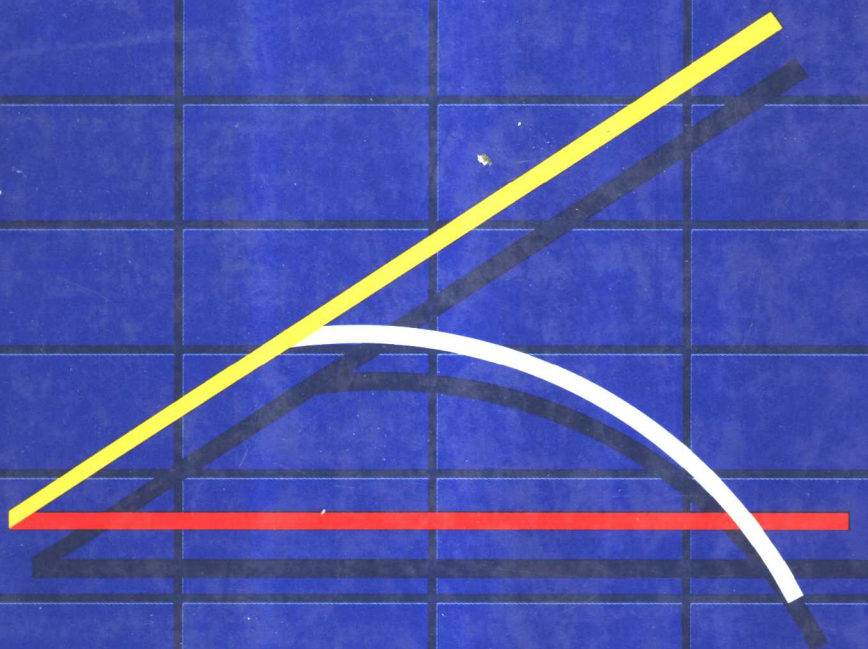


Fundamentals of Financial Management

Fifth Edition



Eugene F. Brigham

Fundamentals of Financial Management

Fifth Edition

Eugene F. Brigham

University of Florida

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Preface

Fundamentals of Financial Management is intended for use in the introductory finance course. It begins, in Part I, with a discussion of such basic concepts as security markets, interest rates, taxes, risk analysis, time value of money, and valuation models. In subsequent parts, we go on to explain how financial managers can help maximize the value of a firm by making better decisions in such areas as capital budgeting, working capital management, and choice of capital structure. This organization has three important advantages:

1. Explaining early in the book how financial markets operate, and how security prices are determined within these markets, helps students see how financial management can affect the value of the firm. Also, early coverage of risk analysis, time value, and valuation models permits us to use and reinforce these key concepts throughout the remainder of the book.
2. Structuring the book around markets and valuation concepts enhances continuity—students can better see how the various topics relate to one another.
3. Most students—even those who do not plan to major in finance—are generally interested in stock and bond valuation, rates of return, and the like. Since people's ability to learn a subject is a function of their interest and motivation, and since *Fundamentals* begins by showing the relationship between security markets, security values, and financial management, this organization is good from a pedagogic standpoint.

CHANGES IN THE FIFTH EDITION

The theory and practice of finance are dynamic, and as new developments occur, they should be incorporated into a textbook such as this one. Also, we and a team of reviewers are constantly on the lookout for ways to improve the book in terms of clarity and understanding. As a result, we have made several important changes in this edition, including the following:

