Bloomberg Finance Fundamentals - Module 2

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Types of Investment: The Financial System

What are some of the Financial Pressures that Companies Face?

In Module 2, we follow Ben, a 21-year-old retail management apprentice whose dream is to rise to the top of Wear It Now, a major UK clothing store. Ben has worked at the company since he was 16, around the time he began living independently. He enjoys the stability the job offers, values interacting with customers, and has built close friendships. Through his retail management apprenticeship, Ben gained a comprehensive understanding of how the store operates—spending time in departments ranging from supply chain to the sales floor, while also earning a business management qualification and receiving guidance from experienced mentors. Though he initially expected to become a Store Manager, Ben discovered a strong fit in the cash management department, where he now appreciates the importance of understanding how global events and economic trends affect retail operations. His work has taught him that a retailer's long-term success depends on their ability to anticipate and manage financial pressures. In this lesson, you'll join Ben in exploring key questions: What are some of the financial pressures that companies face? And how is the financial system structured? Let's get started.

Cash management plays a crucial role in every type of business because companies must maintain a steady flow of cash coming in and going out. Similar to personal finances, businesses can't pay their bills if they don't have enough money in the bank, so they must closely monitor income and upcoming expenses. A strong cash reserve is often viewed as a sign of financial health, which makes a company more attractive to investors. Efficient cash flow management ensures that the company can meet its financial obligations, respond to emergencies, and reinvest in its own growth—this ability is known as liquidity. The responsibility for managing corporate cash typically falls to professionals such as Business Managers, Corporate Treasurers, and most importantly, the Chief Financial Officer (CFO), who oversees the entire process. To illustrate this further, the CFO of global logistics and delivery company DHL shares her perspective on why maintaining a strong balance sheet is so valuable.

How is the Financial System Structured?

In his weekly catch-up meeting, Ben informs his mentor Mark that he has decided not to apply for the Team Manager role in the store. Instead, he plans to pursue a more behind-the-scenes career in finance. Mark, who has a background in finance, is enthusiastic about Ben's decision and offers to help him understand the financial system. He gives Ben an overview of how it all works and highlights the various roles Ben should consider as he maps out this new career path.

The financial system is made up of two interconnected parts: the buyside and the sellside. These two sectors function as the core of the financial system, each relying on the other to keep income flowing. The buyside consists of institutions like retail banks that invest money on behalf of households. Clients deposit their savings into these banks, which then use the funds to pursue investment opportunities that can grow wealth over time. These investments, known as securities or financial instruments, commonly include stocks (or shares) and bonds. The sellside, on the other hand, comprises institutions such as investment banks that support companies with their strategic financial needs. When a company wants to raise money, it turns

to the sellside for guidance. This may involve issuing equity by selling shares to the public or raising debt through loans and bonds. Sellside institutions help structure these deals and package them into financial instruments, which they then offer to professional investors on the buyside.

Investment banks, which operate on the sellside, help companies raise money in the public market to fund growth initiatives such as opening new stores, launching new product lines, expanding marketing efforts, or building manufacturing and distribution facilities. These banks act as intermediaries, connecting companies in need of capital with investors on the buyside who are looking for promising investment opportunities. The process typically begins when a company identifies a growth opportunity and decides to raise capital—often by borrowing. At this stage, a Relationship Manager at the investment bank collaborates with the company and other financial experts to determine the most effective strategy for securing funds, much like a Bank Manager would when arranging a personal loan. Once a plan is agreed upon and approved by the company's Chief Financial Officer (CFO), the bank initiates a thorough diligence process. During this phase, the investment bank carefully reviews the company's financials to ensure transparency and accuracy, minimizing the risk of fraud, which could jeopardize investor trust. After confirming that everything is in order, the bank prepares a prospectus—a detailed marketing document that outlines the investment opportunity and appeals to potential investors on the buyside.

