



# Fundamentals of Financial Management

## Course Details

Course Title: Fundamentals of Financial Management

Course Code: FIN-223

Program: BS A&F

Prerequisite: None

Credit Hours: 3

## Course Description

The module aims at building competence in corporate finance further by extending the coverage in Business Finance module to include three more of the finance functions – financial planning and control, working capital management and financing sources. It continues to emphasize on strategic decision making techniques that best serve the interests of shareholders, which is to maximize the value of the company.

The syllabus for FIN 223 – Fundamentals of Financial Management, is designed to equip students with the skills that would be expected from a finance manager responsible for the finance function of a business. The course, therefore, starts by introducing the role and purpose of the financial management function within a business. Before looking at the three key financial management decisions of investing, financing, and dividend policy, the syllabus explores the economic environment in which such decisions are made.

The next section of the syllabus is the introduction of investing decisions. This is done in two stages - investment in (and the management of) working capital and the appraisal of long-term investments.

The next area introduced is financing decisions. This section of the syllabus starts by examining the various sources of business finance, including dividend policy and how much finance can be raised from within the business. Cost of capital and other factors that influence the choice of the type of capital a business will raise then follows. The principles underlying the valuation of business and financial assets, including the impact of cost of capital on the value of business, is covered next.

The syllabus finishes with an introduction to, and examination of, risk and the main techniques employed in the management of such risk.

## **Course Objectives**

To develop the knowledge and skills expected of a finance manager, in relation to investment, financing, and dividend policy decisions. The objective of this course is that the student should be able to:

- Discuss the role and purpose of the financial management function
- Assess and discuss the impact of the economic environment on financial management
- Discuss and apply working capital management techniques
- Carry out effective investment appraisal
- Identify and evaluate alternative sources of business finance
- Explain and calculate the cost of capital and the factors which affect it
- Discuss and apply principles of business and asset valuations
- Explain and apply risk management techniques in business.

## **Course Outcomes**

On successful completion of this course the student will be able to understand:

- Role of financial planning and control– financial forecasting and cash budgeting tools – in planning for the firm's short term financial requirements
- Working capital and its components, applications of different techniques that managers can use to manage various aspects of working capital –cash and liquidity, credit and receivables, inventories, etc.
- Short term sources of financing
- Long term financing –venture capital, equity, debentures etc
- Different theories of capital structure, their predictions about optimal capital structure and the limitations of using debt in the firms" capital structure

## Required Course Material

The required text for this course includes:

### **Corporate Finance**

**Authors:** Michael C. Ehrhardt, Eugene F. Brigham

**Edition:** (4<sup>th</sup> Edition)

### **Supplementary Material:**

- CFA reading material

## Course Evaluation (Grade Breakup)

Grading will be done as per NBS criteria. The breakup of the grade points is as follows:

Quizzes 15%

Assignments 10%

Group Project 10%

Mid Semester Examination 25%

Final Examination 40%

## Course Content (Weekly)

Weekly breakdown is given below

Week	Lecture Topic
1	<b>PART I: FUNDAMENTAL CONCEPTS OF CORPORATE FINANCE.</b> <b><i>Chapter 1. An Overview of Financial Management and the Financial Environment.</i></b> <ul style="list-style-type: none"><li>• The Corporate Life Cycle</li><li>• The Primary Objective of the Corporation: Value Maximization</li><li>• An Overview of the Capital Allocation Process</li><li>• Financial Securities</li><li>• The Cost of Money</li><li>• Financial Institutions</li><li>• Financial Markets</li><li>• Trading Procedures in Financial Markets</li><li>• Types of Stock Market Transactions</li><li>• The Secondary Stock Markets</li></ul>

