

FUNDAMENTALS OF
**CORPORATE
FINANCE**

Ross



Westerfield



Jordan



Roberts



 Ninth Canadian Edition

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FINANCE**

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PREFACE

Fundamentals of Corporate Finance continues on its tradition of excellence that has earned it its status as market leader. The rapid and extensive changes in financial markets and instruments have placed new burdens on the teaching of corporate finance in Canada. As a result, every chapter has been updated to provide the most current examples that reflect corporate finance in today's world. This best-selling text is written with one strongly held principle—that corporate finance should be developed and taught in terms of a few integrated, powerful ideas: emphasis on intuition, unified valuation approach, and managerial focus.

An Emphasis on Intuition We are always careful to separate and explain the principles at work on an intuitive level before launching into any specifics. The underlying ideas are discussed, first in very general terms and then by way of examples that illustrate in more concrete terms how a financial manager might proceed in a given situation.

A Unified Valuation Approach We treat net present value (NPV) as the basic concept underlying corporate finance. Many texts stop well short of consistently integrating this important principle. The most basic notion—that NPV represents the excess of market value over cost—tends to get lost in an overly mechanical approach to NPV that emphasizes computation at the expense of understanding. Every subject covered in *Fundamentals of Corporate Finance* is firmly rooted in valuation, and care is taken throughout the text to explain how particular decisions have valuation effects.

A Managerial Focus Students will not lose sight of the fact that financial management concerns *management*. Throughout the text, the role of the financial manager as decision maker is emphasized, and the need for managerial input and judgment is stressed. “Black box” approaches to finance are consciously avoided.

These three themes work together to provide a sound foundation, and a practical and workable understanding of how to evaluate and make financial decisions.

New to This Edition In addition to retaining the coverage that has characterized *Fundamentals of Corporate Finance* from the beginning, the Ninth Canadian Edition features enhanced Canadian content on current issues, such as updated and expanded coverage of corporate governance, social responsibility, ethical investing, and shareholder activism (Chapters 1, 8, and 23).

COVERAGE

This book was designed and developed explicitly for a first course in business or corporate finance, for both finance majors and non-majors alike. In terms of background or prerequisites, the book is nearly self-contained, assuming some familiarity with basic algebra and accounting concepts, while still reviewing important accounting principles very early on. The organization of this text has been developed to give instructors the flexibility they need.

Just to give an idea of the breadth of coverage in the Ninth Canadian Edition, the following grid presents, for each chapter, some of the most significant features, as well as a few selected chapter highlights. Of course, in every chapter, opening vignettes, boxed features, illustrated examples using real companies, and end-of-chapter materials have been thoroughly updated as well.

