

**ACCA**

**Applied Skills**

**Financial Management (FM)**

**Study Text**

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## How to use the Materials

These Kaplan Publishing learning materials have been carefully designed to make your learning experience as easy as possible and to give you the best chances of success in your examinations.

The product range contains a number of features to help you in the study process. They include:

- (1) Detailed study guide and syllabus objectives
- (2) Description of the examination
- (3) Study skills and revision guidance
- (4) Study text
- (5) Question practice

The sections on the study guide, the syllabus objectives, the examination and study skills should all be read before you commence your studies. They are designed to familiarise you with the nature and content of the examination and give you tips on how to best approach your learning.

The **Study text** comprises the main learning materials and gives guidance as to the importance of topics and where other related resources can be found. Each chapter includes

- The **learning objectives**, which have been carefully mapped to the examining body's own syllabus learning objectives or outcomes. You should use these to check you have a clear understanding of all the topics on which you might be assessed in the examination.
- The **chapter diagram** provides a visual reference for the content in the chapter, giving an overview of the topics and how they link together.
- The **content** for each topic area commences with a brief explanation or definition to put the topic into context before covering the topic in detail. You should follow your studying of the content with a review of the illustration/s. These are worked examples, which will help you to understand better how to apply the content for the topic.
- **Test your understanding** sections provide an opportunity to assess your understanding of the key topics by applying what you have learned to short questions. Answers can be found at the back of each chapter.
- **Summary diagrams** complete each chapter to show the important links between topics and the overall content of the examination. These diagrams should be used to check that you have covered and understood the core topics before moving on.
- **Question practice** is provided at the back of each text.

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Our Quality Coordinator will work with our technical team to verify the error and take action to ensure it is corrected in future editions.

### Icon Explanations



**Definition** – Key definitions that you will need to learn from the core content.



**Key point** – Identifies topics that are key to success and are often examined.



**Test your understanding** – Exercises for you to complete to ensure that you have understood the topics just learned.



**Illustration** – Worked examples help you understand the core content better.



**Tricky topic** – When reviewing these areas care should be taken and all illustrations and Test your understanding exercises should be completed to ensure that the topic is understood.



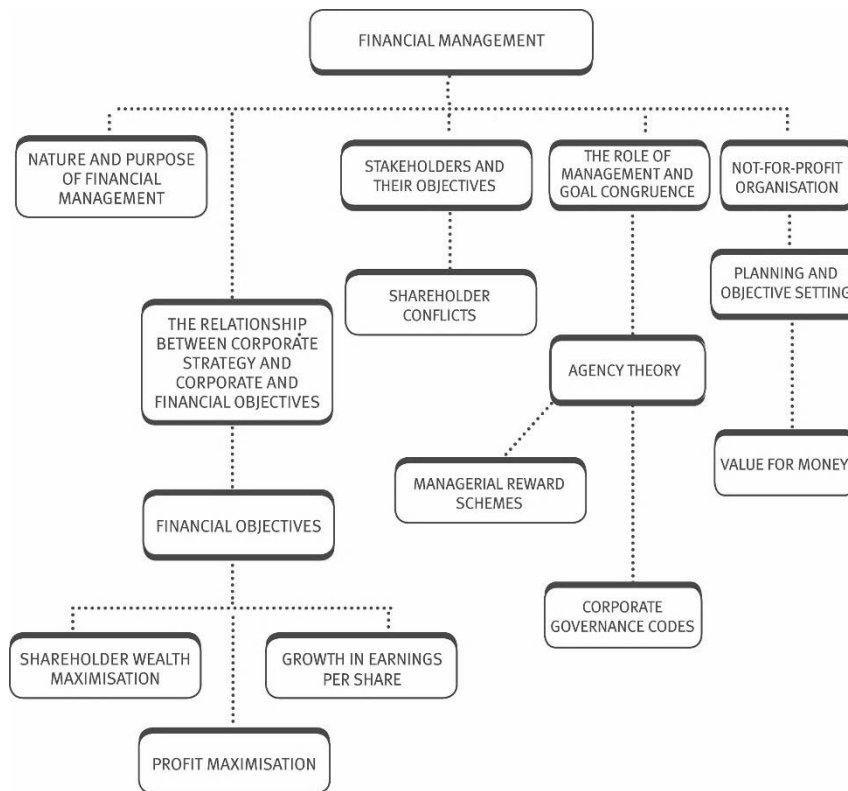
**Supplementary reading** – These sections will help to provide a deeper understanding of core areas. The supplementary reading is NOT optional reading. It is vital to provide you with the breadth of knowledge you will need to address the wide range of topics within your syllabus that could feature in an exam question. **Reference to this text is vital when self-studying.**

# The financial management function


## Chapter learning objectives

Upon completion of this chapter, you will be able to:

- explain the nature and purpose of financial management
- distinguish between financial management and financial and management accounting
- discuss the relationship between financial objectives, corporate objectives and corporate strategy
- identify and describe a variety of financial objectives, including:
  - shareholder wealth maximisation
  - profit maximisation
  - earnings per share growth
- identify stakeholders, their objectives and possible conflicts
- discuss the possible conflict between stakeholder objectives
- discuss the role of management in meeting stakeholder objectives, including the use of agency theory
- explain ways to encourage the achievement of stakeholder objectives, including:
  - managerial reward schemes
  - regulatory requirements
- discuss the impact of not-for-profit status on financial and other objectives
- discuss the nature and importance of Value for Money as an objective in not-for-profit organisations
- discuss ways of measuring the achievement of objectives in not-for-profit organisations.



