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MINISTRY OF HIGHER EDUCATION AND SCIENTIFIC RESEARCH

University Mohamed BOUDIAF of M'sila
Faculty of Economic Sciences, Commercial and Management Sciences
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وبناءا على تقارير الخبراء الايجابية للسادة الأساتذة:

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بوسالم بوبكر	المركز الجامعي البيض

تم اعتماد المطبوعة العائد(ة) للأستاذة: ذياب محمد

الموسوم(ة) بـ: English for Finence and Accounting

رئيس المجلس العلمي

أ.د: لقليطي الأخضر

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ENGLISH FOR

FINANCE AND ACCOUNTING

English courses for first-year master's students in finance and accounting

English for Finance and Accounting

Prepared by:

Dr. Mohamed Diab

Target Audience:

Master’s Degree Students specializing in Finance and Accounting

Brief Description

This handout is designed to provide students with practical and theoretical English language skills tailored specifically for the fields of finance and accounting. The content spans two semesters, covering 28 lessons that address essential concepts, terminologies, and practices within the financial and accounting sectors. Students will enhance their vocabulary, reading comprehension, and written and spoken communication skills in a professional context.

Targeted Community

This material is tailored for Master’s students specializing in Finance and Accounting. It aims to prepare them for global professional environments where English is the primary medium of communication in finance and accounting.

General Objectives

1. Equip students with specialized English vocabulary and concepts in finance and accounting.
2. Develop students’ ability to comprehend, analyze, and interpret financial documents in English.
3. Enhance students' proficiency in writing and presenting financial information in English.
4. Foster communication skills for interacting in professional financial and accounting settings.

General Objectives in Terms of Measurable Action Verbs

By the end of this course, students will be able to:

1. **Identify** and **define** essential financial and accounting terminologies.
2. **Interpret** and **analyze** financial statements and documents.
3. **Write** structured reports and presentations in English on financial topics.
4. **Compare** and **contrast** different banking systems, including Islamic and conventional.
5. **Apply** technical vocabulary to solve accounting problems and discuss financial strategies.

Contact Form and Course Information

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Course Location: Finance Department, University of Mohamed Boudiaf, M'sila

Prerequisites

Students should have a basic understanding of general English, equivalent to an intermediate level (B1/B2), and foundational knowledge of finance and accounting concepts.

Possible Prerequisite Test

A preliminary test may be conducted to assess students' current English proficiency and their familiarity with basic financial and accounting terminology.

Global Plan

Semester 1

1. Money and Associated Terminology
2. Key Concepts in Business Finance
3. Accounting, auditing and international accounting

4. Fundamentals of Bookkeeping
5. Fundamental Assumptions and Principles of Accounting
6. Understanding Depreciation and Amortization in Accounting
7. Auditing: Internal, external, and detecting irregularities
8. The Balance Sheet 1
9. The Balance Sheet 2
10. The Balance Sheet 3
11. Profit and Loss Account and Cash Flow
12. Key financial ratios
13. Profitability and leverage ratios
14. Cost accounting essentials

Semester 2

15. Pricing strategies in business
16. Overview on personal banking
17. Understanding banking
18. Overview of financial institutions
19. Investment banking
20. Central banks and commercial banks
21. Understanding interest rates and monetary policy
22. Money markets
23. Islamic banking
24. Money supply and control
25. Venture capital and startups
26. Stocks and Shares
27. The dynamics of trading stocks and shares
28. Shareholders or speculators?

Semester 1

Lesson 1: Money and associated terminology

A. Currency

The monetary unit used in a country—such as euros, dollars, or yen—is called its currency. Cash refers to physical currency in the form of banknotes and coins. Most money today exists as bank deposits, which are funds held by individuals and companies in bank accounts. Only about ten percent of money is available as physical cash.

B. Personal finance

1. **Income Types:**

- **Salary:** Fixed monthly payment from an employer.
- **Wages:** Payment for daily or hourly work, often received weekly.
- **Overtime:** Extra pay for working beyond regular hours.
- **Commission:** Earnings based on a percentage of sales.
- **Bonus:** Extra pay for achieving specific goals.
- **Fees:** Payments for professional services, such as legal or architectural work.
- **Social Security:** Financial aid from the government for unemployed or ill individuals.
- **Pension:** Payments made by a company or government after retirement.

2. **Deductions:**

   Employers may deduct amounts for social security and pension contributions before paying compensation.

C. Outgoings (Expenses)

Regular expenses include:

- **Living expenses:** Money spent on food, clothing, and public transportation.
- **Bills:** Payments for utilities like electricity, gas, and telecommunications.
- **Rent:** Monthly payment for using a house or apartment.
- **Mortgage:** Loan repayment for purchasing a home.
- **Health insurance:** Coverage for medical costs due to illness or accidents.
- **Tax:** Money paid to support government programs and services.
- **Budget:** A financial plan showing expected income and expenses.

D. Exercises

Exercise 1

Are the following statements true or false? Justify your answers using information from Sections A and B:

1. Bank deposits are not considered money.
2. Individuals receiving wages are paid more often than those earning a salary.
3. People working on commission always earn the same amount.
4. Retired individuals receive a pension.
5. Paying rent is the same as paying a mortgage.

Exercise 2

Put the correct word in each space.

account _ back _ banknotes _ borrowed _ change _ coin _ currency _ earn _ lent _ note _ salary _ spend _ sum _ wages _ waste _ win

1. In the USA, "quarters" (25 cents) and "dimes" (10 cents) are types of _______________.

2. In the United Kingdom, "a tenner" means a ten pound _______________.

3. The US dollar, the Yen and the Euro are types of _______________.

4. Hundred dollar bills and twenty pound notes are _______________.

5. 2,000,000 Swiss francs is a large _______________ of money.

6. I need to _______________ some Euros into Australian dollars.

7. My friend _______________ a hundred pounds from me.

8. I _______________ a hundred pounds to my friend. When she can, she'll pay me _______________

9. I buy a lottery ticket every week, but I never _______________ anything.

10. Most dentists _______________ at least £30,000 a year.

11. __________ are paid to employees weekly. _______________ are paid to employees monthly.

12. In business, you have to _______________ money to make money.

13. A: Do you have a bank _______________? B: Yes. I bank with the Bank of Scotland.

14. In my opinion, eating in expensive restaurants is a _______________ of money.

Exercise 3

Match the words on the left with the words on the right

1. a small	a. a profit
2. an income	b. amount of money
3. donate	c. cash
4. high	d. cost of living
5. make	e. credit card
6. pay by	f. losers
7. pay in	g. money to charity
8. winners and	h. of £25,000 a year

Exercise 4

Choose the correct word.

1. Spain now uses the euro. Pesetas are no longer ____________.

a. good money b. legal money c. legal tender

2. I bought a TV which doesn't work. I'll take it back to the shop to get ___________.

a. my money returned b. a refund c. a repayment

3. In a shop, to get a refund, you usually have to show the ___________.

a. receipt b. recipe c. payment ticket

4. I'm paying for my new car in 36 monthly __________.

a. instalments b. pieces c. parts

5. I earn a lot of money, but I have a lot of _________.

a. payouts b. expenses c. paying

6. Famous paintings are usually sold by __________.

a. bid b. highest price c. auction

7. In an auction, the item is sold to the person who makes the highest __________.

a. bid b. price c. offer

8. In Japan, the US dollar is __________ .

a. foreign money b. strange money c. a foreign currency

9. In Britain, it's not usual to discuss your personal __________

a. money b. finances c. money arrangements

10. You can __________ a house and ___________ a car.

a. hire / rent

b. hire / hire

c. rent / rent or hire

11. Here's the fifty dollars I ___________.

a. owe you

b. pay you back

c. must return

12. The best things in life are ___________.

a. free

b. not for sale

c.not bought and sold

Lesson 2: Key concepts in business finance

A. Capital

To establish or start a company, individuals need money, referred to as **capital**. Companies can obtain this capital by borrowing money in the form of a **loan** from banks. Loans must be repaid with **interest**, which is the cost of borrowing the money (the mainstream justification of interest rate).

Another source of capital is through issuing **shares** (BrE) or **stocks** (AmE), which are certificates representing ownership units in a company. Individuals who invest money in these shares are called **shareholders** (BrE) or **stockholders** (AmE), and they collectively own a portion of the company. The money they invest is referred to as **share capital**.

Companies can also raise funds by issuing **bonds**, which are loans made by **investors** (including individuals and financial institutions). Bonds pay interest and must be repaid on a specified future date.

Debt refers to money that a company owes and must repay to other parties. In accounting, debts are categorized as **liabilities**:

- **Long-term liabilities** include items like bonds.
- **Short-term liabilities** include debts owed to suppliers for goods or services purchased on credit, to be paid later.

The money available to a business for daily operations and expenses is known as **working capital** or **funds**.

Key Terms:

- BrE: *shares*, *shareholder*
- AmE: *stocks*, *stockholder*

B. Revenue

Revenue is the total money a company earns during a specific period. When the costs of goods sold and operating expenses (e.g., rent, salaries) are subtracted from revenue, the remaining amount is called **profit**, **earnings**, or **net income**.

A company may distribute a portion of its profits to shareholders as **dividends**. Additionally, companies pay a share of their profits as **taxes** to the government to support public spending. The portion of profits that a company retains (keeps) for future use is called **retained earnings**.

Key Terms:

- **Revenue**: Income from all sources.
- **Profit/Earnings**: Revenue minus costs and expenses.
- **Dividends**: Share of profits paid to shareholders.
- **Retained Earnings**: Profit saved for future use.

C. Financial statements

Companies communicate their financial health through **financial statements**:

1. **Balance Sheet**: This statement details the company's financial position, including:

- **Assets**: What the company owns.
- **Liabilities**: What the company owes.
- **Capital**: The funding the company has.

2. **Profit and Loss Account** (BrE) or **Income Statement** (AmE): This document shows the company's revenues and expenses over a specific period, such as a quarter or a year.

Key terms:

- BrE: *profit and loss account*
- AmE: *income statement*

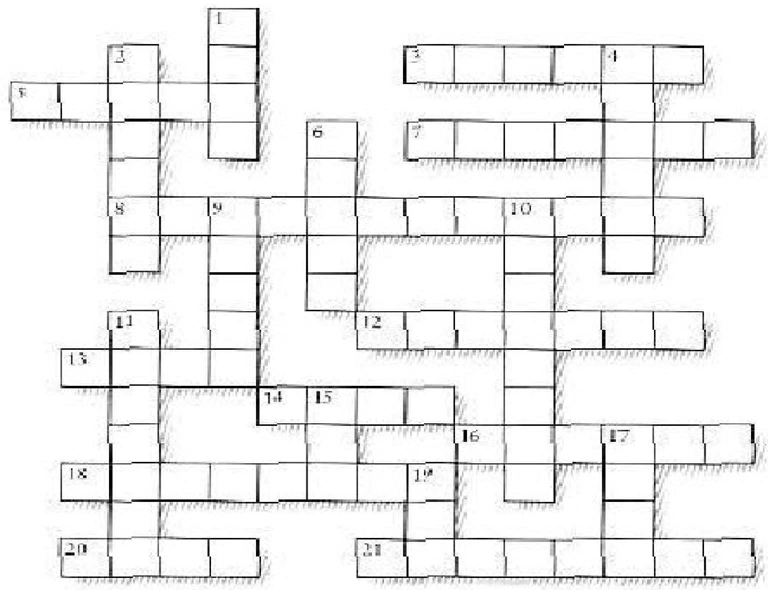
Summary of key concepts:

- **Sources of capital**: Share capital, loans, bonds.
- **Revenue and profit**: Revenue minus expenses equals profit.
- **Financial statements**: Balance sheet and profit/loss account.

D. Exercises

Exercise 1

Complete the crossword. Look at A, B and C opposite to help you.



Across

3 Small companies often try to get bank loans when they need to .... money. (6)

3 We don’t have sufficient _ to build a completely new factory. (5)

7 and 6 down Details of a company’s liabilities are shown on the ....(7,5)

8 We're going to raise more money by selling new shares to our existing .... (12)

12 We had to raise €50,000 .... in order to start the business. (7)

13 We're going to pay back some of the people who lent us money and reduce our..........(4)

14 I decided to buy a $10,000............ instead of shares, as it's probably safer. (4)

16 Another term for profit is net .... (6)

18 I think this is a good investment: it pays 8%...........(8)

20 When they saw our financial statements, the bank refused to........... us any more money. (4)

21 Profit is the difference between revenue and.... (8)

Down

1 The profit and .... account shows if a company is receiving more money than it’s spending. (4)

2 If you don’t like taking risks, you should only .... in very successful companies. (6}

4 A company’s retained earnings belong to its ....(6)

6 See 7 across.

9 Anything a company uses to produce goods or services is an....... (5)

10 The company made such a big profit, I expected a higher .... (8)

11 We sold a lot more last year, so our .... Went up. (7)

15 We... our suppliers $100,000 for goods bought on credit. (3)

{7 Everyone who buys a share ....part of the company. (4)

19 Thirty percent of our profits goes straight to the government in............. (3)

Exercise 2

Put the words into the spaces below.

black market _ hard currency _ pegged _ stability _ transactions _ convertible

A soft currency

The Kzarnian florint is not 1_______________ outside the Republic of Kzarnia. Until recently, the official exchange rate was KF20 to the US dollar, although the 2_______________ rate was at least double that. However, last month the government 3_______________ the currency to the dollar at a lower level, and the gap between the official and unofficial rates has narrowed. The official rate currently stands at around KF35. Despite the improved 4_______________ of the currency, most major 5_______________ within the country are still carried out in 6_______________. Tourists may never even see a Kzarnian florint, as all goods and services they are likely to require can be paid for in euros or US dollars.

Lesson 3: Accounting, auditing and international accounting

A. Accounting

1. **Definition and role**:
   Accounting is the process of recording, summarizing, and reporting an organization's transactions—such as purchases and sales—in the form of financial statements. Many countries have professional organizations governing the accounting profession. These bodies establish training, examinations, and ethical as well as technical standards that ensure consistent and accepted practices.
2. **Components of accounting**:
   - **Bookkeeping**: The daily recording of financial transactions.
   - **Financial accounting**: Encompasses bookkeeping and the preparation of financial statements for stakeholders like shareholders and creditors.
   - **Management accounting**: Utilizes accounting data to assist managers in planning and decision-making processes.

B. Auditing

1. **Purpose and scope**:
   Auditing involves examining a company's control systems and financial records to ensure accuracy and detect errors or fraudulent activities.
2. **Types of audits**:
   - **Internal audit**: Conducted by the company's accountants or internal auditors.
   - **External audit**: Performed by independent auditors who assess the truth and fairness of financial statements, striving to prevent "creative accounting"—a practice that manipulates financial data to present misleading results, often inflating profits artificially.
3. **Standards of reporting**:
   British companies, for example, must ensure that their accounts provide a "true and fair view" of their financial health. This principle requires financial statements to present an accurate and reasonable depiction of the company's condition.

