

6 and 7 of the



## FIN 320F

**TITLE:** Foundations of Finance Summer 2015

**Instructor** Dr. Robert C. Duvic  
**Email** [robert.duvic@mcombs.utexas.edu](mailto:robert.duvic@mcombs.utexas.edu)

**Office Hours:** As this is an online course, you may contact me via email with your questions and comments. I am also available to meet with you in my office. Please email me and set up an appointment.

### Course Description

This course develops your ability to use economic decision tools in a market environment. Making good economic decisions involves integrating behavioral, economic, and political information into a qualitative and quantitative decision process. While a main focus of this course is business decision making, the course also shows that the market-valuation approach is essential for all market participants, including investors, governments, and non-profits.

### Course Outcomes

A market is a structure within which individuals and institutions buy and sell goods and services. This is a simple concept. However, this concept has big implications for those making economic decisions. The following issues will be woven into this course:

- **Market values:** Choice and competition exist in a market environment and affect all decisions, even those that may appear strictly internal to the company or not to involve profit at all. Business managers must value projects from the viewpoint of those outside of the company (investors and customers) whose choice determines the company's survival and profitability. Non-profit entities and governments must obtain resources from markets and use those assets to produce the most value for their stakeholders.
- **Cash flow:** There are two types of information available to decision makers. First, accounting statements follow specific rules that develop internally focused information for control and externally focused information for reporting. Second, economic information focuses on uncertain future cash flows. Market decisions are based on future cash flow, not accounting information. This course concentrates on cash flow analysis, but brings in enough accounting information to clarify the difference.
- **Time value of money:** Interest rates exist, and the value of a dollar expended today is not the same as a dollar received in three years. Decision makers must be able to relate investments made in the current period with cash inflows expected to be received from investments at a future point in time.
- **Risk:** Projects extend into an uncertain future. Managers must develop procedures for factoring this uncertainty into cash flow estimates and into the interest rate used to relate cash flows at different points in time. Individuals planning for retirement face huge uncertainty, and must understand the difference between expected and realized returns!
- **Opportunity cost:** All projects must provide an acceptable rate of return. This return, often called the required rate of return, or the discount rate, is the opportunity cost. The opportunity cost is the basis for all decisions.

While a main focus of this course is business decision making, the course also shows that the market-valuation approach is essential for all market participants, including investors, governments, and non-profits.

## Course Outline

The course consists of fifteen units divided into seven parts.

**Part I: The Economy:** Market participants operate in a complex social, legal, political, and behavioral environment. Decision makers must understand how this environment determines the structure and goals of businesses.

**Unit 1: Human Nature and Economic Activity**

*Main Issue:* What forces shape corporate decision-making?

*Comments:* All organizations, business, governments, NGOs, religions, etc. are composed of humans. This unit builds an understanding of human nature, which it then uses to explain markets and profit.

**Unit 2: Human Nature and the Ethics of Decision Making**

*Main Issue:* What ethic guides economic decision-making?

*Comments:* Unit 2 builds on Unit 1 and defines the ethical framework in which market/ business decisions are made. Surprisingly, business ethics is not an oxymoron!

**Part II: The Business Decision Framework:** Business information is organized into financial statements: “The Books.” Students should understand the information in these statements, which provide a basis for understanding the current condition of a business.

**Unit 3: Structuring the Business Firm**

*Main Issue:* What is the goal of a business?

*Comments:* Given the foundation of human nature, markets, and ethics, you can now define the goal of a business and how it’s governed.

**Unit 4: The Accounting Framework**

*Main Issue:* How are managerial decisions reflected in the accounting statements?

*Comments:* Managers use two information systems: accounting and economic. These are interrelated and you can’t understand one without the other. In this unit you see how major managerial decisions are reflected in the balance sheet and income statement.

**Part III: Economic Value:** Market prices are based on expectations of the future. Decision makers must estimate the future cash inflows and outflows resulting from their decisions and use economic decision rules—Net Present Value and Internal Rate of Return—to identify the best decisions.

