



THE UNIVERSITY OF
NEW SOUTH WALES
SYDNEY • 2052 • AUSTRALIA

SCHOOL OF BANKING AND FINANCE

FINS5514 CAPITAL BUDGETING AND FINANCIAL DECISIONS
Course Outline, Session 1, 2005

Introduction

Capital budgeting and financial decisions is primarily concerned with the major financial decisions faced by the firm. These decisions can be broadly classified as the investment decision, the financing decision, the dividend decision and the restructuring decision. This course will examine the main theories and empirical evidence surrounding these decisions and to use this knowledge to help solve typical 'real' finance problems.

Key Learning Outcomes

On completion of the course, you will:

- Be able to explain why the separation of the ownership and the control of most major corporations can cause agency problems and describe how a judicious use of different financing vehicles (equity, debt, convertibles, dividends, etc.) can reduce these costs;
- Be able to apply several capital budgeting techniques using MS Excel, appreciating the strengths and weaknesses of the different techniques;
- Have an understanding of how to incorporate risk and uncertainty into capital budgeting decisions and how capital budgeting is applied in practice;
- Be able to describe how the arbitrage-based arguments of Modigliani and Miller establish the irrelevance propositions and to explain why their framework can contribute to our understanding of financing decisions;
- Be able to explain why managers face an adverse selection problem to convince investors to give the financing that managers need to implement investment decisions and to describe how costly signalling mechanisms can assist the managers to make informed corporate finance decisions;
- Be able to explain the key issues surrounding the formulation of a company's dividend policy;
- Have an understanding of the restructuring choices faced by managers and how these choices can help resolve agency problems within the firm;
- Be able to critically evaluate the core empirical evidence related to each of the key financial decisions.

Prerequisites

The prerequisite / corequisite for this course is:

Security Valuation and Portfolio Selection (FINS5513).

It is the student's responsibility to ensure that the prerequisites have been met prior to the commencement of the course.

Web Page

This subject has a WebCT site (<http://webct.edtec.unsw.edu.au/webct/public/home.pl>). Lecture overheads, information on lab sessions, tutorial questions and solutions will be downloadable from this site. Class announcements will also be posted to this site. To access the site, you need a valid Unipass number if you are using campus wide PCs. If you wish to access the site from your home or work PC you will need to connect to the University Dial-Up System (UDUS).

Lectures

Tuesday	11.00 - 14.00	ME 304
Thursday	11.00 - 14.00	Mathews Theatre C
Thursday	18.00 - 21.00	Rupert Myers Theatre

Lab Classes. Week 6 Only.

Tuesday	11.00 - 14.00	Quad Lab 6, Room 1030
Thursday	11.00 - 14.00	Quad Lab 10, Room 1038
Thursday	18.00 - 21.00	Quad Lab 10, Room 1038

Lecturers

Dr Sian Owen (Weeks 1, 7-14)

(Lecturer in Charge)

Office: Quad 3057

Email: Sian.Owen@unsw.edu.au

Tel: 9385 4412

Consultation Hours: See WebCT for details

Dr Kathryn Wong (Weeks 2-6)

Office: Quad 3041

Email: K.Wong@unsw.edu.au

Tel: 9385 7886

Course Format

A combination of formal lectures, tutorials (problem solving classes) and computer lab sessions will be used. The computer lab sessions give you an opportunity to experience practical applications of material covered in the lectures.

- Tutorials/problem-solving classes: Students must prepare answers in advance to the exercises set for each week. A tutorial / problem-solving class will be held during the last hour of each lecture. Selected solutions will be available via WebCT after the tutorials.
- Labs: A computer lab session will be held in week 6. Details will be posted on the web.

Workload Expectations

It is expected that you will spend at least ten hours per week studying this course. This time should be made up of reading, group work, working on exercises and problems, performing computer tasks and attending classes. In periods where you need to complete assignments or prepare for examinations the workload may be greater.

Over commitment has been a cause of failure for many students. You should take the required workload into account when planning how to balance study with employment and other activities.

Assessment

The course will be assessed through a combination of class tests, a formal written exam and a project.

