

BUSINESS ADMINISTRATION 351

Financial Management Fall Semester 2006

- INSTRUCTOR:** Deborah N. Pittman
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OFFICE HOURS: 12:30 – 1:30 Tues Thurs
4:30 –5:30 Tues Thurs
Other times by appointment
- REQUIRED TEXTS:** Fundamentals of Corporate Finance, by Ross, Westerfield and Jordan, seventh edition. The text includes a CD with many supplementary features that will help you understand the material. Also required: The Student Problem Manual that accompanies the text.
- REQUIRED READINGS:** On reserve in the library.
The Founders of Modern Finance: Their Prize-Winning concepts and 1990 Nobel Lectures
Capital Ideas by Peter Bernstein.
- REQUIRED:** Financial calculator, SHARP EL-733
- REQUIRED:** Daily reading of Wall Street Journal

COURSE OBJECTIVES:

By the end of the course, the student should:

1. Understand NPV as a basic concept of corporate finance and be proficient in solving all types of time value of money problems.
2. Appreciate the relevance of finance in our daily lives through exposure to contemporary financial issues by outside reading and selected videos.
3. Have a sound grasp of underlying financial theories and the objectives and tradeoffs involved in corporate financial decision making.
4. Understand how today's financial managers use spreadsheets and calculators to perform financial analysis and make capital budgeting decisions.
5. Be familiar with the key contributions of the Nobel laureates in financial economics, specifically Markowitz, Sharpe, and Miller and Modigliani, and have a better appreciation of financial research through the reading of seminal works and a description of how key financial theories evolved.

COURSE STRUCTURE AND RESOURCES:

Lectures, working homework problems, written assignments using computer spreadsheets, and outside reading of contemporary issues will all be used in this course. It has been found that students of finance learn better when they have plenty of opportunity for practice. There are many new concepts being introduced, all of which build on one another, and the student must stay current with the schedule in order to understand the lectures.

The Ross, Westerfield, and Jordan text has a strong approach to teaching the first course in finance. It emphasizes the modern fundamentals of finance and makes the subject come alive with contemporary examples. Corporate finance is the working of a small number of integrated and very powerful intuitions. These are emphasized in the Ten Important Concepts that is in the General Folder.

Class time will begin by answering questions left over from the previous session and placing the current topic in perspective to the course's objectives. There will be chapter lectures which will include working problems as a class or in small groups and then among the class as a whole.

The course will be organized around the 351 Folder housed in

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6

Please look in the folder that is named with the date of the next class before you come to class. It contains:

1. A Chapter Outline if we are beginning a new chapter
2. A PowerPoint Presentation that pertains to the chapter we are beginning
3. Any articles you are to read before class, and it contains
4. A practice quiz that will review the new terminology of the chapter.

You may want to print out some of this material before class – especially the Chapter Outline – and bring it with you so that you may take notes. If there is nothing in the next folder then we are continuing the chapter from the previous class.

Students are responsible for reading the assigned material, and working the homework problems at the end of the chapter that relate to the readings before coming to class.

We are using the alternate edition of RWJ, which includes several chapters that are only used in International Finance and the Case Studies course. This enables the student to avoid additional costs in upper level courses.

The Excel Tutor, the Student Problem Manual, and the Self-test CD are all supplements that support your study of this material. The student problem manual contains concepts for review, chapter highlights, and problems and tests along with answers in the back of the book. They are to help you master the material and provide more practice outside of class. You will not have assignments from these packets. The Student Problem Manual will be helpful as you review for tests.

GRADING:

The grading scale is as follows:

97-100	A+
93-96	A
90-92	A-
87-89	B+
83-86	B
80-82	B-
77-79	C+
73-76	C
70-72	C-
67-69	D+
63-66	D
60-62	D-
< 60	F

Grades will be based on the following:

1. Section Test 1	20%
2. Section Test 2	20%
3. Section Test 3	20%
5. Written Assignment	20%
7. Final Exam	20%

100% plus Bonus Opportunity Points

Each grade will be scored in terms of 100 points. Then the scores will be weighted as indicated above to determine the final grade. Bonus points will be accumulated, divided by the total bonus points possible, and weighted by 6% so that the average bonus points earned times .06 equals the points added to your final grade for the course.

