

# Finance for Management and Organizational Studies MOS3310A Section 002



Course Outline: Summer 2010

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## COURSE DESCRIPTION

The concepts developed in MOS3310 form the foundation for all elective finance courses. The main topics include: 1) an overview of managerial finance and the financial environment; 2) the time value of money and capital budgeting techniques; 3) uncertainty and the trade-off between risk and return; 4) security market efficiency and how corporations issue securities; 5) optimal capital structure; 6) dividend policy decisions; 7) short-term and long-term financial decisions; 8) working capital management and 9) credit management and collection.

## TEACHING MATERIALS

Brealey, R., Myers, C., Marcus, A.J., Maynes, E.M., and Mitra D., Fundamentals of Corporate Finance, 4<sup>th</sup> Canadian Edition, McGraw-Hill Ryerson, 2009, ISBN-13: 978-0-07-098403-5

Finance Lab Website: <http://lyryx.com>

## INSTRUCTOR

Danny L. Morrison, MBA  
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## CLASSROOM

SSC-2020 7:00 PM to 10:00 PM Monday and Wednesday's

## OFFICE HOURS

Before class and other times by appointment

## EVALUATION

|                     |            |  |
|---------------------|------------|--|
| Midterm Examination | 40%        | Friday, May 21, 2010, 1 PM to 3 PM, 3M Building, room 3250     |
| Final Examination   | 40%        | Saturday, June 12, 2010, 9 AM to 11 AM, 3M Building, room 3250 |
| Assignment (7 Labs) | <u>20%</u> |  |
| Total               | 100%       |  |

## TOPICS

- I. Introduction (Chapters 1–3)
- II. Value (Chapters 4–9)
- III. Risk and Return (Chapters 10–12)
- IV. Financing (Chapters 13–14)
- V. Capital Structure and Dividend Policy (Chapters 15–16)
- VI. Financial Planning (Chapters 17–19)
- VII. Short-term Financial Decisions (Chapters 20–21)
- VIII. Special Topics (if time permits)

## LECTURE SCHEDULE\*

Topics will be covered in the following order during the term. Approximate lecture dates are given so that you can keep up with the readings. Ideally, you should do the required readings before the topic is covered in class. **Lectures are intended to highlight certain areas of each topic--there is not enough time available for us to cover all the material in class.** However, you are responsible for **all** the material in the text. Thus, it is important for you to keep up with the readings. Students should also note that the workload for this course is heavy and should schedule their time accordingly.

| Date    | Lecture | Read             | Topic  |
|---------|---------|------------------|--|
| May 3   | 1       | Chapter 1        | Course Introduction and Overview of Managerial Finance               |
| May 5   | 2       | Chapters 2 & 3   | Financial Markets and Institutions                                   |
| May 10  | 3       | Chapters 4 & 5   | Time Value of Money, and Valuing Bonds                               |
| May 12  | 4       | Chapters 6 & 7   | Valuing Stocks and Net Present Value                                 |
| May 17  | 5       | Chapters 8 & 9   | Discounted Cash Flow Analysis and Project Analysis                   |
| May 19  | 6       | Chapters 17 & 18 | Financial Statement Analysis, and Financial Planning                 |
| May 21  |         | Lectures 1 - 6   | <b>MIDTERM TEST</b> [1 PM – 3 PM 3M 3250]                            |
| May 26  | 7       | Chapters 10 & 11 | Risk, Return, and the Opportunity Cost of Capital, Capital Budgeting |
| May 31  | 8       | Chapters 12 & 13 | Weighted-Average Cost of Capital, and Corporate Financing            |
| June 2  | 9       | Chapters 14 & 15 | How Corporations Issue Securities, and Debt Policy                   |
| June 7  | 10      | Chapters 16 & 19 | Payout Policy, and Working Capital Management                        |
| June 9  | 11      | Chapter 20 & 21  | Cash and Inventory Management; Credit Management and Collection      |
| June 12 |         | Lectures 7 - 11  | <b>FINAL TEST</b> [9 AM – 11 AM 3M 3250]                             |

\*Dates and order subject to change

## Assignment: Finance Labs

| Lab | Start Date   | Due Date      |
|-----|--------------|---------------|
| 1*  | May 5, 2010  | June 11, 2010 |
| 2*  | May 7, 2010  | June 11, 2010 |
| 3*  | May 12, 2010 | June 11, 2010 |
| 4*  | May 14, 2010 | June 11, 2010 |
| 5*  | May 26, 2010 | June 11, 2010 |
| 6*  | May 26, 2010 | June 11, 2010 |
| 7*  | June 2, 2010 | June 11, 2010 |
| 8** | June 2, 2010 | June 11, 2010 |

\* Labs 1 -7 required, count for marks

\*\* Lab 8 Available and recorded, but doesn't count towards lab mark

## DETAILED CONTENT

### **The firm and the financial manager:**

- Organizing a Business (advantages and disadvantages of various firm types)
- Who is the Financial Manager?
- The role of the Financial Manager
- Goals of the Corporation
- Explain why maximizing market value is the logical financial goal of the corporation
- Is Value Maximization Ethical?

