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EUGENE F. BRIGHAM  
JOEL F. HOUSTON



THE CONCISE EDITION

FUNDAMENTALS  
OF  
FINANCIAL  
MANAGEMENT

# FUNDAMENTALS OF FINANCIAL MANAGEMENT



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EUGENE F. BRIGHAM  
JOEL F. HOUSTON  
UNIVERSITY OF FLORIDA



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# PREFACE

Finance is an exciting, challenging, and ever-changing discipline. *Fundamentals of Financial Management* was first published 18 years ago, and since then we have tried to reflect changes in the world of finance in each new edition, along with the latest innovations in education and publishing. These changes have resulted in a better, more complete textbook, but one that is much longer than it was originally. This may present a problem: today, covering the textbook in a single term is increasingly difficult. Not only is size an issue, but cost is, as well.

When we became aware of the problem, we turned to students and other professors for advice. Some students and professors advised us not to worry about the size issue. They argued that a larger, more complete textbook is better because it provides professors more flexibility in designing their courses, is better as a reference for students after they complete the course, and is better because it allows interested students to read chapters not covered in the course on their own. Others took a different position, arguing that as a textbook gets larger, it becomes increasingly difficult to develop a manageable syllabus, and that many students buy a larger, more expensive textbook than they want or need. In the end, we concluded that both arguments have merit, so we decided to create *Fundamentals of Financial Management: The Concise Edition (FFM-C)* for those who like *Fundamentals* but think a smaller, more concise textbook would better serve their needs.

## THE PRICE FACTOR

Another motivating factor behind the development of *FFM-C* was to reduce the price of the textbook. When asking professors about our ideas for streamlining the textbook, we heard the importance of price. It makes sense that a “smaller” textbook should be less expensive. Dryden priced this textbook at a suggested retail price of \$39.99, which we believe is an educational value whose low cost and high quality will benefit students.

## INTENDED MARKET AND USE

Like *Fundamentals*, *FFM-C* is intended for use in the introductory finance course. Unlike the larger textbook, it is possible to cover *FFM-C* in a single term, and per-

haps even to supplement it with a few outside readings or cases. *FFM-C* may also be used in courses in which the material is covered in two terms, allowing professors the flexibility to assign even more additional cases, readings, and exercises.

Although the chapters in *FFM-C* are sequenced logically, they are written in a flexible, modular format, allowing instructors to cover the material in a different sequence.

## STEPS TAKEN TO STREAMLINE THE TEXTBOOK

We debated streamlining the textbook either by covering the same topics in less depth or by covering fewer topics, but with the same depth and rigor as in *Fundamentals*. We chose to retain the depth and level of rigor in *Fundamentals*, while eliminating some dispensable topics. While these topics are interesting and important, they are typically covered in subsequent courses. Consequently, many instructors do not attempt to cover them in the introductory course. Such core topics as the time value of money, the relationship between risk and return, the financial environment, and financial statements are still discussed in great detail.

Accordingly, we reduced *FFM-C* from 22 to 16 chapters, or by 6 chapters, in two steps. First, we eliminated the three chapters on hybrid securities, mergers, and international finance. We address these issues in other parts of the textbook, but in less depth than was contained in the deleted chapters. Second, we consolidated (a) the three chapters on stocks, bonds, and security valuation into two chapters; (b) the three chapters on capital budgeting into two chapters; and (c) the three chapters on working capital into two chapters. Thus, these consolidations eliminated three more chapters.

These consolidations produced some unexpected benefits. First, moving the institutional material on bonds and stocks from late in the textbook to the beginning of the new valuation chapters enables students to understand better the nature of bonds, stocks, and the markets in which they trade, which helps students understand the valuation process. Second, consolidating the capital budgeting and working capital chapters enabled us to delete details that do little to help students understand the basic issues. To some extent, students had difficulty seeing the forest for the trees, and it helped to remove a few trees.

*FFM-C* is significantly different from *Fundamentals*, but most of the chapters will be familiar to users of *Fundamentals*. While we pruned some material and clarified, updated, and otherwise improved all the chapters, *FFM-C* should still be regarded as an alternative version of *Fundamentals* rather than as a *de novo* textbook.

## FEATURES OF THE BOOK

Although *FFM-C* is a streamlined version of *Fundamentals*, we did retain all the pedagogical elements and supporting materials which helped make the larger textbook so successful. Included are the following items:

- Each chapter opens with a vignette describing how an actual corporation has contended with the issues discussed in the chapter. These vignettes heighten students' interest by pointing out the real-world relevance and applicability of what might otherwise seem to be dry, technical material.

