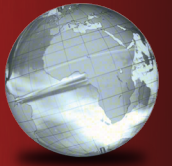


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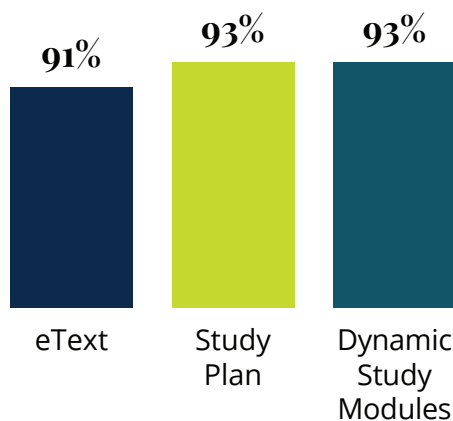
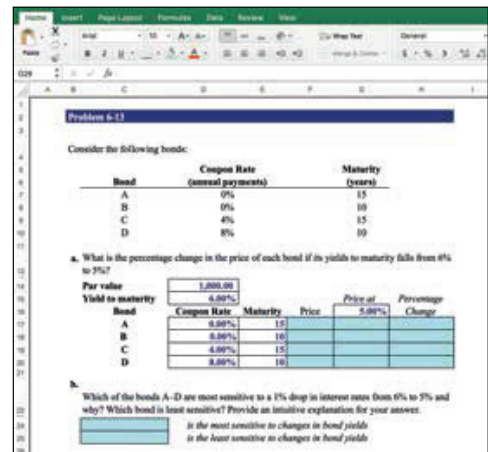
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Principles of Managerial Finance

BRIEF

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*Dedicated to our good friend and mentor,
Dr. Lawrence J. Gitman,
who trusted us as coauthors and successors
of Principles of Managerial Finance, Brief Edition.*

CJZ

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Brief Contents

Contents	9
About the Authors	25
Preface	27
Acknowledgments	40

PART 1 Introduction to Managerial Finance 43

- 1** The Role of Managerial Finance 44
- 2** The Financial Market Environment 81

PART 2 Financial Tools 113

- 3** Financial Statements and Ratio Analysis 114
- 4** Long- and Short-Term Financial Planning 179
- 5** Time Value of Money 225

PART 3 Valuation of Securities 285

- 6** Interest Rates and Bond Valuation 286
- 7** Stock Valuation 333

PART 4 Risk and the Required Rate of Return 369

- 8** Risk and Return 370
- 9** The Cost of Capital 418

PART 5 Long-Term Investment Decisions 447

- 10** Capital Budgeting Techniques 448
- 11** Capital Budgeting Cash Flows and Risk Refinements 487

PART 6 Long-Term Financial Decisions 547

- 12** Leverage and Capital Structure 548
- 13** Payout Policy 600

PART 7 Short-Term Financial Decisions 635

- 14** Working Capital and Current Assets Management 636
- 15** Current Liabilities Management 678

Appendix 709

Glossary 737

Index 761

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Contents

About the Authors 25
Preface 27
Acknowledgments 40

PART 1 Introduction to Managerial Finance 43

1 The Role of Managerial Finance 44

1.1 Finance and the Firm 45

What Is Finance? 45
What Is a Firm? 46
What Is the Goal of the Firm? 46
The Role of Business Ethics 50

in practice **FOCUS ON PRACTICE:**
Must Search Engines Screen Out Fake
News? 52

→ **REVIEW QUESTIONS** 52

1.2 Managing the Firm 52

The Managerial Finance Function 53

→ **REVIEW QUESTIONS** 61

1.3 Organizational Forms, Taxation, and the Principal-Agent Relationship 61

Legal Forms of Business Organization 61
Agency Problems and Agency Costs 68
Corporate Governance 68

→ **REVIEW QUESTIONS** 72

1.4 Developing Skills for Your Career 72

Critical Thinking 72
Communication and Collaboration 73
Financial Computing Skills 73

Summary 73

Self-Test Problem 75

Warm-Up Exercises 75

Problems 77

Spreadsheet Exercise 80

2

The Financial Market Environment 81

2.1 Financial Institutions 82
Commercial Banks, Investment Banks,
and the Shadow Banking System 82
→ **REVIEW QUESTIONS** 84

2.2 Financial Markets 84
The Relationship Between Institutions
and Markets 84
The Money Market 85
The Capital Market 86
The Role of Capital Markets 90
in practice ► **FOCUS ON ETHICS:**
Should Insider Trading Be Legal? 92
→ **REVIEW QUESTIONS** 93

