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UK Edition

# Corporate Finance

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## Learn to:

- Make sense of the maths and equations associated with corporate finance
- Understand the key concepts and terminology
- Get to grips with accounting statements, cash flow, business valuation, risk management and more

**Steve Collings**

*Author of IFRS For Dummies*

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*Owner and operator, OPII Schools*





**by Steve Collings and Michael Taillard**

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## **Corporate Finance For Dummies®**

Published by: John Wiley & Sons, Ltd., The Atrium,  
Southern Gate, Chichester, [www.wiley.com](http://www.wiley.com)

This edition first published 2013

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Registered office

John Wiley & Sons Ltd, The Atrium, Southern Gate,  
Chichester, West Sussex, PO19 8SQ, United Kingdom

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A catalogue record for this book is available from the British Library.

ISBN 978-1-118-74350-8 (paperback); ISBN 978-1-118-74348-5 (ebk); ISBN 978-1-118-74347-8 (ebk)

Printed in Great Britain by TJ International, Padstow, Cornwall

10 9 8 7 6 5 4 3 2 1

# Corporate Finance For Dummies®

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to view this book's cheat sheet.

## Table of Contents

### Introduction

[About This Book](#)

[Foolish Assumptions](#)

[Icons Used in This Book](#)

[Beyond the Book](#)

[Where to Go from Here](#)

### Part I: Getting Started with Corporate Finance

#### Chapter 1: Introducing Corporate Finance

[Considering Corporate Finance and the Role of Money in the World](#)

[Identifying What Makes Corporate Finance Unique](#)

[Serving as an intermediary](#)

[Analysing interactions between people](#)

[Recognising How Corporate Finance Rules Your Life](#)

[Becoming Proactive about Corporate Finance](#)

## Chapter 2: Navigating the World of Corporate Finance

### Visiting the Main Attractions in Finance Land

Investigating the incorporated entity

Discovering depository institutions

Covering yourself: Insurance companies

Spotting securities firms

Understanding underwriters

Finding out about funds

Obtaining other loans: Financing institutions

Buying and selling shares: Stock markets

Setting the rules: Regulatory bodies

Banking on the Bank of England

Governing policy: HM Treasury

### Meeting the Inhabitants of Finance Land

Starting at entry-level positions

Researching the analysts

Checking the auditors

Assessing loss adjusters

Taking in the view from the top: Executives and managers

Making money: Traders

Taking financial responsibility: Treasury officers

Considering other finance positions

### Visiting the Finance Land Information Resources

Using Internet resources

Reading print resources

Hunting out human resources

## Chapter 3: Raising Money for Business Purposes

Raising Capital

Acquiring Debt to Raise Funds

Asking the right people for money.

Making sure the loan pays off in the long run

Looking at loan terms

Selling Equity to Raise Cash

Selling shares to the public

Looking at the different types of shares

## Part II: Reading Financial Statements as a Second Language

### Chapter 4: Seeing What You're Worth with the Balance Sheet

Introducing the Balance Sheet

Knowing the Weights on the Balance Scale

Assessing Your Assets

Considering current assets

Finding out about fixed assets

Investigating intangible assets

Gathering the rest: Other assets

Looking at Liabilities

Calculating current liabilities

Exploring long-term liabilities

## Valuing the Company: Shareholders' Funds

Ordinary shares

Treasury shares

Share premium

Profit and loss reserves

Revaluation reserve

## Making Use of the Balance Sheet

# Chapter 5: Getting Paid with the Profit and Loss Account

## Adding Income and Subtracting Costs: What's on the Profit and Loss Account

Calculating profitability: Gross profit

Finding the costs of doing business: Operating profit

Accounting for other costs and revenues: Earnings before interest and taxes

Considering tax and interest to arrive at net profit

Including earnings per share

Completing the picture: Supplemental notes

## Putting the Profit and Loss Account to Good Use

# Chapter 6: Easy Come, Easy Go: Understanding the Cash Flow Statement

## Piecing Together a Puzzle of Cash Flows

Earning or spending cash: Operating activities cash flows

Buying and selling: Investing activities cash flows

Raising capital: Financing activities cash flows

Combining the three types of operations to find net change in cash

Using the Cash Flow Statement

## Chapter 7: Making Financial Statements Useful with Ratio Analysis

Being Able to Pay the Bills: Liquidity Ratios

Current ratio

Acid test ratio

Analysing Efficiency with Activity Ratios

Trade debtors' days

Days sales in trade debtors

Trade debtors turnover

Trade creditors ratio

Days sales in stock

Stock turnover

Stock turnover in days

Operating cycle

Working capital

Turnover (sales) to working capital

Fixed asset turnover

Measuring Profit Generation and Management with Profitability Ratios

Return on capital employed (ROCE)

