Fall Semester 2012

TEMBA: BA 385T- Financial Management

Unique 02255: W 6:00 pm – 9:15 pm, 5 Sep, ATT 105
M 6:00 pm – 9:15 pm, 10 Sep ~ 12 Nov, ATT 106
M 6:00 pm – 9:15 pm, 26 Nov ~ 10 Dec, ATT 106

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Course Objectives

This course has the following objectives:

- Introduce the concepts and theories of modern financial management
- Develop an appreciation for the usefulness of these theories for financial decision making
- Increase the student's financial decision-making skills
- Provide an overview of current financial management theories and practices

Required Materials

Required: Corporate Finance by Ross, Westerfield and Jaffe, 9th ed., McGraw-Hill Irwin

Supplemental: Selected chapters (available on Blackboard) from Financial Management, Concepts and Applications, *3rd ed.*, 1995, Ramesh K.S. Rao, SouthWestern Publishing Co., Cincinnati, a division of International Thompson. The required chapters will be scanned and made available to students.

A reading package with the *required* readings has been put together for the course. You will not be tested on the *recommended* readings. Approximately 5% of the questions on the exams will come from the *required* readings.

McCombs Classroom Professionalism Policy

The highest professional standards are expected of all members of the McCombs School community. The collective class reputation and the value of the Texas MBA/MPA experience hinge on these standards. Faculty are expected to be professional and prepared to deliver value for each and every class session. Students are expected to be professional in all respects.

The Texas MBA classroom experience is enhanced when:

Students arrive on time. Timely arrival ensures that classes are able to start and finish at the scheduled time. Timely arrival shows respect for both fellow students and faculty and it enhances learning by reducing avoidable distractions.
Students display their name cards. This permits fellow students and faculty to learn names, enhancing opportunities for community building and evaluation of in-class contributions.
Students are fully prepared for each class. Much of the learning in the Texas MBA program takes place during classroom discussions. When students are not prepared they cannot contribute to the overall learning process. This affects not only the individual, but also their peers who count on them.
Students respect the views and opinions of their colleagues. Disagreement and debate are encouraged; however, intolerance for the views of others is unacceptable.

Laptops are to be used only for class work.
Phones and wireless devices are turned off.

Academic Dishonesty

The McCombs School has no tolerance for acts of academic dishonesty. Such acts damage the reputation of the school and the MBA degree and demean the honest efforts of the majority of students. The minimum penalty for an act of academic dishonesty will be a zero for that assignment or exam.
The responsibilities for both students and faculty with regard to the Honor System are described at http://mba.mccombs.utexas.edu/students/academics/honor/index.asp and within this syllabus. As the instructor for this course, I agree to observe all the faculty responsibilities described therein. During Orientation, you signed the Honor Code Pledge. In doing so, you agreed to observe all of the student responsibilities of the Honor Code. If the application of the Honor System to this class and its assignments is unclear in any way, it is your responsibility to ask me for clarification. As specific guidance for this course, you should consider the *writing* of all examinations to be an individual effort without any use of books, notes, or other unpermitted aids. Group *preparation* for examinations is acceptable and encouraged.

Honor Code Purpose

Academic honor, trust, and integrity are fundamental to The University of Texas at Austin McCombs School of Business community. They contribute directly to the quality of your education and reach far beyond the campus to your overall standing within the business community. The University of Texas at Austin McCombs School of Business Honor System promotes academic honor, trust, and integrity throughout the Graduate School of Business. The Honor System relies upon The University of Texas Student Standards of Conduct (Chapter 11 of the Institutional Rules on Student Service and Activities) for enforcement, but promotes ideals that are higher than merely enforceable standards. Every student is responsible for understanding and abiding by the provisions of the Honor System and the University of Texas Student Standards Of Conduct. The University expects all students to obey the law, show respect for other members of the university community, perform contractual obligations, maintain absolute integrity and the highest standard of individual honor in scholastic work, and observe the highest standards of conduct. Ignorance of the Honor System or The University of Texas Student Standards of Conduct is not an acceptable excuse for violations under any circumstances.

The effectiveness of the Honor System results solely from the wholehearted and uncompromising support of each member of the Graduate School of Business community. Each member must abide by the Honor System and must be intolerant of any violations. The system is only as effective as you make it.