**Unit 5: Economic Value**

*Main Issue:* What is it worth?

*Comments:* This unit sets out the logic and process of economic evaluation. Any decision involves a comparison of the benefits with the costs of the decision. This cost-benefit analysis is called Net Present Value.

**Unit 6: Applying Time Value Techniques**

*Main Issue:* How do managers analyze cash flows through time?

*Comments:* This unit expands the concept of time value into a useful decision framework by introducing multiple cash flows, annuities, perpetuities, and compounding.

**Part IV: Valuing Financial Securities:** Companies, governments, and not-for-profit entities raise capital by issuing financial securities—stocks and bonds. The market values of these securities are determined by the investors’ view of future cash flows.

**Unit 7: Valuing the Corporation**

*Main issue:* How do investors value a corporation?

*Comments:* This unit lays the foundation for all of our future work by developing the economic balance sheet and linking real assets and financial assets. It also defines important elements of the capital markets.

**Unit 8: Valuing Bonds**

*Main issue:* How do investors value a corporation?

*Comments:* This unit explains bonds: their nature, values and risks.

**Unit 9: Valuing Equity**

*Main Issue:* How do investors determine stock prices?

*Comments:* The stock price is the major connection between the corporation and its stockholders. This unit's discussion of growth stock, income stock, EPS and P-E ratio is crucial for an understanding of stocks.

**Part V: Valuing Non-financial Assets:** Every business or organization must invest in long-term productive projects—plant, equipment, technology, major marketing campaigns, outsourcing, offshoring, and more. Project evaluation involves the application of economic decision rules—NPV and IRR—to measure the cost-benefit tradeoff of the project.

**Unit 10: Capital Budgeting Investment Decision Rules**

*Main Issue:* How can managers identify wealth-increasing projects?

*Comments:* Unit 7 introduced two important decision rules: NPV and IRR. This Unit expands your understanding of these rules and introduces other evaluation methods.

**Unit 11: Capital Budgeting Cash Flow Analysis**

*Main Issue:* How do managers identify and organize cash flows for analysis?

*Comments:* Unit 11 identifies what cash flows are relevant for capital budgeting decisions and how to place these cash flows on a project time line. It also describes special capital budgeting situations.

**Part VI: Risk and the Cost of Capital:** This part shows how the risk-adjusted opportunity cost, more commonly called the discount rate or cost of capital, is calculated.

**Unit 12: Risk and the Opportunity Cost**

*Main Issue:* How do managers calculate the opportunity cost for a project?

*Comments:* This is one of the most important units in the course, as it formally quantifies the opportunity cost, which is at the heart of economic decision making.

**Unit 13: Risk and the Cost of Capital**

*Main Issue:* How do managers use security prices to determine a project's opportunity cost?

*Comments:* The cost of capital is the rate of return that investors require from their investment in a company. This cost of capital can in many cases be used as the discount rate for corporate projects. This unit takes this concept and quantifies it through the Weighted Average Cost of Capital.

**Part VII: The Global Environment:** Investors generally do not hold just one security; they hold a portfolio of different securities from different classes of investment. Investment management focuses on the securities to hold and how to combine them into investment portfolios.

**Unit 14: The Investment Management Framework**

*Main Issue:* How does an investor invest?

*Comments:* This unit covers investment management. This type of management involves the decisions regarding which securities to hold, and how to combine these securities and other assets into investment portfolios.

**Unit 15: The Global Environment**

*Main Issue:* How does the global political and economic environment shape economic decisions?

*Comments:* This unit uses the balance of payments and exchange rates to define the risks and opportunities of operating in global markets.

## Required Materials

**Textbook:** Parrino, R., Kidwell, D., & Bates, T. (2014). *Essentials of Corporate Finance*. Hoboken, N.J. John Wiley & Sons, Inc.

You will receive information on how to obtain the text and other class materials when the class opens up on July 6.

## Grading Criteria

Finance is an applied discipline: theories and logic have no impact unless they can be converted into decisions measured in terms of dollars and rates of return. This course provides you with many opportunities to use the logic of finance to determine the economic value of specific decisions. So please look on your grade not just as a number but as feedback on how well you have mastered the ability to manage money!