| Chapters | Selected Topics of Interest | Benefits to You |
|--|---|--|
| PART ONE OVERVIEW OF CORPORATE FINANCE | | |
| Chapter 1 Introduction to Corporate Finance | <ul style="list-style-type: none"> • <i>New material:</i> Updates on “say on pay” and other governance issues • <i>New material:</i> Update on ethics and corporate social responsibility • <i>New material:</i> In Their Own Words box on corporate social responsibility • Goal of the firm and agency problems | <ul style="list-style-type: none"> • Brings in real-world issues concerning conflicts of interest and current controversies surrounding ethical conduct and management pay. • Stresses value creation as the most fundamental aspect of management and describes agency issues that can arise. |
| Chapter 2 Financial Statements, Cash Flow, and Taxes | <ul style="list-style-type: none"> • <i>New material:</i> Expanded discussion of financial statements conforming to IFRS vs. Canadian GAAP • Cash flow vs. earnings • Market values vs. book values | <ul style="list-style-type: none"> • Links to current practice. • Defines cash flow and the differences between cash flow and earnings. • Emphasizes the relevance of market values over book values. |
| PART TWO FINANCIAL STATEMENTS AND LONG-TERM FINANCIAL PLANNING | | |
| Chapter 3 Working with Financial Statements | <ul style="list-style-type: none"> • Using financial statement information | <ul style="list-style-type: none"> • Discusses the advantages and disadvantages of using financial statements. |
| Chapter 4 Long-Term Financial Planning and Corporate Growth | <ul style="list-style-type: none"> • Explanation of alternative formulas for sustainable and internal growth rates • Thorough coverage of sustainable growth as a planning tool | <ul style="list-style-type: none"> • Explanation of growth rate formulas clears up a common misunderstanding about these formulas and the circumstances under which alternative formulas are correct. • Provides a vehicle for examining the interrelationships among operations, financing, and growth. |
| PART THREE VALUATION OF FUTURE CASH FLOWS | | |
| Chapter 5 Introduction to Valuation: The Time Value of Money | <ul style="list-style-type: none"> • First of two chapters on time value of money | <ul style="list-style-type: none"> • Relatively short chapter introduces the basic ideas on time value of money to get students started on this traditionally difficult topic. |
| Chapter 6 Discounted Cash Flow Valuation | <ul style="list-style-type: none"> • Second of two chapters on time value of money | <ul style="list-style-type: none"> • Covers more advanced time value topics with numerous examples, calculator tips, and Excel spreadsheet exhibits. Contains many real-world examples. |
| Chapter 7 Interest Rates and Bond Valuation | <ul style="list-style-type: none"> • <i>New material:</i> Updated In Their Own Words box: Edward Altman on Junk Bonds • “Clean” vs. “dirty” bond prices and accrued interest • Bond ratings | <ul style="list-style-type: none"> • Links chapter material to current events. • Clears up the pricing of bonds between coupon payment dates and also bond market quoting conventions. • Up-to-date discussion of bond rating agencies and ratings given to debt. Includes the latest descriptions of ratings used by DBRS. |
| Chapter 8 Stock Valuation | <ul style="list-style-type: none"> • <i>New material:</i> Updates on shareholder activism and “say on pay” • Stock valuation using a variety of models | <ul style="list-style-type: none"> • Expands governance coverage and links chapter material to current events. • Broadens coverage of valuation techniques. |

Coverage

| PART FOUR CAPITAL BUDGETING | | |
|---|--|--|
| Chapter 9 Net Present Value and Other Investment Criteria | <ul style="list-style-type: none"> Detailed discussion of multiple IRRs and modified IRR Practice of capital budgeting in Canada <i>New material:</i> Discussion of capital rationing moved to this chapter First of three chapters on capital budgeting NPV, IRR, payback, discounted payback, and accounting rate of return | <ul style="list-style-type: none"> Clarifies properties of IRR. Current Canadian material demonstrates relevance of techniques presented. A better fit for this material. Relatively short chapter introduces key ideas on an intuitive level to help students with this traditionally difficult topic. Consistent, balanced examination of advantages and disadvantages of various criteria. |
| Chapter 10 Making Capital Investment Decisions | <ul style="list-style-type: none"> Project cash flow Alternative cash flow definitions Special cases of DCF analysis | <ul style="list-style-type: none"> Thorough coverage of project cash flows and the relevant numbers for a project analysis. Emphasizes the equivalence of various formulas, thereby removing common misunderstandings. Considers important applications of chapter tools. |
| Chapter 11 Project Analysis and Evaluation | <ul style="list-style-type: none"> <i>New material:</i> New examples added of scenario analysis in copper mining and managerial options in oil storage due to low price of oil Sources of value Scenario and sensitivity “what-if” analyses Break-even analysis | <ul style="list-style-type: none"> Brings technique to life in real-world example. Stresses the need to understand the economic basis for value creation in a project. Illustrates how to apply and interpret these tools in a project analysis. Covers cash, accounting, and financial break-even levels. |
| PART FIVE RISK AND RETURN | | |
| Chapter 12 Lessons from Capital Market History | <ul style="list-style-type: none"> <i>New material:</i> Capital market history updated through 2014 Geometric vs. arithmetic returns Market efficiency | <ul style="list-style-type: none"> Extensively covers historical returns, volatilities, and risk premiums. Discusses calculation and interpretation of geometric returns. Clarifies common misconceptions regarding appropriate use of arithmetic vs. geometric average returns. Discusses efficient markets hypothesis along with common misconceptions. |
| Chapter 13 Return, Risk, and the Security Market Line | <ul style="list-style-type: none"> <i>New material:</i> In Their Own Words box on ETF investing in Canada Diversification, systematic, and unsystematic risk Beta and the security market line | <ul style="list-style-type: none"> Current material to illustrate growth trend in ETFs. Illustrates basics of risk and return in straightforward fashion. Develops the security market line with an intuitive approach that bypasses much of the usual portfolio theory and statistics. |
| PART SIX COST OF CAPITAL AND LONG-TERM FINANCIAL POLICY | | |
| Chapter 14 Cost of Capital | <ul style="list-style-type: none"> <i>New material:</i> Section on company valuation with WACC <i>New material:</i> Discussion of flotation costs and internal equity Cost of capital estimation | <ul style="list-style-type: none"> Expands application of WACC. Broadens coverage of flotation costs. Contains a complete step-by-step illustration of cost of capital for publicly traded Loblaw Companies. |
| Chapter 15 Raising Capital | <ul style="list-style-type: none"> <i>New material:</i> Discussion of exempt securities and crowd funding Dutch auction IPOs IPO “quiet periods” Lockup agreements IPOs in practice Updated In Their Own Words box by Jay Ritter | <ul style="list-style-type: none"> Addresses current trends. Explains uniform price auctions using Google IPO as an example. Explains the OSC’s and SEC’s quiet period rules. Briefly discusses the importance of lockup agreements. Takes in-depth look at IPOs of Facebook, Twitter, Weibo, and Canadian IPO of Seven Generations Energy. Current material on IPOs around the world. |