### **Financial Markets and Institutions:**

- The Flow of Savings to Corporations
- Basic structure of mutual funds, pension funds, banks and other intermediaries
- The functions of Financial Markets and Intermediaries
- Introduction to Cost of Capital

### **Accounting and Finance:**

- Financial statement analysis and distinguishing between market and book value
- Calculate free cash flow and use various financial ratios to analyze an organization
- Explain why income differs from cash flow

### **The time value of money (TFM):**

- Present Value (PV)
- Future value (FV)
- Future value of an annuity (FVA)
- Present value of an annuity (PVA)
- Annuity Dues, Perpetuities, and Growing Perpetuities

### **Determining interest rates:**

- Real and nominal cash flows and real and nominal interest rates
- Compare interest rates quoted over different time intervals (e.g., Annual Percentage Rate and Effective annual rate)

### **Valuing bonds:**

- Bond characteristics
- Bonds coupon rate, current yield, and yield to maturity via linear interpolation and approximation YTM
- Find the market price of a bond
- Pricing Bonds between payment periods; clean price, dirty price and determining day count
- Yield curve and why expected short-term interest rates affect its shape
- Why bonds exhibit interest rate risk
- Default risk and why investors pay attention to bond ratings

### **Valuing stocks:**

- Stock trading reports
- Calculate the present value of a stock
- Income stocks, growth stocks and the present value of growth opportunities
- Use stock valuation formulas to infer the expected rate of return
- Interpret primary and fully diluted price-earning (p-e) ratios
- Understanding why reported earnings is a poor indicator of corporate value
- No free lunches on Wall Street or Bay Street
- Investment theories of efficient capital markets and three forms of market efficiency
- Market Anomalies and Behavioural Finance

**Net Present value (NPV) and other investment criteria:**

- Payback and discounted payback rules and book rate of return
- Calculate the net present value of an investment
- Calculate IRR of a project and understand the pitfalls associated with the IRR evaluation method
- Calculate profitability index (PI) and use it to choose between projects when funds are limited and Equivalent Annual NPV (EANPV) calculations

**Using discounted cash flow analysis to make investment decisions:**

- Identify the cash flows properly attributable to a proposed new project as well as how to handle incremental costs, sunk costs, and calculate the opportunity cost of capital
- Understand how the tax bill, depreciation, and changes in working capital affect project cash flows and project value
- Calculate NPV, the CCA Tax Shield and make investment decisions

**Project analysis:**

- Practical problems of capital budgeting
- Sensitivity, scenario, and break-even analysis to see how project profitability would be affected by an error in your forecasts and understand why an overestimate of sales is more serious for projects with high operating leverage
- Decision Trees: Diagram of sequential decisions and possible outcomes as well as the calculate the expected value of perfect information when making decisions
- Managerial flexibility in capital budgeting

**Risk, return, and the opportunity cost of capital:**

- Estimate the opportunity cost of capital for an “average risk” project
- Calculate the standard deviation of returns for individual common stocks or for a stock portfolio
- Understand why diversification reduces risk
- Distinguish between unique risk and market risk

**Risk, return, and capital budgeting:**

- Measure and interpret the market risk, or beta, of a security using the CAPM
- Relate the market risk of a security to the rate of return that investors demand
- Calculate the opportunity cost of capital for a project
- Pure play approach or pure play method for estimating the cost of capital for a proposed new project

**The weight-average cost of capital and company valuation:**

- Calculate a firm’s capital structure
- Estimate the required rates of return on the securities issued by the firm
- Identify how often the Cost of Capital should be calculated
- Calculate and fully understand why WACC works and state the limitations of the WACC

**Corporate financing and governance:**

- Describe the major classes of securities issued by firms to raise capital
- Financial Innovation: Debt with a Collar, Zero-coupon bonds, and Convertible Provisions
- Calculate and distinguish between Call Option values and Putt Option values
- Shareholder rights and voting procedures
- Summarize recent trends in the use made by firms regarding different sources of finance

**Venture capital, IPOs, and seasoned offerings:**

- How venture capital firms design successful deals
- How firms make IPOs and the costs of such offerings
- Valuing an IPO using Comparables
- What is involved when established firms make a general cash offer or a private placement of securities
- The role of the underwriter in an issue of securities