1. All sections were updated to reflect the latest tax laws, interest rates, and other financial developments.

2. At the suggestion of reviewers, the section on capital budgeting was expanded from two to three chapters. This expansion allowed us to cover such topics as inflation effects, replacement chains, and equivalent annual annuities. However, we structured the book in modular form so that some topics (and even chapters) can be omitted by instructors who prefer not to cover them in the introductory course.
3. The expanded coverage of capital budgeting also allowed us to devote an entire chapter (Chapter 10) to cash flow estimation. Indeed, we were able to expand the discussion and simplify the analysis by use of an income statement/cash flow statement approach that is much clearer than the formulas used in the fourth edition.
4. Risk analysis was moved from Chapter 6 to Chapter 4, so that it follows immediately the chapter on interest rates and capital markets and precedes the chapter on valuation models. This arrangement provides for a smoother, more logical transition from the discussion of interest rates and risk premiums to risk-adjusted rates of return, then on to time value of money and valuation models.
5. A new section on business ethics was added to Chapter 1, and special attention was given to pointing out ethical issues throughout the remainder of the book.
6. The statement of changes in financial position was replaced with a statement of cash flows to reflect the recent change in financial accounting standards.
7. The discussion of zero coupon bonds was completely rewritten to reflect the current tax treatment of these bonds.
8. A discussion on puttable bonds has been added to Chapter 13, Long-Term Debt, and the coverage of bond indentures has been updated to include material on the impact of LBO strategies on the bond rating of firms such as RJR Nabisco.
9. International finance is no longer covered as a separate chapter. Important topics are now covered in a special international section at the end of selected chapters.
10. Numbered equations are now set in blue type. Highlighting the most important equations serves as an effective study and review tool for students.
11. We also added to the end-of-chapter problems for each chapter an integrative problem that covers in a comprehensive manner all the major concepts discussed in the chapter. These problems can be used as the basis for lectures, or they can be used by students as comprehensive study problems. To facilitate their use as lecture problems, we wrote the *Instructor's Manual* solutions in a lecture note format, and we developed a set of transparency masters that can be used to make transparencies for overhead projectors. Furthermore, since students often get left behind when instructors use overheads, we developed a new ancillary,

Blueprints: A Problem Notebook. Designed as a note-taking or study tool, *Blueprints* comes with each new copy of the book and corresponds to the integrative problems in the text. Each integrative problem is restated in *Blueprints*, space is provided for taking notes, and graph set-ups and other features designed to help students take clear notes or think through the problems are provided. Using *Blueprints* as a guide, students will be able to take good notes and still have time to follow the lecture.

12. The number of end-of-chapter problems was increased, and the range of difficulty was expanded. Also, a separate section, entitled Computer-Related Problems, was added to most chapters, and a diskette that contains *Lotus 1-2-3* models for these problems is available to instructors from The Dryden Press. The computerized problems are designed to show students the power of computers in financial analysis; however, no knowledge of computers or programming is needed to use them.
13. The old chapter summaries were replaced by new sections entitled Summary and Key Concepts, in which we summarize key concepts covered in each chapter in bulleted lists. The new format makes it easier for students to review the concepts than did the narrative format used previously.

ANCILLARY MATERIALS

Blueprints: A Problem Notebook. This supplement is supplied free of charge with each new textbook. It contains a statement of the integrative problems developed for each chapter, space for taking notes or for solving the problem and discussing the concepts involved, and graph set-ups to facilitate working the problems.

A number of other items are included in the *Fundamentals* package and are available free of charge to adopting instructors.

1. **Instructor's Manual.** A comprehensive manual is available to instructors who adopt the book. The manual contains answers to all text questions and problems, a detailed set of lecture notes (including suggestions for use of the acetate transparencies described in the next section), detailed solutions to integrative lecture problems with transparency masters to illustrate them, sample exams, and suggested course outlines.
2. **Transparencies.** A comprehensive set of acetate transparencies (six to eight per chapter), including 40 color acetates, is available to instructors who adopt the text. Also, an extensive set of transparency masters (six to eight per chapter) was developed for use with the integrative lecture problems.
3. **Test Bank.** A revised and enlarged test bank with more than 1,000 class-tested questions and problems, in objective format, is available both in

book form and on IBM computer diskettes (5¼" and 3½"). The new questions are more challenging than those in many test banks, and they are well suited for exams. Also, the topics covered, the degree of difficulty, and the correct answer are provided in the margin for each question.