C. Laws, rules, and standards

1. **Global frameworks**:
    - In continental European countries and Japan, accounting laws are established by governments.
    - In the US, publicly traded companies follow rules set by the Securities and Exchange Commission (SEC).
    - In Britain, standards are developed by independent organizations like the Accounting Standards Board (ASB) and the accountancy profession.
2. **Focus of financial statements**:
    - In **English-speaking countries**, where businesses are funded by shareholders, financial statements cater primarily to shareholders.
    - In **continental Europe**, where banks are the primary funders, financial statements are tailored to meet the requirements of creditors and tax authorities.

D. International accounting

International companies can choose how they present financial information to outside parties. The rules and regulations between countries vary significantly. Accountants worldwide are familiar with the words 'Generally Accepted Accounting Principles (GAAP)'. Some of the basic principles are:

- the going concern principle
- the prudence principle
- the matching principle
- the consistency principle.

The development of these principles has greatly differed between countries. For example, in most English-speaking countries it is often accepted practice to offset unrealized gains from unrealized losses, or to re-value long term assets upwards, provided sufficient proof of the current value can be shown. This means that accounts can have very different values, depending on whether the company chooses to follow local accounting standards, International Financial Reporting

Standards (IFRS) - formerly the International Accounting Standards (IAS)- or U.S. GAAP. Whether the company can choose is governed by the laws of the country where it is registered. For example, the U.S.A. and Japan currently allow publicly traded companies to prepare their financial statements using the standards of the International Accounting Standards Committee (IASC), but they must also include a reconciliation to domestic GAAP.

E. Exercises

Exercise 1

Here are some jobs and definitions. Fill in the gaps in the definitions with words from the box below.

specializing	studying	for inspecting its accounts	processing the records
giving administrative support		to inspect its accounts	

Trainee accountants

Accountants who are ________ 1 for professional examinations

Bookkeepers

Administrative staff responsible for _________ 2 of a business's financial activities Tax accountant

An accountant _________ 3 in a company's tax affairs

Back-office manager

Person in charge of the staff responsible for _________ 4 to the Finance department

Internal auditors

Employees of a company who are responsible _________ 5

External auditors

People employed by an outside firm of accountants and hired by a company _________ 6

Exercise 2

Now fill in the gaps with a suitable word from the box.

bad • absolutely • very • know • start • fill • fairly

1 You're _______ right.

2 Would you like to _______ by telling me a little about your experience? 3 I guess you that I studied economics in New York.

4 And then I'll _______ you in on our group.

5 Your C.V. is _______impressive.

6 But that's not a_______thing.

7 We're_______international here now.

Exercise 3

Use words from each box to make word partnerships. Then match them to the definitions below.

outside • accepted • English-speaking • local accounting • publicly-traded

company • practice • standards • parties • countries

1 A firm that sells its shares to anyone who wants to buy them.

2 For example, Australia, the U.K., and the U.S.A.

3 The way that most people do something.

4 The rules and regulations which state how accountants operate in a particular place.

5 People or groups who are not involved with the company.

Exercise 4

The article mentions four basic principles of accounting. Match them to the definitions below.

1 | |
|---|

This principle is concerned with the timing of the recognition of transactions in the accounts. Items are recorded when the income or expense arises, and are not dependent on the movement of cash.

2

When preparing accounts, one must assume that the enterprise will still be viable in the years to come. Practically all accounting items are affected by this assumption, such as the carrying value of fixed assets and inventories, and the ability to repay debts and other obligations.

3

What value should be given to the numbers in the accounts? It is normal to act pessimistically, so that profits and assets are not overstated, and expenses and liabilities realistically valued.

4

Accounts should be produced using the same principles from one year to the next. Deviations from this principle must be noted, and the effects on the accounts shown.

Lesson 4: Fundamentals of bookkeeping

A. Double-entry bookkeeping

Before we get immersed in the details associated with the accounting process, it is important to remember that such functions as journalizing, posting, and closing are bookkeeping functions. You must be familiar with the mundane details of bookkeeping and know how to analyze transactions in terms of debits and credits, but you should not expect to spend your entire accounting career doing bookkeeping. As an accountant, you will spend a great deal of your time involved in designing information systems, analyzing complex transactions, aggregating data for the financial statements, and interpreting accounting results. A knowledge of the fundamentals of bookkeeping provides a foundation upon which these activities are based. These activities are vital to the management of an organization. Bookkeepers handle the daily recording of transactions, such as sales, purchases, debts, and expenses. Each transaction is entered into a specific account—like the cash account or liabilities account.

Double-entry bookkeeping is a system that captures two aspects of every transaction. Each transaction is recorded as a **debit** (a deduction) in one account and a corresponding **credit** (an addition) in another. For example:

- If a company buys raw materials (used in manufacturing) on credit, it debits its purchases account and credits the supplier's account.
- When the company sells a product on credit, it credits the sales account and debits the customer's account. Simultaneously, the stock account is debited to reflect the reduction in inventory, while the debtors (or accounts receivable) account is credited to record the amount owed by customers.

In double-entry bookkeeping, debits are always recorded on the left and credits on the right. If done correctly, the total debits will always equal the total credits."

Key terminology:

- **BrE**: Debtors / **AmE**: Accounts Receivable
- **BrE**: Creditors / **AmE**: Accounts Payable
- **BrE**: Stock / **AmE**: Inventory

B. Day books and ledgers

For accounts with frequent transactions, such as purchases and sales, companies initially record the details in **day books** or **journals**. Later, they transfer summarized daily or weekly entries into the main double-entry records.

In the UK, the primary books of account are referred to as **nominal ledgers**. Specific ledgers include:

- The **bought ledger**, which records creditors—suppliers the company owes money for credit purchases.

Although modern systems are computerized, these traditional terms are still in use. In British accounting, "debtors" and "creditors" may refer to individuals or entities owing or owed money, as well as the monetary amounts in the accounts.

C. Balancing the books

Financial accounting rests on a foundation of basic assumptions, concepts, and principles that govern the recording, classifying, summarizing, and reporting of accounting data. Double-entry accounting is an old and universally accepted system for recording accounting data. With double-entry accounting, each transaction is recorded in a way that maintains the equality of the basic accounting equation:

Assets= Liabilities+ Owners' Equity

To review how double-entry accounting works, recall that a debit is an entry on the left side of an account and a credit is an entry on the right side.

You will note that assets, expenses, and dividends are increased by debits and decreased by credits. Liabilities, capital stock, retained earnings, and revenues are increased by credits and decreased by debits. Note that while dividends reduce retained earnings, they are not classified as an expense and are not reported on the income statement. Journal entries provide a systematic method for summarizing a business event's effect on the accounting equation. Every journal entry involves a three-step process:

- Identify the accounts involved with an event or transaction.

- Determine whether each account increased or decreased (this will tell you if the account was debited or credited).
- Determine the amount by which each account was affected.

This three-step process, properly applied, will always result in a correct journal entry

To summarize, you should remember the following important features of double-entry accounting:

- Assets are increased by debits and decreased by credits.
- Liability and owners' equity accounts are increased by credits and decreased by debits.
- Owners' equity for a corporation includes capital stock accounts and the retained earnings account.
- Revenues, expenses, and dividends relate to owners' equity through the retained earnings account.
- Expenses and dividends are increased by debits and decreased by credits because they reduce owners' equity.
- Revenues are increased by credits and decreased by debits.
- The difference between total revenues and total expenses for a period is net income (loss), which increases (decreases) owners' equity through the retained earnings account.

With this brief overview of the accounting equation and journal entries, we are now ready to proceed through the steps in the accounting process.

At the close of an accounting period, such as the fiscal year, bookkeepers prepare a **trial balance**. This document consolidates the debit and credit balances of all accounts onto a single page. As always, the total debits must match the total credits.

The trial balance forms the foundation for accountants to create the organization's financial statements, ensuring accuracy and completeness in reporting.

D. Exercises

Exercise 1

Match the words in the box with the definitions below. Look at A and B opposite to help you.

credit – ledger- debit- creditors- stock- debtors

1- an amount entered on the left-hand side of an account, recording money paid out.
2- a book of accounts.
3- customers who awe money for goods or services not yet paid for.
4- an amount entered on the right-hand side of an account, recording a payment received.
5- goods stored ready for sale.
6- suppliers who are owed money for purchases not yet paid for.

Exercise 2

Use liability, liabilities, debt, or debts to complete the sentences below.

1 He'll have paid his ______ off by next year.

2 Look at the assets and ______ on the balance sheet if you want to know how the company's doing.

3 Many developing countries are burdened by heavy _____ _

4 We need to look at the long-term ______ before we think about any major new purchases.

5 The partnership has limited _____ _ status.

6 Current _____ are those which are paid off within a year.

7 The company's in _____ to the tune of 10 million.

Exercise 3

Complete the sentences using "debit'' or "credit".

1 If you buy new assets, you ______ the cash or capital account.

2 If you pay some bills you ______ the liabilities account.

3 If you buy materials from a supplier on 60 days' credit, you ______ the purchases account and ______ the supplier's account.

4 If you sell something to a customer who will pay 30-day latter, you ______ the sales account and ______ the customer's account.

Lesson 5: Fundamental assumptions and principles of accounting

A. Assumptions

When preparing accounts and financial statements, accountants adhere to several fundamental assumptions, principles, and conventions. An assumption is generally regarded as an accepted truth. Below are the key accounting assumptions:

1. **Separate entity assumption**
    - This principle states that a business is considered an independent accounting entity, separate from its owners, creditors, and managers, as well as their personal assets. Regardless of changes in ownership or management, the business remains distinct and continues operating as an independent unit.
2. **Time-period assumption**
    - According to this assumption, the economic life of a business can be divided into distinct (and often artificial) time periods, such as financial years or quarterly intervals, to facilitate reporting and analysis.
3. **Continuity (going concern) assumption**
    - This assumption presumes that a business will continue to operate into the foreseeable future. Consequently, the current market value of its assets is deemed less significant than their long-term utility or function within the business.
4. **Unit-of-measure assumption**
    - All financial transactions must be recorded in a single monetary unit or currency. For businesses with subsidiaries operating in multiple countries, their financial results must be consolidated into one currency in the group's financial statements.

B. Principles

The following principles underpin the preparation of financial statements, alongside the consistency principle and the historical cost principle:

1. **Full-disclosure principle**
    - Financial reports must include all significant information that could impact users' decisions. Any detail that may affect the interpretation or reliability of the financial statements should be disclosed.
2. **Materiality principle**
    - Minor or insignificant amounts do not need to be explicitly reported if they are unlikely to influence the decisions of users.
3. **Conservatism principle**
    - When multiple accounting methods are available, the method least likely to overstate assets or income should be selected. This ensures a cautious and prudent approach to financial reporting.
4. **Objectivity principle**
    - Accounting records and financial statements must be based on factual evidence rather than subjective opinions or feelings. For example, they should be verifiable through audits. However, certain aspects, such as depreciation, amortization, or

provisions for bad debts, are inherently subjective and rely on professional judgment.

5. **Revenue recognition principle**
   - Revenue is recognized in the accounting period when it is earned, regardless of when payment is received. This means income is recorded when goods are delivered or services are provided.
6. **Matching principle**
   - Closely related to the revenue recognition principle, this principle dictates that expenses related to generating revenue must be recorded in the same accounting period as the revenue itself. This ensures accurate matching of costs with the income they help produce.

C. Exercises

Exercise 1

Complete the sentences below with the correct term from the text:

1. The __________ assumption treats a business as a separate accounting unit, independent of its owners, creditors, and managers.
2. The __________ principle ensures that financial reports include all significant information that could affect decision-making.
3. The __________ assumption states that a business will continue to operate into the future, making the current market value of assets less important.
4. According to the __________ principle, revenue is recorded in the accounting period when goods are delivered or services are provided, not when payment is received.
5. The __________ principle ensures that expenses are recorded in the same period as the revenue they help to generate.

Exercise 2

Mark the following statements as **True** or **False** based on the text:

1. The materiality principle requires that all amounts, no matter how small, must be shown in financial statements. __________
2. The unit-of-measure assumption allows businesses to record financial transactions in multiple currencies without conversion. __________
3. The principle of conservatism suggests choosing the accounting method that overstates assets and income. __________

4. The time-period assumption divides the economic life of a business into specific reporting intervals, such as a financial year. _________
5. The objectivity principle ensures that financial statements are free from personal opinions and are based solely on verifiable facts. __________

Exercise 3

Match the accounting assumptions and principles (1-6) to the activities they prevent (a-f).

1- conservatism principle
2- matching principle
3- separate entity assumption
4- revenue recognition principle
5- time-period assumption
6- unit-of-measure assumption

a- showing a profit divided into US dollars, euros, Swiss francs, etc.
b- publishing financial statements for a 15-month period, because this will show better profits
c- waiting until customers pay before recording revenue
d- waiting until customers pay before recording expenses
e- listing the owners' personal assets in a company's financial statements
f- valuing assets and estimating future revenue at the highest possible figures

Lesson 6: Understanding depreciation and amortization in accounting

A. Fixed assets

A company's assets are typically classified into two categories: **current assets**, such as cash and inventory, which are expected to be utilized or converted into cash within a year; and **fixed assets**, such as buildings and equipment, which are used over a long period.

However, fixed assets tend to deteriorate over time due to wear and tear, becoming obsolete or outdated, and eventually losing their value. To account for this, fixed assets undergo **depreciation**, which reduces their value on the balance sheet annually through a charge against profits in the profit and loss account. This process spreads the cost of the asset over its useful life, ensuring that the expense is matched with the revenue it helps generate, adhering to the **matching principle**.

In British English, these are referred to as "fixed assets," while in American English, they are known as "property, plant, and equipment."

B. Valuation

Fixed assets such as buildings, machinery, and vehicles are grouped under this category. Land, however, is an exception as it generally appreciates in value and is therefore not depreciated. British companies occasionally revalue fixed assets like land and buildings to reflect their current replacement cost (the cost of purchasing new ones) or their **net realizable value (NRV)**—the amount for which they could be sold. This practice is prohibited in the United States, where historical cost accounting is predominant.

In countries using **historical cost accounting**, only the original purchase price of assets is recorded, rather than their current market value. This approach aligns with the **conservatism** and **objectivity principles**, as market value is deemed irrelevant for a **going concern** (a business expected to continue operating).

C. Depreciation systems

The most commonly used depreciation method for fixed assets is the **straight-line method**, which allocates an equal annual expense over the asset's lifetime (e.g., deducting 10% of the asset's cost annually for ten years).

In contrast, some countries, particularly in continental Europe, permit **accelerated depreciation**, allowing businesses to deduct the entire cost of an asset over a shorter period. This approach serves as an **incentive for investment** by reducing taxable profits and encouraging the acquisition of new assets. For instance, a company that deducts the full cost of an asset in one year lowers its tax liability significantly. However, this method can result in newly acquired assets, including large buildings, being listed at zero value on balance sheets, which in Britain would not be considered a true and fair representation of the company's financial position.

D. Exercises

Exercise 1

Circle the odd one out in each of the following.