**Debt policy:**

- Analyze the effect of debt finance on the risk and required return of equity holders
- Does debt matter? Advantages and disadvantages of debt finance
- Various costs of financial distress
- Why the debt-equity mix varies across firms and across industries

**Payout policy:**

- How dividends are paid and how companies decide on dividend payments
- Why dividend policy would not affect firm value in an ideal world
- How differences in the tax treatment of dividends and capital gains might affect dividend policy
- Fully understand Modigliani and Miller's Dividend Irrelevance Theory as well as the Residual Theory of Dividends
- Why dividends may be used by management to signal the prospects of the firm

**Financial statement analysis:**

- Calculate and interpret measures of a firm's leverage, liquidity, efficiency, and profitability
- Use the DuPont formula
- Examine the statement of cash flows and telling the cash flow story
- Evaluate the potential pitfalls of ratios based on accounting data
- Calculate and understand Market value added (MVA) and economic value added (EVA)

**Financial planning:**

- Describe the contents and uses of a financial plan
- Construct a simple financial planning model based on percentage of sales method
- Calculate the Internal Growth Rate and the Sustainable Growth Rate
- Estimate the effect of growth on the need for external financing

**Short-term financial planning:**

- Why a firm needs to invest in net working capital
- How long-term financing policy affects short-term financing requirements
- Trace a firm's sources and uses of cash and evaluate the need for short-term borrowing
- Develop a short-term financing plan that meets the firm's need for cash

**Cash and inventory management:**

- Measure float and explain why it arises and how it can be controlled
- Calculate the value of changes in float
- Costs and benefits of holding inventories and of holding cash
- Why an understanding of inventory management can be useful for cash management

**Credit management and collection:**

- Steps in Credit Management and determining a credit policy
- Measure the implicit interest rate on credit
- Probability that a customer will pay, and decide whether it makes sense to grant credit to that customer
- Introduction to Credit Scoring Models
- Bankruptcy procedures when firms cannot pay their creditors

## IMPORTANT REMARKS

***There will be no make-up midterm exam given.*** If you miss the midterm examination and provide valid official documentation (subject to approval by Academic Counseling), then the weight of the midterm will be added to the final.

***Requests for make-up exams and other special arrangements will ONLY be considered in extenuating circumstances and ONLY upon recommendation of Academic Counseling or the Dean's Office. Please see Academic Counseling before requesting exam accommodation.***

Requests for reassessments must be made within 7 working days after the graded material has been made available to students (i.e., the day the test is returned). If a student does not claim the returned material within 7 working days after the grade material has been returned to class, the student automatically forfeits the right to request for reassessments. Reassessments should normally be completed within 20 working days of the request. The instructor reserves the rights to adjust the grade upward or downward due to the reassessment.

If a student misses any classes, it is the student's responsibility to cover any materials missed. Answers and solutions to any questions or practice problems taken up in the lectures will not be posted.

Students who hand in their assignments late will be penalized at 10% per day late (i.e., 2 points towards the final grade), including Saturdays and Sundays.

If a student misses the final exam, it is the student's responsibility to petition Academic Counseling, Dean's Office in order to write a special exam in place of the original exam. Academic Counseling will expect the student to submit the appropriate documentation explaining the student's absence during the time of the original exam.

Cheating, plagiarism, and disruption of classes are not permitted; UWO considers these to be serious offences. Students must write their essays and assignments in their own words. Whenever students take an idea or passage from another author, they must acknowledge their debt both by using quotation marks where appropriate and by proper referencing such as footnotes or citations. (See, "Scholastic Offences" in the UWO Calendar for further explanation).

Plagiarism is a major academic offence. For information on scholastic offences, penalties and other academic rights and responsibilities please see the [Academic Rights and Responsibilities](#) section of the academic calendar.

All required papers may be subject to submission for textual similarity review to the commercial plagiarism detection software under license to the University for the detection of plagiarism. All papers submitted will be included as source documents in the reference database for the purpose of detecting plagiarism of papers subsequently submitted to the system. Use of the service is subject to the licensing agreement, currently between The University of Western Ontario and Turnitin.com.

Students may want to communicate to the instructor via email. It is advised that these questions require only a short answer. Questions that may need an answer longer than three sentences should be addressed during the office hours. In some instances, the information in the email may be beneficial to the whole class. In this case, the email may be broadcasted to the class. Students are advised, therefore, not to include private or personal information in any emails.

