

Principles of Financial Management



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Preface

Some of you may be familiar with the chronic complaint of the college professor, "I have found a book from which to lecture; now if I can only find one for the students to read." This book is for the students to read.

This is not a book about finance theory per se, nor does it set out to describe academic research. On the contrary, it is a book which deals with the major problems of corporate finance, explicitly from the viewpoint of the financial manager. However the book is a product of our underlying conviction that the modern theory of finance can (and does) provide useful guidelines for practical financial management.

It is a book about corporate financial decisions and how they are made. As such, it emphasizes the practical application of finance theory to actual problems in the uncertain environment which characterizes the business world. The book does not purport to solve all of the financial problems confronting the firm; however it is designed to help you *ask* the relevant questions at the proper time. Recognition of new problems in a changing environment, and developing the skills to deal with them, is a challenging but rewarding task. And as you will soon learn it can also be a lot of fun, just as writing this book has been for us.

If you have an eye for a graph and do not have an aversion to numerical examples you are well prepared to understand the text. Unnecessary complexities and mathematical formulations have been ruthlessly weeded out. All you really need is the desire to understand the logic of financial decisions and the common sense to want to learn more than common sense alone can teach you about them.

The book is completely self-contained; no rigid prerequisites beyond a reasonable secondary education are necessary, although some familiarity with elementary accounting and statistics can be helpful. But as we are risk-averse, each chapter contains a detailed summary, a review exercise (and answers), sample problems and their step-by-step solutions, a glossary of key terms (marked in bold face), questions, problems, and annotated suggestions for further reading. In addition, a computer disk is available which provides templates for those problems that have been designated as "computer problems". Finally, a study guide (Tom O'Brien, *Study Guide to Principles of Financial Management*, Prentice-Hall, 1988) includes additional insights, study material, and problems.

Financial management in practice and in theory is a dynamic, ever-

changing subject. We have expended every effort to reflect these changes in the text. For example, the United States tax reform has had a significant impact on the substance of the theory of finance. Therefore old theorems have been discarded or replaced and the implications of the new tax environment for financial decision-making are spelled out. Similarly, important innovations have made deep inroads into the way we view traditional financing problems. The book is designed to help you enter, and learn to survive in, the colorful world of “green shoes,” “white knights,” “options,” and “leveraged buyouts.” Finally, the stock market collapse of October 19, 1987, a day that has come to be called “Black Monday,” is examined in an appendix on the “Crash of ’87.” In short, everything you have wanted to know about modern financial management—but perhaps were afraid to ask.

A book like this is the result of the efforts of many people and, as a result, we have accumulated a long list of people whose help we want to acknowledge. Frank Cross, the University of Texas at Austin, wrote Chapter 2 on the business and tax environment. George Szpiro, Hebrew University, coauthored the Instructor’s Manual and provided the software templates. Ghassem Homaifar, Middle Tennessee State University, compiled the Test Item File. Helpful comments and criticism were received from the following:

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This list is far from complete, but it would be remiss indeed not to mention our many colleagues at Hebrew University and at the University of Florida. We have picked their brains without mercy and much of what is good in this book reflects their comments and suggestions. Finally, thanks are due to the students at Hebrew University, University of Florida, New York University, and U.C.L.A. who served as a sounding board for much of the material.

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