corporate and Personal Taxes 501
- 19.3 Costs of Financial Distress 503 Bankruptcy Costs / Evidence on Bankruptcy Costs / Direct versus Indirect Costs of Bankruptcy I Financial Distress ivithout Bankruptcy I Debt and Incentives / Risk Shifting: The First Game /Refusing to Contribute Equity Capital: The Second Came /And Three More Games, Briefly / What the Games Cost / Costs of Distress Vary with Type ofAsset /The Trade-off Theory of Capital Structure
- 19.4 The Pecking Order of Financing Choices 517 Debt and Equity Issues with Asymmetric Information / Implications of the Pecking Order /The Trade-OffTheory vs. the Pecking-Order Theory—Some Recent Tests/The Bright Side and the Dark Side of Financial Slack Summary 522

Further Reading 524

Concept Review Questions 524 Quiz 524 Practice Questions 525 Challenge Questions 528

## Chapter 20

#### FINANCING AND VALUATION 529

- 20.1 The After-Tax Weighted-Average Cost of Capital 530 Example: Sangria Corporation /Review of Assumptions
- 20.2 Valuing Businesses 533 Valuing Rio Corporation / Estimating Horizon Value I WACC vs. the Flow-to-Equity Method
- 20.3 Using WACC in Practice 538 Some Tricks of the Trade /Mistakes People Make in Using the Weighted-Average Formula /Adjusting WACC When Debt Ratios or Business Risks Differ/ Unlevering and Relevering Betas / The Importance of Rebalancing / The Modigliani-Miller Formula, Plus Some Final Advice
- 20.4 Adjusted Present Value 546 APVfor the Perpetual Crusher / Other Financing Side Effects /APVfor Businesses /APVfor International Investments
- 20.5 Your Questions Answered 550
  Summary 552
  Further Reading 554
  Concept Review Questions 554
  Quiz 554
  Practice Questions 555
  Challenge Questions 559

Appendix: Discounting Safe, Nominal Cash Flows 559

\_Part Six

# OPTIONS 563

#### Chapter 21

### UNDERSTANDING OPTIONS 564

- 21.1 Calls, Puts, and Shares 565 Call Options and Position Diagrams /Put Options/ Selling Calls, Puts, and Shares / Position Diagrams Are Not Profit Diagrams
- 21.2 Financial Alchemy with Options 569 Spotting the Option
- 21.3 What Determines Option Values? 576 *Risk and Option Values*Summary 582
  Further Reading 582

Concept Review Questions 582

Quiz 583 Practice Questions 584 Challenge Questions 586

#### Chapter 22

## VALUING OPTIONS 588

- 22.1 A Simple Option-Valuation Model 589 Why Discounted Cash Flow Won't Work for Options / Constructing Option Equivalents from Common Stocks and Borrowing / Valuing the Cenentech Put Option
- **22.2** The Binomial Method for Valuing Options 593 Example: The Two-Stage Binomial Method/The General Binomial Method /The Binomial Method and Decision Trees
- **22.3** The Black-Scholes Formula 599 Using the Black-Scholes Formula/The Black-Scholes Formula and the Binomial Method
- 22.4 Black-Scholes in Action 603 Executive Stock Options / Warrants /Portfolio Insurance / Calculating Implied Volatilities
- 22.5 Option Values at a Glance 606
- 22.6 The Option Menagerie 608 Summary 608 Further Reading 609 Concept Review Questions 609 Quiz 609 Practice Questions 610 Challenge Questions 613 Mini-case: Bruce Honiball's Invention 613 Appendix: How Dilution Affects Option Value 615

## <u>Chapter 23</u> REAL OPTIONS 619

- 23.1 The Value of Follow-on Investment Opportunities 620 Questions and Answers about Blitzen's Mark II/Other Expansion Options
- 23.2 The Timing Option 624 Valuing the Malted Herring Option / Optimal Timing for Real Estate Development
- 23.3 The Abandonment Option 627 The Zircon Subductor Project /Abandonment Value and Project Life/Temporary Abandonment
- 23.4 Flexible Production 632
- 23.5 Aircraft Purchase Options 634
- 23.6 A Conceptual Problem? 636 Practical Challenges

Summary 638 Further Reading 638 Concept Review Questions 639 Quiz 639 Practice Questions 640 Challenge Questions 642

#### Part Seven

# DEBT FINANCING 645

#### Chapter 24

## CREDIT RISK AND THE VALUE OF CORPORATE DEBT 646

- 24.1 Yields on Corporate Debt 647 What Determines the Yield Spread?
- 24.2 The Option to Default 651 Valuing the Default Option I Valuing Government Loan Guarantees
- 24.3 Bond Ratings and the Probability of Default 656
- 24.4 Predicting the Probability of Default 658 Credit Scoring /Market-Based Risk Models
- 24.5 Value at Risk 663
  Summary 664
  Further Reading 665
  Concept Review Questions 665
  Quiz 665
  Practice Questions 666
  Challenge Questions 666