| | | |
|---|--|--|
| Chapter 16 Financial Leverage and Capital Structure Policy | <ul style="list-style-type: none"> • Basics of financial leverage • Optimal capital structure • Financial distress and bankruptcy | <ul style="list-style-type: none"> • Illustrates the effect of leverage on risk and return. • Describes the basic trade-offs leading to an optimal capital structure. • Briefly surveys the bankruptcy process. |
| Chapter 17 Dividends and Dividend Policy | <ul style="list-style-type: none"> • <i>New material:</i> Examples of dividend signalling by Canadian firms, Bombardier and Goldcorp • Recent Canadian survey evidence on dividend policy • Dividends and dividend policy | <ul style="list-style-type: none"> • Current examples. • Survey results show the most important (and least important) factors that financial managers consider when setting dividend policy. • Describes dividend payments and the factors favouring higher and lower payout policies. |
| PART SEVEN SHORT-TERM FINANCIAL PLANNING AND MANAGEMENT | | |
| Chapter 18 Short-Term Finance and Planning | <ul style="list-style-type: none"> • <i>New material:</i> Examples of cash management at Boeing and trends in short-term financing by Canadian firms • Operating and cash cycles • Short-term financial planning | <ul style="list-style-type: none"> • Relates to current trends. • Stresses the importance of cash flow timing. • Illustrates creation of cash budgets and potential need for financing. |
| Chapter 19 Cash and Liquidity Management | <ul style="list-style-type: none"> • <i>New material:</i> Updates on Electronic Data Interchange • <i>New Material:</i> In Their Own Words box on mobile wallets • Float management discussion related to current practice • Cash collection and disbursement | <ul style="list-style-type: none"> • Updates reflect changing technologies in payments and growth of e-commerce. • Addresses student resistance to this topic. • Covers float management thoroughly. • Examines systems that firms use to handle cash inflows and outflows. |
| Chapter 20 Credit and Inventory Management | <ul style="list-style-type: none"> • <i>New material:</i> Current examples involving Toyota, Honda, Nissan, EDC, and BlackBerry • Credit management • Inventory management | <ul style="list-style-type: none"> • Relates material to current practice. • Analysis of credit policy and implementation. • Briefly surveys important inventory concepts. |
| PART EIGHT TOPICS IN CORPORATE FINANCE | | |
| Chapter 21 International Corporate Finance | <ul style="list-style-type: none"> • <i>New material:</i> Examples of how lower Canadian dollar is affecting Maple Leaf Foods and the Blue Jays • <i>New Material:</i> Discussion of differences in corporate governance and culture across countries and their impact on international capital budgeting • Exchange rate, political, and governance risks • Foreign exchange • International capital budgeting | <ul style="list-style-type: none"> • Relates chapter material to current trend of lower Canadian dollar. • Expanded discussion of research on international practices. • Discusses hedging and issues surrounding sovereign and governance risks. • Covers essentials of exchange rates and their determination. • Shows how to adapt basic DCF approach to handle exchange rates. |
| Chapter 22 Leasing | <ul style="list-style-type: none"> • <i>New material:</i> Expanded discussion of IFRS rule for financial leases • Synthetic leases • Leases and lease valuation | <ul style="list-style-type: none"> • More in-depth coverage of IFRS and leasing. • Discusses controversial practice of financing off the statement of financial position (also referred to as off-balance sheet financing). • Discusses essentials of leasing. |
| Chapter 23 Mergers and Acquisitions | <ul style="list-style-type: none"> • <i>New material:</i> Updated discussion of dual-class stock, investor activism, and ownership and control • Alternatives to mergers and acquisitions • Divestitures and restructurings • Mergers and acquisitions • <i>New material:</i> In Their Own Words box on Canadian national interests and foreign takeovers • <i>New Material:</i> Expanded discussion of merger accounting under IFRS | <ul style="list-style-type: none"> • Presents topical issues with Canadian examples. • Covers strategic alliances and joint ventures, and explains why they are important alternatives. • Examines important actions, such as equity carve-outs, spins-offs, and split-ups. • Develops essentials of M&A analysis, including financial, tax, and accounting issues. • More-detailed accounting coverage. • Adds coverage of topical social issue related to mergers. |