- Class tests: A class test will be held during the normal lecture times in week 5 and week 14. The tests will be of multiple-choice format in which students have to answer 35-questions in 1 hour. The first (second) test will cover material from weeks 1 to 4 (7 to 12). The tests carry a weight of 10% each (total 20%)
- Project: The project will be in the form of a mini-case study. You will be required to provide a solution to a capital budgeting problem using Microsoft Excel and to write-up the results in the form of a business report. You will carry out this task in groups. Details will be posted on the web. The project has a weight of 30%.
- A formal end of semester written exam will be held during the University's exam period. Details will be posted on the web later in the semester. The final exam has a weight of 50%.
- The weighted average mark across all assessments will be used to determine pass or failure.

Summary of Assessment Procedures					
Exam / Test	Week Held	Material Covered	Venue and Time	Duration	Weight
1 st Class Test	5	Weeks 1 to 4	During Lecture	1 hour	10%
Project	Submit Week 8				30%
2 nd Class Test	14	Weeks 7 to 12	During Lecture	1-hour	10%
Final Exam	TBA	Weeks 7 to 13	TBA	3-hours	50%
Total					100%

Textbooks / Reference Material

Required purchase available from UNSW bookshop:

Brealey, R.A. and S.C. Myers, 'Principles of Corporate Finance', 7th Edition, McGraw-Hill, 2000 (S658.15/349). Book web site:

http://highered.mcgraw-hill.com/sites/0072467665/information_center_view0/

Students may also want to consult the following texts (listed alphabetically by author name), which are available from the library:

Bierman, H., and S. Smidt, 'The Capital Budgeting Decision: Economic Analysis of Investment Projects, Eighth Edition, Macmillan (S332.6/15)

Chew, D. H. (Ed.) (1998), The New Corporate Finance: Where Theory Meets Practice, Second Edition, McGraw-Hill (S658.15/472).

Copeland, T and F. Weston, 'Financial Theory and Corporate Policy, Third Edition.

Copeland, T., Koller, T. and J. Murrin, 'Valuation: Measuring and Managing the Value of Companies, Third Edition, Wiley, 2000 (S658.15/460).

Damodaran, A, 'Corporate Finance, Theory and Practice', Wiley, 1997.

Levy, H and M. Sarnat, 'Capital Investment and Financial Decisions', Fifth Edition, Prentice-Hall (S658.15/329).

Ross, S. A., R. W. Westerfield and J. F. Jaffe (1998), Corporate Finance, Fifth Edition, Irwin (S658.15/440).

Damodaran, Levy and Sarnat and Ross, Westerfield and Jaffe all cover the same material as Brealey and Myers, albeit in a different style. Bierman and Smidt provide quite an extensive coverage of capital budgeting with a good discussion of capital budgeting applications and the difficult aspect of dealing with the uncertainty problem. Copeland, Koller and Murrin is primarily aimed at financial managers and provides an excellent coverage of the more practical aspects of investment decision making and how such decisions impact on firm value. Copeland and Weston, although a little dated, provides a much more rigorous analysis of most of the subject matter.

The academic papers listed below are available in full-text format (pdf files) from the library. Links are provided from the course pages on WebCT. As a postgraduate course, you are expected to read broadly on each subject area. The list of references provided under each subject heading should be regarded as the minimum reading necessary to achieve a pass in this course.

Web site resources:

Brealey and Myers web site:

http://highered.mcgraw-hill.com/sites/0072467665/information_center_view0/

Corporate Finance online: Covering 27 different topics, you can complete challenging exercises and discussion questions that draw on recent articles, company reports, government data and other Web-based resources.

<http://www.mhhe.com/business/finance/corpfonline/>

Lecture Program***Week 1.*****Introduction to the Course****Agency Theory, including recent examples.**

Required Reading: BM Chapter 1

Ang, J., Cole, R. and J. Wuh Lin, 'Agency Costs and Ownership Structure' Journal of Finance, Vol. 55, 2000.