- Fixed assets could include

a) buildings b) plant and machinery
c) the firm's delivery vans d) fuel for the vans

- Depreciation due to physical deterioration of an asset may include

a) wear and tear b) theft c) erosion d) rot

- Machinery becomes obsolete due to

a) new technology b) consumption
c) changes in production methods d) changes in fashion

- Amortization is the provision for consumption of the following items

a) mortgages b) leases c) patents d) copyright

- A provision for depletion would be used for the following items

a) mines b) buildings c) quarries d) oil wells

- The following are methods of depreciation

a) straight-line b) reducing balance

c) the sum of the year's digits d) market value

- A machine could be disposed of by being

a) scrapped b) resold c) revalued d) traded in

- The accounts which would record the sale or disposal of a machine are

a) machinery account b) sales account c) machinery disposals account

d) provision for depreciation (machinery) account

Exercise 2

- Match the words in the box with the definitions below. Look at A and B opposite to help you.

appreciate	current assets	fixed assets
obsolete	revalue	wear out

1 to record something at a different price

2 assets that will no longer be in the company in 12 months' time

3 to increase rather than decrease in value

4 out of date, needing to be replaced by something newer

5 assets that will remain in the company for several years

6 to become used and damaged

- Match the nouns in the box with the verbs below to make word combinations.

costs	fixed assets	market value
profits	value	purchase price

deduct ……………

record …………
…………

depreciate ……………

reduce ……………
…………

Lesson 7: Auditing: Internal, external, and detecting irregularities

A. Internal auditing

After bookkeepers finalize accounts and accountants prepare financial statements, these documents undergo scrutiny by internal auditors. Internal auditing involves a thorough examination of a company's financial records conducted by its own auditors or controllers. These auditors ensure the accuracy of the accounts and identify any errors. They verify that the accounts adhere to established policies, procedures, standards, laws, and regulations.

Internal auditors also assess the adequacy of the company's control systems related to recording transactions, valuing assets, and similar processes. Where necessary, they recommend improvements to existing policies and procedures to enhance compliance and operational efficiency.

B. External auditing

Public companies are required to submit their financial statements for external auditing, which is conducted by independent auditors unaffiliated with the company. External auditors evaluate whether the financial statements provide a true and fair representation of the company's financial position and performance.

During the audit, external auditors review the company's internal control systems to ensure transactions are recorded correctly. They verify the existence and valuation of assets listed on the balance sheet, confirming, for instance, that debtors are genuine. They also examine the annual stock take (or inventory count) and investigate any unusual entries in the financial records.

Historically, many auditing firms provided consulting services alongside auditing. However, following major financial scandals, most firms separated these services to maintain auditor independence. Auditors offering consulting advice to the same clients posed a conflict of interest, undermining their impartiality.

C. Detecting irregularities

Auditing serves as a mechanism to evaluate organizations' financial systems, processes, projects, and services. It helps uncover illicit practices such as false certifications, cost misallocations, duplicate invoicing, and other corrupt activities or system weaknesses. However, the auditing process itself is not immune to corruption.

Individuals involved in unethical practices or underperformers may attempt to manipulate audit outcomes for personal gain. This can include collusion between auditors and supervisors, accountants, or board members, or selecting auditors known to overlook irregularities in exchange for favors. Other tactics include withholding crucial information or restricting the auditor's scope of work.

Certain forms of misconduct, such as ghost workers or procurement corruption, often require targeted forensic audits to uncover. These specialized audits delve deeper into specific areas, making them essential for detecting sophisticated irregularities.

D. Example of an extract from an independent auditors' report in the U.S.A.

To Share Owners and Board of Directors of Megatrap Corp

We have audited the accompanying statement of financial position of Megatrap Corp and consolidated affiliates as of December 31, 2024 and 2025, and the statements of earnings, changes in share owners' equity and cash flows for each of the years in the three-year period ended December 31, 2024. These consolidated financial statements are the responsibility of the company's management. We have to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Under these standards we have to plan and perform the audit to obtain reasonable assurance that the financial statements do not have any material misstatement. We examined on a test basis the evidence supporting the figures and disclosures in the financial statements. We also assessed the accounting principles used and significant estimates made by management, and we evaluated the presentation of the statements.

In our opinion, the aforementioned financial statements present fairly in all material respects, the financial position of Megatrap Corp and consolidated affiliates at December 31, 2024 and 2025, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2024, in conformity with accounting principles generally accepted in the United States of America.

E. Exercises

Exercise 1

Match the job titles (1-4) with the descriptions (a-d). Look at A and B to help you.

1- bookkeeper
2- accountants
3- internal auditors
4- external auditors

a- company employees who check the financial statements
b- expert accountants working for independent firms who review companies’ financial statements and accounting records
c- people who prepare financial statements
d- people who prepare a company’s day-to-day accounts

Exercise 2

March the nouns in the box with the verbs bdow to make word combinations. Some words can be used twice.

Accounts	procedures	opinions		system of control
regulations	policies	stock take	advise	laws

check ……………….
………………
……..………

examine ……………………
…………………...

comply with …………………
…………………
…………………..
…………………

give …………………..
.…………………

Exercise 3

Fill in the missing prepositional phrases in the following sentences. Choose from the box.

agree with	blame for	caused by	difference between	in line with
insist on	reason for	refer to	responsible for	suspicious of

- The auditor discovered that there was a _______ the cash book and the bank balance.
- If the entries in the accounts are not clear, he can _______ the original invoices.
- You must _______ an official signature on all large orders.
- The auditor must check that the records are _______ the company requirements.
- The auditor must ask the _______ any large discounts or allowances.
- The auditor is _______ checking the reason for any changes in the accounts.
- The authorities will _______ the auditor _______ any mistakes in the accounts.
- The auditor must check that the purchase invoices _______ the entries in the Purchases Journal.
- The auditor should be _______ any short-cut methods of correcting errors.
- Mistakes may be _______ the wrong steps used in the original accounting process.

Lesson 8: The balance sheet 1

A. Assets, liabilities and capital

Balance Sheet, 31 December 20_ _ ($’000)

Current assets	3,500	Liabilities	6,000
Fixed assets	6,500	Shareholders’ equity	4,000
Total assets	10,000	Total liabilities and Shareholders’ equity	10,000

Company law in Britain, and the Securities and Exchange Commission in the US, require companies to publish annual balance sheets: statements for shareholders and creditors. The balance sheet is a document which has two halves. The totals of both halves are always the same, so they balance. One half shows a business's assets, which are things
owned by the company, such as factories and machines, that will bring future benefits. The other half shows the company’s liabilities, and its capital or shareholders’ equity (see below). Liabilities are obligations to pay other organizations or people: money that the company owes, or will owe at a future date. These often include loans, taxes that will soon have to be paid, future pension payments to employees, and bills from suppliers: companies which provide raw materials or parts. If the suppliers have given the buyer a period of time before they have to pay for the goods, this is known as granting credit. Since assets are shown as debits (as the cash or capital account was debited to purchase them), and the total must correspond with the total sum of the credits — that is the liabilities and capital — assets equal liabilities plus capital (or A = L + C).
American and continental European companies usually put assets on the left and capital and liabilities on the right. In Britain, this was traditionally the other way round, but now most British companies use a vertical format, with assets at the top, and liabilities and capital below.

BrE: balance sheet	AmE: balanee sheet or statement of financial position
BrE: shareholders’ equity;	AmE: stockholders’ equity

B. Shareholders’ equity

Shareholders’ equity consists of all the money belonging to shareholders. Part of this is share capital — the money the company raised by selling its shares. But shareholders’ equity also includes retained earnings: profits from previous years that have not been distributed - paid out to shareholders — as dividends. Shareholders' equity is the same as the company's net assets, or assets minus liabilities.

A balance sheet does not show how much money a company has spent or received during a year. This information is given in other financial statements: the profit and loss account and the cash flow statement.

C. Exercise

- Are the following statements true or false?

1- British and American balance sheets show the same information but arranged differently.
2- The revenue of the company in the past year is shown on the balance sheet.
3- The two sides or halves of a balance sheet always have the same total,
4- The balance sheet gives information on how much money the company has received from sales of shares,
5- The assets total is always the same as the liabilities total.
6 The balance sheet tells you how much money the company owes.

- Complete the sentences. Look at A and B opposite to help you.

1............are companies that provide other companies with materials, components, etc.

2............are profits that the company has not distributed to shareholders.

3.............are things a company owns and uses in its business.

4............ consist of everything a company owes.

5............consists of money belonging to a company's owners.

Exercise 2

Match these words with their meanings.

1 debt	a) an agreement between two or more parties, often written
2 lease	b) the opposite of assets

3 gearing	c) buying or selling something
4 liabilities	d) someone who owns parts of a company
5 contract	e) money that is owed
6 transaction	f) an agreement where the owner of something allows someone else to use it for a specific time for a sum of money
7 shareholder	g) the proportion of own capital to borrowed funds when buying an asset or financing a company

Lesson 9: The balance sheet 2

A. Fixed and current assets

Mackenzie Inc, New York Balance Sheet 31 December 20 ($'000)

Current assets	
Cash and equivalents	3.415
Accounts receivable	8,568
Inventory	5,699
Other current assets	5,562
Total current assets	23,244
Non-current assets	
Property, plant and equipment	4,500
Goodwill	950
Long-term investments	6,265
Total non-current assets	11.715
Total assets	34,959

In accounting, assets are generally divided into fixed and current assets. **Fixed assets** (or **non-current assets**) and investments, such as buildings and equipment, will continue to be used by the business for a long time. **Current assets** are things that will probably be used by the business in the near future. They include cash — money available to spend immediately, debtors — companies or people who owe money they will have to pay in the near future, and stock.

If a company thinks a debt will not be paid, it has to **anticipate the loss** — take action in preparation for the loss happening, according to the conservatism principle. It will write off or abandon, the sum as a **bad debt**, and **make provisions** by charging a corresponding, amount against profits: that is, deducting the amount of the debt from the year's profits.

B. Valuation

Manufacturing companies generally have a stock of raw materials, work-in-progress — partially manufactured products — and products ready for sale. There are various ways of valuing stock or inventory, but generally, they are valued at the lower of cost or market, which means whichever figure is lower: their cost— the purchase price plus the value of any work done on the items - or the current market price. This is another example of conservatism: even if the stock is expected to be sold at a profit, you should not anticipate profits.

C. Tangible and intangible assets

Assets can also be classified as tangible and intangible. Tangible assets are assets with a physical existence — things you can touch - such as property, plant and equipment. Tangible assets are generally recorded at their historical cost, less accumulated depreciation charges — the amount of their cost that has already been deducted from profits. This gives their net book value.

Intangible assets include brand names — legally protected names for a company's products, patents — exclusive rights to produce a particular new product for a fixed period, and trademarks — names or symbols that are put on products and cannot be used by other companies. Networks of contacts, loyal customers, reputation, trained staff or "human capital', and skilled management can also be considered as intangible assets. Because it is difficult to give an accurate value for any of these things, companies normally only record tangible assets. For this reason, a going concern should be worth more on the stock exchange than simply its net worth or net assets: assets minus liabilities. If a company buys another one at above its net worth — because of its intangible assets — the difference in price is recorded under assets in the balance sheet as goodwill.

D. Exercises

Exercise 1

Find words and expressions in A, b and C with the following meanings:

1- an amount of money that is owed but probably won't be paid

2- the accounting value of a company (assets minus liabilities)

3- a legal right to produce and sell a newly invented product for a certain period of time

4- the historical cost of an asset minus depreciation charges

5- the amount a company pays for another one, in excess of the net value of its assets

6- a legally protected word, phrase, symbol or design used to identify a product

7- to accept that a debt will not be paid

8- to deduct money from profits because of debts that will not be paid

9- products that are not complete or ready for sale

10- the amount of money owed by customers who have bought goods but not vet paid for them

Exercise 2

- Match the words with their partners.

1- consolidated

2- retained

3- current

4 - common

5- total

6- accumulated

7- intangible

assets		stock
	receivables	gains
liabilities		affiliates
	earnings	

- Now match the word partners to their definitions.

a) An asset which does not have a physical nature (such as a trademark or a patent).

b) The holding company owns a minority interest (less than 50%), but the accounts are nevertheless consolidated.

c) The total legal obligations of a company to pay other parties.

d) The ordinary shares held by the owners, who therefore are the last to receive their money back in the event of liquidation.

e) Amounts that will be collected in the normal course of business within one year.

f) Profit which is not paid out to shareholders in the form of dividends, but instead is kept by the company to reinvest or pay off debts.

g) The amounts affecting common stockholders, but not from movements in the stock of the company (e.g. currency translation adjustments).

Lesson 10: The balance sheet 3

A. Liabilities

Liabilities are amounts of money that a company owes, and are generally divided into two types — long-term and current. Long-term liabilities or non-current liabilities include bands.

Current liabilities are expected to be paid within a year of the date of the balance sheet.
They include:
1- creditors — largely suppliers of goods or services to the business who are not paid at the time of purchase
2 - planned dividends
3 - deferred taxes — money that will have to be paid as tax in the future, although the payment does not have to be made now.

Current liabilities	
Short-term debt	1,655
Accounts payable	5,049
Accrued expenses	8,593
Total current liabilities	15,197
Non-current liabilities	
Deferred income taxes	950
Long-term debt	3,402
Other non-current Habilities.	4,201
Total non-current liabilities	5,553
Total liabilities	20,750
Shareholders' equity	
Common stock	10,309

Retained earnings	3,900
Total	14,209
Total liabilities and shareholders' equity	34,959

B. Accrued expenses

Because of the matching, principle, under which transactions and other events are reported in the periods to which they relate and not when cash is received or paid, balance sheets usually include accrued expenses. These are expenses that have accumulated or built up during the accounting year but will not be paid until the following year, after the date of the balance sheet. So accrued expenses are charged against income — that is, deducted from profits — even though the bills have not yet been received or the cash paid. Accrued expenses could include taxes and utility bills, for example, electricity and water.

C. Shareholders' equity on the balance sheet

Shareholders' equity is recorded on the same part of the balance sheet as liabilities. because it is money belonging to the shareholders and not the company.

Shareholders' equity includes:

- the original share capital (money from stocks or shares issued by the company)
- share premium: money made if the company sells shares at above their face value — the value written on them
- retained earnings: profits from previous years that have not been distributed to shareholders
- reserves: funds set aside from share capital and earnings, retained for emergencies or other future needs.

BrE: share premium; AmE paid-in surplus

C. Exercises

Exercise 1

- Are the following statements true or false? Find reasons for your answers in A, B and C.

1- A current liability will be paid before the date of the balance sheet.
2- A liability that must be paid in 13 months' time is classified as long-term.
3- A company's accrued expenses are like money an individual saves to pay bills in the future.
4- Shareholders' equity consists of the money paid for shares, and retained earnings.
5- If companies retain part of their profits, this money no longer belongs to the owners.
6- Companies can sell shares at a higher value than the one stated on them.

- Find words in A, B, and C with the following meanings.

1- Money that will be paid in less than 12 months from the balance sheet date.
2- The money that investors have paid to buy newly issued shares, minus the shares' face value.
3- Delayed, put off, or postponed until a later time.
4- Built up or increased over a period of time.