PART NINE DERIVATIVE SECURITIES AND CORPORATE FINANCE

| | | |
|---|--|---|
| Chapter 24 Enterprise Risk Management | <ul style="list-style-type: none">• <i>New material:</i> Enterprise risk management framework and insurance• <i>New material:</i> Recent survey results on derivatives use• Hedging with forwards, futures, swaps, and options | <ul style="list-style-type: none">• Illustrates need to manage risk and some of the most important types of risk.• Relates material to practice by financial executives.• Shows how many risks can be managed with financial derivatives. Includes current examples of hedging by Canadian and U.S. companies. |
| Chapter 25 Options and Corporate Securities | <ul style="list-style-type: none">• Put-call parity and Black–Scholes• Options and corporate finance• <i>New material:</i> Mini Case on convertible debt issue | <ul style="list-style-type: none">• Develops modern option valuation and factors influencing option values.• Applies option valuation to a variety of corporate issues, including mergers and capital budgeting.• Provides in-depth, exam-level problem on convertibles. |
| Chapter 26 Behavioural Finance: Implications for Financial Management | <ul style="list-style-type: none">• Introduction to behavioural finance• Behavioural finance and market efficiency• Market efficiency and the performance of professional money managers• <i>New material:</i> Example of bubble in Tesla Motors stock• <i>New material:</i> Updates to discussion of performance of professional money managers | <ul style="list-style-type: none">• Introduces biases, framing effects, and heuristics.• Explains limits to arbitrage and discusses bubbles and crashes, including the Crash of 2008.• Expands on efficient markets discussion in Chapter 12 and relates it to behavioural finance.• Adds a current example.• Updated example of overall market efficiency. |

LEARNING SOLUTIONS

In addition to illustrating pertinent concepts and presenting up-to-date coverage, the authors strive to present the material in a way that makes it logical and easy to understand. To meet the varied needs of the intended audience, our text is rich in valuable learning tools and support.

