SUNWAY TES
Centre for Accountancy Excellence

CHAPTER 1: FINANCIAL MANAGEMENT FUNCTION

LEARNING OUTCOME

A1a : The **nature** and **purpose** of financial management

A1b : **Explain** the relationship between financial management and financial and management accounting.

A2a : **Discuss** the relationship between financial objectives, corporate objectives and corporate strategy.

A2b **Identify** and **describe** a variety of financial objectives, including:
i) shareholder wealth maximisation
ii) profit maximisation
iii) earnings per share growth.

A3a **Identify** the range of stakeholders and their objectives.

A3b **Discuss** the possible conflict between stakeholder objectives.

A3c **Discuss** the role of management in meeting stakeholder objectives, including the application of agency theory.

A3d **Describe** and **apply** ways of measuring achievement of corporate objectives including:
i) ratio analysis, using appropriate ratios such as return on capital employed, return on equity, earnings per share and dividend per share
ii) changes in dividends and share prices as part of total shareholder return.

A3e **Explain** ways to encourage the achievement of stakeholder objectives, including:
i) managerial reward schemes such as share options and performance-related pay
ii) regulatory requirements such as corporate governance codes of best practice and stock exchange listing regulations.

A4a **Discuss** the impact of not-for-profit status on financial and other objectives.

A4b **Discuss** the nature and importance of Value for Money as an objective in not-for-profit organisations.

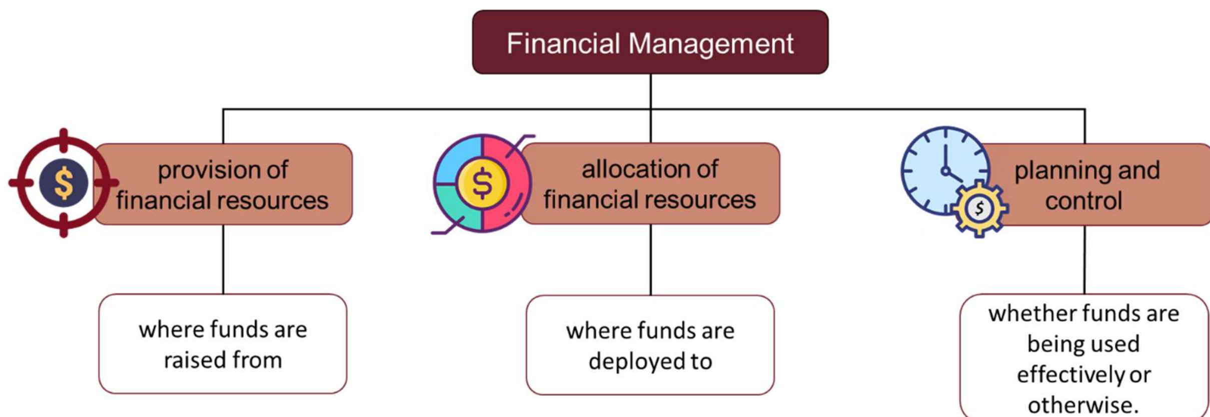
A4c **Discuss** ways of measuring the achievement of objectives in not-forprofit organisations.

1.1 Financial Management and Financial Objectives

Learning Outcome (ACCA Study Guide Area A)
A1a: The **nature** and **purpose** of financial management
A1b: **Explain** the relationship between financial management and financial and management accounting

1.1.1 Financial Management

Diagram 1.1.1: The nature and purpose of financial management



Financial management is the efficient and effective management of an organisation's financial resources to meet the objectives of that organisation. It incorporates the planning and control of the:

- provision of financial resources – where funds are raised from;
- allocation of financial resources – where funds are deployed to;
- control of financial resources – whether funds are being used effectively or otherwise.

Financial Management Decisions

INVESTMENT	• Long term – capital expenditure – which projects to undertake? • Short-term – working capital – how best to manage the company's working capital position?
FINANCING	• How best to finance projects? • How best to finance the company?
DIVIDEND	• How best to return the wealth created to the shareholders? • A reflection of investment and financing decisions • Should a company pay a dividend? • How much to pay?

- Underpinning these decisions is the ***management of risk***.
- These decisions are not made in isolation but are ***interconnected***.

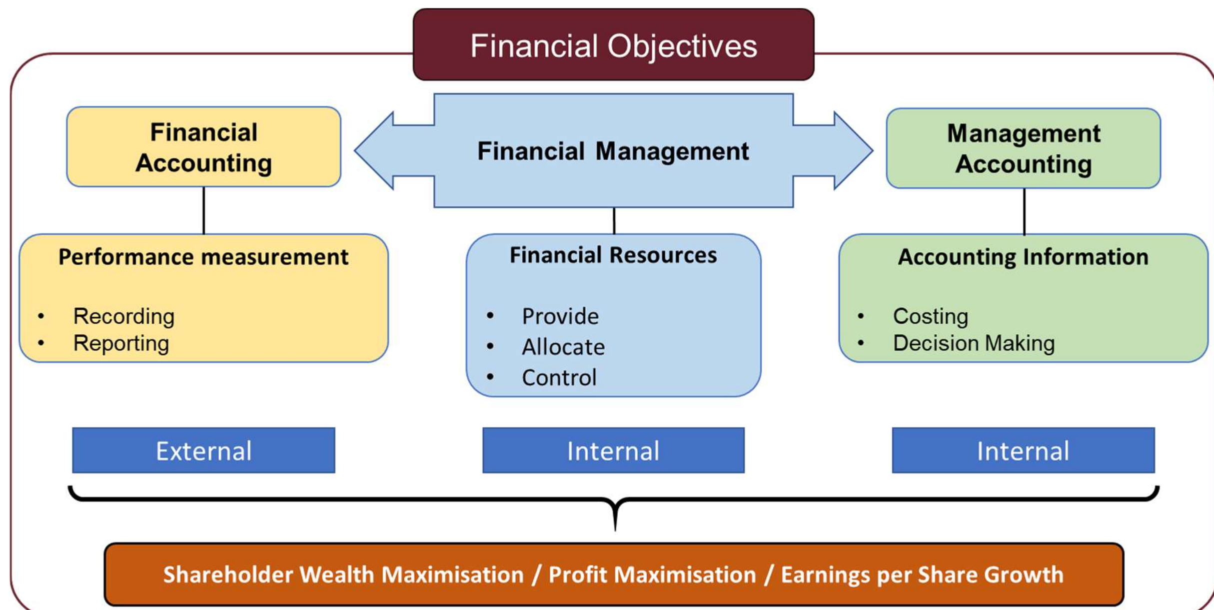
Example

- Decision to increase *dividends*
- Reduction in retained earnings
- Greater need for external *finance* to meet requirements for proposed capital *investment* projects

The *primary aim of financial management* is to optimise the allocation of scarce (financial) resources to maximise utility.