Exercise 2

- Write the words into the spaces.

arm _ cash flow _ founded _ in its own right liabilities _ outstanding _ pounds' worth _ sale or return subsidiary _ tied up _ trading _ went public

Parker Publishing was 1__________________ in 1872 by Hieronymous Parker, originally as the publisher of a
religious periodical called *The Preacher*. It now specialises in lifestyle magazines, and, through its
2__________________ Tekpress, also publishes several highly successful periodicals on consumer interest

subjects such as computing and hi-fi. The distribution 3_________________ also distributes magazines from
other publishers, and has become highly profitable 4__________________.
The company 5__________________ in 1987. The shares, originally priced at 50p, are
6__________________ at the time of writing for around £3.20.
Like many magazine publishers, Parker are vulnerable to 7__________________ problems. As their
magazines are on 8__________________, they usually have millions of pounds 9__________________ from
retailers, and have 10__________________ of several million more in printers' bills. In addition they have to
keep large sums of money 11__________________ in stock – the firm's warehouses in London and Manchester usually contain around five million 12__________________ of magazines.

- Look at the article above and the balance sheet on the opposite page. Answer the questions.

1. What are Parker Publishing's main current liabilities?

a. money owed to other companies (particularly printers).

b. salaries and wages

2. The article doesn't mention long-term liabilities. In the case of Parker Publishing are these more likely to be…?

a. money that must be paid to printers in the distant future.

b. repayments on a bank loans used to buy a fleet of lorries and the warehouse in Manchester.

3. The company's share capital is £20m. Does this mean that…?

a. their shares are currently worth a total of £20m

b. the shares were worth £20m when issued, but are now worth much more

4. What's the company currently worth?

a. £20,000,000

b. £98,000,000

c. £118,000,000

Lesson 11: Profit and loss account and cash flow

A. The profit and loss account

Companies' annual reports include a **profit and loss account**, which is a financial statement showing the difference between revenues and expenses for a specific period. Nonprofit organizations, such as charities, public universities, and museums, typically produce an **income and expenditure account**. If income exceeds expenditure, the result is called a **surplus** rather than a profit.

At the top of these statements is **total sales revenue** or **turnover**, representing the total money received during a particular period. The next item is the **cost of sales** or **cost of goods sold (COGS)**, which includes expenses like raw materials, labor, and factory costs associated with sold products. The difference between total sales revenue and the cost of sales is known as **gross profit**.

Other costs, such as rent, utilities, and office salaries, are grouped as **selling, general, and administrative expenses (SG&A)** and are deducted from gross profit. Financial statements often report **EBITDA (earnings before interest, tax, depreciation, and amortization)** and **EBIT (earnings before interest and tax)**. EBITDA is considered more objective because depreciation and amortization depend on the accounting system used.

At the bottom of the statement is the **net profit**, often referred to as the **bottom line**. This figure can either be distributed as dividends or retained as reserves to cover potential losses.

Example: Searby PLC

Annual Profit and Loss Account (1/20__)

(£000)

Category	**Amount (£)**
Sales Revenue	48,782
Cost of Sales	33,496

Category	Amount (£)
Gross Profit	15,286
Selling, General, and Administrative Expenses	10,029
EBITDA	5,257
Depreciation and Amortization	1,368
EBIT	3,889
Interest Expenses	237
Income Tax	1,064
Net Profit	**2,568**

Note:

- BrE: **Net profit** | AmE: **Net income**
- BrE: **Profit and loss account** | AmE: **Income statement**

B . The Cash flow statement

Both British and American companies prepare a **cash flow statement**, detailing the movement of money into and out of the business. Cash flow is categorized as:

- **Operations**: Money from day-to-day activities, like selling goods and services.
- **Investing**: Cash spent on or earned from acquiring or selling property, plants, and equipment.
- **Financing**: Cash raised through issuing or repaying debt, issuing shares, or paying dividends.

C. Exercise

Exercise 1

Complete the text with words from the box. You will need to use each word more than once. Look at B to help you.

financing	investing	operations

1_________________ means making money by selling goods and services. 2_________________ is spending cash, for the business's future growth, including cash acquired by selling assets. 3 _________________ involves raising money by issuing stocks and bonds (and also paying dividends and interest and repaying bonds). It is better for the company if it can pay for future growth out of money from 4_________________ Without having to use 5_________________ So 'healthy' cash flow means that the amount of cash provided by 6_________________ is greater than the cash used for 7_________________

Exercise 2

Complete the text with words from the box. **Words:** financing, investing, operations

1. **Operations** means making money by selling goods and services.
2. **Investing** involves spending cash for future growth, including funds generated by selling assets.
3. **Financing** raises money through issuing stocks and bonds, paying dividends, or repaying debt.
4. It is better for a company to fund future growth using money from **operations**, rather than relying on **financing**.
5. A "healthy" cash flow means the cash provided by **operations** is greater than the cash used for **investing**.

Exercise 3

Categorize financial activities

Match the following activities with their cash flow category (**Operations**, **Investing**, or **Financing**).

1. Selling goods to customers
2. Purchasing new machinery
3. Issuing company shares
4. Paying employee salaries
5. Selling a building
6. Paying interest on loans

Lesson 12: Key financial ratios

A. Ratio analysis

Once you understand how a set of accounts is constructed, you need to be able to analyse them to find out what they really disclose. Interpreting and analysing financial statements will enable you, as a manager, to compare the performance of your company this year with last year, to compare your company with its competitors, and to detect weaknesses which you can improve. Absolute figures in financial statements do not tell you much. For example, to be told that Retail Stores Plc made £196 million profits before tax is not a useful piece of information unless it is related to, say, the turnover which produced the profit or to the capital employed in the group. Ratio analysis is a useful tool with which to interpret financial accounts. But for ratios to be meaningful, they must be compared with equivalent ratios calculated for previous years and with those of the industry in which the company is positioned. Industrial ratios are produced by a variety of clearing houses for industrial statistics. 15 Ratios reduce the amount of data contained in the financial statements to workable form. This aim is defeated if too many are calculated. You must learn which combination of ratios will be appropriate to your needs. Ratios lead you to ask the right questions; however, they seldom provide conclusive answers.

B. Types of financial ratios

Financial ratios are tools used to analyze and compare the relationships between different items on a company's financial statements. These ratios help investors and creditors evaluate a company's current financial health, past performance, and standing compared to other companies. Key financial ratios measure the following:

- **Liquidity:** Assesses how easily a company can convert certain assets into cash.
- **Solvency:** Determines if a company can meet its short-term debt obligations or if it risks bankruptcy (requiring its assets to be sold to repay creditors).
- **Efficiency:** Evaluates how effectively a company utilizes its resources.

B. Liquidity and solvency ratios

1. Current ratio

Formula: (Current Assets) ÷ (Current Liabilities)

The current ratio measures a company's liquidity by comparing its current assets to its current liabilities. It indicates how much of the company's assets need to be converted into cash within the year to meet debt obligations.

- A **higher ratio** increases the likelihood of creditors being paid, while a **lower ratio** suggests limited liquidity.
- Example: If MacKenzie Inc. has current assets of $23,244,000 and current liabilities of $15,197,000, its current ratio is 1.53. This is acceptable, though financial experts often prefer a ratio closer to 2.0.

Stakeholder perspectives:

- **Suppliers** granting credit prefer a higher ratio, as it reduces their financial risk.
- **Shareholders,** however, often favor a lower ratio, as it suggests that the company has reinvested its assets for future growth.

3. **Quick ratio (Acid Test)**

Formula : (Liquid Assets) ÷ (Current Liabilities)

The quick ratio measures short-term solvency by excluding inventory (or stock) from current assets since inventory can be harder to liquidate quickly.

- Example: If MacKenzie Inc. subtracts inventory from its current assets, its quick ratio is 1.15.

C. Earnings and dividend ratios

Shareholders are particularly interested in ratios that reveal insights into a company's share price, earnings, and dividend distribution.

1. Earnings per share (EPS)

Formula: (Total Earnings for the Year) ÷ (Number of Ordinary Shares)

EPS indicates the portion of a company's profit attributed to each share.

- Example: If a company earns €1.5 million after tax and has issued 2 million shares, the EPS is €0.75.

2. Price-to-Earnings (P/E) Ratio

Formula: (Market Price of an Ordinary Share) ÷ (EPS)

The P/E ratio shows how much investors are willing to pay per euro of earnings, reflecting future growth expectations.

- Example: If a share sells for €9.00 and the EPS is €0.75, the P/E ratio is 12.

3. Dividend cover (Times Dividend Covered)

Formula: (Ordinary Share Dividend) ÷ (Net Profit)

This ratio indicates how many times a company's total dividends could be covered by its earnings.

- Example: If EPS is €0.75 and the dividend paid is €0.30, the dividend cover is 2.5.

Key insights:

- A **high dividend cover** suggests financial stability but may indicate the company is retaining more profits instead of rewarding shareholders.
- A **low dividend cover** (below 1.0) means dividends are being paid from retained earnings, posing a financial risk.

D. Exercises

Exercise 1

Make word combinations using a word from each box. One word can be used twice, then use the word combinations to complete the sentences below, Look at B and C opposite to help you.

acid current dividend liquid quick	assets cover ratio test

1__________________ consist of cash and things that can be easily sold and converted to cash.

2 A high__________________ shows that the company is retaining a lot of money belonging to its shareholders.

3 The __________________ or __________________ does not count stock or inventory this might be difficult or impossible to turn into cash.

4 The __________________ shows a company's ability to pay its short-term debts.

Exercise 2

Match each financial ratio to its corresponding purpose:

a. Current Ratio

b. Quick Ratio (Acid Test)

c. Price-to-Earnings (P/E) Ratio

d. Earnings Per Share (EPS)

e. Dividend Cover

1. Measures the liquidity of a company by comparing its liquid assets to its current liabilities.
2. Indicates how much profit is allocated to each ordinary share.
3. Assesses a company's ability to pay short-term debts by analyzing current assets and liabilities.
4. Reflects the market's willingness to pay a premium on earnings for future growth expectations.
5. Shows how many times the total annual dividends could be covered by the company's earnings.

Exercise 3

Using the following information, calculate the required ratios:

- Current Assets: $50,000
- Current Liabilities: $30,000
- Liquid Assets: $35,000
- Net Profit: $10,000
- Dividends Paid: $4,000
- Earnings: €2,000,000
- Ordinary Shares Issued: 4,000,000
- Market Price per Share: €15.

a. Current Ratio

b. Quick Ratio

c. Earnings Per Share (EPS)

d. P/E Ratio

e. Dividend Cover

Lesson 13: Profitability and leverage ratios

A. Profitability ratios

Profitability ratios allow investors and analysts to evaluate how well a company generates profit in relation to its sales, assets, or equity. These ratios are fundamental in financial analysis and are commonly featured in corporate performance reports.

1. **Gross profit margin**
   Formula:

$$\textit{Gross Profit Margin} = \frac{Gross\ Profit\ (Sales - Cost\ of\ Goods\ Sold)}{Sales}$$

   Purpose:
   This ratio indicates the proportion of revenue left after accounting for the cost of goods or services sold. A higher gross profit margin compared to industry peers signifies greater operational efficiency and the potential for sustained profitability.

2. **Return on assets (ROA)**
   Formula:

$$ROA = \frac{Net\ Profit}{Total\ assets}$$

   Purpose:
   ROA measures how effectively a company utilizes its assets to generate profits. Higher ROA indicates better asset efficiency.

3. **Return on equity (ROE)**
   Formula:

$$\mathrm{ROE} = \frac{Net\ Profit}{Shareholders\ Equity}$$

   Purpose:
   ROE reflects the profitability generated from shareholders' investments. It helps gauge how effectively the company manages equity to deliver returns.

B. Leverage ratios

Leverage ratios assess how a company finances its operations and how well it manages debt obligations. They are crucial for evaluating financial risk and long-term stability.

1. **Gearing (or Leverage Ratio)**
   Formula:

$$\text{Gearing} = \frac{Debt}{Shareholders' \; Equity}$$

   Purpose:

   This ratio, often expressed as a percentage, illustrates the extent to which a company relies on borrowed funds versus its own capital. A highly leveraged company has significant debt relative to equity, which can indicate higher financial risk.

2. **Interest Cover (or Times Interest Earned)**
   Formula:

$$\text{Interest Cover} = \frac{EBIT}{Interest \; Charges}$$

   Purpose:

   This ratio measures a company's ability to meet its annual interest obligations using (Earnings Before Interest and Tax) (EBIT). A low interest cover, typically below 1.0, signals difficulty in generating sufficient cash to cover debt servicing costs.

Conclusion

Profitability and leverage ratios are essential metrics for evaluating a company's financial performance and stability. While profitability ratios focus on efficiency in generating profits, leverage ratios highlight the balance between debt and equity financing. Together, they provide a comprehensive view of a company's financial standing, enabling better-informed investment and management decisions.

D. Exercises

Exercise 1

Match the two parts of the sentences. Look at A and B opposite to help you.

1 - After borrowing millions to finance the takeover of a rival firm, the company's

2 - Although sales fell 5%, the company's

3 - Like profit growth, return on equity is a measure of

4 - With just 24% gearing, the company can afford

a- gross profit margin rose 9% from a year ago, so senior management is not worried.
b- how good a company is at making money.
c- interest cover is the lowest it has ever been.
e- to acquire its rival, which would help to increase its steady growth.

Exercise 2
Calculate and interpret ratios

Use the following financial data for Company XYZ to calculate and interpret the specified financial ratios.

Company XYZ Financial Data:

- Sales: $1,200,000
- Cost of Goods Sold: $750,000
- Net Profit: $150,000
- Total Assets: $900,000
- Shareholders' Equity: $600,000
- Debt: $300,000
- EBIT: $200,000
- Annual Interest Charges: $50,000

Tasks:

1. Calculate the following profitability ratios:
   - Gross Profit Margin
   - Return on Assets (ROA)
   - Return on Equity (ROE)
2. Calculate the following leverage ratios:
   - Gearing (Leverage Ratio)
   - Interest Cover (Times Interest Earned)

3. Interpret the calculated ratios:
    - For profitability ratios: Is Company XYZ efficient and profitable?
    - For leverage ratios: Is the company over-reliant on debt?

Exercise 3

Imagine two companies, Alpha Inc. and Beta Corp., operate in the same industry and have the following financial ratios:

Ratio	**Ratio Alpha Inc.**	**Beta Corp.**
Gross Profit Margin	45%	38%
Return on Assets (ROA)	8%	12%
Return on Equity (ROE)	15%	18%
Gearing	75%	50%
Interest Cover	2.5	6.0

Tasks:

1. **Profitability analysis:**
    - Which company is more profitable overall? Justify your answer based on the given ratios.
2. **Leverage analysis:**
    - Compare the leverage ratios of both companies. Which company is managing debt more effectively?
3. **Investment recommendation:**
    - Based on the ratios provided, which company would you recommend to an investor seeking long-term stability and profitability? Explain your reasoning.

Lesson 14: Cost accounting essentials

A. Direct and indirect costs

Cost accounting is the process of determining the costs associated with producing specific products or services, enabling managers to set appropriate prices and identify the most profitable offerings.

- **Direct costs**: These are costs that can be directly attributed to the production of specific units, such as raw materials and manufacturing wages. Calculating direct costs is relatively straightforward.
- **Indirect costs (Overheads)**: These are expenses that cannot be directly linked to individual products or production processes. Examples include office rent, factory property taxes, utilities for lighting and heating, maintenance, canteen services, and managerial salaries. Indirect costs are typically grouped under "Selling, General, and Administrative Expenses" in financial statements.