Each feature can be categorized by the benefit to the student:

- Real Financial Decisions
- Application Tools
- Study Aids

Real Financial Decisions

We have included key features that help students connect chapter concepts to how decision makers use this material in the real world.

In Their Own Words Boxes A unique series of brief essays are written by distinguished scholars and Canadian practitioners on key topics in the text. To name just a few, these include essays by Jeremy Siegel on efficient market theory and the financial crisis, Eric Lie on option backdating, Edward Altman on junk bonds, and Pat Chiefalo, Managing Director, head of iShares Canada at BlackRock Asset Management Canada.

IN THEIR OWN WORDS...

Sophie Cousineau on How Gildan Drew the Line on Cost-Cutting in Bangladesh

T-shirt giant Gildan Activewear Inc. came to Bangladesh for the same reasons international retailers and apparel manufacturers have been crazy about the South Asian country: duty-free access to rich countries, cheap electricity, and ultra-cheap labour.

But the Montreal-based company drew the line on cost-cutting when it acquired a factory three years ago in Savar, in that same swampland suburb to the north of the capital Dhaka where the doomed Rana Plaza stood until a week ago. Instead of closing its eyes to the hazards of the manufacturing facility it had just bought, Gildan set out to make it a safe working place.

Enhanced Real-World Examples There are many current examples integrated throughout the text, tying chapter concepts to real life through illustration and reinforcing the relevance of the material. For added reinforcement, some examples tie into the chapter-opening vignettes.

Web Links We have added and updated website references, a key research tool directing students to websites that tie into the chapter material.

Integrative Mini Cases These longer problems seek to integrate a number of topics from within the chapter. The Mini Cases allow students to test and challenge their abilities to solve real-life situations for each of the key sections of the text material.

Internet Application Questions Questions relevant to the topic discussed in each chapter are presented for the students to explore using the Internet. Students will find direct links to the websites included in these questions on the Ross Connect site and linked out directly from the eBook.

Application Tools

Realizing that there is more than one way to solve problems in corporate finance, we include sections that will not only encourage students to learn different problem-solving methods, but will also help them learn or brush up on their financial calculator and Excel® spreadsheet skills.

Calculator Hints This feature introduces students to problem solving with the assistance of a financial calculator. Sample keystrokes are provided for illustrative purposes, although individual calculators will vary.

Calculator HINTS

Annuity Payments

Finding annuity payments is easy with a financial calculator. In our example just above, the PV is \$100,000, the interest rate is 18 percent, and there are five years. We find the payment as follows:

Enter 5 18 100,000
 N I/Y PV PMT FV
 Solve for -31,978

Here we get a negative sign on the payment because the payment is an outflow for us.

Spreadsheet Strategies This feature either introduces students to Excel® or helps them brush up on their Excel® spreadsheet skills, particularly as they relate to Corporate Finance. This feature appears in self-contained sections and shows students how to set up spreadsheets to analyze common financial problems—a vital part of every business student's education.


Spreadsheet STRATEGIES

Loan Amortization Using a Spreadsheet

Loan amortization is a very common spreadsheet application. To illustrate, we will set up the problem that we have just examined, a five-year, \$5,000, 9 percent loan with constant payments. Our spreadsheet looks like this:

| | A | B | C | D | E | F | G | H |
|---|--|---|----------------|------------|---|---|---|---|
| 1 | | | | | | | | |
| 2 | Using a spreadsheet to amortize a loan | | | | | | | |
| 3 | | | | | | | | |
| 4 | | | Loan amount: | \$5,000 | | | | |
| 5 | | | Interest rate: | 0.09 | | | | |
| 6 | | | Loan term: | 5 | | | | |
| 7 | | | Loan payment: | \$1,285.46 | | | | |
| 8 | | | | | | | | |

Note: payment is calculated using $PMT(rate, nper, -pv, fv)$

Excel® Spreadsheet Templates Selected questions within the end-of-chapter material, identified by the following icon, , can be solved using the Excel® Spreadsheet Templates available on this text's Connect. These Excel® templates are a valuable extension of the Spreadsheet Strategies feature.

