

3rd edition

Foundations *of* **FINANCE**

The Logic and Practice
of Financial Management

Keown • Martin • Petty • Scott

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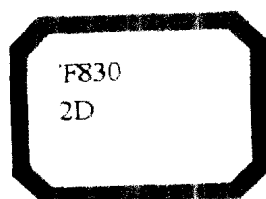


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YOUR JOURNEY OF LEARNING STARTS HERE...



The next few pages reveal many of the key features that *Foundations of Finance*, Third Edition has included to help you be successful in the classroom and beyond.

The cornerstone features included in every chapter are:

10 AXIOMS These core principles of finance tie together concepts within the text. The 10 Axioms allow students to see a more complete picture.

PAUSE AND REFLECT In-text inserts appear throughout the text and focus the student's attention on "the big picture." These inserts help students identify the interrelationships and motivating factors behind the core concepts.

Axiom 10: Ethical Behavior Is Doing the Right Thing, and Ethical Dilemmas Are Everywhere in Finance

Ethics, or rather a lack of ethics in finance, is a recurring theme in the news. During the late 1980s and early 1990s the fall of Ivan Boesky and Drexel, Burnham, Lambert, and the near collapse of Salomon Brothers seemed to make continuous headlines. Meanwhile, the movie *Wall Street* was a hit at the box office and the book *Liar's Poker*, by Michael Lewis, chronicling unethical behavior in the bond markets, became a best-seller. As the lessons of Salomon Brothers and Drexel, Burnham, Lambert illustrate, ethical errors are not forgiven in the business world. Not only is acting in an ethical manner morally correct, it is congruent with our goal of maximization of shareholder wealth.

PAUSE AND REFLECT

Keep in mind that future cash flows are assumed to occur at the end of the time period during which they accrue. For example, if a cash flow of \$100 occurs in time period 5, it is assumed to occur at the end of time period 5, which is also the beginning of time period 6. In addition, cash flows that occur in time $t = 0$ occur right now; that is, they are already in present dollars.

FINANCIAL MANAGEMENT IN PRACTICE

These boxes demonstrate the relevance of the topics discussed and the implementation of the theory.

FINANCIAL MANAGEMENT IN PRACTICE

Reading a Stock Quote in the
Wall Street Journal

Below is shown a section of the *Wall Street Journal* that gives the quotes on July 8, 1999, for some of the stocks traded on the New York Stock Exchange on that date.

The stocks listed below include some familiar companies, such as General Electric (GE), General Mills, and General Motors, that are listed in the *Wall Street Journal* on a daily basis. To help us understand how to read the quotes, consider General Electric:

- The 52 week high column shows that General Electric stock reached a high of $117\frac{7}{16}$ (\$117.44) during the past year
- The 52 week low column shows that General Electric sold for a low of 69 (\$69.00) during the past year
- The stock (GenElec) and sym (GE) columns give an abbreviated version of the corporation's name and the ticker symbol, respectively
- Div, the dividend column, gives the amount of dividend that General Electric paid its common stockholders in the last year; \$1.40 per share
- Yld % (1.2) is the stock's dividend yield—the amount of the dividend divided by the day's closing price ($\$1.40 \div \117.94)
- PE (41) gives the current market price ($117\frac{15}{16}$ divided by the firm's earnings per share
- The amount of General Electric stock traded on July 8, 1999, is represented in the Vol 100s column, or 7,948,100 shares
- General Electric stock traded at a high price (Hi- $118\frac{3}{4}$) and a low price (Lo- $114\frac{1}{8}$) during the day
- The previous day's closing price is subtracted from the closing price (Close) of $117\frac{15}{16}$ for July 8, 1999, for a net change (Net Chg) of +3

52 Weeks		Stock	Sym	Div	Yld %	PE	Vol 100s	Hi	Lo	Close	Net Chg
Hi	Lo										
118 $\frac{1}{2}$	69	GenElec	GE	1.40	1.2	41	79481	118 $\frac{3}{4}$	114 $\frac{1}{8}$	117 $\frac{15}{16}$	+ 3
39 $\frac{1}{2}$	31 $\frac{1}{2}$	GenGriffProp	GQP	1.96	5.6	20	779	35 $\frac{1}{2}$	34 $\frac{1}{4}$	35 $\frac{1}{2}$	- $\frac{1}{4}$
20	7 $\frac{1}{2}$	GenHouse	GHW	0.32	1.6	38	83	19 $\frac{1}{2}$	19 $\frac{1}{2}$	19 $\frac{1}{2}$	+ $\frac{1}{2}$
47 $\frac{1}{2}$	16 $\frac{1}{2}$	GenInstr	GIC	...	...	...	17910	46	42 $\frac{1}{2}$	43 $\frac{1}{2}$	+ 2 $\frac{1}{2}$
84 $\frac{1}{2}$	59 $\frac{1}{2}$	GenMills	GIS	2.20	2.7	24	5390	82 $\frac{1}{2}$	80 $\frac{1}{2}$	82 $\frac{1}{2}$	+ $\frac{1}{2}$
63 $\frac{1}{2}$	30 $\frac{1}{2}$	GenMotor H	GNH	...	...	...	6180	60 $\frac{1}{2}$	58 $\frac{1}{2}$	59 $\frac{1}{2}$	- $\frac{1}{2}$
78 $\frac{1}{2}$	38 $\frac{1}{2}$	GenMotor	GM	2.00	2.9	14	26275	71 $\frac{1}{2}$	69 $\frac{1}{2}$	70	- $\frac{1}{2}$