All students will take all three tests plus the comprehensive exam. You may drop the lower of your first two test grades without penalty.

Homework Problems:

Students are encouraged to work on the homework problems with another student or in groups. I will ask that students form study groups on the first day of class.

Although homework will not be collected, it is essential that you keep up with your homework. The end-of-chapter problems, the problems on the bonus opportunities, and the problems that the instructor works in class are indicative of the problems you will find on the tests. There is no substitute for working as many problems as possible. A copy of the authors' answers to the homework will be kept in the box outside of my door. The instructor's manual may be borrowed for one hour at a time. Please be considerate of your classmates.

Chapter Tests:

There will be three tests, each covering a major portion of material. The test dates are indicated in the course schedule. They will be offered at times outside of class. See your syllabus. If, for some reason you cannot avoid missing an exam, or if an emergency arises, contact me as soon as possible. Those students with college-related activities may take the test earlier, but not later than other students. If you miss a test (with a valid excuse) and cannot quickly make it up, I reserve the right to refuse a make-up, and increase the weight of the comprehensive final accordingly.

You will need to bring your calculator to each of the chapter tests and the final examination. These tests will be problems and essays, weighted approximately 50/50. They will only cover certain chapters, but the student will soon recognize the "building-block" nature of the chapters. Tests will cover the chapters in the textbook, the lectures on those chapters, and any outside material assigned in conjunction with the chapters, including the readings on reserve in the library.

Financial Analysis Project:

The financial analysis project is meant to provide you with practice in thinking critically; you will also work with computer spreadsheets and sharpen your writing skills. The financial analysis project consists of three phases: (1) ratios (2) cash flow statement and (3) narrative. You will receive points for each portion of the assignment. The student will turn in two spreadsheets that he or she programmed. The spreadsheet portion of the assignment is intended as a learning experience. The spreadsheet assignments are not group projects, because one can't learn to program spreadsheets effectively unless one does the project individually. In general, programming help is acceptable if it results in learning how to program a spreadsheet. Help is not acceptable if the result is that someone else makes changes in your spreadsheet because you don't know how to make the appropriate changes yourself. Copying all or part of another person's file into your spreadsheet, either electronically, or keystroke by keystroke is a violation of the Honor Code. Obtaining any help from any source on the analytical part of the case or the research part of the case is a violation of the Honor Code.

I will offer some voluntary classes at night to give extra help in the computer lab, and you are always encouraged to come to my office for help. If you have never programmed Excel spreadsheets, you will find the Excel tutorial included with your text helpful.

Bonus Opportunities:

During most classes there will be opportunities for students to earn additional grade points (up to 6% of the original possible points) through short quizzes or problems given in class. Since these are bonus opportunities, and grades do not count against the student, there are absolutely no make-ups on these, regardless of your reason for a class absence. Bonus opportunities are designed to encourage students to stay caught up and to attend class having prepared the daily assignment. The material covered on the bonus opportunities will come from the day's assignment or from the previous class' lecture.

Attendance Policy:

If you are absent from class due to illness or other excusable reason, you must provide me an explanation of the absence. Always follow up with an e-mail explanation so I will have a record. Whenever possible, this explanation should be given prior to the absence so your work may be continued with minimal interruption. Absences for which an excuse is not given or not accepted is an unexcused absence. It is the responsibility of the student to determine what make-up work is to be submitted whether the absence is excused or unexcused. When excessive absences from class jeopardize your work in the course, the Asst. Dean of Academic Affairs Notice will be sent as a warning that further absences will result in at least a lowering of the final grade, and may lead to failure in or a suspension from the course. If you receive such a notice, I ask that you meet with me immediately so that there is a complete understanding of the implications of continued absences. You will not be permitted to make-up Bonus Opportunities, whether excused or unexcused.

