5. Detailed study guide

A Financial management function

1. The nature and purpose of financial management

a) Explain the nature and purpose of financial management.[1]

b) Explain the relationship between financial management and financial and management accounting.[1]

2. Financial objectives and the relationship with corporate strategy

a) Discuss the relationship between financial objectives, corporate objectives and corporate strategy.[2]

b) Identify and describe a variety of financial objectives, including: [2]
   i) shareholder wealth maximisation
   ii) profit maximisation
   iii) earnings per share growth.

3. Stakeholders and impact on corporate objectives

a) Identify the range of stakeholders and their objectives.[2]

b) Discuss the possible conflict between stakeholder objectives.[2]

c) Discuss the role of management in meeting stakeholder objectives, including the application of agency theory.[2]

d) Describe and apply ways of measuring achievement of corporate objectives including:[2]
   i) ratio analysis, using appropriate ratios such as return on capital employed, return on equity, earnings per share and dividend per share
   ii) changes in dividends and share prices as part of total shareholder return.

e) Explain ways to encourage the achievement of stakeholder objectives, including:[2]
   i) managerial reward schemes such as share options and performance-related pay.
   ii) regulatory requirements such as corporate governance codes of best practice and stock exchange listing regulations.

4. Financial and other objectives in not-for-profit organisations

a) Discuss the impact of not-for-profit status on financial and other objectives.[2]

b) Discuss the nature and importance of Value for Money as an objective in not-for-profit organisations.[2]

c) Discuss ways of measuring the achievement of objectives in not-for-profit organisations.[2]

B Financial management environment

1. The economic environment for business

a) Identify and explain the main macroeconomic policy targets.[1]

b) Define and discuss the role of fiscal, monetary, interest rate and exchange rate policies in achieving macroeconomic policy targets.[1]

c) Explain how government economic policy interacts with planning and decision-making in business.[2]

d) Explain the need for, and the interaction with, planning and decision-making in business of:
   i) competition policy [1]
   ii) government assistance for business [1]
   iii) green policies and sustainability [1]
   iv) corporate governance regulation.[2]

2. The nature and role of financial markets and institutions

a) Identify the nature and role of money and capital markets, both nationally and internationally.[2]

b) Explain the role of financial intermediaries.[1]

c) Explain the functions of a stock market and a corporate bond market.[2]

d) Explain the nature and features of different securities in relation to the risk/return trade-off.[2]

e) Explain the impact of Fintech in changing the nature and role of financial markets and institutions. [1]

3. The nature and role of money markets

a) Describe the role of the money markets in:[1]

   i) providing short-term liquidity to the private sector and the public sector
   ii) providing short-term trade finance
   iii) allowing an organisation to manage its exposure to foreign currency risk and interest rate risk.

b) Explain the role of banks and other financial institutions in the operation of the money markets.[2]

c) Explain and apply the characteristics and role of the principal money market instruments:[2]
   i) interest-bearing instruments
   ii) discount instruments
   iii) derivative products.

C Working capital management

1. The nature, elements and importance of working capital

a) Describe the nature of working capital and identify its elements.[1]

b) Identify the objectives of working capital management in terms of liquidity and profitability, and discuss the conflict between them.[2]

c) Discuss the central role of working capital management in financial management.[2]

2. Management of inventories, accounts receivable, accounts payable and cash

a) Explain the cash operating cycle and the role of accounts payable and accounts receivable.[2]

b) Explain and apply relevant accounting ratios, including: [2]
   i) current ratio and quick ratio
   ii) inventory turnover ratio, average collection period and average payable period
   iii) sales revenue/net working capital ratio.

c) Discuss, apply and evaluate the use of relevant techniques in managing inventory, including the Economic Order Quantity model and Just-in-Time techniques.[2]

d) Discuss, apply and evaluate the use of relevant techniques in managing accounts receivable, including:
   i) assessing creditworthiness [1]
   ii) managing accounts receivable [1]
   iii) collecting amounts owing [1]
   iv) offering early settlement discounts [2]
   v) using factoring and invoice discounting [2]
   vi) managing foreign accounts receivable.[2]

e) Discuss and apply the use of relevant techniques in managing accounts payable, including:
   i) using trade credit effectively [1]
   ii) evaluating the benefits of early settlement and bulk purchase discounts [2]
   iii) managing foreign accounts payable.[1]

f) Explain the various reasons for holding cash, and discuss and apply the use of relevant techniques in managing cash, including:[2]
   i) preparing cash flow forecasts to determine future cash flows and cash balances
   ii) assessing the benefits of centralised treasury management and cash control
   iii) cash management models, such as the Baumol model and the Miller-Orr model
   iv) investing short-term.

