FIN 3715

Course Objectives

Finance 3715 is an introduction to the finance function within the firm. The course objectives are to develop the financial and analytical skills, logical thought processes, and information literacy necessary to make and implement strategic corporate financial decisions in a global environment. The course stresses the impact of a global economy and legal, social, technological, and ethical considerations on efficient economic outcomes. Upon successful completion of this course, students will have developed an understanding of firm organization, principal-agent relationships, fundamental financial statement analysis, short-term working capital management, risk/return relationships, time-value-of-money, valuation, and capital budgeting, as they relate to the financial management of the firm and its interactions with the financial markets. Students will also obtain institutional knowledge of how financial markets function and their roles in a free market economy. Through assignments and in-class discussions, students will develop the effective written and oral communication skills required to implement financial decisions in the corporation. Since most business activities involve collaboration among various individuals, students will develop teamwork skills by engaging in group assignments and activities.

Coverage and Learning Outcomes

Each instructor puts his or her personal stamp on their sections of FIN 3715 through creative and innovative exercises, learning methods, etc. At the same time, however, all instructors will include the same minimum set of learning outcomes described below. These topics are arranged in the one possible order; your section may follow a different sequence.

Working capital management and global finance are integrated throughout the course. In the learning objectives that follow, (WC) indicates a working capital objective and (G) indicates a global finance objective.

By the end of the term, all students should be able to demonstrate competence in each of the learning outcomes.

Overview

♦ Be familiar with the major organizational structures of businesses: proprietorship, partnership, and the corporation.
♦ Be able to describe the advantages and disadvantages of the publicly held corporation.
♦ Know the international equivalents of publicly held corporations: joint stock companies, public limited companies, limited liability companies, etc. (G).
♦ Be able to describe wealth maximization as the primary goal of the publicly held corporation and how financial managers contribute to the attainment of this goal.
♦ Be able to describe and distinguish the two types of agency conflicts that exist in the publicly held corporation.
♦ Understand the relationship between the firm and the capital markets including the globalization of the financial markets as capital flows across international boundaries (G).
♦ Be able to distinguish the difference between primary and secondary markets and identify major secondary markets around the world: NYSE, NASDAQ, London, Tokyo, etc. (G).
Review of Financial Statements

♦ Understand and be able to distinguish between the three major financial statements: the balance sheet, the income statement, and the statement of cash flows.
♦ Be able to distinguish between accounting revenues and expenses and cash flow.
♦ Be able to find any major accounting item on a financial statement. For instance, they should know that inventory is an asset, payables are liabilities, and cost of goods sold is an income statement expense.
♦ Be able to compile an indirect statement of cash flows (sources and uses).

Financial Statement Analysis

♦ Conduct financial statement analysis using the DuPont breakdown.
♦ Be able to analyze financial statements to assess the liquidity of a firm.
♦ Understand the uses and relationships between ratios, common size statements, and cash flows.
♦ Know how to conduct both trend analysis and industry comparisons.
♦ Students should understand the limitations of financial statement analysis.
♦ Be able to calculate and interpret the operating cycle and the cash cycle (WC).

Financial Forecasting and Growth

♦ Be able to construct a pro forma income statement and balance sheet using a percent-of-sales forecasting technique.
♦ Know how to use the pro forma financial statements to estimate the financing needs of the firm.
♦ Understand the use of target ratios, trends, etc. as a means of customizing a percent-of-sales forecast to obtain better estimates.
♦ Be able to use the sustainable growth model to forecast sustainable growth rates for the firm and understand the influence of excess assets, particularly inventories and receivables, on sustainable growth. (WC).

TVM and DCF Valuation

♦ Define an opportunity cost rate.
♦ Be able to illustrate any TVM problem with a time line.
♦ Be able to express any TVM problem mathematically.
♦ Know how to calculate (using a financial calculator and mathematically) present and future values for
  ▪ Simple lump sums
  ▪ Uneven cash flows
  ▪ Annuities – ordinary, annuities due, and perpetuities.
♦ Be able to adjust for compounding periods and calculate an effective annual rate (EAR).
♦ Be able to apply TVM principles to amortize loans, plan for retirement, etc. and EAR to calculating the cost of trade discounts (WC).
♦ Be able to calculate present and future values for continuous compounding.
Interest Rates and Bond Valuation

♦ Understand the general terminology and characteristics that describe bonds: debenture, indenture, the role of a trustee, call provisions, call protection, sinking fund, restrictive covenants, etc.

♦ Know the various types of bonds: debentures, mortgage bonds, indexed bonds, subordinated bonds, convertible bonds, income bonds, Eurobonds, foreign bonds, treasury bonds, and zero-coupon bonds.

♦ Be familiar with the growth of international capital markets, Eurobonds, and foreign bonds (G).

♦ Know the bond pricing parameters and be able to price a bond.

♦ Be able to calculate a yield to maturity and yield to call for any bond.

♦ Know how to decompose nominal interest rates into the real interest rate and the inflation component using the Fisher effect and understand the relationship between inflation, interest rates, and bond values.

Stock Valuation

♦ Understand stock valuation as the sum of future expected cash flows discounted to the present time at an appropriate cost of capital.

♦ Be able to price stocks using the (1) zero-growth perpetuity model, (2) the constant growth perpetuity model and (3) the uneven (supernormal) growth model.

♦ Understand the rights of common stockholders and the differences between equity and debt.

♦ Know the characteristics of preferred and commons stock.

♦ Be familiar with the institutional details of the stock markets, the role of a market maker, and the differences between the NYSE and NASDAQ.

♦ Know the definition of an American Depository Receipt and be familiar with the proliferation of foreign firms that are traded on the NYSE (G).

