



INTRODUCTION TO

CORPORATE FINANCE

Terry S. Maness

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Baylor University

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About The Author

Terry S. Maness received his B.A. and M.S. degrees in Economics from Baylor University. His doctorate degree in finance was earned at Indiana University. He currently holds the Carr P. Collins Endowed Chair in Finance and is also Chairman of the Department of Finance, Insurance, and Real Estate at Baylor University. His articles have appeared in leading publications including the *Journal of Finance*, the *Journal of Financial and Quantitative Business Analysis*, the *Journal of Portfolio Management*, the *Journal of Futures Markets*, the *Journal of Banking and Finance* among others. He recently published *Small Business Management Using Lotus 1-2-3* with Southwestern Publishers. He has been active in numerous academic and professional associations including the Dallas Cash Management Association, Financial Management Association, and has served as President, Program Chairman, and Treasurer of the Southwestern Finance Association. He recently received the designation of Certified Cash Manager (CCM) from the National Association of Corporate Cash Management. He is active as a consultant and is co-owner of Financial Micro-Systems, Inc.

To my wife, Nancy,
and our children, Amy and David

Preface

Corporate financial management has become very complex over the last two decades. Initially, the study of corporate finance was very institutional. It covered the institutions involved in the marketplace and the structure of the various financial markets. The study of finance then evolved into the use of accounting data to make financial decisions. Over time the role the financial manager became better understood. The area of corporate financial management began to develop as a unique area separate from either economics or accounting. It has since developed into a very decision oriented field where internal decisions are made in the context of the external financial environment with a goal of maximizing the value of shareholder wealth.

As the finance area has grown in sophistication, so have the financial management textbooks. Today, introductory finance texts have expanded to the point where the material cannot be adequately covered in a one term course. This textbook addresses this problem. It is written for the introductory course in corporate financial management with a focus on teaching the basic principles of modern financial management using the valuation approach. Conscious decisions were made in developing this textbook to

include material essential for the general business student as well as material which serves as a foundation for students who will major in finance.

Because the typical U.S. corporation is either involved in international markets or impacted by foreign competition in its U.S. domestic market, this textbook develops the international aspects of corporate finance within the appropriate chapters. The international aspects of a particular decision model are developed after the basic model has been developed and discussed and therefore will not interfere with the flow of the text. In addition, a separate international financial management chapter, Chapter 21, is developed to introduce the more sophisticated aspects of managing foreign exchange risk.

Intended Market

This textbook was developed for the introductory course in corporate finance. It covers the financial management material which is expected to be included as a part of the common body of knowledge by schools accredited by the American Assembly of Collegiate Schools of Business (AACSB). It can be used at either the undergraduate level or at the graduate level for those students who have not yet had a course in corporate finance.

Organization of the Text

The two basic organizations used by corporate finance textbook authors are the balance sheet approach and the valuation approach. The balance sheet approach generally moves from working capital to capital budgeting then to capital structure and cost of capital. The valuation approach begins by developing valuation principles followed by capital budgeting topics followed by capital structure issues concluding with working capital topics.

This book follows the general valuation organization. It begins by introducing the student to the various financial markets and how they function. Next, the student is introduced to financial statement analysis and financial planning as a means to give a comprehensive overview to the area of corporate finance. The student is then introduced to time value of money and valuation models for the various forms of corporate securities. The concept of cost of capital is then developed as the market's required return for investing in corporate securities representing the firm's assets.

At this point, capital budgeting is introduced. The student is made aware that this is the area where financial managers have the greatest opportunity to create shareholder wealth. Chapter 8 develops the basic capital budgeting tools used for assessing projects which do not change the risk profile of the corporation. Consequently this chapter builds on the foundation provided by the previous valuation and cost of capital material. Chapter 9 then develops tools and techniques for assessing capital budgeting projects with risk characteristics which differ from the corporation. The student's attention is consistently focused on how the decision area being discussed impacts shareholder wealth.

The student is next introduced to the capital structure management area. The focus again is on the impact that capital structure decisions have on the value of the corporation. The appropriate mix of debt and equity is approached at both a practical level and theory level with the basic arguments of Modigliani and Miller developed in a very intuitive fashion. This unit not only discusses the mix of debt and equity but also develops the decision models to decide between various types of debt contracts including the lease versus borrow and bond refunding decision.

Once the financial manager has invested in capital budgeting projects and financed them with long-term sources, the liquidity of the corporation must be managed. The cash flow within the organization must be managed encompassing the areas of inventory, receivables, cash and marketable securities, and short-term financing including spontaneous as well as non-spontaneous sources.

The final unit provides supplemental material which may be covered at the discretion of the instructor. Topics include contingent claim securities, mergers and acquisitions, and managing foreign exchange exposure.

Features of the Text

The textbook develops the area of corporate financial management as a separate area from economics or accounting. It does so by utilizing a valuation approach to developing the material. Although this approach tends to be a little more theoretical than the balance sheet approach, the author has found this to be the best approach for showing the student how finance differs from accounting and economics. Every attempt has been made to develop the financial theory at a very intuitive level therefore allowing the textbook to remain truly introductory.

Each unit begins with an overview of the unit and how it fits in with the previous units leading up to it. Each chapter then has an introductory section placing the chapter in the context of its unit.

This textbook contains many features which will aid the student's learning process. For example, a list of key terms and concepts is located at the end of each chapter. In addition, each chapter has a running glossary of terms printed in the margin of the chapter pages. The student can conveniently check his or her understanding of the terms or concepts developed in each chapter with these aids. There is also an alphabetized glossary of approximately 400 key terms at the end of the textbook. The definition of each term is provided along with the chapter reference. There is also an alphabetized index of the company's used as real-life examples. Each chapter ends with a full complement of questions and problems designed to test the student's basic understanding of the chapter, such as recalling facts or testing definitions, as well as to expand the student's understanding by providing extensions.

The textbook also contains many "Financial Manager in Action" sections which help the student better understand the application of the various decision models developed throughout the text.

Finally, several units contain integrative applications found at the end of the respective unit. These are short caselike problems designed to teach the student how the various topics within a given unit are related.

Supporting Materials

The textbook is supported by a full complement of teaching materials. A Study Guide has been developed by Professor Coleen Pantalone of Northeastern University. The Study Guide closely follows the textbook material and provides an overview of the chapter, a sentence outline of each chapter, and a variety of student exercises including fill in the blanks to test understanding of key terms and concepts and an additional problem set with step-by-step solutions. The Study Guide also includes the documentation for the software which was developed for the textbook. The software consists of over 20 menu-driven Lotus 1-2-3 worksheets which replicate the decision models developed in the textbook. Unlike problem diskettes with other textbooks, this system of worksheets allows the student to solve any of the end of chapter problems or Study Guide problems. The student can work the problem and then test the sensitivity of the solution by changing any of the input variables. With this system, the student can see how the decision model works. It is not just a black box. The student will find that this software will also be usable with other finance courses. The asterisk (*) to the left of the problem number indicates which problems can be worked using the Lotus.

An Instructor's Manual is provided to adopters with fully developed answers to the questions and solutions to the problems and the integrative cases. It also includes an outline for each of the chapters.

A test bank of over 1,000 questions in both hardcopy and computer diskette is provided to each adopter.

Finally, adopters will receive a package of transparency masters of all the major exhibits in the textbook.

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