Investment Decision Making in the Private and Public Sectors

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I am always in search of a text that can be used as a supplement to the texts and readings assigned to my classes. I am also always willing to adopt a new text that is able to provide a new, innovative or clearer picture of the topical coverage of Investments and Portfolio Management. To find a text that accomplishes either of these tasks and to find one that bridges the gap between the private and public sectors would be a text of great value. Thus, when asked to review Henri Beenhakker's text I thought that I might have been on to something. To suggest disappointed in what was provided is an understatement.

Beenhakker's purpose for writing this book was to provide both "educators who wish to bridge the gap between the worlds of practice and education … the connection between what a student learns in school and what he or she will need to solve problems faced by real managers," and "professionals who have the responsibility for investing money in new ventures," a text that could be used by "business schools and departments of economics or industrial engineering." This is a formidable task. It is a task that spans three distinct and comprehensive areas of study: corporate finance, investments and portfolio management, and public finance.

Beenhakker believes that *Investment Decision Making* "comprehensively describes the multifaceted approach to investment planning that involves the interactions of various disciplines." He assumes that the reader has both no prior knowledge of investment planning and has very limited knowledge of mathematics. Beenhakker thus gears his text to "business managers and investment analysts who lack a sophisticated mathematical background."

Investment Decision Making is a compilation of chapters that are lacking in theory, application, and relevant detail. The book too haphazardly thrown together to provide either sufficient direction or support to provide the reader with a comprehensive understanding of any one of the defined areas of study, let alone provide an integrated understanding of the combination of financial management, investments and portfolio management, and public finance.

The chapters included in Beenhakker's text are*: Financial Statements and Ratios*; *Valuation and Investment Problems When Shares Are Under- or Overvalued*; *Derivative Securities*; *Cost of Capital*; *Project Appraisal*; *Programming and Planning*; and, *Cost Minimization Problems*.

Beenhakker's text did not employ standard terminology. Moreover, when changes are made to standard terminology, appropriate definition and notation did not occur. For example, Beenhakker uses the terms *pwf* and *sppwf* in Chapter 2, *Valuation and Investment Problems*. I assume that *pwf* stands for present weighting factor, corresponding to a present value interest factor familiar to all. The *sppwf*, I assume, is comparable to the present value interest factor of an annuity, though I am not quite sure. The meanings of s or either p in *sppwf* is anyone's guess.

Chapter 1, *Financial Statements and Ratios*, provides the reader with a brief review to a firm's financial statements, and of ratio analysis. Little time is spent reviewing comparability problems that result when firms employ different accounting methods. Problems associated with the seasonal nature of firms were neither identified nor discussed. Problems with a changing economic environment leading to noncomparable time series analysis were not discussed. Domestic versus global comparability was neither identified nor discussed.

Chapter 2 presents the fundamentals of bond and stock valuation. The chapter provides a framework of present value analysis for bonds and equity security valuation. By the fifth page of the chapter, the basics of valuation for bonds and stocks are complete. A discussion of whether the dividend discount model leads to incorrect share valuation is now initiated. Four pages devoted to defining risk, return, and intrinsic value are simply not sufficient to

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cover complex topics. Risk measures for either bonds or equities are not covered. Embedded options in financial assets are not covered. Risk differences between various financial assets are not covered.

The author suggests that "the simple fact that takeover offers often exceed 30% for uncontested bids … 50% for contested bids" are indicative of market inefficiencies "more often than we would be inclined to think." Although the statistics cited may be accurate, no alternative explanations as to the endogenous or exogenous factors that might lead to premiums of this size (sub-optimal corporate strategy, synergy, foreign acquisition, inefficient management, etc.) were presented. To suggest that the market is not efficiently pricing the specific characteristics of firms is simply not justified given the material presented in the chapter.

Chapter 4 presents Beenhakker's concept of *Diversification*. In an investment and portfolio management text, one would expect that diversification refers to the combination of assets in a manner that results in the elimination or reduction of company specific risk. Not so in *Investment Decision Making*. A better title of the chapter might have been *Merger and Acquisitions a Very Brief Overview*. Nowhere is there a mention of correlation, the efficient frontier, the CML, the SML, or Beta. One does, however, receive a brief review of synergy, merger motivation, and a very brief taste of accounting methodology and standards associated with acquisitions.

Chapter 5, *Cost of Capital* would have been better served with a thorough review of the economic theory of capital structure. Better yet, it should have included a thorough analysis of risk. In an analysis of risk -- duration, correlation, CAPM, and APT should have been covered.

Chapter 6, *Project Appraisal*, would have been improved by providing a detailed review of the applications, merits, and pitfalls of various capital budgeting techniques. Relating NPV to shareholder wealth maximization and then providing applications to the public sector would also have helped the chapter. Table 6.1 attempts to present the various ways the costs of a project are classified or defined according to the management, economics, public sector, and value engineering disciplines. The table is poorly structured, such that one would believe that the cost of direct materials (management), fixed costs (economics), opportunity costs (public sector), and costs to produce (engineering) are different terms for the same cost item. Clearly, they are not. The table is an indication of other problems in the chapter.

Chapter 7, *Programming and Planning*, is a mystery. To this point, mathematics has been kept to a minimum. Here, however, the author introduces linear programming and his heuristic model. Although linear programming is an important topic in capital budgeting, a greater use of mathematics should have been presented in earlier chapters.

Overall, the idea of providing linkages of Investment and Portfolio Management to both the public and private sectors is commendable. The differences between the two sectors are not as great as some would have us believe. Beenhakker's attempt to provide the linkage between the public and private sectors is a noble one that falls far short of the mark.