Міністерство освіти і науки України
Таврійський Державний агротехнологічний університет

КАФЕДРА ІНОЗЕМНИХ МОВ

Англійська мова

НАВЧАЛЬНО-МЕТОДИЧНИЙ ПОСІБНИК З ПОЗААУДИТОРНОГО ЧИТАННЯ ДЛЯ СТУДЕНТІВ СПЕЦІАЛЬНОСТІ «ФІНАНСИ ТА КРЕДИТ»

ESSENTIALS OF FINANCE

Мелітополь
2015

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Навчально-методичний посібник з поза аудиторного читання для студентів за спеціальністю «Фінанси та кредит» схвалено на засіданні кафедри іноземних мов ТДАТУ

Протокол № 7 від 30 квітня 2015року

Посібник затверджено на засіданні методичної комісії інституту економіки та бізнесу

Протокол № 6 від 21 травня 2015 року

Передмова

Даний навчально-методичний посібник призначений для студентів факультету економіки та бізнесу за спеціальністю «Фінанси та кредит». Посібник розрахований на студентів, які вже мають знання нормативної граматики англійської мови та словниковий запас науково-професійної лексики. Матеріали посібника пов'язані з матеріалами навчального посібника "Elementary Finance" і дають додаткову інформацію до тем, викладених у посібнику.

Навчальний посібник «Essentials of Finance» має на меті забезпечення у студентів розвитку навичок самостійного читання, розуміння і перекладу наукових текстів на англійській мові в галузі фінансів, а також розвинення навичок усного мовлення, формування широкого професійного словника та навичок ведення бесіди у рамках професійної тематики.

Методичні розробки складаються з 3 частин, що включають наукові тексти пов'язані з питаннями аудиту, фінансів, бюджету.

Для полегшення роботи з даними методичними розробками надається словник науково-професійної лексики та список скорочень, які використовуються у галузі фінансів.

Зміст

UNIT I

What is finance?

Corporate or Business Finance is basically the methodology of allocating financial resources, with a *financial value*, in an optimal manner to maximize the wealth of a business enterprise. There are three major decisions to be made in this allocation process: *capital budgeting*, financing, and dividend policy. Capital *budgeting* is the decision regarding the choice of which investments are to be made with the resources that have been brought into the business or earned and retained by the business. The choice depends on the *returns* to be made from the investment exceeding the cost of capital. The method used to do this is the *discounted time-value of money* of the cash flow from the investment. This value is the *internal rate of return* (IRR), a measure of return on investment. When the IRR exceeds the *required return*, which is equal to the cost of the funds invested then the investment should be made. If such a required return is used as the *discount rate*, then that is the same as saying the investment will yield a positive *net present value* (NPV).

If there are two or more investments that can be made, but they are *mutually exclusive*, then they must be ranked; and the one with the highest NPV should be chosen. If there is a limited amount of funds to be invested, then some bankers or advisers who obtain additional funds for a business may require that the business choose among the investments so as not to exceed the limited level of funds available. This selection process, which is called *capital rationing*, should be done in a similar manner *to rank* the projects by selecting the combination of investments that do not exceed the total funds available and that yield the maximum *total net present value*.

What is financing?

Financing is the decision of which resources or funds are to be brought into the business from external investors and creditors in order to be invested in profitable projects. The first external source of finance is debt, which includes loans from banks and bonds purchased by bondholders. The debt creditors take less risk of non repayment because the business must repay them if there are funds available to do so when the debt *becomes due.*

The second external source of finance is equity, which includes common stock and preferred stock. The equity investors in the business take more business risk and may not receive payment until the creditors are repaid and the management of the business decides to distribute funds back to the investors.

The goal of the financing decision is to obtain all the resources necessary, to make all the investments that yield a *return* in *excess of the cost* of the funds invested or the *required rate of return*, and to obtain these funds at the lowest average cost, so as to reduce the required rate of return and increase the net present value of the projects selected.

What is a dividend policy?

