This book describes the theory and practice of corporate finance. We hardly need to explain why financial managers have to master the practical aspects of their job, but we should spell out why down-to-earth managers need to bother with theory.

Managers learn from experience how to cope with routine problems. But the best managers are also able to respond to change. To do so you need more than time-honored rules of thumb; you must understand why companies and financial markets behave the way they do. In other words, you need a theory of finance.

Does that sound intimidating? It shouldn’t. Good theory helps you to grasp what is going on in the world around you. It helps you to ask the right questions when times change and new problems need to be analyzed. It also tells you which things you do not need to worry about. Throughout this book we show how managers use financial theory to solve practical problems.

Of course, the theory presented in this book is not perfect and complete—no theory is. There are some famous controversies where financial economists cannot agree. We have not glossed over these disagreements. We set out the arguments for each side and tell you where we stand.

Much of this book is concerned with understanding what financial managers do and why. But we also say what financial managers should do to increase company value. Where theory suggests that financial managers are making mistakes, we say so, while admitting that there may be hidden reasons for their actions. In brief, we have tried to be fair but to pull no punches.

This book may be your first view of the world of modern finance theory. If so, you will read first for new ideas, for an understanding of how finance theory translates into practice, and occasionally, we hope, for entertainment. But eventually you will be in a position to make financial decisions, not just study them. At that point you can turn to this book as a reference and guide.

**Changes in the Tenth Edition**

We are proud of the success of previous editions of *Principles*, and we have done our best to make the tenth edition even better.

What is new in the tenth edition? First, we have rewritten and refreshed several basic chapters. Content remains much the same, but we think that the revised chapters are simpler and flow better. These chapters also contain more real-world examples.

- **Chapter 1** is now titled “Goals and Governance of the Firm.” We introduce financial management by recent examples of capital investment and financing decisions by several well-known corporations. We explain why value maximization makes sense as a financial objective. Finally, we look at why good governance and incentive systems are needed to encourage managers and employees to work together to increase firm value and to behave ethically.

- **Chapter 2** combines Chapters 2 and 3 from the ninth edition. It goes directly into how present values are calculated. We think that it is better organized and easier to understand in its new presentation.

- **Chapter 3** introduces bond valuation. The material here has been reordered and simplified. The chapter focuses on default-free bonds, but also includes an introduction to corporate debt and default risk. (We discuss corporate debt and default risk in more detail in Chapter 23.)

- Short-term and long-term financial planning are now combined in **Chapter 29**. We decided that covering financial planning in two chapters was awkward and inefficient.

- **Chapter 28** is now devoted entirely to financial analysis, which should be more convenient to instructors who wish to assign this topic early in their courses. We explain how the financial statements and ratios help to reveal the value, profitability, efficiency, and financial strength of a real company (Lowe’s).

The credit crisis that started in 2007 dramatically demonstrated the importance of a well-functioning financial system and the problems that occur when it ceases to function properly. Some have suggested that the crisis disproved the lessons of modern finance. On the contrary, we believe that it was a wake-up call—a call to remember basic principles, including the importance of good systems of governance, proper
management incentives, sensible capital structures, and effective risk management.

We have added examples and discussion of the crisis throughout the book, starting in Chapter 1 with a discussion of agency costs and the importance of good governance. Other chapters have required significant revision as a result of the crisis. These include Chapter 12, which discusses executive compensation; Chapter 13, where the review of market efficiency includes an expanded discussion of asset price bubbles; Chapter 14, where the section on financial institutions covers the causes and progress of the crisis; Chapter 23, where we discuss the AIG debacle; and Chapter 30, where we note the effect of the crisis on money-market mutual funds.

The first edition of this book appeared in 1981. Basic principles are the same now as then, but the last three decades have also generated important changes in theory and practice. Research in finance has focused less on what financial managers should do, and more on understanding and interpreting what they do in practice. In other words, finance has become more positive and less normative. For example, we now have careful surveys of firms’ capital investment practices and payout and financing policies. We review these surveys and look at how they cast light on competing theories.

Many financial decisions seem less clear-cut than they were 20 or 30 years ago. It no longer makes sense to ask whether high payouts are always good or always bad, or whether companies should always borrow less or more. The right answer is, “It depends.” Therefore we set out pros and cons of different policies. We ask “What questions should the financial manager ask when setting financial policy?” You will, for example, see this shift in emphasis when we discuss payout decisions in Chapter 16.

This edition builds on other changes from earlier editions. We recognize that financial managers work more than ever in an international environment and therefore need to be familiar with international differences in financial management and in financial markets and institutions. Chapters 27 (Managing International Risks) and 33 (Governance and Corporate Control around the World) are exclusively devoted to international issues. We have also found more and more opportunities in other chapters to draw cross-border comparisons or use non-U.S. examples. We hope that this material will both provide a better understanding of the wider financial environment and be useful to our many readers around the world.

As every first-grader knows, it is easier to add than to subtract. To make way for new topics we have needed to make some judicious pruning. We will not tell you where we have cut out material, because we hope that the deletions will be invisible.

Making Learning Easier

Each chapter of the book includes an introductory preview, a summary, and an annotated list of suggested further reading. The list of possible candidates for further reading is now voluminous. Rather than trying to list every important article, we have largely listed survey articles or general books. More specific references have been moved to footnotes.

Each chapter is followed by a set of Basic questions, intermediate questions on both numerical and conceptual topics, and a few challenge questions. Answers to the odd-numbered basic questions appear in an appendix at the end of the book.

We have added a Real-Time Data Analysis section to chapters where it makes sense to do so. This section now houses some of the Web Projects you have seen in the previous edition, along with new Data Analysis problems. These exercises seek to familiarize the reader with some useful Web sites and to explain how to download and process data from the Web. Many of the Data Analysis problems use financial data that the reader can download from Standard & Poor’s Educational Version of Market Insight, an exclusive partnership with McGraw-Hill.

The book also contains 10 end-of-chapter mini-cases. These include specific questions to guide the case analyses. Answers to the mini-cases are available to instructors on the book’s Web site.

Spreadsheet programs such as Excel are tailor-made for many financial calculations. Several chapters now include boxes that introduce the most useful financial functions and provide some short practice questions. We show how to use the Excel function key to locate the function and then enter the data. We think that this approach is much simpler than trying to remember the formula for each function.

Many tables in the text appear as spreadsheets. In these cases an equivalent “live” spreadsheet appears on the book’s Web site. Readers can use these live spreadsheets to understand better the calculations behind the table and to see the effects of changing the underlying data. We have also linked end-of-chapter questions to the spreadsheets.

We conclude the book with a glossary of financial terms.

The 34 chapters in this book are divided into 11 parts. Parts 1 to 3 cover valuation and capital investment decisions, including portfolio theory, asset
pricing models, and the cost of capital. Parts 4 to 8 cover payout policy, capital structure, options (including real options), corporate debt, and risk management. Part 9 covers financial analysis, planning, and working-capital management. Part 10 covers mergers and acquisitions, corporate restructuring, and corporate governance around the world. Part 11 concludes.

We realize that instructors will wish to select topics and may prefer a different sequence. We have therefore written chapters so that topics can be introduced in several logical orders. For example, there should be no difficulty in reading the chapters on financial analysis and planning before the chapters on valuation and capital investment.

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