



# INTRODUCTION TO FINANCIAL MANAGEMENT

LAWRENCE D. SCHALL  
CHARLES W. HALEY

SIXTH  
EDITION

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# **INTRODUCTION TO FINANCIAL MANAGEMENT**

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## ***INTRODUCTION TO FINANCIAL MANAGEMENT***

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# ***PREFACE***



In this edition our primary goal is to provide students with a thorough foundation in finance. For many students the introductory course is the only exposure to finance, and we cover all the material that we believe is essential to a comprehensive understanding of financial management. In today's world such an understanding must include international aspects of finance, and we have integrated international issues throughout. Although the text covers a wide range of topics and issues, we have treated the material at an introductory level in all cases. Our method has been to explain the main issues very carefully in order to provide the student with an intuitive understanding of finance concepts and an appreciation of the way those concepts are applied in practice.

The text does not neglect students who will be taking additional courses in finance. Basic principles, techniques, and institutional aspects needed for effective analysis of business finance cases are well covered. A foundation for more advanced theoretical courses is provided in the chapter appendixes and in Chapters 6 and 9. Throughout we have tried to ensure that our approach here is consistent with current theory. Students completing a course of study using this book should be well prepared for courses in investments because of our stress on risk and return in the financial markets and our coverage of the basic characteristics of securities and markets.

The book is designed for undergraduate one-quarter or one-semester courses, although it is unlikely that all chapters can be assigned in a single course. If supplemented by cases and readings, it will be suitable as the primary text for courses extending two quarters or more. Instructors using this text for an introductory course for MBA students will find that Chapters 6 and 9 and the appendixes to Chapters 4, 5, 8, 9, 12, and 17 enable them to approach basic finance on a more advanced level.

We have made a special effort to provide an integrated discussion of the topics covered. Nevertheless, the book has been designed to offer great flexibility in choosing the order of presentation of most chapters. Furthermore, many chapters have one or more sections that can be deleted without any loss of continuity. Appendixes in several chapters explore major concepts in greater depth. These are intended as supplements to the basic

coverage in the text and are designed for use by well-prepared undergraduate and beginning graduate students.

The first six chapters provide an introduction to the book and an introduction to finance in general. In Part 1 we examine the general nature of financial management, the financial system, taxes and other legal issues, organization, compound-interest calculations, risk, and the principles of market valuation.

Parts 2 through 4 cover the basic concepts and techniques of financial management. Part 2 is concerned with long-term decisions involving investments and financing, including dividend policy. Part 3 explores techniques of financial analysis, including ratio analysis, funds flow, break-even analysis, and forecasting. Part 4 deals with the problems of managing the firm's current assets and current liabilities. The discussion in Part 4 is unusual in that the firm's working capital decisions are explicitly linked to the discussion of long-term investment and financing decisions in Part 2.

Parts 5 deals with several special topics that are often not covered in an introductory course. This section covers leasing as a method of financing, the characteristics of securities involving options including convertible debt and warrants, holding companies, mergers, and acquisition.

## **CHANGES IN THE SIXTH EDITION**

In this edition we decided to reorganize the text. The two objectives in this reorganization were to integrate international aspects of financial management throughout and to make all topics more accessible to students. The specific changes include:

- 1 Integration of international material into all chapters where it is relevant. This includes the majority of chapters.
- 2 A new Chapter 3 on the legal environment including organizational form, taxes, and bankruptcy. The tax treatment is up to date as of the beginning of 1990.
- 3 A new Chapter 9 on special topics in capital budgeting. Chapter 8 now provides the fundamentals of capital budgeting.
- 4 A new Chapter 11 that describes the major types of securities issued by firms and the issuing process. Chapter 12 focuses on the decision as to which securities to issue.
- 5 Current asset management is now covered in two chapters—Chapter 17 dealing with inventory and accounts receivable management and Chapter 18 dealing with cash and securities management.
- 6 The majority of problems are new or revised from the fifth edition and many of them have an international focus.

