

THE UNIVERSITY OF NORTH CAROLINA AT GREENSBORO
Joseph M. Bryan School of Business and Economics
Department of Business Administration

MBA 625: Corporate Strategy and the Finance Function
Fall 2006

I. Meeting Time and Place

Bryan 111, Monday 6:30 to 9:20

II. Instructor:

Dr. William Brown
Room: 489 Bryan Bldg.
Phone: 256-0110
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Blackboard: <http://blackboard.uncg.edu>
Office Hours: Monday 1:00 pm to 2:00 pm, 3:30 pm to 4:00 pm
Wednesday 1:00 pm to 2:00 pm
By appointment

Required Textbooks:

Corporate Finance: A Focused Approach, Second Edition. Michael Ehrhardt and Eugene Brigham, Thomson South-Western College Publishing (2006).

Almost all of you should have this textbook from your MBA 605 course. We will use the Chapters covered in 605 primarily as background material and begin where that course left off. If you did not take 605, then similar chapters from another Corporate Finance Text may be sufficient.

Course Cases: We will also make extensive use of cases for this course. In some instances these will be cases provided with your text and available online, other public access cases available online and some copyrighted cases that you must purchase online and download.

Electronic Resource:

Blackboard will be used for this course. The sign-on site for Blackboard is <http://blackboard.uncg.edu>. Students enrolled in this course will have access to the applicable section of Blackboard. Updates of the Course Syllabus, if required, as well as notes, solutions and other material deemed necessary will be posed to this site and available for download.

We will make use of Microsoft Excel. If you do not have a personal computer or if you do not have MS Excel installed on your computer, it is available on the University's computer network.

Purpose: As a follow-up to MBA 605, MBA 625 addresses the linkage between a firm's financial policy and its corporate strategy. Upon completion of this module, students should be equipped to:

1. Recognize the role played by the finance function in developing a global strategic plan.
2. Evaluate the extent to which a firm's investment, financing, and dividend decisions contribute to creating value for its common stockholders. Assess the degree to which these financial policies support the firm's overall corporate strategy.
3. Identify the major stakeholders in the modern corporation. Explain how the interests of the stockholders in a multinational firm may be in conflict with other stakeholders.
4. Estimate the required rate of return for a firm, and where appropriate, its various divisions. Use this financial standard as a basis for making investment decisions that create value for the shareholders.
5. Understand how dividends and share repurchases affect the firm's financial statements and operating structure.
6. Estimate the firm's debt capacity and use it to choose a target capital structure that is consistent with the firm's overall corporate strategy.

Course Requirements: Final grades will be based on class participation, two exams and two case write-ups. The relative weights given to each component are as follows:

Grading:

Course grades will be determined as follows:

Exam 1	25%
Case Write-Up 1 (Teletch Case)	20%
Case Write-up 2 (Tonka Case)	20%
Final Exam (Cumulative)	30%
Class Participation	5%

Write-ups should no more than three doubled-spaced typed pages, exclusive of exhibits (i.e. Tables, charts and figures). They are due on the day of discussion. Students will have all of the analytical and/or theoretical tools they need prior to the date the case is due. While you may discuss the case with your classmates, the write-up should be an *individual effort* that reflects both an understanding of (1) the decision/policy issues facing the firm, and (2) the alternatives available *based on case data*. Each paper must indicate clearly what the company should do. Computational work should be directed towards supporting your recommendation.

In addition to its technical aspects, the grade assigned to the case write-up will reflect how well you defend your point. In many cases, the financial analysis is the simple part compared to selling people on your recommendations within a specific organizational setting. Guidelines for preparing case write-ups are provided at the end of the syllabus. Please read it before turning in your first write-up.

Since finance is not a spectator sport, daily preparation is necessary to obtain the maximum benefit from the course. To “encourage” your on-going involvement, 5% of your final grade will be determined by class participation. In the limit, students who simply turn in their written work and do not get involved at all in class discussions cannot expect to receive an A.

Class Overview:

Most classes will begin with a lecture and discussion of key concepts followed by a case. I expect everyone to have completed the background readings and studied the case in detail before the class meeting.

The brief outline below notes the chapters and cases for each class, dates of exams and assignments. Directly after the outline is a more detailed description for each case and some of the relevant questions to consider when preparing for class.