Net profit margin

Net asset turnover

Gross profit margin

EBITDA/capital employed

Return on assets

Operating profit margin

Operating asset turnover

Return on operating assets

Return on total equity

Return on investment

Evaluating a Company's Debt Management with Debt Ratios

Interest cover

Fixed charge coverage

Debt to equity ratio

## Chapter 8: Measuring Financial Wellbeing with Special-Use Ratios

Focusing on Earnings and Dividends with Investor Ratios

Return on equity

Earnings per share

Dividend per share

Price to earnings ratio

Earnings yield

Dividend payout ratio

Dividend yield

Book value per share

Dividend cover

Generating Earnings from Interest: Ratios for Banks

Earning assets to total assets ratio

Net interest margin

Loan loss coverage ratio

Equity to total assets ratio

Deposits times capital

[Loans to deposits ratio](#)

[Using Ratios to Measure Operating Asset Management](#)

[Operating ratio](#)

[Percentage earned on operating property](#)

[Operating revenue to operating property ratio](#)

[Long-term debt to operating property ratio](#)

## [Part III: Placing Valuations on the Price Tags of Business](#)

### [Chapter 9: Determining Present and Future Values: Time Is Money](#)

[Losing Value over Time](#)

[Increasing prices, decreasing value: Inflation](#)

[Maintaining your curiosity: Interest rates](#)

[Predicting Future Value](#)

[Making simple interest easy](#)

[Building an understanding of compound interest](#)

[Calculating the Present Value](#)

[Taking a closer look at earnings](#)

[Discussing discounted cash flows](#)

### [Chapter 10: Looking to the Future with Capital Budgeting](#)

[Understanding Capital Budgeting](#)

[Rating Your Returns](#)

[Looking at costs](#)

[Reckoning your revenue](#)

[Calculating the accounting rate of return](#)

[Making the most of the internal rate of return through modification](#)

[Netting Present Values](#)

[Totting up NPV over time](#)

[Managing the project's value](#)

[Determining the Payback Period](#)

[Managing Capital Allocations](#)

[Assessing the equivalent annual cost](#)

[Considering liquid assets](#)

[Looking at a Piece of Project Management](#)

[Doing the value schedule calculations](#)

[Carrying out the budget calculations](#)

## [Chapter 11: Bringing on Your Best Bond Bets](#)

[Exploring the Different Types of Bonds](#)

[Considering corporate bonds](#)

[Gauging government gilts](#)

[Receiving periodic interest with coupon bonds](#)

[Forgoing periodic payments with zero-coupon bonds](#)

[Figuring out deep discounted bonds](#)

[Sizing up asset-backed securities](#)

[Having the best of two worlds with convertible bonds](#)

[Using callable bonds to capitalise on interest rates](#)

[Looking at the pros and cons of puttable bonds](#)

[Getting the gist of registered bonds](#)

[Counting on forgiveness with catastrophe bonds](#)

[Looking at Bond Rates](#)

[Reading Bond Information](#)

[Understanding Bond Valuation](#)

## [Chapter 12: Being Savvy When Shopping for Shares](#)

[Exchanging Shares: Where to Buy and Sell](#)

[Looking at the Different Types of Orders](#)

[Making market orders](#)

[Controlling prices with stop and limit orders](#)

[Pondering pegged orders](#)

[Counting on time-contingent orders](#)

[Comparing Long and Short Stocks](#)

[Buying long](#)

[Using margin trading](#)

[Selling short](#)

[Classifying Shares: Chips, Caps and Sectors](#)

[Dipping into chips](#)

[Capitalising on market caps](#)

[Selecting by sectors](#)

[Knowing Where the Market Stands: Bulls versus Bears](#)

[Watching Stocks and Shares Indices](#)

[Calculating the Value of Stocks and Shares](#)

[Surveying equity valuation models](#)

[Checking out corporate analysis](#)

[Evaluating industry performance](#)

[Factoring in stock market fluctuations](#)

[Mulling over macroeconomics](#)

## [Chapter 13: Measuring Valuations of the May-Be: Derivatives](#)

[Introducing the Derivatives Market](#)

[Buying or Selling – Then Again, Maybe Not: Options](#)

[Managing risk](#)

[Generating revenue](#)

[Valuing](#)

[Customising the Contract with Forwards](#)