3. Determining working capital needs and funding strategies

a) Calculate the level of working capital investment in current assets and discuss the key factors determining this level, including:[2]

   i) the length of the working capital cycle and terms of trade
   ii) an organisation's policy on the level of investment in current assets
   iii) the industry in which the organisation operates.

b) Evaluate and discuss the key factors in determining working capital funding strategies, including:
   i) the distinction between permanent and fluctuating current assets [2]
   ii) the relative cost and risk of short-term and long-term finance [2]
   iii) the matching principle [2]
   iv) the relative costs and benefits of aggressive, conservative and matching funding policies [2]
   v) management attitudes to risk, previous funding decisions and organisation size.[1]

D Investment appraisal

1. Investment appraisal techniques

a) Identify and calculate relevant cash flows for investment projects.[2]

b) Calculate payback period and discuss its usefulness as an investment appraisal method.[2]

c) Calculate discounted payback and discuss its usefulness as an investment appraisal method.[2]

d) Calculate return on capital employed (accounting rate of return) and discuss its usefulness as an investment appraisal method.[2]

e) Calculate net present value and discuss its usefulness as an investment appraisal method.[2]

f) Calculate internal rate of return and discuss its usefulness as an investment appraisal method.[2]

g) Discuss the superiority of discounted cash flow (DCF) methods over non-DCF methods.[2]

h) Discuss the relative merits of NPV and IRR.[2]

2. Allowing for inflation and taxation in DCF

a) Apply and discuss the real-terms and nominal-terms approaches to investment appraisal.[2]

b) Calculate the taxation effects of relevant cash flows, including the tax benefits of tax-allowable depreciation and the tax liabilities of taxable profit.[2]

c) Calculate and apply before- and after-tax discount rates.[2]

3. Adjusting for risk and uncertainty in investment appraisal

a) Describe and discuss the difference between risk and uncertainty in relation to probabilities and increasing project life.[2]

b) Apply sensitivity analysis to investment projects and discuss the usefulness of sensitivity analysis in assisting investment decisions.[2]

c) Apply probability analysis to investment projects and discuss the usefulness of probability analysis in assisting investment decisions.[2]

d) Apply and discuss other techniques of adjusting for risk and uncertainty in investment appraisal, including:
i) simulation [1]
ii) adjusted payback [1]
iii) risk-adjusted discount rates. [2]

4. Specific investment decisions (Lease or buy, asset replacement, capital rationing)

a) Evaluate leasing and borrowing to buy using the before- and after-tax costs of debt.[2]

b) Evaluate asset replacement decisions using equivalent annual cost and equivalent annual benefit.[2]

c) Evaluate investment decisions under single-period capital rationing, including:[2]

i) the calculation of profitability indexes for divisible investment projects
ii) the calculation of the NPV of combinations of non-divisible investment projects
iii) a discussion of the reasons for capital rationing.

E Business finance

1. Sources of, and raising, business finance

a) Identify and discuss the range of short-term sources of finance available to businesses, including:[2]
i) overdraft
ii) short-term loan
iii) trade credit
iv) lease finance.

b) Identify and discuss the range of long-term sources of finance available to businesses, including:[2]
i) equity finance
ii) debt finance
iii) lease finance
iv) venture capital.

c) Identify and discuss methods of raising equity finance, including:[2]
i) rights issue
ii) placing
iii) public offer
iv) stock exchange listing.

d) Identify and discuss methods of raising short- and long-term Islamic finance, including:[1]

i) major differences between Islamic finance and the other forms of business finance.
ii) the concept of riba (interest) and how returns are made by Islamic financial securities.
iii) Islamic financial instruments available to businesses including:
   i) murabaha (trade credit)
   ii) ijara (lease finance)
   iii) mudaraba (equity finance)
   iv) sukuk (debt finance)
   v) musharaka (venture capital).

(note: calculations are not required)

e) Identify and discuss internal sources of finance, including:[2]
   i) retained earnings
   ii) increasing working capital management efficiency
   iii) the relationship between dividend policy and the financing decision
   iv) the theoretical approaches to, and the practical influences on, the dividend decision, including legal constraints, liquidity, shareholder expectations and alternatives to cash dividends.

2. Estimating the cost of capital

a) Estimate the cost of equity including:[2]
   i) application of the dividend growth model, its assumptions, advantages and disadvantages.
   ii) explanation and discussion of systematic and unsystematic risk
   iii) relationship between portfolio theory and the capital asset pricing model (CAPM)
   iv) application of the CAPM, its assumptions, advantages and disadvantages.

b) Estimating the cost of debt:[2]
   i) irredeemable debt
   ii) redeemable debt
   iii) convertible debt
   iv) preference shares
   v) bank debt.

c) Estimating the overall cost of capital including:[2]
   i) distinguishing between average and marginal cost of capital
   ii) calculating the weighted average cost of capital (WACC) using book value and market value weightings.