B. Fixed and variable costs

Cost accounting also distinguishes between fixed and variable costs:

- **Fixed costs**: These remain constant in the short term, regardless of production levels. Examples include rent and interest payments.
- **Variable costs**: These fluctuate in direct proportion to production volume, such as raw material costs, components, and overtime wages.

Allocating these costs to specific products is crucial for accurate pricing.

- **Absorption costing**: Assigns all direct costs and production-related indirect costs—and sometimes administrative expenses—to individual products or services.
- **Activity-based costing (ABC)**: Calculates costs associated with specific activities (e.g., product design, manufacturing, distribution, customer service), even when these activities span multiple departments.

To better track costs, companies often designate non-revenue-generating departments, like accounting or legal, as **cost centers**, allocating their expenses separately.

C. Breakeven analysis

When evaluating the profitability of a new product or service, companies use **breakeven analysis**. This tool compares projected sales with anticipated costs—both direct and indirect—at various production levels.

- **Breakeven point**: The sales volume at which total revenues equal total costs, ensuring the company covers all expenses. Sales exceeding this point result in profit.

While cost accounting provides valuable insights into production costs, pricing decisions also consider:

- Market demand.
- Competitor pricing.
- The company's financial health.
- Strategic objectives, such as prioritizing sales growth or maximizing profit.
- Marketing policies.

Cost accounting is thus a critical tool in managing expenses, setting prices, and making informed business decisions.

D. Exercise

Exercise 1

Match the words in the box with the definitions below. Look at A, B and C opposite to help you.

breakeven point	cost center	fixed costs
overheads	variable costs	profitable

1. Expenses that are not clearly related to production or manufacturing
2. a unit of activity in an organization for which costs are calculated separately
3. costs that depend on the amount produced
4. adjective meaning providing income for a company
5. costs that do not change according to the production volume
6. the sales volume at which a company doesn’t make a loss, but doesn’t make a profit

Exercise 2

Fill in the missing words in the terms below. Choose from the following:

apportionment	centre	conversion	direct	fixed
integrated	indirect	interlocking	labour	marginal

Term	**Definition**
1_________________cost	Costs which arr directly related to making a product (e.g.m aterialsl' abour and expenses)
2_________________cost	Costs of changingm aterialsi nto products
3_________________cost	Costs which are not directly related to making a product e.g. rent, administration
4 cost _________________	This could be a location, a function, a piece of equipment or a group of employees where you can identify and allocate costs for control purposes
5 cost _________________	You divide the common overhead costs between the various activities which use them according to how much they use

6 __________________cost — Costs which always stay the same even if the number of items produced changes

7__________________cost — The cost of paying workers to make the product

8__________________cost — The cost of making a single extra unit above the number already planned.

9 __________________ cost account — You don't separate flnancial and cost accounting

10 _________________cost account — Separate cost and financial accounts which are reconciled sometimes

Exercise 3

Sort the following into direct, indirect, fixed, and variable costs.

Cost	**Direct**	**Indirect**	**Fixed**	**Variable**
Advertising expenses				
Bad debts				
Components				
Electricity to run machines				
Electricity for heating				
Equipment repairs				
Factory canteen				
Overtime pay				
Raw materials				
Property tax				
Rent				

Semester 2

Lesson 15: Pricing strategies in business

A. Manufacturers' pricing strategies

Pricing strategies adopted by manufacturers are shaped by a combination of costs, market dynamics, and business objectives. Here are key approaches:

1. **Cost-plus pricing (Markup pricing):**
   Some firms base their prices on production costs, adding a percentage markup to determine the selling price.
2. **Holistic considerations:**
   While costs are central, most companies also factor in demand trends, competitors' pricing, and sales or profit targets when setting prices.
3. **Market penetration pricing:**
   Companies may launch products at a low price with minimal profit margins to secure significant market share. Over time, economies of scale allow for higher profitability. Examples include Bic (pens, lighters, razors) and Dell (PCs).
4. **Market skimming:**
   This strategy targets customers willing to pay premium prices for innovative products, such as cutting-edge technology. The price is reduced later to attract broader market segments, as seen with Intel microchips.
5. **Demand-driven price adjustment:**
   When demand exceeds supply, companies—especially monopolists—may raise prices to capitalize on scarcity.
6. **Prestige pricing (image pricing):**
   Luxury brands position products with high price tags to appeal to affluent customers who associate cost with exclusivity. Examples include BMW and Rolex.
7. **Going-rate pricing:**
   For products that are nearly identical to competitors' offerings, companies often match prevailing market prices.

B. Retail pricing strategies

Retailers implement specific strategies to attract customers and maximize profits:

1. **Loss-leader pricing:**
   Retailers, such as supermarkets, offer certain items at a loss to draw in customers who then purchase other, more profitable goods.
2. **Odd pricing (Odd-even pricing):**
   Pricing items just below a round number (e.g., €29.95) creates a psychological perception of affordability, as customers often view it as closer to €20 than €30.
3. **Elasticity of demand:**
   - **Elastic demand:** Sales volume changes significantly in response to price fluctuations. For instance, a price cut boosts sales.
   - **Inelastic demand:** Sales remain stable regardless of price changes.

C. Key pricing terminology

To better understand pricing concepts, research the following terms:

1. Unit Cost
2. Sales Target/Profit Target
3. Launch
4. Market Share
5. Economies of Scale
6. Market Segments
7. Monopolists
8. Target Customers

D. Exercises

Exercise 1

Find five verbs in A and B above that can be used to make word combination with “prices”.

Then use the verbs to complete the sentences below.

____
____
____
____
____

prices

1 Economists say that if sales increase when you _________________ a price, demand is elastic.

2 If we have more customers than products available, we generally ________________ Our prices

3 Luxury goods companies make huge profits, because their customers are prepared to __________________ really high prices.

4 Our product's really the same as our competitors’, so we'll probably __________________ the same price

5 After we've skimmed the market, we can __________________the price to get more customers.

Exercise 2

Match the pricing strategies in the box with the statements below. Look to the text above to help you.

going-rate pricing	loss-leader pricing	market penetration	market skimming
mark-up pricing	odd pricing	prestige pricing	

Because of our famous brand name and our reputation for quality, we can charge a very high price

Demand isn’t very elastic, so we charge the same price as our main competitors

We never use whole numbers like $ 10 0r $ 20. Our prices always end in 95 or 99 cents

We actually sell a few products at breakeven price, but this brings in customers who also buy a lot of other things

We launch our products at high prices, and then reduce them a few months later to get more customers

We just get the cost accountants to work out how much it cost to make the product, and add our profit

We charge a really low price at first, because we want to sell a many units of the product as possible

Lesson 16: Overview on personal banking

A. Current accounts

A current account provides customers with easy access to their money, allowing withdrawals without restrictions. While these accounts typically earn little or no interest, many individuals also maintain savings or deposit accounts, which offer higher interest rates but impose limitations on withdrawals.

Banks issue **monthly statements** summarizing transactions:

- **Debits**: Money withdrawn or spent.
- **Credits**: Money deposited or received.

Most customers hold a **debit card** for ATM withdrawals and transactions, and a **credit card** for purchasing goods, services, or borrowing funds. Payment methods vary by country:

- In some, **cheques** are common for bill payments.
- In others, **bank transfers** are prevalent, including:
    - **Standing orders**: Regular, fixed payments.
    - **Direct debits**: Variable payments on flexible dates.

B. Banking products and services

Commercial banks offer a wide range of financial products and services:

1. **Loans**: Fixed sums lent for a predetermined period, such as two years.
2. **Overdrafts**: Flexible borrowing that allows customers to overdraw their accounts up to a set limit, with interest calculated daily—ideal for short-term needs.
3. **Mortgages**: Long-term loans for property purchases, with the property itself serving as **collateral**. If the borrower defaults, the bank can repossess and sell the property.

Banks also facilitate:

- **Foreign currency exchange** for travelers.
- **Traveler's cheques**, protected against theft or loss.
- **Investment advice** and **private pension plans** for retirement savings.
- **Insurance products**, which banks increasingly market to their customers.

C. E-banking

The rise of technology in the 1990s brought innovations like **telephone banking** and **internet banking (e-banking)**. While these services gained traction, many customers still preferred visiting **local branches**, especially those with extended hours and locations in convenient places, such as shopping centers.

D. Exercises

Exercise 1

Answer the following based on the text:

1. What is the main difference between a current account and a savings account?
2. Explain the purpose of a debit card and how it differs from a credit card.
3. What is a standing order, and how does it differ from a direct debit?
4. Why might someone choose an overdraft instead of a loan?
5. What happens if a borrower cannot repay their mortgage?

Exercise 2

Find words in B with the following meanings.

1 - what you can earn when you leave your money in the bank
2 - an amount of money borrowed from a bank for a certain length of time, usually for a specific purpose
3 - something that acts as a security or a guarantee for a debt
4 - an arrangement to withdraw more money from a bank account than you have placed in it
5 - a long-term loan to buy somewhere to live
6 - an arrangement for saving money to give you an income when you stop working
7- to take back property that has not been completely paid for

Exercise 3

Match the terms on the left with their correct definitions on the right:

1. Collateral
2. Overdraft

3. Direct debit
4. Monthly statement
5. Cheques

Definitions:

a. Written orders to transfer money from an account.

b. A document summarizing transactions for a given period.

c. Security offered for a loan, such as property.

d. A facility allowing you to withdraw more money than you have in your account.

e. A payment method where the amount and date can vary.

Lesson 17: Understanding banking

A. Commercial banks

When individuals have surplus money, they often save it by depositing it in a bank account at a commercial or ‘’retail bank’’. In return, the bank pays interest on these deposits. The deposited funds are then used by the bank to provide loans to borrowers who need more funds than they currently have. Banks generate profit by charging borrowers a higher interest rate than they pay to depositors. Additionally, commercial banks facilitate money transfers, moving funds from one customer’s account to another, either within the same bank or across different banks, upon the customer’s request.

B. Credit creation

Banks play a key role in creating credit — making money available for borrowing. Money lent from deposits is typically spent and subsequently transferred to other bank accounts. A bank’s capital and issued loans are its assets, while customers’ deposits are liabilities, as the bank owes this money to the depositors.

Banks must retain a percentage of their assets as reserves to meet withdrawal demands. This percentage, called the reserve requirement, dictates how much a bank can lend. For instance, with a 10% reserve requirement, a €100 deposit allows the bank to lend €90. If the borrower spends the €90 and it is deposited elsewhere, the receiving bank can lend €81, and so on. Through this cycle, an initial €100 deposit can expand to nearly €1,000 in the banking system, creating approximately €900 in credit.

C. Loans and risk management

Before granting a loan, banks evaluate the associated risks. Higher risks of non-repayment typically result in higher interest rates. Retail banks offer standardized loan products to individual customers, meaning all borrowers are subject to the same terms and conditions. For corporate clients, risk assessments are more complex. However, many large businesses prefer raising their own capital rather than borrowing from banks.

Banks must balance liquidity (having cash available for depositors) with loan maturities (repayment schedules). Additionally, they need to weigh the yield (income generated from loans) against the risk involved. Striking this balance is essential to maintaining financial stability and profitability.

D. Exercises

Exercise 1

Match the two parts of the sentences. Look at the text to help you.

1- Banks lend savers' deposits

2- They also create credit by

3- How much credit banks can create

4- Before lending money,

5- The interest rate on a loan

6- Banks always need liquidity,

a- banks have to assess the risk involved.

b- depends on the reserve requirements.

c- depends on how risky it is for the bank to lend the money.

d- so they can't lend all their money in loans with long maturities.

e- lending the same original deposit several times.

f- to people who need to borrow money.

Exercise 2

Fill in the Blanks

1. Commercial banks generate profit by charging borrowers a higher ___________ rate than they pay to depositors.

2. The percentage of a bank's assets that must be kept as reserves is known as the __________ requirement.
3. The money that a bank owes to its depositors is recorded as __________ in its accounts.
4. Large companies often prefer to raise their own __________ rather than borrow from banks.

Exercises 3

Complete the sentences from banks' websites. Look at the text to help you

1- If you need instant access to all your money, this is the __________ for you

2- Our products for __________ include business overdrafts, loan repayments that reflect your cash flow, and commercial mortgages.

3- Our local branch managers are encouraged to help local businesses and are authorized to __________ and overdrafts.

4- We offer standardized loans: you can be sure you won't get less favorable terms and__________ than our other__________

Lesson 18: Overview of financial institutions

A. Types of financial institutions

For most of the 20th century, banks typically operated within a single country—sometimes within a single state, as in the US—and performed specialized financial roles. The primary types of financial institutions included:

1. **Retail banks (Commercial banks)**
    - Served individuals and small businesses.
    - Primary functions:
        - Receiving deposits.
        - Providing loans.
2. **Investment banks**
    - Worked with large corporations.
    - Services offered:
        - Financial advisory.
        - Raising capital by issuing stocks, shares, and bonds.
        - Organizing mergers and managing takeover bids.
3. **Insurance companies**
    - Offered life insurance policies and pension plans.
4. **Building societies**
    - Specialized in mortgages.
    - Many have since transitioned into standard commercial banks.

Terminology differences:

- In British English: "Merchant banks" correspond to "Investment banks" in American English.
- British "High Street banks" are equivalent to "Retail banks" or "Commercial banks" in both British and American English.
- British "Building societies" are akin to American "Savings and loan associations."

B. Deregulation

The financial industry underwent significant transformation during the 1980s and 1990s due to deregulation.

- **Before deregulation:**
  - Strict rules in countries like the US, Britain, and Japan restricted commercial banks from engaging in investment banking activities.
  - In contrast, countries such as Germany and Switzerland already had universal banks capable of performing all types of financial services.
- **Post-deregulation:**
  - Deregulation enabled the emergence of large international financial conglomerates.
  - These institutions now provide a comprehensive range of services, allowing individuals and businesses to fulfill all their financial needs under one roof.

C. Specialized financial institutions

Despite the trend towards universal banking, some financial institutions maintain specialized functions:

1. **Central banks**
   - Issue national currency and implement government financial policies.
2. **Private banks**
   - Manage the wealth and assets of affluent individuals, often referred to as high-net-worth individuals (HNWIs).
3. **Clearing banks**
   - Facilitate the processing of cheques and other payment transactions within the banking system.
4. **Non-bank financial intermediaries**
   - Entities such as car manufacturers, food retailers, and department stores have entered the financial sector, offering products like personal loans, credit cards, and insurance.

This evolving landscape reflects the dynamic nature of financial institutions and their increasing diversification of services.

D. Exercises

Exercise 1

Find words in A and B with the following meanings.

1- a company offering financial services
2- the money a company uses, raised by way of shares and bonds
3- when two formerly separate companies agree to join together
4- a company formed by the merger or takeover of several other companies
5- the ending of some rules and restrictions
6- when a company offers to buy the shares of another company to gain control of it

Exercise 2

Grimleys Bank
Open an account today!

Open an account with Grimleys Bank, and start benefiting from our great **rates** / **levels** of interest and **small** / **low** charges. With over 3,000 **branches** / **outlets**, you'll never be far from us, and unlike many other **high street** / **town centre** banks, we're open all day on Saturdays.
Grimleys customers can **take money** / **make withdrawals** from more than a million **cash dispensers** / **money machines** worldwide, and of course you'll receive a **cheque book** / **book of cheques** and a **paying card** / **debit card** within a few days of opening your account.
Computer-users may be interested in our e-account - all the benefits of a regular Grimley's **current** / **day-to-day** account, with the added convenience of being able to view your **lists** / **statements** and **make** / **do** payments online.