Palepu, K. G. and P. M. Healy, 'The Fall of Enron' Harvard NOM Working Paper Number 03-38. 2003 (http://papers.ssrn.com/sol3/papers.cfm?abstract_id=417840)

Week 2.**The Investment Decision I**

Required Reading: BM Chapters 2, 3, 4

Week 3**The Investment Decision II**

Required Reading: BM Chapters 5, 6

Week 4.**The Investment Decision III**

Required Reading: BM Chapters 9, 10

Week 5.**st 1 class test****The Investment Decision IV**

Required Reading : BM Chapter 11

Drury, C. and M. Tayles, 'The Misapplication of Capital Investment Appraisal Techniques', Management Decision, Vol. 35, 1997.

Phelan, S., 'Exposing the Illusion of Confidence in Financial Analysis', Management Decision, Vol. 35, 1997.

Week 6.**The Investment Decision V: Practical Applications**

Held in computer labs

Week 7.

The Financing Decision I

Required Reading: BM Chapter 17, 18, 19

Harris, M. and A. Raviv, 'The Theory of Capital Structure', The Journal of Finance, 1991.

Week 8.

The Financing Decision II

Required Reading: BM Chapter 30

Week 9.

The Dividend Decision I

Required Reading: BM Chapter 16

Handley, J. and K. Maheswaran, 'The Value of Australian Imputation Credits', University of Melbourne Working Paper, 2003.

Fama, E. and K. French, 'Disappearing Dividends: Changing Firm Characteristics or Lower Propensity to Pay? Journal of Financial Economics, Vol 60, 2001

Week 10.

The Dividend Decision II

Required Reading: BM Chapter 16

Week 11.

The Restructuring Decision I

Required Reading : BM Chapter 15

Welch, I. and J. Ritter, 'A Review of IPO Activity, Pricing and Allocations, Yale ICF Working Paper No. 02-01, 2002

Week 12.

The Restructuring Decision II

Required Reading: BM Chapters 33, 34

Andrade, G., Mitchell, M. and E. Stafford, 'New Evidence and Perspectives on Mergers', Journal of Economic Perspectives, Vol. 15, 2001

Week 13.

The Restructuring Decision III

Required Reading: BM Chapters 33, 34

Holmstrom, B. and S. Kaplan, 'Corporate Governance and Merger Activity in the United States: Making Sense of the 1980s and 1990s', Journal of Economic Perspectives, Vol. 15, 2001.

Week 14.

2nd Class test

Revision Lecture

IMPORTANT STUDENT INFORMATION

Education Development Unit

Additional learning support, tailored to the needs of FCE students, is available from the Education Development Unit (EDU) in the Faculty. The EDU offers a range of services for FCE students including:

- Academic skills workshops run throughout the session;
- Printed and on-line study skills resources e.g. referencing guide, report writing and exam preparation;
- A drop-in resource centre containing books and audio visual material that can be borrowed;
- A limited consultation service for students with individual or small group learning needs.

More information about the EDU services including on-line resources, workshop details and consultation request forms are available from the EDU website.

Contacts and location:

EDU Web: <http://education.fce.unsw.edu.au>

EDU Location: Room 2039, Level 2 Quadrangle Building

EDU services are free and confidential and are available to students of the Faculty of Commerce and Economics.

Other UNSW support

In addition to the EDU services, the UNSW Learning Centre provides academic skills support services for students. The Learning Centre is located on Level 2 of the Library and can be contacted by Phone: 9385 3890 or through their website: <http://www.lc.unsw.edu.au/>. Students experiencing problems of an academic or personal nature are encouraged to contact the Counselling Service at UNSW. This service is free and confidential and run by professional counsellors. The Counselling Service is located on Level 2, Quadrangle East Wing, and can be contact on 9385 5418.

Failure to Sit an Examination

Students should notify employers of the requirement to attend examinations. If you miss any of the class tests (for any reason – employment, sickness, timetable clashes etc.), then in exceptional circumstances (for example, hospitalisations), you may be permitted to sit the missed section at a future date when the School offers supplementary examinations. If you have been granted a supplementary exam, this information will be posted on the class web site on the last day of the examination period. You will not be advised by any other means. Failure to undertake an exam at its scheduled time does not automatically lead to reassessment (see Supplementary Exam information at the end of this handout). It is emphasized that in the event that a supplementary exam is granted, the highest grade awarded will be a PASS for that component of the assessment.