## \_\_\_Chapter 25

## THE MANY DIFFERENT KINDS OF DEBT 667

- 25.1 Domestic Bonds, Foreign Bonds, and Eurobonds 668
- 25.2 The Bond Contract 669 Indenture, or Trust Deed/The Bond Terms
- 25.3 Security and Seniority 671 Asset-Backed Securities
- 25.4 Repayment Provisions 674 Sinking Funds /Call Provisions
- 25.5 Debt Covenants 676
- 25.6 Convertible Bonds and Warrants 678 The Value of a Convertible at Maturity /Forcing Conversion I Why Do Companies Issue Convertibles? / Valuing Convertible Bonds /A Variation on Convertible Bonds: Mandatory Convertibles /Another Variation on Convertible Bonds: The Bond-Warrant Package

- 25.7 Private Placements and Project Finance 684 Project Finance / Project Finance—Some Common Features I The Role of Project Finance
- 25.8 Innovation in the Bond Market 688
  Summary 691
  Further Reading 692
  Concept Review Questions 692
  Quiz 692
  Practice Questions 694
  Challenge Questions 696
  Mini-case: The Shocking Demise of

# Chapter 26

## LEASING 698

26.1 What Is a Lease? 698

Mr. Thorndike 697

- 26.2 Why Lease? 699 Sensible Reasons for Leasing / Some Dubious Reasons for Leasing
- 26.3 Operating Leases 703 Example of an Operating Lease / Lease or Buy?
- 26.4 Valuing Financial Leases 706 Example of a Financial Lease I Who Really Owns the Leased Asset? / Leasing and the Internal Revenue Service / A First Pass at Valuing a Lease Contract / The Story So Far
- 26.5 When Do Financial Leases Pay? 712 Leasing Around the World
- 26.6 Leveraged Leases 713
  Summary 714
  Further Reading 715
  Concept Review Questions 716
  Quiz 716
  Practice Questions 717
  Challenge Questions 719

#### Part Eight

# RISK MANAGEMENT 721

<u>Chapter 27</u> MANAGING RISK 722

27.1 Why Manage Risk? 722 Reducing the Risk of Cash Shortfalls or Financial Distress /Agency Costs May Be Mitigated by Risk Management / The Evidence on Risk Management

- 27.2 Insurance 726 How BP Changed Its Insurance Strategy
- 27.3 Forward and Futures Contracts 729 A Simple Forward Contract /Futures Exchanges / The Mechanics of Futures Trading / Trading and Pricing Financial Futures Contracts / Spot and Futures Prices—Commodities /More about Forward Contracts /Homemade Forward Rate Contracts
- 27.4 Swaps 736 Interest Rate Swaps /Currency Swaps / Swaps
- 27.5 How to Set Up a Hedge 741 Using Theory to Set Up the Hedge: An Example/ Options, Deltas, and Betas
- 27.6 Is "Derivative" a Four-Letter Word? 744
  Summary 747
  Further Reading 748
  Concept Review Questions 748
  Quiz 749
  Practice Questions 750
  Challenge Questions 754

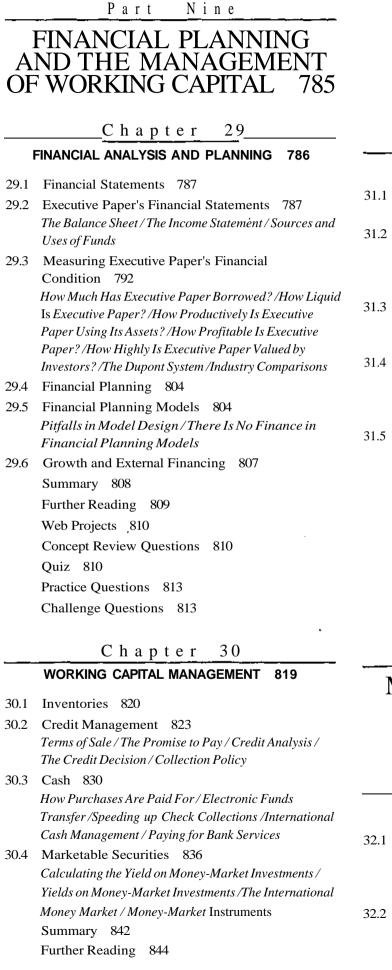
#### <u>Chapter 28</u>

#### MANAGING INTERNATIONAL RISKS 755

- 28.1 The Foreign Exchange Market 755
- 28.2 Some Basic Relationships 757 Interest Rates and Exchange Rates / The Forward Premium and Changes in Spot Rates / Changes in the Exchange Rate and Inflation Rates /
  - Interest Rates and Inflation Rates / Is Life Really That Simple?
- 28.3 Hedging Currency Risk 767 Transaction Exposure and Economic Exposure / Currency Speculation
- 28.4 Exchange Risk and International Investment Decisions 771

More about the Cost of Capital

28.5 Political Risk 774
Summary 776
Further Reading 777
Web Project 778
Concept Review Questions 778
Quiz 778
Practice Questions 780
Challenge Questions 782
Mini-case: Exacta, s.a. 782



Web Projects 844 Concept Review Questions 845 Quiz 845 Practice Questions 847 Challenge Questions 849

