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Our primary aim for the fourth edition remains true to the original objective of the book: to provide a bridge to the more theoretical articles and treatises on finance theory. For doctoral students the book provides a framework of conceptual knowledge, enabling them to understand what the literature on financial theory is trying to do and how it all fits together. For MBAs it provides an in-depth experience with the subject of finance. Our aim here is to equip the MBA for his or her future development as a practicing executive. We seek to prepare the MBA for reading the significant literature of the past, present, and future. This will help practicing financial executives keep up to date with developments in finance theory, particularly as they affect the financial executive's own thinking processes in making financial decisions.

As with the earlier editions, our emphasis is on setting forth clearly and succinctly the most important concepts in finance theory. We have given particular attention to testable propositions and to the literature that has developed empirical tests of important elements of finance theory. In addition, we have emphasized applications so that the nature and uses of finance theory can be better understood.

## Purpose and Organization

Over the past 45 years a branch of applied microeconomics has been developed and specialized into what is known as modern finance theory. The historical demarcation point was roughly 1958, when Markowitz and Tobin were working on the theory of portfolio selection and Modigliani and Miller were working on capital structure and valuation. Prior to 1958, finance was largely a descriptive field of endeavor. Since then major theoretical thrusts have transformed the field into a positive science. As evidence of the changes that have taken place we need only look at the types of people who teach in the schools of business. Fifty years ago the faculty were drawn from the ranks of business and government. They were respected and experienced statesmen within their fields. Today, finance faculty are predominantly academicians in the traditional sense of the word. The majority of them have no business experience except for consulting. Their interest and training is in developing theories to explain economic behavior, then testing them with the tools provided