1.1.2 Relationship between Financial Management, Financial Accounting and Management Accounting

Diagram 1.1.2: **Explain** the relationship between financial management and financial and management accounting



- **Financial Management (FM)**

In contrast, financial management is inherently *forward-looking* with a focus on *cash flows* rather than profit. It requires the utilisation of tools and analysis for informed *financial decision-making* – both short- term and long-term decisions.

- **Financial Accounting (FA)**

Financial accounting addresses the principal-agent problem by measuring and monitoring the agent's past performance or results. They are *historic* in nature with a focus on *profit* but nonetheless reflect the outcome of business and financial decisions made by management to connected/**external** stakeholders.

- **Management Accounting (MA)**

Management accounting is concerned with the provision and use of managerial accounting information to provide management with a basis to make informed business decisions.

**Financial Objectives will be discussed further in the next topic.*

1.2 Financial Objectives and Relationship with Corporate Strategy

Learning Outcome (ACCA Study Guide Area A)

A2a: Discuss the relationship between financial objectives, corporate objectives and corporate strategy.

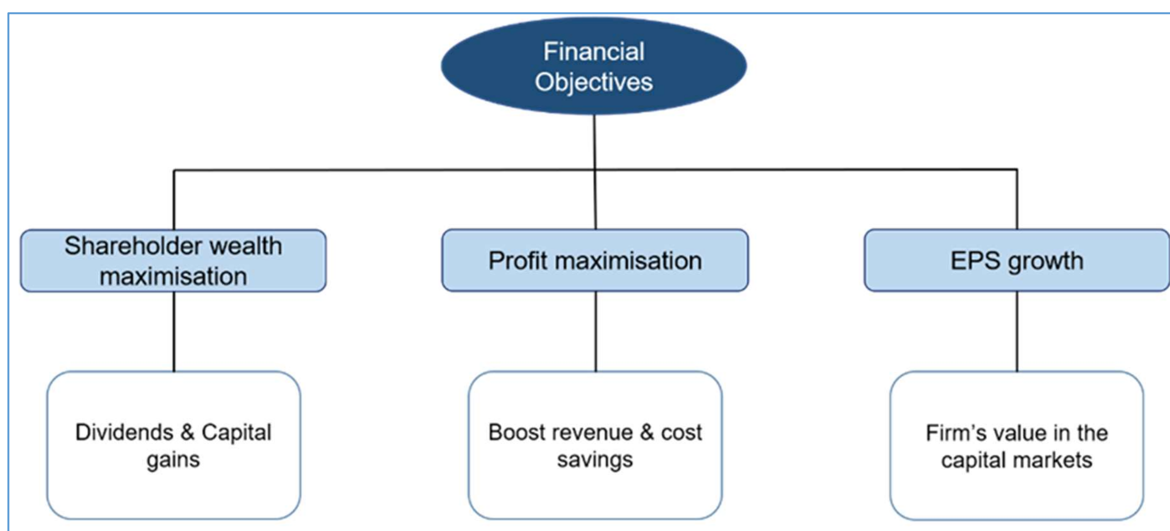
A2b: Identify and **describe** a variety of financial objectives, including:

I. shareholder wealth maximisation
II. profit maximisation
III. earnings per share growth.

1.2.1 Financial Objectives

Diagram 1.2.1: Identify and describe a variety of financial objectives, including:

I. shareholder wealth maximisation
II. profit maximisation
III. earnings per share growth.



The **primary financial objective** of financial management is the **maximisation of shareholder wealt**h.

The following are examples of a variety of financial objectives of an organisation:

- **Shareholder Wealth Maximisation**

  The primary financial objective of financial management is the *maximisation of shareholder wealth*. Since shareholders derive their wealth by way of *dividends and capital gains* (from increases in share value) in invested corporations, shareholders' wealth will be maximised by way of maximising the quantum of dividends and firm's value.

- **Profit Maximisation**

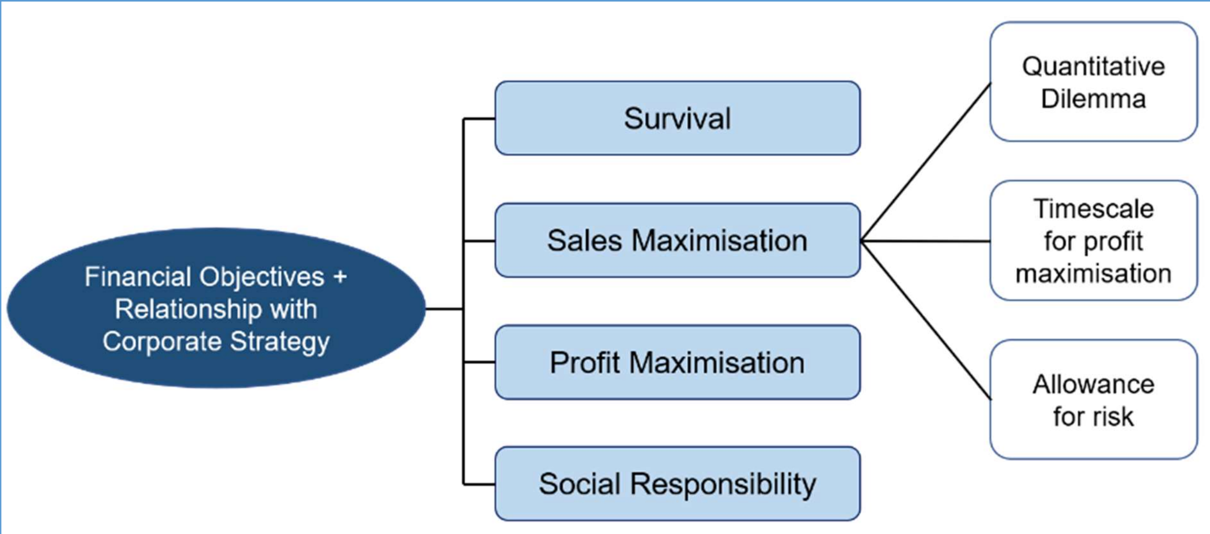
  The financial decisions undertaken by a company may eventually reflect in the financial accounting information. With the objective of profit maximisation in mind, marketing initiatives to boost revenue and cost savings projects (for example, replacement of old machinery) may be undertaken provided it is economically viable. In situations of divorce between shareholder and management, we hold the assumption of profit maximisation to serve shareholders' interests to be close to the truth.