#### Chapter 31

#### SHORT-TERM FINANCIAL PLANNING 851

- 31.1 Links between Long-Term and Short-Term Financing Decisions 852
- 31.2 Tracing Changes in Cash and Working Capital 855 Tracing Changes in Net Working Capital/Profits and Cash Flow
- 31.3 Cash Budgeting 859 Preparing the Cash Budget: Inflow/Preparing the Cash Budget: Outflow
- 31.4 The Short-Term Financing Plan 862 Options for Short-Term Financing /Dynamic's Financing Plan / Evaluating the Plan /A Note on Short-Term Financial Planning Models
- 31.5 Sources of Short-Term Borrowing 865 Bank Loans / Commercial Paper /Medium-Term Notes Summary 872
  Further Reading 874 Web Project 874 Concept Review Questions 874 Quiz 875 Practice Questions 876 Challenge Questions 879

Part Ten

MERGERS, CORPORATE CONTROL. AND GOVERNANCE 881

Chapter 32

#### MERGERS 882

- 32.1 Sensible Motives for Mergers 882 Economies of Scale / Economies of Vertical Integration / Complementary Resources / Surplus Funds / Eliminating Inefficiencies /Industry Consolidation
- 32.2 Some Dubious Reasons for Mergers 888 Diversification/Increasing Earnings per Share: The Bootstrap Game/Lower Financing Costs

- 32.3 Estimating Merger Gains and Costs 891 Right and Wrong Ways to Estimate the Benefits of Mergers /More on Estimating Costs—What If the Target's Stock Price Anticipates the Merger?/ Estimating Cost When the Merger Is Financed by Stock I Asymmetric Information
- 32.4 The Mechanics of a Merger 896 Mergers, Antitrust Law, and Popular Opposition /The Form of Acquisition /Merger Accounting / Some Tax Considerations
- 32.5 Proxy Fights, Takeovers, and the Market for Corporate Control 900 Proxy Contests I Takeovers I Oracle Bids for PeopleSoft/ Takeover Defenses / Who Cains Most in Mergers?
- 32.6 Mergers and the Economy 907 Merger Waves /Do Mergers Generate Net Benefits? Summary 909 Further Reading 909 Concept Review Questions 910 Quiz 910

Practice Questions 911 Challenge Questions 913 Appendix: Conglomerate Mergers and Value Additivity 913

## <u>Chapter</u> <u>33</u>

## CORPORATE RESTRUCTURING 916

- 33.1 Leveraged Buyouts 917 *RJR Nabisco /Barbarians at the Gate? /Leveraged Restructurings ILBOs and Leveraged Restructurings*
- 33.2 Fusion and Fission in Corporate Finance 921 Spin-offs /Carve-outs /Asset Sales /Privatization
- 33.3 Private Equity 927 Private-Equity Partnerships I Are Private-Equity Funds Today's Conglomerates?
- 33.4 Bankruptcy 933
  Is Chapter 11 Efficient?!'Workouts/Alternative Bankruptcy Procedures
  Summary 938
  Further Reading 939
  Concept Review Questions 940
  Quiz 940
  Practice Questions 941
  - \_\_Chapter 34\_

### GOVERNANCE AND CORPORATE CONTROL AROUND THE WORLD 943

34.1 Financial Markets and Institutions 944 Investor Protection and the Development of Financial Markets

- 34.2 Ownership, Control, and Governance 948 Ownership and Control in Japan/Ownership and Control in Germany/European Boards of Directors/ Ownership and Control in Other Countries/ Conglomerates Revisited
- 34.3 Do These Differences Matter? 957 Risk and Short-termism / Growth Industries and Declining Industries /Transparency and Governance Summary 961 Further Reading 963 Concept Review Questions 963 Quiz 963 Practice Questions 964

Practice Questions 964

## <u>Part Eleven</u> CONCLUSION 966

## <u>Chapter 35</u>

## CONCLUSION: WHAT WE DO AND DO NOT KNOW ABOUT FINANCE 966

35.1 What We Do Know: The Seven Most Important Ideas in Finance 966

 Net Present Value/2. The Capital Asset Pricing Model / 3. Efficient Capital Markets /4. Value Additivity and the Law of Conservation of Value/
 Capital Structure Theory /6. Option Theory/
 Agency Theory

- 35.2 What We Do Not Know: 10 Unsolved Problems in Finance 969
  - 1. What Determines Project Risk and Present Value? / 2. Risk and Return—What Have We Missed? / 3, How Important Are the Exceptions to the Efficient-Market Theory? /4. Is Management an Off-Balance-Sheet Liability? /5. How Can We Explain the Success of New Securities and New Markets? / 6. How Can We Resolve the Payout Controversy? 17. What Risks Should a Firm Take? /8. What Is the Value of Liquidity? 19. How Can We Explain Merger Waves? /10. How Can We Explain International Differences in Financial Architecture?
- 35.3 A Final Word 976

Appendix A Present Value Tables A Appendix B Answers to Quizzes B Glossary G Global Index 1-1 General Index 1-7