[Managing risk](#)

[Generating revenue](#)

[Valuing](#)

[Adding Some Standardisation to the Contract with Futures](#)

[Managing risk](#)

[Generating revenue](#)

[Valuing](#)

[Exchanging This for That and Maybe This Again: Swaps](#)

[Managing risk](#)

[Generating revenue](#)

[Valuing](#)

## [Part IV: Walking in a Risk Management Wonderland](#)

## Chapter 14: Managing the Risky Business of Corporate Finances

Understanding that Risk Is Unavoidable

Investigating Interest Rate Risk and Inflation Risk

Minimising Market Risk

Evaluating the Risk of Extending Credit

Understanding Off-Balance-Sheet Risk

Factoring in Foreign Exchange Risk

Describing transaction risk

Tackling translation risk

Considering other foreign exchange risks

Identifying Operating Risk

Looking at Liquidity Risk

## Chapter 15: Through the Looking Glass of Modern Portfolio Theory

Delving into Portfolio Practicalities

Surveying portfolio management strategies

Looking at modern portfolio theory

Understanding passive versus active management

Hypothesising an Efficient Market

Risking Returns

Looking at the trade-off between risk and return

Diversifying to maximise returns and minimise risk

Considering risk aversion

Measuring risk

Optimising Portfolio Risk

## Chapter 16: Entering the Science Lab: Financial Engineering

Creating New Tools through Financial Engineering

Making Securities from Just about Anything

Realising that you can securitise everything

Slicing securities into tranches

Looking at Hybrid Finances

Meeting the mixed-interest class of hybrids

Circling around single asset class hybrids

Becoming a financial Frankenstein: Index-backed CDs

Bundling Assets

Making a bundle with multi-asset bundles

Unbundling securities

Appealing to a Large Market with Exotic Finances

Owning options

Seeking out swaps contracts

Living with exotic loans

Engineering Your Portfolio to the Max

Examining the fundamentals of portfolio engineering

Finding out about flash crashes

Moving into Computational Finance

Changing the face of trading

Offering online banking

Looking at logic programming

## Chapter 17: Assessing Capital Structure

Making More Money than You Borrow

Calculating the Cost of Capital

Measuring cost of capital the WACC way

Factoring in the cost of debt

Looking at the cost of equity

Discussing dividend policy

Choosing the Proper Capital Structure

## Part V: Understanding Financial Management

### Chapter 18: Assessing Financial Performance

Understanding the Importance of Analysing Financial Success

Using Common-Size Comparisons

Looking at vertical common-size comparisons

Handling horizontal common-size comparisons

Considering cross comparisons

Providing Context by Performing Comparatives

Contrasting over time

Comparing against industry competitors

Determining the Quality of Profits

Tackling accounting concerns

Thinking about sources of cash flows

Assessing Investment Performance

Employing conventional evaluations of success

[Perusing portfolio manager evaluations](#)

## [Chapter 19: Forecasting Finances Is Easier than Predicting the Weather](#)

[Seeing with Eyes Analytical](#)

[Collecting data](#)

[Finding an average](#)

[Measuring data distribution](#)

[Understanding probability](#)

[Viewing the Past as New](#)

[Finding trends and patterns](#)

[Looking at regression](#)

[Seeing the Future Unclouded: Forecasting](#)

[Using statistics and probability](#)

[Seeking a precedent: Reference class forecasting](#)

[Evaluating forecast performance](#)

## [Chapter 20: Spelling out the ABC of M&A](#)

[Getting the Lowdown on M&A](#)

[Differentiating Between the M and the A](#)

[Joining together: Mergers](#)

[Purchasing a company: Acquisitions](#)

[Taking control: Buyouts](#)

[Considering other forms of integration](#)

[Clearing up the Mess: Divestitures](#)

[Identifying Motives for M&A](#)

[Discovering diversification](#)

Expanding geographically

Benefiting from economies of scale

Enjoying economies of scope

Integrating up, down and all around

Eliminating competitors

Seeking manager compensation

Gaining synergies

Measuring What a Business Is Worth to You

Assessing a price

Choosing an evaluation method

Financing M&A

## Part VI: The Part of Tens

### Chapter 21: Ten Things You Need to Know about International Finance

Understanding that Trade Imbalances Don't Exist

Revealing that Purchasing Power Is Different to Exchange Rate

Examining Eurobonds (which Aren't Necessarily from Europe)

