CONTENTS

	About the author	xiii
	Acknowledgments	xiv
	Author's Acknowledgments	XV
	Introduction	xvi
1	What is the firm's objective?	1
	Introduction	2
	A common purpose	2
	The assumed objective for finance	7
	What is shareholder value?	11
	Profit maximization is not the same as shareholder	
	wealth-maximization	12
	Getting manager's objectives aligned with those of shareholders	15
	What happens if control over directors is weak?	19
	Conclusion	20
	SECTION I: INVESTING IN PROJECTS	
2	State-of-the-art project appraisal techniques	23
	Introduction	23
	How do you know if an investment generates value for shareholders?	25
	State-of-the-art technique 1: net present value	30
	State-of-the-art technique 2: internal rate of return	39
	Choosing between NPV and IRR	47
	Conclusion	49
	Appendix 2.1 Mathematical tools for finance	50
3	Traditional appraisal techniques	61
	Introduction	62
	What appraisal techniques do businesses use?	62
	Payback	62
	Accounting rate of return	67
	Internal rate of return: reasons for continued popularity	70
	Conclusion	71

4	Investment decision-making in companies	73
	Introduction	74
	The managerial art of investment selection	75
	More tricky issues in real world project appraisal	82
	The stages of investment decision-making	85
	Conclusion	92
5	Allowing for risk in project appraisal	93
	Introduction	95
	What is risk?	95
	Adjusting for risk through the discount rate	98
	Sensitivity analysis	98
	Scenario analysis	104
	Probability analysis	106
	Problems with using probability analysis	112
	Evidence of risk analysis in practice	113
	Conclusion	113
	SECTION II: SHAREHOLDER VALUE	
6	Value managed vs earnings managed companies	117
	Introduction	118
	The pervasiveness of the value approach	118
	Case studies: FT100 companies creating and destroying value	121
	Why shareholder value?	123
	Three steps to value	125
	Earnings-based management's failings	126
	Return on capital employed has failings	133
	Focussing on earnings is not the same as value	134
	How a business creates value	134
	The five actions for creating value	137
	Conclusion	143
7	Value through strategy	145
	Introduction	146
	Value principles touch every corner of the business	146
	The firm's objective	146
	Strategic business unit management	148
	Strategic assessment	150
	Strategic choice	158
	Strategy implementation	159
	What use is the head office?	159
	Targets and motivation	162
	Conclusion	164

		CONTENTS
8	Measures of value creation	165
	Introduction	166
	Using cash flow to measure value	166
	Shareholder value analysis	172
	Economic profit	181
	Economic value added	189
	Cash flow return on investment	191
	Conclusion	191
9	Entire firm value measurement	195
	Introduction	196
	Total shareholder return	197
	Wealth Added Index	200
	Market Value Added	204
	Market to Book Ratio	208
	Conclusion	209
10	What is the company's cost of capital?	211
	Introduction	212
	A word of warning	212
	The required rate of return	213
	Two sides of the same coin	214
	The weighted average cost of capital	215
	The cost of equity capital	221
	The cost of retained earnings	232
	The cost of debt capital	232
	The cost of preference share capital	236
	Hybrid securities	236
	Calculating the weights	236
	The WACC with three or more types of finance	237
	Classic error	237
	What about short-term debt?	238
	Applying the WACC to projects and SBUs	238
	What do managers actually do?	239
	Implementation issues	243
	Which risk-free rate?	245
	Fundamental beta	248
	Some thoughts on the cost of capital	249
	Conclusion	251