BACK TO THE FOUNDATIONS These in-text inserts appear throughout the text to allow the student to take time out and reflect upon the meaning of the material just presented. The use of these inserts, coupled with the use of the 10 axioms, keeps the student focused on the interrelationships and motivating factors behind the concepts.

BACK TO THE FOUNDATIONS
Some have thought junk bonds were fundamentally different from other securities, but they are not. They are bonds with a great amount of risk, and therefore promise high expected returns. Thus, Axiom 1: The Risk-Return Trade-off—We Won't Take on Additional Risk Unless We Expect to Be Compensated with Additional Return.

NEW TO THIS EDITION!

FOUNDATIONS OF FINANCE, THIRD EDITION, HAS INCLUDED SEVERAL OTHER LEARNING TOOLS

CONCEPT CHECK

1. What features of common stock indicate ownership in the corporation versus preferred stock or bonds?
2. What are the two ways that a shareholder benefits from ownership?
3. How does internal growth versus the infusion of new capital affect the original shareholders?
4. If a corporation decides to retain its earnings, when would the value of the market price actually decrease?
5. What is the three-step process for common stock valuation? Explain the difference in the equations for a single-holding period and multiple-holding periods.

CONCEPT CHECKS At the end of most major sections, concept checks highlight the key ideas just presented and allow students to test their understanding of the material.

FINANCE AND THE MULTINATIONAL FIRM: FINANCIAL STATEMENTS AND INTERNATIONAL FINANCE

As of 1999, many countries had different guidelines for firms to use in preparing financial statements. In other words, a dollar of earnings in the United States is not the same as DM 1.84 (deutsche [German] Marks) (the equivalent of a U.S. dollar based on the exchange rate). The two countries simply have different generally accepted accounting principles. In fact, the differences in accounting practices are significant enough that a firm reporting according to German standards could have \$100 million in profits, but if U.S. standards are used that same company might report a loss. Just imagine what this does for an investor trying to interpret financial statements across different country boundaries.

FINANCE AND THE MULTINATIONAL FIRM Each chapter closes with a section that discusses the international aspects of the material presented in that chapter.

Takin' It to the Net

The rates of return in Figure 9-2 come from a company called Ibbotson Associates. Go to their home page, <http://www.ibbotson.com>, to see what information they provide on the Internet.

TAKIN' IT TO THE NET This new feature is found in each chapter and directs students to related Web sites.

THE SUPPORT PACKAGE

Student Study Guide Written by the authors, the Study Guide contains several innovative features to help the student of *Foundations of Finance*. Each chapter begins with an overview of the key points, which can serve both as a preview and quick survey of the chapter content, and as a review. There are problems (with detailed solutions) and self-tests that can be used to aid in the preparation of outside assignments and to study for examinations. The problems are keyed to the end-of-chapter problems in the text in order to provide direct and meaningful student aid. Multiple-choice and true/false questions are also included to provide a self-test over the descriptive chapter material.

Instructor's Manual with Solutions The Instructor's Manual, prepared by the authors, contains these four key elements for each chapter:

1. A chapter orientation, which offers the instructor a simple statement of the authors' intent for the chapter, and a useful point of departure for in-class lecture;
2. A chapter outline for easy reference to key issues;
3. Answers to all end-of-chapter questions in the text;
4. A second set of alternative problems with answers.

Test Bank The Test Bank, revised for this edition by Philip T. Thames of California State University, Long Beach, provides more than 1,500 multiple-choice, true/false, and short-answer questions with complete and detailed answers. There are approximately 340 questions that are new to this edition of the Test Bank.

Prentice Hall Test Manager, Version 4.1 The Test Bank is designed for use with the Prentice Hall Test Manager, a computerized package that allows instructors to custom design, save, and generate classroom tests. The test program (in Windows format) permits instructors to edit, add, or delete questions from the test bank; edit existing graphics and create new graphics; analyze test results; and organize a database of tests and student results.

PowerPoint Presentation Over 50 slides per chapter of new lecture notes has been prepared by Professor Anthony Byrd of the University of Central Florida. These electronic slides allow the instructor to create full-color presentations coordinated with *Foundations of Finance*, Third Edition. The PowerPoint slides are available from the Prentice Hall Web site www.prenhall.com/keown.

Spreadsheet Templates and Solutions In addition to the solutions being provided in the Instructor's Manual, we have also developed **Spreadsheet Solutions** for virtually all of the end-of-chapter problems. These solutions have been prepared in Excel. The user can change the assumptions in the problem and thereby generate new solutions. (Available to download at www.prenhall.com/keown).

