*Name* : ..............................................................

*Roll No.* : ..............................................................

*Invigilator's Signature* : ..............................................

**CS/MBA (NEW)/SEM-3(PT)/MB-207/2010-11**

## 2010-11

# FINANCIAL MANAGEMENT

*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 :

$10 \times 1 = 10$

i) When coupon interest rate is less than required yield, it is called

a) premium bond — b) discount bond

c) par value bond — d) none of these.

ii) Which of the following statements is correct in relation to the theory of cost of capital ?

a) Business risk is assumed to be constant

b) Financial risk is assumed to be constant

c) Both (a) and (b)

d) None of these.

iii) Working capital is affected by

a) production policy of the firm

b) credit policy of the firm

c) production cycle of the firm

d) all of these.

iv) Operating cycle increases with the

a) increase in time lag between sale of goods and the receipt of cash

b) decrease in time lag between sale of goods and the receipt of cash

c) introduction of efficient production system

d) providing more incentive for paying within smaller credit period.

v) Current yield of 10 years, 12% coupon bond with a par value of Rs. 1000 and selling for Rs. 950 is

a) 13·62%

b) 12·63%

c) 12%

d) 13%

e) none of these.

vi) For a normal business organization

a) $K_d > K_e$ b) $K_d < K_e$

c) $K_d = K_e$ d) None of these.

vii) A project is financially viable if its

a) IRR $> K_o$ b) IRR $< K_o$

c) NPV $< 0$ d) PI $< 1$.

viii) Commercial paper is essentially

a) another term for a junk bond

b) a short-term unsecured corporate IOU

c) an intermediate-term corporate bond

d) a certificate that may be exchanged for a share of common stock at a specified future date.

ix) An increase in the firm's receivable turnover ratio means that

a) it is collecting credit sales more quickly than before

b) cash sales have decreased

c) it has initiated more liberal credit terms

d) inventories have increased.

x) A profitability index of 0·85 for a project means that

a) the present value of benefits is 85% greater than the project's costs

b) the project's NPV is greater than zero

c) the project returns 85 paise in present value for each current rupee invested

d) the payback period is less than one year.

xi) A firm's degree of operating leverage (DOL) depends primarily upon its

a) sales variability

b) level of fixed operating cost

c) closeness to its operating break-even point

d) debt-to-equity ratio.

xii) A critical assumption of the net operating income (NOI) approach to valuation is

a) that debt and equity levels remain unchanged

b) that dividends increase at a constant rate

c) that $K_0$ remains constant regardless of changes in leverage

d) that interest expense and taxes are included in the calculation.

xiii) Which of the following is an argument for the relevance of dividends ?

a) Informational content

b) Reduction of uncertainty

c) Some investors' preference for current income

d) All of these.

## GROUP – B

**( Short Answer Type Questions )**

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

2. In what respect is the objective of wealth maximization superior to profit maximization ?

3. "PBP method is a test of liquidity and not profitability." Discuss.

4. Mr. Banerjee deposits each year Rs. 5,000 , Rs. 10,000, Rs. 15,000, Rs. 20,000 & Rs. 25,000 in his savings bank account for 5 years at the interest rate of 6%. He wants to know his future value of deposits at the end of 5 years.

5. Briefly discuss the concept about 'Optimum Capital Structure.'

6. A company has the following features :

   Earning per share for 1st year = Rs. 10/-

   Cost of capital = 10%

   Rate of Return on Investment Scenario I-15% p.a.

   Scenario II-10% p.a.

   Scenario III-5% p.a.

   Compute the price of each share if the pay-out ratio is 40% by using Walter's model.

**GROUP – C**

**( Long Answer Type Questions )**

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

7. Define financial management ? What are the different functions of financial management ? How are these functions interrelated with each other ? 3 + 7 + 5

8. *XYZ* Company has currently an equity share capital of Rs. 40 lakhs consisting of 40,000 equity shares of Rs. 100 each. The management is planning to raise another Rs. 30 lakhs to finance a major program of expansion through one of the four possible financing plans.

   The options are as follow :

   i) Entirety through equity shares.

   ii) Rs. 15 lakhs in equity shares of Rs. 100 each and the balance in 8% Debentures.

   iii) Rs. 10 lakhs in equity shares of Rs. 100 each and the balance through long-term borrowing at 9% interest p.a.

   iv) Rs. 15 lakhs in equity shares of Rs. 100 each and the balance through preference shares with 5% dividend.

   The company's expected earning before interest and taxes (EBIT) will be Rs. 15 lakhs. Assuming corporate tax of 50%, you are required to determine the EPS and comment on the financial leverage that will be authorized under each of the above schemes of financing. 15

9. From the following budget data, forecast the cash position at the end of April, May and June 2010. 15

| Month | Sales (Rs) | Purchase (Rs) | Wages (Rs) | Miscellaneous (Rs) |
|---|---|---|---|---|
| February | 1,20,000 | 84,000 | 10,000 | 7,000 |
| March | 1,30,000 | 1,00,000 | 12,000 | 8,000 |
| April | 80,000 | 1,04,000 | 8,000 | 6,000 |
| May | 1,16,000 | 1,06,000 | 10,000 | 12,000 |
| June | 88,000 | 80,000 | 8,000 | 6,000 |

Additional information :

i) Sales : 20% realized in the month of sales, discount allowed 2%. Balance realized equally in two subsequent months.

ii) Purchase : These are paid in the month following the month of supply.

iii) Wages : 25% paid in the arrears following month.

iv) Miscellaneous expenses : Paid a month in arrear.

v) Rent : Rs. 1,000 per month paid quarterly in advance due in April.

vi) Income tax : First installment of advance tax Rs. 25,000 due on or before 15th June.

vii) Income from investments : Rs. 5,000 received quarterly, in April, July etc.

viii) Cash in hand : Rs. 5,000 on 1st April, 2010.

10. a) Discuss the importance of Credit Period, Credit Standard and Credit Policy.

b) *XYZ* Co. currently has annual sales of Rs. 5,00,000 an average collection period of 30 days. It is considering a more liberal credit policy. If the credit period is extended, the company expects sales and bad debts to increase in the following manner :

| Credit Policy | Increase in credit periods | Increase in salsas (Rs.) | Bad debt % of Total Sales |
|---|---|---|---|
| *A* | 10 days | 25,000 | 1·2 |
| *B* | 15 days | 35,000 | 1·5 |
| *C* | 30 days | 40,000 | 1·8 |

The selling price per unit is Rs. 2. Average cost per unit at the current level of operation is Rs. 1·50 and variable cost per unit is Rs. 1·20. If the current bad debt loss is 1% of sales and required rate of return of investment is 20%, which credit policy should be undertaken ? Ignore taxes and assume 360 days in a year. 5 + 10

11. a) Explain how Miller-Modigliani analytically showed the irrelevance of dividend decision in determining firm value.

b) A company has the following book value of capital structure :

| Securities | Amount (Rs.) | After Tax Cost |
|---|---|---|
| Equity Capital ( 15 lakhs share @ Rs. 100 ) | 1,50,00,000 | ? |
| 10% Pref. Shares | 50,00,000 | 10% |
| Retained Earnings | 1,00,00,000 | ? |
| 13% Debentures | 60,00,000 | 13% |
| Term Loan (12%) | 70,00,000 | 12% |

Expected dividend is Rs. 20·00 per share. The rate of tax may be assumed at 50%. Calculate weighted average cost. 7 + 8

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

    a) Risk-return relationship

    b) Capital Rationing

    c) Permanent and variable working capital

    d) Valuation of Common Stock

    e) Motive for holding cash.