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CS/BBA(H), BIRM, BSCM/SEM-4/BBA-403/2012

2012

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) Which of the following is not considered to be a financial decision ?

      a) Recruitment of 100 sales people in five zones.

      b) Launching a new detergent with a marketing budget of Rs. 1 crore.

      c) Implementing SAP, ERP to connect 450 offices in India and abroad

      d) Lunch time is deferred by half an hour.

   ii) Higher operating leverage is related to the use of additional

      a) fixed costs

      b) variable costs

      c) debt financing

      d) common equity financing.

iii) Calculate the degree of financial leverage (DFL) for a firm when its EBIT is Rs. 2,000,000. The firm has Rs. 3,000,000 in debt that costs 10% annually. The firm also has a 9%, Rs. 1,000,000 preferred share issue outstanding. The tax rate is 40%.

a) 0.78 b) 0.80

c) 1.24 d) 1.29.

iv) 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.

v) Spontaneous financing includes

a) Accounts receivable b) Accounts payable

c) Short-term loans d) A line of credit.

vi) As per Baumol's Model, minimum cash balance is ascertained by

a) $\sqrt{2BT/i}$ b) $\sqrt{3BT/i}$

c) $\sqrt{4BT/i}$ d) $\sqrt{5BT/i}$.

vii) In deciding the appropriate level of current assets for the firm, management is confronted with

a) A trade-off between profitability and risk.

b) A trade-off between liquidity and marketability.

c) A trade-off between equity and debt.

d) A trade-off between short-term versus long-term borrowing.

viii) The common stock of a company must provide a higher expected return than the debt of the same company because

a) There is less demand for stock than for bonds

b) There is greater demand for stock than for bonds

c) There is more systematic risk involved for the common stock

d) There is a market premium required for bonds.

ix) Financing a long-lived asset with short-term financing would

a) An example of "moderate risk-moderate (potential) profitability" asset financing.

b) An example of "low risk – low (potential) profitability" asset financing.

c) An example of "high risk – high (potential) profitability" asset financing.

d) Include accounts payable.

x) In calculating the costs of the individual components of a firm's financing, the corporate tax rate is important to which of the following component cost formulae ?

a) Common stock	b) Debt
c) Preferred stock	d) None of these.

xi) The cost of procuring additional capital is known as

a) Marginal cost of capital

b) Variable cost of capital

c) Overall cost of capital

d) Average cost of capital.

xii) Degree of financial leverage refers to

a) % change in EPS/% change in EBIT

b) % change in EBIT/% change in EPS

c) % change in EPS X/% change in EBIT

d) None of these.

GROUP – B

(Short Answer Type Questions)

Answer any *three* of the following. $3 \times 5 = 15$

2. Discuss the condition that should be satisfied for using a firm's WACC for evaluating new investment.

3. What are the fundamental principles of Finance ? Describe the key activities of financial management.

4. Calculate DFL from the following information :

particulars	**Rs**
10% Preference share capital	20000
15% debentures	30000
EBIT	40000
Tax Rate	50%

5. "Accruals are a free source of finance." Explain your viewpoint with an example.

6. Define the relationship between Real rate and Inflation rate.

7. a) What do you mean by cost of capital ?

   b) A company has 80,00,000 ordinary shares outstanding. The current market price is Rs. 25 and the book value is Rs. 18 per share. The company's earning per shares are Rs. 3.60 and dividend per share is Rs. 1.44. What is the growth rate assuming that the past performance will continue ? Calculate the cost of equity capital.

GROUP – C

(Long Answer Type Questions)

Answer any *three* of the following. $3 \times 15 = 45$

8. A company has an investment opportunity of Rs. 40,000. The following is the expected Net Cash Flow (after tax, before depreciation) :

Years	1	2	3	4	5	6	7	8	9	10
Cash Flow	7000	7000	7000	7000	7000	8000	10000	15000	10000	4000

Assuming 10% as the cost of capital; determine

a) Pay Back Period

b) Net Present Value at 10% discounting factor

c) Profitability Index at 10% discounting factor

d) Internal Rate of Return.

9. Corona Electricals Ltd of Siliguri, maintains a majority of electrical installations of hydel power plants located in the districts of Durjeeling and Jalpaiguri of West Bengal. The Capital Structure of the company as on 31st March, 2012 was as following :

	Rs.	
Equity Share Capital	5,00,000	(With face value of Rs.100 each)
Retained Earnings	2,50,000	
14% Debentures	2,50,000	
Total	10,00,000	

The company wants to undertake an expansion scheme of Rs. 6,00,000 which can be financed —

i) entirely by issue of equity shares, or

ii) by 12% debentures of Rs. 100 each at par.

As a result of expansion, sales and operating fixed costs will increase by 50% and 100% respectively. The present operating details are as follows :

Sales	Rs. 20,00,000
Vairable cost	60% of sales
Operating fixed cost	Rs. 2,00,000
Corporate tax	40%

a) Calculate the leverage and EPS before and after expansion and give your recommendations. Assume that there is no change in corporate tax rate.

b) If EBIT levels are expected to fluctuate widely, state :

i) The EBIT level above which financing by 12% debentures will be more profitable

ii) The EBIT level below which financing by equity will be more profitable.

10. a) What are the determinants of Capital Structure ?

b) Company *X* and Company *Y* have an expected annual net operating income (EBIT) Rs. 50,000 each. The *X* Company has Rs. 2,00,000 worth of 10% debenture. The equity capitalization rate of both the companies is 12.5% and the tax rate 35%.

Find the value of the firms *X* and *Y* under Net Income Approach. 5 + 10

11. From the following particulars prepare a statement showing the working capital needed to finance a level of activity of 1200 units of output p.a.

Raw Material	Rs. 50 per unit
Labour	Rs. 30 per unit
Overhead	Rs. 20 per unit
Total Cost	Rs. 100 per unit
Profit / unit	Rs. 20
Selling Price / unit	Rs. 120

Additional information :

i) Raw Materials are to remain in store on an average of 2 months.

ii) Materials are processed on an average of 3 months.

iii) Finished goods are in stock on an average of 3 months.

iv) Credit allowed to debtors is 4 months

v) Credit availed from supplier for 2 months.

vi) Cash in hand is desired to be maintained at Rs. 30,000.

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

a) Inventory holding cost

b) Preference Shares

c) Operating cycle

d) Degree of Combined leverage

e) Risks in long-term project management.