- Throughout the book, there are boxes which provide additional real-world illustrations of how the finance concepts covered in the chapter are applied in practice.
- An “Integrated Case,” generally relating to the vignette, appears at the end of each chapter, illustrating the topics covered in the chapter. These cases are ideal for use as the basis for lectures—going through them systematically covers the key material in the chapter. Instructors can also assign the cases as comprehensive study problems.
- A large number of end-of-chapter questions, problems, and exam-type problems varying in level of difficulty thoroughly cover the various topics.
- Most chapters contain a “Computer-Related Problem,” enabling students to use a computer spreadsheet program such as *Lotus 1-2-3* or *Microsoft Excel* to answer a set of questions. These problems reinforce the concepts covered in the chapter and provide students with an opportunity to become more proficient with computers. Our models for these problems are available to instructors, who can, if they choose, make them available to students.
- Throughout the textbook, key terms are highlighted in the text and defined in the margins. This enables students to quickly find and review key topics within the chapter. International references are also defined in the margins.
- Self-Test questions are provided after each major section within each chapter. These questions provide useful check points for students to test their understanding.

### THE INSTRUCTIONAL PACKAGE: AN INTEGRATED SYSTEM

*FFM-C* includes a broad range of ancillary materials designed to enhance the student’s learning experience, while making it easier for the instructor to prepare for and conduct classes. The ancillaries are described below:

1. **Instructor’s Manual.** This comprehensive manual contains answers to all text questions and problems, as well as detailed solutions to the integrated cases. At the suggestion of numerous instructors, the format of the *Instructor’s Manual* was changed from the format of *Fundamentals’ Instructor’s Manual* so that all elements for a given chapter (lecture tips, answers to questions, solutions to problems, solutions to integrated cases, and solutions to computer-related problems) are given together. If a computerized version of the IM would help in class preparation, instructors can contact The Dryden Press for a copy.
2. **Lecture Presentation Software or Computerized Lecture Slide Show.** This ancillary, formatted in Microsoft PowerPoint, is a computer graphics slide show covering all the essential issues presented in the chapter. Graphs, tables, lists of points, and calculations are developed sequentially, much as one might develop them on a blackboard. However, the slides are more crisp and clear with use of color coding to tie elements of a given slide together, and they are generally more polished than anything previously available. The slides for *FFM-C* are similar to those provided with *Fundamentals*, which were initially developed with the assistance of Dr. Larry Wolken of Texas A&M University. On their end-of-course evaluations, our students over-

whelmingly liked the slides and recommended that we continue using them as an integral part of our lectures.

When we first began using the slide show, we were concerned about the lack of flexibility in the classroom, thinking that although one can navigate easily from slide to slide, one cannot change the slides themselves in the classroom. Our fears were unfounded. We had spent a great deal of time designing the slides, using examples and materials that would be appropriate in almost any lecture situation. When we used the slide show in class, we discovered that we can easily depart from it by going to the blackboard, which also provides variety and spontaneity. Now, the slides provide the backbone of our lectures, and we spice them up by going to the blackboard to address current events, present alternative examples, and answer questions.

The fact that the *FFM-C* set of slides is available in *PowerPoint* should also allow more flexibility for instructors. It is our understanding that *Microsoft Office* is one of, if not *the*, most popular packages in the country. We reasoned that if the vast majority of professors already had access to *PowerPoint*, the slide show would be of even greater benefit because of the ease of making any type of changes to it—colors, text, organization, and style, to name a few.

3. **Blueprints.** This supplement was first developed several years ago for the purpose of guiding students through the chapter material. Since the integrated cases systematically cover the key points in the chapters, and the examples in these cases are designed to explain both logical relationships and calculations, we use them as the basis for both *Blueprints* and the lectures.

As lectures move away from the blackboard, it becomes increasingly important to provide students with a hard copy of the lecture materials, thus enabling students to focus on the lecture and still develop a complete set of notes. With this in mind, we have continually modified *Blueprints* to maximize its benefit to students.

Originally, *Blueprints* contained the lecture case and partially completed solutions which the students completed during the course of the lecture. It worked well, receiving favorable feedback from our students and from other instructors who used it in their classes. However, once we chose the slide show format, we concluded that students would best be served with a completely revamped version of *Blueprints*. Each chapter of the new *Blueprints* begins with the case itself, followed by copies of the slides—with space for notes and comments. At the end of each chapter, we include several example problems which are either covered in class or left up to the students to solve on their own. Now students can watch and listen to the lecture, yet still end up with a good set of notes.