4. **Supplemental Problems.** A set of additional problems, organized according to topic and level of difficulty, is also available to instructors.
5. **Problem Diskette.** A diskette (5¼" and 3½") containing *Lotus 1-2-3* models for the computer-related end-of-chapter problems is also available. To obtain the diskette, complete the insert card found at the front of the *Instructor's Manual*.

A number of additional items are available for purchase by students:

1. **Study Guide.** This supplement outlines the key sections of each chapter, provides students with self-test questions, and provides a set of problems and solutions similar to those in the text and in the *Test Bank*.
2. **Casebook.** The tax update edition of *Cases in Managerial Finance*, sixth edition (Dryden Press, 1987), by Roy L. Crum and Eugene F. Brigham, is well suited for use with this text. The cases provide real-world applications of the methodologies and concepts developed in the text.
3. **Readings Book.** A readings book, *Issues in Managerial Finance*, third edition (Dryden Press, 1987), edited by Ramon E. Johnson, provides an excellent mix of theoretical and practical articles which can be used to supplement the text.
4. **Finance with Lotus 1-2-3: Text, Cases, and Models.** This text by Eugene F. Brigham, Dana A. Aberwald, and Susan E. Ball (Dryden Press, 1988), enables students to learn, on their own, how to use *Lotus 1-2-3* and explains how many commonly encountered problems in financial management can be analyzed with electronic spreadsheets.
5. **PROFIT +.** This software supplement by James Pettijohn of Southwest Missouri State University contains 18 user-friendly programs that include the time value of money, forecasting, and capital budgeting. The program includes a user's manual, and it is available for the IBM PC.

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ERRORS IN THE TEXT

At this point, most authors make a statement like this: "I appreciate all the help I received from the people listed above, but any remaining errors are, of course, my own responsibility." And generally there are more than enough remaining errors. As a part of my quest for clarity, I resolved to avoid this problem in *Fundamentals*, and as a result of the error detection procedures we used, I am convinced that it is virtually free of mistakes.

Some of my colleagues suggested that if I am so confident about the book's accuracy, I should offer a reward to people who find errors. With this in mind, but primarily because I want to detect any remaining errors and correct them in subsequent printings, I hereby offer a reward of \$7.50 per error (misspelled word, arithmetic mistake, and the like) to the first person who reports it to me. (Any error that has follow-through effects is counted as two errors only.) Two accounting students have set up a foolproof audit system to make sure I pay—accounting students tend to be skeptics! Please report any errors to me at the address below.

CONCLUSION

Finance is, in a real sense, the cornerstone of the enterprise system—good financial management is vitally important to the economic health of business firms, and, hence, to the nation and the world. Because of its importance, finance should be widely and thoroughly understood, but this is easier said than done. The field is relatively complex, and it is undergoing constant change in response to shifts in economic conditions. All of this makes finance stimulating and exciting, but also challenging and sometimes perplexing. I sincerely hope that *Fundamentals* will meet its own challenge by contributing to a better understanding of our financial system.