Course Schedule

DATES	TOPICS and ASSIGNMENTS
Aug 24, Th	Course Introduction What is Corporate Finance? Accounting, Economics and Statistics Review <u>Video: Careers in Finance</u> FMA Handout NYC Job Trek
Aug 29, T	HW: Read Chapter 1 and answer questions at end of chapter Chapter 1: Introduction to Corporate Finance Forms of Business Organizations Goal of Financial Management Agency Problem Cash flows between the firm and the financial markets Primary versus Secondary Markets <u>Video: Role of the Chief Financial Officer</u>
Aug 31, Th	HW: Read chapter 2 and work problems at end of chapter Chapter 2: Financial Statements, Taxes, and Cash Flow Cash Flow Identity The Balance Sheet Income Statement Taxes
Sep 5, T	HW: Work cash flow identity in folder Chapter 2 continued <u>Video: Financial Markets</u> Liquidity
Sep 7, Th	HW: Read Chapter 5 and Sharp EL-733 Owners Manual Chapter 5: Introduction to Time Value of Money Future Value and Compounding Present Value and Discounting

Work Problems on Calculator

- Sep 12, T HW: Read Chapter 6 and work problems at end of chapter 5
- Chapter 6: Discounted Cash Flow
Multiple Cash flows: Annuity and Unequal
Compounding more frequently than annually - EAR
- Sep 14, Th HW: Work first half of problems at end of chapter 6
- Chapter 6: Discounted Cash Flow
- Sep 19, T HW: Work second half of problems at end of chapter 6
- Chapter 6 continued
Mortgages, Installment Loans, Add-on interest loans
Two Step Problems
- Sep 21, Th **Review Session During Class**
Test #1
6:00-7:30 P.M. or 7:30-9:00 P.M.
Test will include questions on your reading of pp. 1-14 in Capital Ideas: The Improbable Origins of Modern Wall Street
- Sep 26, T HW: Read chapter 3 and work problems at end of chapter
- Chapter 3: Working with Financial Statements
Discussion of Written Assignment
Financial Statement Analysis
The DuPont Identity
- Sep 28, Th HW: Work cash flow statement problem and industry ratio problem in folder
- Chapter 3: Working with Financial Statements
Ratio Analysis
Cash Flow and Financial Statements
- SEP 28 6:00 P.M. in COMPUTER LAB: VOLUNTARY HELP SESSION ON SPREADSHEETS**

- Oct 3, T HW: Read Chapter 7 and work end of chapter problems
Chapter 7: Interest Rates and Bond Valuation
- Bond and Bond Valuation
Inflation and Interest Rates
Determinants of Bond Yields
- Oct 5, Th HW: Read Chapter 8 and work end of chapter problems
Chapter 8: Stock Valuation
Difference between valuation of stocks and bonds
Common Stock Valuation
Three Growth Assumptions
- Oct 10, T HW: Read Chapter 9 and work end of chapter problems
- DUE:PHASE 1 of Financial Analysis Project
Ratios, Common-Size Balance Sheets and Income Statements for
Project (Place spreadsheet file with your name on it in my Pittman
Inbox)**
- Chapter 9: Net Present Value
Calculation of NPV
Calculation of Payback
[Ignore Discounted Payback](#)
Average Accounting Return
Internal Rate of Return
Video: Capital Budgeting
[Ignore Profitability Index](#)
Problems with the IRR
NPV Profile and Crossover rate
- Oct 12, Th *Video: Greed*
Video:Bonds
Video: Capital budgeting
- I'm at a conference presenting a paper.
There will be class. You will either have an outside speaker or there will
be the above videos for you to watch. In either case, the material covered
in class will be on your next test.