## **TEXT ORGANIZATION AND SUPPLEMENTARY MATERIALS**

Although this book has been written to offer substantial latitude in selecting which chapters to cover and their order of presentation, we suggest that certain chapters be taught in a given order. Chapters 4, 5, 7, 8, 11, 14, 16, and 17 are prerequisites for certain other chapters. Specifically, Chapter 4 should precede Chapter 5, and Chapters 4 and 5 should precede all of Part 2 (Chapters 7 through 13). We recommend that the

chapters in Part 2 be taught in sequence. However, not all of this material need be covered. A complete discussion of the possibilities for alternative sequences is included in the *Instructor's Manual* for the text. Many instructors may choose to assign Chapters 14, 15, and 16—which cover financial statement analysis, break-even analysis, and forecasting, respectively—early in the course. This can be done with no difficulty, although the discussion of financial leverage in Chapter 15 is most effectively taught if it is presented after Chapter 12. A sequence that we find quite workable in one quarter consists of Chapters 1 through 5, 7 through 14 and 16 through 20.

Students come to the basic finance course with a wide range of prior preparation in accounting, mathematics, and economics. We have assumed minimal background in these areas, but we do expect that students have had at least one quarter of financial accounting shortly before taking the class. Able students should be capable of mastering the material almost without regard to their previous formal course work. We have tried to make the book as self-contained as possible and, through extensive use of examples, to make it suitable for self-study. Many of the problems are suitable for solution using a microcomputer, and a software disk designed for this text is available.

As an aid to students, many instructors recommend a study guide when such is available. The *Study Guide* written by Thomas E. Stitzel serves as an excellent review and supplement to this book. It contains additional solved problems as well as questions in a programmed learning format. We believe that many students will find this supplement helpful.

The *Instructor's Manual* includes a substantial amount of supplementary teaching material, as well as recommended course outlines, a test bank, and answers to text questions and problems. Overhead transparencies are available upon adoption.

The test items are available from McGraw-Hill, Inc., on the Rhtest microcomputer system for computerized test generation. These systems can be obtained by contacting your local McGraw-Hill representative.

The *Computer Models* software package contains a series of spreadsheets to solve many of the problems contained within the text. The spreadsheets are arranged by chapters and cover the major topics of the text.

## **ACKNOWLEDGMENTS**

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The editorial staff at McGraw-Hill has been a critical resource for us. Kaye Pace, Editor in Chief of Business and Economics, gave us early encouragement and support on this project. Finance Editors Suzanne BeDell and Kenneth MacLeod guided this edition through its various stages and were encouraging supporters at every turn. And we remain deeply indebted to Marjorie Singer, whose numerous recommendations and suggestions were invaluable in our writing the first and second editions; her legacy lives on in the sixth edition. Finally, the book could not have been written without the continued support of Anne Haley.

*Lawrence D. Schall*  
*Charles W. Haley*

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# THE ENVIRONMENT OF FINANCIAL DECISIONS

*Part 1 consists of six chapters in which we present the general background for individual and company financial decisions. Chapter 1 is an introduction to business finance and to this text. Here we discuss the nature and objectives of financial management. In Chapter 2 we examine the American financial system: the network of financial institutions and markets that is an important part of the financial manager's environment. Chapter 3 covers other aspects of this environment, the legal form of business organizations, the tax laws that affect financial decisions, and financial distress. Whereas the material in the first three chapters is largely descriptive, in Chapter 4 we develop a fundamental financial concept, the time value of money. We show here how to solve a variety of basic financial problems involving time and money. Chapter 5 explains how securities (bonds and stocks)*

*are valued in the market, and examines the theory of efficient markets. In an appendix, we discuss the term structure of interest rates. Chapter 6 explores the concept of risk and shows how risk affects the value of securities. We introduce a model of financial market equilibrium—the Capital Asset Pricing Model—and discuss its implications for financial management.*

*The material in Part 1 is important not just to the managers of business firms. Most of the topics covered are of equal importance to an individual concerned with such financial problems as borrowing money and choosing alternative ways of investing personal savings. The remainder of the text is almost exclusively concerned with problems faced by financial managers; but these first six chapters cover financial concepts that are useful to everyone.*