## GENERAL INFORMATION

If, on medical or compassionate grounds, you are unable to meet your academic responsibilities, i.e., unable to write term tests or final examinations or complete course work by the due date, you should follow the instructions listed below. You should understand that academic accommodation will not be granted automatically on request. You must demonstrate that there are compelling medical or compassionate grounds that can be documented before academic accommodation will be considered. Read the instructions carefully. In all cases, action must be taken at the earliest possible opportunity, preferably prior to the scheduled examination, test or assignment.

1. Check the course outline to see if the instructor has a policy for missed tests, examinations, late assignments or attendance. The course outline should include the preferred method of contact (e-mail, phone, etc.).
2. Inform the instructor prior to the date of the scheduled time of the test or examination or due date of the assignment. If you are unable to contact the instructor, leave a message for him/her at the department office.
3. Bring your request for accommodation to the Social Science Academic Counselling Office, Room 2105, Social Science Centre, telephone 519 661-2011 or fax 519 661-3384. Be prepared to submit documentation of your difficulties.
4. If you decide to write a test or an examination you should be prepared to accept the mark you earn. Rewriting tests or examinations or having the value of the test or examination reweighted on a retroactive basis is not permitted.

## TERM TESTS and MID-TERM EXAMS

1. If you are unable to write a term test, inform your instructor (preferably prior to the scheduled date of the test). If the instructor is not available, leave a message for him/her at the department office.
2. Be prepared, if requested by the instructor, to provide supporting documentation. Submit your documentation to the Social Science Academic Counselling Office.
3. Make arrangements with your professor to reschedule the test.
4. The Academic Counselling Office will contact your instructor to confirm your documentation.

## FINAL EXAMINATIONS

1. You require the permission of the Dean, the instructor, and the Chair of the department in question to write a special final examination.
2. If you are unable to write a final examination, contact the Social Science Academic Counselling Office in the first instance to request permission to write a special final examination and to obtain the necessary form. You must also contact your instructor at this time. If your instructor is not available, leave a message for him/her at the department office.
3. Be prepared to provide the Social Science Academic Counselling Office and your instructor with supporting documentation.
4. You must ensure that the Special Examination form has been signed by the instructor and Department Chair and that the form is returned to the Social Science Academic Counselling Office for approval without delay.

## LATE ASSIGNMENTS

1. Advise the instructor if you are having problems completing the assignment on time (prior to the due date of the assignment).
2. Submit documentation to the Social Science Academic Counselling Office.
3. If you are granted an extension, establish a due date.

- Extensions beyond the end of classes must have the consent of the instructor, the Department Chair and Dean. A Recommendation of Incomplete form must be filled out indicating the work to be completed and the date by which it is due. This form must be signed by the student, the instructor, the Department Chair, and the Dean's representative in the Academic Counselling Office.

## **SHORT ABSENCES**

If you miss a class due to a minor illness or other problems, check your course outlines for information regarding attendance requirements and make sure you are not missing a test or assignment. Cover any readings and arrange to borrow notes from a classmate.

## **EXTENDED ABSENCES**

If you are absent more than approximately two weeks or if you get too far behind to catch up, you should consider reducing your workload by dropping one or more courses. This must be done by the appropriate deadlines. (Refer to the Registrar's website for official dates.) The Social Science Academic Counsellors can help you to consider the alternatives. At your request, they can also keep your instructors informed of your difficulties.

## **DOCUMENTATION**

- Personal Illness: If you consulted Student Health Services regarding your illness or personal problem, you should complete a Records Release Form at the time of your visit allowing them to notify Social Science Academic Counselling Office. Once your documentation has been assessed, the academic counsellor will inform your instructor that academic accommodation is warranted.
- If you were seen by an off-campus doctor, obtain a certificate from his/her office at the time of your visit. The doctor must provide verification of the severity of the illness for the period in question. Notes stating "For Medical Reasons" are not considered sufficient.
- In Case of Serious Illness of a Family Member: Obtain a medical certificate from the family member's physician.
- In Case of a Death: Obtain a copy of the newspaper notice, death certificate or documentation provided by the funeral director.
- For Other Extenuating Circumstances: If you are not sure what documentation to provide, ask an Academic Counsellor.

**Note:** Forged notes and certificates will be dealt with severely. To submit a forged document is a scholastic offence and you will be subject to academic sanctions.

## **ACADEMIC CONCERNS**

- You need to know if your instructor has a policy on late penalties, missed tests, etc. This information may be included on the course outline. If not, ask your instructor.
- You should also be aware of attendance requirements in courses such as Business and English. You can be debarred from writing the final examination if your attendance is not satisfactory.
- If you are in academic difficulty, check the minimum requirements for progression in your program. If in doubt, see your Academic Counsellor.
- If you are registered in Social Science courses but registered in another faculty (e.g., Arts or Science), you should immediately consult the Academic Counselling Office in your home faculty for instructions.