

I. Course Objectives: The Big Picture and the “Nitty-Gritty”

This course is designed to study the value creation process in corporations; that is, the process that generates superior *economic* performance for the firm over the long run. The course will analyze value creation both conceptually and in terms of the challenges it poses for the top-management of a corporation. The analytical framework will employ precepts from finance, economics, and competitive strategy. Topics will be covered through a series of case studies and reading assignments. These materials will generally take the integrative perspective of a high-level manager (such as the CEO or the CFO). As will quickly become clear, however, a strong foundation in the functional areas of finance, accounting etc. will be an asset in the course.

The fact that the framework of the course will be derived both from finance and competitive strategy implies that we will be looking both at the “**big picture**,” and the “**nitty-gritty**,” i.e., the emphasis will be to show how the more quantitative and precise aspects of finance concepts serve to both *identify* and *implement* value-creating strategies.

II. Course Materials

We will build on the analytical foundations laid out in the core courses and the finance courses preceding the course. To ensure some uniformity in the background preparation for finance, class notes on capital budgeting, portfolio analysis, and the cost of capital (written by the course instructor) are included as part of course materials. You should generally scan these notes to see if you are comfortable with most of the material. However, when appropriate, specific parts of the notes will be assigned as readings and discussed in class (see the syllabus below).

The more course specific material will take the form of:

- Books;
- Readings or notes on analytical techniques (or concepts) that underlie the case studies;
- Case studies of “real-life” decision-making situations that invite students to bring together their technical knowledge and apply it to situations that challenge top-management.

The books for the course include a collection of case studies relating to strategy and finance, a book on competitive strategy, and a very recent book that interprets strategy and financial policy formulation through a “real options” framework. These books are:

- *Case Studies in Finance: Managing for Corporate Value Creation (Third Edition)*
Author: Robert Bruner
- *Competitive Strategy*
Author: Michael Porter
- *Real Options: Managing Strategic Investment in an Uncertain World*
Authors: M. Amaram and N. Kaulitaka

(In the syllabus, the Bruner book is referred to as RB, the Porter book is referred to as MP, and the Amaram and Kaulitaka book is referred to as AK).

III. Class Content

Class time will largely be given over to discussion of the assigned cases. The assignment of cases and the focus questions to help in the preparation or analysis of these cases are clearly spelt out in the syllabus below. However, the case discussions are organized around topics in finance or strategy. As we move into these topics, there will be “background” lectures to highlight and review the most important analytic concepts (relating to that topic).

Since case discussions in class will be such an important part of the course, it is well worth briefly commenting on the case method. I would urge everyone to read these comments since the “quality” of the course will be to a large extent determined by the case preparation and discussion by the students.

III.I Case Method

Cases provide a context for application of analytic concepts, and illustrate the issues that arise in the complex decision-making situations that typically face top-management. As in real business problems, there are no “right” answer for case studies that we will examine in the course, although there are correct and incorrect ways to analyze or approach them. The challenge for the student is to (1) examine the facts and the data contained in the case, (2) employ the analytical frameworks learned in earlier classes (and concurrently), (3) reach conclusions, and (4) make specific recommendations that will resolve the issues presented by the case.

To prepare for a case discussion, you should read each case and analyze the data that it presents. Texts and readings from earlier courses should be used to the extent that they assist in your preparation. A thorough preparation for discussions includes systematically (1) outlining the major issues presented by the case, (2) identifying the analytical techniques or frameworks appropriate for resolving the problem, and (very important) (3) outlining steps to implement a

specific course of action that is supported by the analysis. It would also be useful to review the “**Note to the Student: How to Study and Discuss Cases,**” in the beginning of Bruner’s book.

IV. Reading Assignments

Reading assignments are shown in the accompanying course outline. For each session, you should complete the reading assignment prior to preparing your analysis of the case.

V. Course Requirements

Students will be required to present both written work and oral analysis of the cases. The written work will involve presenting **three group case reports**. The relevant dates for the three reports are as follows:

- (1) The first case will be assigned (or handed out) in class on January 15, and is due in class (**no exceptions**) on January 29.
- (2) The second case will be assigned (or handed out) on February 14. This case is due in class (**no exceptions**) on February 18.
- (3) The third case will be assigned (or handed out) on February 18. This case is due in class (**no exceptions**) on March 3.

