

NUS Business School
Department of Finance & Accounting

BMA5008

Financial Management

Lecturer: Dr Hassan Naqvi
naqvi@nus.edu.sg

1 Course objectives

In the recent past, changes in financial markets have made both the theory and practice of finance more challenging and sophisticated than it was before. The rapid increase in technological progress has meant that markets are now informationally more efficient and subsequently more competitive. Financial managers now have access to a host of derivative securities and their ability to manage corporate risk has received more attention. Given the rapid strides in competitiveness it is felt that successful corporate managers will be those who can take advantage of the growing sophistication of financial markets and use their analytical skills to enhance the value of their corporations.

The objective of this course is to introduce to the students the basic tools and techniques required in modern financial management. Further, the course will also introduce some of the underlying concepts and theories involved. The course is roughly divided in two parts: **capital markets** and **corporate finance**. However, as will be obvious from the list of the topics, there is substantial overlap between the two parts. All the topics covered will start from the basics but will gradually build up so that the students gain a comprehensive understanding of the material covered. An important aim of the course will be to improve the analytical skills of the future managers.

2 Course contents

2.1 Capital markets

1. The environment and the role of the financial manager (RWJJ chapter 1)
 - What is a corporation?
 - The role of the financial manager
 - Different types of financial markets and securities
2. Investment appraisal using NPV (RWJJ chapters 4 and 7)
 - Present values
 - Discount rate
 - Valuing a project

- Cash flows and accounting profit
 - Inflation and NPV
3. Alternative investment appraisal methods (RWJJ chapter 6)
- Investment and cash transfers
 - Payback period
 - Book rate of return
 - Internal rate of return
 - Profitability index
 - The practice of capital budgeting
4. Fixed income securities (RWJJ chapters 5 and 25)
- Definition and eg. of a fixed income security
 - Different types of bonds
 - How to value bonds
 - Yield to maturity
 - Bond concepts
 - Bond portfolio management: Hedging interest rate risk
5. Stock pricing (RWJJ chapter 5)
- Expected return
 - Valuing common stocks
 - Valuing a business
 - Stock market reporting
6. Portfolio theory (RWJJ chapter 9)
- Risk-Return tradeoff: A historical perspective
 - Basic statistics for individual securities
 - Return and risk for portfolios
 - Portfolio frontier and efficient set
 - Gains from diversification
 - Riskless borrowing and lending
7. CAPM and its limitations (RWJJ chapter 10)
- CAPM assumptions
 - Systematic vs. unsystematic risk

- The beta of a security
 - Securities market line (SML)
 - Tests of the CAPM
 - Overview of the Fama-French (1992) model
8. Derivatives: Options (RWJJ chapter 22)
 - Definitions and Basic concepts
 - Reading *The Wall Street Journal*
 - Combinations of options
 - Factors affecting option prices
 9. Market Efficiency (RWJJ chapter 13)
 - Efficient Markets Hypothesis (EMH)
 - Three types of market efficiency
 - Testing market efficiency
 - The behaviour challenge to market efficiency

2.2 Corporate finance

1. Raising capital (RWJJ chapters 14,19 and 20)
 - Various forms of financing
2. Capital structure irrelevance (RWJJ chapter 15 and 12)
 - Capital structure: Basic concepts
 - Financial leverage and firm value
 - Modigliani-Miller model (without taxes)
 - Modigliani-Miller model (with taxes)
 - Weighted average cost of capital (WACC)
3. Alternative theories of capital structure (RWJJ chapter 16)
 - Costs of financial distress
 - Tradeoff theory of capital structure
 - Risk shifting hypothesis
 - Debt overhang
 - Milking the property
 - Free cash flow hypothesis
 - Pecking order hypothesis

- How firms establish capital structure
4. Dividend policy (RWJJ chapter 18)
 - Lintner's stylized facts
 - Different types of dividends
 - Standard method of cash dividend payment
 - MM dividend irrelevance
 - Stock repurchase
 - Imperfect capital markets
 - Informational content of dividends
 - Free cash flow hypothesis vs. signalling model
 - Clientele theory
 5. Short-term financing (RWJJ chapter 26)
 - The operating cycle and the cash conversion cycle
 - Alternative short-term financing policies

The above list should not be considered exhaustive. These are the basic topics which a corporate manager should be aware of. Some of these topics are short and can be covered in half a lecture, while others are longer and may extend to two lectures.