3. Sources of finance and their relative costs

a) Describe the relative risk-return relationship and the relative costs of equity and debt.[2]

b) Describe the creditor hierarchy and its connection with the relative costs of sources of finance.[2]

c) Identify and discuss the problem of high levels of gearing.[2]

d) Assess the impact of sources of finance on financial position, financial risk and shareholder wealth using appropriate measures, including:[2]
   i) ratio analysis using statement of financial position gearing, operational and financial gearing, interest coverage ratio and other relevant ratios
   ii) cash flow forecasting
   iii) leasing or borrowing to buy.

e) Impact of cost of capital on investments including:[2]
   i) the relationship between company value and cost of capital.
   ii) the circumstances under which WACC can be used in investment appraisal
   iii) the advantages of the CAPM over WACC in determining a project-specific cost of capital.
   iv) the application of the CAPM in calculating a project-specific discount rate.

4. Capital structure theories and practical considerations

a) Describe the traditional view of capital structure and its assumptions.[2]

b) Describe the views of Miller and Modigliani on capital structure, both without and with corporate taxation, and their assumptions.[2]

c) Identify a range of capital market imperfections and describe their impact on the views of Miller and Modigliani on capital structure.[2]

d) Explain the relevance of pecking order theory to the selection of sources of finance.[1]

5. Finance for small and medium sized entities (SMEs)

a) Describe the financing needs of small businesses.[2]

b) Describe the nature of the financing problem for small businesses in terms of the funding gap, the maturity gap and inadequate security.[2]

c) Explain measures that may be taken to ease the financing problems of SMEs, including the responses of government departments and financial institutions.[1]

d) Identify and evaluate the financial impact of sources of finance for SMEs, including sources already referred to in syllabus section E1 and also [2]
   i) Business angel financing
   ii) Government assistance
   iii) Supply chain financing
   iv) Crowdfunding / peer-to-peer funding.

F Business valuations

1. Nature and purpose of the valuation of business and financial assets

a) Identify and discuss reasons for valuing businesses and financial assets.[2]

b) Identify information requirements for valuation and discuss the limitations of different types of information.[2]

2. Models for the valuation of shares

a) Discuss and apply asset-based valuation models, including:[2]
   i) net book value (statement of financial position) basis
   ii) net realisable value basis
   iii) net replacement cost basis.

b) Discuss and apply income-based valuation models, including:[2]
   i) price/earnings ratio method
   ii) earnings yield method.

c) Discuss and apply cash flow-based valuation models, including:[2]
   i) dividend valuation model and the dividend growth model
   ii) discounted cash flow basis.

3. The valuation of debt and other financial assets

a) Discuss and apply appropriate valuation methods to:[2]
   i) irredeemable debt
   ii) redeemable debt
   iii) convertible debt
   iv) preference shares.

4. Efficient Market Hypothesis (EMH) and practical considerations in the valuation of shares

a) Distinguish between and discuss weak form efficiency, semi-strong form efficiency and strong form efficiency.[2]

b) Discuss practical considerations in the valuation of shares and businesses, including:[2]
   i) marketability and liquidity of shares
   ii) availability and sources of information
   iii) market imperfections and pricing anomalies
   iv) market capitalisation.

c) Describe the significance of investor speculation and the explanations of investor decisions offered by behavioural finance.[1]

G Risk Management

1. The nature and types of risk and approaches to risk management

a) Describe and discuss different types of foreign currency risk:[2]
   i) translation risk
   ii) transaction risk
   iii) economic risk.

b) Describe and discuss different types of interest rate risk:[1]
   i) gap exposure
   ii) basis risk.

2. Causes of exchange rate differences and interest rate fluctuations

a) Describe the causes of exchange rate fluctuations, including:
   i) balance of payments [1]
   ii) purchasing power parity theory [2]
   iii) interest rate parity theory [2]
   iv) four-way equivalence.[2]

b) Forecast exchange rates using:[2]
   i) purchasing power parity
   ii) interest rate parity.

c) Describe the causes of interest rate fluctuations, including: [2]
   i) structure of interest rates and yield curves
   ii) expectations theory
   iii) liquidity preference theory
   iv) market segmentation.

3. Hedging techniques for foreign currency risk

a) Discuss and apply traditional and basic methods of foreign currency risk management, including:
   i) currency of invoice [1]
   ii) netting and matching [2]
   iii) leading and lagging [2]
   iv) forward exchange contracts [2]
   v) money market hedging [2]
   vi) asset and liability management.[1]

b) Compare and evaluate traditional methods of foreign currency risk management.[2]

c) Identify the main types of foreign currency derivatives used to hedge foreign currency risk and explain how they are used in hedging.[1]

   (No numerical questions will be set on this topic)

4. Hedging techniques for interest rate risk

a) Discuss and apply traditional and basic methods of interest rate risk management, including:
   i) matching and smoothing [1]
   ii) asset and liability management [1]
   iii) forward rate agreements.[2]

b) Identify the main types of interest rate derivatives used to hedge interest rate risk and explain how they are used in hedging.[1]

   (No numerical questions will be set on this topic)

H Employability and technology skills

1. Use computer technology to efficiently access and manipulate relevant information

2. Work on relevant response options, using available functions and technology, as would be required in the workplace

3. Navigate windows and computer screens to create and amend responses to exam requirements, using the appropriate tools

4. Present data and information effectively, using the appropriate tools