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December 1988

Contents

Part I	Fundamental Concepts in Financial Management	1
Chapter 1	An Overview of Financial Management	3
	<i>Differences in Financial Policy: Delta vs. Eastern</i> 3 The Financial Manager's Responsibilities 4 The Changing Role of Financial Management 5 Increasing Importance of Financial Management 7 Alternative Forms of Business Organization 9 Finance in the Organizational Structure of the Firm 12 The Goals of the Corporation 12 The Agency Problem 17 Managerial Actions to Maximize Shareholder Wealth 23 The Economic Environment 24 Organization of the Book 25 <i>International: The International Environment</i> 26 <i>Small Business: Goals and Resources in the Small Firm</i> 27 Summary and Key Concepts 29	
Chapter 2	Financial Statements, Taxes, and Cash Flows	33
	<i>What Corporate Report Cards Measure: Apple Computer's Success</i> 33 Financial Statements and Securities 34 The Federal Income Tax System 39 Depreciation 47 Cash Flow Analysis 50 <i>Small Business: Taxes and the Small Firm</i> 52 Summary and Key Concepts 53 Appendix 2A Effects of Depreciation Methods on Taxes, Net Income, and Cash Flows 60	
Chapter 3	Financial Markets, Institutions, and Interest Rates	65
	<i>Knowing When to Borrow: Caterpillar and Financial Corporation of America</i> 65 The Financial Markets 66 Financial Institutions 68 The Stock Market 72 The Cost of Money 75 Interest Rate Levels 76 The Determinants of Market Interest Rates 80 The Term Structure of Interest Rates 85 Other Factors That Influence Interest Rate Levels 89 Interest Rate Levels and Stock Prices 91 Interest Rates and Business Decisions 92 <i>International: Eurocurrency Market</i> 94 Summary and Key Concepts 94	
Chapter 4	Risk and Rates of Return	103
	<i>Why Risk Varies: Homestake versus Du Pont or GE</i> 103 Defining and Measuring Risk 104 Expected Rate of Return 106 Portfolio Risk and the Capital Asset Pricing Model 114 The Relationship Between Risk and Rates of Return 127 Physical Assets versus Securities 133 A Word of Caution 133 <i>International: The Risk of Foreign Investment</i> 134 Summary and Key Concepts 135 Appendix 4A Calculating Beta Coefficients 143	

Chapter 5	Time Value of Money	149
	<i>How the Value of Money Changes over Time, or What Bank of America Bonds, Your College Education, and a GM Electric Car Have in Common</i> 149	
	Future Value 151 Present Value 155 Future Value versus Present Value 157 Future Value of an Annuity 158 Present Value of an Annuity 161 Perpetuities 163 Present Value of an Uneven Series of Payments 164 Determining Interest Rates 167 Semiannual and Other Compounding Periods 168 Amortized Loans 172 Summary and Key Concepts 173 Appendix 5A Continuous Compounding and Discounting 189	
Chapter 6	Bond and Stock Valuation	191
	<i>Picking Winners and Avoiding Losers in the Bond and Stock Markets</i> 191	
	Bond Values 192 Preferred Stock Valuation 208 Common Stock Valuation 208 Stock Market Equilibrium 222 Recent Developments 230 <i>Small Business: Valuation of Small Firms</i> 231 Summary and Key Concepts 232	
Part II	Financial Statements and Financial Forecasting	249
Chapter 7	Analysis of Financial Statements	251
	<i>Reaping the Rewards of Proper Financial Statement Analysis</i> 251	
	Financial Statements and Reports 253 Ratio Analysis 265 Comparative Ratios 282 Uses and Limitations of Ratio Analysis 284 <i>Small Business: Financial Analysis in the Small Firm</i> 286 Summary and Key Concepts 287	
Chapter 8	Financial Forecasting	303
	<i>Details Magazine: Lack of Financial Forecasting Leads to Loss of Control</i> 303	
	Sales Forecasts 304 Forecasting Financial Requirements: The Percentage of Sales Method 306 Forecasting Financial Requirements When the Balance Sheet Ratios Are Subject to Change 314 Modifying the Forecast of Additional Funds Needed 317 Computerized Financial Planning Models 320 <i>International: Currency Exchange Rates</i> 321 Summary and Key Concepts 322 Appendix 8A Microcomputers and Financial Forecasting 334	
Part III	Strategic Long-Term Investment Decisions	339
Chapter 9	The Basics of Capital Budgeting	341
	<i>Lockheed's Tri-Star Project: Flawed Capital Budgeting Analysis Leads to Failure</i> 341	
	Importance of Capital Budgeting 342 Obtaining Ideas for Capital Projects 343 Project Classifications 344 Relationship Between Capital Budgeting and Security Valuation 346 Capital Budgeting Ranking Criteria 346 Evaluation of the Decision Rules 354 Comparison of the NPV and IRR Methods 355 The Reinvestment Rate (Opportunity Cost) Assumption 358 Modified Internal Rate of Return (IRR*) 359 Multiple IRRs 361 The Post-Audit 363 <i>Small Business: Capital Budgeting in the Small Firm</i> 364 Summary and Key Concepts 366	