- **Earnings per Share (EPS) Growth**

  The EPS figure while derived from accounting convention, *plays a very important role in the appraisal of a firm's value in the capital markets*. Historical EPS growth rates are at times extrapolated to give an indication of the company's future growth rate and have a direct positive correlation with the firm's value. This will in turn increase the perceived share value and ultimately result in shareholder wealth maximisation.

1.2.2 Financial Objectives and Relationship with Corporate Strategy

Diagram 1.2.2: <u>Discuss</u> the relationship between financial objectives, corporate objectives and corporate strategy.



Typical organisations are surrounded by different stakeholders with a multitude of stakeholders' objectives. As such, there may be alternatives and trade-offs to the objective of shareholder wealth maximisation to meet other corporate objectives as well.

Whilst organisations must consider the different views of other stakeholders, financial management advocates suggest that organisations may adopt one or several **alternate corporate objectives** only in support of the overriding long-term goal of maximising shareholder wealth.

Corporate objectives which may possibly conflict with financial objectives are as follows:

- **Survival**

Survival while it may guarantee job security of management and its employees, should not be accepted as a satisfactory long-term objective of a company. Companies should seek for capital projects providing sustainable long-term returns at least as great as those offered by comparable alternative investment opportunities.

Survival however may be a quintessential short-term objective especially in bad times or economic recession. If liquidation were a possibility, near-term survival would be consistent with shareholder wealth maximisation as shareholders stand last to recoup their investment in the orderly liquidation of a company. As such, corporate turnaround or debt restructuring may be the flavour of the day as compared to profit optimisation.

- **Sales Maximisation**

While an ambitious management may adopt an aggressive marketing stance to establish market share, such strategy may prove a strain to the company’s profit margin and short-term liquidity. This may result in a stage of overtrading where over-reliance on short-term creditors becomes imminent and failure to fulfil such short-term obligations may lead to liquidation.

- **Profit Maximisation**

Firms should operate in a manner that maximises its economic profits (Hayek; Friedman). The notion of economic profit is distinguished from the accounting profit figure in the profit and loss account. Economic profit broadly equates the increase in investors’ wealth from making the investment, considering all costs associated with the investment including the opportunity cost of capital.

Problems associated with profit maximisation:

i. ***Quantitative dilemma*** – profit cannot be accurately defined and measured (even with the presence of prescribed accounting standards) and such may not be meaningful and easily comparable.

ii. ***Timescale for profit maximisation*** – given that profits are commonly reported on an annual basis, there may be occurrence of short-term profit maximisation at the expense of long-term investment for profit sustainability, putting the long-term viability of the company at doubt.

iii. ***Allowance for risk*** – profit does not take account of risk assumed to generate that profit, and such management may be assuming excessive risks to boost profitability which does not commensurate with investors’ risk appetite.

A tenet of shareholder wealth, dividends, is paid with cash and not profit. Therefore, the timing and associated risk of sustaining dividend payment are important factors in determining shareholder wealth.

- **Social Responsibility**

  Social responsibility *should play a supporting role* within the framework of corporate objectives, and not the primary goal. A demotivated workforce is detrimental to the company's long-term prosperity. Upset local residents dissatisfied with a factory's environmental policies will cause adverse publicity, which in turn, affect sales. However, corporate social responsibility may be a costly affair with intangible or immeasurable benefits from a finance perspective.

1.3 Organisation Governance and Leadership Qualities

Learning Outcomes (ACCA Study Guide Area A)

A3a: Identify the range of stakeholders and their objectives.

A3b: Discuss the possible conflict between stakeholder objectives.

A3c: Discuss the role of management in meeting stakeholder objectives, including the application of the agency theory.

A3d: Describe and **apply** ways of measuring the achievement of corporate objectives, including:

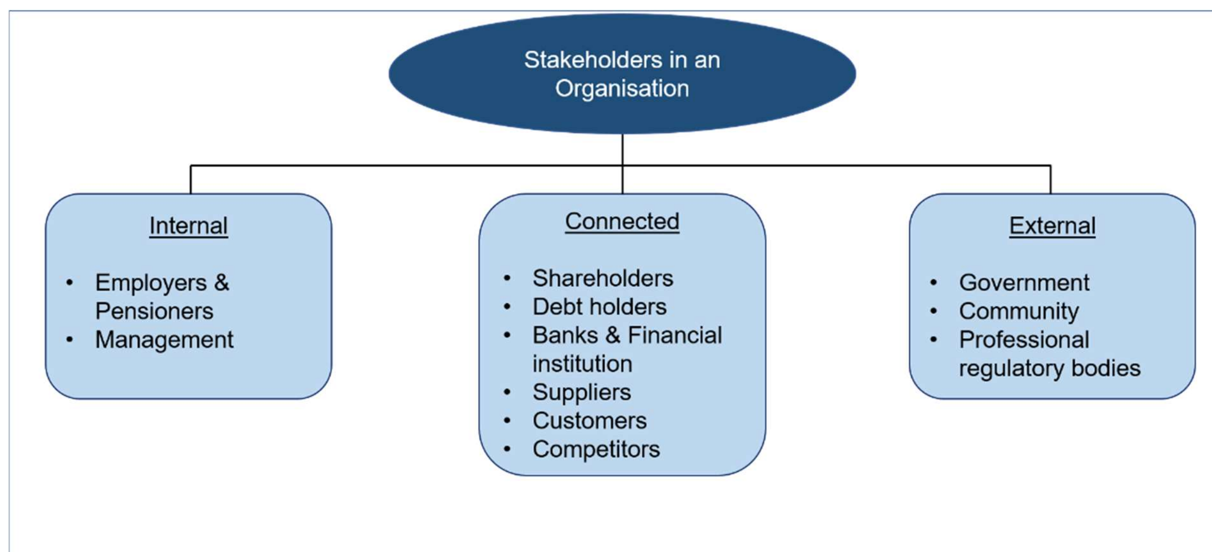
I. Ratio analysis, using appropriate ratios such as Return on Capital Employed, Return on Equity, Earnings per Share and Dividend per Share.
II. Changes in dividend and share prices as part of total shareholder return.

