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Second Semester MBA. Degree Examination, December 2011
Financial Management

Time: 3 hrs.

Max. Marks:100

Note: 1. Answer any FOUR questions from Q.No. 1 to Q.No. 7.

2. Q.No. 8 is compulsory.

3. Candidates to be provided with log tables, Present value, Annuity and Future value.

- 1
 - a. What is financial management? (03 Marks)
 - b. A firm issues debentures of Rs 1,00,000 and realizes Rs 98,000 after allowing 2% commission to brokers. The debentures carry an interest rate of 10%. The debentures are due for maturity at the end of 10th year. You are required to calculate the effective cost of debt before tax and after 30% tax. (07 Marks)
 - c. What are the factors affecting dividend policy of a company? (10 Marks)
- 2
 - a. Mention the reasons why money has time value. (03 Marks)
 - b. Critically examine the objectives of financial management. (07 Marks)
 - c. The selected financial data of ABC Company for the year ended 31.3.08 were as follows :

| | A | B | C |
|--|--------|--------|---------|
| Variable exp. on a percentage of sales | 66.66% | 75% | 50% |
| Interest expenses | Rs 200 | Rs 300 | Rs 1000 |
| Deg. of op. leverage | 5 - 1 | 6 - 1 | 2 - 1 |
| Deg. of fin. leverage | 3 - 1 | 4 - 1 | 2 - 1 |
| Income tax rate | 50% | 50% | 50% |

Prepare the income statement for ABC Company.

(10 Marks)

- 3
 - a. Differentiate between capital structure and financial structure. (03 Marks)
 - b. The relevant financial information for X Ltd for the year ended 31.12.08 is given below : (07 Marks)

| P/L a/c data in Millions | Balance sheet data Million (Rs) | |
|--------------------------|---------------------------------|----------|
| | 01.1.08 | 31.12.08 |
| Sales 80 | Inventory 9 | 12 |
| Cost of goods sold 56 | A/cs receivable 12 | 16 |
| | A/cs payable 7 | 10 |

What is the length of the operating cycle, the cash cycle? Assume 365 days to a year.

- c. From the following capital structure of a company, calculate the overall cost of capital using
 - i) Book value weights and
 - ii) Market value weights.

| Source | Book value (Rs) | Market value (Rs) |
|-------------------------------------|-----------------|-------------------|
| Equity share capital (Rs 10 shares) | 45000 | 90000 |
| Retained earnings | 15000 | - |
| Preference capital | 10000 | 10000 |
| Debentures | 30000 | 30000 |

The after tax cost of different sources of finance is : Equity capital 14%, Retained earnings 13% , Preference share capital 10%, Debentures 5%. (10 Marks)

- 4 a. What is corporate governance? Why is it required? (03 Marks)
 b. What is a financial system? What are its functions? (07 Marks)
 c. Briefly discuss the factors determining the working capital requirements. (10 Marks)
- 5 a. Differentiate between primary market and secondary market for shares. (03 Marks)
 b. i) Mr. Mahesh deposits Rs 2,00,000 in a bank which paid 10% interest p.a. How much can be withdrawn annually for a period of 15 years?
 ii) You want to undertake a world tour which costs Rs 10,00,000. This is expected to remain the same in nominal terms. You can save Rs 80,000 p.a. How long would you have to wait for the savings to return you the amount at 14% p.a? (07 Marks)
 c. After undertaking a survey that cost Rs 2,00,000 Z Ltd., decided to undertake a project for putting a new product in the market. The company's cost of rate is 12%. It was estimated that the project would have a life of 5 years. The project would cost Rs 40,00,000 in plant and machinery in addition to working capital of Rs 10,00,000. The scrap value of plant and machinery at the end of 5 years was estimated at Rs 5,00,000. After providing for depreciation on straight line basis Profit & Loss were estimated as follows :

| Year | Rupees | PV factor @ 12% p.a. |
|------|-----------|----------------------|
| 1 | 3,00,000 | 0.8929 |
| 2 | 8,00,000 | 0.7972 |
| 3 | 13,00,000 | 0.7118 |
| 4 | 5,00,000 | 0.6355 |
| 5 | 4,00,000 | 0.5674 |

Ascertain the NPV of the project. (10 Marks)

- 6 a. What are bonus shares? (03 Marks)
 b. Briefly mention the ways and means of reforming corporate governance. (07 Marks)
 c. Briefly explain the scope of financial management (Modern approach only). (10 Marks)
- 7 a. Briefly comment on the significance of operating and financial leverage. (05 Marks)
 b. Following are the details regarding three companies :

| | A Ltd | B Ltd | C Ltd |
|-------|-------|-------|-------|
| r | 15% | 5% | 10% |
| K_e | 10% | 10% | 10% |
| E | Rs 8 | Rs 8 | Rs 8 |

Calculate value of an equity share of each of these companies applying Walter's formula when dividend payment ratio (D/P ratio) is i) 50% ii) 75% iii) 25%. (15 Marks)

8 CASE STUDY :

A Company has been operating on single shift basis, to manufacture its product, with the following cost price structure. Per Unit

| | |
|-------------------------|-------|
| Raw materials | Rs 12 |
| Wages (60% variable) | Rs 10 |
| Overhead (20% variable) | Rs 10 |
| | 32 |
| Profit | 4 |
| Selling price | 36 |

Sales for the year ended 30.6.2005 amounted to Rs 8, 64,000. As on 30.6.05 the company held :

| Rs | |
|---------------------------------------|--------|
| Stock of raw material at cost | 72000 |
| WIP (valued at prime cost) | 44000 |
| Finished goods (valued at total cost) | 144000 |
| Sundry debtors | 216000 |

At present, the company receives 2 months credit from the suppliers of material and there is a lag of payment of wages and expenses at half a month.

In view of increased market demand, it is proposed to double the production, by working an extra shift. It is expected that a 10% discount will be available from suppliers of raw materials.

In view of increased volume of production, extra production can be sold at the existing price.

There will not be any change in the credit policy. Credit from suppliers of materials and time lag in payment of wages and expenses will continue to remain at the present level.

You are asked by management to ascertain the effects on working capital of introducing an extra shift working.

(20 Marks)