Oct 19, Th	<p>HW: Read Chapter 10 and work easier problems at end of chapter</p> <p>Begin Chapter 10</p> <p>Concepts: Relevant Cash Flows</p> <p>Stand-Alone Principle</p> <p>Sunk Costs</p> <p>Opportunity Costs</p> <p>Side Effects</p> <p>Net Working Capital</p> <p>Financing Costs</p>
Oct 24, T	<p>HW: Read Chapter 10 and work remainder of problems at end of chapter including EAC and Setting the Bid Price</p> <p>Chapter 10: Making Capital Investment Decisions</p> <p>Alternative Definitions of Operating Cash Flows</p> <p>Cost Cutting Proposal</p> <p>Setting the Bid Price</p> <p>Equivalent Annual Cost for Projects with Different Lives</p>
Oct 26, Th	<p>Review Session During Class</p> <p>TEST #2</p> <p>6:00-7:30 P.M. or 7:30-9:00 P.M.</p> <p>Test 2 will include questions from your reading of Chapter 2,3 and 4 from <i>Capital Ideas</i> on reserve in the library.</p>
Oct 31, T	<p>Begin Chapter 12</p> <p>Some Lessons from Capital Market History</p> <p>Dollar Returns and Percentage Returns</p> <p>Historical Record</p> <p>Video: Test Your Insider I.Q.</p> <p>Capital Market Efficiency</p> <p>Forms of Market Efficiency</p> <p>Longer Investment Horizons</p>
Nov 2, Th	<p>HW: Read Chapter 12 and work problems at the end of the chapter</p> <p>Chapter 12 (continued) Emphasis on Capital Market Efficiency and Insider Trading</p> <p><i>Ibbotson Asset Allocation Library Presentation</i></p>

NOV 2

**HELP SESSION IN COMPUTER LAB AT 6:00 P.M. ON
PROGRAMMING CASH FLOW**

Nov 7, T

HW: Read Chapter 13 and work problems at the end of the chapter
Chapter 13: Risk, Return, & the Security Market Line
Expected Returns and Variances
Portfolio Returns
Portfolio Variances

Nov 9, Th

HW: Work remainder of the problems in Chapter 13
Chapter 13 continued
Announcements, Surprises, and Expected Returns
Risk: Systematic and Unsystematic
Diversification and Portfolio Risk
Systematic Risk and Beta
The Security Market Line
The SML and the Cost of Capital
Video: Portfolio Management

**DUE: PHASE 2 of Financial Analysis Project:
Cash Flow Statement; name the spreadsheet file with your name and
place in Pittman Inbox Folder**

Nov 14, T

HW: Read Chapter 15 and work problems at the end of chapter

Chapter 15: Cost of Capital
Required return, cost of capital, appropriate discount rate
Cost of equity
Cost of debt and preferred stock
Weighted average cost of capital
Divisional and Project Costs of Capital
Flotation Costs and the WACC

Nov 16, Th

Chapter 15 continued

Nov 21, T

HW: Read Chapter 17

The Capital Structure Question
Example of the Effects of Leverage

Nov 28, T

HW: Work problems in Chapter 17 folder

Chapter 17 continued

M&M Proposition I and II without taxes

M&M Proposition I and II with taxes

Static Theory of Capital Structure

**DUE: PHASE 3 of Financial Analysis Project;
Narrative Section of Project, including Graphs
Turn in printed presentation at the beginning of the class**

Nov 30, Th HW: Read Chapter 16, pp. 525-546; (do not work problems)
Video: Going Public

Dec 5, T **Review Session During Class**
TEST #3
6:00 – 7:15 P.M. or 7:30 – 9:00 P.M.
**Test 3 will include questions from your reading of Chapter 9 and 11 in
Capital Ideas on reserve in the library.**

Exam dates:

You may select **either of the two times.**

Saturday, Dec 9 5:30 P.M.

Wednesday, Dec 13 1:00 P.M.

**Your final comprehensive exam will include an essay question on your readings
in The Founders of Modern Finance: Their Prize-winning concepts and 1990
Lectures. If you have read any ONE of the articles and any ONE of the Nobel
Lectures, you will be able to write the essay.**

**SUGGESTED READINGS FOR THOSE INTERESTED IN PURSUING A CAREER IN
FINANCE OR GRADUATE WORK IN FINANCE:**

Peter Bernstein's history of the development of financial theory called *Capital Ideas*

Three Nobel Laureates in finance: seminal works of Sharpe, Markowitz, and Miller

A Random Walk Down Wall Street ,by Malkiel

Graham and Dodd's Security Analysis

Berkshire Hathaway Annual Report by Warren Buffet

Suggested contemporary books are:

Infectious Greed by Partnoy

Take on the Street by Levitt

Irrational Exuberance by Shiller

Beyond Greed and Fear by Shefrin

24 Days: WSJ reporters on Enron's demise
Against the Gods: The Remarkable Story of Risk by Bernstein
The Revolution in Corporate Finance edited by Stern and Chew
The Bear Book by Rothchild
Conspiracy of Fools by Eichenwald

*I keep copies of these readings in my office, should you wish to borrow them.