Class 1: Monday October 16th

Overview of Corporate Financial Strategy, Investment Decisions vs. Financing Decisions

Case: Walt Disney Productions, June 1984.

Class 2: Monday October 23rd

The Cost of Capital, Multiple Hurdle Rates

Cases: Conway (A), Conway (B), The Cost of Capital at Ameritrade

Article: “Best Practices In Estimating the Cost of Capital” Bruner, et al.

Chapters: Chapter 6 Ehrhardt and Brigham

Class 3: Monday October 30th

Corporate Investment Choices, Capital Budgeting and Capital Rationing

Cases: Euroland Foods, Super Project

Article: Comparative Financial Practice: Capital Budgeting & Risk Assessment

Chapters: Chapter 7 Ehrhardt and Brigham

Assignment Due: Write up of Teletech Case

Class 4: Monday November 6

EXAM 1, Introduction to Capital Structure

Class 5: Monday November 13

Capital Structure, continued

Cases: Dupont 1983, American Home Products

Chapters: Chapter 13 Ehrhardt and Brigham

Class 6: Monday November 20

Dividend and Distribution Policy

Cases: Eastboro

Chapters: Chapter 14 Ehrhardt and Brigham

Assignment Due: Write up of Tonka Case

Class 7: Monday November 27

Dividend Policy, **EXAM 2**

Cases covered in class and cases for assigned write-ups.

Walt Disney Productions (1984)

Provider: Darden

Author: Robert F. Brunner

Case Id: UVA-F-0676

Available at <http://store.darden.virginia.edu/>

The case is multifaceted and is designed to (1) show how competitive advantage and creating shareholder value are two sides of the same coin, (2) motivate a discussion of what “excellence” means from a financial viewpoint, and (3) indicate how the CAPM can assist shareholders in evaluating corporate management.

In preparation, please address the following issues:

1. What are Disney’s major business segments? What are the industry characteristics for each business segment? What’s Disney’s position in each business segment? Do there appear to be any problems/issues in each of the segments?
2. Ron Miller, the CEO of Disney, said “We have created unique value along with competitive and strategic advantage.” What are the unique value and advantages to which he refers?
3. Does the proposed Gibson Greetings acquisition make strategic sense? Do you think Disney would have proposed it if they were not worried about Steinberg trying to acquire Disney?
4. From the data in case Exhibit 6, calculate the required return on Disney’s common stock for 1974-1983 using the capital asset pricing model (CAPM). Assume a market risk premium (i.e., $R_m - R_f$) of 8%. How do these figures compare with Disney’s after-tax return on equity (ROE)? How would you interpret the differences?
5. Calculate the book value per share of Disney after making adjustments for the differences in historical cost and estimated current value of assets such as (a) Disneyland, (b) the film library, and (c) the firm’s enormous holdings of raw land. How does this compare with the market price per share in late 1983?
6. Based on your calculations in (2), what’s Disney’s market-to-book ratio? Is Disney an “excellent” firm in financial terms?
7. As a member of Disney’s Board of Director’s, what would be your recommendation to Disney management regarding Saul Steinberg’s offer?
8. If Disney rejects Steinberg’s offer what would if any changes would you propose they make to the company?

Conway Products (A) and Conway Products (B)
These two cases are provided on Blackboard.

We'll take up the Conway Products case. This case provides an introduction to cost of capital, and illustrates some of the common pitfalls in establishing required rates of return on investment projects. The case contains data that will allow students to (1) calculate a firm's weighted average cost of capital, and (2) use this benchmark to make capital budgeting decisions. In preparing the Conway (A) case answer the following questions:

1. Is Brenda Beeman justified in being concerned about the way in which Conway Products has established its hurdle rate?
2. Estimate Conway's weighted average cost of capital. How does this "new" hurdle rate change the firm's allocation of capital?
3. Should Conway consider separate hurdle rates for each of its divisions?

Conway (B) provides students with a data set in order to calculate risk-adjusted hurdle rates for a firm with two divisions that may have different risk characteristics. Address the following issues:

1. What are the arguments for or against Conway going to a multiple hurdle rate system?
2. Calculate the risk-adjusted hurdle rates for each of Conway's divisions.
3. Would capital be allocated differently? Which division would benefit? Are there any "losers"?
4. What organizational issues would Conway have to overcome in implementing a risk-adjusted hurdle rate system?

