International Managerial Economics

2 sessions relating to corporate objectives and strategy.

Lecturer: Peter Howells

All references are available in short loan. Arnold as easiest to follow.

Lecture1: Corporate Finance: Risk

Readings:

G Arnold, Corporate Financial Management (FT-Pearson,2e, 2002) ch 17
AG Puxty and J C Dodds, Financial Management (Chapman and Hall, 1990), sects 2.1, 5.2, 6.3
R Brealey and S Myers, Principles of Corporate Finance (McGraw-Hill, 5e, 1996) ch.4, sect 8.3.

Seminar Question:

(a) Distinguish between 'business risk' and 'financial risk'

(b) 3. Company X is ungeared. Company Y is geared and its debt is such that it has to make interest payments of £42,000 per year. Operating profits for both companies in years 1, 2, 3 are:

Year 1: £156,000
Year 2: = Yr 1 - 25%
Year 3 = Yr 1 + 25%

Calculate and comment on the percentage change in *net* profit (i.e. after interest) for both companies between years 1 and 3.

(c) The risk free rate of interest is 8% while the whole market risk premium is 7%. Chartwell plc consists of three divisions as shown below, together with their relative contribution (by value) to the firm as a whole and their betas.

		ß
Food	0.25	0.47
Leisure	0.3	0.91
Property	0.45	2.00

(i) Find the beta coefficient for the firm as a whole and the return required by shareholders.

(ii) The firm is considering reducing its property interests to 0.25 and diversifying into office products (which will form 20% of the firm). Its best

estimate of the riskiness of office products is ß = 1.2. Find the ß-coefficient for Chartwell as a whole and the new required rate of return, if it goes ahead.

Lecture 2: Corporate Finance: Capital Structure

G Arnold, Corporate Financial Management (FT-Pearson,2e, 2002) ch 18
AG Puxty and J C Dodds, Financial Management (Chapman and Hall, 1990) ch 11
R Brealey and S Myers, Principles of Corporate Finance (McGraw-Hill, 5e, 1996) ch 17

Seminar Question:

(a) Outline the Miller-Modigliani capital irrelevance propositions I and II

(b) on what do these propositions depend?

(c) Tick and Tock have identical business risk and gross earnings of £700K and £500K respectively. Both distribute all profits.

Tick is an all-equity coy with a current market value of £3.9m. The current value of Tock's equity is £2.56m. It also has irredeemable debentures which have a current market value of £0.64m.

Individual investors and firms can borrow and lend at 5%. Ignore taxation.

(i) Explaining carefully your reasoning, discuss whether there is any scope for an investor currently holding shares in Tick or Tock to change his/her portfolio in a way that will achieve better returns without altering risk.

(ii) Explain what will happen to the costs of capital of the two coys if a large no. of investors alter their portfolios as in (i)?