The new *Blueprints* has several other advantages. First, it offers more flexibility for presenting alternative examples and discussing current events because, as mentioned previously, students have a complete set of notes, regardless of whether all of the materials in the case (chapter) are discussed in the lecture. Second, because the professor's notes are also the lecture notes, and because the professor's comments about the slides can be placed next to the slides in the space provided, the slides and alternative examples reinforce one another. This helps students to better relate the professor's comments to the slides and to develop a better set of notes.

Each term, we use a course pack consisting of the syllabus, some old exams, and *Blueprints*, made available to students through an off-campus copy

center. We also make available 10- to 12-page write-ups on several popular calculators (see “Technology Supplement” below) which can be selectively added to the course pack by students.

4. **Test Bank.** Although some instructors do not prefer multiple-choice questions, they do provide a good means of testing students in many situations. It is critically important, however, that the questions be unambiguous and be consistent with the lectures and assigned readings. To meet this need, a revised and enlarged *Test Bank* with more than 1,200 class-tested questions and problems is available both in book form and on diskettes. A number of new and thoroughly class-tested conceptual questions and problems, which range in level of difficulty, have been added to the *Test Bank* for FFM-C. Information regarding the topics covered, the degree of difficulty, and the correct answer, along with complete solutions for all numerical problems, is provided with each question. Questions which require the use of a financial calculator are grouped together in a separate section at the end of each chapter.

A complete *Test Bank* is offered in the *WordPerfect* format for instructors who are more comfortable with that program. Answer keys are automatically generated for each version of an exam—the solutions always following the problems. One can, of course, utilize all the features of *WordPerfect* to customize tests.

The *Test Bank* is also available in Dryden’s **computerized test bank form (EXAMaster+)**. This software has many features that make test preparation, scoring, and grade recording easy. For example, **EXAMaster+** allows automatic conversion of multiple-choice questions and problems into free-response questions. The order of test questions can be altered to make different versions of a given test. In addition, the software permits the user to add to and edit the existing test items, and, through key-word searches and qualifier screening, the user can easily compile a test covering specific topics.

5. **Supplemental Test Bank.** A *Supplemental Test Bank* will be provided in the future each year. Instructors obviously use the *Test Bank* for exams, but some also like to provide students with samples of *Test Bank* questions for study purposes. Instructors also use *Test Bank* questions for pre-exam reviews. This multiple usage can exhaust even the largest of *Test Banks*. Since we develop new problems in our own classes each term, we decided to provide these new problems on a more timely basis through the use of this annual *Supplemental Test Bank*.
6. **Supplemental Problems.** A set of additional problems similar to the end-of-chapter problems, organized according to topic and level of difficulty, is available with this textbook. The Dryden Press will provide this problem set to instructors upon request.
7. **Problem Diskette.** A diskette containing spreadsheet models for the computer-related end-of-chapter problems is also available. To obtain the diskette, contact The Dryden Press.
8. **Data Disk.** In the textbook itself we incorporate many real-company examples to better illustrate how the concepts apply to actual companies. However, several professors involved in a focus group suggested that we should take this emphasis one step further and provide instructors with real-company data in a computerized form. Although in most introductory

courses students do not have the opportunity to do much computer work, this may change in the not-so-distant future. Thus, with the help of Stan Eakins of East Carolina University, we have put together a set of financial data from several companies along with a set of key economic statistics, including interest rates and stock market indices.

9. **Technology Supplement.** The *Technology Supplement* contains tutorials for five commonly used financial calculators and for *Lotus 1-2-3*. The 1-2-3 tutorial can be used, with slight modifications, with *Microsoft Excel* or other spreadsheets. The calculator tutorials cover everything a student needs to know about the calculator to work the problems in the text, and we provide them as a part of our course pack. These tutorials are generally about 12 typewritten pages. Some students are intimidated by the rather large manuals that accompany the calculators, and they find our brief, course-specific versions easier to use to get started.
10. **Video Package: Integrating Print and Video Technologies.** We live in a visually oriented world, so it is important that we take advantage of the educational tools available through video. It was a long process, but with the tremendous help of Sarah Bryant and Scott Weiss of George Washington University and Brett Spalding of Archipelago Productions, a complete video package consisting of 10-minute tapes to accompany each chapter was developed for the seventh edition of *Fundamentals*. The videos were developed on the assumption that students will view them in class before the relevant chapter is covered. In addition to introducing the main ideas of the chapter, each video includes either news footage regarding the company and/or situation presented in the chapter's opening vignette, or a very similar situation. The video closes with a lead-in to the chapter and, in general terms, to the integrated case at the end of the chapter.