Chapter 10	Cash Flow Estimation, Replacement, and Other Topics in Capital Budgeting	377
	<i>Federal Express Learns the Importance of Accurate Cash Flow Estimation</i> 377 Cash Flow Estimation 378 Identifying the Relevant Cash Flows 379 Changes in Net Working Capital 382 Capital Budgeting Project Evaluation 382 Comparing Projects with Unequal Lives 389 Adjusting for Inflation 393 Capital Rationing 395 <i>International: Cash Flow Analysis of International Investments</i> 396 Summary and Key Concepts 397	
Chapter 11	Risk Analysis in Capital Budgeting	409
	<i>LILCO and FPC: Different Approaches to Risk Analysis Lead to Very Different Outcomes</i> 409 Introduction to Risk Assessment 410 Techniques for Measuring Stand-Alone Risk 412 Beta (or Market) Risk 418 Techniques for Measuring Beta Risk 422 Portfolio Effects within the Firm 423 Conclusions on Project Risk 423 Incorporating Project Risk and Capital Structure into Capital Budgeting Decisions 424 <i>International: Risk and International Capital Budgeting</i> 426 Summary and Key Concepts 427	
Part IV	Strategic Long-Term Financing Decisions	435
Chapter 12	Common Stock and the Investment Banking Process	437
	<i>Compaq Computers: High Growth Causes Need for New Capital</i> 437 Balance Sheet Accounts and Definitions 438 Legal Rights and Privileges of Common Stockholders 441 Types of Common Stock 442 Evaluation of Common Stock as a Source of Funds 443 The Market for Common Stock 445 The Investment Banking Process 452 IBM's Initial Debt Offering 460 Emerging Trends 462 <i>Small Business: Raising Equity Capital for the Small Firm</i> 463 Summary and Key Concepts 464	
Chapter 13	Long-Term Debt	471
	<i>Raising Debt Capital</i> 471 Traditional Debt Instruments 473 Specific Debt Contract Features 477 Recent Innovations 480 Bond Ratings 485 Rationale for Using Different Types of Securities 490 Factors Influencing Long-Term Financing Decisions 491 <i>International: International Markets for Long-Term Debt</i> 495 Summary and Key Concepts 496 Appendix 13A Bankruptcy and Reorganization 504 Appendix 13B Refunding Operations 511	
Chapter 14	Hybrid Financing: Preferred Stock, Leasing, and Option Securities	519
	<i>Using Hybrid Financing to Meet Different Firms' Need: Compaq, Apple, and Datapoint</i> 519 Preferred Stock 520 Leasing 525 Options 535 Warrants 540 Convertibles 542 Reporting Earnings When Warrants or Convertibles Are Outstanding 548 <i>Small Business: Lease Financing for Small Businesses</i> 548 Summary and Key Concepts 549	