2.3 Regulation of Financial Markets
and Institutions 93
Regulations Governing Financial
Institutions 93
Regulations Governing Financial
Markets 94
→ **REVIEW QUESTIONS** 95

2.4 The Securities Issuing
Process 95
Issuing Common Stock 95
→ **REVIEW QUESTIONS** 103

2.5 Financial Markets in Crisis 103
Financial Institutions and Real Estate
Finance 104
Spillover Effects and Recovery from the
Great Recession 106
→ **REVIEW QUESTIONS** 107
Summary 107
Self-Test Problem 109
Warm-Up Exercises 110
Problems 110
Spreadsheet Exercise 112

PART 2 Financial Tools 113

3 Financial Statements and Ratio Analysis 114

3.1 The Stockholders' Report 115

The Letter to Stockholders 115

The Four Key Financial Statements 115

in practice FOCUS ON ETHICS:

Earnings Shenanigans 116

Notes to the Financial Statements 122

Consolidating International Financial
Statements 122

→ REVIEW QUESTIONS 123

3.2 Using Financial Ratios 124

Interested Parties 124

Types of Ratio Comparisons 124

Cautions About Using Ratio Analysis 127

→ REVIEW QUESTIONS 128

3.3 Liquidity Ratios 129

Current Ratio 129

Quick (Acid-Test) Ratio 131

→ REVIEW QUESTIONS 132

3.4 Activity Ratios 132

Inventory Turnover 132

Average Collection Period 133

Average Payment Period 135

Total Asset Turnover 135

→ REVIEW QUESTION 136

3.5 Debt Ratios 136

Debt Ratio 138

Debt-to-Equity Ratio 138

Times Interest Earned Ratio 139

Fixed-Payment Coverage Ratio 140

→ REVIEW QUESTIONS 140

3.6 Profitability Ratios 140

Common-Size Income Statements 140

Gross Profit Margin 141

Operating Profit Margin 143

Net Profit Margin 143

Earnings Per Share (EPS) 144

Return on Total Assets (ROA) 145

Return on Equity (ROE) 145

→ REVIEW QUESTIONS 147

3.7 Market Ratios 147

Price/Earnings (P/E) Ratio 148

Market/Book (M/B) Ratio 150

→ REVIEW QUESTION 151

3.8 A Complete Ratio Analysis 151

Summary of Whole Foods' Financial
Condition 151

DuPont System of Analysis 155

→ REVIEW QUESTIONS 158

Summary 158

Self-Test Problems 160

Warm-Up Exercises 161

Problems 162

Spreadsheet Exercise 177

4 Long- and Short- Term Financial Planning 179

- 4.1 The Financial Planning Process** 180
 - Long-Term (Strategic) Financial Plans 180
 - Short-Term (Operating) Financial Plans 181

→ **REVIEW QUESTIONS** 182

- 4.2 Measuring the Firm's Cash Flow** 182

- Depreciation 182
- Depreciation Methods 183
- Developing the Statement of Cash Flows 185
- Free Cash Flow 190

in practice ► **FOCUS ON ETHICS:**
Is Excess Cash Always a Good Thing? 191

→ **REVIEW QUESTIONS** 192

- 4.3 Cash Planning: Cash Budgets** 193

- The Sales Forecast 193
- Preparing the Cash Budget 193
- Evaluating the Cash Budget 198
- Coping with Uncertainty in the Cash Budget 199
- Cash Flow within the Month 201

→ **REVIEW QUESTIONS** 201

- 4.4 Profit Planning: Pro Forma Statements** 201
 - Preceding Year's Financial Statements 202
 - Sales Forecast 202

→ **REVIEW QUESTION** 203

- 4.5 Preparing the Pro Forma Income Statement** 203

- Considering Types of Costs and Expenses 204

→ **REVIEW QUESTIONS** 205

- 4.6 Preparing the Pro Forma Balance Sheet** 205

→ **REVIEW QUESTIONS** 207

- 4.7 Evaluation of Pro Forma Statements** 207

→ **REVIEW QUESTIONS** 208

- Summary 208
- Self-Test Problems 210
- Warm-Up Exercises 212
- Problems 212
- Spreadsheet Exercise 223