Instructors do not have to assign or utilize either the opening vignette or the integrated case to show the videos, or vice versa. There are many different classroom settings and course objectives, and our video format will not meet all needs. However, we believe that many of you will find these videos extremely useful. To hold costs down, the videos were not edited or updated to coincide with the changes made in the concise version of *Fundamentals*. Nevertheless, the *Fundamentals* videos will go well with *FFM-C*, and The Dryden Press will provide them to instructors who adopt this textbook.

11. **Finance by FAX.** One of the difficulties inherent in textbooks is trying to keep them current in a constantly changing world. When Orange County goes bankrupt or Barings Bank collapses or Procter & Gamble loses \$200 million, it would be useful to relate these events to the textbook. Fortunately, a new communications technology—the fax machine—can help us keep up to date. By contacting your Dryden sales representative and providing your departmental fax number, you, the instructor, can receive a one-page fax every two weeks. This faxed information will cite one or two recent articles in *The Wall Street Journal*, *Business Week*, and other major business publications and provide summaries, discussion questions, and references to the text to facilitate the incorporation of late-breaking news in class discussions. One can also use the accompanying questions for quizzes and exams.

In addition to updates via the fax machine, this information will also be available on The Dryden Press Bulletin Board, “Dryden On-Line.” With a modem and communication software, professors can connect with Dryden

On-Line by dialing 1-800-950-1299. The Dryden Bulletin Board is developing quickly with teaching information posted regularly.

A number of additional items are offered for students, as described here:

1. **Study Guide.** This supplement outlines the key sections of each chapter, provides students with self-test questions, and provides a set of problems and solutions similar to those in the text and in the *Test Bank*.
2. **Cases and Casebooks.** A set of 64 cases written by Eugene F. Brigham, Louis C. Gapenski, and others is now in a custom case bank which allows instructors to select cases for their own customized casebook. These cases can be used to illustrate the various topics covered in the textbook. The cases come in directed and nondirected versions (with and without guidance questions), with most of the cases having accompanying spreadsheet models. The models are not essential for working the cases, but they do reduce number crunching and thus leave more time for students to consider conceptual issues.
3. **Finance with Lotus 1-2-3: Text and Models.** In its second edition, this textbook by Eugene F. Brigham, Dana A. Aberwald, and Louis C. Gapenski (Dryden Press, 1992) enables students to learn, on their own, how to use *Lotus 1-2-3* and apply it to financial decisions. This textbook takes students from formatting and copying diskettes to the development of macros and other complex procedures, and it also provides students with substantially more information about spreadsheet modeling than does the *Technology Supplement*.

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## ERRORS IN THE TEXTBOOK

At this point, most authors make a statement like this: "We appreciate all the help we received from the people listed here but any remaining errors are, of course, our own responsibility." And generally there are more than enough remaining errors. Having experienced difficulties with errors ourselves, both as students and as instructors, we resolved to avoid this problem in *Fundamentals of Financial Management: The Concise Edition*. As a result of our detection procedures, we are convinced that the book is relatively free of significant errors, meaning those that either confuse or distract readers.

Partly because of our confidence that few such errors remain, but primarily because we want very much to detect those errors that may have slipped by to correct them in subsequent printings, we decided to offer a reward of \$10.00 per error to the first person who reports it to us. For purposes of this reward, errors are defined as misspelled words, nonrounding numerical errors, incorrect statements, and any other error that inhibits comprehension. Typesetting problems such as irregular spacing and differences in opinion regarding grammatical or punctuation conventions do not qualify for the reward. Finally, any qualifying error that has follow-through effects is counted as two errors only. Please report any errors to us at the address given below.

## CONCLUSION

Finance is, in a real sense, the cornerstone of the enterprise system—good financial management is vitally important to the economic health of business firms, and hence to the nation and the world. Because of its importance, finance should be widely and thoroughly understood, but this is easier said than done. The field is relatively complex, and it is undergoing constant change in response to shifts in economic conditions. All of this makes finance stimulating and exciting but also challenging and sometimes perplexing. We sincerely hope that this concise edition of *Fundamentals* will meet its own challenge by contributing to a better understanding of our financial system.

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