More detailed instructions on the case reports are now provided. Case-specific instructions will also be provided when the cases are assigned (or handed out).

Case Reports

The case assignments will be specific as to the objectives of the analysis, and will also identify the target audience for the analysis (for example, the CEO or the Board of Directors etc.). The reports will have two components. The first part will be an *executive summary of no more than 350 words*. In this section, you will summarize your specific policy recommendations. You need not backup your recommendations at this point. In the second part of the paper you should provide a full analysis of the case situation, and justify your action recommendations. This part should not *exceed 4 double-spaced pages*. Only a minimal number of attachments will be allowed.

The main requirement in terms of the content of the reports is that the logical foundations of your analysis be clearly documented. More precise criteria employed in the grading of the reports are given below. However, it should be mentioned here that in all of the written work, sentences such as

“ the firm should make innovative products at the lowest possible financial costs, and market them effectively”

will be totally unacceptable. You should be very precise in the action recommendation section, and backup your assertions with facts or analysis at all points in the other parts of the paper.

Grading Criteria for Reports

The grades on the reports will be based on the extent to which the report

1. Grounds the analysis on the analytical concepts discussed in class;
2. Explicitly states the assumptions in the analysis;
3. Isolates the fundamental problems for the situation, and remains focussed on these;
4. States criteria for choosing among alternative action plans;
5. Integrates the action plans with the analysis;
6. Ensures that the action plans are situation-contingent, i.e., constitute a *strategy* rather than being isolated action recommendations;
7. Is persuasive that the action plans are reasonable, effective and efficient.

Overall, the logical consistency, precision and analytic structure of the paper will be emphasized in the grading.

VI. Grading

The grading weights of the written work are as under:

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|---------------------------------|---------------|
| 1. Case report 1 | 27.5 percent. |
| 2. Case report 2 | 27.5 percent. |
| 3. Case report 3 | 30 percent |
| 4. Participation in discussions | 15 percent |

I will expect each student to have prepared the case for class discussion. I will usually pick a student at random to “start the case”. A good lead-off is important for an effective discussion of the case. The case will then be opened for general discussion. In terms of grading criteria for class participation, I will look for whether the student (1) has thoroughly prepared the case, (2) is

a good listener, i.e., can link his or her arguments to the comments of others, and (3) is willing to be “creative” in offering new ideas.

VII. Class Schedule

The class will commence at 8:15 a.m., and finish at noon, punctuated by two ten-minute breaks. The class will, thus, be divided into the following three sessions:

First Session	8:15-9:30 a.m.
Second Session	9:40-10:55 a.m.
Third Session	11:05 a.m.-noon.

Background Readings

Your course “binder” includes the following notes and articles. As mentioned above, the five class notes form the analytic backdrop for the course. A lot of the material will probably already be familiar to you. The cases will often require specific analytic material, much of which is summarized in the notes. I will review those techniques/models in class before the case discussion, and in those situations, the notes should come as a handy reference.

Notes

1. Notes on Capital Budgeting (I)
2. Notes on Capital Budgeting (II)
3. Capital Budgeting with Risk (I)
4. Capital Budgeting with Risk (II)
5. Cost of Capital Calculations

Articles

It may also be worth your while to look through the following articles. The course is built on a perspective on finance, which is probably broader than what is traditionally taken in corporate finance courses. The point of these articles is to show that the broader perspective of the course seems to be reflected in the “new” role of CFOs (chief financial officers) that the marketplace is demanding.