Study Aids

We want students to get the most from this resource and their course, and we realize that students have different learning styles and study needs. We therefore present a number of study features to appeal to a wide range of students.

Chapter Learning Objectives This feature maps out the topics and learning goals in each chapter. Each end-of-chapter problem is linked to a learning objective to help students organize their study time appropriately.

LEARNING OBJECTIVES

After studying this chapter, you should understand:

- LO1** How to determine the future and present value of investments with multiple cash flows.
- LO2** How loan payments are calculated, and how to find the interest rate on a loan.
- LO3** How loans are amortized or paid off.
- LO4** How interest rates are quoted (and misquoted).

Concept Building Chapter sections are intentionally kept short to promote a step-by-step, building block approach to learning. Each section is then followed by a series of short concept questions that highlight the key ideas just presented. Students use these questions to make sure they can identify and understand the most important concepts as they read.

Numbered Examples Separate numbered and titled examples are extensively integrated into the chapters. These examples provide detailed applications and illustrations of the text material in a step-by-step format. Each example is completely self-contained so students don't have to search for additional information. Based on our classroom testing, these examples are among the most useful learning aids because they provide both detail and explanation.

Key Terms Within each chapter, key terms are highlighted in **boldface** type the first time they appear. Key terms are defined in the text, and also in a running glossary within the text for quick reminders. For reference, there is a list of key terms at the end of each chapter and a full glossary with page references for each term at the back of the textbook.

Summary Tables These tables succinctly restate key principles, results, and equations. They appear whenever it is useful to emphasize and summarize a group of related concepts.

Key Equations These are called out in the text and identified by equation number. An Equation Index is available at the end of the book and a Formula Sheet can be found on the text's Connect site.

Chapter Summary and Conclusion These paragraphs review the chapter's key points and provide closure to the chapter.

Chapter Review Problems and Self-Test Appearing after the Summary and Conclusions and Key Terms, each chapter includes Chapter Review Problems and a Self-Test section. These questions and answers allow students to test their abilities in solving key problems related to the chapter content and provide instant reinforcement.

Concepts Review and Critical Thinking Questions This section facilitates students' knowledge of key principles, and their intuitive understanding of chapter concepts. A number of the questions relate to the chapter-opening vignette—reinforcing students' critical-thinking skills and the learning of chapter material.

CONCEPTS REVIEW AND CRITICAL THINKING QUESTIONS

1. **(LO1)** In evaluating an annuity present value, there are four pieces. What are they?
2. **(LO1)** As you increase the length of time involved, what happens to the present value of an annuity? What happens to the future value?
3. **(LO1)** What happens to the future value of an annuity if you increase the rate, r ? What happens to the present value?
4. **(LO1)** What do you think about a lottery advertising a \$500,000 prize when the lump-sum option is \$250,000? Is it deceptive advertising?

Questions and Problems We have found that many students learn better when they have plenty of opportunity to practice; therefore, we provide extensive end-of-chapter questions and problems. These are labelled by topic and separated into three learning levels: Basic, Intermediate, and Challenge. Throughout the text, we have worked to supply interesting problems that illustrate real-world applications of chapter material. Answers to selected end-of-chapter material appear in Appendix B (now available on Connect).

As described earlier in this Preface, students' learning and understanding of the chapter content is further supported by the following end-of-chapter materials:

- Internet Application Questions
- Mini Cases
- Suggested Readings (now available on Connect)

MARKET LEADING TECHNOLOGY



Learn without Limits

McGraw-Hill Connect® is an award-winning digital teaching and learning platform that gives students the means to better connect with their coursework, with their instructors, and with the important concepts that they will need to know for success now and in the future. With Connect, instructors can take advantage of McGraw-Hill's trusted content to seamlessly deliver assignments, quizzes and tests online. McGraw-Hill Connect is a learning platform that continually adapts to each student, delivering precisely what they need, when they need it, so class time is more engaging and effective. Connect makes teaching and learning personal, easy, and proven.