The course grade consists of 1,000 points based on three types of evaluations:

Three Assessments totaling 150 points. These exercises require you to verbally answer logical and technical questions. While you may use course and other resources, you must do these exercise on your own without help from others.. These assessments are graded in two ways.

One Short Answer Question that I will grade.

Two Peer Review Questions will be graded by your classmates. I may adjust the grades as appropriate to ensure fairness.

Forty Practice Quizzes, each worth between 5 and 10 points, totaling 270 points. These practice exercises consist of verbal and quantitative questions and are graded on completion. If you answer a Practice Quiz question you will get credit for it, even if your answer is incorrect. You may use whatever resources you like and take multiple attempts. These practice quizzes are where much of you logical understanding and skill-development occur, so please devote sufficient time for them. I may adjust Practice Grades for students who do not put reasonable effort into the Practice Quizzes.

Thirteen Unit Quizzes, each worth 45 points, totaling 580 points. The quizzes consist of verbal and quantitative multiple-choice questions. You are allowed only one attempt on the Unit Quizzes. Also, they are timed exercises: you will be allowed between 30 to 75 minutes for each quiz. Once you begin the clock runs and you must complete them. They cannot be paused, and there is no credit for loss of connectivity or logging out, so please plan accordingly. You may use written and digital materials, a calculator, and a self-created note sheet. Direct or indirect assistance from any individual(s) is(are) **STRICTLY PROHIBITED** and is an unequivocal violation of the McCombs School of Business Code of Ethics and University's policy on Academic Dishonesty and Cheating.

## Assignment Deadlines

This course gives you flexibility on scheduling your work. However, the course includes assignments that require coordinated grading. Additionally, I have found that having no structure leads students to procrastinate, resulting in their not completing the course and receiving a failing grade.

To minimize these difficulties I have established the following deadlines. These deadlines apply to the graded Unit Quizzes and to the Short Answer Assessments and Peer reviewed Assessments. These deadlines do not apply to the Practice Quizzes. All Practice Quizzes will be available throughout the semester.

These are the dates by which the assignments for each Part must be submitted. The due time is 10pm CST on each specified date.

Date	Part to be completed
Friday, July 17	Part I: The Economy
Wednesday, July 22	Part II: The Business Decision Framework
Monday, July 27	Part III: Economic Value
Sunday, August 2	Part IV: Valuing Financial Securities
Friday, August 7	Part V: Valuing Non-financial Assets
Wednesday, August 12	Part VI: Risk and the Cost of Capital
Monday, August 17	Part VII: The Global Environment

At the designated day/time all Unit Assessments and Unit Quizzes for that Part will be closed. Any evaluation submitted after the deadline will receive a "0" grade. These deadlines are the latest submission date, and I encourage you to complete the assignment prior to the last minute. There are no extensions of the deadlines for any reason, so please ensure you have enough flexibility to complete the evaluations on time.

### Course Grading Scale

Our course will probably follow the standard academic grading scale. There may be some adjustments to this grading scale depending on the performance of the class this semester.

From	To	Grade	GPA
93	100	A	4.00
90	92.9	A-	3.67
86	89.9	B+	3.33
83	85.9	B	3.00
80	82.9	B-	2.67
76	79.9	C+	2.33
73	75.9	C	2.00
70	72.9	C-	1.67
66	69.9	D+	1.33
63	65.9	D	1.00
60	62.9	D-	0.67
0	59	F	0.00