Whether you're opening your first current account, **switching** / **changing** from another bank or simply want to take advantage of our **range** / **variety** of savings accounts, you'll be glad you chose Grimleys – the bank that always **makes** / **puts** the customer first.

Match the method of payment with the definition.

1. Credit card	a. A piece of paper which transfers money from your account to somebody else's account
2. Debit card	b. Similar to a credit card, but usually operated by a chain of shops or other retailer
3. Charge card	c. The money is deducted from your bank account almost immediately.
4. Cheque	d. These can be exchanged for foreign currency, or in some cases used instead of cash.
5. Traveler's cheque	e. You owe the card provider money. You can pay it back in one instalment, or over a longer period if you wish.
6. Charge account	f. You owe the retailer money.

Exercise 3

Choose the best word to complete the sentence**.**

1. A person who gives you information about financial products is a __________.

a. financial adviser **b.** financial helper **c.** financial assistant

2. Some financial advisers only earn money by giving advice. Others earn ________ from selling financial products.

a. wages **b.** payments **c.** commission

3. An actuary is a person who __________ insurance risk and calculates premiums.

a. thinks about **b.** assesses **c.** decides

4. When an endowment __________, you receive a lump sum.

a. finishes **b.** ends **c.** matures

5. Prices go up every year. This is because of __________.

a. inflation **b.** expansion **c.** evolution

6. Some pension payments increase every year __________ inflation.

a. in time with **b.** in line with **c.** at the speed of

7. Pension payments which increase in line with inflation are __________.

a. index connected **b.** index linked **c.** index controlled

8. Many financial analysts predict a __________ caused by too many pensioners and not enough workers.

a. pensions crisis **b.** pensions disaster **c.** pensions emergency

9. A small additional pension is known as a __________.

a. topper pension **b.** topping pension **c.** top-up pension

10. Banks and insurance companies are types of __________.

a. financial institution **b.** finance company **c.** financier

11. Pension funds are usually administered by a __________ of trustees.

a. group **b.** bunch **c.** board

12. Pension funds, insurance companies and other financial institutions that invest on the stock market are known as __________.

a. commercial investors **b.** institutional investors **c.** company investors

13. Individual people who invest on the stock market are known as __________.

a. private investors **b.** personal investors **c.** one-man investors

14. In most countries, financial products and services are __________ by the government.

a. watched **b.** decided **c.** regulated

Lesson 19: Investment banking

A. Raising capital

Ruth Healy works in an investment bank in New York. Unlike commercial banks, investment banks like ours don't lend money. Instead, we act as intermediaries between companies and investors. We help companies and governments raise capital by issuing securities such as stocks and bonds — that is, we offer them for sale. We often underwrite securities issues: in other words, we guarantee to buy the securities ourselves if we can’t find other purchasers.

As well as initial public offerings (IPOs), when companies offer stock for sale for the first time, there are other occasions when they raise funds. For example, they might want to expand their operations. or to acquire another company, or to reduce their amount of debt, or to finance a specific project. They don’t only raise capital from the public: they can sell stocks or shares to institutional investors like insurance companies, investment funds — companies that invest the money of lots of small investors, and pension funds — companies that invest money that will later be paid to retired workers.

We also have a stockbroking and dealing department. This executes orders — buys and sells stocks for clients = which is broking, and trades with our own money, which is dealing. The stockbroking department also offers advice to investors.”

BrE: flotation; AmE: initial public offering (IPO)

B. Mergers and acquisitions

Investment banks often represent firms in mergers and acquisitions, and divestitures. A divestiture is when a company sells a subsidiary - another company that it owns. Most of the fee - the money the company pays us for the service - will depend on us completing the deal successfully. This gives the bank a good reason to make sure that the transaction succeeds.

C. Consulting and research

Large corporations have their own finance and corporate development departments. But they often use an investment bank like ours because, like a consulting firm, we can offer independent advice, and we have a lot of experience in financial transactions. We also have a large network of contacts, and relationships with investors and companies that could be interested in a merger or acquisition.

If we've worked on a transaction with a company, we know a lot about its business. This means we can give advice about strategic planning - deciding what do to in the future - or financial restructuring — changing the way the business is financed. Large investment banks also have extensive research departments with analysts and forecasters who specialize in the valuation of different markets, industries, companies, securities and currencies. Analysts try to work out how much things are worth now, and forecasters study the prospects for the future.

D. Exercises

Exercise 1

Match the words in the box with the definitions below. Look at the text to help you.

Financial restructuring – Consulting firms – Forecasters - Institutional Investors – Strategic planning – Pension Fund – Subsidiary - Valuation

1 - a company of experts providing professional advice to businesses for a fee
2- a financial institution that invests money to provide retirement income for employees
3- deciding what a company is going to do in the future
4 - people who try to predict what will happen in the future
5 - a company thar is partly or wholly owned by another one
6 - a financial institution that purchases securities
7 - making changes to how a company is financed
8- establishing how much something is worth

Exercise 2

True or False

1. Investment banks only raise capital for companies through public stock offerings.
True / False

2. Underwriting securities means that an investment bank guarantees to buy the securities themselves if they cannot find other buyers.

True / False

3. A divestiture occurs when a company merges with another company.

True / False

4. Large investment banks provide independent advice and have access to a network of contacts that can help with mergers and acquisitions.

True / False

Exercise 3

Fill in the blanks using the words provided in the box.

stocks	bonds	project	debt	divestiture	independent	shares

1. Investment banks help companies raise capital by issuing __________ and __________ for sale.
2. A company may decide to raise capital to finance its __________ or reduce its __________.
3. A __________ is when a company sells a subsidiary, or a company it owns, to another business.
4. Investment banks provide __________ advice to companies on strategic planning and financial restructuring.
5. The stockbroking department of an investment bank executes orders by buying and selling __________ for clients.

Lesson 20: Central banks and commercial banks

A. The Functions of central banks

Central banks play a crucial role in maintaining the financial stability of a country. Their primary functions are to act as bankers to the government and to commercial banks, manage reserves of gold and foreign currencies, and maintain financial stability. In most countries, central banks are responsible for setting the minimum interest rates and minimum deposit requirements for commercial banks, and they issue banknotes and securities for the government. In addition, central banks occasionally lend money to commercial banks facing financial difficulties, and they may intervene in foreign exchange markets to influence exchange rates.

In some countries, central banks supervise the banking system and regulate the financial sector. For example, in the United Kingdom, this responsibility is shared between the central bank and the Financial Services Authority. Central banks also publish monetary and banking statistics, which help monitor the economy and provide transparency.

While central banks are responsible for controlling monetary policy—specifically, regulating inflation through interest rate changes—there is a trend toward central bank independence in many countries. In the Eurozone, for example, the European Central Bank is responsible for setting the inflation target and determining the necessary interest rate changes, whereas in countries like Britain, the government may play a role in setting these targets. However, central banks do not manage the assets of wealthy individuals, issue securities for companies, or lend money to small businesses.

Commercial banks, on the other hand, manage the day-to-day banking services for individuals and small businesses. In some countries, such as Scotland, commercial banks are even authorized to issue banknotes, although this is rare.

B. The role of central banks and commercial banks

Commercial banks are required to keep a reserve of a certain percentage of their deposits in case customers wish to withdraw funds. This reserve is held by the central bank, which can adjust the reserve-asset ratio—setting the minimum amount of deposits that must be held in reserve. If a bank faces financial difficulties and is unable to meet the demands of its depositors, it can lead to a "bank run," where many depositors rush to withdraw their money, potentially draining the bank's reserves. In these cases, central banks can step in as the "lender of last resort," providing emergency funding to keep the bank operational. However, central banks are cautious about bailing out banks, as doing so could encourage excessive risk-taking.

C. Central banks and exchange rates

Central banks also manage their country's reserves of gold and foreign currencies. By intervening in foreign exchange markets, central banks can influence the exchange rate—the price at which their currency is traded against others. By buying or selling their own currency, they can affect the supply and demand, thereby stabilizing or adjusting the exchange rate to meet economic goals. In conclusion, central banks serve as essential players in the financial system, ensuring the stability of the banking sector, managing monetary policy, and influencing the exchange rate. While their specific functions may vary by country, their overarching role is to protect the financial system and maintain economic stability.

D. Exercise

Exercise 1

Tick (✓) the things you think central banks do.

1 ☐ issue banknotes and coins

2 ☐ store the country's reserves of gold

3 ☐ provide current accounts and mortgages for government ministers

4 ☐ regulate the money supply

5 ☐ set official interest rates

6 ☐ supervise the work of other banks in the country

7 ☐ maintain monetary and financial stability

Exercise 2

Match the two parts of the sentences. Look at A and B opposite to help you.

1 -The central bank will sometimes lend money

2 -Banks would probably start taking too many risks

3 -Central banks are usually responsible for

4 -The central bank can alter

5 -There will be low and stable inflation

a- if they could always be sure of rescue by the central bank.

b -if there is a run on a commercial bank.

c- if monetary policy is successful,

d- printing and distributing banknotes.

e- the amount of money commercial banks are able to lend.

Exercise 3

* You are going to read about the major functions of the Bank of England. Before you read, check your understanding of the words (1-9) below by matching them with their definitions (a-i).

1 policy	**a** a level or situation which you intend to achieve
2 threats	**b** a general, continuous increase in prices
3 oversight	**c** an agreed plan of what to do
4 target	**d** basic and most important
5 core (adjective)	**e** in good condition
6 sound (adjective)	**f** paid
7 sterling	**g** potential sources of danger
8 inflation	**h** supervision
9 remunerated	**i** the name of the British currency

* A student has made notes during a lecture about the role of the Bank of England. Read them and put each of the previous nine words in the appropriate blank space in the text.

The Bank of England

The Bank of England has two (1) _____ purposes. One is ensuring monetary stability, i.e. having stable prices - low (2) _____ - and consequently confidence in the currency. The government sets an inflation (3) _____, and the Bank's Monetary Policy Committee tries to meet it by raising or lowering the official interest rate when necessary. UK banks and building societies have to hold reserves at the Bank. These are (4) _____ at the Bank's official interest rate. If British banks need to borrow short-term funds they do this in the (5) _____ money markets. The Bank can influence the amount of money and the interest rates in these markets - this is how it implements its monetary (6) ____ _ The Bank also deals in the foreign exchange market. It can use the UK's foreign currency and gold reserves to try to influence the exchange rate if needed. The Bank's other core purpose is to maintain the stability of the financial system. The Bank has to detect and reduce any (7) _____ to financial stability, and make sure the overall system is safe and secure. It monitors and analyses the behaviour of the major participants in the financial system and the wider financial and economic environment, and tries to identify potential risks. A (8) ____ _ and stable financial system is important, and is also necessary for carrying out monetary policy efficiently. The Bank's role also includes (9) _____ of payment systems for transactions between individuals, businesses and financial institutions. The Bank sometimes acts as 'lender of last resort' to financial institutions in difficulty, to prevent panic or a loss of confidence spreading through the whole financial system.

Lesson 21: Understanding interest rates and monetary policy

A. The role of interest rates in monetary policy

Interest rates signify the cost of borrowing money, expressed as a percentage of the loan amount paid by borrowers to lenders for using their funds. Central banks typically set a minimum interest rate—the lowest rate lenders can charge—as part of their monetary policy to control inflation.

The goal of monetary policy is to maintain a balance between demand and supply in the economy. Demand reflects the consumption by individuals and investment by businesses in activities such as purchasing equipment, expanding operations, and creating jobs. Supply refers to the production of goods and services using labor and capital.

Lower interest rates encourage borrowing, leading to increased spending by consumers and higher investments by businesses, which boosts demand. Conversely, higher interest rates make borrowing more expensive, promoting saving over spending and causing businesses to scale back investments, thereby reducing demand.

If interest rates are set too low, demand for goods and services may exceed supply, driving up prices and causing inflation. However, excessively high interest rates can curtail borrowing and spending, which helps reduce inflation but may also hinder economic growth and employment.

B. Types of interest rates

The discount rate is the interest rate at which the central bank provides short-term loans to commercial banks. When the discount rate changes, commercial banks adjust their base rates, which they charge their most creditworthy customers, such as large corporations. This base rate serves as the benchmark for all other lending and deposit rates.

Banks earn profits from the margin or spread between the interest rates charged to borrowers and those paid to depositors. The interest rate a borrower is charged depends on their creditworthiness, also known as credit rating or credit standing, which is an evaluation of their ability to repay debt. Borrowers with better creditworthiness typically receive lower interest rates.

Secured loans, backed by collateral such as property or securities, usually come with lower interest rates. For example, mortgages secured by real estate often have lower rates than standard bank loans or overdraft arrangements, which allow individuals to spend more than their account balance. Long-term loans like mortgages often feature floating or variable interest rates, which adjust based on money supply and demand.

In contrast, leasing or hire purchase (HP) agreements typically have higher interest rates. These agreements allow consumers to acquire durable goods, such as vehicles or furniture, through monthly installments. Until fully paid off, the items remain the property of the lender. Higher interest rates in these agreements reflect the added risk for lenders, as the goods may become damaged during the payment period.

This overview highlights the critical role interest rates play in monetary policy and their wide-ranging effects on borrowers, lenders, and the economy at large.

C. Exercises

Exercise 1

Match the words in the box with the definitions below. Look at the text to help you.

creditworthy	floating rate	invest	labor
spread	output	solvency	interest rate

1 - the cost of borrowing money, expressed as a percentage of the loan

2 - having sufficient cash available when debts have to be paid

3 - paid work that provides goods and services

4 - a borrowing rate that isn't fixed

5 - safe to lend money to

6 - the difference between borrowing and lending rates

7 - the quantity of goods and services produced in an economy

8- to spend money in order to produce income or profits

Exercise 2

Name the interest rates and loans.

a_____ a loan to buy property (a house, flat, etc.)

b_____ borrowing money to buy something like a car, spreading payment over 36 months

c_____ commercial banks' lending rate for their most secure customers

d _____ occasionally borrowing money by spending more than you have in the bank

e _____ the rate at which central banks make secured loans to commercial banks

Exercise 3

Are the following statements true or false? Find reasons for your answers in the text above.

1 All interest rates are set by central banks

2 When interest rates fall, people tend to spend and borrow more.

3 A borrower who is very solvent will pay a very high interest rate.

4 Loans are usually cheaper if they are guaranteed by some form of security or collateral.

5 If banks make loans to customers with a lower level of solvency, they can increase their margins.

6 One of the causes of changes in interest rates is the supply and demand for money.

Lesson 22: Money markets

A. The money markets

The money markets consist of a network of corporations, financial institutions, investors, and governments, which need to borrow or invest short-term capital (up to 12 months). For example, a business or government that only needs cash for a few weeks can use the money market. So can a bank that wants to invest money that depositors could withdraw at any time. Through the money markets, borrowers can find short-term liquidity by turning assets into cash. They can also deal with irregular cash flows — in comings and out- goings of money — more cheaply than borrowing from a commercial bank. Similarly, investors can make short-term deposits with investment companies at competitive interest rates: higher ones than they would get from a bank. Borrowers and lenders in the money markets use banks and investment companies whose business is trading financial instruments such as stocks, bands, short-term loans, and debts, rather than lending money.