A3e: Explain ways to encourage the achievement of stakeholder objectives, including:

I. Managerial reward schemes such as share options and performance-related pay.
II. Regulatory requirements such as corporate governance, codes of best practice and stock exchange listing regulations.

1.3.1 Stakeholders in an Organisation

Diagram 1.3.1: **Identify** the range of stakeholders and their objectives



Stakeholders are groups or individuals whose interests are directly affected by the activities of a firm. They may be classified into the following:

Table 1.1: Stakeholder Groups and their Objectives

STAKEHOLDER GROUPS		OBJECTIVES
Internal	Employees and pensioners	• Maximise own rewards in the form of remuneration. • Job security or continuity of employment
	Management	• Maximise own rewards. • Recognition for outstanding achievement.
Connected	Shareholders	• Wealth maximisation in the form of dividend payments and capital gains.
	Debt holders	• Recover principal and interest payments as and when they fall due. • Minimise the risk of default and do not wish to lend more than is prudent. • Periodically assess credit rating in evaluating default risk.
	Banks and financial institution	• Same as debt holders
	Suppliers	• Receiving full payment for credit extended when they fall due. • Continuity of trading relationship.
	Customers	• Continuity of reliable source of supply.
	Competitors	• Capitalise on opportunities in increasing market share and economic profit.
External	Government	• Macroeconomic objectives for example, sustainable economic growth and low levels of unemployment. • Inland revenue in support of development and operating expenditure.
	Community at large	• Corporate social responsibility for example, minimising adverse environmental discharge, sustainable non-renewable natural resources extraction. • Job opportunities for the local community.
	Professional/regulatory bodies	• Ensure compliance and adherence to regulatory and professional standards.

1.3.2 Possible Conflicts with Stakeholders' Objectives

a. Management and Various Providers of Finance (shareholders and long-term creditors)

- Management would be keen to undertake their pet projects for which returns may be satisfactory but does not commensurate with the risk assumed. This could contradict with the core business for which shareholders knowingly invested in. In doing so, it may seek to finance it by taking up long-term and medium-term loans simultaneously leveraging up for their risky non-core investments.

- Providers of debt finance would in turn assess the company's ability to meet repayment obligations when they fall due, and proceed to lend should there be enough cash inflows to meet timely interest payments and eventually repay the loans.

- In servicing the additional debt burden, less cash inflows are available to distribute as dividends to shareholders. Some companies are known to take on higher debt financing to increase dividend pay-out to their shareholders. Simultaneously the additional gearing or leverage levels increases bankruptcy risk.

- If companies fail to meet their obligations when they fall due or observe the restrictive covenants imposed by the lenders, the latter will in turn exercise their rights to appoint a receiver. At this point, the administration of the company will shift to the receivers cum managers who serve in the interest of the debt financiers.

- A debt restructuring plan, if feasible, will seek a compromise between various stakeholders. Notably, some debt financiers will convert their debt into equity stakes should they believe in the feasibility of the business model and all parties are better off in a turnaround. Should such restructuring plan fails, the shareholders are the worse affected since they have residual interest in the orderly liquidation of a company.

b. Management, Shareholders and the Government

- Corporate taxes are a major constituent of various government revenue and corporations also serve as collectors of consumption taxes (for example, VAT or GST). Corporations are also a medium through which employment is created. As such, the government often has a strong indirect interest in the affairs of corporations.

- Government macroeconomic policies often have ramifications on business activity. For example, a government's exchange rate policy of having its currency strengthen may hurt the export competitiveness of exporting firms but make imports cheaper to domestic consumers.
- The loss in competitiveness may compel businesses to relocate their manufacturing facilities to other lower cost producing countries (for example, China and Vietnam in recent years) and in turn loss of jobs and tax revenue to the home country.

1.3.3 Measures to achieve Stakeholder Objectives

The achievements of stakeholder objectives are also made possible with regulatory requirements such as:

1. Corporate Governance Codes of Best Practice

Proper corporate governance contains the concentration of powers with executive management in traditional boardrooms. With the appointment of a Chairman or Independent Non-Executive Directors to serve as check and balance for management decisions may deter self-interest of executive management and promote decisions in the best interest of other stakeholders.