Dividend policy is the decision regarding funds to be distributed or returned to the equity investors. This can be done with common *stock dividends*, preferred stock dividends, or *stock repurchase by the business of its own stock.* The aim of this decision is to retain the resources in the business that are required to run the business or make additional investments in the business, as long as the returns earned exceed the required return.

In theory, management should return or distribute all resources that cannot be invested in the business at levels in excess of the required return. In practice, however, dividends are often maintained at or changed to certain levels in order *to convey* the proper signals to the investors and the financial markets. For example, dividends can be maintained at moderate levels to demonstrate stability, maintained at or reduced to low levels to demonstrate the growth opportunities for the business, or increased to higher levels to demonstrate the restoration of a strong financial (capital) structure (debt and equity capital) for the business.

What is a capital?

Capital is the total of financial resources invested in the business. In terms of the sources, there are two types of capital: *interest-bearing debt funds*, such as loans, bonds, short-term notes, and *interest-bearing payables* to trade suppliers; and equity, such as common and preferred stock and the *earnings retained* in the business that add to stockholders' share of the *entities*.

In terms of uses, there are also two types of capital: *net working capital*, such as *operating cash*, *inventory*, and *receivables*, less *interest-free payables* to trade suppliers; and fixed capital, such as property, plant and equipment. Capital is managed to maximize wealth by maximizing the rates of return on investments of capital and thus maximizing the total net present value of the business.

Weighted average cost of capital is the *weighted average of the returns* on investment or future dividends for the stockholders and interest rates on debt for the creditors. This average return should be used as the required return for investments, as mentioned earlier, because it represents the weighted average of the required returns of all the different debt creditors and equity investors. It also represents the weighted average of the costs that can be saved by the business if the resources or financial funds are returned to the creditors and investors instead of being used for investments within the business.

Capital structure is represented by the types of sources of capital funds invested in the business. A common measure of sources is the *percentage of debt relative* to equity that appears on a company's balance sheet. Usually, the cost or required returns for the debt is much less than the equity, especially on an *after-tax* basis.

Thus, the total cost of capital declines when some debt funds from creditors are substituted for equity funds from investors. Yet as more debt is added, the business becomes riskier because of the higher amount of fixed payments that must be made to creditors, whether or not the business is generating adequate funds from earnings; and then the costs of both the debt and equity funds are increased to the point where the weighted average cost increases.

Some words about acquisitions.

Acquisitions, which are purchases of other businesses, are merely another type of capital budgeting investment for a business. Such purchases should be evaluated in the same manner as any other capital investment, as outlined earlier, to obtain the maximum positive net present value.

Price/earnings ratio is often used in making acquisitions as an abbreviated measure of valuation. This ratio is of the value or price of a business or its stock to its *earnings*. Yet the actual decision to make an acquisition is a capital budgeting decision; the resultant determination of price or net present value can then be described in relative terms to the earnings in the price/earnings ratio.

Some words about returns.

Returns for any business or particular debt or investment made in the business are *merely* the cash flows that will ultimately be earned by the business or particular creditors and stockholders. These can be expressed in dollar terms or as percentages, with the latter being the average annual percentage of the cash flows relative to the overall investment in the business or the particular amounts of debt or stock involved. For debt instruments, these percentage rates are called interest rates.

Return/interest rates are based on three components: pure return for the investor or creditor providing funds; coverage of inflation rates, and additional return for additional risk. These components are then compounded with each other, to obtain the overall interest rate or required return on equity investment. When calculating return or interest rates, any additional *up-front money*, such as *closing costs*, must also be added to the investment; this amount increases or reduces the return, depending on who pays for it.

Residual values are a portion of the returns to be earned in an investment that is returned to the business when the investment is sold or the project is terminated. This can be most important in the liquidation of inventory and receivables when operations of a portion of a business are terminated or when *real estate ceases to be required* and thus can be sold, for example, when a factory is closed or when a lease term is complete. *Maturities of debt instruments*, such as bonds, loans, or *notes payable*, are the amounts of time outstanding before the debt becomes due.