Capital Budgeting

♦ Be able to express mathematically, calculate, and utilize the following techniques to make capital investment decisions
  ▪ Net Present Value
  ▪ Internal Rate of Return
  ▪ Payback and Discounted Payback.

♦ Know the pitfalls of using accounting rate of return and payback and why NPV is superior to other capital budgeting measures.

♦ Be able to demonstrate when IRR is equivalent to NPV for investment decisions.

♦ Understand how the profitability index is constructed and how it can be used to rank projects under capital rationing.

♦ Distinguish between opportunity costs, sunk costs, and externalities.

♦ Be able to estimate incremental operating project cash flows from revenue and cost estimates.

♦ Know how to determine the depreciable basis for an investment and be able to use the MACRS depreciation schedule to calculate incremental depreciation for capital projects.

♦ Be able to calculate the incremental salvage value for any capital project.

♦ Understand how capital projects affect working capital needs and know how to incorporate this additional capital investment into the analysis (WC).

♦ Know how to conduct sensitivity and scenario analysis (excellent opportunity for an Excel application).

♦ Understand the difference between the home currency approach and the foreign currency approach in international capital budgeting.
Risk, Return & Capital Markets

♦ Students should understand the basic risk-return tradeoff and how this relates to (1) average historical returns, (2) risk premiums, and (3) return variability.

♦ Be able to discuss the historical average returns and variability of large company stocks, small company stocks, long-term corporate bonds, long-term government bonds, and treasury bills within a risk-return framework.

♦ Know the definition of an informationally efficient market and the implications for prices of securities that are traded in an efficient market.

♦ Be able to distinguish between the three forms of market efficiency – weak form, semi-strong form, and strong form – and be aware of the empirical evidence on market efficiency.

Risk, Return, & SML

♦ Be able to calculate the expected return, the variance, the standard deviation, and the coefficient of variation for any security given (1) a probability distribution or (2) a time series of historical data.

♦ Be able to distinguish between total risk and market risk.

♦ Know how a portfolio of stocks diversifies risk and be able to illustrate this concept by calculating the expected return for a portfolio, and the variance and standard deviation for a two-stock portfolio.

♦ Understand beta as a risk-return measure and calculate portfolio betas given security betas.

♦ Be capable to using the security market line to estimate security returns and be aware of the evidence regarding the CAPM.

Cost of Capital and WACC

♦ Be able to estimate the cost of debt for a firm as the yield to maturity on outstanding bonds.

♦ Be able to estimate the cost of preferred equity using the perpetuity model.

♦ Be able to estimate the cost of common equity using the CAPM or the constant growth model.

♦ Know how to combine each of the above to create a weighted average cost of capital.

♦ Understand when it is acceptable to use WACC as a discount rate in capital budgeting and be familiar with techniques that are used to adjust WACC for divisions with different risk.

♦ Know how to apply the cost of capital to making decisions about working capital policy using the NPV approach.

Raising Capital

♦ Be able to compare and contrast the advantages and disadvantages of issuing debt versus equity.

♦ Understand the financing life cycle of a firm, the role of venture capitalist, and the issues involved in the going-public decision.

♦ Know the steps in the investment banking process and the institutional detail of the primary markets, e.g., syndicates, greenshoe options, shelf registrations, etc.

♦ Know the evidence and basic explanations for IPO ‘underpricing.’

♦ Understand the difference between an IPO and SEO.
Short-term Financing and Planning

♦ Be able to calculate and interpret the operating cycle and the cash cycle -- this was first introduced ‘mechanically’ under financial statement analysis; the impact of working capital management on the value of the firm should now be apparent (WC).

♦ Students should know the differences and understand the risk-return tradeoffs between an ideal (hedged) short-term financial policy, a flexible (conservative) policy, and a restrictive (aggressive) policy as they relate to carrying costs and shortage costs.

♦ Understand the basic types of short-term financing including (1) a line of credit, (2) the role and cost of a compensating balance, (3) letters of credit, (3) accounts receivable financing or factoring, (4) commercial paper (including securitization), and (trade credit).

♦ Be able to calculate a cash budget for a firm.

Calculator Requirements

Students are required to use a financial calculator capable of calculating NPV and IRR. Recommended calculators are (1) TI BAII Plus, (2) HP 10-B, or (3) HP17-B. The first two calculators sell for approximately $35-$40 and the last for about $95. Students should understand the intuition and mathematics underlying Time Value of Money and valuation exercises, and not simply know calculator procedures.

Evaluation and Grading

Grading should be objective and based on criteria stated in the syllabus. Although grades will vary depending on the composition of the class, the faculty consensus is that a reasonable average grade across all sections of FIN 3715 is in the range of 2.6-2.9. Each instructor, however, has the right and the responsibility to determine the final grade distribution for his or her class. Course syllabi should clearly state the grading criteria and the method of determining the student’s grade. A typical range for grade distributions (after withdrawals) is:

<table>
<thead>
<tr>
<th>Grade</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>A</td>
<td>15-25%</td>
</tr>
<tr>
<td>B</td>
<td>25-35%</td>
</tr>
<tr>
<td>C</td>
<td>30-50%</td>
</tr>
<tr>
<td>D</td>
<td>5-15%</td>
</tr>
<tr>
<td>F</td>
<td>0-5%</td>
</tr>
</tbody>
</table>

Student Responsibility

Students are responsible for attending all classes except as excused under PS-22 (available on the LSU Web). Viable excuses include documented sickness, death in the immediate family, or participation in university sanctioned activities. Students who do not attend the first class meeting without making prior arrangements with the department may be dropped to provide space for other students.

Instructors will enforce the university policy on academic misconduct, and will report suspected academic misconduct to the Dean of Students.