

Contents

1	Finance and its Fundamental Problems	1
1.1	Financial Theory and Business Practice.	1
1.2	Finance in Academic Knowledge Spectrum	3
1.3	Fundamental Problems in Finance	5
1.3.1	Financial Decision Criteria.	5
1.3.2	Fundamental Problems in Finance	6
1.3.3	Fundamental Problems Remain Unsolved.....	8
2	Does a Positive Perpetual Growth Rate Exist?	9
2.1	Average Annual Growth Rate Revisit.	9
2.2	Arithmetic or Geometric Average Growth Rate.....	11
2.3	ZZ Growth Paradox	12
2.4	Bankruptcy Probability and Firm Life	14
2.5	Is Bankruptcy Loss Incorporated into Discount Rate?.....	17
2.6	The Implied Perpetual Growth Rate.....	18
2.7	The Stage of Finance as a Science	20
	References.....	20
3	Valuation Based on Required Payback Period	23
3.1	Absolute Valuation and Relative Valuation	23
3.1.1	Absolute Valuation	23
3.1.2	Relative Evaluation.	24
3.1.3	Option Pricing Valuation	26
3.2	Cases When Current Absolute and Relative Valuation Invalid.....	31
3.3	A New Absolute Valuation Method Based on Required Payback Period.	33
3.3.1	ZZ Growth Model	34
3.3.2	Solutions Based on ZZ Growth Model.	35
3.3.3	Comparison of Gordon model and ZZ Growth Model.....	36
3.4	The Theoretical Ratio Models	38
3.4.1	ZZ P/E Model.....	38
3.4.2	ZZ P/B Model.....	41
3.4.3	ZZ P/S Model.....	43

3.5	Some of the Applications of ZZ Growth Model and ZZ Ratio Models	44
3.5.1	Calculating the Fair-Priced Ratios	44
3.5.2	Measuring the Market Bubble	46
3.5.3	Predicting the Change of Stock Price.	47
3.6	Summary	50
	References	50
4	Certainty Equivalent, Risk Premium and Asset Pricing	51
4.1	Alternatives to Determine a Discount Rate	51
4.1.1	The Industrial Average Rate of Return.	52
4.1.2	The Opportunity Cost of Capital	52
4.1.3	The Weighted Average Cost of Capital	53
4.1.4	The Capital Asset Pricing Model	55
4.2	Certainty Equivalent and Risk Equivalent	56
4.2.1	On Certainty Equivalent.	57
4.2.2	Risk Equivalent Model	58
4.2.3	Certainty Equivalent Model	61
4.2.4	Exemplifications.	62
4.3	Risk Premium and a New CAPM.	64
4.3.1	Modeling Risk Premium and a New CAPM	64
4.3.2	Comparison Between Sharpe's CAPM and ZZ CAPM	65
4.3.3	Exemplifications.	67
4.4	Summary	68
	References	69
5	Tax Shield, Bankruptcy Cost and Optimal Capital Structure	71
5.1	Firm's Goal and its Capital Structure.	71
5.2	The Potential Benefits and Costs of Debt Financing	72
5.2.1	General Analyses	72
5.2.2	MM Model I.	73
5.3	Efforts to Value Tax Shield and Bankruptcy Cost	74
5.3.1	MM Model II	74
5.3.2	The Trade-Off Model	75
5.3.3	Other Efforts.	76
5.4	Decision-Oriented Valuation of Tax Shield and Bankruptcy Cost.	77
5.4.1	The Time Horizon	77
5.4.2	Value the Tax Shield.	78
5.4.3	Value the Bankruptcy Cost.	80
5.5	Decision-Oriented Optimal Capital Structure Model.	83
5.5.1	Derivation of the model	83
5.5.2	Basic Features of the Model.	84
5.5.3	Basic Insights from the Model.	86
5.5.4	Assumptions of the Model	89

5.6	Some Application Extensions.	90
5.6.1	Abnormal Growth.	90
5.6.2	Bankruptcy Expectancy	91
5.6.3	Market Value Versus Book Value	92
5.6.4	Guaranteed Debt.	93
5.6.5	Transaction Costs	94
5.6.6	Personal Income Tax	95
5.6.7	Inter-Firm's Investments.	96
5.7	Explanations to Some Capital Structure Puzzles	97
5.7.1	Why Financial Conservatism	97
5.7.2	Why No Leverage Target	98
5.7.3	Why Averse-Change With Profitability	99
5.7.4	Why Over Stable Leverage.	99
5.7.5	Why Pecking Order	100
5.7.6	Why Market Timing	101
5.7.7	Dynamic Consideration?	102
5.7.8	Why Not 0 % Debt in Absence of Corporate Tax	102
5.8	Summary	103
	Appendix	104
	References	107