5 Time Value of Money 225

5.1 The Role of Time Value in Finance 226

Future Value Versus Present Value 226

Computational Tools 227

Basic Patterns of Cash Flow 229

→ **REVIEW QUESTIONS** 229

5.2 Single Amounts 230

Future Value of a Single Amount 230

Present Value of a Single Amount 234

→ **REVIEW QUESTIONS** 237

→ **EXCEL REVIEW QUESTIONS** 237

5.3 Annuities 238

Types of Annuities 238

Finding the Future Value of an Ordinary Annuity 239

Finding the Present Value of an Ordinary Annuity 240

Finding the Future Value of an Annuity Due 242

Finding the Present Value of an Annuity Due 243

Finding the Present Value of a Perpetuity 245

→ **REVIEW QUESTIONS** 246

→ **EXCEL REVIEW QUESTIONS** 246

5.4 Mixed Streams 247

Future Value of a Mixed Stream 247

Present Value of a Mixed Stream 249

→ **REVIEW QUESTION** 250

→ **EXCEL REVIEW QUESTION** 250

5.5 Compounding Interest More Frequently than Annually 250

Semiannual Compounding 250

Quarterly Compounding 251

A General Equation for Compounding 252

Using Computational Tools for Compounding 252

Continuous Compounding 253

Nominal and Effective Annual Rates of Interest 254

→ **REVIEW QUESTIONS** 256

in practice **FOCUS ON ETHICS:**

Was the Deal for Manhattan a Swindle? 256

→ **EXCEL REVIEW QUESTIONS** 257

5.6 Special Applications of Time Value 257

Determining Deposits Needed to Accumulate a Future Sum 257

Loan Amortization 258

Finding Interest or Growth Rates 260

Finding an Unknown Number of Periods 262

→ **REVIEW QUESTIONS** 264

→ **EXCEL REVIEW QUESTIONS** 264

Summary 265

Self-Test Problems 266

Warm-Up Exercises 267

Problems 268

Spreadsheet Exercise 284

PART 3 Valuation of Securities 285

6 Interest Rates and Bond Valuation 286

6.1 Interest Rates and Required Returns 287

Interest Rate Fundamentals 287
Term Structure of Interest Rates 292
Risk Premiums: Issuer and Issue Characteristics 297

→ REVIEW QUESTIONS 298

6.2 Government and Corporate Bonds 299

Legal Aspects of Corporate Bonds 299
Cost of Bonds to the Issuer 301
General Features of a Bond Issue 301
Bond Yields 302
Bond Prices 302
Bond Ratings 303
Common Types of Bonds 303
International Bond Issues 305

in practice FOCUS ON ETHICS:
"Can Bond Ratings Be Trusted?" 305

→ REVIEW QUESTIONS 306

6.3 Valuation Fundamentals 307

Key Inputs 307
Basic Valuation Model 308
→ REVIEW QUESTIONS 309

6.4 Bond Valuation 309

Bond Fundamentals 310
Bond Valuation 310
Semiannual Interest Rates and Bond Values 312
Changes in Bond Values 314
Yield to Maturity (YTM) 317

→ REVIEW QUESTIONS 319

→ EXCEL REVIEW QUESTIONS 319

Summary 319
Self-Test Problems 321
Warm-Up Exercises 322
Problems 323
Spreadsheet Exercise 332

7

Stock Valuation 333

7.1 Differences Between Debt and Equity 334

Voice in Management 334
Claims on Income and Assets 334
Maturity 335
Tax Treatment 335

→ REVIEW QUESTION 335

7.2 Common and Preferred Stock 335

Common Stock 336
Preferred Stock 339

→ REVIEW QUESTIONS 341

7.3 Common Stock Valuation 341

Market Efficiency and Stock Valuation 341
Common Stock Dividend Valuation Model 343

in practice FOCUS ON PRACTICE:

Understanding Human Behavior Helps Us Understand Investor Behavior 344

Free Cash Flow Stock Valuation Model 348

Other Approaches to Common Stock Valuation 351

→ REVIEW QUESTIONS 354

7.4 Decision Making and Common Stock Value 354

Changes in Expected Dividends 355
Changes in Risk 355
Combined Effect 356

→ REVIEW QUESTIONS 356

Summary 357

Self-Test Problems 359

Warm-Up Exercises 359

Problems 360

Spreadsheet Exercise 368

PART 4 Risk and the Required Rate of Return 369

8

Risk and Return 370

8.1 Risk and Return Fundamentals 371

What Is Risk? 371

What Is Return? 371

Risk Preferences 373

→ REVIEW QUESTIONS 374

8.2 Risk of a Single Asset 374

Risk Assessment 374

Risk Measurement 377

→ REVIEW QUESTIONS 382

8.3 Risk of a Portfolio 382

Portfolio Return and Standard Deviation 382

Correlation 384

Diversification 385

Correlation, Diversification, Risk, and Return 387

International Diversification 388

in practice GLOBAL FOCUS:
An International Flavor to Risk
Reduction 389

→ REVIEW QUESTIONS 390

8.4 Risk and Return: The Capital Asset Pricing Model (CAPM) 390

Types of Risk 390

The Model: CAPM 391

→ REVIEW QUESTIONS 400

Summary 400

Self-Test Problems 402

Warm-Up Exercises 403

Problems 404

Spreadsheet Exercise 416

9 The Cost of Capital 418

9.1 Overview of the Cost of Capital 419

in practice FOCUS ON ETHICS:

The Cost of Capital Also Rises 419

The Basic Concept 420

Sources of Long-Term Capital 422

→ REVIEW QUESTIONS 423

9.2 Cost of Long-Term Debt 423

Net Proceeds 423

Before-Tax Cost of Debt 424

After-Tax Cost of Debt 426

→ REVIEW QUESTIONS 427

→ EXCEL REVIEW QUESTION 427

9.3 Cost of Preferred Stock 427

Preferred Stock Dividends 428

Calculating the Cost of Preferred
Stock 428

→ REVIEW QUESTION 428

9.4 Cost of Common Stock 428

Finding the Cost of Common Stock
Equity 429

Cost of Retained Earnings 432

→ REVIEW QUESTIONS 433

9.5 Weighted Average Cost of Capital 433

Calculating the Weighted Average Cost of
Capital (WACC) 433

Capital Structure Weights 435

→ REVIEW QUESTIONS 436

Summary 436

Self-Test Problem 437

Warm-Up Exercises 438

Problems 439

Spreadsheet Exercise 446

PART 5 Long-Term Investment Decisions 447

10 Capital Budgeting Techniques 448

10.1 Overview of Capital Budgeting 449

- Motives for Capital Expenditure 449
- Steps in the Process 449
- Basic Terminology 450
- Capital Budgeting Techniques 451
- **REVIEW QUESTION** 452

10.2 Payback Period 452

- Decision Criteria 453
- Pros and Cons of Payback Analysis 453
- **REVIEW QUESTIONS** 456

10.3 Net Present Value (NPV) 456

- Decision Criteria 457
- NPV and the Profitability Index 458
- NPV and Economic Value Added 459
- **REVIEW QUESTIONS** 460
- **EXCEL REVIEW QUESTION** 460

10.4 Internal Rate of Return (IRR) 461

- Decision Criteria 461
- Calculating the IRR 461
- **REVIEW QUESTIONS** 464
- **EXCEL REVIEW QUESTION** 464

10.5 Comparing NPV and IRR Techniques 464

- Net Present Value Profiles 464
- Conflicting Rankings 466
- Which Approach Is Better? 469
- **in practice** ► **FOCUS ON ETHICS:**
Baby You Can Drive My Car—Just Not
a VW Diesel 471

→ **REVIEW QUESTIONS** 471

- Summary 472
- Self-Test Problem 473
- Warm-Up Exercises 474
- Problems 475
- Spreadsheet Exercise 485

11

Capital Budgeting Cash Flows and Risk Refinements 487

- 11.1 Project Cash Flows** 488
 Major Cash Flow Types 488
 Replacement Versus Expansion
 Decisions 489
 Sunk Costs and Opportunity Costs 490
in practice **FOCUS ON ETHICS:**
 Fumbling Sunk Costs 491
→ REVIEW QUESTIONS 492

- 11.2 Finding the Initial
Investment** 492
 Installed Cost of the New Asset 493
 After-Tax Proceeds from the Sale of the
 Old Asset 493
 Change in Net Working Capital 496
 Calculating the Initial Investment 497
→ REVIEW QUESTIONS 498

- 11.3 Finding the Operating Cash
Flows** 498
 Interpreting the Term *Cash Flows* 498
 Interpreting the Term *After-Tax* 499
 Interpreting the Term *Incremental* 501
→ REVIEW QUESTIONS 503

- 11.4 Finding the Terminal Cash
Flow** 503
 After-Tax Proceeds from the Sale of New
 and Old Assets 503
 Change in Net Working Capital 504
→ REVIEW QUESTION 505