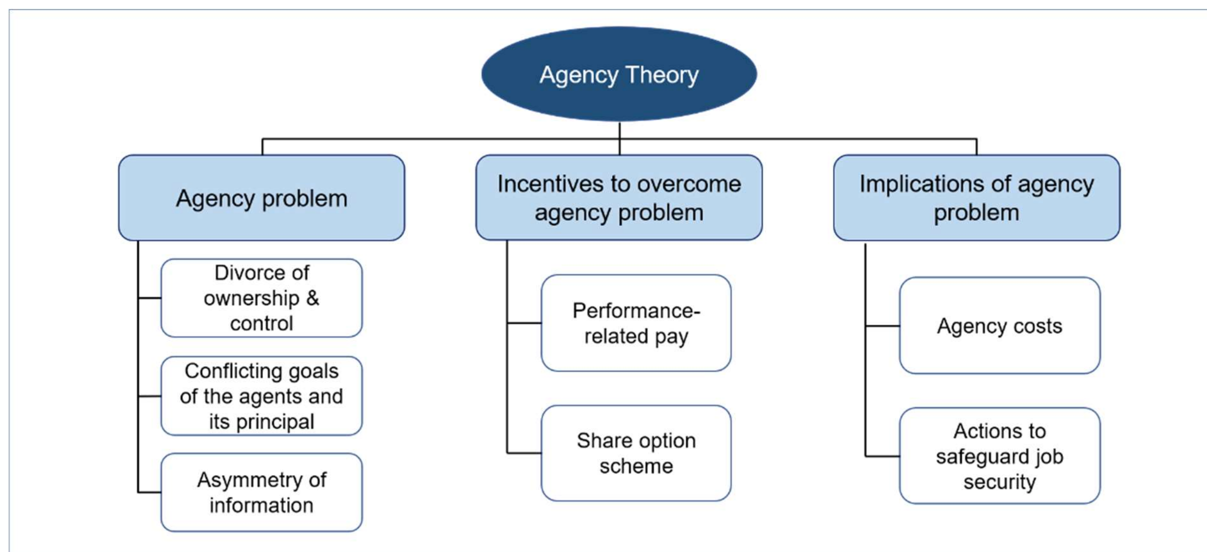
2. Stock Exchange Listing Regulations

The International Organization of Securities Commissions (IOSCO) prescribes the following objectives relating to securities regulation: the protection of investors; ensuring markets are fair, efficient and transparent; and the reduction of systemic risk. As such, Securities Commissions (SC) worldwide that adopt such objectives impose highly stringent regulations to meet the abovementioned objectives, including grave punishment for violations of regulations.

Such stringent regulations combined with constant enforcement serves as a reminder to company management and officers to serve their fiduciary duties in the best interests of investors.

1.3.4 The Agency Theory

*Diagram 1.3.4: **Discuss** the role of management in meeting stakeholder objectives, including the **application** of the agency theory*



Agency theory suggests the agency relationship between the management (the agents) who shall use delegated authority to act in the best interests of its shareholders (the principals). Thus, the management shall make decisions consistent with the objective of maximising shareholder wealth.

Agency Problem

Agency problem occurs when management makes decisions which are inconsistent with the shareholders' best interests. This is due to the following factors:

Divorce of Ownership and Control	Those who own the company (shareholders) appoint agents to manage the company on their behalf.
Conflicting Goals	Managers are leaned to maximising their own wealth first rather than the wealth of their shareholders.
Asymmetry of Information	Managers in the daily running of business have access to various management and financial information as opposed to shareholders who only receive annual reports, which may be subject to manipulation and biased presentation by the management.

Implications of Agency Problem

The combined factors above allow agents to act in their own best interests undetected by the owners of the company. Among the **implications of the agency problem** include:

- Emphasis on short-term performance measures to exploit managerial reward schemes.
- Undertaking low-risk projects whereas investor preference is for higher-risk projects, to avoid failure and safeguard job security.
- Preference for equity finance (which is relatively more expensive) than debt finance because lower interest obligations result in lower bankruptcy risk and greater job security
- The financial implications (or **agency cost**) include loss of wealth owing to sub-optimal behaviour by the agent, opportunity cost of rejected projects, cost of managers' excessive remuneration, audit fees and so forth.

Incentives to overcome Agency Problem

The agency problem is addressed by encouraging goal congruence between shareholders and managers. Two common incentives awarded to agents are performance-related pay and share option scheme:

- **Performance-related Pay**

  Encourages profit-maximisation behaviour by management including revenue enhancement and cost cutting measures.

  Drawbacks:

  - Performance measures themselves (profit, EPS and ROCE) are open to manipulation.
  - Accounting profits do not equate to cash or wealth creation and therefore contain no direct link to shareholder wealth maximisation.

- **Share Option Scheme**

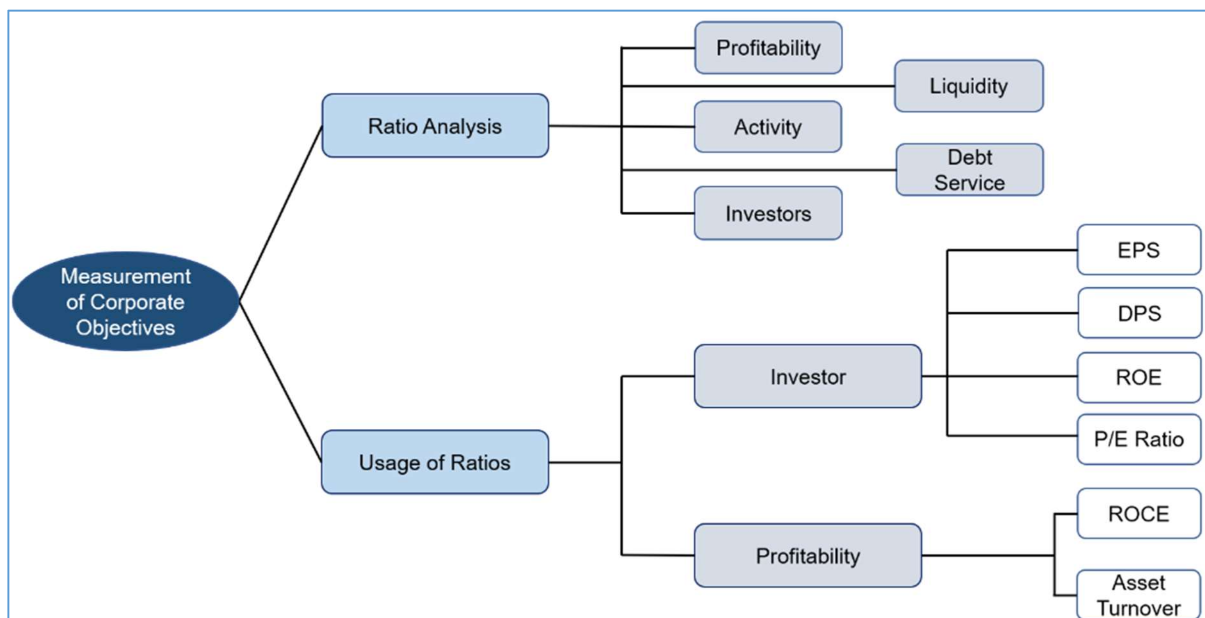
  Share options are granted to management giving them the right, but not the obligation, to purchase specified number of the company's shares at a pre-determined exercise price. The share options only become in-the-money when the market price of the company's shares exceeds that exercise price thus aligning management's objectives with that of shareholders – to maximise share price.

