



FIFTH EDITION

ANALYSIS
FOR FINANCIAL
MANAGEMENT

ROBERT C. HIGGINS

ANALYSIS FOR FINANCIAL MANAGEMENT

Fifth Edition

ROBERT C. HIGGINS

The University of Washington



**Irwin
McGraw-Hill**

Boston, Massachusetts Burr Ridge, Illinois
Dubuque, Iowa Madison, Wisconsin
New York, New York San Francisco, California
St. Louis, Missouri

Irwin/McGraw-Hill

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ANALYSIS FOR FINANCIAL MANAGEMENT

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This book is printed on acid-free paper.

4 5 7 8 9 0 DOC/DOC 9 0 9

ISBN 0-256-16703-6

Vice president and editorial director: *Michael W. Junior*

Publisher: *Gary Burke*

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Designer: *Matthew Baldwin*

Compositor: *GAC/Shepard Poorman*

Typeface: *11/13 Times Roman*

Printer: *R. R. Donnelley & Sons Company*

Library of Congress Cataloging in-Publication Data

Higgins, Robert C.

Analysis for financial management / Robert C. Higgins.—5th ed.
p. cm.

Includes index.

ISBN 0-256-16703-6 (alk. paper)

1. Corporations—Finance.

HG4026.H496 1998

658.15'1—dc21

97-17268

<http://www.mhhe.com>

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*In memory of Alex Robichek
teacher, colleague, and friend.*

P R E F A C E

Like its predecessors, the fifth edition of *Analysis for Financial Management* is for nonfinancial executives and business students interested in the practice of financial management. It introduces standard techniques and recent advances in a practical, intuitive way. The book assumes no prior background beyond a rudimentary and perhaps rusty familiarity with financial statements, although a healthy curiosity about what makes business tick is also useful. Emphasis throughout is on the managerial implications of financial analysis.

Analysis for Financial Management should prove valuable to individuals interested in sharpening their managerial skills and to participants in executive programs. The book has also found a home in university classrooms as the sole text in applied finance courses, as a companion text in case-oriented courses, and as a supplementary piece in more theoretical finance courses.

Analysis for Financial Management is my attempt to translate into another medium the enjoyment and stimulation I have experienced over the past three decades working with executives and college students. This experience has convinced me that financial techniques and concepts need not be abstract or obtuse; that recent advances in the field such as market signaling, market efficiency, and capital asset pricing are important to practitioners; and that finance has much to say about the broader aspects of company management. I also believe any activity in which so much money changes hands so quickly cannot fail to be interesting.

Part I looks at the management of existing resources, including the use of financial statements and ratio analysis to assess a company's financial health, its strengths, weaknesses, recent performance, and future prospects. Emphasis throughout is on the ties between a company's operating activities and its financial performance. A recurring theme is that a business must be viewed as an integrated whole and effective financial management is possible only within the context of a company's broader operating characteristics and strategies.

The rest of the book deals with the acquisition and management of new resources. Part II examines financial forecasting and planning with particular emphasis on managing growth and decline. Part III considers

the financing of company operations, including a review of the principal security types, the markets in which they trade, and the proper choice of security type by the issuing company. The latter requires a close look at financial leverage and its effect on the firm and the firm's shareholders.

Part IV deals with the use of discounted cash flow techniques, such as the net present value and the internal rate of return, to evaluate investment opportunities. It also addresses the difficult task of incorporating risk into investment appraisal. The book concludes with an examination of business valuation and company restructuring within the context of the ongoing debate over the proper roles of shareholders, boards of directors, and incumbent managers in governing America's public corporations.

CHANGES IN THE FIFTH EDITION

Readers familiar with earlier editions of *Analysis for Financial Management* will note several changes and refinements in this edition, including

- An introduction to currency and interest rate swaps with emphasis on the ability of swaps to increase corporate financing flexibility
- A thorough rewrite of "Using Financial Markets to Manage Corporate Risks" to simplify and clarify the exposition
- Increased emphasis on the important tie between present value and creating shareholder wealth
- Increased emphasis on the significance of real options in investment appraisal
- An extensive revision of Chapter 9, "Business Valuation and Corporate Restructuring," to expand the treatment of discounted cash flow approaches to valuation, summarize empirical studies of mergers and leveraged buyouts, and de-emphasize the significance of hostile takeovers.

A word of caution: *Analysis for Financial Management* emphasizes the application and interpretation of analytic techniques in decision making. These techniques have proved useful for putting financial problems into perspective and for helping managers anticipate the consequences of their actions. But techniques can never substitute for thought. Even with the best technique, it is still necessary to define and prioritize issues, to

modify analysis to fit specific circumstances, to strike the proper balance between quantitative analysis and more qualitative considerations, and to evaluate alternatives insightfully and creatively. Mastery of technique is only the necessary first step toward effective management.

I want to thank Bill Alberts, David Beim, Dave Dubofsky, Bob Keeley, George Parker, Megan Partch, Alan Shapiro, and Nik Varaiya for insightful help and comments on this and prior editions. I also want to thank my daughter, Sara Higgins, for her advice and editorial assistance, my wife for her patience, and my students and colleagues at the University of Washington, the Darden Graduate School of Business, the University of Hawaii Advanced Management Program, Bank of America, Advanced Technology Laboratories, and Microsoft, among others, for stimulating my continuing interest in financial management.

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