Use of Electronic Calculators During Examinations

Students may use either a non-programmable electronic/scientific or non-programmable financial calculator (such as Texas Instruments BAI+ for examination purposes). Note that hand-held computers, Apple Newton, personal information managers or devices with a full alphanumeric keypad or with character recognition are strictly prohibited. Failure to follow this requirement and use an unprescribed aid during an examination is a serious offence and will be regarded as a most grave form of academic misconduct. If you are unsure about the calculator read the operating manual provided with your calculator. Students are responsible for ensuring their calculator meets with these requirements.

INFORMATION CONCERNING STUDENT CONDUCT AND RESPONSIBILITIES

Students should be aware of general University, Faculty and School rules that are discussed in detail in the UNSW Calendar. However, I draw your attention to the following issues that are particularly relevant to this course.

Student Identification Required for All Examinations

Student ID should be visible at all times during the examination. Students without photographic ID may not be allowed to sit the examination.

It is the student's responsibility to ensure that they are aware of the University rules concerning their degree and meet the assessment criteria in this subject. Failure to misread this document, the Faculty handbook/University Calendar or examination timetable, or to receive announcements in class or sit examinations does not mean that further assessment is automatically granted.

Special Consideration

Attention is drawn to the following extract from the UNSW Calendar 'Procedures':

'Students who believe that their performance in a subject, either during session or in an examination, has been adversely affected by sickness or any other reason should inform the Registrar and apply for special consideration in the determination of their standing. The application must be made on the 'Application for Special Consideration' form available from the Student Centre. This application explains the specific information the University requires in order to make a decision. Such requests should be lodged as soon as practicable after the occurrence and in any event not more than three days after the final examination in a subject'.

A photocopy of all material supporting an application for special consideration, as lodged with the Registrar, must also be provided to the Lecturer-in-charge within seven (7) days of any event for which special consideration is sought (preferably before the examination). Students should be aware that 'minor' ailments are not eligible grounds for special consideration. Any unsubstantiated request for special consideration will be considered to be 'minor'.

Supplementary Examinations

NOTE: Supplementary examinations are EXCEPTIONALLY RARE and are NOT given automatically. An ORAL component may also be required in addition to sitting a formal examination paper. If your performance (or attendance) throughout the session has not been satisfactory, or the reason why you did not attend the examination is not acceptable, you will be denied a supplementary examination. In sitting a supplementary exam, the highest grade awarded will be a PASS for that component of the assessment.

If a student is granted a supplementary examination but does not attend that supplementary examination, he/she will not be granted further assessment except in **HIGHLY EXCEPTIONAL** circumstances. Students are advised that if they are intending to travel overseas at the end of session/year they should consider taking out travel insurance which allows supplementary examinations as valid circumstances for cancelling travel.

Academic Misconduct

Attention is drawn to the following extract from the UNSW Calendar 'Procedures':

Academic Misconduct

'Students are reminded that the University regards academic misconduct as a very serious matter. Students found guilty of academic misconduct are usually excluded from the University for two (2) years. Because of the circumstances in individual cases, the period of exclusion can range from one session to permanent exclusion from the University.'

The following are some of the actions, which have resulted in student being found guilty of academic misconduct in recent years:

- 1. Taking unauthorised materials into an examination;*
- 2. Submitting work for assessment knowing it to be the work of another person;*
- 3. Improperly obtaining prior knowledge of an examination paper and using that knowledge in the examination;*
- 4. Failing to acknowledge the source of material in an assignment.*

Acknowledgment of Sources

Students are expected to acknowledge the source of ideas and expressions used in submitted work. To provide adequate documentation is not only an indication of academic honesty but also a courtesy enabling the marker to consult sources with ease. Failure to do so may constitute plagiarism, which is subject to a charge of academic misconduct'.