ADVANCED FINANCIAL MANAGEMENT – PAPER 16

SYLLABUS CHART

Advanced Financial Management – Paper 16

Financial Management – Paper 11

OVERALL AIM

To enable the learner broaden their knowledge and skills, and exercise judgment in the effective management of financial resources.

LEARNING OUTCOMES

On completion of this course, the learner should be able to:

1. Apply the concept of cost of capital in financial management.
2. Evaluate plans, actions and financial position of entities.
3. Evaluate and advise on investment decisions.
4. Evaluate the various types of securities and financial markets.
5. Recommend appropriate financing options.
6. Recommend appropriate corporate restructuring strategies.
7. Discuss the ethical responsibilities and challenges in financial management.

LEVEL OF ASSESSMENT

The examination will test the learner's evaluation, analytical and synthetic skills in financial decision making.

EXAMINATION STRUCTURE

There will be a three hour examination made up sections A and B. Section A will comprise of one compulsory question of 50 marks. Section B will comprise of four questions of 25 marks each, of which the candidate will be required to attempt any two.

A. CAPITAL BUDGETING

1. Investment appraisal under conditions of risk, inflation and taxation:

    (a) Capital investment and working capital investment

    (b) Capital budgeting process and organisational strategy, mission and goals

    (c) Role of investment appraisal in the capital budgeting process

    (d) Determination and usefulness of non-discounted investment appraisal methods:

        (i) Payback period

        (ii) Accounting rate of return

    (e) Discounted investment appraisal methods:

        (i) Relationship between interest rates and inflation; real and nominal discount rates

        (ii) Time value of money and the role of cost of capital in the capital budgeting process

        (iii) Present values of cash flows, including annuities and perpetuities

        (iv) Relevant cash flows for capital budgeting projects

        (v) Determination and usefulness of:

        - Net present value
        - Internal rate of return
        - Profitability index

    (f) Discounted versus non-discounted cash flow methods

    (g) Determination and application of before and after tax discount rates

    (h) Determination and application of tax effects on cash flows, including the tax benefits of capital allowances

2. Probability and sensitivity analysis in investment appraisal:

    (a) Relationship between risk and uncertainty in relation to project lifespan

    (b) Application, usefulness and limitation of sensitivity analysis in capital budgeting

    (c) Application, usefulness and limitation of probability analysis to capital budgeting

    (d) Application, usefulness and limitation of other risk adjusting techniques like adjusted payback and simulation models

3. Replacement and other specific investment decisions:

   (a) Asset investment decisions using equivalent annual cost method
   (b) Leasing or borrowing to purchase assets using the before and after tax cost of debt

4. Capital rationing (Single and Multi period rationing):

   (a) Capital rationing concept; its causes in investment
   (b) Profitability indices and selection of divisible capital investment projects
   (c) Combinations of non-divisible investments
   (d) Sub-optimal decisions of capital rationing

B. COST OF CAPITAL, CAPITAL STRUCTURE AND DIVIDEND THEORY

1. Concept of cost of capital; relevance in investment management

2. Gearing and the cost of capital:

   (a) Concept of gearing and its relation to the overall cost of capital
   (b) Implications of high levels of gearing and its relation to financial risk using ratio analysis, and cash flow forecasting

3. Theories of capital structure:

   (a) The traditional school of thought about the relevance of capital structure
   (b) The Modigliani and Miller school of thought about the relevance of capital structure, both with and without taxes

4. Interaction between financing and investment decisions

5. Dividend policy:

   (a) Relationship between the dividend decision and the financing decision
   (b) Practical factors that influence the dividend decision
   (c) Relevance of the dividend decision using both the traditional and Modigliani and Miller school of thought
   (d) Forms of dividends:
      (i) Stock splits
      (ii) Bonus shares
      (iii) Cash dividends

C. PORTFOLIO ANALYSIS

1. Meaning of portfolio return
2. Properties of expected value and computation of portfolio expected return
3. Computation of covariance of a portfolio
4. Computation of covariance using joint probability function
5. Properties and computation of correlation

D. THE CONCEPT OF RISK-RETURN

1. Risk and return for a single asset:
    - (a) The risk-return relationship in corporate investments
    - (b) Determination of risk of a single asset using standard deviation/ variance
    - (c) The return of a single asset using expected values and probability theory
2. Determination of risk and return for a two asset portfolio
3. The role of correlation and covariance in selecting investments in a portfolio
4. Risk diversification and reduction; meaning, role in investment management
5. Application of the mean-variance approach in portfolio selection process

E. THE CAPITAL ASSET PRICING MODEL (CAPM)

1. Systematic versus unsystematic risks
2. Basic assumptions of CAPM
3. The capital and security market lines:
    - (a) Meaning
    - (b) Relationship
    - (c) Relevance of capital and security market lines
4. Estimation of beta values using the security market line as well as covariance/ correlation formulae
5. Practical applications and limitations of CAPM
6. Determination of the adjusted present value of investments
7. Concept of arbitrage pricing theory and its relevance in financial investments

