Name : ....

Roll No. : ....

Invigilator's Signature : ....

CS/BBA (H)/BIRM/BSCM/SEM-4/BBA-403/2013

2013

FINANCIAL MANAGEMENT – I

Time Allotted : 3 Hours *Full Marks :* 70

The figures in the margin indicate full marks.

Candidates are required to give their answers in their own words as far as practicable.

GROUP – A

(Multiple Choice Type Questions)

1. Choose the correct alternatives for any *ten* of the following : 10 × 1 = 10

   i) When NPV = 0, cost of capital of the firm is equal to its

      a) EPS b) IRR

      c) EBIT d) ARR.

   ii) The financial leverage explains the relationship between

      a) EPS and EBIT of a firm

      b) EPS and EAT of a firm

      c) Sales and EBIT of a firm

      d) MPS and EPS of a firm.

iii) Below the indifference point EBIT, what should be incorporated in the capital structure ?

a) Debt capital b) Equity capital

c) Both of these d) None of these.

iv) The CAPM model calculates the cost of equity shares by taking into consideration

a) Risk-free rate of return

b) Beta coefficient for measuring market risk

c) Expected returns on the market as a whole

d) All of these.

v) Indifference point refers to the level of EBIT between two financing plans where

a) DOL of the two plans equals

b) DFL of the two plans equals

c) DCL of the two plans equals

d) EPS of the two plans equals.

vi) Degree of financial leverage increases if

a) long term loan increases

b) long term loan decreases

c) equity capital increases

d) equity capital decreases.

vii) Which of the following is *not* a component of working capital ?

a) Bills receivable b) Preliminary expenses

c) Prepaid wages d) Cash in hand.

viii) Lock-box system

a) reduces floating time b) increases floating time

c) no effect d) increases cost.

ix) Operating leverage can be computed by

a) Contribution / EBIT

b) EBIT / Fixed cost × Capital employed

c) Sales / EBIT

d) Fixed cost / EBIT.

x) If the present value of cash inflows are greater than the present value of cash outflows, the project would be

a) accepted b) rejected with condition

c) rejected with approval d) rejected.

xi) Poor liquidity and higher risk represent

a) conservative current assets policy

b) aggressive current assets policy

c) moderate current assets policy

d) closure of business.

xii) Modigliani and Miller argue that the dividend decision

a) is irrelevant as the value of the firm is based on the earning power of its assets

b) is relevant as the value of the firm is not based just on the earning power of its assets

c) is irrelevant as dividends represent cash leaving the firm to shareholders, who own the firm anyway

d) is relevant as cash outflow always influences other firm decisions.

GROUP – B

(Short Answer Type Questions)

Answer any *three* of the following. 3 × 5 = 15

2. What is cash budget ? State the motives behind holding cash by businesses.

3. A firm has a following capital structure and after-tax costs for the different sources of funds used :

Source of finds	Amount (Rs.)	Proportion (%)	After-tax cost (%)
Debt	15,00,000	25	5
Preference shares	12,00,000	20	10
Equity shares	18,00,000	30	12
Retained earnings	15,00,000	25	11
Total	60,00,000	100	

You are required to compute the weighted average cost of capital.

4. Discuss the importance of capital budgeting technique in investment decision.

5. Explain the term 'Operating cycle' in a manufacturing firm.

6. Explain the factors determining the cost of capital.

GROUP – C

(Long Answer Type Questions)

Answer any *three* of the following. 3 × 15 = 45

7. The existing capital structure of *XYZ* Ltd. is as under :

Equity shares of Rs. 100 each	Rs. 40,00,000
Retained earnings	Rs. 10,00,000
9% preference shares	Rs. 25,00,000
7% debentures	Rs. 25,00,000

The existing rate of return on company's capital is 12% and income tax is 50%.

The company requires a sum of Rs. 25,00,000 to finance its expansion programme for which it is considering the following alternatives :

i) Issue of 20,000 equity shares at a premium of Rs. 25 per share.

ii) Issue of 10% preference shares

iii) Issue of 8% debentures.

It is estimated that P/E ratios in case of equity, preference and debenture financing would be 20, 17 and 16 respectively.

Which of the above alternatives would you recommend and why ?

8. a) "In today's dynamic world of finance all the traditional dividend theories like Walter model, Gordon's model and M-M model are outdated and they have lost their relevance." Do you agree with this statement ? State your view either for or against with logic.

   b) Illustrate with examples the different forms of dividend payment.

9. Krishna Enterprise has to replace one of its machines which had become unserviceable. Two options are available :

   i) A more expensive machine (EM) with 12 years of life

   ii) A less expensive machine (LM) with 6 years of life.

   If machine LM is chosen, it will be replaced at the end of 6 years by another LM machine. The pattern of maintenance, running cost and prices are as under :

Particulars	**(figures in Rupees)**	
	EM	**LM**
Purchase price	10,00,000	7,00,000
Scrap value at the end of life	1,50,000	1,50,000
Overhauling cost is due at the end of	8th year	4th year
Overhauling costs	2,00,000	1,00,000
Annual repairs	1,00,000	1,40,000

Cost of capital 14%. You are required to recommend with supporting calculations which of the machines should be purchased.

End of 4th Year — 0·5921 End of 12th Year — 0·2076

End of 6th Year — 0·4556 Years 1 to 6 — 3·8890

End of 8th Year — 0·3506 Years 1 to 12 — 5·6600.

10. Relevant information about three companies is given below :

	BIL	PIL	MIL
Annual production capacity (units)	1,00,000	1,50,000	2,50,000
Capacity utilization and sales	75%	75%	75%
Unit selling price (Rs.)	40	40	40
Unit variable cost (Rs.)	15	15	20
Fixed cost p.a. (Rs.)	2,00,000	3,00,000	5,00,000
Equity capital (Rs. 100 per share)	5,00,000	7,00,000	10,00,000
10% preference share capital (Rs.)	—	50,000	1,00,000
15% debentures (Rs.)	1,00,000	2,00,000	3,00,000

Calculate operating leverage, financial leverage and EPS of the three companies.

11. You are required to prepare for the Board of Directors of Sumana Ltd. a statement showing the working capital needed to finance a level of activity of 5,200 units of output.

You are given the following information :

Elements of cost	**Amount per unit Rs.**
Raw materials	8
Direct labour	2
Overheads	6
Total cost	16
Profit	4
Selling price	20

Additional information :

i) Raw materials are in stock, on average, one month.

ii) Materials are in process, on average, half a month.

iii) Finished goods are in stock, on average, 6 weeks

iv) Credit allowed by creditors is one month

v) Credit allowed to debtors is two months

vi) Lag in payment of wages is 1·5 weeks.

Cash in hand and at bank is expected to be Rs. 7,300. You are informed that production is carried on evenly during the year and wages and overheads accrue similarly.

12. Write short notes on any *three* of the following : 3×5

a) Wealth maximation

b) Cost of retained earning

c) Stock splits

d) Bonus shares

e) Dividend equalization reserve.