International finance

International finance is concerned with the same methodology of allocating financial resources, but with modifications or areas of emphasis required by the restrictions of currency and capital movements among countries and the differences in the currencies used in different countries. The following paragraphs represent some of the major changes to the basic financial decisions:

1. Foreign capital budgeting requires the use of foreign cash flows and local tax rates, but U.S. inflation rates and U.S. dollars at the current exchange rates can be used.

The required return or cost of capital then *need only be adjusted*, as with any investment, for the greater or lesser risk of the project in which the investment is made, which includes the greater or lesser risk of the country in which the investment is being made.

2. Foreign capital markets are a source for both debt and equity funds, for both foreign subsidiary operations and the general needs of the overall business. Foreign subsidiary capital structures often utilize more local debt when legally and practically available in order to reduce the risk of blockages of earned funds from repatriation to the parent company in another country. In addition, local-currency debt reduces the risk for the parent company if the exchange rates for the local currency change adversely.

3. *Foreign-exchange rates* can change dramatically and therefore pose a significant risk for the *value of assets held* in or future payments from foreign countries. These *exposures* may be in dealings with third parties or within a company's own foreign subsidiaries. *Forward currency contracts* or *currency options*, instruments used to purchase one currency for another currency in the future at guaranteed exchange rates, can be used to protect against such risk. While these contracts are often also used to make profits by managers who believe the exchange rates *will change in a manner different from the expectations implicit* in the overall currency market, such use should be viewed as risky speculation.

4. Personal finance is concerned with the same methodology of allocating resources, but with a greater emphasis on allocating some of them to obtain the maximum consumption satisfaction at the lowest cost, as opposed to earning income and cash flow returns on the investments.

5. Budgeting and financial planning are the processes used by financial managers to forecast future financial results for a business, a person, or a particular investment.

Usually, the major components of earnings, cash flow, and capital are projected in the form of forecasted income statements, cash-flow statements, and balance sheets. The latter show where the capital funds are invested in the components of fixed and working capital, as well as the sources of these capital funds in terms of the debt, stock, and retained earnings.

Comprehension

I. Match the given words with Ukrainian equivalents.

1. financial value
2. capital budgeting
3. return
4. acquisition
5. earning
6. residual value
7. net working capital
8. interest-free payables
9. operating cash
10. stock dividend

a) капітальний бюджет
b) прибуток
c) фінансова вартість
d) відсоткові боргові зобов’язання
e) дохід від операцій
f) прибуток ; окупність
g) залишкова вартість
h) акціонерні дивіденди
i) власні оборотні кошти
j) придбання

II. Choose the verbs with the similar meaning.

1) to provide
2) to estimate
3) to compile
4) to exceed
5) to earn
6) to increase
7) to prevent
8) to allocate

a) to expand
b) to restrain
c) to distribute
d) to gain
e) to supply
f) to compose
g) to overtake
h) to evaluate

III. Complete the sentences with the words from the previous exercises.
Put them in the correct form.

Business Finance is the methodology of **1**. … financial resources, with a **2.** …, in an optimal manner to **3.** … the wealth of a business enterprise. There are three major decisions to be made in this allocation process: **4**. …, financing, and dividend policy. **5**.… is the decision regarding the choice of which investments are to be made with the resources that have been brought into the business or **6**. … and retained by the business. The choice depends on the **7**.… to be made from the investment **8**.…. the cost of capital. The method used to do this is the *discounted time-value of money* of the cash flow from the investment.

IV. Match terms with their definitions.

1) finance
2) acquisition
3) equities
4) exchange rate
5) manager
6) ownership

a) the legal state of owning something
b) a person employed to control and direct part or all of the wok of the employees in a business
c) the amount of one currency that can be bought with another
d) the ordinary shares of a company traded in stock market
e) funding for the business activity
f) one company taking over controlling interest in another company

V. Make up sentences putting the words in the correct order beginning from the first word.

1) **Financial,** processes, planning, managers, are, by, the, used, financial.
2) **The second,** equity, external, of finance, source, is.
3) **Acquisitions**, are, type, another, investment, of capital, for a business, budgeting.
4) **Equities**, are, the, shares, traded, ordinary, market, company, of, a, in, stock.