The question now is: which career path should Ben choose? Should he continue with his current company and work toward becoming a Corporate Treasurer, a role that would allow him to deepen his expertise in managing company finances? Or should he explore a new direction on the sellside, pursuing a position as a Relationship Manager at an investment bank, where he would help companies raise capital and connect with investors?

Plenary

In this lesson, you've explored the concept of cash management and why it's essential for businesses to maintain a steady flow of funds. You've also learned about the structure of the financial system, including the distinct but interconnected roles of buyside and sellside institutions. Additionally, you were introduced to two key financial careers: the Corporate Treasurer, who manages internal company finances, and the Relationship Manager, who helps companies raise capital through investment banks. Now, it's time to test your understanding with a game of Financial Jeopardy—can you correctly match each answer to its question? Remember, only one will be right, and two will be wrong!

Types of Investment: Company Investments

What Should Ben Consider Before Investing?

Five years later, Ben is now a Corporate Treasurer and couldn't be happier with his decision to pursue this path. He enjoys his role even more than he did when he started, appreciating the dynamic nature of the job, where no two days are the same. Stability remains important to Ben, and he's grateful he chose to stay with Wear It Now, where he feels like a long-term member of the team and considers his colleagues more like family. In his role, Ben focuses on raising capital, working closely with internal financial teams and investment banks on the sellside to secure funding for new projects, expansions, or investments. One of the benefits of the role is the deep understanding he's gained of global currencies and exchange rates—knowledge he now uses to manage his own finances effectively. He earns a solid income, has control over his savings, and plans for the future with confidence. In this lesson, you'll follow Ben through a day in his life as a Corporate Treasurer to understand how companies invest, especially when facing financial uncertainty. You'll learn about various investment types—including foreign currencies, bonds, and commodities—and gain insight into the risks involved. Along the way, you'll see how professionals like Ben rely on expertise and strong relationships to navigate complex financial markets.

How do Companies Invest?

Ben begins his day the way he always does—by checking the latest headlines on Bloomberg News to stay informed about any developments that might impact his company. After reviewing the news, he checks his calendar and sees a packed schedule ahead filled with meetings. Just as he's getting ready, his phone rings from an unfamiliar number. Focused on preparing for his first meeting, he lets the call go to voicemail and listens to the message as he heads to the conference room. The message is from Arjun, a journalist from The Citizen newspaper, who wants to ask Ben some questions. Ben decides to put it on hold for now since there's nothing urgent in the news. By 8:30 AM, he receives a call about buying foreign currency to support the purchase of new machinery being manufactured in the United States.

Ben's first meeting is with the foreign exchange team at an investment bank, where the focus is on foreign exchange—or FX—the process of buying and selling currencies. Just as travelers must exchange money when going abroad due to different countries having different currencies, companies operating internationally must also convert currencies to do business. To manage this, businesses like Wear It Now work with foreign exchange desks at investment banks. For Ben, managing currency risk is a critical part of his role as Corporate Treasurer, since fluctuations in exchange rates directly affect company profits. These rates vary based on factors like supply and demand for goods and services, interest rates, and overall confidence in a country's government and economy. Financial experts often refer to currencies as being "strong" or "weak," depending on their purchasing power. A strong currency allows a company—or a traveler—to buy more, stretching their money further. A weak currency, by contrast, reduces buying power, making goods and services more expensive. Ben and his company base strategic decisions, such as which countries to conduct business with, on the relative strength of the British pound—their home currency.

In the foreign exchange market, the institutions with the most influence are central banks—public entities responsible for managing their nation's currency. Beyond issuing physical money and, more recently, digital currencies, central banks play a crucial role in overseeing payment systems, supporting financial institutions, and managing foreign currency reserves. Unlike retail or commercial banks, central banks don't offer accounts or loans to individuals or businesses. Their main goal is to maintain price stability, which they typically achieve by adjusting interest rates as part of their monetary policy. Changes in interest rates can influence how attractive a currency is to investors—rising rates can increase demand, while falling rates can have the opposite effect. Because of this, market professionals closely monitor central bank actions and announcements, knowing they have a significant impact on currency values and the broader economy.