3 Recommended reading

- Modern Financial Management, 8th edition, by Ross, Westerfield, Jaffe and Jordan (RWJJ), The McGraw-Hill Companies

4 Supplementary texts

- Principles of Corporate Finance, by Brealey and Myers, The McGraw-Hill Companies
- Financial Markets and Corporate Strategy, by Grinblatt and Titman, The McGraw-Hill Companies
- A random walk down wall street, by Burton Malkiel, Norton publications
- Modern portfolio theory and investment analysis, by Elton and Gruber, Wiley publications

The text by Brealey and Myers is a basic introduction to principles of finance. Grinblatt and Titman is a relatively more advanced text. Students with no prior background to finance should read the relevant chapters from Brealey and Myers first before reading Grinblatt and Titman.

The book by Malkiel is a nontechnical and very readable account of how capital markets work. It is a very interesting read. The text by Elton and Gruber covers some of the topics in the course very well. It is a good read for Portfolio theory, CAPM, APT and efficient markets hypothesis.

Students are also encouraged to read the Wall Street Journal, Financial Times, The Economist, and other financial magazines.

5 Assessment

Students will be assessed on the basis of class participation, class assignments, case analyses and a closed book exam. The exact weight given to each of these criteria is as follows:

Participation	5%
Assignments	$2 \times 6\%$
Case studies	$3 \times 10\%$
Midterm test	13%
Final Exam	$\frac{40\%}{100\%}$

6 Groups

Please form groups of not more than five or six. (Five is a good number). The assignments and case studies will be submitted by the groups as a whole rather than individuals. When forming groups, try to keep the group as heterogenous as possible as this will have obvious benefits. For example, a person with an engineering background will be able to help with the technical aspects of the work required while someone with a finance background will be able to give more intuition and help with the theory. Also heterogeneity should not just be limited to skills but it would be useful if individuals in a group come from different backgrounds with varying job experiences.

After groups have been formed, please write the names, email addresses and backgrounds of the different group members and submit it to me by the second week of the course.

7 Organisation of the classes

The 3 hours class will be roughly divided into a lecture and a tutorial. The lecture will introduce the basic material of a particular topic. It is strongly en-

couraged that the students participate in the lectures and ask me any questions that they might have.

The lecture will then be followed by a tutorial where assignments related to the topic taught will be distributed to the students. The students will then form groups and attempt these assignments. The assignments will apply the material covered in the lectures and text books to different problems at hands. It is important to note that **the assignments will complement the lectures rather than merely reproduce the material covered**. Hence, some of these assignments might seem daunting. However, I would encourage the groups to attempt these as best as possible because in doing so they will enhance their analytical skills. Also the questions in the final exam will be very similar to the questions in the assignments and thus students would already have seen questions of this nature by the time of the exam. Any two of these problem sets/assignments will be marked and students will be told one week in advance which of the assignments will be marked.

After the assignments are submitted to me, I will solve the problem set in the class. Again, at this point students should ask questions if they do not understand any aspects of the solutions.

Finally at some point we will go through three case studies. These case studies are yet to be decided and more details will be given out once this is done.

N.B. Students are expected to do preparatory reading before the classes. This will not only help them in understanding the lecture material better but would also better enable them to solve the problem sets.

8 Appointments

If there are any queries/comments regarding the course, students can meet me by setting appointments by email. My office is in BIZ 1 Building #03-34.