- 11.5 Risk in Capital Budgeting
(Behavioral Approaches)** 505
 Breakeven Analysis 506
 Scenario Analysis 508
 Simulation 509
→ REVIEW QUESTIONS 510
→ EXCEL REVIEW QUESTION 510

- 11.6 Risk-Adjusted Discount
Rates** 510
 Determining Risk-Adjusted Discount Rates
 (RADRs) 511
 Applying RADRs 513
 Portfolio Effects 516
 RADRs in Practice 516
→ REVIEW QUESTIONS 518

- 11.7 Capital Budgeting
Refinements** 518
 Comparing Projects with Unequal
 Lives 518
 Recognizing Real Options 521
 Capital Rationing 522
→ REVIEW QUESTIONS 525
→ EXCEL REVIEW QUESTION 525

- Summary 525
 Self-Test Problems 527
 Warm-Up Exercises 529
 Problems 531
 Spreadsheet Exercise 546

PART 6 Long-Term Financial Decisions 547

12**Leverage
and Capital
Structure** 548**12.1** Leverage 549

Breakeven Analysis 550

Operating Leverage 553

in practice **FOCUS ON PRACTICE:**

Qualcomm's Leverage 556

Financial Leverage 557

Total Leverage 561

→ **REVIEW QUESTIONS** 563**12.2** The Firm's Capital
Structure 563

Types of Capital 564

External Assessment of Capital
Structure 564

Capital Structure of Non-U.S. Firms 566

Capital Structure Theory 567

Optimal Capital Structure 575

→ **REVIEW QUESTIONS** 577**12.3** EBIT–EPS Approach to
Capital Structure 578Presenting a Financing Plan
Graphically 578Comparing Alternative Capital
Structures 579Considering Risk in EBIT–EPS
Analysis 580Basic Shortcoming of EBIT–EPS
Analysis 581→ **REVIEW QUESTION** 581**12.4** Choosing the Optimal Capital
Structure 581

Linkage 581

Estimating Value 582

Maximizing Value Versus Maximizing
EPS 582Some Other Important
Considerations 584→ **REVIEW QUESTIONS** 585

Summary 585

Self-Test Problems 586

Warm-Up Exercises 588

Problems 588

Spreadsheet Exercise 599

13

Payout Policy 600

13.1 The Basics of Payout Policy 601

Elements of Payout Policy 601
Trends in Earnings and Dividends 601
Trends in Dividends and Share Repurchases 602

→ REVIEW QUESTIONS 604

in practice FOCUS ON ETHICS:

Buyback Mountain 605

13.2 The Mechanics of Payout Policy 605

Cash Dividend Payment Procedures 606
Share Repurchase Procedures 608
Tax Treatment of Dividends and Repurchases 609
Dividend Reinvestment Plans 610
Stock Price Reactions to Corporate Payouts 610

→ REVIEW QUESTIONS 611

13.3 Relevance of Payout Policy 611

Residual Theory of Dividends 611
The Dividend Irrelevance Theory 612
Arguments for Dividend Relevance 613

→ REVIEW QUESTIONS 614

13.4 Factors Affecting Dividend Policy 614

Legal Constraints 615
Contractual Constraints 616
Growth Prospects 616
Owner Considerations 616
Market Considerations 617

→ REVIEW QUESTION 617

13.5 Types of Dividend Policies 617

Constant-Payout-Ratio Dividend Policy 617
Regular Dividend Policy 618
Low-Regular-and-Extra Dividend Policy 619

→ REVIEW QUESTION 619

13.6 Other Forms of Dividends 619

Stock Dividends 620
Stock Splits 621

→ REVIEW QUESTIONS 623

Summary 623

Self-Test Problem 625

Warm-Up Exercises 625

Problems 626

Spreadsheet Exercise 633

PART 7 Short-Term Financial Decisions 635

14

Working Capital and Current Assets Management 636

14.1 Net Working Capital Fundamentals 637

Working Capital Management 637
Net Working Capital 638
Tradeoff between Profitability and Risk 638

→ REVIEW QUESTIONS 640

14.2 Cash Conversion Cycle 640

Calculating the Cash Conversion Cycle 641
Funding Requirements of the Cash Conversion Cycle 642
Strategies for Managing the Cash Conversion Cycle 646

→ REVIEW QUESTIONS 646

14.3 Inventory Management 646

Differing Viewpoints about Inventory Level 647
Common Techniques for Managing Inventory 647
International Inventory Management 652