Before finalizing the purchase of new machinery from the US, Ben takes a moment to compare prices with a potential German supplier. The US equipment is priced in US dollars, while the German alternative is quoted in euros—the official currency of 20 European countries. To determine which option offers the better deal, Ben uses the Bloomberg Terminal to review current exchange rates. Since his company will ultimately pay in one of these foreign currencies, he needs to convert each quoted price into British pounds to evaluate the true cost and decide which purchase offers the best value.

Ben has successfully secured the US dollars he needed at a favorable exchange rate. With the deal done, it's now 10 o'clock—just enough time for a quick mid-morning snack before his next meeting. He's scheduled to meet with his Relationship Manager from the investment bank to explore funding options for a new warehouse project in northern England. His Relationship Manager, Ana-Theresa, presents two potential solutions: Ben could either take out a loan from the bank or issue a bond to raise the necessary capital.

In Module 1, you were introduced to loans—agreements where a lender provides a borrower with a sum of money to be repaid over a specified period. The terms of the loan, usually set by the lender, dictate repayment conditions, including any restrictions on future borrowing and the interest to be paid on top of the principal amount. These terms are often strict to ensure the borrower can meet repayment obligations. In contrast, bonds offer an alternative way for companies to raise money. A bond is essentially an IOU with interest: the borrower issues the bond, promising to repay the full amount on a future date, while making regular interest payments until then. Unlike loans, bonds involve collaboration with investment bank profession-

als on the sellside who structure the bond's terms and promote it to investors through buyside institutions. These investors can purchase and even trade the bonds. By issuing bonds, companies can attract institutional investors to lend them money under agreed-upon conditions, all formalized through legally binding contracts.

Ben's personal pension fund is primarily invested in bonds, as they are generally less risky than other investment types like stocks, while still offering returns through interest payments. Financial advisors often recommend having a mix of low-risk and high-risk assets in a portfolio to balance potential returns and stability. In his role as Corporate Treasurer, Ben also favors issuing bonds over taking out loans. Bonds typically come with lower interest rates, which benefits his company's profit margins, and they are usually less restrictive than loans. Loans can impose conditions, such as preventing further borrowing until the debt is repaid, which would complicate Ben's job. In contrast, bonds offer a way to raise capital with fewer limitations—making them, from Ben's perspective, similar to loans but with lower interest and fewer strings attached.

Ben is pleased with his decision to issue bonds and move forward with the warehouse construction. His day continues on a high note, and he rewards himself with his favorite lunch. As he eats, his phone buzzes again with a call from an unfamiliar number—likely the journalist who contacted him earlier. He chooses to return the call later, after his scheduled end-of-day check-in with Shelby, the CFO. At 1 o'clock, lunch is over and Ben heads into a meeting with Hiroko from Procurement. The topic is urgent: securing a large amount of diesel to fuel the company's trucks. Earlier, Ben had noticed potential price increases and supply chain disruptions while reviewing market data on the Bloomberg Terminal. Ana-Theresa, his Relationship Manager, had also flagged these risks. Now, Ben must plan accordingly to safeguard the company's finances. He makes his way to Corporate Procurement, the team tasked with sourcing all the goods and services needed for operations—including fuel. Negotiating prices with suppliers is critical, as fuel costs directly impact profit margins. Ben and the treasury team work closely with Procurement to help manage and mitigate these pricing risks.