5) **Manager,** is, a, to, the, wok, control, of, the, employees, employed, person, in, a, business.

VI. Look at the picture and using the words from previous exercises describe it.

VII. Answer the questions:

1. What do we understand under the definition “finance”?
2. What is the essence of capital budgeting?
3. Is it possible to say that financing and capital budgeting have the same meaning?
4. What are the external sources of financing?
5. What is the goal of financial decision?
6. What is a dividend policy?
7. What are the tasks of management?
8. Are there any differences between management’s work in theory and in practice? What are they?
9. What is a capital?
10. What types of capital do you know?
11. What are the acquisitions?
12. How can the returns be expressed?

VIII. Arrange the paragraphs of the text according to the degree of significance.

Define the key idea of the text.

1. The goal of the financing decision is to obtain all the resources necessary, to make all the investments that yield a *return* in *excess of the cost* of the funds invested or the *required rate of return*, and to obtain these funds at the lowest average cost, so as to reduce the required rate of return and increase the net present value of the projects selected.

2. The second external source of finance is equity, which includes common stock and preferred stock. The equity investors in the business take more business risk and may not receive payment until the creditors are repaid and the management of the business decides to distribute funds back to the investors.

3. Financing is the decision of which resources or funds are to be brought into the business from external investors and creditors in order to be invested in profitable projects. The first external source of finance is debt, which includes loans from banks and bonds purchased by bondholders. The debt creditors take less risk of non repayment because the business must repay them if there are funds available to do so when the debt *becomes due.*

IX. Substitute the words by definition.

1. It is basically the methodology of allocating financial resources, with a *financial value*, in an optimal manner to maximize the wealth of a business enterprise.
2. It is the decision of which resources or funds are to be brought into the business from external investors and creditors in order to be invested in profitable projects.
3. It is the decision regarding funds to be distributed or returned to the equity investors.
4. It is the total of financial resources invested in the business.
5. It is the type of capital budgeting investment for a business.
6. It the cash flows that will ultimately be earned by the business or particular creditors and stockholders.

X. Draw up the thesis to the contents of the text «*What is the capital?*»

XI. Single out the main points of the texts. Use the following opening phrases:

1) The text looks at (the problem of…)

2) The text deals with the issue of..
3) It is clear from the text that…
4) Among other things the text raises the issue of…
5) The problem of…is of great importance
6) One of the main points to be singled out is
7) Great importance is also attached to…
8) In this connection, I'd like to say…
9) It further says that…
10) I find the question of…very important because…
11) We shouldn't forget that…
12) I think that…should be mentioned here as a very important…mechanism of…

XII. Make a summary or resume according to the contents of the texts.

TEST YOURSELF

1. …is basically the methodology of allocating financial resources, with a financial value, in an optimal manner to maximize the wealth of a business enterprise.
a) business finance
b) finance

2. …is the decision regarding the choice of which investments are to be made with the resources that have been brought into the business or earned and retained by the business.
a) budgeting
b) capital budgeting

3. …is the decision of which resources or funds are to be brought into the business from external investors and creditors in order to be invested in profitable projects.
a) financing
b) budgeting

4. …is the decision regarding funds to be distributed or returned to the equity investors.
a) capital policy

b) dividend policy

5. … is the total of financial resources invested in the business.

a) dividend
b) capital

6.…:,which are purchases of other businesses, are merely another type of capital budgeting investment for a business.

a) acquisitions
b) returns

7. The first external source of finance is…, which includes loans from banks and bonds purchased by bondholders.

a) debt
b) returns

8. The second external source of finance is …

a) equity
b) debt

9. The goal of the financing decision is…all the resources.

a) to obtain
b) to spend

10. … is a financial plan for the upcoming period.

a) finance
b) budget