Chapter 15	Mergers, Divestitures, Holding Companies, and LBOs	563
	<i>Low Stock Price and Undervalued Assets Make Federated Attractive for Takeover</i> 563 Rationale for Mergers 564 Types of Mergers 567 Level of Merger Activity 567 Procedures for Combining Firms 571 Merger Analysis 572 Valuing the Target Firm 575 The Role of Investment Bankers 577 Joint Ventures 580 Divestitures 580 Holding Companies 583 Leveraged Buyouts (LBOs) 586 <i>International: International Mergers</i> 587 Summary and Key Concepts 588	
Part V	The Cost of Capital, Leverage, and Dividend Policy	595
Chapter 16	The Cost of Capital	597
	<i>Supplying Power to Florida Requires Cost of Capital Estimate</i> 597 The Logic of the Weighted Average Cost of Capital 598 Basic Definitions 599 Cost of Debt, $k_d(1 - T)$ 600 Cost of Preferred Stock, k_p 601 Cost of Retained Earnings, k_s 602 Cost of Newly Issued Common Stock, or External Equity, k_e 607 Weighted Average, or Composite, Cost of Capital, $WACC = k_a$ 609 The Marginal Cost of Capital 610 Combining the MCC and Investment Opportunity Schedules 618 <i>Small Business: Cost of Equity Capital for Small Firms</i> 622 Summary and Key Concepts 624	
Chapter 17	Capital Structure and Leverage	637
	<i>Has the Debt Binge Gone Too Far?</i> 637 Business and Financial Risk 639 Determining the Optimal Capital Structure 646 Degree of Leverage 654 Liquidity and Cash Flow Analysis 661 Capital Structure Theory 663 Asymmetric Information Effects 665 Capital Structure and Mergers 668 Checklist for Capital Structure Decisions 669 Variations in Capital Structures among Firms 671 <i>International: International Financial Management</i> 672 Summary and Key Concepts 673	
Chapter 18	Dividend Policy	687
	<i>United Brands: How One Company Sets Its Dividend Policy</i> 687 Dividend Policy Theories 688 Tests of Dividend Theories 691 Other Dividend Policy Issues 693 Dividend Policy in Practice 694 Summary of Factors Influencing Dividend Policy 704 Stock Dividends and Stock Splits 706 Stock Repurchases 710 <i>Small Business: Dividend Policy for Small Business</i> 714 Summary and Key Concepts 715	
Part VI	Working Capital Management	725
Chapter 19	Working Capital Policy and Short-Term Credit	727
	<i>After Riding the Wave of Short-Term Interest Rates, Transamerica's Debt Expenses Take A Refreshing Plunge</i> 727 Working Capital Terminology 728 Requirement for External Working Capital Financing 729 The Working Capital Cash Flow Cycle 730 Working Capital Investment and Financing Policies 733 Advantages and Disadvantages of Short-Term Credit 738 Accruals 739 Accounts	

Payable, or Trade Credit	739	Short-Term Bank Loans	744
Commercial Paper	753	Use of Security in Short-Term	
Financing	754	Growth and Working Capital Needs	755
and Key Concepts	756	Appendix 19A Secured Short-Term	
Financing	768		

Chapter 20 Cash and Marketable Securities 777

<i>How Some Successful Firms Determine How Much Cash to Hold</i>	777
Cash Management	778
The Cash Budget	780
Increasing the Efficiency of Cash Management	785
Bank Relationships	789
Matching the Costs and Benefits of Cash Management	791
Marketable Securities	792
The Baumol Model for Balancing Cash and Marketable Securities	798
<i>International: International Cash Management</i>	801
Summary and Key Concepts	802

Chapter 21 Receivables and Inventory Management 813

<i>How a Better Inventory Control System Can Improve a Firm's Profitability</i>	813
Receivables Management	814
Credit Policy	816
Monitoring the Receivables Position	824
Analyzing Changes in the Credit Policy Variables	826
Inventory Management	829
The Optimal Ordering Quantity	834
<i>International: International Credit Management and Inventory Management</i>	843
Summary and Key Concepts	844

Appendix A Mathematical Tables

Appendix B Answers to Selected End-of-Chapter Problems

Appendix C Selected Equations

Index

I

Fundamental Concepts in Financial Management

Chapter 1	An Overview of Financial Management
Chapter 2	Financial Statements, Taxes, and Cash Flows
Appendix 2A	Effects of Depreciation Methods on Taxes, Net Income, and Cash Flows
Chapter 3	Financial Markets, Institutions, and Interest Rates
Chapter 4	Risk and Rates of Return
Appendix 4A	Calculating Beta Coefficients
Chapter 5	Time Value of Money
Appendix 5A	Continuous Compounding and Discounting
Chapter 6	Bond and Stock Valuation