Diesel is considered a commodity—a physical, tangible raw material used by companies to operate their businesses. Unlike equities or debt instruments, the commodity market deals in goods such as oil, coal, gold, wheat, coffee, livestock, and more. These items may be raw resources like petroleum or iron, or manufactured products like diesel, plastics, and steel. Commodities are often bought and sold using "futures contracts," where a company agrees to purchase a set amount today for delivery in the future. These contracts are traded on commodities exchanges, and their prices can fluctuate significantly due to supply and demand. When supply is low, prices rise; when supply is high, prices drop—giving rise to either a seller's or buyer's market. These fluctuations make companies vulnerable to financial instability, especially if the cost of essential inputs like diesel is unpredictable. To manage this risk and stabilize their costs, companies like Ben's turn to commodity trading. They purchase financial instruments called derivatives, which allow them to lock in prices in advance. These contracts are crafted by Commodity Traders—specialists at investment banks who analyze factors like weather, politics, and market trends to forecast prices. If a trader expects prices to rise, they may secure a bulk order at today's rate through a futures contract. If they're right, the company benefits by avoiding higher costs. If they're wrong and prices stay low, the company still pays the agreed-upon rate. Even in that case, the futures contract provides price stability, enabling Ben to plan ahead and keep Wear It Now financially secure.

Ben's meeting with Procurement has gone smoothly. Hiroko recommended that he purchase a futures contract for diesel to lock in a fixed price over the next six months, helping protect the company from sudden cost increases. Back at his desk with a cup of tea, Ben prepares to contact the Commodity Trader to explore contract options. But before he can, he receives a surprise call from Frank, the personal assistant to Shelby, the CFO. Frank informs him that Shelby needs to see him immediately due to an issue with their company's stock price triggered by a breaking news story. At the same time, Ben notices an urgent email from Investor Relations requesting a call. His stomach drops—he regrets not calling the journalist back earlier and begins to worry about what the problem could be. Taking a deep breath, he heads upstairs to face whatever comes next.

Plenary

In this lesson, you've learned how fluctuations in currency and commodity prices can significantly impact business decisions. You explored the role central banks play in maintaining currency stability through tools like interest rate adjustments. Additionally, you were introduced to key financial instruments available to companies—such as bonds and derivatives—that help manage risk and secure funding. Now, let's take a moment to review how all of this unfolded throughout Ben's day.

Types of Investment: Financial Risks

What are the Different Types of Financial Risks that Companies Face?

When Ben walks into the CFO's office, he's met by the Investor Relations team and shown a breaking news story: Arjun, the journalist who had previously contacted him, has exposed their retail partner, EDGY, as a fraudulent company. EDGY, a US-based app that recruited young influencers to buy and resell designer clothes, was found to be engaging in deceptive practices—charging ambassadors upfront, taking their money, placing fake orders for high-end clothing, and canceling them before fulfillment. The news shocks Wear It Now's management, who had invested in EDGY when its stock was soaring and had even partnered with them on marketing campaigns targeting young consumers. The fallout is swift: a major asset manager issues warnings, EDGY's stock drops 20% following the SEC's announcement of a formal investigation, and the CEO tries to calm investors by promising to restore trust—only to be caught selling his own shares two weeks later in another report by Arjun. EDGY, now in financial freefall, approaches an investment bank to explore a merger in a last-ditch effort to avoid bankruptcy, but no firm is willing to take the risk. The U.S. Department of Justice launches a criminal investigation, media coverage explodes with reports of fraud charges and potential jail time, and EDGY ultimately files for bankruptcy, with its stock crashing from $70 to 10 per share and the NYSE moving to delist it. To make matters worse, photos go viral showing truckloads of unused clothing—meant for EDGY's influencers—being dumped into landfills, sparking public outrage over the environmental consequences of influencer culture and fast fashion.

In this lesson, you'll help Ben explore two key questions: What are the different types of financial risks that companies face? And how do companies navigate and mitigate those risks? You'll follow Ben as he manages the fallout of being linked to the EDGY scandal, uncovering the strategies businesses use to protect themselves in uncertain financial situations.