  Drawbacks:

  - Share price movements are also subject to other external factors beyond management control, for example, in the occasion of a bullish market, share price increases may not be entirely attributable to good financial management.
  - Share options are not seen as an apparent cost to the company and may be set at too generous a level without proper justification.

1.3.5 Measurement of Corporate Objectives

*Diagram 1.3.5 **Describe** and **apply** ways of measuring the achievement of corporate objectives*



Ratio Analysis

- Ratios quantify and compare relationships between financial variables and is commonly used in performance measurement. Financial ratios have little meaning when looked at in isolation, and therefore they must be compared against appropriate benchmarks, for example:
  - financial targets set pursuant to a company's strategic plan;
  - historical financial ratios from previous years (adjusted for inflation if required) to identify trends or changes;
  - financial ratios of competitors/companies engaged in a similar business;
  - financial ratios of industry/sector averages.

- Calculated performance measures or ratios and comparison against appropriate benchmarks are not an end to itself – there is still the intricate task of interpreting and explaining the differences found.

- Ratios are broadly categorised into the following categories:
  - **Profitability Ratios**: Gross and Net Profit Margin, Return on Capital Employed (ROCE), Asset Turnover, etc.
  - **Liquidity Ratios**: Current ratio, Quick ratio
  - **Activity Ratios**: Receivables days, Inventory days, Payables days, Sales/Working Capital, etc.
  - **Debt Service Ratios**: Interest Cover, Debt/Equity ratio, etc.
  - **Investor Ratios**: Return on Equity, Dividend Cover, Price/Earnings ratio, Dividend Yield, etc.

Use of Ratios

a. PROFITABILITY RATIOS

i. Return on Capital Employed (ROCE)

$$\textbf{ROCE} = \frac{\textbf{Profit before Interest and Tax}}{\textbf{Average capital employed (s/holders funds + preference shares + long-term debt)}}$$

- ROCE relates the overall profitability of a company to the amount of capital invested into the business. Where possible, average capital employed during the year shall be used (the average of the capital employed at the beginning and end of year).

ii. Asset Turnover

$$\textbf{Asset Turnover} = \frac{\textbf{Turnover}}{\textbf{Average capital employed}}$$

- This ratio is an indicator to productive efficiency – whether assets have been employed efficiently in generating sales.

b. INVESTOR RATIOS

i. Return on Equity (ROE)

$$\textbf{ROE} = \frac{\textbf{Profit after tax - preference dividends}}{\textbf{Shareholders funds}} \times 100\%$$

- While ROCE looks at the overall return to all providers of capital, ROE measures the earnings attributable to the ordinary shareholders. Shareholders' funds specifically exclude preference share capital. Where possible, average shareholders' funds shall be used (the average of shareholders' funds at the beginning and end of year).

ii. Earnings per Share (EPS)

$$\textbf{EPS} = \frac{\textbf{Profit after tax - preference dividends}}{\textbf{No. of ordinary shares outstanding during the year}}$$

- EPS is regarded as a key ratio by stock market investors. It is also employed in the calculation of P/E ratios, dividend cover and earnings retention rate. A historical uptrend that exceeds inflation rates signifies real earnings growth of the company in favour of investors.

iii. Dividend per Share

- Dividend per share (DPS) may be important for shareholders who require a steady income stream rather than capital growth. DPS is also employed in the calculation of the dividend pay-out ratio which can be used in the analysis of a company's dividend policy. Earnings retention rate are sometimes used to forecast future earnings/dividend growth rates.

Earnings retention rate = $\dfrac{\textbf{Earnings carried forward}}{\textbf{EPS}}$ **or (1 – Dividend pay-out ratio)**

Implied sustainable growth rate, g = **Earnings retention rate (RR) × ROE**

Accordingly, *g,* may be used as the implied growth rate for Gordon's dividend growth model.

iv. Price/Earnings (P/E) Ratio

P/E ratio =

Market price per share
[illegible]

- P/E ratio indicates how much an investor is willing to pay for a company's shares given its current EPS. A high P/E ratio in comparison with peers may indicate high investor confidence in the future performance of that company (common in growth stocks). Alternatively, it may also be attributed to a one-off expense in the profit and loss account rendering a low EPS.

1.4 Financial and Other Objectives in Not-for-Profit (NFP) Organisations

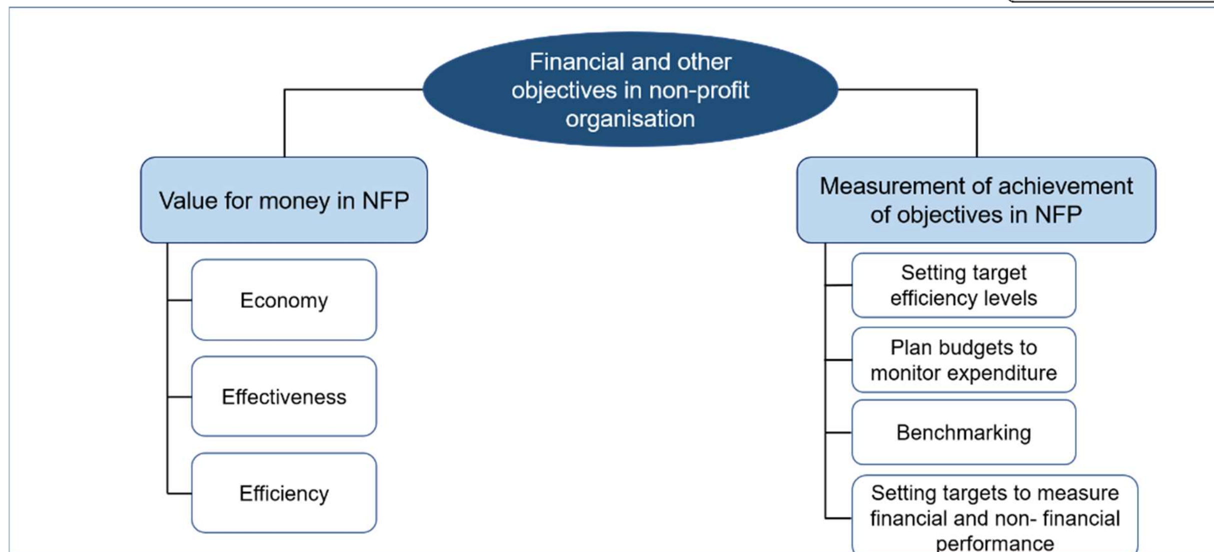
Learning Outcomes (ACCA Study Guide Area A)

A4a: **Discuss** the impact of not-for-profit status on financial and other objectives.