→ REVIEW QUESTIONS 652

14.4 Accounts Receivable Management 652

Credit Selection and Standards 653

in practice ► **FOCUS ON ETHICS:**
If You Can Bilk It, They Will Come 654

Credit Terms 658

Credit Monitoring 660

→ REVIEW QUESTIONS 662

14.5 Management of Receipts and Disbursements 662

Float 663

Speeding Up Collections 663

Slowing Down Payments 664

Cash Concentration 664

Zero-Balance Accounts 665

Investing in Marketable Securities 666

→ REVIEW QUESTIONS 667

Summary 668

Self-Test Problems 670

Warm-Up Exercises 670

Problems 671

Spreadsheet Exercise 676

15

Current Liabilities Management 678

15.1 Spontaneous Liabilities 679

Accounts Payable Management 679

Accruals 684

→ **REVIEW QUESTIONS** 684

15.2 Unsecured Sources of Short-Term Loans 684

Bank Loans 684

Commercial Paper 690

in practice → **FOCUS ON PRACTICE:**

The Ebb and Flow of Commercial Paper 691

International Loans 692

→ **REVIEW QUESTIONS** 693

15.3 Secured Sources of Short-Term Loans 694

Characteristics of Secured Short-Term Loans 694

Use of Accounts Receivable as Collateral 695

Use of Inventory as Collateral 697

→ **REVIEW QUESTIONS** 699

Summary 699

Self-Test Problem 700

Warm-Up Exercises 701

Problems 701

Spreadsheet Exercise 708

Appendix 709

Glossary 737

Index 761

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Preface

NEW TO THIS EDITION

Finance is a dynamic discipline, as illustrated on this book's cover by the evolution of payment methods from coins and paper currency to bitcoin. As we made plans to publish the eighth edition, we were mindful of feedback from users of the seventh edition and of changes in managerial finance practices that have taken hold in recent years. For example, in the United States of America, the Tax Cuts and Jobs Act of 2017 made sweeping changes to the corporate and personal tax codes. The new tax law changes the corporate tax from a progressive structure to one with a flat 21% tax rate. It also allows firms to immediately expense many types of capital assets while imposing limits on interest deductibility. This edition incorporates these changes and highlights how tax changes may alter firms' incentives in a variety of ways.

In every chapter, our changes were designed to make the material more up to date and more relevant for students. A number of new topics have been added at appropriate places, and new features appear in each chapter:

- We have rewritten all of the *Focus on Ethics* boxes, using new examples to highlight situations in which businesses or individuals have engaged in unethical behavior. The boxes explore the consequences of ethical lapses and the ways in which markets and governments play a role in enforcing ethical standards.
- New in this edition are Chapter Introduction Videos and animations. In the introduction videos the authors explain the importance of the chapter content within the context of managerial finance. The animations for select in-chapter figures and examples allow students to manipulate inputs to determine outputs in order to illustrate concepts and reinforce learning. MyLab Finance also offers new and updated Solution Videos that allow students to watch a video of the author discussing or solving in-chapter examples. We have also updated the financial calculator images that appear in the book to better match the financial calculator available on MyLab Finance.
- The chapter-ending Spreadsheet Exercises as well as select end-of-chapter problems in the text are now offered in MyLab Finance as auto-graded Excel Projects. Using proven, field-tested technology, auto-graded Excel Projects allow instructors to seamlessly integrate Microsoft Excel content into their course without having to manually grade spreadsheets. Students have the opportunity to practice important finance skills in Excel, helping them to master key concepts and gain proficiency with the program.
- We added new problems to each chapter, many of which require students to use real-world data and features of the new tax code to reach a solution.

The chapter sequence is essentially unchanged from the prior edition, but there are some noteworthy changes within each chapter. This edition contains fifteen chapters divided into seven parts. Each part is introduced by a brief overview, which is intended to give students an advance sense for the collective value of the chapters included in the part.

Part 1 contains two chapters. Chapter 1 provides an overview of the role of managerial finance in a business enterprise. It contains new, expanded content focusing on the goal of the firm and the broad principles that financial managers use in their pursuit of that goal. Chapter 2 describes the financial market context in which firms operate, with new coverage focusing on the transactions costs investors face when trading in secondary markets.