The EDGY scandal has dealt a serious blow to Ben's margins, and things worsen when Arjun publishes another article exposing Wear It Now's involvement as a major investor and partner of the disgraced company. This revelation prompts the media, investors, and customers to question the integrity and sustainability of Wear It Now, damaging its reputation by association. As Corporate Treasurer, it's Ben's responsibility to evaluate the financial impact this scandal could have on the business. He worries that if the brand's connection to EDGY leads to a loss of public trust, customers may stop buying their products. If sales decline, the company could be left with large volumes of unsold inventory and mounting liabilities. Ben begins to consider the serious operational costs Wear It Now must continue to cover, such as rent for retail locations, employee wages, and payments to suppliers for raw materials. Without steady revenue, meeting these obligations could become extremely difficult, putting the company's financial health at risk.

Financial risk refers to the possibility of a company losing money due to a business or investment decision, and it covers any danger that could lead to financial loss. Companies face a range of financial risks daily, from fraud and operational breakdowns to environmental disasters. For Ben and Wear It Now, several key financial risks have become especially pressing. One is operational risk, which arises from failures in internal systems, people, or processes—or from external events—and can lead to costly consequences, such as lawsuits from defective products. Another is reputational risk, which affects a company's public image and can drive away customers and revenue. For instance, Wear It Now's reputation has been damaged by its association with EDGY, especially with viral images of unused clothes being dumped. Then there's liquidity risk, which involves the inability to meet financial obligations. Ben's inability to sell EDGY shares, now

rendered worthless, jeopardizes the company's ability to pay suppliers and maintain a cash buffer. Lastly, there's credit risk, or the danger that money borrowed won't be repaid. Due to the scandal, Ben's company may now be viewed as a higher credit risk, forcing them to accept worse lending terms and higher interest rates from financial institutions.

How do Companies Navigate and Mitigate Financial Risks?

It's now been a few months since the EDGY scandal erupted, and the fallout continues. Environmental groups have begun protesting outside Wear It Now stores, amplifying public scrutiny. Just as Ben predicted, the company's reputation has taken a serious hit, leading to a noticeable decline in sales—particularly among younger customers, the very demographic targeted by their partnership with EDGY. This drop in revenue has affected the company's overall profitability. As a result, Wear It Now's stock price has fallen, reducing its market valuation. Investor Relations is overwhelmed with emails and calls from concerned shareholders demanding answers and reassurance. Ben is now required to attend yet another emergency meeting to discuss how the company will respond and what steps they must take next.

In the emergency meeting, Ben explains that Wear It Now only has enough funds in reserve to cover operating expenses for the next six months. He reminds the team of his earlier decision to issue bonds for the construction of a new warehouse and notes that bondholder payments will soon come due. If they can't meet those obligations, the company could face even greater reputational damage. Recognizing the urgency, Ben recommends taking out a loan to help cover operating costs during the sales slump and to finance a rebranding campaign to help the company recover from the EDGY scandal. The CFO agrees with Ben's proposal, and the team decides to proceed with borrowing from a commercial bank. Ben offers to loop in his Commercial Banker, Patricio, to join the discussion via phone.

Plenary

In this lesson, you've explored the different types of financial risks companies face, including operational, reputational, liquidity, and credit risk. You've also seen how a scandal—like the one involving EDGY—can impact a company's stakeholders, damaging trust, reducing sales, and triggering financial instability. Finally, you learned about the proactive steps businesses can take to mitigate these risks, such as issuing bonds, securing loans, managing cash flow, and implementing rebranding strategies to rebuild confidence and ensure long-term resilience.

In this module, you've explored how buyside and sellside institutions operate—serving households and companies respectively—and examined the various financial instruments available to each, including loans, bonds, and derivatives. You've learned how fluctuations in currency and commodity prices can influence business decisions and seen how central banks play a critical role in maintaining currency stability through tools like interest rate adjustments. Finally, you've studied the different types of financial risks companies face—such as operational, reputational, liquidity, and credit risk—and the strategies they can use to manage and mitigate those risks effectively.