What do CEOs Want? EEO Magazine, July 1999

Super CFOs: They Can't Jump... Fortune 1995

**Friday
January 7**

Session # 1

Reading Assignment

1. Chapters 1, 2, 8 and 16 in MP (Competitive Strategy)
 2. Value-Based Management, Ch. 4, in Copeland et. al.
 3. Evidence on EVA by Biddle et. al.
 4. The Reaction of Security Prices to Tracking Stock Announcements by Elder & Westra.
 5. Murphy's Law & Market Anomalies by Dimson and Marsh.
 6. The Market for Corporate Control by Jensen and Ruback.
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This session will expedit the major concepts, and lay out some basic themes of the course. The principal concepts to focus on are:

- The precise notion of value creation (and destruction);
- The principal avenues for value creation;
- The relative strengths and weaknesses of different “measures” of value creation;
- The role of the implicit assumption of capital market efficiency in these measures.

**Saturday
January 8**

Session # 2

Case to Prepare

RB, #4, The Battle for Value: Fed-Ex vs. UPS

Case Questions

1. Analyze the structure of the overnight package delivery industry. What strategies have been employed by Fed-Ex and UPS?
2. Do you think either firm can attain a sustainable competitive advantage in this business? Be specific.
3. Why did Fed-Ex's stock price decline following J.C. Penney's announcement? Are the stock markets inefficient? If not, how do you interpret a loss of \$85 million in Fed-Ex's equity value?
4. Which firm is doing better since mid-1980s? How would you apply the EVA concept here? What insights do you gain regarding the strengths and weaknesses of this concept?
5. If you had to identify *one* of these companies as "excellent", which would you choose? Why? Be prepared to justify your notion of "excellence" here.

This is fascinating case that combines both the **"big picture" and the "nitty-gritty" issues**---Enjoy!

**Saturday
January 15**

Session # 3

Reading Assignment

1. Review Notes: Notes on Capital Budgeting (II) (the section on Internal Rates of Return (IRRs)), Capital Budgeting with Risk (II), and Cost of Capital Calculations.
2. Read Case 12 in RB: “Best Practices in Estimating the Cost of Capital: Survey and Synthesis.”

Case to Prepare

RB, #14, The Boeing 777

Case Questions

1. What is an appropriate required rate of return against which to evaluate prospective IRRs from the Boeing 777?
 - (a) Which beta did you use? Why?
 - (b) When you used the CAPM which risk-free rate and risk-premium did you use? Why?
 - (c) Which capital-structure weights did you use? Why?
2. Judged against your WACC, how attractive is the Boeing Project?
 - (a) Under what circumstances is this project economically attractive?
 - (b) What does sensitivity analysis reveal about the nature of Boeing’s gamble on the 777?
3. Should Boeing have launched the 777 in October 1990?

**Friday
January 21**

Session # 4

Reading Assignment

1. The “Hot” Issue market of 1980 by J. Ritter
 2. The Long-Run Performance of Initial Public Offerings by J. Ritter
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Case to Prepare

Netscape’s Initial Public Offering (Readings Packet)

Case Questions

1. Why has Netscape been so successful to date? What appears to be its strategy? What must be accomplished if it is to be a highly successful going concern in the long-run? How risky is its current competitive position?
2. Does Netscape need to go public to satisfy its capital needs? What would be the magnitude of these needs in the next five years? What other sources of funding are there?
3. Why, in general, do companies go public? What are the advantages and disadvantages of public ownership?
4. Should Netscape board be concerned about underpricing? Why or why not?
5. Can the recommended offering price of \$28 per share for Netscape be justified? How would you derive some base line estimates of Netscape’s value?

**Saturday
January 29**

Session # 5

Reading Assignment

1. Notes on Capital Structure.
 2. Structuring Corporate Financial Policy: Diagnosis of Problems and Evaluation of Strategies.
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Case to Prepare

RB, # 28, Polaroid Corporation, 1996

Case Questions

1. What are the main objectives of the debt policy that Ralph Norwood should recommend to Polaroid's board of directors?
2. What financing requirements do you foresee for the firm in coming years?
3. What are the risks associated with Polaroid's business and strategy? Who are Polaroid's peer firms?
4. Drawing on the financial ratios in case exhibit 9, how much debt could Polaroid borrow at each rating level? What EBIT coverage ratio would result from the borrowings implied by each rating category?
5. Using exhibit 11, which rating category has the lowest overall costs of funds? Do you agree with Hudson's view that equity investors are indifferent to the increases in financial risk across investment grade categories?