Part 2 contains three chapters focused on basic financial skills such as financial statement analysis, cash flow analysis, and time-value-of-money calculations. Chapter 3 provides an in-depth ratio analysis using real data from Whole Foods just prior to its acquisition by Amazon. The ratios provide opportunities for interesting discussion about some of the possible motives for that acquisition. We reorganized the flow of material in Chapter 4 to emphasize first the broad goals of strategic and operational financial planning and then the importance of cash flow within any financial plan. In Chapter 5, we rewrote much of the discussion to make time-value-of-money concepts simpler and more intuitive. We also added new coverage of growing perpetuities.

Part 3 focuses on bond and stock valuation. We placed these two chapters just ahead of the risk and return chapter to provide students with exposure to basic material on bonds and stocks that is easier to grasp than some of the more theoretical concepts in the next part. New in Chapter 6 is a discussion of the negative interest rates prevailing on government bonds in Japan and some European countries, as well as an expanded discussion of the tendency of the yield curve to invert prior to a recession. Chapter 7 offers new coverage of the use of price-to-earnings multiples to value stocks.

Part 4 contains the risk and return chapter as well as the chapter on the cost of capital. We believe that following the risk and return chapter with the cost of capital material helps students understand the important principle that the expectations of a firm's investors shape how the firm should approach major investment decisions (which are covered in Part 5). In other words, Part 4 is designed to help students understand where a project "hurdle rate" comes from before they start using hurdle rates in capital budgeting problems. Updates to Chapter 8 include new historical data on stocks, bonds, and Treasury bills, as well as examples and problems featuring real data on companies such as Apple, Google, Coca-Cola, and Wal-Mart. Chapter 9 contains new material on the use of market-value-based weights in the cost of capital calculation featuring actual data on the capital structure of Netflix. Throughout the chapter we have revised examples and problems to reflect today's low interest rate environment and the correspondingly low after-tax cost of debt faced by most public companies.

Part 5 contains two chapters on various capital budgeting topics. The first chapter focuses on capital budgeting methods such as payback and net present value analysis. A new feature of this chapter is an updated discussion of economic value added using data from Exxon Mobil Corp. The second chapter in this part explains how financial analysts construct cash flow projections, which are a required component of net present value analysis. It also describes how firms analyze the risks associated with capital investments.

Part 6 deals with the topics of capital structure and payout policy. These two chapters contain updated material on trends in firms' use of leverage and their payout practices. Chapter 12 provides a new *Focus on Practice* box discussing how Qualcomm's highly skilled labor force turns what often is thought of as a variable cost into a fixed cost and thereby creates operating leverage.

The chapter also contains new expanded coverage of the role that expected bankruptcy costs play in capital structure decisions. A new discussion in Chapter 13 highlights how and why companies have shifted their payout policies away from dividends and toward share repurchases over time.

Part 7 contains two chapters centered on working capital issues. A major development in business has been the extent to which firms have found new ways to economize on working capital investments. The first chapter in Part 7 explains why and how firms work hard to squeeze resources from their investments in current assets such as cash and inventory. The second chapter in this part focuses more on management of current liabilities.

Although the text content is sequential, instructors can assign almost any chapter as a self-contained unit, enabling instructors to customize the text to various teaching strategies and course lengths.

Like the previous editions, the eighth edition incorporates a proven learning system, which integrates pedagogy with concepts and practical applications. It concentrates on the knowledge that is needed to make financial decisions in an increasingly competitive business environment. The strong pedagogy and generous use of examples—many of which use real data from markets or companies—make the text an easily accessible resource for in-class learning or out-of-class learning, such as online courses and self-study programs.

SOLVING TEACHING AND LEARNING CHALLENGES

The desire to write *Principles of Managerial Finance, Brief Edition* came from the experience of teaching the introductory managerial finance course. Those who have taught the introductory course many times can appreciate the difficulties that some students have absorbing and applying financial concepts. Students want a book that speaks to them in plain English and explains how to apply financial concepts to solve real-world problems. These students want more than just description; they also want demonstration of concepts, tools, and techniques. This book is written with the needs of students in mind, and it effectively delivers the resources that students need to succeed in the introductory finance course.

Courses and students have changed since the first edition of this book, but the goals of the text have not changed. The conversational tone and wide use of examples set off in the text still characterize *Principles of Managerial Finance, Brief Edition*. Building on those strengths, eight editions, numerous translations, and well over half a million users, *Principles* has evolved based on feedback from both instructors and students, from adopters, nonadopters, and practitioners. In this edition, we have worked to ensure that the book reflects contemporary thinking and pedagogy to further strengthen the delivery of the classic topics that our users have come to expect. Below are descriptions of the most important resources in *Principles* that help meet teaching and learning challenges.