Cost of Capital at Ameritrade

Provider: Harvard Business School

Author: Mark Mitchell

Case Id: 201046

Available at <http://harvardbusinessonline.hbsp.harvard.edu>

Ameritrade Holding Corp. is planning large marketing and technology investments to improve the company's competitive position in deep-discount brokerage by taking advantage of emerging economies of scale. In order to evaluate whether the strategy would generate sufficient future cash flows to merit the investment, Joe Ricketts, chairman and CEO of Ameritrade, would need an estimate of the project's cost of capital. There is considerable disagreement as to the correct cost of capital estimate. A research analyst pegs the cost of capital at 12%, the CFO of Ameritrade uses 15%, and some members of Ameritrade management believe that the borrowing rate of 9% is the rate by which to discount the future cash flows expected to result from the project. There is also disagreement as to the type of business that Ameritrade is in. Management insists that Ameritrade is a brokerage firm, whereas some research analysts and managers of other online brokerage firms suggest that Ameritrade is a technology/Internet firm.

Note: This case provides data on security returns under the assumption that you will estimate Beta for the companies involved. However, I will provide you with these estimates.

Questions to Consider?

1. What factors should Ameritrade management consider when evaluating the proposal? Why?
2. How can the Capital Asset Pricing Model (CAPM) be used to estimate the cost of capital for a real investment (as opposed to a financial investment)?
3. Using the CAPM:
 - a. What is your estimate of the risk-free rate to use for the cost of capital for Ameritrade? Why?
 - b. What is your estimate for the market risk premium? Why?
 - c. In principal, how would you compute the asset beta of a project?
4. Ameritrade has a short history of trading, so the beta cannot be computed from historical data. Exhibit 4 provides some choices for comparable firms. Which of these firms do you think are appropriate to use as comparables to determine the beta of Ameritrade's planned advertising and technology investments? Why?
5. Using the stock price and returns presented in Exhibit 5 and Exhibit 6, and the capital structure from Exhibit 4, calculate the asset betas for the comparable firms. What beta should Ameritrade use? Why?

NOTE: THIS CASE IS FOR STUDENTS TO WRITE UP AS AN ASSIGNMENT AND NOT FOR CLASS DISCUSSION

Teletech Corporation 2005

Provider: Darden

Author: Robert F. Brunner

Case Id: UVA-F-1485

Available at <http://store.darden.virginia.edu/>

The Teletech case to explore the issues associated with the use of a single hurdle rate to evaluate all segments of a business versus a risk-adjusted hurdle rate system. There is also data in the case to give students some drill in calculating risk-adjusted required rates of return. A procedure on how to calculate the required rate of return of a firm and its divisions can be found in SB – Chapter 10, Section 10.3. When you prepare the case, try to answer the questions below:

1. How does Teletech currently use its hurdle rate? Does this seem to be appropriate?
2. Estimate hurdle rates for each of Teletech's business segments. What implications do these have for capital allocation? Assume a market risk premium ($R_f - R_m$) of 5.5 percent.
3. Should Teletech consider separate hurdle rates each of its division? What are the arguments for and against Teletech going to a multiple hurdle rate system?
4. Is Helen Bruno correct right that management would destroy all value if all of the firm's assets were redeployed to the telecommunication business segment? Why or why not?
5. What should Teletech say in response to Victor Yossarian?

Euroland Foods, S.A.

Provider: Darden

Author: Casey Opitz & Robert F. Brunner

Case Id: UVA-F-1356

Available at <http://store.darden.virginia.edu/>

In January 2001, the senior management committee of this company has to decide which major projects should be funded for the coming year. The board of directors has set a limit of €120 million to be spent on capital projects for projects in 2001. Various managers, however, have proposed projects totaling €316 million. The task at hand is to evaluate the discounted cash flow (DCF) analyses that the case presents, along with the qualitative factors (mainly strategic considerations and the internal politics of the company) and to choose the projects to be approved.