The Honor Pledge

The University of Texas at Austin McCombs School of Business requires each enrolled student to adopt the Honor System. The Honor Pledge describes the conduct promoted by the Honor System, as follows:

"I affirm that I belong to the honorable community of The University of Texas at Austin Graduate School of Business. I will not lie, cheat or steal, nor will I tolerate those who do."

"I pledge my full support to the Honor System. I agree to be bound at all times by the Honor System and understand that any violation may result in my dismissal from the Graduate School of Business."

Students with Disabilities

Upon request, The University of Texas at Austin provides appropriate academic accommodations for qualified students with disabilities. Services for Students with Disabilities (SSD) is housed in the Office of the Dean of Students, located in the Student Services Building. Additional information is available online at http://deanofstudents.utexas.edu/ssd/index.php. Please contact SSD at (512) 471-6259, VP: (512) 232-2937 or via e-mail if you have any questions.

Course Structure and Grading

The course consists of lectures, optional homework assignments, two cases and two exams (a midterm and a comprehensive final). Relevant course materials are posted on Blackboard.

Lectures

The lectures are designed to provide an understanding of the major elements of finance. The emphasis is on the logic underlying concepts, on how each concept is used in finance, and on how the concepts are interrelated. The lectures are not note taking drills; rather, they are dynamic sessions in which information is presented by the instructor via visual aids and through direct interaction with the class.

Homework

Optional problem-solving practice assignments, with solutions, are available on Blackboard. You will be notified through email by the TA as these problem sets become available. These assignments have recommended problems from the RWJ text and some additional problems. It is important that you work through these problems on your own. The TA is available to help you with any questions you may have.

Cases and Exams (400 points)

- **Midterm exam** (100 points): October 15, beginning of class. The exam will cover relevant text chapters (RWJ and Rao), class lectures, and required readings. A sample midterm is posted on blackboard (this may not reflect the precise scope of your exam).
- **Case 1. Massey Ferguson** (50 points): Due October 29, beginning of class
- **Case 2. Sampa Video** (50 points): Due November 26, beginning of class
- **Final Exam** (200 points): TBD. The final exam covers the whole course. The exam will cover relevant text chapters (RWJ and Rao), class lectures, and required readings.

Course Policies and Administrative Procedures

- **Grades:** All grades are assigned after a careful examination of the work done. Any grade disputes should be submitted in writing to the TA after 24 hours and within two weeks of the receipt of the disputed exam/paper. No adjustments will be made after this two-week period.
- **Extra Problems:** Students can work out additional end-of-chapter problems in the text. Solutions to these problems are posted on Blackboard. Students having difficulty with these problems should seek help from the instructor or his assistant.
- **Missed exams:** Students missing exams with valid excuses should notify the instructor, in advance, where possible. They will have the final exam weighted proportionally more. Note that work pressures and travel obligations are not considered valid excuses.
- **Students with disabilities:** The University of Texas at Austin provides upon request appropriate academic accommodations for qualified students with disabilities. For more information, contact the Office of the Dean of Students at 471-6259, 471-4641 TTY.

Background readings

The following readings are not part of the course and you will not be tested on these, but they are useful because they provide a broad perspective on some current economic realities. The to locate these readings on your own, if interested.

- "A matter of life and debt," The Wall Street Journal, October 21, 2008,
- "Global business: in praise of the stateless multinational," The Economist, September 20, 2008, page 55.
- "Information age: the 1% panic," The Wall Street Journal, October 13, 2008, page A17.
- "Loose money and the roots of the crisis," The Wall Street Journal, September 30, 2008, page A19.
- "The $1.4 trillion question," The Atlantic, January/February 2008, pages 36-48
- "Money: the century's agony," The Wall Street Journal, December 10, 1999, page A18

Schedule – Class Sequence

In the schedule below, "RWJ" refers to the Ross, Westerfield and Jaffe text and "Rao Chapter" refers to chapters in the Rao text.

Note: A Block does not necessarily represent one day. It is a collection of like concepts. Most blocks will be taught over more than one class period.

Block I: Introduction and Overview

Discussion of Course, Class Procedures, and the "Big Picture."