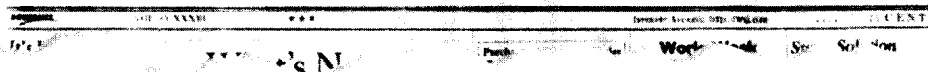
Color Transparencies Approximately 150 four-color acetates of the major figures in the text are available.

NEW! Instructor's Resource CD-ROM The Instructor's Resource CD-ROM includes the computerized test bank, Instructor's Manual, PowerPoint Presentations, and Transparency Masters of all the figures and tables from the text. It is dual platform for both PC and Macintosh.

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The Prentice Hall Finance Center Web Site and CD-ROM Located in the inside back cover of this text and at www.prenhall.com/financecenter is the *Prentice Hall Finance Center*. This robust learning tool contains the following features all designed to increase student awareness of what finance professionals do, to ensure comprehension and mastery of the financial mathematics contained in the text, and to supply a direct link to myPHLIP—the Prentice Hall Learning on the Internet Partnership.



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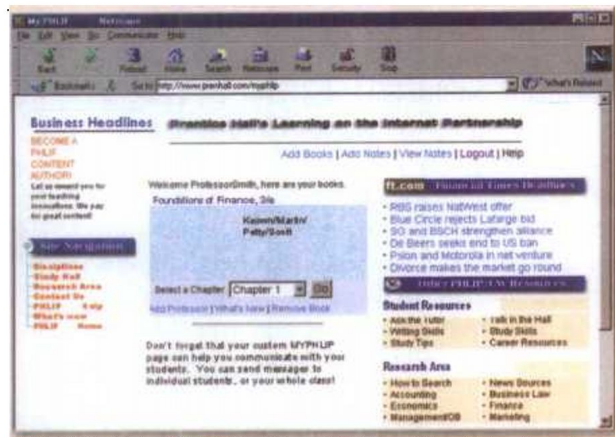
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- ✓ **On-line faculty support** including downloadable supplements, additional cases, articles, links, and suggested answers to Current Events Activities.
- ✓ **What's New** gives you one click access to all newly posted PHLIP resources.
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Use Prentice Hall materials created by professors for professors and their students.

Our development team:

- Checks course material and tests for accuracy;
- Clears permissions for content and images;
- Edits material for consistency with the supported title.

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- **Lecture Notes** containing additional exercises, discussion questions, lecture notes, and graphics created to reinforce concepts in the book.

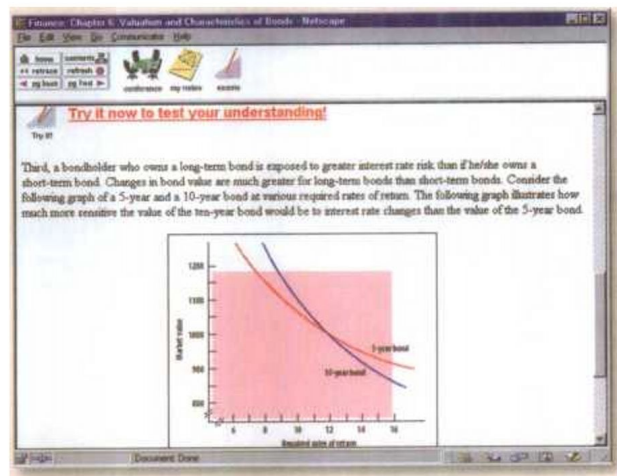
- **Tests and Quizzes** created for each chapter give instructors hundreds of questions to select and customize for every chapter.

Instructional Design:

- **Readiness Assessment Quizzes** allow students to pre-test their understanding of chapter material.
- **Discussion Questions** are built into the lectures

to encourage interpersonal relationships by asking students to discuss questions in the conference or chat rooms.

- **In-Line Exercises**, built into the lecture materials, serve as pedagogical speedbumps, requiring students to stop and make sure they understand the material.



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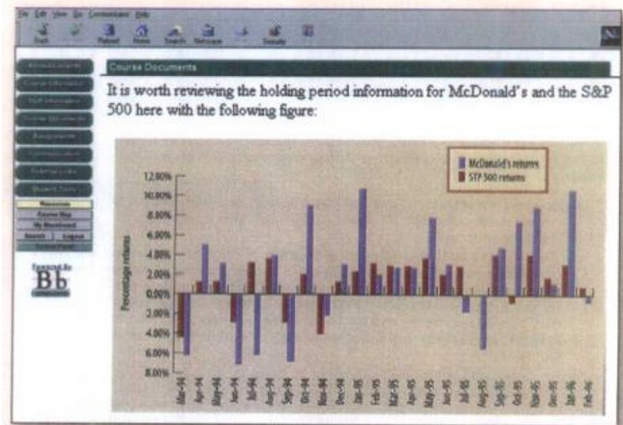
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FOUNDATIONS OF FINANCE

Third Edition

FOUNDATIONS OF FINANCE

**The Logic and Practice
of Financial Management**

Third Edition

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