Sorting the Muddled Relationship of Interest and Exchange Rates

Spotting the Spot Rate and Other Currency Transactions

Diversifying Can't Completely Eliminate Risk Exposure

Cross-Listing Allows Companies to Tap the World's Resources

Outsourcing as a Taxing Issue

Complicating Your Life with Politics

Knowing Your Neighbours: Cultural Understanding Is Vital

## Chapter 22: Ten Things You Need to Understand about Behavioural Finance

[Making Financial Decisions Is Rarely Entirely Rational](#)

[Executing Sound Financial Decisions Involves Identifying Logical Fallacies](#)

[Getting Emotional about Financial Decisions Can Leave You Crying](#)

[Stampeding in Finance Can Get You Trampled](#)

[Letting Relationships Influence Finances Can Be Dangerous](#)

[Satisficing Can Optimise Your Time and Energy](#)

[Explaining Life in the Improbable: Prospect Theory](#)

[Accepting that People Are Subject to Behavioural Biases](#)

[Analysing and Presenting Information Is Fraught with Problems](#)

[Measuring Irrationality in Finance Is Rational Behavioural Finance](#)

## About the Authors

## Cheat Sheet

## Connect with Dummies

# Introduction

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In case you didn't already know, this book is about corporate finance. If you were looking for dog grooming, we're afraid you've picked up the wrong book.

Corporate finance is the study of how groups of people work together as a single organisation to provide something of value to society. If a company is using up more value than it's producing, it loses money and goes bust. So the job of people in corporate finance is to manage the organisation so that it uses resources efficiently (to the best advantage of the company), pursues the most valuable projects, remains competitive and people get to keep their job. You can accomplish this task through an easy process: measuring. In corporate finance, you measure value using money, because the final goal of all companies is to make money. When a company makes money - that is, when it's profitable - it's making sales that have more value than the things it buys and it's adding value to society rather than sucking the life out of it. Ensuring that a company is financially successful, however, is far more complicated than simply ensuring that it's profitable.

In this book, we discuss a wide range of topics in corporate finance. Think of it as a sampler or a greatest-hits album - an introductory book that provides everything you need to understand what corporate finance is and how to begin functioning at a basic level in the world of finance.

## ***About This Book***

This book is a little different from other corporate finance books. First of all, it's better! More useful than that, though, is that this book is written and organised so that people with absolutely no understanding of corporate finance can use it as a reference guide. It's also a wonderfully interesting read.

Everything in this book is written as if you're a complete newbie. The little details are pointed out, and when stuff gets complicated we just summarise the topic. We also explain - or at least clarify - everything, in down-to-earth language, without sounding technical. This book is all about making the subject of corporate finance accessible to everyone, while keeping it from being too dry. Corporate finance books can be really boring, which is sad because they don't need to be.

This book is organised to be used as a reference book. We still recommend reading it all, of course, but we break down and structure everything carefully to give the book what we like to call a disjointed continuity. This organisation makes looking things up without reading the entire book easy, while maintaining enough fluid continuity to make sense if you want to read the book from start to finish.

## ***Foolish Assumptions***

While writing this book, we did our best to assume that you know absolutely nothing. That being said, no one is perfect and we forgive you for failing to live up to the expectation that you're a complete dummy. In return, we'd appreciate it if you forgive us for the assumptions we made throughout this book. What we can do for you, though, is give you a heads up regarding some things you need to be aware of, know or perhaps prepare yourself with.

Unavoidably, this book involves a bit of maths. Yes, we know, maths is hard; we never liked it, either. That's why we supplement the majority of the maths with explanations of how to do the calculations that are simple enough to spare you from needing to know how to study maths. In other words, you can often skip over the majority of the equations and just read the paragraph(s) following them to get an understanding of what you're supposed to do. That's not always the case, though. To understand this book – to understand corporate finance at all – you do need a basic understanding of arithmetic (addition, subtraction, multiplication, division) as well as algebra (how to find  $x$ ). We talk a bit about statistics and calculus in this book as well, but we provide you with careful, step-by-step instructions or simple summaries for that. We don't discuss anything that's very difficult. As long as you know arithmetic and a little algebra, you'll be fine – nothing's harder than  $4 + x = 10$ .

You can also supplement the information in this book by checking out *For Dummies* books on accounting. The two subjects have some overlap, and we bring up accounting subjects occasionally. Looking at *Accounting For Dummies* by John A. Tracy (Wiley), for example, can help give you more background about these topics. We try to include only those details relevant to the subject of corporate finance.

Other than that, if you're reading this right now, you're prepared to begin reading *Corporate Finance For Dummies!*

## ***Icons Used in This Book***

We scatter a few icons around the book to help you find relevant material. These icons highlight bits of

information that are of particular importance to you. Here's what to look for.