A4b: **Discuss** the nature and importance of Value for Money as an objective in not-for-profit organisations.

A4c: **Discuss** ways of measuring the achievement of objectives in not-for-profit organisations.

Diagram 1.4 Financial and Other Objectives in an NFP



1.4.1 Value for Money in Not-for-Profit (NFP) Organisations

NFP organisations include charities, government agencies and health care providers. Their primary objective is not making profits, but rather non-financial aims such as service to the community. Nevertheless, financial management is still required to operate within the limitation of financial resources at their disposal.

NFP organisations should seek Value for Money (VFM) in the use of funds, by considering the following three elements:

Economy	Operating in a frugal manner where unnecessary spending should be avoided.
Efficiency	Getting out as much as possible for what money is spent on.
Effectiveness	The achievement of targets and objectives by means of economy and efficiency, of what was supposed to be done.

1.4.2 Measurement of Achievement of Objectives in NFP

The measurement of the achievement of objectives is complex in NFP organisations owing to the manifold objectives and difficulty in deciding which is more important. Methods that can be employed to measure the achievement of such objectives are elaborated below:

- **Setting targets to measure financial and non-financial performance**

  For example, a charity may set a maximum target that administration costs shall not exceed 20% of total expenditure while 80% of total funding shall be deployed for a good cause.

- **Benchmarking**

  Comparisons are made with a similar public or private organisations to identify best practice and this may subsequently be the basis on which target is set.

- **Plan budgets to monitor expenditure**

  This reinforces the awareness of total funding and identified beneficiaries for the funds so as to ensure the objectives are met. Any differences in the outcome of the spending shall be investigated to identify improper allocation or wastage.

- **Setting target efficiency levels**

  For example, an objective for a heart centre may be that waiting time for operations shall be 14 days or less. In order to achieve this objective, optimal utilisation of resources is necessary and a minimum target of three operations per surgeon-day may be set to measure performance towards that objective.

Chapter Review

Model Question 1

Tick the following to show whether the following objectives are financial or non-financial objectives of a company.

	Financial	Non-financial
Growth in earnings		
Maximising market share		
Growth in sales revenue		
Achieving a target level of employee satisfaction		
Achieving a target level of accounting rate of return		

Model Question 2

Indicate whether the following statements are true or false.

Statement	True	False
Management accounting is related to providing information for the more day-to-day control functions and decision making.		
Financial management is inherently forward-looking with a focus on cash flow rather than profit		
Financial accounting is related with providing historical results of past plans and decisions		

Model Question 3

Stakeholders are groups or individuals whose interests are directly affected by the activities of a firm. There are three groups of stakeholders in an organisation.

***Requirement*:**

a. State the groups of stakeholders in an organisation

b. State 5 examples of connected stakeholders

c. State 2 objectives of management

d. State 2 possible conflicts of stakeholders' objectives

Model Question 4

Which of the following is the indicator of shareholder wealth? Tick in the column below

Ratios	
Price Earnings ratio	
Return on Capital Employed (ROCE)	
Return on Equity	
Current ratio	
Gearing ratio	

Model Question 5

Not-for-profit (NFP) organisations include charities, government agencies and health care providers. Their primary objective is not making profits, but rather non-financial aims such as service to the community.

Requirement:

a. List the 3Es in the Value for Money concept.

b. List 2 methods of measuring the achievement of the objectives in NFP.

Chapter Review - Answers:

Model Question 1

	Financial	Non-financial
Growth in earnings	/	
Maximising market share		/
Growth in sales revenue	/	
Achieving a target level of employee satisfaction		/
Achieving a target level of accounting rate of return	/	

Model Question 2

All three statements are TRUE.

Model Question 3

a. Internal; External; Connected
b. Shareholders; debt holders; bank & financial institution; suppliers; customers; competitors
c. Maximise own rewards; Recognition for outstanding achievement.
d. Managers and various finance providers; Managers, Shareholders and Government

