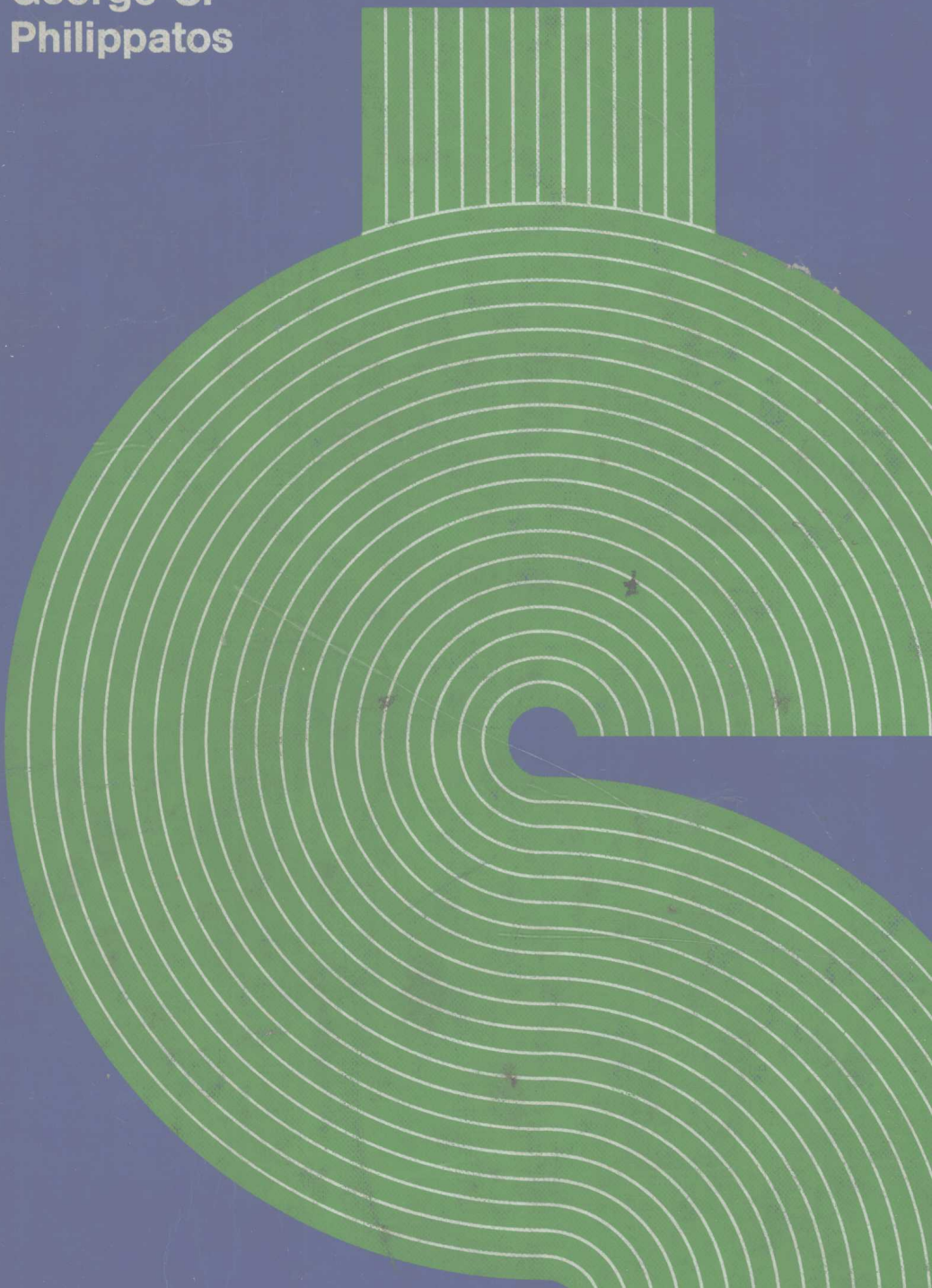
Financial Management
Theory and Techniques

George C.
Philippatos



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FINANCIAL MANAGEMENT
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To Liana and Crito

Preface

The scope and methodology of modern financial management have undergone a series of significant transformations during the past 15 years. A combination of internal and external developments has changed the discipline from a descriptive body of knowledge, concerned with financial instruments and institutions, to an analytically oriented field of study, with a full complement of advanced mathematical and statistical methodology. As is typical in such situations, the existing textual material has not been successful at capturing the spirit and flavor of the dynamic changes. Thus the present volume attempts to synthesize the analytical and empirical developments from several disciplines into a unified framework dealing with the problems encountered in financial management.

The material in this book is presented along two converging paths: theoretical considerations and policy implications of various financial decisions and techniques for financial decisions. The book is organized into seven parts. Part I explores the implications of various theories of business behavior on the financial theory of the firm. Parts II and III introduce the investment and financing decisions of the corporation. Part IV briefly deals with the major decisions involved in the administration of short-term sources and uses of funds. Part V relates the corporate decisions on budgeting and financing to market expectations and the valuation of the enterprise. Part VI extends

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the investment decision to account for the beneficial effects of diversification, within the framework of portfolio selection. Part VII introduces a number of sophisticated techniques and their applications to various decisions encountered earlier in the text.

The book has been designed for use in advanced undergraduate courses in financial management and business economics, and first-year graduate courses in the same subjects. When used in undergraduate courses, it is recommended for a two-term sequence of theory followed by techniques. Intensive utilization of the text can be achieved by reference to the mathematical appendices provided at the end of most chapters.

I would like to express my gratitude to a number of gifted colleagues who have taken time during the past six years to test the manuscript in their courses in order to improve the content and presentation of the material. Valuable feedback has been provided by Professors R. J. Brown, A. J. Curley, J. R. Ezzell, and N. Gressis, The Pennsylvania State University; A. Eubank, The University of Missouri, Columbia; R. Reilly, University of Michigan; R. Curcio, Kent State University; T. Martell, University of Alabama; R. Malcolm, Lycoming College; W. Busse von Colbe, Ruhr Universität Bochum; G. Franke, Universität des Saärlandes; and E. Billeter-Frey, University of Fribourg. In addition, Professors J. A. Haslem, University of Maryland, N. H. Hakansson, University of California at Berkeley, and R. W. Roll, Carnegie-Mellon University, read the entire manuscript and provided very constructive criticism. Needless to say, since their advice was not always followed, they are absolved from the final responsibility for the remaining shortcomings. I would also like to express my gratitude to our dean, Ossian MacKenzie, for his enthusiastic support of this project, and to the editorial staff at Holden-Day for a very thorough and professional job.

Able research assistance was provided by J. Cunningham, L. Lalitsasivimol, T. Paisley, and T. Webber. Finally, the fantastic amount of secretarial work through the many versions of this manuscript was cheerfully performed by Helen R. Mueller, who was assisted by Jeune G. Kilian, Paula May, and Barbara L. Smith.

A small note of appreciation must also go to my wife, Liana, and my son, Crito, to whom this book is dedicated. May the acceptance of this book by colleagues justify the countless hours spent away from my family.

George C. Philippatos
University Park, Pennsylvania

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