**Detailed Evaluation Schedule**

<b>Points In Unit</b>	<b>Evaluations in Each Unit</b>	<b>Points for Each Evaluation</b>
38	<u>Unit 1: Human Nature and Economic Activity</u>	
	Unit 1: Assessment: Short Answer Questions	38
43	<u>Unit 2: Human Nature and the Ethics of Decision Making</u>	
	Lesson 2 Practice Quiz	5
	Unit 2 Assessment: Short Answer Question	38
92	<u>Unit 3: Structuring the Business Firm</u>	
	Lesson 1 Practice Quiz	5
	Lesson 2 Practice Quiz-Part 1	5
	Lesson 2 Practice Quiz-Part 2	5
	Unit 3 Assessment: Short Answer Questions	37
	Unit 3 Quiz	40
55	<u>Unit 4: The Accounting Framework</u>	
	Lesson 1 Practice Quiz 1	5
	Lesson 2: Practice Quiz	5
	Unit 4 Quiz	45
70	<u>Unit 5: Economic Value</u>	
	Lesson 1: Practice Quiz	5
	Lesson 2 Practice Quiz Part 1	5
	Lesson 2 Practice Quiz Part 2	5
	Lesson 2 Practice Quiz Part 3	5
	Lesson 3 Practice Quiz	5
	Unit 5 Quiz	45
75	<u>Unit 6: Applying Time Value Techniques</u>	
	Lesson 1 Practice Quiz Part 1	5
	Lesson 1 Practice Quiz Part 2	5
	Lesson 2 Practice Quiz Part 1	5
	Lesson 2 Practice Quiz Part 2	5
	Lesson 2 Practice Quiz Part 3	5
	Lesson 2 Practice Quiz Part 4	5
	Unit 6 Quiz	45
92	<u>Unit 7: Valuing the Corporation</u>	
	Lesson 1 Practice Quiz Part 1	5
	Lesson 1 Practice Quiz Part 2	5
	Unit 7 Assessment: Short Answer Question	37
	Unit 7 Quiz	45

70	<u>Unit 8: Valuing Bonds</u>	
	Lesson 1 Practice Quiz Part 1	10
	Lesson 1 Practice Quiz Part 2	5
	Lesson 2 Practice Quiz	10
	Unit 8 Quiz	45
65	<u>Unit 9: Valuing Stocks</u>	
	Lesson 1 Practice Quiz	10
	Lesson 2 Practice Quiz	10
	Unit 9 Quiz	45
85	<u>Unit 10: Capital Budgeting Investment Decision Rules</u>	
	Lesson 1 Practice Quiz Part 1	10
	Lesson 1 Practice Quiz Part 2	10
	Lesson 1 Practice Quiz Part 3	10
	Lesson 2 Practice Quiz	10
	Unit 10 Quiz	45
75	<u>Unit 11: Capital Budgeting Cash Flow Analysis</u>	
	Lesson 1 Practice Quiz Part 1	5
	Lesson 1 Practice Quiz Part 2	10
	Lesson 2 Practice Quiz Part 1	5
	Lesson 2 Practice Quiz Part 2	10
	Unit 11 Quiz	45
65	<u>Unit 12: Risk and the Opportunity Cost</u>	
	Lesson 1 Practice Quiz	10
	Lesson 2 Practice Quiz	10
	Unit 12 Quiz	45
65	<u>Unit 13: Risk and the Cost of Capital</u>	
	Lesson 1 Practice Quiz	10
	Lesson 2 Practice Quiz	10
	Unit 13 Quiz	45
55	<u>Unit 14: The Investment Management Framework</u>	
	Lesson 1 Practice Quiz	5
	Lesson 2 Practice Quiz	5
	Unit 14 Quiz	45
55	<u>Unit 15: The Global Environment</u>	
	Lesson 1 Practice Quiz	5
	Lesson 2 Practice Quiz	5
	Unit 15 Quiz	45

## Course Payoff

This course is entirely about employing resources to get a future benefit.

$$\text{Net Present Value} = \text{Benefits of the investment} - \text{Cost of the investment}$$

You should take your investment in this course seriously and approach it as you would any investment.

### Cost of the investment:

- Time: Budget time for this course. Set regular times, such as three sessions per week.
- Effort: Your human capital is your major investment. Work to understand the course material and how it builds a framework for economic decisions.
- Many units contain practice problems. Think through each question or problem before beginning your answer. Once you've completed your answer, check the recommended solution. Make sure that you understand the issues covered in each question before continuing on to the next one.