RWJ Chapter 1. Introduction to Corporate Finance
Rao Chapter 1. The Firm and its Environment
Rao Chapter 2. Maximizing Stockholders' Welfare

Readings:

- (Profits and Economic Welfare) "Private Profit, Public Service," The Economist, December 9, 1995, 66-67.
- (The Market Mechanism and Market Failures) "State and Market," The Economist, February 17, 1996, 64-65.
- Note on the Financial Perspective: What Should Entrepreneurs Know? Harvard Business School, 9-293-045. (Read this now, but the larger context will be meaningful only at the end of the course).
- "Governing the Modern Corporation," The Economist, May 3, 2001.
- "How to avoid getting lost in the numbers" HBS 9-682-01
- "Small Company Finance: What the Books Don't Say" HBR 87608

Recommended:

- (The Principle of Comparative Advantage) "The Miracle of Trade," The Economist, January 27, 1996, 61-62.

- If you are interested in reading more about the myriad dimensions of the concept of capital and the philosophy of capitalism, Hernando De Sotos' book The Mystery of Capital: Why Capitalism Triumphs in the West and Fails Everywhere Else, is an interesting read. Basic Books, 2000.
- In previous years, students have wanted me to discuss in class the philosophy of Libertarianism. Without endorsing this website, I point out that one source of information is http://www.libertarianism.com/what-it-is.htm

Block 2: Operating and Financial Leverage

Rao Chapter 19: The Impact of Operating and Financial Decisions on Cash Flows
Application: Wyoming Gas and Electric

Block 3: Time Value, Bond and Stock Valuation

RWJ Chapter 4: Discounted Cash Flow Valuation
RWJ Chapter 8: Interest Rates and Bond Valuation
RWJ Chapter 9: Stock Valuation
RWJ Chapter 15: Long-Term Financing: An Introduction

Note: Depending on time constraints, we may not cover Chapter 15 in class. You will be responsible for them (i.e., read them on your own). A brief PP will be posted on Blackboard.

Note: Printer-friendly time value tables, time value formulas, and "Financial Functions in Excel," posted on Blackboard.

Readings:
- (The net effects of interest rate changes) "How Low Can They Go?" The Economist, 1995, December 2nd, p. 76-77.
- "Yield to Maturity," Chapter 3 in Tuckman, B., Fixed Income Securities, John Wiley, 1995.

Recommended:
- "Introduction to Islamic Finance" (interest is proscribed), Harvard Business School Note 9-2-002

Block 4: Capital Budgeting

RWJ Chapter 5: Net Present Value and Other Investment Rules
RWJ Chapter 6: Making Capital Investment Decisions
Applied Research Technologies, posted on Blackboard.

Readings:
- Supplement on Capital Budgeting under Inflation, posted on Blackboard
- Rao, Ramesh K. S. and Neeraj Bharadwaj, 2008, "Marketing Initiatives, Expected Cash Flows, and Shareholders' Wealth," Journal of Marketing, January 2008.

- Shapiro, A. "Corporate Strategy and the Capital Budgeting Decision," The New Corporate Finance, Where Theory Meets Practice, Don Chew (ed.), McGraw Hill, Inc., 1993.

Recommended:

- Rao, Ramesh K. S. and Genaro J. Gutierrez, forthcoming 2010, "Shareholders' Wealth Maximizing Operating Decisions and Risk Management Practices in a Mixed Contracts Economy," Production and Operations Management.
- Thomas Friedman's The Lexus and the Olive Tree, Anchor Books 2000, is an interesting book about how the wealth-creation process has changed with globalization.

Block 5: Risk and Expected Returns

RWJ Chapter 10: Risk and return: Lessons from Market History
RWJ Chapter 11: Return and Risk: The Capital Asset Pricing Model (CAPM)

Readings:

- Roll, R. 1994, "What Every CFO Should Know About Scientific Progress in Financial Economics: What Is Known and What Remains to be Resolved," Financial Management, 23(2), Summer, 69-75.

Recommended:

- Bernstein, P. L. 1995, "Risk as a History of Ideas," Journal of Financial Education, 21, Fall, 5-8.
- Kritzman, M. P., 1994, "... About Higher Moments," Financial Analysts Journal, September-October, 10-17.
- Robert Shiller's The New Financial Order: Risk in the 21st Century, Princeton University Press, 2003, argues that "our infatuation with stock markets distracts us from more durable economic prospects." He suggests six new ideas for risk-reduction that finance theory has largely ignored.