1. Currently, Euroland Foods is using both IRR and payback to evaluate investment projects. Are these appropriate measures given the firm's current situation? If not, what measures would you suggest?
2. Rank the ten proposals on the basis of purely economic considerations. Then rank them a second time based on any considerations you believe to be important. Are the rankings identical? Why or why not?
3. Are there any interdependencies between projects? Which are mutually exclusive? Which are contingent projects?
4. What projects should Euroland implement if it had no limit on the amount of Capital to invest? What projects should Euroland implement given the limit of €120 million to be spent on capital projects?
5. Why would a firm impose capital rationing? Are such capital investment limits voluntary?

The Super Project

Provider: Harvard Business School

Author: Richard Vancil and Harold Wyman

Case Id: 112034

Available at <http://harvardbusinessonline.hbsp.harvard.edu>

This case is chronologically old and deals with the introduction of an instant dessert by General Foods. However, the case is a classic in the sense that most of the issues raised are still relevant today. Specifically, students are asked to (1) identify the key assumptions needed to calculate the relevant cash flows from the project, (2) specify the relevant cash flows based on these assumptions, and (3) test the sensitivity of the projects returns to these assumptions. As you prepare the case, consider the following issue:

1. What are the relevant cash flows associated with the Super Project? In particular, how should management deal with issues like (a) test market expenses; (b) overhead expenses; (c) erosion of Jell-O contribution profits; (d) allocation of charges for the use of excess agglomerator capacity.
2. What is your feeling about the General Foods use of return on funds employed (ROFE) and payback as measures of investment attractiveness? If you don't like these measures, what measure(s) should be used? Why?
3. How attractive is the Super Project in strategic and competitive terms? What potential risks and benefits does General Foods incur in either accepting or rejecting the project?
4. Should General Foods proceed with the Super Project? Why or why not? Note: To help in making this decision, you must calculate Super's net present value (NPV). This means that you must also estimate General Food's WACC. There is enough data in the case to make this calculation.

E.I. du Pont & de Nemours & Co. 1983

Provider: Harvard Business School

Author: Robert R. Glauber

Case Id: 284062

Available at <http://harvardbusinessonline.hbsp.harvard.edu>

As an introduction to capital structure policy, the Du Pont case focuses on the practical issues confronting a firm in determining its debt policy. In reading the case, consider the following issues/questions:

1. Review case Exhibit 6. How much external financing will Du Pont have to raise in the near future? From a strategic perspective, what's driving the need for external financing?
2. How does Du Pont's acquisition of Conoco affect the risk of the firm?
3. How and why did Du Pont keep its AAA bond rating in 1975? Why did Du Pont lose its AAA rating in 1981?
4. Examine the data in case Exhibit 7. What, if anything, does it tell us about the relationship between bond ratings and interest rates? Are there any other "goodies" imbedded in the exhibit that might be of interest to Du Pont's chief financial officer?
5. Compare and contrast the two debt policies in case Exhibit 8 for 1987. What bond rating would Du Pont receive under each alternative? How would its financial performance, access to the capital markets, and financial risk differ under the two alternative debt policies?
6. What target capital structure should the firm adopt?

American Home Products

Provider: Harvard Business School

Author: David Mullins

Case Id: 283065

Available at <http://harvardbusinessonline.hbsp.harvard.edu>

The American Home Products (AHP) case challenges students to look at the notion of an optimal capital structure in theory and in practice. At issue is how explain why this successful cash cow company have any debt on its balance sheet. In preparing the case, consider the following questions:

1. What (if any) are the sources of AHP's competitive advantage? How much business risk do they face?
2. How much financial risk would AHP face at each of the proposed level of debt shown in case Exhibit 3? How much potential value, if any, would AHP create for its shareholders at each of the proposed debt levels?
3. What capital structure would you recommend?
4. In light of AHP's unique corporate culture, how would you convince Mr. LaPorte or his successor to adopt your recommendation?
5. AHP currently has a large amount of cash on its balance sheet. If the firm issues debt, then it will have an even larger cash balance. What should it do with this additional cash?