Connect Key Features:

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Connect Insight is Connect's new one-of-a-kind visual analytics dashboard—now available for instructors—that provides at-a-glance information regarding student performance, which is immediately actionable. By presenting assignment, assessment, and topical performance results together with a time metric that is easily visible for aggregate or individual results, Connect Insight gives instructors the ability to take a just-in-time approach to teaching and learning, which was never before available. Connect Insight presents data that helps instructors improve class performance in a way that is efficient and effective.

Simple Assignment Management

With Connect, creating assignments is easier than ever, so instructors can spend more time teaching and less time managing.

- Assign SmartBook learning modules.
- Instructors can edit existing questions and create their own questions.

Market Leading Technology

- Draw from a variety of text specific questions, resources, and test bank material to assign online.
- Streamline lesson planning, student progress reporting, and assignment grading to make classroom management more efficient than ever.

Smart Grading

When it comes to studying, time is precious. Connect helps students learn more efficiently by providing feedback and practice material when they need it, where they need it.

- Automatically score assignments, giving students immediate feedback on their work and comparisons with correct answers.
- Access and review each response; manually change grades or leave comments for students to review.
- Track individual student performance—by question, assignment, or in relation to the class overall—with detailed grade reports.
- Reinforce classroom concepts with practice tests and instant quizzes.
- Integrate grade reports easily with Learning Management Systems including Blackboard, D2L, and Moodle.

Instructor Library

The Connect Instructor Library is a repository for additional resources to improve student engagement in and out of the class. It provides all the critical resources instructors need to build their course.

- Access Instructor resources.
- View assignments and resources created for past sections.
- Post your own resources for students to use.

INSTRUCTOR RESOURCES

Instructor Resources

- Instructor's Manual (prepared by Shiu-Yik Au, *York University*). The Instructor's Manual contains two main sections. The first section contains a chapter outline with lecture tips, real-world tips, and ethics notes. The second section includes detailed solutions for all end-of-chapter problems.
- Instructor's Solutions Manual (prepared by Shiu-Yik Au, *York University*).
- Computerized Test Bank (prepared by Sepand Jazzi, *Kwantlen Polytechnic University*). The computerized test bank is available through EZ Test Online—a flexible and easy-to-use electronic testing program—and allows instructors to create tests from book-specific items. EZ Test accommodates a wide range of question types and allows instructors to add their own questions. Test items are also available in Word format (Rich text format). For secure online testing, exams created in EZ Test can be exported to WebCT and Blackboard. EZ Test Online is supported at mhhe.com/eztest where users can download a Quick Start Guide, access FAQs, or log a ticket for help with specific issues.
- Microsoft® PowerPoint® Lecture Slides (prepared by Anne Inglis). The Microsoft® PowerPoint® Presentation slides have been enhanced to better illustrate chapter concepts.
- Excel® Templates with Solutions (prepared by Brent Matheson, *University of Waterloo*). Excel® templates are included with solutions for end-of-chapter problems indicated by an Excel® icon in the margin of the text.

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For more information, please visit us online: <http://www.mheducation.ca/he/solutions>.

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Introduction to Corporate Finance



Loblaws is a registered trademark of Loblaws Incorporation.

In 1919, Theodore Pringle Loblaws and J. Milton Cork opened in Toronto the first Loblaws Groceries store, which became today's Loblaws Company Ltd. With the concept of "self-serve" combined with that of "cash and carry," Loblaws expanded radically in 1920s and 1930s. By the time of the death of one of its co-founders, Theodore Loblaws, there were over 150 stores in Ontario and more in the U.S. In 1950, George Weston Ltd. gained a controlling interest and Loblaws officially became its subsidiary. In the 1970s and 1980s, the company achieved huge success through introducing the private labels No Name and President's Choice, resulting in Loblaws becoming Canada's largest supermarket. Next, the company extended its product mix into banking, fashion, ethnic retail, and pharmacy through organic growth and strategic acquisitions. In 2013, the tragic collapse of a Bangladesh garment factory building where Loblaws's fashion brand Joe Fresh items were manufactured shocked Canadians and heightened public scrutiny of the company's level of corporate social responsibility. Later in 2013, Loblaws spun off its real estate investment trust (REIT), which is a form of income trust. The Loblaws story touches on different forms of business, financial management, corporate control, and corporate social responsibility, all topics that are discussed in this chapter.