Block 6: Capital Structure

RWJ Chapter 16: Capital Structure: Basic Concepts
RWJ Chapter 17: Capital Structure: Limits to the Use of Debt

Reading:

- "Valuing Companies in Corporate Restructuring" HBS 9-201-073

Recommended:

- Rao, Ramesh K. S., and Susan White, "The Creation of First City Financial Corporation: A Clinical Study of the Bankruptcy Process" in Principles of Corporate Renewal Casebook, edited by H. D. Platt and M.B. Platt, University of Michigan Press.

Block 7: Cost of Capital and Valuation of the Levered Firm

RWJ Chapter 13: Risk, Cost of Capital, and Capital Budgeting
RWJ Chapter 18: Valuation and Capital Budgeting for the Levered Firm

Readings:

- Graham, J. R., and C. R. Harvey, 2001, "The Theory and Practice of Corporate Finance: Evidence from the Field," Journal of Financial Economics.

Recommended:

- "A Note on Capital Cash Flow Valuation" HBS 9-295-069
- "A Note on Valuing Equity Cash Flows" HBS 9-295-085
- "A Note on Private Equity Securities" HBS 9-200-027

Block 8: Financial Distress and Capital Markets

Rao Chapter 16: Resolving Financial Distress
RWJ Chapter 20: Issuing Securities to the Public
Update on Investment Banking (on Blackboard)
RWJ Chapter 14: Efficient Capital Markets and Behavioral Challenges (we may have to skip this chapter if time constraints are binding)

Readings:

- Smith, C., "Raising Capital, Theory and Evidence," The New Corporate Finance, Where Theory Meets Practice, 294-310 Don Chew (ed.), McGraw Hill, Inc., Second Edition
- Bruner, Robert F., Kenneth M. Eades, Robert S. Harris, Robert C Higgins, "Best Practices in Estimating the Cost of Capital: Survey and Synthesis," Financial Practice and Education, Volume 8, Number 1, 13-28

Recommended:

- "The Other-Worldy Philosophers" (views on global crisis) and "Efficiency and Beyond" (discussion of efficient markets), The Economist, July 18, 2009. pp58-62
- Schwert, G. W., 2001, "Anomalies and Market Efficiency," Ch. 17 in Handbook of Economics and Finance, G. Constantinides, M. Harris and R. Stulz (eds.), North-Holland.
- Andre Shliefer's Inefficient Markets: An Introduction to Behavioral Finance 2000, (Clarendon Lectures in Economics: Oxford) provides arguments against efficient markets (book is aimed at academic audience).
- Ramesh K. S. Rao and Eric C. Stevens, 2006, "The Firm's Cost of Capital, Its Effective Marginal Tax Rate, and the Value of the Government's Tax Claim," Berkeley Electronic Press, Topics in Economic Analysis & Policy: Vol. 6: No. 1, Article 3. Available at: http://www.bepress.com/bejeap/topics/vol6/iss1/art3.

The article argues that extant cost of capital results and intuitions change dramatically when one admits risky debt and non-debt tax shields into the analytical framework (article is aimed at a technical audience, but the introduction and conclusion will give you the needed context).

Block 9: Strategic Risk Management

Rao Chapter 11: Managing Total Risk with Derivative Securities

Readings:

- A Note on Fair Value (on Blackboard)

The subsequent material is outside the intended scope of this class. If we have time, we will cover some of this.

RWJ Chapter 22: Options and Corporate Finance
Lecture: The Martingale Intuition and Real Options (Notes to be handed out in class)

Readings:

- Luehrman, Timothy A., 1998, "Investment Opportunities as Real Options: Getting Started on the Numbers," Harvard Business Review, July-August
- "A Note on Private Equity Securities" HBS 9-200-027

Recommended:

- (Speculation and arbitrage) "Pennies from Hell," School Brief, The Economist, February 3, 1996.
- Rao, Ramesh K. S., and S. White. 2005. "Sulphur Dioxide Allowance: The Price of Pollution," Journal of Financial Education.
- (The "State of Real Options Application in Industry") "Real Options: State of the Practice," A. Triantis and A. Borison, Journal of Applied Corporate Finance, Summer 2001, 8-24).
- (How risk management can affect the firm, the markets and the economy) "The Impact of Risk Management," from C. Smithson and C. W. Smith with D. S. Wilford, Managing Financial Risk, Irwin.
- (Motivation for the "Options way of thinking") Chapter 1-3 in Martha Amram and Nalin Kalutilaka, Real Options: Managing Strategic Investment in an Uncertain World, Harvard Business School Press, 1999