NOTE: THIS CASE IS FOR STUDENTS TO WRITE UP AS AN ASSIGNMENT AND NOT FOR CLASS DISCUSSION

Tonka Corporation

Provider: Darden

Author: Casey Opitz & Robert F. Brunner

Case Id: UVA-F-0774

Available at <http://store.darden.virginia.edu/>

The Tonka Corporation case presents the financial and strategic positions of the sixth largest toy company as of 1987. At that time the company carried virtually no debt on its balance sheet in sharp contrast to other major toy manufacturers. Based on financial and strategic considerations, students are challenged to recommend a capital structure policy for the firm. As you prepare the case, consider the following questions/issues:

1. How much business risk does Tonka face?
2. How much potential value, if any, can Tonka create for shareholders at each of the proposed levels of debt? How would leveraging up affect the firm's taxes?
3. How much financial risk does Tonka face at each of the proposed levels of debt in case Exhibit 12? How would the capital markets react to a decision by the company to increase the use of debt in their capital structure?
4. What is the importance of a target capital structure? What target capital structure would you recommend? What argument (s) would you advance to persuade the firm to adopt your recommendations?

Eastboro Machine Tools Corporation

Provider: Darden

Author: Robert F. Brunner & Casey Opitz

Case Id: UVA-F-1360

Available at <http://store.darden.virginia.edu/>

The Eastboro Machine Tools Corporation deals with a company that is trying to decide whether to reinstate its cash dividend and if so, by how much. Assume that you are Jennifer Campbell, the chief financial officer, and prepare a recommendation to the board of directors on what Eastboro should do. As you prepare your recommendation, consider the following questions:

1. Using case Exhibit 8, explain what happens to Eastboro's financing needs and reserve borrowing policy if no dividends are paid versus pursuing a 40 percent payout policy.
2. Based on the finance literature (and case data), is there any connection between dividend payouts and stock prices?
3. What are the arguments for a zero dividend payout versus a 40 percent payout? What do you think of the residual-payout-policy? Is it appropriate for Eastboro?
4. Should Campbell recommend the corporate-image advertising campaign and corporate name change to the directors? Do advertising and name change have any bearing on the firm's dividend policy?
5. What recommendations would you to the board of directors?

GUIDELINES FOR CASE WRITE-UPS

1. All of the cases assigned require a decision and /or a specific set of policy recommendations. Your recommendation will invariably involve balancing a set of conflicting concerns. This is not a simple process, and your instructor is very sympathetic to the trauma that may accompany a thoughtful case analysis. However, the need to take a position is essential. Write-ups void of conclusions are unacceptable.
2. Your recommendations should come as early in the paper as possible, followed by the background and details of how you reached your conclusions.
3. Your paper should communicate a sense of literacy. It is difficult for a reader to take your policy recommendations seriously if the write-up contains poor grammar, typos, and/or lacks a professional look.
4. **You should assume the reader already knows the details of the case.** A useful format is to assume you are the assistant to the major decision-maker in the case, and to put your paper in memo form. This perspective allows you to limit discussion to the issues at hand without spending a great deal of time on background material that the reader already knows.
5. An important determinate of your grade will be the degree to which your conclusions or recommendations flow logically from your analysis. I am less concerned with “the answer” than how you arrived at it. Internal inconsistencies (i.e. saying something in one part of your paper and then contradicting yourself later on) are not only “untidy” but can negate an otherwise sound analysis.
6. The central issues in most cases can be addressed in no more than 3 pages *exclusive* of exhibits. In this context, your instructor will not be impressed with bunches of computer-generated exhibits, graphs, etc., unless they are needed to support your position. Remember, your instructor, like your boss, will reward short and concise recommendations not lengthy diatribes.
7. Be sensitive to your audience. Avoid phrasing that is insulting or condescending, since this will put the reader on the defensive.
8. Unfamiliarity with institutional detail/terminology in the cases is no excuse for a faulty analysis. In practice, you would be expected to know this information and/or learn quickly.
9. It is generally not a good idea to raise questions that you cannot answer. The case decision-makers are interested in answers, not more problems to add to their worry-box. Limit your discussion to those issues where there is sufficient data to provide defensible answers. Lists of “problems” beyond this point simply clutter your paper.

The same thing can be said for introducing strategy alternatives that cannot be defended by case data.

10. Finally, each case is accompanied by a set of questions that are designed to stimulate your thinking about the issues facing the firm's management. They are not intended as a "punch list" to be answered 1,2,, etc. Instead, they should be integrated into the write-up as you see fit. Case write-ups that are nothing more than the answer to a set of questions will be penalized by a full letter grade.