LEARNING OBJECTIVES

After studying this chapter, you should understand:

- LO1** The basic types of financial management decisions and the role of the financial manager.
- LO2** The financial implications of the different forms of business organization.
- LO3** The goal of financial management.
- LO4** The conflicts of interest that can arise between managers and owners.
- LO5** The roles of financial institutions and markets.

To begin our study of modern corporate finance and financial management, we need to address two central issues. First, what is corporate finance, and what is the role of the financial manager in the corporation? Second, what is the goal of financial management? To describe the financial management environment, we look at the corporate form of organization and discuss some conflicts that can arise within the corporation. We also take a brief look at financial institutions and financial markets in Canada.

1.1 | Corporate Finance and the Financial Manager

In this section, we discuss where the financial manager fits in the corporation. We start by looking at what corporate finance is and what the financial manager does.

What Is Corporate Finance?

Imagine that you were to start your own business. No matter what type you started, you would have to answer the following three questions in some form or another:

1. What long-term investments should you take on? That is, what lines of business will you be in and what sorts of buildings, machinery, equipment, and research and development facilities will you need?
2. Where will you get the long-term financing to pay for your investment? Will you bring in other owners or will you borrow the money?
3. How will you manage your everyday financial activities, such as collecting from customers and paying suppliers?

These are not the only questions by any means, but they are among the most important. Corporate finance, broadly speaking, is the study of ways to answer these three questions.

Accordingly, we'll be looking at each of them in the chapters ahead. Though our discussion focuses on the role of the financial manager, these three questions are important to managers in all areas of the corporation. For example, selecting the firm's lines of business (Question 1) shapes the jobs of managers in production, marketing, and management information systems. As a result, most large corporations centralize their finance function and use it to measure performance in other areas. Most CEOs have significant financial management experience.

The Financial Manager

A striking feature of large corporations is that the owners (the shareholders) are usually not directly involved in making business decisions, particularly on a day-to-day basis. Instead, the corporation employs managers to represent the owners' interests and make decisions on their behalf. In a large corporation, the financial manager is in charge of answering the three questions we raised earlier.

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It is a challenging task because changes in the firm's operations, and shifts in Canadian and global financial markets, mean that the best answers for each firm are changing, sometimes quite rapidly. Globalization of markets, advanced communications and computer technology, and increased volatility of interest rates and foreign exchange rates have raised the stakes in financial management decisions. We discuss these major trends and how they are changing the financial manager's job after we introduce you to some of the basics of corporate financial decisions.

The financial management function is usually associated with a top officer of the firm, such as a vice president of finance or some other chief financial officer (CFO). Figure 1.1 is a simplified organization chart that highlights the finance activity in a large firm. The CFO reports to the president, who is the chief operating officer (COO) in charge of day-to-day operations. The COO reports to the chairman, who is usually CEO. However, as businesses become more complex, there is a growing pattern among large companies to separate the roles of chairman and CEO. The CEO has overall responsibility to the board. As shown, the vice president of finance coordinates the activities of the treasurer and the controller. The controller's office handles cost and financial accounting, tax payments, and management information systems. The treasurer's office is responsible for managing the firm's cash, its financial planning, and its capital expenditures. These treasury activities are all related to the three general questions raised earlier, and the chapters ahead deal primarily with these issues. Our study thus bears mostly on activities usually associated with the treasurer's office.

Financial Management Decisions

As our discussion suggests, the financial manager must be concerned with three basic types of questions. We consider these in greater detail next.

FIGURE 1.1

A simplified organization chart. The exact titles and organization differ from company to company.