2&3	<ul style="list-style-type: none"> <li>• Stock Market Returns</li> <li>• Web Extensions</li> <li>• 1A: An Overview of Derivatives</li> <li>• 1B: A Closer Look at the Stock Markets</li> </ul> <p><b>Chapter 2. Financial Statements, Cash Flow, and Taxes.</b></p> <ul style="list-style-type: none"> <li>• Financial Statements and Reports</li> <li>• The Balance Sheet</li> <li>• The Income Statement</li> <li>• Statement of Stockholders' Equity</li> <li>• Net Cash Flow</li> <li>• Statement of Cash Flows</li> <li>• Modifying Accounting Data for Managerial Decisions</li> <li>• MVA and EVA</li> <li>• The Federal Income Tax System</li> <li>• Web Extensions <ul style="list-style-type: none"> <li>◦ 2A: The Federal Income Tax System for Individuals</li> </ul> </li> </ul> <p><b>Chapter 3. Analysis of Financial Statements.</b></p> <ul style="list-style-type: none"> <li>• Financial Analysis</li> <li>• Liquidity Ratios</li> <li>• Asset Management Ratios</li> <li>• Debt Management Ratios</li> <li>• Profitability Ratios</li> <li>• The Case of IFRS versus FASB</li> <li>• Market Value Ratios</li> <li>• Trend Analysis, Common Size Analysis, and Percentage Change Analysis</li> <li>• Tying the Ratios Together: The Du Pont Equation</li> <li>• Comparative Ratios and Benchmarking</li> <li>• Uses and Limitations of Ratio Analysis</li> <li>• Looking beyond the Numbers</li> </ul> <p><b>PART II: FIXED INCOME SECURITIES.</b></p> <p><b>Chapter 4. Time Value of Money.</b></p> <ul style="list-style-type: none"> <li>• Time Lines</li> <li>• Future Values</li> <li>• Present Values</li> <li>• Finding the Interest Rate, I</li> <li>• Finding the Number of Years, N</li> <li>• Annuities</li> <li>• Future Value of an Ordinary Annuity</li> <li>• Future Value of an Annuity Due</li> </ul>
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3&4	<ul style="list-style-type: none"> <li>• Present Value of Ordinary Annuities and Annuities Due</li> <li>• Finding Annuity Payments, Periods, and Interest Rates</li> <li>• Perpetuities</li> <li>• Uneven, or Irregular, Cash Flows</li> <li>• Future Value of an Uneven Cash Flow Stream</li> <li>• Solving for I with Irregular Cash Flows</li> <li>• Semiannual and Other Compounding Periods</li> <li>• Fractional Time Periods</li> <li>• Amortized Loans</li> <li>• Growing Annuities</li> <li>• Adjustable Rate Mortgages</li> <li>• Web Extensions <ul style="list-style-type: none"> <li>○ 4A: The Tabular Approach</li> <li>○ 4B: Derivation of Annuity Formulas</li> <li>○ 4C: Continuous Compounding</li> </ul> </li> </ul>
4&5	<p><b><i>Chapter 5. Bonds, Bond Valuation, and Interest Rates.</i></b></p> <ul style="list-style-type: none"> <li>• Who Issues Bonds?</li> <li>• Key Characteristics of Bonds</li> <li>• The Case of Treasury Bond Credit Default Swaps</li> <li>• Bond Valuation</li> <li>• Changes in Bond Values over Time</li> <li>• Bonds with Semiannual Coupons</li> <li>• Bond Yields</li> <li>• The Pre-Tax Cost of Debt: Determinants of Market Interest Rates</li> <li>• The Real Risk-Free Rate of Interest, <math>r^*</math></li> <li>• The Inflation Premium (IP)</li> <li>• The Nominal, or Quoted, Risk-Free Rate of Interest, <math>r_{RF}</math></li> <li>• The Default Risk Premium (DRP)</li> <li>• The Liquidity Premium (LP)</li> <li>• The Maturity Risk Premium (MRP)</li> <li>• The Term Structure of Interest Rates</li> <li>• Financing with Junk Bonds</li> <li>• Bankruptcy and Reorganization</li> <li>• Web Extensions <ul style="list-style-type: none"> <li>○ 5A: A Closer Look at Zero Coupon Bonds</li> <li>○ 5B: A Closer Look at TIPS: Treasury Inflation-Protected Securities</li> <li>○ 5C: A Closer Look at Bond Risk: Duration</li> <li>○ 5D: The Pure Expectations Theory and Estimation of Forward Rates</li> </ul> </li> </ul>
6&7	<p><b>PART III: STOCKS AND OPTIONS.</b></p> <p>Chapter 6. Risk, Return, and the Capital Asset Pricing Model.</p>

