

Learning Goal #3: Integrating Financial Principles

Definition: Financial principles underlie all areas of financial thought. To this point, scholars have pointed out that the institutional areas – banking, insurance and real estate - apply financial principles within a unique institutional or regulatory environment. Furthermore, each of the sub-areas – investments, corporate finance, and derivatives - also applies a consistent set of principles applied within a different context. Valuation as the present value of future cash flows, the association between risk and return, and value additivity:

- Underlie all of the areas within Finance
- Integrate material from different courses in problem-solving skills
- Understand the consistency of financial principles across courses

This includes:

- A. Reading, understanding, and interpreting financial statements
- B. Understanding the risk-return tradeoff
- C. Estimating cost of capital even when risk and capital structure are not constants
- D. Determining effects of strategic changes on forecasted cash flow
- E. Understanding the role of regulation in financial decisions

Measurement:

- A. Integrating material from different courses and sub-areas in problem solving skills
- B. Understanding consistency of financial principles

A sample of students in one section of FIN 640 (Mergers and Acquisitions) in AY 2008-09 was assigned a comprehensive case as an individual project – not a group or team project – to be graded and assessed. The case involves a series of ongoing bidding competitions between Heileman Brewing and S&P Brewing for the Pabst Brewing Company. In 1982, the Heileman Company outbid S&P for acquisition of Pabst, but the acquisition was blocked by the Justice Department. Pabst reorganized in 1984 after an asset swap with Heileman and Olympia Brewing. After the swap S&P and Heileman were again preparing to bid for the new Pabst Brewing. The two protagonists have completely different intentions and strategies for the acquisition; with Heileman wanting to improve margins and market share while S&P wants to bleed cash flows from Pabst by slashing expenses, primarily advertising and marketing expenses, and eventually sell off assets after market share has been decimated. The intentions and strategy are not given to the students but must be inferred from the financial statements reporting results of current operations of the firms. Students must:

- A. Determine the intentions and strategies of Heileman and S&P
- B. Prepare forecasts of cash flows that follow from the strategy
- C. Estimate the cost of capital for each of the potential acquirers

- D. Estimate the value for each of the potential acquirers
- E. Consider potential regulatory impact on the outcome