Professionals get good at what they do by making stupid mistakes and learning from them. Now you can benefit from these stupid mistakes without the unfortunate side-effects of making them yourself. Just look for the Tip icon.



Whenever you see this icon, it means that you may one day need to remember the information included. You may want to consider keeping it in mind.



When you see this icon, we're talking about something that may pose a serious threat. We're not being facetious, either. Corporate finance is a study in money, and this is an introductory book, and so in some instances you need to talk to a professional before you get yourself or others into financial or legal trouble.



This icon clues you into the fact that the paragraph contains some interesting but not essential-to-know information. If you prefer, you can skip this material secure in the knowledge that you aren't missing anything vital. But then again, if you want to gain that extra edge. . . .

## ***Beyond the Book***

As you walk your journey of discovery into the world of corporate finance, you can augment what you read here by checking out some of the access-anywhere extra goodies that we've hosted for you online.

You can find the book's e-cheat sheet online, at [www.dummies.com/cheatsheet/corporatefinanceuk](http://www.dummies.com/cheatsheet/corporatefinanceuk). The at-a-glance tips and info that we offer in this cheat sheet can help you to make room for the basic skills you need in order to understand corporate finance, to understand how behaviour affects corporate finance, and more.

Additionally, you can also find bonus content online, at [www.dummies.com/extras/corporatefinanceuk](http://www.dummies.com/extras/corporatefinanceuk), which includes an extra Part of Tens chapter – 'Ten Key Points about Islamic Finance' – and some great bonus articles.

## ***Where to Go from Here***

We didn't write the chapters in order and you don't have to read them in order. If we can make a recommendation, though, you may want to begin with the chapters in Parts II and III before attempting Parts IV and V. At least flip through the earlier pages to make sure that you're familiar with how to read financial statements and the time value of money before you attempt to move on to Parts IV and V. As long as you're familiar with those things (financial statements and the time value of money), nothing in this book is going to be out of your grasp.

Part I  
**Getting Started with  
Corporate Finance**



*For Dummies* can help you get started with lots of subjects. Visit [www.dummies.com](http://www.dummies.com) to learn more and do more

with *For Dummies*.

## *In this part . . .*

- ✓ Bone up on the basics of corporate finance and become proactive with your corporate finance know-how.
- ✓ Navigate your journey through the complex world of corporate finance, stopping off at the major organisations and visiting the major roles involved along the way.
- ✓ Get to grips with how companies raise money by incurring debt and by selling equity.

# Chapter 1

## Introducing Corporate Finance

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### ***In This Chapter***

- ▶ Understanding the meaning of money
  - ▶ Looking at the study of corporate finance
  - ▶ Seeing the role corporate finance plays in your life
  - ▶ Making corporate finance work for you
- 

Corporate finance is more than just a measure of money. In fact, as you discover in this chapter - where we talk about the nature of money, how it applies to corporate finance and how it connects to you and your life - money is somewhat incidental to finance. When you're discussing corporate finance, you're looking at the whole world in a brand new way that measures it and what it contains so as to make the information useful to people. You can calculate things in terms of corporate finance that you simply can't measure accurately in any other way.

Part of the role of this chapter is also to introduce you to the book as a whole. Therefore, as part of helping you become proactive with your corporate finance know-how, we clue you into other chapters to allow you to follow your personal interests quickly and easily.

# ***Considering Corporate Finance and the Role of Money in the World***

*Corporate finance* is the study of relationships between groups of people that quantifies the otherwise immeasurable. (Corporate finance can also refer to a department, such as the corporate finance department in an investment bank that deals with advice given to companies about financial arrangements.) To understand how this rather wordy definition makes any sense at all, you have to take a quick look at the role of money in the world.

According to Adam Smith, an 18th century economist, the use of money was preceded by a *barter system*, in which people exchanged goods and services of relatively equivalent value. For example, if you worked growing hemp and making rope out of it, you'd give that rope to people in exchange for food, clothes or whatever else you needed that the people around you were offering.

But what happens when someone wants rope but that person has nothing you want, or you need food but no one needs rope? These times caused people to start using a basic form of money. So, you sell your rope to someone with nothing you want and he gives you a credit note for his services that you're free to give to anyone else. You decide to go and buy some beer, giving the brewer the credit note, ensuring that the person who bought your rope would provide the brewer a service in exchange for giving you beer. Thus, the invention of money was born, though in a very primitive form.