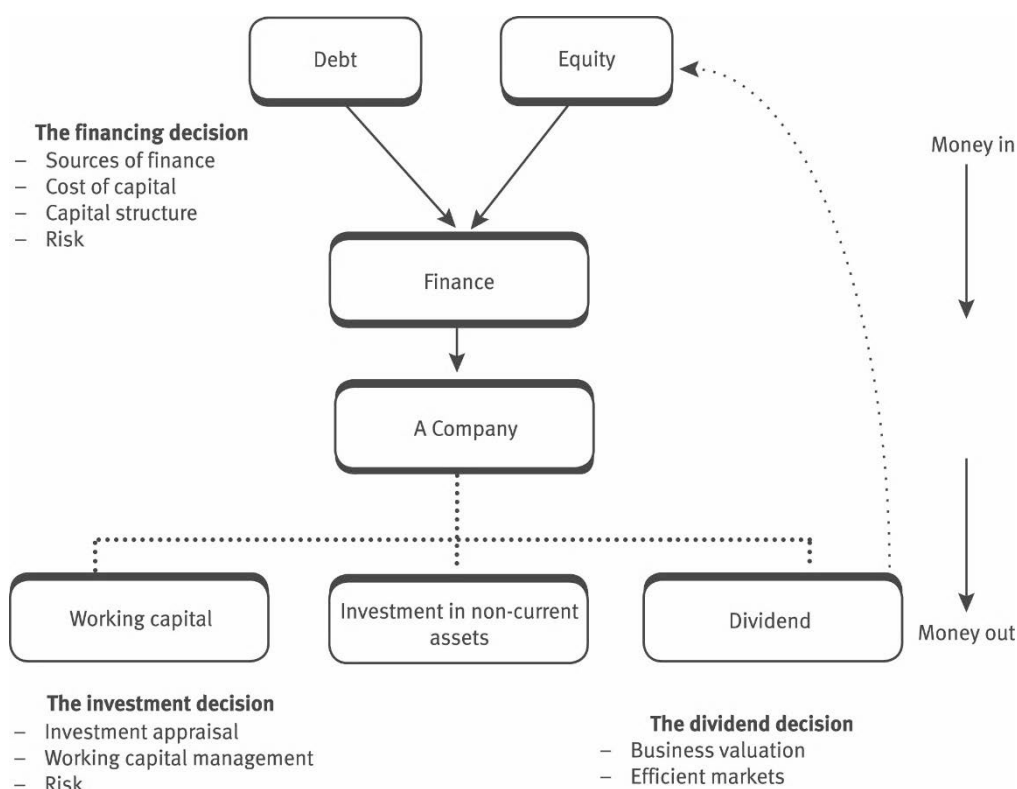
## 1 The nature and purpose of financial management

 Financial management is concerned with the efficient acquisition and deployment of both short- and long-term financial resources, to ensure the objectives of the enterprise are achieved.

Decisions must be taken in three key areas:

- investment – both long-term investment in non-current assets and short-term investment in working capital;
- finance – from what sources should funds be raised?
- dividends – how should cash funds be allocated to shareholders and how will the value of the business be affected by this?

These decisions are influenced by each other. For example, increasing the amount of cash allocated for investment projects means that either less cash is available to pay dividends, or the business’s available cash needs to be increased by raising new funding.



**Key** An understanding of these three key areas is fundamental for the examination.

In taking these decisions, the financial manager will need to take account of:

- the organisation's commercial and financial objectives
- the broader economic environment in which the business operates
- the potential risks associated with the decision and methods of managing that risk.

The FM syllabus covers all these key aspects of financial management, which will also be relevant for those who choose to study for the advanced financial management exam.



### The investment decision

To operate, all businesses will need finance and part of the financial manager's role is to ensure this finance is used efficiently and effectively to ensure the organisation's objectives are achieved. This can be further broken down into two elements:

- Investment appraisal considers the long-term plans of the business and identifies the right projects to adopt to ensure financial objectives are met. The projects undertaken will nearly always involve the purchase of non-current assets at the start of the process.

- For a business to be successful, as well as identifying and implementing potentially successful projects, it must survive day to day. Working capital management is concerned with the management of liquidity – ensuring debts are collected, inventory levels are kept at the minimum level compatible with efficient production, cash balances are invested appropriately and payables are paid on a timely basis.



### The financing decision

Before a business can invest in anything, it needs to have some finance. A key financial management decision is the identification of the most appropriate sources (be it long- or short-term), taking into account the requirements of the company, the likely demands of the investors and the amounts likely to be made available.



### The dividend decision

Having invested wisely, a business will hopefully be profitable and generate cash. The final key decision for the financial manager is whether to return any of that cash to the owners of the business (in the form of dividends) and if so, how much should be distributed.

The alternative is to retain some of the cash in the business where it can be invested again to earn further returns. This decision is therefore closely linked to the financing decision.

The decision on the level of dividends to be paid can affect the value of the business as a whole as well the ability of the business to raise further finance in the future.



Financial management should be distinguished from other important financial roles:

- management accounting – concerned with providing information for the more day-to-day functions of control and decision making
- financial accounting – concerned with providing information about the historical results of past plans and decisions.





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