B. Common money market instruments

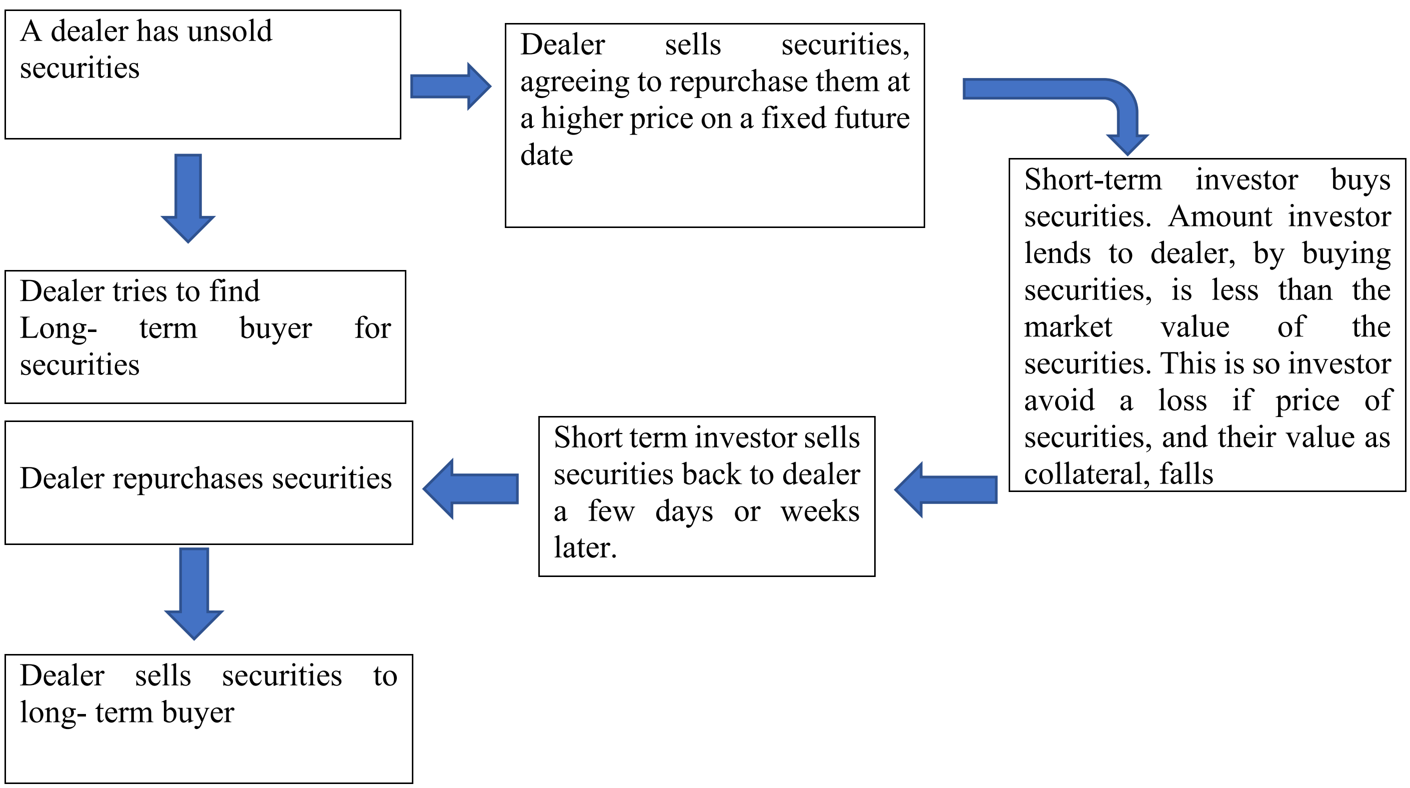
1- Treasury bills (or T-bills) are bonds issued by governments. The most common maturity - the length of time before a bond becomes repayable- is three months, although they can have a maturity of up ro one year, T-bills in a country's own currency are generally the safest possible investment. They are usually sold at a discount from their nominal value — the value written on them — rather than paying interest. For example, a T-bill can be sold at 99% of the value written on it, and redeemed or paid back at 100% at maturity, three months later.

2- Commercial paper is a short-term loan issued by major companies, also sold at a discount. It is unsecured, which means it is not guaranteed by the company's assets.

3- Certificates of deposit (or CDs) are short- or medium-term, interest-paying debt instruments — written promises to repay a debt. They are issued by banks to large depositors who can then trade them in the short-term money markets. They are known as time deposits, because the holder agrees to lend the money — by buying the certificate - for a specified amount of time.

Note: Nominal value is also called par value or face value.

4- Repos Another very common form of financial contract is a repurchase agreement (or repo). A repo is a combination of two transactions, as shown below. The dealer hopes to find a long-term buyer for the securities before repurchasing them.



C. Exercises

Exercise 1

Are the following statements true or false? Find reasons for your answers in the text

1 Organizations use the money markets as an alternative to borrowing from banks.

2 Money markets are a source of long-term finance

3 All money market instruments pay interest.

4 Certificates of deposit are issued by major manufacturing companies.

5 Commercial paper is guaranteed by the government.

6 Some money market instruments can have more than one owner before they mature**.**

Exercise 2

Match the wards in the box with the definitions below. Look at the text to help you.

cash flaw	competitive	discount
liquidity	maturity	par value
redeemed	short-term	unsecured

1 a price below the usual or advertised price

2 adjective describing a good price, compared to others on the marker

3 the ability to sell an asset quickly for cash

4 {in finance) adjective meaning up to one year

5 adjective meaning with no guarantee or collateral

6 repaid

7 the length of time before a bond has to be repaid

8 the movement of money in and out of an organization

9 the price written on a security

Lesson 23: Islamic banking

A. Interest-free banking

Some financial institutions operate without charging interest on loans or paying interest on savings, as doing so contradicts certain ethical or religious principles. For instance, Islamic banks—found in Islamic countries and major financial hubs—offer interest-free banking services.

Islamic banks neither pay interest to depositors nor charge it to borrowers. Instead, they invest funds in businesses and share the resulting profits with depositors. Financing in Islamic banks, whether for investments or trade, is conducted on a profit-and-loss sharing (PLS) basis. As a result, banks, depositors, and borrowers share both profits and risks. This approach resembles venture capitalism, where investors purchase shares in startups and participate in the associated risks and rewards.

B. Types of accounts

1. **Current accounts**

   Current accounts in Islamic banks do not provide a return to depositors, as they do not accrue interest. These accounts function as safekeeping arrangements, allowing depositors to withdraw their funds at any time while granting the bank permission to utilize these funds. Overdrafts are generally not offered for current accounts in Islamic banks.

2. **Savings accounts**

   Savings accounts may provide returns to depositors, but these returns are contingent on the bank's profitability—its ability to generate profits during a given period. The amount of return is variable and depends on the bank’s earnings; however, such payments are not guaranteed. Unlike conventional banking, there is no fixed rate of return. Returns, expressed as a percentage of the invested amount, fluctuate with the bank's financial performance. To minimize risk, Islamic banks typically invest savings account funds in short-term, low-risk projects.

3. **Investment accounts**

   Investment accounts involve fixed-term deposits that cannot be withdrawn before their maturity date. Holders of these accounts receive a portion of the bank's profits. In theory, returns could be negative if the bank incurs losses, meaning the capital invested is not guaranteed.

C. Leasing and short-term loans

To facilitate the purchase of expensive consumer goods, Islamic banks may buy the item on behalf of the customer, who then repays the bank at a higher price later. Alternatively, the bank may provide the item under a leasing or hire-purchase arrangement. In some cases, the bank may offer interest-free loans, covering its costs through a service charge.

For businesses requiring sudden, short-term capital or working capital to address unexpected expenses or purchases, obtaining financing through the PLS system can be challenging. However, the PLS model fosters close relationships between banks and their customers, encouraging banks to thoroughly evaluate projects since they effectively become shareholders in the business.

D. Short comparison

Conventional banks	Islamic banks
• Pay interest to depositors • Charge interest to borrowers • Lend money to finance personal consumption goods	• Give no return on current accounts; share profits with holders of saving accounts and investment accounts. • Share borrowers' profits (or losses) • Buy items for personal customers with a leasing or hire-purchase arrangement

E. Exercises

Exercise 1

Match the two parts of the sentences, look at the text to help you.

1- The basic feature of Islamic banking
2 - Instead of charging and paying interest
3 - Depositors in Islamic banks
4 - Businesses that deal with Islamic banks
5 - Islamic banks operate in a similar way

a - do not receive a fixed return.
b- have to share their profits with the bank.
e - Islamic banks and their customers share profits and losses.
d- is that it is interest-free.
e- to venture capitalists who buy companies' stocks or shares.

Exercise 2

Part 1: True or false

State whether the following statements are true or false. If false, correct the statement.

1. Islamic banks charge interest on loans but do not pay interest on savings.
2. Current accounts in Islamic banks allow depositors to withdraw their money at any time but do not provide any returns.
3. Savings account returns in Islamic banks are guaranteed and fixed.
4. Investment accounts in Islamic banks may result in a loss for the depositor if the bank performs poorly.
5. Islamic banks can provide short-term financing for businesses using the profit-and-loss sharing system without additional challenges.

Part 2: Fill in the blanks

Complete the sentences with the correct terms from the text.

1. Financing in Islamic banks is done on a __________ basis, where banks, depositors, and borrowers share profits and __________.
2. Savings accounts in Islamic banks invest money in __________, __________-term projects to minimize risk.
3. Unlike conventional loans, Islamic banks may charge a __________ fee to cover costs when offering interest-free loans.
4. __________ accounts are fixed-term deposits where the capital is not __________.

Part 3: Short answer

Answer the following questions based on the text.

1. What is the main ethical or religious principle behind Islamic banking's prohibition of interest?
2. How is the profit-and-loss sharing system similar to venture capitalism?

3. What are two financing methods Islamic banks use to help customers purchase expensive consumer goods?
4. Why do Islamic banks need to be particularly careful in evaluating projects under the PLS system?

Lesson 24: Money supply and control

A. Understanding money and its Measures

In an insightful interview, Professor John Webb, a banking expert, explains the nuances of money supply and measurement.

The money supply encompasses both the stock of existing money and the creation of new money. While currency in circulation—coins and banknotes used for transactions—forms only a small portion of the total money supply, the majority consists of bank deposits.

The definition of money supply varies depending on what is included. For instance, narrow money consists solely of currency and sight deposits—bank deposits that customers can withdraw at will. On the other hand, broad money encompasses a wider range of financial assets, including savings deposits, time deposits (accessible only after a specified period), money market funds, certificates of deposit, commercial paper, and repurchase agreements.

Another critical factor in measuring money is its velocity of circulation—how frequently money changes hands within a given period. This velocity, combined with the money supply, determines the total quantity of money spent in the economy.

B. Adjusting the money supply

Governments or, more commonly, central banks regulate the money supply through monetary policy. The primary goal is to control inflation, the persistent rise in prices that diminishes purchasing power. Key strategies for controlling the money supply include:

- **Adjusting the discount rate**: This is the interest rate at which central banks lend short-term funds to commercial banks. Lowering the rate encourages borrowing, which increases the money supply, while raising it has the opposite effect.
- **Modifying the reserve-asset ratio**: Central banks set the percentage of deposits that commercial banks must retain as reserves to meet withdrawal demands. A higher ratio means banks have less money to lend, reducing the money supply. Conversely, a lower ratio boosts lending.
- **Conducting open-market operations**: Central banks buy or sell treasury bills to commercial banks. Selling these bonds reduces commercial banks' lending capacity, while buying them back increases it, thus influencing the money supply.

C. The Monetarist perspective

Monetarist economists advocate that controlling the money supply is essential for managing inflation. They argue that price and wage levels are directly linked to the quantity of money in circulation and its velocity of circulation. Monetarists believe that excessive monetary growth—introducing too much new money—leads to inflation.

However, not all economists agree. Some contend that an expanding money supply often reflects increased economic activity, with more goods being sold and services performed, rather than being the cause of inflation.

D. Exercises

Eexercise 1

Insert the words in the boxes in the following paragraphs:

bonds	prices	commercial	tight	monetarist	velocity

Following the (1) .... argument that the average level of (2) .... and wages is determined by the amount of money in circulation, and its (3) .... of circulation, many central banks now set money supply targets. By increasing or decreasing the money supply, the central bank indirectly influences interest rates, demand, output, growth, unemployment and prices. The central bank can reduce the reserves available to (4) .... banks by changing the reserve requirements. This reduces the amount of money that banks can create and makes money (5) .... or scarce . Alternatively, the central bank can engage in what are called open market operations, which involve selling short-term government (6) .... (such as three-month Treasury bills) to the commercial banks, or buying them back.

Exercise 2

Are the following statements true or false? Find reasons for your answer in A and B.

1 Most money exists on paper, in bank accounts, rather than in nores and coins.

2 Banking customers can withdraw time deposits whenever they like.

3 The amount of money spent is the money supply multiplied by its velocity of circulation.

4 Central banks can try to control the money supply.

5 Commercial banks can choose which percentage of their deposits they keep in their reserves.

Exercise 3

Part 1: Multiple choice questions

1. What is the smallest measure of the money supply?

   a) Broad money

   b) Narrow money

   c) Savings deposits

   d) Time deposits
2. Which of the following is included in broad money but not in narrow money?

   a) Currency in circulation

   b) Sight deposits

   c) Certificates of deposit

   d) Coins
3. What does the velocity of circulation measure?

   a) The frequency with which money is spent within a given period.

   b) The amount of time deposits held by banks.

   c) The discount rate set by the central bank.

   d) The percentage of reserves held by commercial banks.
4. What is one way the central bank can decrease the money supply?

   a) Lowering the discount rate.

   b) Buying treasury bills from commercial banks.

   c) Raising the reserve-asset ratio.

   d) Allowing commercial banks to reduce their reserves.

Part 2: Fill in the blanks

1. Narrow money includes currency and _________ deposits that customers can withdraw at any time.

2. Broad money encompasses narrow money along with ________ deposits, money market funds, and certificates of deposit.
3. The ________ rate is the interest rate at which the central bank lends funds to commercial banks.
4. Inflation can result from excessive _________ growth, which adds too much new money to the money stock.

Part 3: True or false

1. Narrow money includes savings deposits.
2. The reserve-asset ratio determines the percentage of deposits that banks must retain for withdrawal purposes.
3. Monetarist economists believe that inflation is caused by excessive monetary growth.
4. Selling treasury bills in open-market operations reduces commercial banks' ability to lend.

Part 4: Short answer questions

1. What is narrow money, and how does it differ from broad money?
2. Explain how the central bank uses the discount rate to influence the money supply.
3. According to monetarists, how does the money supply impact inflation?
4. Describe one method the central bank uses to increase the money supply and its effect on commercial banks.