Users of *Principles of Managerial Finance, Brief Edition* have praised the effectiveness of the book's **Teaching and Learning System**, which they hail as one of its hallmarks. The system, driven by a set of carefully developed learning goals, has been retained and polished in this eighth edition. The “walkthrough” on the pages that follow illustrates and describes the key elements of the Teaching and Learning System. We encourage both students and instructors to acquaint themselves at the start of the semester with the many useful features the book offers.

CHAPTER 1

The Role of Managerial Finance

LEARNING GOALS

- LG 1** Define finance and the managerial finance function.
- LG 2** Describe the goal of the firm, and explain why maximizing the value of the firm is an appropriate goal for a business.
- LG 3** Identify the primary activities of the financial manager.
- LG 4** Explain the key principles that financial managers use when making business decisions.
- LG 5** Describe the legal forms of business organization.
- LG 6** Describe the nature of the principal-agent relationship between the owners and managers of a corporation, and explain how various corporate governance mechanisms attempt to manage agency problems.

44

MyLab Finance Chapter Introduction Video

WHY THIS CHAPTER MATTERS TO YOU

In your *professional* life

ACCOUNTING You need to understand the relationships between the accounting and finance functions within the firm, how decision makers rely on the financial statements you prepare, why maximizing a firm's value is not the same as maximizing its profits, and the ethical duty you have when reporting financial results to investors and other stakeholders.

INFORMATION SYSTEMS You need to understand why financial information is important to managers in all functional areas, the documentation that firms must produce to comply with various regulations, and how manipulating information for personal gain can get managers into serious trouble.

MANAGEMENT You need to understand the various legal forms of a business organization, how to communicate the goal of the firm to employees and other stakeholders, the advantages and disadvantages of the agency relationship between a firm's managers and its owners, and how compensation systems can align or misalign the interests of managers and investors.

MARKETING You need to understand why increasing a firm's revenues or market share is not always a good thing, how financial managers evaluate aspects of customer relations such as cash and credit management policies, and why a firm's brands are an important part of its value to investors.

OPERATIONS You need to understand the financial benefits of increasing a firm's production efficiency, why maximizing profit by cutting costs may not increase the firm's value, and how managers have a duty to act on behalf of investors when operating a corporation.

In your *personal* life

Many principles of managerial finance also apply to your personal life. Learning a few simple principles can help you manage your own money more effectively.

Six **Learning Goals** at the start of the chapter highlight the most important concepts and techniques in the chapter. Students are reminded to think about the learning goals while working through the chapter by strategically placed **learning goal icons**.

To help students understand the relevance of a chapter within the overarching framework of managerial finance, every chapter has available in **MyLab Finance** a short chapter introduction video by an author.

Every chapter opens with a feature, titled **Why This Chapter Matters to You**, that helps motivate student interest by highlighting both professional and personal benefits from achieving the chapter learning goals.

Its first part, **In Your Professional Life**, discusses the intersection of the finance topics covered in the chapter with the concerns of other major business disciplines. It encourages students majoring in accounting, information systems, management, marketing, and operations to appreciate how financial acumen will help them achieve their professional goals.

The second part, **In Your Personal Life**, identifies topics in the chapter that will have particular application to personal finance. This feature also helps students appreciate the tasks performed in a business setting by pointing out that the tasks are not necessarily different from those that are relevant in their personal lives.

LG 1 LG 2
1.1 Finance and the Firm

The field of finance is broad and dynamic. Finance influences everything that firms do, from hiring personnel to building factories to launching new advertising campaigns. Because almost any aspect of business has important financial dimensions, many financially oriented career opportunities await those who understand the principles of finance described in this textbook. Even if you see yourself pursuing a career in another discipline such as marketing, operations, accounting, supply chain, or human resources, you'll find that understanding a few crucial ideas in finance will enhance your professional success. Knowing how financial managers think is important, especially if you're not one yourself, because they are often the gatekeepers of corporate resources. Fluency in the language of finance will improve your ability to communicate the value of your ideas to your employer. Financial knowledge will also make you a smarter consumer and a wiser investor with your own money.

Learning goal icons tie chapter content to the learning goals and appear next to related text sections and again in the chapter-end summary, end-of-chapter problems and exercises, and supplements such as the *Test Bank* and MyLab.