

# Contents

Co-Authors .....	9
Authors' Foreword .....	10
Finance Cartoons .....	13
Acknowledgements & Thanks .....	14
List of Main Terms and Abbreviations .....	15
Online Compendiums .....	18
<b>CHAPTER 1</b>	
The Background to Financial Management .....	21
1.1. The Nature of Finance .....	23
1.2. A Fundamental Idea: Shareholder Value Creation .....	28
1.3. Ideological Challenges to the Shareholder Model .....	33
1.4. Addressing the Agency Problem and Asymmetric Information Problem .....	41
1.5. Managing the Balance Sheet .....	54
1.6. The Financial Management Function .....	57
1.7. The FD's Job Description .....	62
<b>CHAPTER 2</b>	
Capital Expenditure Decisions .....	65
2.1. Capital Expenditure ("CAPEX") Decisions a.k.a. Capital Budgeting .....	67
2.2. Key Idea: Time Value of Money .....	76
2.3. Key Idea: Relevant Cash Flow .....	83
2.4. Overview of CAPEX Methods .....	87
2.5. Why NPV is 'Best Practice' .....	89
2.6. Payback Period (P-B) Method .....	90
2.7. Accounting Rate of Return (ARR) .....	95
2.8. Net Present Value (NPV) Method: Its Supporting Logic .....	98
2.9. Internal Rate of Return .....	101

2.10. Important Details of NPV Method .....	105
2.10.1. Income Taxes .....	105
2.10.2. Working Capital .....	109
2.10.3. Inflation .....	110
2.10.4. Opportunity Costs .....	111
2.11. Some Useful NPV Tools .....	117
2.12. Investment Decisions Risk Analysis .....	126
2.13. Analysis of CAPEX Decisions with Real Options Method .....	133
2.14. Summing Up the NPV Method .....	138

## CHAPTER 3

Financing Decisions .....	141
3.1. Introduction to Financing Decisions .....	143
3.2. Types of Long-Term Capital: Overview .....	146
3.3. Weighted Average Cost of Capital (WACC) .....	148
3.4. Cost of Debt Capital .....	153
3.5. Cost of Convertible Debt .....	155
3.6. Cost of Preferred Shares .....	157
3.7. Cost of Common Equity .....	158
3.8. Worked Example: WACC Calculation .....	165
3.9. The Marginal Cost of Capital .....	167
3.10. The Efficient Market Hypothesis (EMH): A Pivotal Assumption in Finance .....	168
3.11. What WACC Tells Us About the Value Creation Process .....	179
3.12. Optimizing Capital Structure .....	183
3.13. Some Financial Theory and Real World Pragmatics .....	187
3.14. Life-Cycle Financing .....	194
3.15. Financing Sources .....	195
3.16. Financing with Retained Earnings and Dividend Policy .....	205
3.17. Issuing and Offering Equity .....	212
3.18. Some Remarks on SME Finance .....	222
3.19. The Pivotal Role of Commercial Banks in SME Finance .....	227
3.20. Going Outside the Firm for External Debt Capital .....	233
3.21. Summing Up: Some Common Sense ‘Rules of Thumb’ in Financing Decisions .....	240

## CHAPTER 4

Working Capital Management .....	243
4.1. The Nature of Working Capital Management .....	244
4.2. Optimizing Working Capital Investment: Three Steps .....	252
4.3. Understanding Working Capital Choices Through Scenarios .....	255
4.4. Good Working Capital Management Creates Shareholder Value .....	259

4.5. The Working Capital Dynamics of Sales Growth .....	260
4.6. The Perils of Overtrading .....	262
4.7. Sustainable Growth Rate and Working Capital .....	263
4.8. The Natural Role of Banking Systems in Working Capital Management .....	264
4.9. Temporary Financing Needs .....	266
4.10. The Cash Flow Dynamic of Expansion .....	267
4.11. Overtrading .....	268
4.12. Cash Management: Flows and Balances .....	271
4.13. Managing Accounts Receivable .....	276
4.14. Bad Debts Expense .....	281
4.15. Factoring .....	284
4.16. Inventory Management .....	286
4.17. Managing Supplier Credit or Accounts Payable (A/P) .....	291
4.18. Short-Term Bank Credit .....	294
4.19. Key Take-Away Points .....	296

## CHAPTER 5

Enterprise Risk Management .....	299
5.1. The Nature of Risk .....	301
5.2. Rationality of Decisions Under Risk .....	307
5.3. How to Manage Risk in Enterprise .....	314
5.4. Measuring Risk .....	320
5.5. Risk-Adjusted Interest Rate .....	324
5.6. Dealing with Possible Risk .....	331
5.7. Forward, Futures and Options .....	339
5.8. Hedging Market Risk .....	345
5.9. Hedging Foreign Exchange Risk .....	350
5.10. Interest Rate Risk .....	365
5.11. Chapter Summary: Some Common Sense ERM Principles .....	377

## CHAPTER 6

Enterprise Valuation .....	379
6.1. The Art and Science of Enterprise Valuation .....	381
6.2. Overview of Enterprise Valuations .....	382
6.3. Many Types of Value .....	383
6.4. The Starting Point: Accounting Book Values .....	386
6.5. Market Value .....	393
6.6. Intrinsic Value .....	396
6.7. Enterprise Value or Firm Value .....	398
6.8. Fundamental Analysis and Enterprise Valuation .....	403

6.9. Present Value Methods .....	407
6.10. Discounted Cash Flows Method .....	417
6.11. Market Comparison Valuation .....	426
6.12. Enterprise Valuation Case Study: Management Buy-Out .....	440
6.13. Some Take-Away Conclusions .....	448
References .....	451