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Business Finance and the Capital Market

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THIRD EDITION

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Preface to the Third Edition

In revising this book for the third edition we have had to reconsider very carefully what ought to be the main aim and scope of the book. Ten years have elapsed since we first set to work on the original edition. Many changes in thought and practice have taken place in that time. In 1967 Britain was experiencing inflation rates of 4 or 5 per cent and interest rates of about 7 per cent, and these rates were thought to be high in comparison with experience during the 1950s and early 1960s.

Ten years ago it was still common to associate full employment with an increasing level of money supply and a moderate degree of inflation. Britain had not fallen behind her European competitors too drastically in terms of productivity and growth, and there had developed an unswerving faith in 'the cult of equity' (i.e. the certainty that prices of ordinary shares would keep pace with inflation) that had not been seriously undermined.

During the period 1973–6 Britain experienced inflation rates of up to 25 per cent, interest rates of 17–18 per cent, the biggest stock exchange crash since 1929, a falling exchange rate, and unemployment rising steadily up to the 1½ million mark. More recently the rate of inflation has been falling back to a more tolerable level, share prices have climbed back to their 1972–3 peaks, and business confidence has regained some ground under the stimuli of the increasing flow of North Sea oil, the temporary restraint of incomes policy, and falling interest rates.

In the theoretical area of business finance during this period the focus of attention has concentrated variously on capital budgeting, inflation accounting, the efficiency of financial institutions and the capital market, financial incentives for managers and workers, more efficient methods of

taxation, and aims, planning and methods of control within large companies, including multinationals.

The differing emphasis on aspects of the whole field of finance is reflected in the various titles of textbooks which have emerged during recent years, for example *Managerial Finance*, *Financial Management*, *Studies in Optimal Financing*, *Management of Company Finance*, *Company Finance in Europe* and our own *The Capital Market: its Nature and Significance*. The term 'business finance' is wide-ranging. It can embrace the financial problems of a particular firm — e.g. raising of funds, managing working capital, planning and budgeting, evaluation of projects, merging, investing funds, etc., and the finance of business as a whole, including the government's role in finance, institutional channelling of funds and the functions of the stock market. As an academic discipline it spills over into such study areas as accounting, economics, management and company law. One of the main problems, then, in drafting a textbook, or for that matter in planning a course of lectures on the subject, is to present this multifarious material in a logical and integrated form, and to give it a theoretical framework. There are several possible approaches, depending on the tastes and propensities of the author(s). We have not diverged radically from our previous format in this edition. We are still anxious to display the interconnection of entrepreneurs, capitalists, firms, institutions, industries, markets and the economy as a whole. However, we go to greater lengths in the opening chapter to link the individual firm with the capital market as a whole; and throughout the work, in addition to undertaking a thorough revision of material which had inevitably dated over the years since the publication of the second edition, we have put greater emphasis on the unifying theme of optimisation.

This work is concerned with the raising of funds, the use of funds in business, the flow of funds in the economy and the saving and channelling of funds by individuals and institutions. Funds are the blood-stream of business: they are scarce; they are a means of growth; and they must be put to the best possible use by all concerned with them. Whether we are discussing the raising of funds for new projects or a new business, the planning and controlling of funds and

their use, the allocation of profits, the channelling of funds from savers through the capital market, or the pressures stemming from the operations of the capital market on firms, their managers and shareholders, the principle of optimisation — i.e. choosing the most economically favourable course of action in a given situation — will be our guiding light.

In more detail, the changes in the third edition include: the introduction of the main financial problems which confront the individual firm; a discussion of the pressures on company management, both direct and indirect, exerted by capital-market operations; a consideration of the effect of gearing and other influences on the cost of capital; an up-to-date review of the different sources of capital with a new emphasis on incentives for small firms; a review of new export finance services; a consideration of developments in inflation accounting; an extension of capital project evaluation to cover lease or buy decisions and problems arising from inflation; an extended discussion of pension schemes; some further thoughts on expansion, mergers and multi-nationals; a revision of the material on business taxation; an outline of trends in savings and the flow of funds in the 1970s; reference to certain European financial developments; a summary of sources of information for investors; and, finally, a brief review of methods of evaluating shares, including a discussion of attempts to evaluate the efficiency of stock markets.

K. M.
R. G. B.

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Preface to the Second Edition

There have been a number of developments in the area of business finance during the three years since we completed our drafts for the first edition of this book. The British tax system, never a particularly stable element of the economy in post-war years, has been subjected to several far-reaching reforms, some of which will not be fully implemented until 1973. Other important recent events include further large industrial amalgamations, changes in methods of bank credit control, the decision to enter the E.E.C., and a generally more rigorous approach to the control of the industrial climate, as evidenced by the government's refusal to bail out Rolls-Royce Ltd, the Industrial Relations Act, and increased resistance to high wage claims.

Such events, and the need to bring statistics up to date wherever possible, have made it imperative that a substantial revision should be undertaken so as to maintain our original aim of presenting business finance as a dynamic economic activity in which we are all participators in one role or another.

Since the first edition was published we have written a complementary volume entitled *Case Studies in Business Finance and Financial Analysis*. This book enables readers to apply many of the principles mentioned in our textbook to actual or closely simulated business situations, and though the two volumes can be used separately, together they form a set providing the theoretical and applied groundwork for a year's course.

K. M.
R. G. B.

Preface to the First Edition

The scope and rationale of this book is discussed at some length in the Introduction. Business finance is no longer, if it ever was, an esoteric study, of interest only to a narrow sector of the public. We are all financiers in a small way. We borrow from building societies, banks and hire-purchase companies, and invest in houses, furniture and cars. We provide funds for business and government through a variety of channels. Financial matters more frequently than ever encroach on to the front pages of our newspapers: mergers, tax measures, Bank Rate changes, business failures, international loans — such news items readily capture the headlines nowadays. In spite of a growing public interest there are comparatively few books on business finance which cover the subject as a whole, and we hope that this book will assist practising businessmen to view the subject of finance in a wider perspective than that to which they may be accustomed, as well as provide a useful aid to students in their preparation for examinations.

The syllabuses which are substantially covered by the contents of this book are those in business finance for the final examinations of professional bodies, degree-level examinations, Higher National Diplomas and Certificates in Business Studies and Diplomas and Certificates in Management Studies. To assist the student in tracking down particular topics, there are included, in addition to the usual index, a detailed list of contents at the front of the book, and brief introductory summaries to chapters.

We give some indication of the help we have received from other writers in the footnotes and reading lists, and we thank the publishers and authors of works which have been quoted. Our thanks are also extended to colleagues who have read and criticised certain chapters, and not least to our wives,

whose privations during the long silent hours of preparation evoked some penetrating criticisms well beyond the subject of finance.

K. M.
R. G. B.