F. SECURITIES AND FINANCIAL MARKETS

1. Long-term financing decisions:
    - (a) Risk-return relationship and relative costs of equity and debt financing
    - (b) Creditor hierarchy and its relationship with costs of the various sources of finance
2. Share capital and long-term debt:
    - (a) Forms of equity and debt finance
    - (b) Merits and demerits of using debt or equity financing
3. Other sources of long-term finance; how they can be obtained, and their relative merits and demerits:

(a) Leasing
(b) Options
(c) Warrants
(d) Convertibles

4. Financial markets:
   (a) Types:
       (i) Primary and secondary
       (ii) Money and capital
   (b) Nature and role of financial markets in a developing economy
   (c) Primary versus secondary markets
   (d) Major players in the financial markets
5. Banks and their role in the financial system
6. Market efficiency:
   (a) Meaning and assumptions
   (b) Forms
   (c) Empirical evidence; capital market efficiency
   (d) Technical, random walk and fundamental analysis
   (e) Meaning and implications of the efficient market hypothesis to finance managers

G. CORPORATE RESTRUCTURING

1. Mergers and acquisitions:
   (a) Nature and role of corporate restructuring
   (b) Differences between mergers and acquisitions
   (c) Motives behind corporate takeovers/mergers
   (d) Reasons why some mergers may fail to meet objectives
   (e) Difference between hostile and friendly mergers
2. Valuation:
   (a) Reasons for valuing business and financial assets
   (b) Methods of valuation; advantages and limitations:
       (i) Net asset valuation
       (ii) Dividend valuation
       (iii) Market capitalisation
   (c) Income based models:
       (i) Price: earnings ratio
       (ii) Earnings yield

(iii) Discounted cash flows

(d) Methods of valuing debt stock and bonds:
   (i) Redeemable and irredeemable debt
   (ii) Preference shares
   (iii) Bonds

3. Financial distress:

   (a) Nature and implications of financial distress in a business organisation
   (b) Forms, signs and causes of financial distress
   (c) Solutions to financial distress

4. Bankruptcy, liquidation and reorganisation and circumstances under which they might be the best alternatives to the business

H. INTERNATIONAL MARKETS

1. Bonds and equity markets:

   (a) Types of bonds and equity markets on the international scene
   (b) Role of international capital flows
   (c) Origin and growth of euro markets

2. Developed versus emerging markets

3. Foreign exchange markets:

   (a) Types of foreign exchange risk
   (b) Factors responsible for exchange rate fluctuations in a country
   (c) Forecast exchange rates using purchasing power parity and interest rate parity formula
   (d) Hedging against foreign exchange risk:
      (i) Invoicing in home currency
      (ii) Netting and matching
      (iii) Leading and lagging
      (iv) Money market contracts
      (v) Forward contracts
      (vi) Asset and liability management
   (e) Foreign currency derivatives used in hedging:
      (i) Foreign exchange risk
      (ii) Options, swaps and futures

4. Interest rates and risk

   (a) Meaning of term structure of interest rates
   (b) The yield curve:

(i) Meaning and role

(ii) Factors that determine the shape of the yield curve

(c) Differences between gap exposure and basis risk as types of interest rate risk

(d) Instruments available to manage interest rate volatility:

(i) Asset and liability management

(ii) Interest rate futures

(iii) Forward rate agreements

5. Passive versus active management strategies

6. Foreign direct investment:

(a) Meaning

(b) Forms:

(i) Exporting

(ii) Joint ventures

(iii) Building subsidiaries

(iv) Licensing

(v) Franchising

(c) Motives

(d) Barriers

(e) Risks and challenges

(f) Application of investment appraisal techniques in foreign direct investments

I. ISLAMIC FINANCE

1. Islamic financing

(a) Meaning

(b) Sudden interest in Islamic financing

(c) Islamic tradition on which Islamic financing is based

(d) Differences between Islamic and conventional modes of finance

2. Banking and Interest (Riba)

(a) Islamic banking; relationship between the user and the supplier of funds

(b) Contracts and products used in Islamic banking

(c) Islamic versus conventional banks

3. Sharia Board:

(a) Composition of the Sharia board

(b) Explain the functions of the Sharia board

4. The principles of Islamic finance:

(a) Interest-free
(b) Need for underlying assets
(c) Avoidance of uncertainty/ gambling
(d) Profit and loss sharing
(e) Rights and liabilities of banks and customers
(f) Sharia compliance
(g) Unlawful goods and services
(h) Profit sharing principle

5. Islamic financing structures:
   (a) Murabaha
   (b) Tawarruq
   (c) Wakala
   (d) Ijara
   (e) Istisna'a
   (f) Musharaka
   (g) Sukuk
   (h) Mudaraba
6. Islamic capital markets:
   (a) Islamic financial instruments
   (b) Potential for Islamic capital instruments
7. Sharia compliance and the equity market
8. Issues that need to be considered:
   (a) Risks and Liabilities
   (b) Co-financing
9. Requirements for sustained growth of Islamic finance

J. ETHICS AND CORPORATE GOVERNANCE

1. Company policies and management of corporate funds
2. Contribution of corporate funds to political parties
3. Other ethical issues:
   (a) Money laundering
   (b) Corruption
   (c) Bribery
   (d) Conflict of interest

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