

This book aims to cover the full scope of corporate finance as it is practised today in Europe.

## A way of thinking about finance

There are four key features that distinguish this book from the many other corporate finance textbooks available on the market today:

- Our strong belief that financial analysis is part of corporate finance. Pierre Vernimmen, who was the mentor and partner in the practice of corporate finance of some of us, understood very early on that a good financial manager must first be able to analyse a company's economic, financial and strategic situation, and then value it, while at the same time mastering the conceptual underpinnings of all financial decisions.
- *Corporate Finance* is neither a theoretical textbook nor a practical workbook. It is a book in which theory and practice are constantly set off against each other, in the same way as we do in our daily practice of corporate finance, as investment bankers at BNP Paribas, DGPA, Mediobanca, as board members of several listed and unlisted companies, and as teachers at the Bocconi and HEC business schools.
- Emphasis is placed on concepts intended to give you an understanding of situations, rather than on techniques, which tend to shift and change over time. We confess to believing that the former will still be valid in 20 years time, whereas the latter will for the most part be long forgotten!
- Financial concepts are international, but they are much easier to grasp when they are set in a familiar context. Written by Europeans for Europeans, *Corporate Finance* explains how finance works on European markets, such as London, Frankfurt and Madrid.

## The four sections

This book starts with an introductory chapter reiterating the idea that corporate financiers are the bridge between the economy and the realm of finance. Increasingly, they must play the role of marketing manager and negotiator. Their products are financial securities that represent rights to the firm's cash flows. Their customers are bankers and investors. A good financial manager listens

to customers and sells them good products at high prices. A good financial manager always thinks in terms of value rather than costs or earnings.

**Section I** goes over the basics of financial analysis – i.e., understanding the company based on a detailed analysis of its accounts. We are amazed at the extent to which large numbers of investors neglected this approach during the latest stockmarket euphoria. When share prices everywhere are rising, why stick to a rigorous approach? For one thing, to avoid being caught in the crash that inevitably follows. How many investors took the trouble to read Enron’s annual report? Those who did found that it spoke volumes!

We are convinced that a return to reason will also return financial analysis to its rightful place as a cornerstone of economic decision making. To perform financial analysis, you must first understand the firm’s basic financial mechanics (Chapters 2–5), master the basic techniques of accounting, including accounting principles, consolidation techniques, and certain complexities (Chapters 6–7), based on international (IAS) standards, now mandatory for listed European companies. In order to make things easier for the newcomer to finance, we have structured the presentation of financial analysis itself around its guiding principle: in the long run, a company can survive only if it is solvent and creates value for its shareholders. To do so, it must create value (Chapters 9 and 10), invest (Chapter 11), finance its investments (Chapter 12) and generate a sufficient return (Chapter 13). The illustrative financial analysis of Ericsson will guide you throughout this section of the book.

**Section II** reviews the basic theoretical knowledge you will need to make an assessment of the value of the firm. Here again, the emphasis is on reasoning, which in many cases will become automatic (Chapters 15–24): efficient capital markets, the time value of money, the price of risk, volatility, arbitrage, return, portfolio theory, present value and future value, market risk, beta, etc.

In **Section III**, “Corporate financial policies”, we review the major types of financial securities: equity, debt and options, for the purposes of valuation, along with the techniques for issuing and placing them (Chapters 25–31). Then, we analyse each financial decision in terms of:

- value in the context of the theory of efficient capital markets;
- balance of power between owners and managers, shareholders and debtholders (agency theory);
- communication (signal theory).

Such decisions include choosing a capital structure, investment decisions, cost of capital, dividend policy, share repurchases, capital increases, hybrid security issues, etc.

In the course of this section, we call your attention to today’s obsession with earnings per share, return on equity and other measures whose underlying basis we have a tendency to forget and which may, in some cases, be only distantly related to value creation. We have devoted considerable space to the use of options (as a technique or a type of reasoning) in each financial decision (Chapters 32–39).

When you start reading **Section IV**, “Financial management”, you will be ready to examine and take the remaining decisions: how to organise a company’s equity capital, buying and selling companies, mergers, demergers, LBOs, bankruptcy and restructuring (Chapters 40–45). Lastly, this section presents cash flow

management, asset-based financing and management of the firm's financial risks (Chapters 46–48).

### Instructions to the reader

To make sure that you get the most out of your book, each chapter ends with a summary, a series of problems and questions (a total of 746) (solutions provided). The appendix contains a 75-entry glossary, with a further 1,300 terms defined on the site [www.vernimmen.com](http://www.vernimmen.com). We've used the last page of the book to provide a cribsheet (nearly 1,000 pages of this book summarised on one page!). For those interested in exploring the topics discussed in greater depth, there is an end-of-chapter bibliography giving suggestions for further reading, covering fundamental research papers, articles in the press and published books. A large number of graphs and tables (over 100!) have been included in the body of the text which can be used for comparative analyses. Finally, the index is fully comprehensive.

### An Internet site with huge and diversified content

[www.vernimmen.com](http://www.vernimmen.com) provides free access to tools (formulas, tables, statistics, lexicons, glossaries), resources that supplement the book (articles, prospectuses of financial transactions, financial figures for more than 10,000 European and North American listed companies, thesis topics, thematic links, a list of must-have books for your bookshelf, an Excel file providing detailed solutions to all of the problems set in the book), problems, case studies, quizzes for testing and improving your knowledge. There is a letterbox for your questions to the authors (we aim to reply within 72 hours, unless of course you manage to stump us!). There are questions and answers and much more. New services are put onto the site, which has its own internal search engine, on a regular basis.

### A free monthly newsletter on corporate finance

Since (unfortunately) we can't bring out a new edition of the *Vernimmen* every month, we have set up the *Vernimmen.com Newsletter*, which is sent out free of charge to subscribers by means of the Internet. It contains:

- A conceptual look at a topical corporate finance problem (e.g., *the European company: a new tool to facilitate cross-border mergers, EU anti-concentration regulations, the value of synergies*).
- Statistics or tables that you are likely to find useful in the day-to-day practice of corporate finance (e.g., *worldwide corporate income tax rates, yield curves, IPOs since 1987*).
- A critical review of a financial research paper with a concrete dimension (e.g., *conglomerates and diversification, new ideas on financial structure, leasing vs. bank loans*).

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- A question left on the *vernimmen.com* site by a visitor plus a response (e.g., *What are the advantages and drawbacks of spinning off a division? Does writedown of goodwill impact on values? What is dilution?*)

Subscribe on *www.vernimmen.com* and become one of the many readers of the *Vernimmen.com Newsletter*.

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- And last but not least to our relatives and our many friends who have had to endure our endless absences over the last two and a half years, and of course Catherine Vernimmen and her children for their everlasting and kind support.

We hope that you will gain as much enjoyment from your *Vernimmen*, whether you are a new student of corporate finance or whether you are using it to revise and hone your financial skills, as we have had in editing this edition and in expanding the services and products that go with the book.

We wish you well in your studies!

Milan and Paris, May 2005

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