### Benefit of the investment:

- As you progress through this course you should develop an understanding of economic decision making: how to employ resources to obtain your goals. If you are seeing only a bunch of disjointed definitions and equations, then you are not developing the understanding and intuition necessary to operate in markets.

### Net Present Value:

- Net Present Value is a term you will become very familiar with. It is a measure of how much you have benefited from an investment.
- Very few people study income statements or annuities for pleasure. You are taking this course to make yourself a better decision maker and increase your employability and personal economic welfare. So, as you work through this course ask yourself: How would the skills you're developing:
  - Be attractive to an employer?
  - Help you better manage your own financial affairs?



### **Code of Ethics – McCombs School of Business**

The McCombs School of Business has no tolerance for acts of scholastic dishonesty. The responsibilities of both students and faculty with regard to scholastic dishonesty are described in detail in the BBA Program's Statement on Scholastic Dishonesty at <http://www.mcombs.utexas.edu/BBA/Code-of-Ethics>

### **Academic Integrity – University of Texas at Austin**

Students of the University of Texas and this course may not share or distribute materials that could be an advantage to another current or future student. Violations are indefensible acts of scholastic dishonesty. For more on the University of Texas policy of Academic Dishonesty and Cheating, follow the link at <http://catalog.utexas.edu/general-information/appendices/appendix-c/student-discipline-and-conduct/>

### **Students with Disabilities**

Students with disabilities may request appropriate academic accommodations from the Division of Diversity and Community Engagement, Services for Students with Disabilities, 512-471-6259, <http://www.utexas.edu/diversity/ddce/ssd/>

### **Religious Holy Days**

By UT Austin policy, you must notify me of your pending absence at least fourteen days prior to the date of observance of a religious holy day. If you must miss a class, an examination, a work assignment, or a project in order to observe a religious holy day, you will be given an opportunity to complete the missed work within a reasonable time after the absence.

### **Scholastic Dishonesty**

The McCombs School of Business has no tolerance for acts of scholastic dishonesty. The responsibilities of both students and faculty with regard to scholastic dishonesty are described in detail in the BBA Program's Statement on Scholastic Dishonesty at <http://www.mcombs.utexas.edu/BBA/Code-of-Ethics.aspx>.

By teaching this course, I have agreed to observe all faculty responsibilities described in that document. By enrolling in this class, you have agreed to observe all student responsibilities described in that document. If the application of the Statement on Scholastic Dishonesty to this class or its assignments is unclear in any way, it is your responsibility to ask me for clarification.

Students who violate University rules on scholastic dishonesty are subject to disciplinary penalties, including the possibility of failure in the course and/or dismissal from the University. Since dishonesty harms the individual, all students, the integrity of the University, and the value of our academic brand, policies on scholastic dishonesty will be strictly enforced. You should refer to the Student Judicial Services website at <http://deanofstudents.utexas.edu/sjs/> to access the official University policies and procedures on scholastic dishonesty as well as further elaboration on what constitutes scholastic dishonesty.

### **Campus Safety and Security**

Please note the following recommendations regarding emergency evacuation from the Office of Campus Safety and Security, 512-471-5767, <http://www.utexas.edu/safety/>

- Occupants of buildings on The University of Texas at Austin campus are required to evacuate buildings when a fire alarm is activated. Alarm activation or announcement requires exiting and assembling outside.
- Familiarize yourself with all exit doors of each classroom and building you may occupy. Remember that the nearest exit door may not be the one you used when

- entering the building.
- Students requiring assistance in evacuation should inform their instructor in writing during the first week of class.
  - In the event of an evacuation, follow the instruction of faculty or class instructors.
  - Do not re-enter a building unless given instructions by the following: Austin Fire Department, The University of Texas at Austin Police Department, or Fire Prevention Services office.
  - Behavior Concerns Advice Line (BCAL): 512-232-5050
  - Further information regarding emergency evacuation routes and emergency procedures can be found at: [www.utexas.edu/emergency](http://www.utexas.edu/emergency).