Advice from a previous semester's students when asked "Is there anything that you did that particularly helped you perform well in this course? Is there anything you wish you had done that in retrospect would have helped you? These are all inclusive and unedited.

1. Do all of the homework and stay caught up on the readings.
2. Read chapters. Do problems.
3. Go to class and do homework problems. Practice is good.
4. Do all your homework, when it is assigned to you.
5. Do not skip class and read the chapters the night before the test.
6. Read, (comprehend!) the book. What worked best for me was to outline the important concepts and equations from the book before class, which helps –bringing me to the next point. Studying bonus opportunities and handouts was THE most effective way to prepare for tests.
7. Keep on top of the theory and essay material type aspects instead of purely concentrating on the math so much. Both are equally important and both must be done.
8. Work back over problems within a couple of days of learning how to do them – make sure you really understand on your own and not just when the professor goes over them.
9. Keep up with reading – saves a lot of time when studying for essays on tests.
10. Working out problems outside of class is very helpful because it is the only way you can truly know if you understand the material.
11. Ask questions if you don't understand because IT WILL come up again in later chapters.
12. Know how to use the calculator!
13. Reading, outlining the chapters, and working problems in the back of the chapter were helpful. I would recommend copying the answers from the solution book and working at least some of the problems at the end of every chapter.
14. It would have helped me if I read and worked problems as we went along more. Especially in doing well on the bonus opportunities. I would study more for the quizzes if I had to do it over again.

Instructions for Financial Analysis Project (SEE FOLDER ENTITLED FINANCIAL ANALYSIS PROJECT FOR DETAILED INFORMATION)

The assignment is to read the annual report of IBM, present the last five years of financial statements on a spreadsheet, compute ratios using EXCEL, and analyze the results.

Phase One:

Compute the following ratios:

- DuPont ratios
- Common size balance sheet
- Common size income statement
- Financial ratios in Table 3.8 on page 72.

You must **use formulas** to compute these ratios. The objective of the exercise is to learn to program a spreadsheet. You will use the copy command once you have programmed one year's results.

Spreadsheet should be saved to a file in your name, and placed in the Pittman Private folder.

Phase Two:

Use the balance sheet and the income statement to compute a cash flow statement on your own

Spreadsheet should be saved to a file in your name, and placed in the Pittman Private folder.

Phase Three:

Prepare analysis in accordance with provided outline entitled "Tools of Financial Analysis" after referring to company's SEC reports, footnotes of financial statement, peer ratios from ZACKS, and press releases. It should be YOUR ANALYSIS supported by facts, not assertions by security analysts.

Create 3 graphs indicating what you consider the most interesting trends in the company's financial condition. Your written narrative and graphs will be turned in on the last day of class.

You should present a financial analysis of this company, no longer than five pages double-spaced. I have examples of financial analyses from previous classes outside my office door should you wish to borrow them. The financial analysis should address your opinion of the financial health of the company based on the trends that you observe. You may utilize current articles about the company and its industry to develop some additional insights into the reasons for the financial trends that YOU observe. Any articles used should be printed and turned in with your analysis. No article should be referenced unless it supports some financial trend that you computed.

You will be graded on the accuracy of your computations, your ability to communicate in writing, your analytical abilities, and completeness. Phase One will count 25%, the cash flow

statement will count 25%, and the narrative will count 50%. The folder entitled Financial Analysis Project contains information that will be helpful to you for this project: It contains samples of previous financial analysis projects, a grading sheet, the Tools of Financial Analysis and a chart depicting financial health.