6. Is Polaroid's current maturity structure of debt appropriate? Why or why not?

7. What should Ralph Norwood recommend regarding

- a. the target bond rating;
- b. the level of flexibility of reserves;
- c. the mix of debt and equity;
- d. the maturity structure of debt;

and any other issues you believe should be brought to the attention of the CEO and the board?

**Friday
February 4**

Session # 6

Reading Assignment

Signalling with Dividends, Stock Repurchases, and Equity Issues

Case to Prepare

Intel Corporation, 1992 (Readings Packet)

Case Questions

1. What is driving the changing competitive structure of the microprocessor industry? What are the sources of value-added (and hence competitive advantage) in the industry?
2. What has been Intel's strategy? In particular, what role has the strong R&D investment played in this strategy? In general, how does the "first mover" position affect Intel's strategy?
3. What are the advantages and disadvantages of being a first mover versus being a "cloner" in the industry?
4. What is the competitive role of financial flexibility? How does it deter entry?
5. What are the other costs and benefits of holding substantial amounts of cash?
6. What kind of cash disbursement policies should Intel consider? In particular, what are the pros and cons of starting substantial dividend payouts versus doing an aggressive program of stock repurchasing?

**Saturday
February 12**

Session # 7

Case to Prepare

Marriott Corporation (A) and (B) (Readings Packet)

Case Questions

1. Why is Marriott's chief financial officer proposing Project Chariot?
2. Is the proposed restructuring consistent with management's responsibilities?
3. The case describes two conceptions of management's fiduciary duty (page 9). Which do you favor: the shareholder conception or the corporate conception? Does your stance make a difference in this case?
4. Should Mr. Marriott recommend the proposed restructuring to the board?
5. Should Marriott make any concessions to the bondholders?

**Friday
February 18**

Session # 8

Reading Assignment

1. Introduction to Derivative Instruments.
 2. Capital Projects as Real Options: An Introduction
 3. Strategy as a Portfolio of Real Options
 4. Note on Adjusted Present Value
 5. Chapters 1-3 in AK.
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**Saturday
February 26**

Session # 9

Reading Assignment

1. Scientific Management at Merck: An Interview with CFO Judy Lewent.
 2. What is it Worth? A General Manager's Guide to Valuation.
 3. Chapters 10, 11, 15 and 20 in AK.
 4. A Framework for Risk-Management.
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Case to Prepare

MW Petroleum Corporation (A)

Case Questions

1. Evaluate Amoco's and Apache's corporate objectives and strategies. Is it possible that MW properties are more valuable to Apache than to Amoco? What sources of value most plausibly account for the difference between buyer and seller?
2. Apply the APV to a discounted cash flow valuation of all MW reserves. Is your estimate more likely to be biased high or low? What are the sources of bias?
3. Which part of MW should be regarded as assets-in-place and which as options? What kind of options are present? Should this approach yield a higher or lower value than the all-APV approach above?

4. How risky are the assets that underlie the options; i.e., how would you estimate σ for each?
5. How much is the whole portfolio worth?
6. Assuming the sale goes through, how does Apache exercise each of the various options?
When should it do so?

**Friday
March 3
Session # 10**

Reading Assignment

1. Chapters 5 and 6 in AK.
 2. How Financial Engineering can Advance Corporate Strategy?
 3. Why manage risk?
 5. Value at risk.
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Case to Prepare

Enron Gas Service (Readings Packet)

Case Questions

1. How would you describe EGS's business? How is it like a bank? What circumstances created the opportunity that EGS is designed to exploit?
2. Why might gas users pay for EGS's services? What is the Enfolio product line? How do they turn a commodity into a differentiated product? Why might utilities and IPPS be receptive to EGS?
3. What problems of gas supply does EGS attempt to solve? How could EGS raise funds for gas suppliers? What are VPPs and what are their associated risks? How do Cactus funds work?

4. What is ERMS? Describe the risk books at EGS. How do they measure the exposure of EGS to various risks? How do traders manage risks?
5. If you were a senior executive at EGS, what would keep you awake at night?