VII

11	Mergers: Impulse, regret and success	253
	Introduction	254
	The merger decision	254
	You say acquisition, I say merger	255
	Merger statistics	257
	What drives firms to merge?	259
	Do the shareholders of acquiring firms gain from mergers?	272
	Managing mergers	273
	Conclusion	284
12	The merger process	287
	Introduction	288
	The City Code on Takeovers and Mergers	288
	Action before the bid	290
	The bid	294
	After the bid	295
	Defense tactics	296
	Paying for the target's shares	298
	Conclusion	304
13	Valuing companies	307
	Introduction	308
	The two skills	308
	Valuation using net asset value	309
	Income flow is the key	314
	Dividend valuation methods	314
	How do you estimate future growth?	321
	Price earnings ratio-to-model	324
	Valuation using cash flow	330
	Valuing unquoted shares	335
	Unusual companies	336
	Managerial control changes the valuation	339
	Managerial control changes the valuation Conclusion	339 345
14		
14	Conclusion	345
14	Conclusion What pay-outs should we make to shareholders?	345 347
14	Conclusion What pay-outs should we make to shareholders? Introduction	345 347 348
14	Conclusion What pay-outs should we make to shareholders? Introduction Defining the problem	345 347 348 348
14	Conclusion What pay-outs should we make to shareholders? Introduction Defining the problem Theorists in their hypothetical world	345 347 348 348 349
14	Conclusion What pay-outs should we make to shareholders? Introduction Defining the problem Theorists in their hypothetical world The other extreme – dividends as a residual	345 347 348 348 349 352

		CONTENTS
	Share buy-backs and special dividends	360
	A round-up of the arguments	361
	Conclusion	364
	SECTION III: FINANCE RAISING	
1 5	Debt finance available to firms of all sizes	369
	Introduction	370
	Contrasting debt finance with equity	371
	Bank borrowing	373
	Overdraft	376
	Term loans	382
	Trade credit	382
	Factoring	386
	Hire purchase	391
	Leasing	393
	Bills of exchange	399
	Acceptance credits (bank bills or banker's acceptance)	401
	Conclusion	402
16	Debt finance from the financial markets	403
	Introduction	404
	Bonds	405
	Syndicated loans	409
	Credit rating	410
	Mezzanine debt and high-yield (junk) bonds	414
	Convertible bonds	420
	Valuing bonds	424
	International sources of debt finance	428
	Medium-term notes	441
	Commercial paper	442
	Project finance	443
	Sale and leaseback	445
	Securitization Conclusion	447 448
	Conclusion	440
17	Raising equity capital	451
	Introduction	453
	What is equity capital?	454
	Preference shares	456
	Floating on the official list	459
	What managers need to consider	460
	Methods of issue	466

IX

	Timetable for a new offer	468
	How does an alternative investment market flotation differ	450
	from one on the official list?	473
	The costs of new issues	475 479
	Rights issues Other equity issues	482
	Scrip issues	484
	Warrants	484
	Equity finance for unquoted firms	485
	Disillusionment and dissatisfaction with quotation	493
	Conclusion	495
	Appendix 17.1 Arguments for and against floating	496
	SECTION IV: MANAGING RISK	
18	The financial risks managers have to deal with	509
	Introduction	510
	Types of risk	511
	Risk in the financial structure	514
	The dangers of gearing	521
	What do we mean by gearing?	523
	Agency costs	534
	Pecking order	536
	Some further thoughts on debt finance	538
	Conclusion	544
19	Options	545
	Introduction	546
	What is a derivative?	546
	A long history	547
	What is an option?	547
	Share options	548
	Index options	558
	Corporate uses of options	561
	Real options	562
	Conclusion	564
20	Using futures, forwards and swaps to manage risk	567
	Introduction	568
	Futures	568
	Short-term interest rate futures	576
	Forwards	580
	Forward rate agreements	583

		CONTENTS	XI
	A comparison of options, futures and FRAs	584	
	Caps	584	
	Swaps	586	
	Derivatives users	589	
	Over-the-counter and exchange-traded derivatives	592	
	Conclusion	593	
21	Managing exchange-rate risk	595	
	Introduction	596	
	The impact of currency rate changes on the firm	597	
	Volatility in foreign exchange	598	
	The currency markets	599	
	Exchange rates	601	
	Covering in the forward market	606	
	Types of foreign-exchange risk	607	
	Transaction risk strategies	611	
	Managing translation risk	622	
	Managing economic risk	625	
	Conclusion	627	
	Appendices I-III	629	
	Glossary	633	
	Further reading	687	
	Index	703	