8	<ul style="list-style-type: none"> <li>• Returns on Investments</li> <li>• Stand-Alone Risk</li> <li>• Risk in a Portfolio Context</li> <li>• Calculating Beta Coefficients</li> <li>• The Relationship between Risk and Return</li> <li>• Some Concerns about Beta and the CAPM</li> <li>• Some Concluding Thoughts: Implications for Corporate Managers and Investors</li> <li>• Web Extensions <ul style="list-style-type: none"> <li>○ 6A: Continuous Probability Distributions</li> <li>○ 6B: Estimating Beta with a Financial Calculator</li> </ul> </li> </ul> <p><b>Mid Term Exam</b></p> <p><b><i>Chapter 7. Stocks, Stock Valuation, and Stock Market Equilibrium.</i></b></p> <ul style="list-style-type: none"> <li>• Legal Rights and Privileges of Common Stockholders</li> <li>• Types of Common Stock</li> <li>• The Market Stock Price versus Intrinsic Value</li> <li>• Stock Market Reporting</li> <li>• Valuing Common Stocks</li> <li>• Valuing a Constant Growth Stock</li> <li>• Expected Rate of Return on a Constant Growth Stock</li> <li>• Valuing Non-constant Growth Stocks</li> <li>• Stock Valuation by the Free Cash Flow Approach</li> <li>• Market Multiple Analysis</li> <li>• Preferred Stock</li> <li>• Stock Market Equilibrium</li> <li>• The Efficient Markets Hypothesis</li> <li>• Web Extensions <ul style="list-style-type: none"> <li>○ 7A: Derivation of Valuation Equations</li> </ul> </li> </ul> <p><b><i>Chapter 8. Financial Options and Applications in Corporate Finance.</i></b></p> <p>Overview of Financial Options</p> <ul style="list-style-type: none"> <li>• The Single-Period Binomial Option Pricing Approach</li> <li>• The Single-Period Binomial Option Pricing Formula</li> <li>• The Multi-Period Binomial Option Pricing Model</li> <li>• The Black-Scholes Option Pricing Model (OPM)</li> <li>• The Valuation of Put Options</li> <li>• Applications of Option Pricing in Corporate Finance</li> </ul> <p><b>PART IV: PROJECTS AND THEIR VALUATION.</b></p>
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<p>9</p> <p>10&amp;11</p>	<p><b>Chapter 9. The Cost of Capital.</b></p> <ul style="list-style-type: none"> <li>• The Cost of Capital</li> <li>• The Weighted Average Cost of Capital</li> <li>• Basic Definitions</li> <li>• Cost of Debt, <math>r_d(1-T)</math></li> <li>• Cost of Preferred Stock, <math>r_{ps}</math></li> <li>• Cost of Common Stock, <math>r_s</math></li> <li>• The CAPM Approach</li> <li>• Dividend-Yield-Plus-Growth-Rate, or Discounted Cash Flow (DCF), Approach</li> <li>• Over-Own-Bond-Yield-Plus-Judgmental-Risk-Premium Approach</li> <li>• Comparison of the CAPM, DCF, and Over-Own-Bond-Yield-Plus-Judgmental-Risk Premium Methods</li> <li>• Adjusting the Cost of Equity for Flotation Costs</li> <li>• Composite, or Weighted Average, Cost of Capital, WACC</li> <li>• Factors That Affect the WACC</li> <li>• Adjusting the Cost of Capital for Risk</li> <li>• Privately Owned Firms and Small Businesses</li> <li>• Four Mistakes to Avoid</li> <li>• Web Extensions <ul style="list-style-type: none"> <li>◦ 9A: The Required Return Assuming Non-constant Dividends and Stock Repurchases</li> </ul> </li> </ul>
	<p><b>Chapter 10. The Basics of Capital Budgeting: Evaluating Cash Flows.</b></p> <ul style="list-style-type: none"> <li>• An Overview of Capital Budgeting</li> <li>• Net Present Value (NPV)</li> <li>• Internal Rate of Return (IRR)</li> <li>• Multiple Internal Rates of Return</li> <li>• Reinvestment Rate Assumptions</li> <li>• Modified Internal Rate of Return (MIRR)</li> <li>• NPV Profiles</li> <li>• Profitability Index (PI)</li> <li>• Payback Period</li> <li>• Conclusions on Capital Budgeting Methods</li> <li>• Decision Criteria Used in Practice</li> <li>• Other Issues in Capital Budgeting</li> </ul>
<p>11&amp;12</p>	<p><b>Chapter 11. Cash Flow Estimation and Risk Analysis.</b></p> <ul style="list-style-type: none"> <li>• Conceptual Issues</li> <li>• Analysis of an Expansion Project</li> <li>• Risk Analysis in Capital Budgeting</li> <li>• Measuring Stand-Alone Risk</li> <li>• Sensitivity Analysis</li> </ul>



13	<ul style="list-style-type: none"><li>• Scenario Analysis</li><li>• Monte Carlo Simulation</li><li>• Project Risk Conclusions</li><li>• Replacement Analysis</li><li>• Real Options</li><li>• Phased Decisions and Decision Trees</li><li>• Appendix 11A Tax Depreciation</li><li>• Web Extensions<ul style="list-style-type: none"><li>○ 11A: Certainty Equivalents and Risk-Adjusted Discount Rates</li></ul></li></ul>
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