Model Question 4

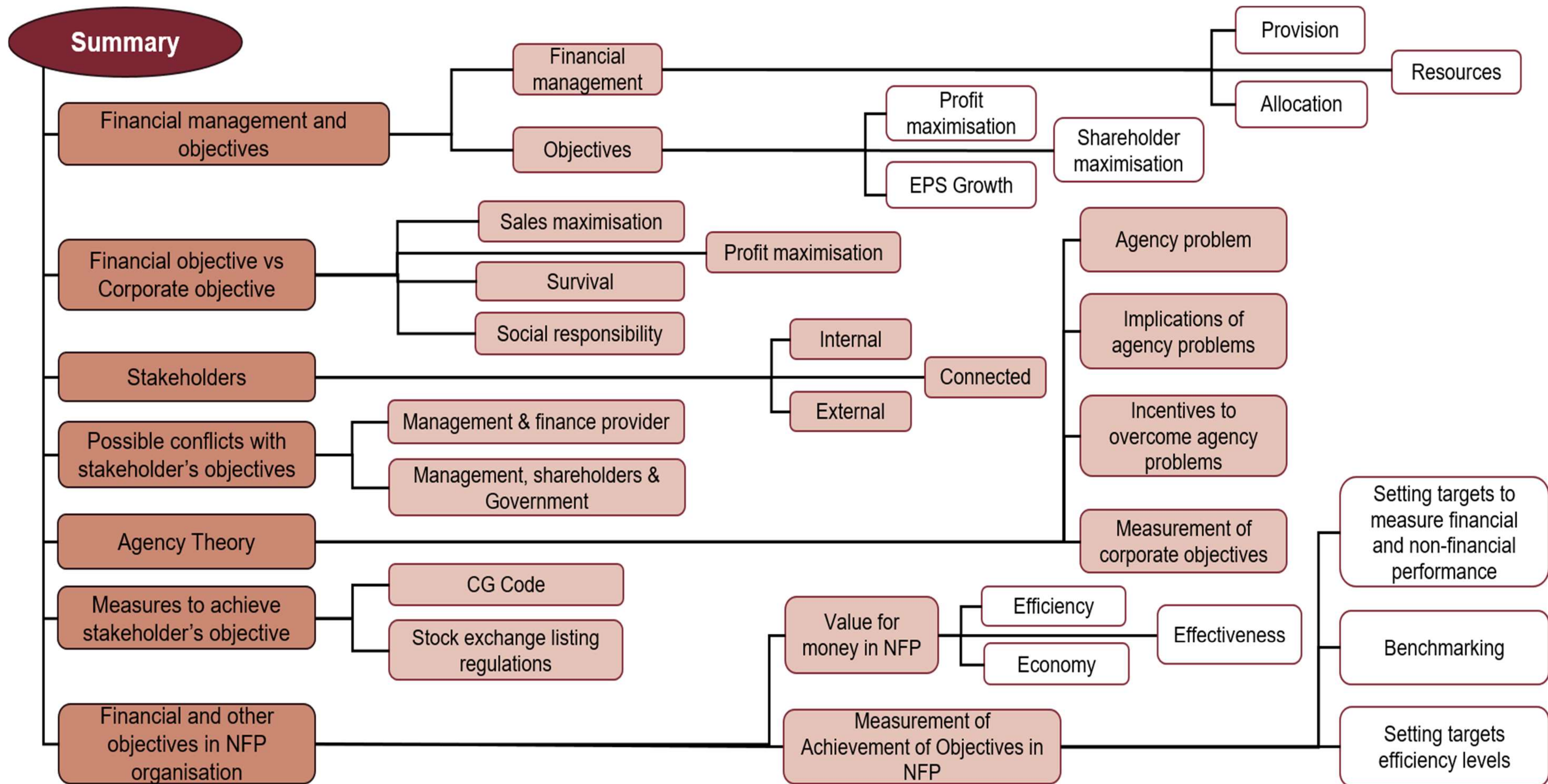
Ratios	
Price Earnings ratio	/
Return on Capital Employed (ROCE)	
Return on Equity	/
Current ratio	
Gearing ratio	

Model Question 5

a. Efficiency; Effectiveness; Economy

Setting target to measure financial & non-financial performance; benchmarking; Plans budget; Setting target efficiency levels

1.5 Chapter 1 Summary



Chapter End Assessment

1. Which of the following are the 3 key areas covered by financial management decisions?

i. Investment
ii. Cash flow
iii. Finance
iv. Dividend

A. i, iii, and iv
B. ii, iii and iv
C. i, ii and iii
D. I, ii and iv

2. The following information relates to Iza Co for the last financial year.

Revenue	$200 million
Asset turnover	10 times
Interest payable	$1.5m
Interest cover ratio	5 times

What is the return on capital employed for Iza Co for the year?

A. 37.5%
B. 3.75%
C. 7.5%
D. 15%

3. A government body uses measures based upon the 'three Es' to the measure value for money generated by a publicly funded train service. It considers the most important performance measure to be 'cost per passenger per train per journey'.

Which of the three Es best describes the above measure?

A. Economy
B. Effectiveness
C. Efficiency

D. Externality

4. A company has recently declared a dividend of 24c per share. The share price is $4.15 cum div and earnings for the most recent year were 80c per share.

What is the P/E ratio?

A. 0.17

B. 4.89

C. 5.19

D. 5.49

5. The following statements relate to various functions within a business.

i. The financial management function makes decisions relating to finance

ii. Financial accounts incorporate non-monetary measures

Are the statements true or false?

A. Statement (i) is true and statement (ii) is false

B. Both statements are true

C. Statement (i) is false and statement (ii) is true

D. Both statements are false

6. Stakeholders can be classified as internal, connected or external. **Which of the following is an external stakeholder?**

A. Shareholders

B. Competitors

C. Customers

D. Professional bodies

7. Which of the following is most appropriate as an objective of a not-for-profit organisation?

A. To minimise input costs

B. To make efficient use of resources

C. To maximise shareholder wealth

D. To maximise profit

8. How might the objectives of a retail company differ from those of a regional health authority?

9. Explain and compare the public sector objective of 'value for money' and the private sector objective 'maximisation of shareholder wealth'.

Chapter End Assessment (Answers)

Questions 1-7

Question	Answer
1	A
2	A
3	C
4	B
5	A
6	D
7	B

Question 8

Public limited companies, like retailers are likely to concentrate on financial objectives. These may include profit or sales maximisation as their primary objectives, although theory assumes that the primary objective for any company will be the maximisation of share price since this is the assumed requirement of owners, the shareholders.

Social and non-financial objectives are likely to have a higher priority for non-profit making organizations. Thus a health authority is much more likely to focus on non-financial objectives related to the level of service relating to health provision; examples would be numbers of patients seen, number of operations performed and the length of waiting lists. However, increasingly they, too must operate under financial constraints.

Question 9

Public Sector Organizations

- Public sector organizations are generally set up with a prime objective, which is not related to making profits.
- These organizations exist to pursue non-financial aims; such as provide a service to the community.
- However, there will be financial constraints, which limit what any such organization can do.
- A not-for-profit organization needs finance to pay for its operations, and the major financial constraint is the amount.
- Having obtained funds, a not-for-profit organization should seek to get value for money from use of funds:

- ❖ This is the meaning of 'value for money', often referred to as the pursuit of economy, efficiency and effectiveness.
- ❖ Economy refers to seeking the lowest level of input costs for a given level output. Not spending £1.
- ❖ Efficiency refers to getting the best use out of what money is spent on.
- ❖ Effectiveness refers to spending funds so as to achieve the organization's objectives.

Private Sector Organizations

- Have to compete for funds in the capital markets and must offer an adequate return to investors.
- The objective of shareholder wealth maximization equates to the view that the primary financial objective of companies is to reward their owners.
- If this objective is not followed, the directors may be replaced or a company may find it difficult to obtain funds in the market since investors will prefer companies that increase their wealth.
- However, shareholder wealth cannot be maximized if companies do not seek both economy ND efficiency in their business operations.