Lesson 25: Venture capital and startups

A. Raising capital

Alex Rodriguez works for a venture capital company. ‘As you know, new businesses, called start-ups, are all private companies that aren’t allowed to sell stocks or shares to the general public. They have to find other ways of raising capital. Some very small companies are able to operate on money their founders—the people who start the company — have previously saved, but larger companies need to get capital from somewhere else. As everybody knows, banks are usually risk-averse. This means they are unwilling to lend to new companies where there’s a danger that they won't get their money back. But there are firms like ours that specialize in finding venture capital: funds for new enterprises.

Some venture capital or risk capital companies use their own funds to lend money to companies, but most of them raise capital from other financial institutions. Some rich people, who banks call high net worth individuals, and who we call angels or angel investors, also invest in start-ups. Although new companies present a high level of risk, they also have the potential for rapid growth—and consequently high profits—if the new business is successful. Because of this profit potential, institutions like pension funds and insurance companies are increasingly investing in new companies, particularly hi-tech ones.

Note: Venture capital il is also called risk capital or start-up capital.

B. Return on capital

Venture capitalists like ourselves expect entrepreneurs—people with an idea to start a new company—to provide us with a business plan.

Because of the high level of risk involved, investors in start-ups usually expect a higher-than-average rate of return—the amount of money the investment pays—on their capital.

If they can’t get a quick return in cash, they can buy the new company’s shares. If the company is successful and later becomes a public company, which means it is listed on a stock exchange, the venture capitalists will be able to sell their shares then at a profit. This will be their exit strategy.

Venture capitalists generally invest in the early stages of a new company. Some companies need further capital to expand before they join a stock exchange. This is often called mezzanine financing and usually consists of convertible bonds — bonds that can later be converted to shares—or preference shares that receive a fixed dividend. Investors providing money at this stage have a lower risk of loss than earlier Investors like us have also less chance of making a big profit.

C. The elevator pitch

The expression 'elevator pitch' is used to describe the 60-90 seconds an entrepreneur has to interest a venture capitalist in his or her business idea. It comes from the approximate amount of time they would have if they travelled together in an elevator from the bottom to the top of a building. Making your presentation interesting is crucial for capturing your audience's attention during an elevator pitch.

D. Exercises

Exercise 1

Match the two parts of the sentences. Look at the text to help you.

1) Banks are usually reluctance
2) Start-ups often get money
3) New companies can grow rapidly
4) Risk capitalists usually expect
5) Venture capitalists need an exit strategy — a way
6) Mezzanine financing is a second round of financing

a) a higher-than-average return on their money.
b) and so are potentially profitable.
c) before a company joins a stock exchange.
d) to get their money back after a few years.
e) to lend money to new companies.
f) from specialized venture capital firms.

Exercise 2

Writing a letter You work for a firm of accountants. One of your clients Omar Farouk, has had initial meetings with CVP, a company that provides venture capital, and hopes to raise funds to build new warehouse facilities. You have recently received a letter from the CVP regarding your client's application for funds.

Read this letter from Baker Sediq, Director of Venture Capital Operations at CVP, in which he queries certain aspects of your client's application. Then, using all the information you have, write a reply (120–180 words) on behalf of your client.

Note: Help yourself with this model letter.

I am writing regarding your client, Omar Farouk, which has recently put in an application for venture capital to build a new warehouse.

Firstly, we noted from the accounts that the company has shown significant growth during the last year. Could you explain the reasons for such a high level of growth? -

We also note from the application that the estimates for construction of the new warehouse were 20% higher than the original figure we discussed with Othman Afan. Can you explain why?

Thirdly, we note that the accounts show a 50% increase in contractors' fees in the last year. Could you clarify this situation?

Finally, we understand that the DIY market, especially kitchens, is highly competitive and wonder if the projected sales figures and the projections for market share are realistic.

We look forward to your reply

Yours sincerely,

Baker Sediq

Director

Calculus Venture Partners

Lesson 26: Stocks and shares

A. Stocks, shares and equities

Stocks and shares are certificates representing part ownership of a company. The people who own them are called stockholders and shareholders. In Britain, stock is also used to refer to all kinds of securities, including government bonds. The word equity or equities is also used to describe stocks and shares. The places where the stocks and shares of listed or quoted companies are bought and sold are called stock markets or stock exchanges.

B. Going public

A successful existing company wants to expand and decides to go public.

↓

The company gets advice from an investment bank about how many shares to offer and at what price.

↓

The company gets independent accounts to produce a due diligence report.

↓

The company produces a prospectus, which explain its financial position and gives details about the senior managers and the financial results from previous years.

↓

The company makes a flotation or IPO (initial public offering).

↓

An investment bank underwrites the stock issue

go public: change from a private company to a public limited company (PLC) by selling shares to outside investors for the first time (with a flotation)

due diligence: a detailed examination of a company and its financial situation

prospectus: a document inviting the public to buy shares, stating the terms of sale and giving information about the company

financial results: details about sales, costs, debts, profits, losses, etc.

flotation: an offer of a company's shares to investors (financial institutions and the general public).

underwrites a stock issue: guarantees to buy the shares if there are not enough other buyers

C. Ordinary and preference shares

If a company has only one type of share, these are ordinary shares. Some companies also have preference shares whose holders receive a fixed dividend (e.g., 5% of the shares' nominal value) that must be paid before holders of ordinary shares receive a dividend.

Holders of preference shares have more chance of getting some of their capital back if a company goes bankrupt—stops trading because it is unable to pay its debts. If the company goes into liquidation — it has to sell all its assets to repay part of its debts — holders of preference shares are repaid before other shareholders, but after owners of bonds and other debts. If shareholders expect a company to grow, however, they generally prefer ordinary shares to preference shares because the dividend is likely to increase over time.

D. Exercises

Exercise 1

Part A: Definitions and terminology

Match the terms with their correct definitions:

1. Stockholders/Shareholders
2. Equities
3. Stock exchanges
4. Flotation (IPO)
5. Due diligence
6. Prospectus
7. Ordinary shares
8. Preference shares

Definitions:

a. A detailed report examining a company's financial situation.

b. Documents representing ownership in a company.

c. An offer of a company’s shares to the public for the first time.

d. A document providing financial and managerial details to potential investors.

e. The places where stocks and shares of listed companies are bought and sold.

f. Shares that provide fixed dividends and priority repayment during liquidation.

g. Shares that allow for potential dividend growth if the company expands.

h. Another name for stocks and shares.

Part B: Multiple choice questions

1. What does "going public" mean for a company?
   a) Issuing government bonds
   b) Selling shares to outside investors for the first time
   c) Buying back shares from the stock market
   d) Acquiring other companies
2. What role does an investment bank play in a company's IPO?
   a) Produces a due diligence report
   b) Underwrites the stock issue
   c) Buys all the company's shares outright
   d) Prepares the company's financial results
3. Who gets priority in repayment during liquidation?
   a) Holders of ordinary shares
   b) Holders of preference shares
   c) Owners of bonds and debts
   d) Investment banks

Part C: True or false

1. Stockholders and shareholders are different terms for the same concept.
2. Equities only refer to shares in government-owned companies.
3. Holders of ordinary shares receive dividends before holders of preference shares.
4. A company must sell all its assets when it goes bankrupt.

Part D: Short answer

1. Why might an investor prefer ordinary shares to preference shares if they expect the company to grow?

2. Explain the main difference between ordinary and preference shares.
3. What is the purpose of a prospectus in an IPO?

Exercise 2

Match the words in the box with the definitions below. Look at the text to help you.

bankrupt	prospectus
going public	ordinary shares
flotation	preference shares.
investors	stock exchange
liquidation	to underwrite

1- a document describing a company and offering stocks for sale

2- a market on which companies' stocks are traded

3 buyers of stocks

4- changing from a private company to a public one, quoted on a stack exchange

5- the first sale of a company's stocks to the public

6- to guarantee to buy newly issued shares if na one else does

7- shares that pay a guaranteed dividend

8- the most common form of shares

9- insolvent, unable to pay debts

10- the sale of the assets of a failed company

Lesson 27: The Dynamics of trading stocks and shares

A. Buying and selling shares

After newly issued shares are sold for the first time—known as the primary market—they can be freely traded on the secondary market at the stock exchange where the company is listed. Major stock exchanges like New York and London require extensive financial disclosures to protect shareholders. In contrast, over-the-counter (OTC) markets, such as NASDAQ and London's Alternative Investment Market (AIM), operate under fewer regulations, making them attractive to smaller companies.

The nominal value of a share (its stated price) rarely matches its market price (the current trading value), which fluctuates continuously during trading hours based on supply and demand. Modern stock exchanges often use automated trading systems to match buyers and sellers. Alternatively, markets rely on market makers, traders who quote bid (buying) and offer (selling) prices. The difference between these prices, known as the spread, is their profit. Most individual investors buy or sell shares through a stockbroker, who interacts with market makers on their behalf.

B - New share issues

When companies need additional capital, they can issue new shares. If these shares are offered to existing shareholders first, it is called a rights issue, giving current shareholders priority in purchasing them.

Alternatively, companies may choose to capitalize part of their profits or retained earnings by issuing new shares to shareholders instead of paying dividends. This process, known as a scrip issue, capitalization issue, or bonus issue, effectively turns profits into equity.

Companies with surplus cash may also buy back shares from the secondary market, which are then held as own shares (BrE) or treasury stock (AmE).

C - Categories of stocks and shares

Investors classify stocks and shares into distinct categories based on their characteristics:

- **Blue chips:** Stocks of large, reputable companies known for reliability and profitability. These stocks are often favored by institutional investors like insurance companies and pension funds.
- **Growth stocks:** Stocks expected to increase in value over time. Typically associated with tech companies, they focus on reinvesting profits rather than paying dividends, leading to a rise in stock prices.
- **Income stocks:** Stocks with a consistent history of paying high dividends, appealing to investors seeking regular income.
- **Defensive stocks:** Stocks offering stable earnings and dividends, with minimal fluctuation in value, even during economic downturns.
- **Value stocks:** Stocks believed to be undervalued compared to the company's assets, presenting an opportunity for long-term gains.

D. Exercises

Exercise 1

Match the words in the box with the definitions below. Look at A and B to help you.

to capitalize	market price	primary market	own shares
rights issue	secondary market	nominal value	

1. new shares offered to existing shareholders
2. the price written on a share, which never changes
3. to turn profits into stocks or shares
4. the market on which shares can be re-sold
5. the price at which a share is currently being traded
6. shares that companies have bought back from their owners
7. the market on which new shares are sold

Exercise 2

Part 1: Definitions

Match the following terms with their correct definitions from the options provided:

1. Primary Market
2. Secondary Market
3. Nominal Value
4. Market Price
5. Market Makers
6. Rights Issue
7. Treasury Stock

Options:

a. Traders who set bid (buy) and offer (sell) prices and earn profit from the spread.

b. Shares that a company buys back from the market and holds for itself.

c. The market where newly issued shares are sold for the first time.

d. The price stated on the share certificate, which may differ from its trading price.

e. The price at which shares are currently traded, determined by supply and demand.

f. Shares offered to existing shareholders as a priority when issuing new shares.

g. The market where shares are traded after their initial issuance.

Part 2: Multiple choice

Choose the correct answer for each question:

1. Which type of stock is associated with large, reliable companies and is often owned by institutional investors?

   a. Growth Stocks

   b. Blue Chips

   c. Income Stocks

   d. Defensive Stocks

2. What type of stock typically reinvests profits rather than paying dividends, leading to a rise in stock prices?

   a. Income Stocks

   b. Value Stocks

c. Growth Stocks

d. Defensive Stocks

3. What is a **scrip issue**?

   a. Issuing new shares to existing shareholders instead of paying dividends.

   b. Buying back shares from the secondary market.

   c. Offering shares to the public for the first time.

   d. Shares that receive fixed dividends before others.

Part 3: True or false

State whether the following statements are True or False:

1. Blue-chip stocks are considered high-risk investments.
2. The spread is the difference between bid and offer prices quoted by market makers.
3. Defensive stocks are highly volatile and often experience dramatic price swings.
4. Treasury stock refers to shares that have been issued and later bought back by the company.

Part 4: Short answer

1. Explain the difference between the **primary market** and the **secondary market** in your own words.
2. Why might a company choose to buy back its shares from the secondary market?
3. List two advantages of holding defensive stocks during an economic downturn.

Lesson 28: Shareholders or speculators?

A. Bulls, Bears, and Stags: Understanding investors

Stock markets are tracked using stock indexes (or indices), which measure the average price changes of a selected group of significant stocks. Examples include the **Dow Jones Industrial Average (DJIA)** in New York and the **FTSE 100 Index** (commonly called the "Footsie") in London. These indexes are key indicators of market performance. For instance, on **Black Monday, October 19, 1987**, the DJIA plummeted by a staggering 22.6% in a single day.
Investors in the stock market are often categorized metaphorically:

- **Bulls** anticipate rising prices.
- **Bears** expect prices to decline.
- **Stags** invest in new share issues, betting on over-subscription (more demand than available stocks), allowing them to sell their shares quickly for a profit.

Market trends are similarly labeled:

- A **bull market** occurs when most stocks rise in value.
- A **bear market** describes a period of widespread decline in stock prices.

B. Dividends and Capital Gains: Shareholder Rewards

Profitable companies can choose to:

1. **Pay dividends** to shareholders.
2. **Retain earnings** within the company, boosting stock value.

Stockholders can realize **capital gains** by selling their shares at a higher price than the purchase price. Some investors prefer capital gains over dividends due to tax advantages, as capital gains are often taxed less than dividend income.
When buying shares on the secondary market, two terms are significant:

- **Cum div**: The buyer is entitled to the next dividend, so the share price includes its estimated value.
- **Ex div**: The buyer is not entitled to the next dividend, resulting in a lower share price.

C. The Role of Speculators

While institutional investors hold stocks long-term, **speculators** trade shares rapidly to profit from market fluctuations. One subset is **day traders**, who buy and sell shares within the same day, avoiding the need to pay for their purchases before selling. Settlement day—typically three business days after a trade—is when payment and ownership are finalized.

Short selling is a strategy used by speculators anticipating a price drop:

1. Agree to sell stocks at the current price (e.g., $26.20).
2. Wait for the price to decline (e.g., to $25.90).
3. Buy the stocks at the lower price and complete the trade on settlement day, profiting from the difference.

Conversely, taking a **long position** means owning the stocks outright and holding them as an investment.

Example of short selling profit calculation:

- **June 1:** Sell 1,000 Microsoft stocks at $26.20.
- **June 3:** Buy 1,000 stocks at $25.90.
- **June 4:** Settlement day: Profit = (Sell price - Buy price) x Quantity = $300.

D. Exercises

Exercise 1

Connect the term and definition in the table below with an arrow.

Investor Type	Definition
Bull	• An investor who expects stock prices to fall.
Bear	• An investor who buys stocks hoping for an immediate profit by reselling them at a higher price.
Stag	• An investor who expects stock prices to rise.
Speculator	• An investor who buys and sells stocks quickly to make short-term profits.

Exercise 2

Fill in the blanks with the appropriate terms from the text: *dividend, capital gain, cum div, ex div.*

1. When an investor buys shares with the right to receive the next dividend, the shares are considered _______.
2. An investor may choose to sell shares at a higher price than they paid for, making a _______.
3. Shares bought without the right to receive the next dividend are considered _______.
4. If a company retains its earnings rather than paying out dividends, the value of its stock may rise, providing an opportunity for a _______.

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